Philequity Corner (05/02/2011)
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Hi Ho Silver! Away!

We have written about nickel, copper and gold in the past. But in today's article, we will talk about another precious metal whose value was long considered second only to gold – SILVER.

Silver is a soft, white, lustrous metal which been used for thousands of years for jewelry, ornaments, utensils and coinage. It is noted for its strength, malleability, ductility, electrical conductivity (the highest of any element), high reflectance to light, and high resistance to temperature (the highest of any metal). Owing to its unique characteristics, silver is now used in a variety of commercial applications such as electronics, medicine & medical applications, photography, superconductivity, solar energy, production of batteries and bearings, and many more.

Much of the world's silver production today is produced as a byproduct of gold, copper, lead and zinc.

New all-time high for silver

While gold usually dominates much of media's attention, it is silver that has been leading the precious metals' surge during the past two years. In 2010, silver gained 82.8 percent vs. gold's 29.6 percent return. Year-to-date, silver has already surged 55.2 percent while gold has expanded by only 10 percent

In the past two months alone, silver went on a parabolic spike, surging 84 percent from a low of $26 in late January to close at $47.87/oz. last week.

On an intraday basis, silver reached a new all-time high of $49.76/oz. last April 25, eclipsing the 1980 peak of $49.45/oz.

Source: www.stockcharts.com

The Hunt Brothers and the Silver Corner

The only other time silver prices went within a whisker of $50/oz. was when Texan brothers William Hebert and Nelson Bunker Hunt tried to corner the silver market in the 1980s that led to bubble and subsequent collapse in the silver market.

The story began in 1973, when the Hunt brothers (sons of American oil tycoon Haroldson Lafayette. Hunt, Jr.) started accumulating precious metals as a hedge against inflation. At that time, the US government prevented private citizens to hold gold, so the Hunts began to buy silver in enormous quantity. By mid-1970s, the Hunts had quietly accumulated almost 10 percent of the known world supply of silver.

As the pace of their buying increased, they drove up the price of silver from around $2/oz. to more than $6/oz. Together with several wealthy Saudi Arabian families, they stepped up their buying of silver, driving prices to $35/oz. by the end of 1979. Other investors who saw the Hunts trying to corner the silver market joined the buying spree, further driving up the prices. On January 18, 1980, silver prices closed just a tad below $50/oz. in response to the Soviet Union's invasion of Afghanistan.

The collapse of the 1980 Silver Bubble

A combination of changed trading rules on the Chicago Board of Trade (CBOT) and New York Mercantile Exchange (COMEX) and the intervention of the US Fed put an end to the Hunts' silver corner. In early January 1980, CBOT and COMEX, backed by the Commodity Futures Trading Commission (the government's futures watchdogs), raised margin requirements for futures contracts. CBOT also ruled that traders could hold no more than 3 million ounces of silver, while COMEX limited traders to 10 million ounces; those holding more were placed in forced liquidation.

Then the US Fed added to the Hunt brothers' troubles when they abruptly raised rates, thus soaking up the excess liquidity which helped fuel the silver boom. The price of silver quickly dropped to $39/oz. and by March 14, it was down to just $21/oz. The silver collapse culminated in a one-day 50 percent decline on March 27, 1980 as the price plummeted from $21.62/oz. to $10.80/oz.

The case for silver today

The difference between the 1980s corner of silver and the present situation of silver is the availability to invest in ETFs. Today central banks, hedge funds, institutions and even retail investors can easily buy silver through silver ETFs. In fact, one such ETF which is the iShares Silver Trust ETF (symbol: SLV) has now become the 11th largest ETF with $17.28 billion market cap.

Why silver is rising faster than gold?

Silver and gold have surged the past two years because of the reasons mentioned above. However, silver has outperformed gold because of the following grounds:

- **Silver is not only a monetary metal but an industrial metal**. Last year, non-investment demand for silver (which includes photographic, industrial and silverware demand) totaled 610 million ounces, according to The Silver Institute. This represents approximately 64 percent of primary supply. In contrast, gold's industrial usage totaled 13 million ounces last year or just 10 percent of primary supply. Thus, in terms of industrial demand, silver's demand is 6.4 times higher than that of gold.

- **Supply of silver as investment is significantly lower than that of gold.** According to the data from The Silver Institute, approximately 341 million ounces of silver are left to satisfy investment demand compared to 125 million ounces of gold available for investment demand. This means that at current prices investors are left with $16 billion worth of silver available for investment versus the $195.4 billion worth of gold, or a 1:12 ratio of silver to gold.

- **Gold/silver ratio of 33:1 points to more upside.** The last time that money was exchangeable to exact amounts of gold and silver, the ratio was set to 16:1. In fact, for most of the past millennium, one ounce of gold would have been convertible to somewhere between 10 and 16 ounces of silver. Therefore, silver still has to double from here (assuming constant gold prices) for it to reach a relative peak against gold.

- **Recent rise not yet comparable to 1980 bubble.** During the Hunt brothers' silver corner, silver rose 8x from $6/oz. in January 1979 to $49.45 in January 1980. Today, silver prices have not yet even tripled from the level it was last year.

Diversification: the key to investment returns

"Filipinos, by nature, are dollar keepers. Call it a form of colonial mentality. Perhaps, we were so used of seeing the peso depreciate against the US dollar that we buy the greenback whenever we have extra savings (see Philequity's article *Hold US dollars = Lose Money* in the November 12, 2007 issue of **The Philippine Star**)."

In our last two articles (including today's), we have seen that an investment in the US dollar has been a losing proposition this year, while investments in precious metals like gold and silver have been very rewarding. The moral of the story is that you as an investor must learn to diversify your assets. At the end of the day, the key to consistent returns is actually DIVERSIFICATION and proper ASSET ALLOCATION.

One's investment portfolio, therefore, should include not only equities and bonds, but also mutual funds, currencies aside from the US dollar and the peso (like the Aussie dollar, Canadian dollar, the Euro, etc.) and precious metals (like gold and silver).

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