SILVER SPIRIT

With the global economy seemingly revived, you wouldn't expect silver to have many cheerleaders as an investment. Think again: its time to shine is now

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There are still presumably plenty of gold bugs among you, but what about silver bugs? How many of you have holdings of physical silver, either stored at home, for which you need a fair bit of space and an elaborate security setup, or more likely with a reliable custodian? And by a reliable custodian I don't mean a physical silver ETF provider or indeed a burly security guard with knuckledusters. In the last resort an ETF is worth no more than the paper it is written on, and with the global financial system built on shifting sands that is not saying a great deal.

One confirmed silver bug is Ned Naylor-Leyland, a fund manager at Quilter Cheviot whose fund combines bullion holdings with mining stocks. Gold bugs tend also to be silver bugs, he suggests — or, put more simply, people who understand the monetary qualities of metals.

'Two-thirds of the world's population live in India and China and they consider gold and silver to be the finest forms of money known to man, not just a store of value but money as well,' he says. 'People who believe in fiat money, in my opinion, are the eccentric ones. Between Iran, China, India and Russia you're seeing a swathe of direct trading agreements where they're bypassing the dollar. It's inevitable they will create a

Illustration by Russ Tudor

currency board to replace the dollar, and it's likely it will have physical backing. Does that include silver? I'm not sure, but if it does include gold, silver will behave in a geared way relative to gold, and will go up substantially more than gold does owing to the smaller liquidity pool. It's just more geared.'

For most gold bugs, gold is money, pure and simple. Silver was demonetised long before gold and couldn't technically be money today, as there just isn't enough of it to go round. But in one sense silver is still money, explains James Turk, founder of web-based metals dealer GoldMoney and author of *The Money Bubble*, because it is a money-substitute for gold. 'One ounce of gold represents a certain amount of money stored outside the banking system, which is particularly important given the problems we have today with the banking system and monetary policy. If that's the case, 66oz of silver can do the same thing for you that one ounce of gold can do, but the important thing is that the relative value is out of whack, and the ratio of the two is likely to fall.'

If that is the case, it would make sense to buy physical silver now and swap it for physical gold once the silver-to-gold ratio has contracted to a point closer to its historical average, but before its inherent volatility causes the ratio to widen again.

A MUST-HAVE

Silver's price is much more volatile than gold's, because of its various industrial applications. 'Silver is strategic in a way that gold isn't,' says Naylor-Leyland. 'We don't *have* to have silver as we do water, but it's jolly useful. It's extremely price-inelastic. Even if the price were to go up eight times, it's really not going to make any difference to Siemens or to the military using it in their missiles. They have to have silver and it doesn't matter what the price is.

'When the market does squeeze, you're going to see industrial users forced to stockpile whatever physical silver they can get their hands on, because they are well aware that there is a very limited supply above ground. Broadly speaking, in 1900 there were 13 billion ounces of silver around in bullion form. There's now about half a billion, whereas above-ground gold has gone from one to eight billion over the same time frame.'

The short supply of physical silver has another implication. You probably remember how the Texan oil magnates the Hunt brothers went belly-up in 1980 after trying to corner the market in silver. 'There wasn't anything like the physical leverage in the market then that there is now, and there was a lot more physical around then,' Naylor-Leyland points out. 'It wouldn't take as much now, in terms of removing physical, to cause chaos.'

Indeed, few holders are willing to lend physical stock into the market because they don't trust the pricing environment. The London Bullion Metals Association runs a highly leveraged, paper-to-physical OTC spot market, which is highly opaque. Estimates of the ratio of paper to physical silver in the market range from 30 to 100.

NUGGETS OF WISDOM

If you're going to accumulate silver, how should you go about it? Certainly, if you're seeking to avoid the potential risks of the banking system it makes absolutely no sense to invest in a physical silver ETF. Naylor-Leyland's message is don't buy ETFs and do buy bullion funds, which are 'basically just de-risked versions of ETFs' — listed securities investing in bullion, covered by the Securities Act.

'Bullion funds go that much further in custodial de-risking, whereas custodians for ETFs in gold and silver are the same banks that make up the LBMA,' he says. For that reason, bullion funds 'don't do custody with those same banks'. Currently, bullion funds are trading at a discount to net asset value of around 6 per cent, whereas an ETF will be trading at spot.

Naylor-Leyland's fund, Abydos Holding, which is an OEIC, is 30 per cent physical, all held in bullion funds, then 70 per cent mining shares. 'I think mining shares will be the ultimate playpen of the investment capital,' he says. 'When these problems really become apparent, physical holders are not going to sell silver, or only in very small volumes. The next best thing is a percentage ownership of a future or current stream of production. While they currently look beaten up and ugly, and on a historic basis silver and gold equities have never been cheaper, and never been cheaper by a substantial margin, there's certainly a value proposition to be had there.'

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James Hathaway explains that his company Tocqueville Capital has a 'Gold Fund', a US mutual fund that holds shares in gold and silver producers. But it also has a 'Bullion Reserve' fund, which acquires and stores physical metal in a structure that is not a security: 'It's not part of the securities system, it's not part of the banking system. It's simply gold and silver stored in warehouses so that in an extreme systemic-risk event the investor would have access to that portion of his capital that was held in this way.'

Similarly, James Turk is a long-standing and calm advocate of gold as money and silver as a money-substitute for gold. He is cynical about the mindset of central bankers and doubts they will truly shut down QE, rather than finesse its continuation under another euphemistic name. 'Central banks only understand one thing: printing money,' he says. 'Gold is so undervalued compared to historical norms and silver is undervalued compared to gold. What will drive a rise in prices is that there is too much debt in the world, there are too many paper promises out there.'