

## Silver: Caveat Emptor

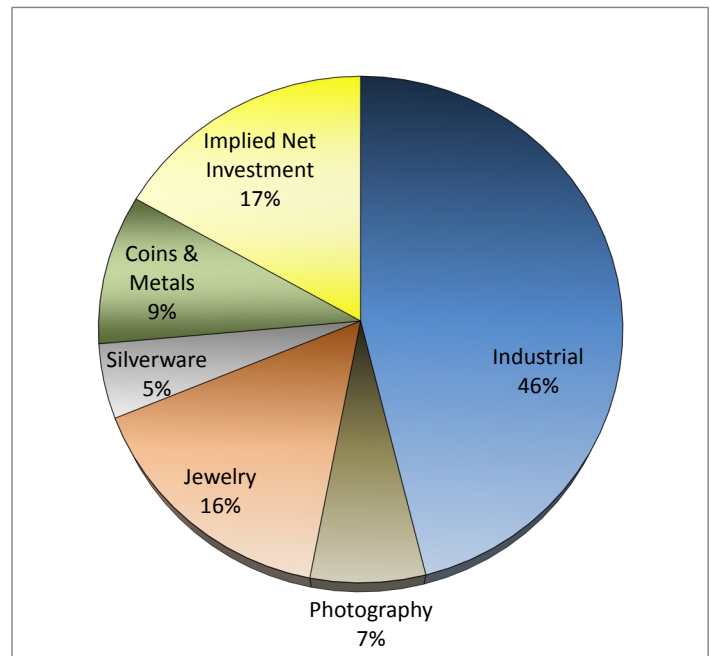
Wayne D. Ryan, CAIA

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### Silver market highlights

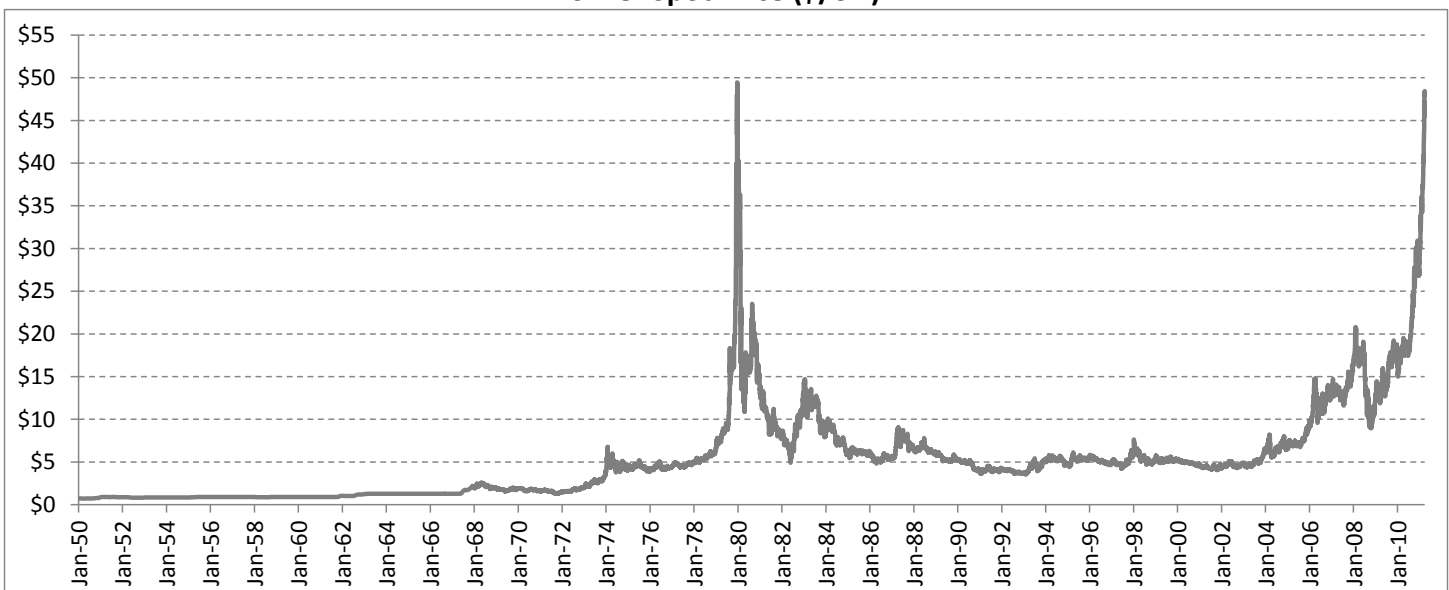
- Prices up dramatically in the past year
- Coveted as both a precious and an industrial metal
- Emerging “green” sources of demand are in their infancy
- Global supply hit a record 1.06 billion troy ounces in 2010

2010 Composition of Silver Demand



Source: Bloomberg, Silver Institute

Silver Spot Price (\$/oz.)



