Current Gold:Silver Ratio Screams: Buy All Things Silver!

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This article suggests that silver is undervalued compared to gold by anywhere from 10% to 50% based on historical gold to silver price relationships.

With primary secular bull or bear trends easily running from 10 to 20 years of the average investor's 40 year investing lifespan it is crucial to identify optimal accumulation points within these primary trends to avoid prolonged periods of under-performance and potentially negative returns and to avoid dramatically reducing the number of productive years in which to build one's fortune.

Within these trends are zigs and zags, up and down, and we can ride these medium term and short term waves to profits by either buying what is going up and/or shorting what is going down. As such, it is critical to step away from all the noise and clutter that passes for knowledge and take the time to gain perspective on where the market is in terms of the 'big picture' and to determine which investments are in a powerful unfolding trend so that an informed investment strategy can be developed and implemented.

Probably the best way to gain perspective on where the different asset classes are in their performance channels is to do a comparative analysis of the various components in the market and how they correlate to each other over the long, medium and short term and, based on those relationships, how they might perform in the near term.

This is part 1 of a 6-part series of articles to provide an informed, objective analysis as to how gold and silver bullion (part 1); the various stock market indices (part 2); precious metals mining shares (part 3); the US dollar (part 4); bonds (part 5); and crude oil (part 6) will likely perform into the next decade.

Gold

The key to a secular gold bull is the collective gold transactions of hundreds of millions of individual investors worldwide buying and selling gold that ultimately sets the price and determines its fortunes. The collective demand trends of private gold investors worldwide effectively divide gold bulls into 3 distinct demand-driven stages, namely:

a) Stage One which occurs when a devaluation of the dominant currency in which gold is priced, i.e. the USD, leads to a moderate increase in the price of gold. Stage One for gold began on February 15th, 2001 when it reached a 22-year secular low of just $255.10.

b) Stage Two occurs when the decoupling of gold from local-currency devaluation begins to outpace the dollar's losses and gold starts rising significantly in virtually all currencies worldwide. Stage Two began on June 5th, 2005 when gold (at $417.67US) first surpassed 350 euros for the first time after repeated attempts.

c) Stage Three occurs when the general public around the world starts investing in gold and this deluge of capital into gold causes it to escalate dramatically (i.e. to go parabolic) in price. We are close to Stage Three and it will become clearly evident when the price for gold begins its daily record ascents to dramatically higher prices.

An analysis of the various trend channels indicates the following:

a) The longer term trend channel for gold is up and has been since early 2001 with a current top line resistance of $1650 and a lower resistance line of $600.

b) The medium term trend channel has been in place since August 30th, 2005 and has a current top line resistance of $1200 and a lower resistance line of $750.

c) The short term trend channel began with a June/July/August 2007 consolidation base of $650 and has an upper resistance line of $1100 and a lower line resistance of $875 which the current price is within.

Conclusion: Gold is now in a consolidation phase between $875 and $1100 and, as such, has limited upside short term potential from its current base. During the past 7 years of bull market activity gold bought by the end of July has appreciated by an average of 12.9% (the equivalent of 30.9% annualized) during the balance of the year. Based on the price for gold of $939.30 as of July 31st, 2009 we could well expect a year end price of $1060.50 which would still be within the short term trend channel upper resistance line.

And long term? That is anybody's guess but there is no shortage of prognosticators who see gold going parabolic. Adam Hamilton of zealllc.com forecasts a price considerably above $1000 before Stage Two ends in 2009 and a price of over $3,500 by 2010/11 if the public enters and ignites a popular speculative mania; Mary Anne and Pamela Aden, as mentioned in a previous article, state that a price of $5,800 is possible by 2012 if gold were to appreciate from its 2001 low of $255 by the same percentage as it did between 1971 and 1980. Now that's momentum!

Silver

Silver has proven itself, time and again, to be a safe haven for investors during times of economic uncertainty and, as such, with the current economy in difficulty the silver market has become a flight to quality investment vehicle. The 85% increase in silver in the past 12 months attests to that in spades. In fact, during the last bull market during the 70's silver went from $1.30 in November 1971 to $42 on January 21st 1980 for a 3,131% gain. A similar rise from silver's low of $4.35 in March 2003 could take silver to $140 or beyond before this current bull market is over.

An analysis of the various trend channels indicates the following:

a) The longer term trend channel for silver began on March 21st, 2003 at a low of $4.35 and has upper resistance of $51 and lower support at $12. Such volatility has always been very high because, with the silver market only about 2% that of gold, even a small amount of money flowing into silver has a huge impact.

b) The medium term trend channel began with a lengthy March through August 2007 consolidation base of $13 - $14 and currently has upper resistance at $32 and lower support at $13.

c) The current short term trend channel began in November 2008 at $8.79 and currently has upper resistance at $22 and lower support at $15.50.

