

Big Autumn Silver Rally

Silver's fundamentals offer plenty of reasons to be bullish in the coming years. Relentlessly growing global investment demand coupled with reduced production is a recipe for much higher prices. With something like 3/4ths of all the silver mined globally being merely a byproduct, primarily of base metals, supplies will remain constrained. Investors will have to compete in a tiny market for this scarce metal.

While silver's long-term bullish case is well-known among its investors, this volatile metal also has incredible near-term potential. In the coming *months*, silver is likely to witness exceptional gains. Unfortunately, the driver of this potential big autumn silver rally is not widely discussed. Thus many investors and speculators still sidelined since the panic risk missing out on this rare opportunity.

And ironically, the stock panic created the silver anomaly that led to this opportunity. Silver has a [long history](#) of following gold. Silver traders watch gold for trading cues, so gold action dominates silver psychology. Thus silver typically trades in lockstep with gold. But during the panic, the extreme fear spawned by the brutal stock-market selloff spilled into silver. It forced silver to decouple from gold and plummet far deeper than gold warranted.

I started telling our subscribers about this anomaly and trading it last October. Already it has proven a very successful strategy. One new long-term silver-stock investment we added then, because of this anomaly, is already up 160%! While silver itself fell under \$9 in the heart of the panic, it has averaged \$14 in the past month. And the panic anomaly driving these gains still hasn't been fully resolved yet. There is more to come.

This whole panic episode, and silver's near-term upside potential, is best understood in terms of the Silver/Gold Ratio. SGR analysis simply divides the daily silver close by the daily gold close and charts the result over time. It is very illuminating. I first wrote about this publicly, after our subscribers had deployed positions, back in [early February](#). But a lot more investors are interested in silver today than back then.

So if you've been hiding out, following the [ostrich strategy](#) of cowering in zero-yielding cash instead of multiplying your capital in these once-in-a-lifetime post-panic opportunities, you really need to consider the SGR's implications for silver. And if you're already trading this SGR anomaly, keep your capital deployed and watch your gains grow. Although unwinding gradually, the SGR anomaly hasn't even come close to being fully unwound yet. But it will.

This SGR reversion's potential silver impact is easiest to understand if we start in the normal years preceding last autumn's crazy stock panic. This first chart

compares silver with gold over the last 5 years or so. The 44 months between January 2005 and August 2008 are the control period, showing silver's natural and normal behavior. And the 4 months between September to December 2008 encompass the panic period where the SGR anomaly erupted.



In the years before the panic, silver's very tight correlation with gold was readily evident. Silver surged when gold was strong and fell when gold was weak. Silver's daily price action mirrored *and amplified* gold's nearly perfectly. Over this 44-month baseline time frame, 94.7% of silver's daily price action could be statistically explained by gold's own. Gold action drove silver sentiment, and hence silver prices.

But late last summer, silver started decoupling from gold. There had been minor decouplings before of course, but they were far smaller and only lasted for days to a couple weeks on the outside. The silver decoupling witnessed as the panic unfolded was utterly unprecedented in its magnitude and duration. Gold was indeed weak, but silver plummeted far faster and deeper than the gold selling warranted.

If you want to understand exactly why gold was weak during the stock panic, read my recent essay on the [stock markets driving gold](#). In a nutshell, bond-market followed by stock-market selling led to flight capital flooding into the US dollar to buy short-term US Treasuries. This safe-haven trade drove the biggest and fastest US dollar rally ever witnessed. Gold futures traders saw the dollar skyrocketing and dumped gold. And as gold fell, silver traders got really scared. Their fears were greatly exacerbated by the stock panic.

Scared traders are emotional traders, so silver was sold far more aggressively than yet seen in this secular bull. Before this surreal fear bubble, silver averaged \$18 in July 2008. By November 2008 in the heart of the stock panic, silver averaged less than \$10. At worst, silver lost a mindboggling 53% of its value in just over 4 months! It was an epic bloodbath that understandably broke the will of many silver investors to go on.

But although the massive panic-driven dollar rally hit gold too, gold's selloff was trivial compared to silver's. At worst at its panic lows, gold hit a 14-month low. But silver just kept on falling and falling, spiraling ever lower. At its own panic nadir, silver had plunged to levels last seen *34 months* earlier! Silver does amplify gold's moves, but the degree of this panic selloff was still utterly ridiculous. It defied all logic and reason.

Over that September-to-December panic span, silver's r-square with gold plunged to 52.5%. In other words, only half of silver's daily price action was statistically explainable by gold's own. In light of silver's ironclad past relationship with gold, this was madness. No one had ever seen anything like it before. Not only was silver going way overboard in amplifying gold's selloff, but gold was nearly eclipsed as the primary driver of silver sentiment.

Provocatively, *the stock markets* were usurping the silver helm. In October and November in the bowels of the panic, silver hit new panic lows on 6 separate trading days. Fully 4 of them happened to be days the S&P 500 (SPX) hit new panic lows as well. Incredibly *none* of silver's new lows happened on days where gold hit new lows! And even though gold bottomed in mid-November, silver didn't bottom until over a week later on the very day the SPX hit its own panic low.