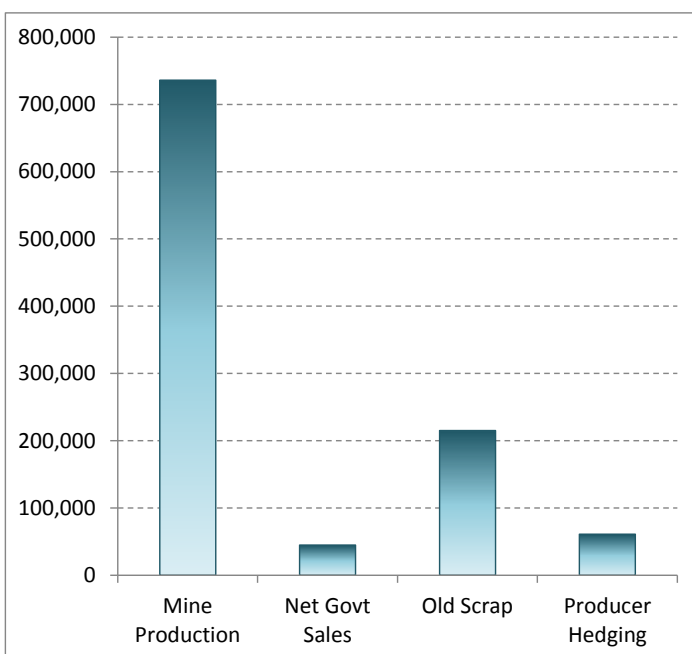
Source: Bloomberg

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## OCCAM’S RAZOR

If silver is “the poor man’s gold” then the poor must have been sitting on a lot of cash if they are solely responsible for pushing silver prices from \$18.64 to \$47.91 in a year’s time. It is entirely plausible that a fertile environment was set for silver to skyrocket through a vastly expanded global money supply, enhanced investor (and trader) access across the world, and a falling U.S. dollar. In fact, through April 2011, silver has been the top performing commodity in the S&P GSCI Commodity Index year-to-date, in the past month, past three months, past six months, and past year. Furthermore, silver has dislocated from any assumed relationship with gold, without a seismic imbalance of fundamentals. The simplest explanation, which many consider to be best, points to accelerating investment and trader demand. Implied net silver investment surged to a record 178 million oz. in 2010, an increase of 47% on the back of frothy demand from ETFs, physical bars, and the over-the-counter market. Fueled by easy access and a slush of global liquidity, silver prices rapidly approached levels not seen since the infamous cornering of the market by the Hunt brothers (amidst the falling dollar and inflation of the late 1970’s).

**2010 Global Silver Supply by Source**  
(‘000 oz.)



Source: Bloomberg, Silver Institute

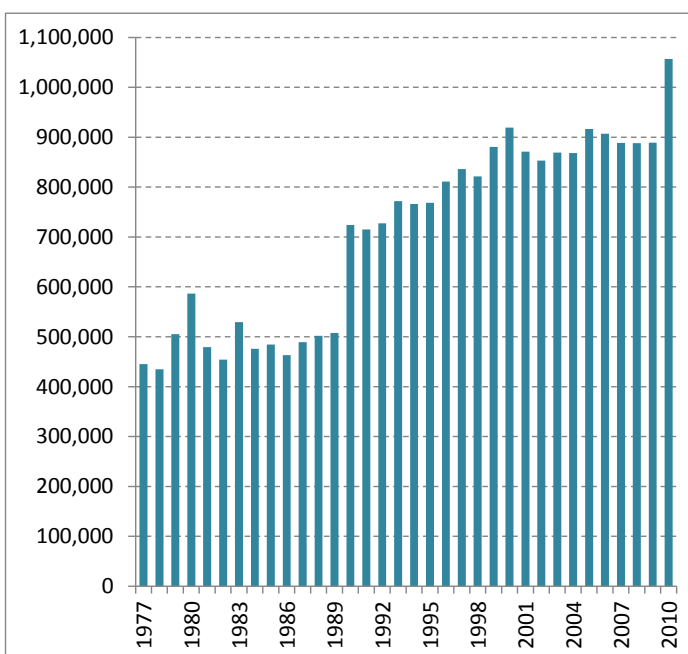
## SUPPLY & DEMAND

The bulk of the 2010 record silver supply came from mines. Mine production results from both primary silver mine activity and as a by-product of other metal mining activity. Mexico is the largest producing country, followed by Peru, China, and Australia. Above-ground sources can be influenced by high price levels and include scrap, producer hedging, and government sales. Silver demand is dominated by fabrication, accounting for 83% of demand. Fabrication includes industrial applications, photography, jewelry, silverware, and coins & metals. However, the most publicized source of demand has been from investment and traders who have flocked to silver as a presumed safe-haven, a presumed inflationary hedge, and a presumed momentum trade. Inevitably, the presumed merits of silver will be tested.

