January 30, 2013 – The Right Pace

The Right Pace

One of the rarest circumstances is for the average investor to score really big on a specific investment. There are many requirements necessary to successfully capture a great investment opportunity. Those requirements generally include seeing and seizing the opportunity before most others and not exiting too soon or too late. This always sounds easy in theory or in retrospect, but is extremely difficult in practice. One reason is because the timeline for any investment homerun is unknowable in advance. The harshest reality of all is that no one can be sure one's personal lifespan will conform to an investment score's timeline. Still, we must play the cards we are dealt as best we can.

Silver has been an outstanding investment opportunity over the past five and ten years, one of the very best. I believe that will continue to be the case in the future, although I can't be sure of the exact timeline. This makes it important to maintain the right personal pace in conformance with the actual investment timeline. In other words, we must try to be Â?in synchÂ? with the actual timeline and not get too bullish or bearish at the wrong time. The easiest way to accomplish that is to buy and hold for the long term as opposed to timing the market, if it appears likely that the investment will do well in time, as does silver to me. Keeping the right pace helps emotionally as well, as it is easy to get unbalanced on a short term basis.

To be fair, it is probably much easier to adopt the proper emotional pace for those who invested in silver at $4 or $5 than for those who invested for the first time at much higher prices over the last couple of years, but if silver does what I think it will do, the most important factor will be to be in synch with whatever the coming timeline turns out to be. At this point, it matters less where a silver position was established than in handling what is to come.

Today, I would like to look at the most optimistic scenario for silver longer term, although I hope you realize there can't be any assurances given that this scenario will be the one that will play out. I'd like to look at the possibility that silver develops into an investment bubble, where the price goes to an unreasonably high level, driven by widespread indiscriminant speculative buying in the end. Such speculative buying, particularly on an extremely leveraged basis, does not exist now. Away from the dealings on the COMEX, where leveraged (highly margined) positions are normal in all futures trading, silver investment appears to be by and large on a cash and carry basis by a regular number of investors. (I never bought the 100 to 1 paper buying to physicals in gold and silver). Certainly I am aware of no excessive borrowing to buy Silver Eagles or shares of SLV or other silver ETFs. In fact, it's easy to show that silver is the opposite of a bubble currently, in that so few investors are attracted to it and they are most conservative in their buying. Besides, the price has been down recently close to 50% off the peak highs of two years ago. A bubble to come? Maybe, but there is no silver price bubble now.

What prompted me to explore this now is a recent article on potential price bubbles in gold and silver. http://www.deviantinvestor.com/2388/past-future-speculative-bubbles-what-they-indicate-for-gold-and-silver/ The author is quick to point out that he is not predicting a bubble will develop in gold or silver, but if such a bubble did occur, he offers some price guidelines based upon past bubbles. In a genuine bubble, the author suggests $9000 for gold and $250 for silver would not be out of the question as ultimate price targets. The article touches on some things I have been writing and thinking about recently. In a nutshell, I can envision (not guarantee) such a price target for silver, but it's hard for me to see that gold price target given the total size of each market.

Certainly, if gold does go to $9000 in a speculative price blow-off, silver would appear cheap to me at Â?onlyÂ? $250 and would probably trade at much higher prices. At the center of my thinking are total market valuations, a theme I have been harping on recently. Currently, the 5.3 billion ounces of gold thought to exist in the world is worth $9 trillion at current prices. At $9000 an ounce, the world's gold would be valued at close to $50 trillion and that valuation would likely exceed all the important asset classes in the world, such as total real estate and world stock and bond markets. By contrast, the entire world's 1.2 billion oz in industry standard 1000 oz bars of silver bullion would be worth $300 billion at $250. Fifty thousand billion dollars for gold at $9000/oz versus 300 billion dollars for silver at $250. Even if you doubled or tripled the amount of silver thought to exist, the total value would not exceed one trillion dollars at $250.

In addition, gold is perhaps the most widely held single asset in the world. Certainly more people in the world own gold than any single stock or bond. More people own gold than own silver. To my way of thinking, the broad ownership of gold may work against it developing into a true investment bubble. Over the past few years, it would appear more of the world's citizens have sold gold than have bought it via the Â?cash for goldÂ? phenomenon brought about by tough economic conditions throughout the world. I don't have a graph, but the current price of gold would appear to be more unaffordable for the average world citizen than ever before. Even in the US or other fairly prosperous economies, $1700 for an ounce of gold is beyond the reach of the average citizen. None of these things can be said about silver.

It's not that I am bearish on gold prices. I can see a quick run up of $100 or $200 or more given the current market structure. But I have trouble envisioning gold price increases of thousands of dollars an ounce due to the growing Â?weightÂ? of the total market value that would result.
A $20 increase in the price of gold increases the total value of the world's gold by $100 billion. Just that increase alone is worth more than three times what the entire world's silver bullion is valued at in total. That doesn't make sense to me.

I guess what I'm saying is that gold doesn't look terribly expensive to me on a single ounce basis or in terms of its cost of mining production per ounce or based upon the market structure on the COMEX, but when I look at the resultant effect of the current price on the total value of the world's gold inventory, I come away feeling that gold is richly priced relative to the total market value of other world assets. Because that total world gold value seems high on a relative basis, I can't help but think total gold valuation may work as a headwind as time advances, particularly on sharply higher gold prices from here. I think the total valuation of various world asset classes is an important indicator of price valuation; not the only one, but an important indicator.

Clearly, there is no total valuation concern in silver. If anything, the current near microscopic total valuation of all the world's silver bullion argues that something is amiss. Even if silver tripled in price while gold's price remained unchanged, the entire world's silver bullion (1000 oz bars) would still be worth only one percent of all the gold in the world. I think the relative total valuation benchmarks not only favor silver compared to gold, but also suggest that any future price bubble will most likely appear in silver rather than gold.

As was indicated in the article referenced above, silver experienced a price bubble back in 1980, having risen to $50 from $1.50 a decade earlier. It would appear to be correct to classify a 33-fold increase in price as a bubble, but a closer examination would reveal that silver was manipulated upward in price by the Hunt Brothers back then and quickly collapsed when the manipulation was terminated. A manipulation is different than a price bubble, in that it takes wide participation to create a bubble. I would contend that the next silver price bubble, should it develop, will be the first.

Given all the facts concerning undervaluation, not only on a per ounce basis but also in terms of total world inventory, and the lack of awareness about silver in the general world of investment, silver is the most likely asset to develop into a speculative bubble. It has all the necessary ingredients to form into a bubble, including a story begging for attention. Throw in an easy to prove downside manipulation that has created an artificially depressed price, it's a wonder we haven't formed a silver price bubble yet.

Of course, if I am wrong about the weight of gold's total market capitalization slowing its ascent and instead gold climbs as high as many proponents suggest, I can't see how that would impede a silver price advance in any way. A speculative price mania and bubble in gold from this point would seem to almost guarantee a similar price bubble in silver.

The important message is that if silver does develop into a speculative mania and price bubble, the pace at which that unfolds and how the individual investor handles it will matter most. Get out too soon and leave too much on the table; get out too late and regret that as well. I think it may come down to cashing out in stages, much in the same manner as many have acquired silver. But please remember that price bubbles and speculative manias are rare. Even rarer is being in the fortunate position of holding an asset that later develops into a mania. It has to be considered a long shot in every way, but compared to anything else I can think of; silver has the best odds of all of turning into a bubble.

Ted Butler

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Silver – $32.15

Gold – $1680

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