Conclusions: Silver has considerable upside potential short term (to $22), medium term (to $32) and long term (to $51 and beyond).

Gold:Silver Ratio

The Gold:Silver ratio has ranged from 14.9-to-1 in January 15, 1980 at the time of the record high gold and silver prices to 99.8-to-1 on February 22, 1991 when the price of silver was particularly depressed. During the past 5 years it has ranged from 43.6-to-1 (April 19, 2006) to 84.4-to-1 (October, 2008). It is currently at 64-to-1 having breached the 28 year support line of 58-to-1 (and 200dma) in August 2008.

An analysis of the various trend channels indicates the following:

a) The longer term channel upper resistance is 58-to-1 with a lower support at 43-to-1.
b) The medium term channel upper resistance is 54-to-1 with a lower support of 47-to-1.
c) The short term channel upper resistance is 52-to-1 with a lower support is 50-to-1.

Conclusions: There are many! Let's look at the various price levels for gold and the various gold:silver ratios mentioned above one by one and see what conclusions we can draw.

Let's use today's (Nov. 4th, 2009) price of $1085 for gold and apply the various gold:silver ratios mentioned above and see what they do for the potential % increase in, and price of, silver.

Gold @ $1085 using the current 63:1 gold:silver ratio puts silver at $17.22 (Nov.4/09)
Gold @ $1085 using the above 58:1 gold:silver ratio puts silver at $18.71 (i.e. +8.6%)
Gold @ $1085 using the above 54:1 gold:silver ratio puts silver at $20.09 (i.e. +16.7%)
Gold @ $1085 using the above 52:1 gold:silver ratio puts silver at $20.87 (i.e. +21.2%)
Gold @ $1085 using the above 50:1 gold:silver ratio puts silver at $21.70 (i.e. +26.0%)
Gold @ $1085 using the above 47:1 gold:silver ratio puts silver at $23.09 (i.e. +34.1%)
Gold @ $1085 using the above 43:1 gold:silver ratio puts silver at $25.23 (i.e. +46.5%)

Were we to apply the various channel upper resistance level prices for gold to the range of gold:silver ratios mentioned above we would arrive at the following potential prices for silver:

Gold @ $1100 using gold:silver ratios between 63:1 and 43:1 puts silver between $17.46 and $25.58
Gold @ $1650 using gold:silver ratios between 63:1 and 43:1 puts silver between $26.19 and $38.37

Gold @ $2500 using gold:silver ratios between 63:1 and 43:1 puts silver between $39.68 and $58.14
Gold @ $3500 using gold:silver ratios between 63:1 and 43:1 puts silver between $55.56 and $81.40
Gold @ $5800 using gold:silver ratios between 63:1 and 43:1 puts silver between $92.06 and $134.88

From the above it seems that, any way we look at it, physical silver is currently undervalued compared to gold bullion and is in position to generate anywhere from 10 - 50% greater returns than investing in gold bullion.

What about the shares of silver mining companies and the royalty companies that buy mines' secondary silver production? Well, a look at those companies that make up the silver component of the Gold and Silver Companies Index (GSCI) reveals that the stocks of such companies have appreciated 15% more than that of silver itself YTD and the warrants associated with those stocks by 30% more than the company stock. Below is a table showing the performance of a broad segment of the market.

Last Week's % Performance

	Prev. Wk	Prev. Mo	YTD(1)
Gold	-0.9	4.3	18.3
Silver	-7.7	1.1	44.3
Crude oil	-4.3	10.1	72.6
USDIndex	1.2	-0.9	-6.1
CRB	-3.6	7.2	17.8
HUI	-9.1	1.1	29.3
CDNX	-6.3	3.8	82.6
CCI	-11.4	2.8	101.7
CWI	-18.9	-6.1	187.7
GSCI	-12.3	-4.6	51.4
PMWI	-23.6	-12.7	67.6

All calculations are based on U.S. dollar equivalents
(1) **Week ending October 30th, 2009**

Sources: preciousmetalswarrants.com (warrant and stocks-with-warrants data), oanda.com (exchange rates) and stockcharts.com (index and commodity prices).

In conclusion it would seem that if one wants to invest in commodities that silver has more upside potential relative to gold; that silver mining/royalty stocks have greater upside potential than silver itself; and that the warrants associated with the silver mining/royalty stocks have even more upside potential (i.e.leverage) than the stocks themselves. It certainly appears evident that now is the time to buy all things silver.

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a) **www.PreciousMetalsWarrants.com** provides a **free** one-of-a-kind database (updated weekly) on all commodity-related warrants trading on exchanges in the United States and Canada. PMW also offers a subscription service that ranks all warrants according to our proprietary leverage/time calculations at four projected stock price appreciation levels. You can also sign up for a **free weekly email** highlighting events in the precious metals marketplace and in the wonderful world of warrants in particular.

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