## INDUSTRIAL METAL

Silver is a classic precious metal as well as an essential industrial metal. Industrial use represents the largest proportion of silver demand and includes batteries, bearings, catalysts, and electronics. However, there are emerging areas of silver demand

**Global Silver Supply 1977 to 2010**  
(‘000 oz.)



Source: Bloomberg, Silver Institute

that are often viewed as environmentally progressive and may represent a meaningful proportion of demand in the future. The most salient emerging source of silver demand is solar energy due to the metal’s conductivity and reflectivity. Although not a major driver of silver prices to date, the marginal solar demand could provide support for prices, especially if China and India make good on their respective pledges to increase solar capacity to 30GW and 20GW, respectively by 2020. Water purification is another area of anticipated marginal demand for silver due the antimicrobial properties of silver and the size of the global potable water market. Water’s demographics are very sobering and Asia (especially China and India) could play a prominent role in the medium term. However, sustained high silver prices could derail emerging applications and projects, especially as the “green” demands of 21st Century politics play out against a deficit-laden inflationary backdrop.

**THE CONSPIRACY OF CLOUD SEEDING**

Silver Iodide, a toxic pollutant according to the EPA, may be used in cloud seeding to induce precipitation. The People’s Republic of China is believed to be the world’s largest cloud seeder. It is

no secret that the weather has been an agricultural nemesis as of late and perhaps, just perhaps, cloud seeding could become a priority in China. To be clear, at this point, there is little evidence of Chinese silver stockpiling for the purpose of cloud seeding. However, as is the case for all conspiracy theories, a lack of evidence is supportive to believers.

**“REALITY IS MERELY AN ILLUSION, ALBEIT A VERY PERSISTANT ONE”**

*Albert Einstein*

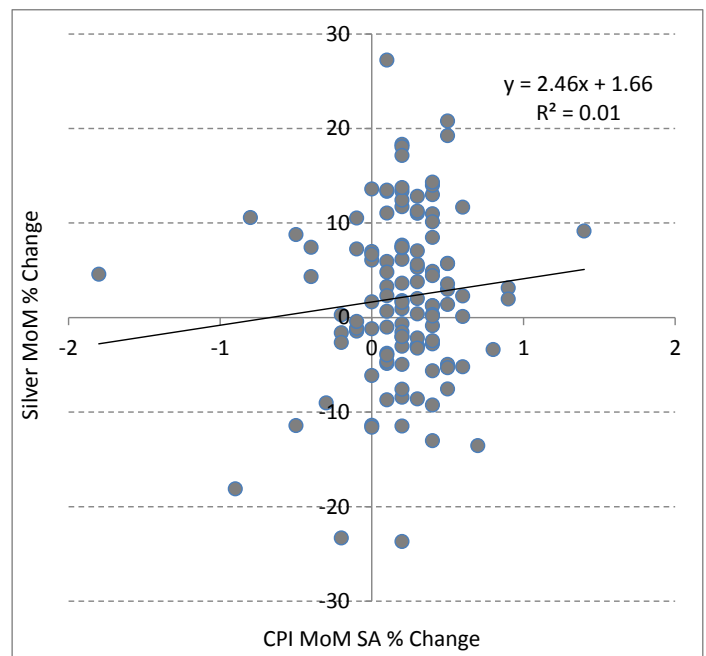
Silver buyers looking to the metal as an inflation hedge should consider the metal’s historical relationship with inflation. Those looking for a mean reversion of the gold/silver ratio will likely have to weather additional volatility in both metals and question the validity of the ratio itself. Silver’s fundamentals are in a tug-of-war with momentum and the power of each should not be underestimated or ignored by investors and traders alike. At some point in time the price of silver will be less influenced by investor and trader behavior than it is today. However, the transition of the fundamentals to an equilibrium that lacks heavy investor and trader demand may prove violent.

**Gold to Silver Ratio (nominal \$/oz.)**



Source: Pelagos Capital, Bloomberg

**Consumer Price Index MoM % Change Versus Silver MoM % Change (10yrs. through Mar 11)**



Source: Pelagos Capital, Bloomberg

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