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WHY IT'S NOW TIME TO LOOK AT SILVER

This summer we turn our attention to silver, which began the year at $16.94, dipped in the spring, and then rose above $17 before settling back into the range it has held over the last two years. With a rising dollar, silver has remained fairly dormant in 2018. It was very surprising to see the metal's price rise on the day the Federal Reserve increased interest rates, an action that generally causes precious metals to weaken. Why? Because rising rates mean that one can earn a (tiny) bit more interest on cash held at the bank, while precious metals offer no dividend or interest payment. If gold and silver can rise in the face of higher interest rates and a stronger dollar, as occurred on Wednesday, June 12, this could be pointing to concerns about problems ahead in the financial system.

On the eve of the Great Depression, the Federal Reserve started raising interest rates, mostly in an effort to contain stock market speculation. Then, like today, debt was at historically high levels. The economy and stock market had enjoyed a very long boom helped by the Fed (although the 20s expansion was far stronger than what we have seen over the last decade). Rising interest rates in the late 20s eventually took a toll on the economy as the ratio of debt service to national income rose from 9% in 1929 to 19.8% in 1932, which caused severe problems for both borrowers and lenders. This situation ultimately gave way to the Great Depression, a time that **led to substantially higher silver prices in the years ahead.**

Though history does not repeat itself, it most certainly rhymes, as Mark Twain said. An economist observing events in the 1930s and today could say that the Fed, by keeping interest rates far lower than normal, encouraged a borrowing surge that artificially boosted the economy to set it up for a big fall. When the Fed lowered interest rates to zero in the wake of the global financial crisis of 2008, rock-bottom borrowing rates encouraged governments, companies, and families around the world to take on more debt. Hopefully, our next recession will not be as severe as it was in the 1930s. But if history rhymes our economy in time will pay for the Fed's greatest financial experiment in U.S. history (keeping interest rates too low for too long), what exactly can we learn from the Great Depression as it pertains to silver at today's low prices?

2018 Proof American Silver Eagle

Perhaps most significantly, consider that the price of silver tripled in less than two years. The white metal had bottomed at an all-time low of 24 cents in December 1932, as banks across the nation were failing. This was a time of deep depression during which the *price of corn eventually went negative*: the county elevator in South Dakota listed corn at minus three cents...you literally had to pay buyers to take corn off your hands! **This caused the government to launch an emergency inflationary policy that involved not only accumulating gold in federal vaults--but silver, as well.** This spurred investors to aggressively accumulate commodities, as they understood what financial authorities were doing: pushing the value of the dollar down hoping to spur economic demand via inflation. (There was also the issue of the government prohibiting gold ownership while people were always free to purchase silver, but we will address that in another issue.) At the time, **nobody knew that this was just the beginning of an upward trend for silver that lasted many years.**

We must emphasize that silver boomed in those years even though above-ground supplies were far more abundant than they are today. Initially, the price of silver collapsed because the metal had been demonetized. Consequently, the tons of silver that had been used in coinage were becoming less and less necessary and the metal's supply began to far exceed demand around the world. The federal government (as part of its inflationary policy but also to help silver miners) began absorbing this excess silver on the market and eventually accumulated a massive 1.7 billion ounces, the largest silver bounty the world has ever known. In fact, the U.S. government purchased 400 million ounces in 1938 alone!

Silver demands a strong upward move, ironically, it occurred even as federal authorities began to sell down these accumulated silver holdings in the 1960s. New demand from the electronics industry, as well as its use in coins, applied upward pressure on silver prices and the government began dumping their cache of silver on the market, but was unable to contain the price. In the four years from 1961 to 1965 alone, our government sold two-thirds of its silver supply. Eventually, the United States' massive store of the precious white metal was completely disposed of, **driven by the booming industrial demand for silver.** Eventually, in 1969 the government was forced to completely remove silver from American coinage for the first time ever because the metal was worth more than the face value of the coinage. In summary, **between 1933 and 1979, the price of silver increased from 24 cents to almost $50 per ounce.** Much of this rise came at the tail end of the boom, with **silver surging almost eightfold in roughly a year.**

WHAT DOES THIS MEAN FOR TODAY'S SITUATION?

The present economic conditions causing concern among many economists and money managers (unprecedented national debt, a rising budget deficit, elevated stock and home prices due to a Fed-driven boom, late innings in the economic cycle, and an incipient trade war) are **reminiscent to those seen in the late 1920s--just before the price of silver was about to take off.** Furthermore, because of silver's importance to the electronics and solar industries, the industrial demand is even more significant today. There are important differences that must be considered, also.

