

# What a gold:silver ratio below 40:1 tells you

*The last time the gold:silver ratio stood below this level was in February 1998 just after silver rallied 33% in 5 weeks, much is the same in the current situation but, investment demand is much higher.*

Author: Rhona O'Connell

Posted: Tuesday , 08 Mar 2011

## LONDON -

The last time the gold:silver ratio stood below 40:1 was in February 1998, just after silver had staged a 33% rally in five weeks, while gold had gained just 4% over the same period (which commenced at the start of the year). The contraction in the ratio over the period was from 48.4:1 to 38.1:1.

This time, some thirteen years on, the gold:silver price ratio is trading at between 39:1 and 40:1 and a similar contraction has taken exactly the same length of time. This time however, gold and silver are trading at over \$1,440 and \$36, while back in 1998 they were at \$300 and just over \$7.

### **So where are the similarities and the differences between then and now?**

This time the silver price has bounded up as a result of a sustained belief (whether right or wrong) in gold's upside on the back of prevailing geopolitical and inflationary concerns. Both gold and silver are already in sustained bull markets, while in 1998 the change in ratio marked the start of a shift in sentiment, albeit one that was buffeted by subsequent external events.

Silver investment can often exceed that of gold for more than one reason: a) the history of silver's higher volatility over gold, prompting professional activity with a view to gearing up on returns; b) silver's lower unit price, which attracts some smaller-scale investors who want exposure to precious metals because of inflationary fears in particular and who don't necessarily have enough wealth to invest in the yellow metal to any meaningful level; c) in the United States in particular, silver has a long-standing investment tradition. This is because of the period when the dollar was on the gold standard and private individuals were prevented from holding gold, so they used silver as a substitute.

### **Twelve years ago; professional attitudes were probably the driver.**

At the start of 1998, gold was starting to stage a recovery after a long period of uncertainty, characterised by intermittent announcements of large-scale central bank sales that unsettled market sentiment; this was augmented by increasingly heavy mine hedging and these two fundamental elements, combined with anti-inflationary fiscal policy, had kept gold prices under some pressure.

What was different about the start of 1998 was the putative formation of the European Monetary Union, which gave the markets a degree of comfort and reduced the expectation of official sector

sales. (This, of course, was latterly to be stymied by the announcement in May 1999 by HM Treasury in the UK of the proposed disposal of up to 40% of UK gold holdings; sentiment then changed substantially as a result of the institution of the first Central Bank Gold Agreement in September 1999). Investors started to return to gold and silver was a natural beneficiary of the change in sentiment.

### **The differences between now and then. Nothing, in terms of industrial demand**

Over those five weeks in early 1998 the net long speculative silver position on COMEX rose from 8,813t to 9,500t, a gain of almost 700 tonnes or 8%. This time around the shift has been from a net long of 6,710t to 8,780t, a gain of 2,070t or 31%. but from a much lower base.

Interestingly enough, silver fabrication demand in 1988 was just over 26,000t; in 2010 it was very close to the same level, suggesting that the market itself is not much deeper than it was in the late 1980s. In fact, on the basis of LBMA clearing figures, the December 2010 daily average clearing rate was just below 100M ounces, less than one-third of the clearing numbers for end-1997.

The structure of the demand side has changed with industrial demand fluctuating, but photography and jewellery+silverware falling substantially. Coin demand, by contrast, has been growing steadily.

### **... but plenty in terms of investment**

Sustained retail demand has helped the rise in silver's price in recent months, reflecting the continued awareness at the retail level of the "affordability" of silver by comparison with gold. This has been particularly marked in the Far East, where silver bars have scarce and commanding high premia, while India and the Middle East have also been strong buyers.

### **The ratio; a life of its own and an important indicator**

As a result the ratio has to some extent taken on a life of its own and been traded as an outright entity in the bullion markets. Now at 13 year lows it is not in uncharted territory, but is certainly oversold.

While the markets remain bullish about the outlook for gold on the back of sustained inflationary and geopolitical fears, silver is likely to continue to attract attention. The outright price may make silver unattractive for fresh bull positions, but technically-driven and momentum trades may yet see prices higher if the political situation is not resolved with a minimum of further trauma. Silver has frequently been the leader among the two "precious metals" because of its lower unit price and higher volatility; the ratio can therefore be regarded as a similar leading indicator. In fact it is probably one of the most significant indicators in terms of precious metals market sentiment and, so, when it comes to looking for guidance, the chart should be watched closely for signs of reversal. Even stabilisation would be significant; a bounce might well trigger stops.