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MARKETS AT A GLANCE

Sprott Asset Management LP

Why are (Smart) Investors Buying 50 Times More Physical Silver than Gold?

By: Eric Sprott

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As long-time students of precious metals investing, there are certain things we understand. One is that, historically, the availability ratio of silver to gold has had a direct influence on the price of the metals. The current availability ratio of physical silver to gold for investment purposes is approximately 3:1. So, why is it that investors are allocating their dollars to silver at a much higher ratio? What is it that these "smart" investors understand? Let's have a look at the numbers and see if it's time for investors to do as a wise man once said and "follow the money."

Average annual gold mine production is approximately 80 million ounces, which together with an estimated average 50 million ounces of annual recycled gold, totals around 130 million ounces available per year. In comparison, annual mined silver production has averaged around 750 million ounces, while recycled silver is estimated at 250 million ounces per year, which adds up to approximately 1 billion ounces. Using this data, there is roughly 8 times more silver available to buy than there is gold. However, not all gold and silver is available for investment purposes, due to their use in industrial applications. It is estimated that for investment purposes (jewelry, bars and coins), the annual availability of gold is roughly 120 million ounces, and of silver it is 350 million ounces. Therefore, the ratio of physical silver availability to gold availability is 350/120, or ~3:1.[1]

Now, let's examine how investors are allocating their investments between gold and silver. The data below is from the US Mint showing gold and silver sales in ounces:

	SILVER	GOLD	SILVER: GOLD
2008	19,583,500	860,500	22.8x
2009	28,766,500	1,435,000	20x
2010	34,662,500	1,220,500	28x
2011	39,868,500	1,000,000	40x
YTD 2012	33,742,000	744,000	45x

Source: US Mint (www.usmint.gov)

As you can see, investors are choosing to buy silver at a ratio to gold that is well above what is available. This uptrend doesn't show any signs of slowing either. The ratio of the physical silver to gold is both rising and extraordinarily above the availability ratio of 3:1.

1 Sources: Gold data is from World Gold Council www.gold.org, and silver data is from Silver Institute, http://www.silverinstitute.org/site/supply-demand/

We can also use other data such as the most recent issues of the Sprott Physical Gold and Silver Trusts. The last Gold Trust issue in September 2012 raised US$393 million and the last Silver Trust issue raised US$310 million. On the basis of prices for each metal at the time of issue, we could purchase ~213 thousand ounces of gold and ~9.1 million ounces of silver. This represents a purchase ratio of 43:1.

If we examine ETF holdings in both gold and silver, we note that in the period from 2007 to 2012, the increase in silver holdings amounted to 12,000 tonnes, compared to 1,200 tonnes of gold – meaning, investors purchased ten times more silver than gold.

These are only three factual data points to consider, but there are other indications that silver investment demand is way out of line with availability. Our favourite question to the bullion dealers we meet, is to ask the ratio of their dollar sales in gold versus silver. The answer is that dollar sales are equal, which means that physical silver sales relative to gold are greater than 50:1.

A recent news headline on Mineweb read, "Silver Sales to Outshine Gold in India.[2]" It went on to quote a bullion dealer that "investors and jewelry lovers **prefer** silver jewelry these days." As the largest importer of gold in the world, it would be impossible for India to purchase an equivalent amount of silver, as it would require more than one billion ounces, essentially more than the current annual mine production.

While these last two confirmations of silver demand are anecdotal, the statistics from the US Mint, the ETFs, and our Physical Trust issues, are factual.

For the time being, the silver price is essentially set in the paper market where the daily average trade on the Comex is approximately 300 million ounces. An outrageous number when you compare it to the daily mine production of about 2 million ounces. As Bart Chilton, Commissioner of the Commodity Futures Trading Commission stated on October 26, 2010, "I believe there have been repeated attempts to influence prices in silver markets. There have been fraudulent efforts to persuade and deviously control that price. Based on what I have been told and reviewed in publicly available documents, I believe violations to the Commodity Exchange Act have taken place in the silver market and any such violation of the law in this regard should be prosecuted."[3]

Which brings us back to the phrase "Follow the money." In our view, it is almost inconceivable that investors would allocate as many dollars to silver as they would to gold, but that is what the data shows.

The silver investment market is very small. While the dollar value of gold in the world approaches $9 trillion, the value of silver in the forms of jewelry, coins, bars and silverware is estimated at around $150 billion (5 billion ounces at $30 per ounce). This is a ratio of 60:1 in dollar terms.[4]

How long can investors continue to buy silver at the current ratios when the availability for investment is only 3:1? We are surprised that the price of silver has remained at such a depressed level compared to gold. Historically, the price ratio between gold and silver has been 16:1, when both were currencies. Today the ratio is 55:1, so what are the numbers telling us? We believe this is one of those times when smart investors will be well rewarded to "Follow the money."

On behalf of all of us at Sprott, I wish you safe and happy Holidays and a prosperous New Year.

P.S. – US Mint Sold Out of Silver Eagle Bullion Coins Until January 7, 2013
The Mint recently informed authorized purchasers that all remaining inventories of 2012-dated Silver Eagle bullion coins had sold out and no additional coins would be struck. Since the 2013-dated coins will not be available to order until January 7, 2013, this leaves a three week void for the Mint's most popular bullion offering.

2 Source: Mineweb.com
3 Source: Bloomberg: http://mobile.bloomberg.com/news/2010-10-26/silver-market-faced-fraudulent-efforts-to-control-price-chilton-says.html
4 Sources: Gold data is from World Gold Council, silver data is from United States Geological Survey (USGS) and Silver Institute.

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Royal Bank Plaza, South Tower
200 Bay Street, Suite 2700, P.O. Box 27
Toronto, ON M5J 2J1
Business: 416.943.6707
Facsimile: 416.943.6497
Toll Free: 1.866.299.9906
www.sprott.com

Sprott
Asset Management LP

For further information, please contact **invest@sprott.com**

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