Perhaps most critical, the days of tremendous excess supply driven by silver's demonetization are behind us. The tonnage that was absorbed by the U.S. government is completely gone because of silver's use in industrial production. It is important to remember that **roughly 25 billion troy ounces of silver have been permanently destroyed in industrial production since the 1930s.** The market capitalization of silver 100 years ago was a significant portion of the total wealth in the country. Today's estimated total above-ground silver in the entire world, around 30 billion ounces, is worth no more than $490 billion--and most of that is off the financial market (held in jewelry, church ornaments, flatware, etc.). As a result, it would not take much investment demand to move the price higher. Furthermore, the slow death of film developing driven by digital photography's rise, which was a major driver of silver's sluggish price behavior in the 1990s, is behind us and is now a negligible source of demand. These days demand from solar energy and electronics has risen in photography's place.

The key driver in the future will clearly be gold, given that the metals tend to move hand in hand. But unlike gold, which by comparison has had a fairly steady rise during

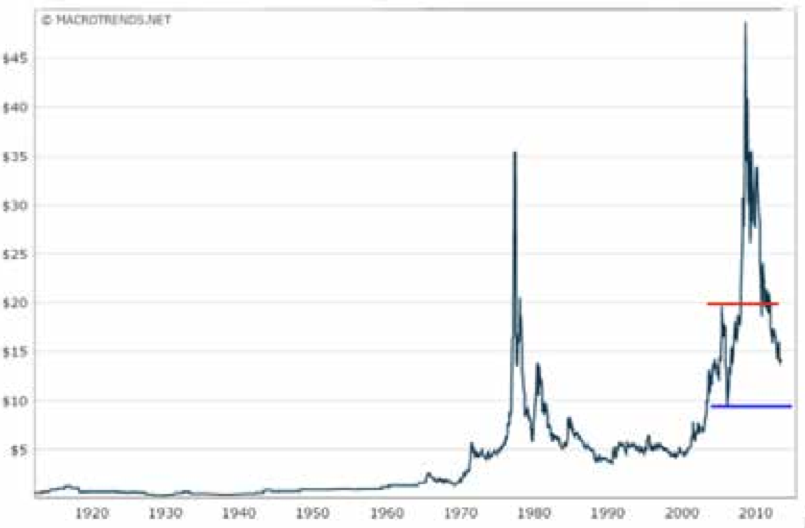
[1] Ben Bernanke, *Essays on the Great Depression* (Princeton: Princeton University Press, 2000), p. 46.
[2] Studs Terkel, *Hard Times: An Oral History of the Great Depression* (New York: Pantheon Books, 1970), p. 245.

this new century from near $250 to around the $1,300 level this year, silver has had some fairly dramatic moves. It started in the $4-5 range, and broke the $10 level in 2006. It surged past $20 in 2008, and then dipped in 2009 before surging five times into the European financial crisis--soaring almost to $50 an ounce in 2011. Regardless, gold and silver have a high correlation (their prices tend to move together historically) and silver has begun to lag gold. This reflects investor preference for gold over silver, not precisely because gold is scarcer than silver. In fact, although there are more ounces of silver in the market by a factor of 6, if we consider the metals' market value, silver is far rarer: there is roughly $490 billion in silver vs. $7 trillion in gold in the world today. Plainly stated, **there is 14 times more gold than silver in dollar terms.**

Shown in the chart to the top right, one is struck by two things. The first is the two spikes, like heart attacks in 1980 and 2011, when silver approached the $50-per-ounce level before descending. Next is the fact that since the 2000s, during which the second spike occurred, **silver has stayed above $15 per ounce, a new higher level.** One might conclude that there are brief periods when silver investors get agitated and the metal moves rapidly, but that eventually it settles down; that demand surges until supply satiates the buyers and the white metal comes to rest.

However, when looking more closely at the chart, one finds that it spent 70 years below $5 per ounce, a reflection of how plentiful silver was relative to demand for decades. Although it fell from its spike in the early 1980s, the metal stayed near a new higher level, though investment demand was subdued in the stock and bond market boom. Things changed in 2000 with the rise of gold and relative to history, silver made a rapid climb above $10. The metal's surge well above $15 and $20 came during the European crisis. Once again after another dramatic spike, silver held its value above a new, higher bottom level of $15 per ounce.

PRICE OF SILVER OVER THE LAST CENTURY



When observing the chart below, which shows silver's performance over the last five years, there has been quite a bit of volatility. However, over the last two years the price has been moving in a much narrower range above $15 despite higher interest rates and widespread expectations of a stronger dollar. All things considered, the price movements of the white metal have been quite tame considering significant movements in years past.

Today, at the tail end of the biggest market bonanza the world has ever known, another Fed-induced real estate boom is beginning to weaken. With government debt and deficits starting to soar, just as a new world trade war has begun--you can look to the 1920s and point to the numerous similarities.

Perhaps the most important one, the one that often leads to recession, **is the simple fact that the Fed is confidently raising rates.** The difference is that much of the silver supply, so plentiful in the 1920s, has been utilized in industrial production with the rise of electronics. **Silver jumped over 200 times in value between 1932 and 1980** and today is hovering around $16 an ounce, still well below the high reached in 1980. We strongly expect history to repeat itself.

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