The idea of the stock markets driving silver seems odd now, but within the extreme fear and stress of the panic it sort of made sense. Unlike gold which is usually perceived as a stable investment and safe haven, silver is primarily viewed as a speculation. It is a hyper-volatile metal heavily dependent on the whims of speculative preference. And during the panic, speculators were so scared that the universal appetite for speculation went negative. Speculators wanted out of *all* risky assets, in any market.

So being highly-speculative over the short term even in the best of times, silver really bore the brunt of the anti-speculation bias in the worst of times. Traders wanted out immediately, at any price. It was this panic sentiment that directly led to the silver anomaly we are still trading today. Weak gold, coupled with extreme general fear driven by the plummeting stock markets, ripped the previously-bullish silver sentiment to shreds.

But the thing that makes an anomaly an anomaly is its short-lived nature. The more extreme the psychology that drives prices out of whack, the quicker it will burn itself out and the anomaly will start to revert back towards normalcy. Indeed we've seen silver do this since the panic ended. This metal has soared from under \$10 to over \$14 on balance, recovering in a nice uptrend.

But this reversion isn't over yet. Note that after the panic gold quickly regained its pre-panic levels between roughly \$875 and \$975, and it's been trading there for most of 2009. Meanwhile, silver is nowhere close to its own pre-panic levels running between \$17 to \$19. But it's gradually getting closer to reestablishing its decades-old relationship with gold. So far this year, silver's r-square with gold has climbed back up to 81.5%.

Although this first chart is certainly adequate to make the case that silver is way undervalued relative to gold today, it is far less precise than a true silver/gold ratio chart. So as I've done [periodically](#) since February, this next chart updates the progress of the SGR. The SGR in blue is superimposed over the silver price in red.

Since the SGR-proper yields an unwieldy small decimal (like 0.01464), I prefer to invert the SGR to wrap my mind around it. The inverse of the actual SGR yields 68.3, which makes more sense (it is technically the gold/silver ratio, but viewed from the silver side). Instead of thinking silver is worth 0.01464 ounces of gold, it is easier to think in terms of it taking 68.3 ounces of silver to equal an ounce of gold. Thus, the SGR axis below is inverted so this measure rises when silver is outperforming gold and vice versa.



The sheer magnitude and ridiculousness of the Great Stock Panic of 2008's impact on silver is crystal clear when viewed through the lens of the SGR. In the 44 normal months before the extreme abnormality of the stock panic, the SGR averaged 54.9. And this mean was based on a fairly tight trading range between 65 and 45 with no extreme outliers skewing it. This 55 number should be familiar to investors.

If you do any deep research into silver miners and gold miners, they often report "equivalent" numbers. A primary silver miner will convert its gold byproduct to silver-equivalent ounces while a primary gold miner does the opposite. One metal is rendered in the cash equivalent of the other. In wading through countless SEC quarterly reports over the years, I've found the number used for this calculation is almost always 55. In the industry, an ounce of silver has long been considered to be worth 1/55th of an ounce of gold.

But during the stock panic, speculative zeal reversed so rapidly and radically that the SGR plummeted to unbelievable depths. Within *months* after breaking below its secular support which had held rock-solid for *years*, the SGR had plummeted to 84! An ounce of silver was worth just 1/84th of an ounce of gold. This was the lowest SGR witnessed over this entire secular bull by far.

During the 4 months ending December that encompassed the stock panic, the SGR averaged 75.8. This was just silly, it made no sense and only persisted for even that long because silver traders were so darned scared. At Zeal we started aggressively buying and recommending elite silver stocks, and the silver ETF, during this panic timeframe because there was no way silver could stay so depressed relative to gold prices.

These trades have proven very profitable since. The SGR has been recovering since the panic and is in a nice uptrend. But as you can see, the SGR still has a long ways to go yet before silver regains some semblance of normalcy relative to gold. But make no mistake, it *will* happen. Since the early 1970s when gold was freed to trade in the States again, [silver's relationship with gold](#) has been strong and unwavering.

You can spin a variety of scenarios for this SGR mean reversion. The most conservative one is simply to assume that gold remains stable in its post-panic trading range as it has for many months now and the SGR simply reverts to its pre-panic average of 55. Over the past month, gold has averaged just under \$950 on close. Gold staying flat and an average SGR implies that silver will normalize to \$17.25 or so, 25% above its levels of this week.

But the SGR mean reversion probably won't stop at 55 and gold probably won't stay flat, so the near-term bullish case for silver is far more compelling depending on the assumptions you make. Note above that the SGR's secular support was

rising steadily for years before the stock panic. If that line is extended to today, it hits 49 or so. A 49 SGR at \$950 gold implies about \$19.50, 40% higher from here.

And psychology in the financial markets seldom stops conveniently at the midpoint, it is like a pendulum. If you pull a pendulum a long way in one direction, and let it go, will it stop dead center? Certainly not, its momentum will keep carrying it well past center in the opposite direction until its energy is dissipated by nearly reaching the *opposite* extreme. Silver saw extreme fear in the panic, among the worst it's ever seen. Give the magnitude of this anomaly, I suspect psychology will overshoot well into greed before it normalizes.

