Nov. 23, 2009 – The Silver Investment Boom Revisited

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Almost two years ago, in January of 2008, I wrote an article that was titled,

Â?The Coming Investment Boom in Silver.Â?
http://www.investmentrarities.com/ted_butler_comentary/01-22-08.html

The premise of that article was to explain that, despite the end of the 60-year structural deficit in silver in which more silver was consumed than produced, the price of silver was not likely to suffer. World silver inventories were so depleted after continuous annual deficits for more than half a century that the deficit consumption pattern had to end at some point and production must then equal consumption. I opined that a new factor would emerge that would replace the deficit as the primary price factor in silver. That factor was investment demand.

I tried to explain in the original article how silver was owned by an incredibly small percentage of investors because the real silver story was unknown and that those few who did own silver were holding it for very high price targets. Well, the silver story is still mostly unknown and the silver owned is still very tightly held. (A rash of new publicity about silver investment does promise to bring more into the fold, which is great.) I pointed out that the biggest potential silver investment boost was likely to come from institutional investors, due to the creation of investment vehicles, called Exchange Traded Funds (ETFs). These vehicles enabled these large investors to buy physical silver for the very first time. And buy they did. From 210 million ounces held in the four largest ETF-type funds at the time of the first article, the collective investment holdings have grown to more than 435 million ounces today. And there is another 25 million ounces in other silver investment vehicles. There is no way to understate the importance of the introduction of the silver ETFs to the investment equation and the price.

What is truly amazing is that prior to the introduction of the first silver ETF, SLV, in 2006, there was hardly any silver held at all in such vehicles (save for the Central Fund of Canada, which held a little over 30 million ounces prior to 2006). That's because there was very little investment demand for silver before 2006, institutional or otherwise. Of course, certain big players, like the Hunt Brothers or Warren Buffett appeared as big silver buyers from time to time, but net silver investment demand was an oddity. In fact, there was no net investment demand in silver for the 60 years prior to 2006. I ask you to think about that for a moment. What I am saying is that for the 60 years from WW II, while the world was depleting silver inventories by more than 90% (from 10 billion ounces to 1 billion), there was no net investment demand in silver. This does go a long way to explaining why prices were so low for most of that period (I'll save the short manipulation issue for another time). Here's my point Â? from no net investment for more than half a century, silver investment demand has truly exploded.

There is no precedent for the surge in silver demand that has occurred over the past three or four years. And although the biggest surge has been in the ETF investment vehicles, the buying binge has not been limited to just this type of silver investment. Retail silver investment demand has also gone through the roof, actually resulting in shortages a while back. The US Mint's Silver Eagle program has gone ballistic, thanks in large amount to my silver mentor Izzy Friedman, in my opinion. (More on this topic coming up soon). Quite simply, although I expected a silver investment boom, I didn't expect this big of a boom. Remarkably, applying the very same thought process now as I did back then, I can't help but conclude that the boom is about to accelerate from here. Let me explain why.

A confluence of factors suggest we are at the beginning of the silver investment boom and we are at the outset of a price explosion, even though more silver has already been bought for investment in the past few years than at any point in history. For one, the silver story is just starting to be recognized. The psychology towards silver is changing. I can't count the stories singing the praises of silver and how it is wonderful that it is a dual industrial and investment metal. It wasn't that long ago when the tone was that silver can't make up its mind whether it is a precious or industrial metal. As if an inert material even had a mind of its own. It is important that the tone is changing, as thought must precede action, namely, people have to think and convince themselves of an investment before they buy. That process is now underway.

Second, there is a decidedly different investment climate than what existed two years ago. Since that time, we've witnessed financial upheavals of historic proportions. The fight to safety includes everything that can't go bankrupt overnight. Silver can't go bankrupt overnight or in any other timeframe. Today, interest rates are lower than in anyone's memory, punishing savers and encouraging a movement to anything safe that could provide a return. Silver meets that profile. Given the decline in important world equities and residential and commercial real estate markets over the past two years, there is probably less net worth existing in the world, even among the mega-wealthy. However, a larger portion of net worth is now held in cash-equivalent forms, like US Treasury securities, where short-term yields hover around 0%. It's understandable that investors want to play it safe after the events of the recent past, but it is also true that investing money for a guaranteed zero return gets old after a while. In that regard, silver would appear to be a logical beneficiary of any switch from such low return accounts.

While I've never been a big believer in the silver is money mindset, a friend passed along a somewhat similar thought that is compelling. Carl Loeb mentioned that he advised some of his acquaintances to consider silver as a substitute for money in the bank, not to be thought of as an investment to be bought and sold, but as a long term savings plan with no particular price target. Instead of holding money in a savings account, hold a portion in silver instead, with the same long term perspective. True, there is more short-term price risk in silver than in a money market account, but there is also a heck of a lot more profit potential as well. I find Loeb's approach very compelling and shudder to think of the price impact of the resultant buying of silver should this logical thought process start to spread.

While big institutional money has flowed into the silver ETFs, it has been mainly a certain type of investment money. Up until now, the passive index funds have been the prime purchasers of the ETFs. These are funds that rigidly buy a certain percentage of various commodities to replicate different commodity indexes. The big hedge fund operators, like Paulson, Einhorn and Tudor Jones, have yet to move big into silver. They have clearly moved into gold, but not yet in silver. The operative word here is yet. It is only a matter of time before they move into silver. That's because they are too smart not to discover silver eventually. As I have written repeatedly, silver has all the merits of gold, except that it is a vital industrial material and there is much less of it than gold. Anyone who invests in gold for all the right reasons will come to appreciate silver in time. These big fund operators are always looking for a good investment and it will be impossible for them not to discover silver at some point. That they have not yet discovered it is bullish beyond words, as their inevitable buying has not yet been reflected in the price. That buying is coming.

Perhaps the most bullish factor in the growing retail and institutional investment demand for silver is what's on the other side of that potential buying, namely, the limited amount of physical material available for purchase. After 60 years of inventory depletion, it is almost unreal that an investment boom would develop precisely when so little material is available to be purchased. As I indicated in the original article, in this regard silver has become more like gold in that new investment demand must be met with selling from existing holders. Sellers who demonstrate no inclination for selling. The kicker in silver, of course, is not only how little physical material is available for sale, but also how little the dollar value of what is is remaining, owing to the depressed price. Because the price of silver is so low, the dollar value of all the silver bullion in the world (one billion ounces x $18) is worth less than 1% of what all the gold bullion is worth (2 billion oz x $1150). I just don't think that most people, including the big hedge fund managers, realize that just one percent of the value of all the gold bullion is worth more than 100% of the silver bullion in the world. In time, I believe they will make this calculation and react accordingly, by trying to buy silver in big quantities. This should prove explosive to the price of silver.

As always, the investment boom is but one facet of the total silver situation. This investment aspect is long term in nature and will exist in spite of short term movements. It is separate and distinct from the concentrated short position, regulatory developments and the coming industrial user inventory panic. I'm increasingly of the opinion that any one of these factors is likely to set off the others, in some historic spontaneous combustion price event. It is imperative to be positioned for this event, even if some dry powder is preserved for a sell-off.

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