So the SGR could, at least temporarily when traders get excited, soar far under 55. How far? Make a guess. It depends on how precious-metals psychology unfolds, on how quickly discouraged silver investors return, and a myriad of other inherently unpredictable factors. But take some SGR well under 55, the temporary overshoot, divide a \$950 gold price by it, and you get some seriously exciting silver targets.

On top of all this, gold isn't likely to stay flat either. All these SGR-reversion silver targets get higher as the gold price they are based on rises. Thanks to the Fed's record monetary growth during and since the panic, [big inflation is coming](#). Few things drive new gold investment like an inflation scare, and we are going to see a doozy of one sooner or later here. And gold's innate [supply and demand fundamentals](#), including [declining mine production](#) despite high prices, remain very bullish with or without inflation.

All this is exciting for silver, but it doesn't offer clues on timing. But other factors are coming into play that I suspect will lead to a substantial acceleration of this in-progress and inevitable SGR reversion in the coming months. Silver has incredible potential for one of its biggest autumn rallies ever witnessed. Investors and speculators long this metal and its elite producers would see huge gains in such a scenario.

Silver ultimately follows gold, so nothing will get traders as excited about silver as quickly as a major gold rally. Provocatively, we are just entering the [seasonally-strongest](#) time of the year for gold prices. On average between 2000 and 2008 prior to the panic, gold rallied 14% between August and February. Off of a \$950 average gold price, a similar move this year would carry gold above \$1075. Gold decisively over \$1000, highly likely soon [technically](#), would ignite all kinds of buying in the tiny silver market.

In addition, remember that the stock panic's universal dampening of the appetite for speculation was what led to silver's panic anomaly. Back in January I did [a historical study](#) showing that the biggest up years ever witnessed in stock-market history tend to *immediately follow* the biggest down years. 2008's 38.5% loss

was the S&P 500's worst year ever. So in January I said we should expect a 25% to 50% gain in the US stock markets in calendar 2009. It was a very heretical and controversial bet back then.

But with the SPX up 10% year-to-date now, 25%+ SPX gains this year seem more plausible to far more investors. And if the SPX is to achieve even 25% this year, let alone 50%, it has a *lot* of rallying to do between now and year-end. If general stocks rally big this autumn, which is likely, the universal appetite for speculation will soar and cash will flood in off the sidelines. Silver, among the most speculative of all commodities, will be a major beneficiary of any speculation renaissance.

With a big autumn silver rally very likely, some wonder how to play it. One of the best ways is in elite silver stocks. While the [SLV silver ETF](#) will match silver's gains, silver stocks have the potential to *multiply* them. Back in March we started gathering data on all the primary silver stocks trading in the US and Canada. Our initial screens turned up nearly 100. But amazingly, the total market capitalization of this entire population was *under \$7b!* It is higher now of course, but still vanishingly small compared to every other sector. For comparison, in late March the HUI gold stocks were worth \$144b and the SPX \$7218b.

So if any capital at all bids on silver stocks during the coming silver rally, their prices have to soar. They are just too small to absorb significant buying. So which silver stocks are the best to own, the highest-potential? We spent several months earlier this year painstakingly narrowing down the universe of primary silver stocks to our favorite dozen. We believe they have the best fundamentals and greatest potential of all the silver stocks.

In June, my business partner Scott Wright profiled each of these elite silver companies in depth in a comprehensive and fascinating 33-page [report](#). Priced at only \$95 for the fruits of hundreds of hours of world-class silver-stock research, it is a steal. [Buy your copy today](#) and get deployed in elite silver stocks before silver leaves without you!

We also publish an acclaimed monthly newsletter, [Zeal Intelligence](#). It analyzes the financial markets including silver with the goal of growing our capital through successful speculation and investment. In it I discuss what is going on in the markets, why, and how we can capitalize on it through real-world trades. With the coming autumn looking to be incredibly exciting, now is the perfect time [to subscribe](#).

The bottom line is silver remains way too cheap relative to gold. The extreme fear generated by the stock panic dragged silver down into an unsustainable anomaly. Since the panic ended, silver has indeed been gradually regaining ground relative to gold. But despite the progress in this normalization, this

anomaly hasn't even come close to fully unwinding yet. But it will, which implies much higher silver prices ahead.

And other factors are likely to drive an acceleration in silver's recovery in the coming months. Gold itself looks very bullish, and growing mainstream inflation fears could rapidly spark big investment demand. Nothing will entice sidelined silver traders back in faster than a major gold rally over \$1000. And the general stock markets are likely to rally into year-end too, fostering a renaissance in speculation. Of course silver is one of the premier commodities speculations.

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August 21, 2009

So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ... www.zeallc.com/subscribe.htm

Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit www.zeallc.com/adam.htm for more information.

Thoughts, comments, or flames? Fire away at zelotes@zeallc.com. Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to respond to comments personally. I will read all messages though and really appreciate your feedback!

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