

RIDING THE SILVER BULL

THE COMPELLING CASE FOR SILVER IN 2005 AND BEYOND



Riding the Silver Bull: The Compelling Case for Silver in 2005 and Beyond

by David Morgan

Most investors, if they could, would only utilize investment strategies that could maximize their profit opportunities, minimize their risk and take very little time or effort. Call it human nature, call it wishful thinking, or call it pure fantasy. We all search for such a “dream” investment.

Everyone’s heard of 20/20 hindsight. It’s always easy to know, after the fact, what you *should* have done in the beginning. Let’s use a bit of hindsight here to see how a decade-long investing strategy could have been used to maximize one’s investment returns.

If an investor, for example, had bought into the Japanese markets in the early 1980s, rode all of the ups and downs and then cashed out in 1990, the investment gains *could* have been fantastic. That investor could have sold at the top of the Japanese craze, bought into technology stocks at just the right time in the early 1990s and, again, rode them all the way to the top in the year 2000. Again, the gains in that decade *could* have been truly spectacular.

Since early in the year 2000, I have been advocating a different decade-long investment strategy, one that I believe has the potential to produce even greater returns than the examples from the 1980s and 1990s that I used above. That strategy is to move largely out of paper assets... and into commodities. I believe that commodities are now in a bull market, and that this bull market could last ten years, and perhaps longer. I also believe that this opportunity is staring most investors in the face, but only a select few can see it... or believe it.

The commodity markets, and specifically the CRB Index, have outperformed both the stock and bond markets recently and, I believe, will continue to do so. This is an important shift to recognize, yet very few individual investors are

aware that this fundamental change in the marketplace has taken place!

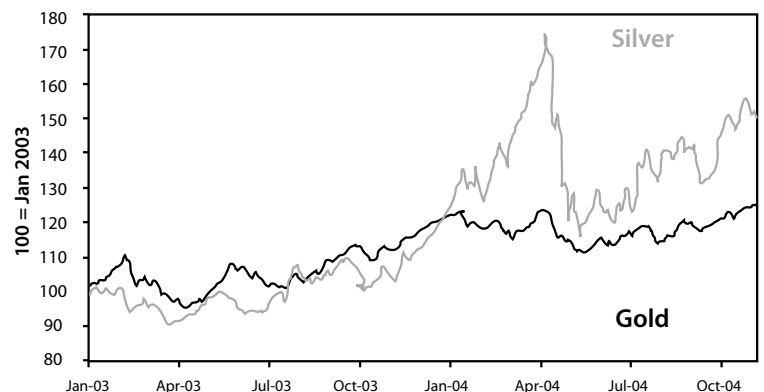
Commodity investing, though, is difficult for many investors because they do not know how to participate. However, one of the best ways to participate in commodities is through precious metals investing.

The *Money Metals* – gold and silver – have been recognized as stores of value for thousands of years of human history. Gold has certainly done its job; it has preserved wealth for those that have invested assets in this metal. Gold has appreciated in U.S. Dollar terms roughly the amount the Dollar has declined. In other words, gold has maintained purchasing power

For the year 2004, however, silver actually outperformed gold. While the price of gold increased approximately six percent from the last day of 2003 until the last day of 2004, the price of silver increased over 15 per cent during the same period.

Silver, however, has several other bullish factors (in addition to its excellent performance in 2004) that make it, in my opinion, a much more compelling investment at this time.

Gold Versus Silver Prices 2003 – to date



Silver: Precious Metal, But Precious Little

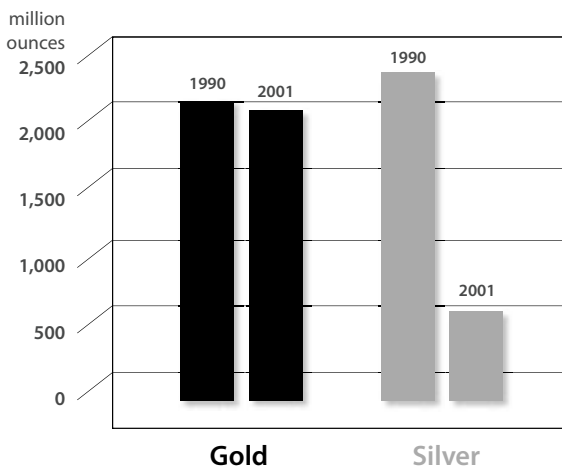
One of the most incredible truths about silver is that demand has outstripped supply for fifteen straight years. This trend is projected to continue for at least the next several years. Annual silver supply deficits have run as high as 200 million ounces in boom years, and as low as 70 million ounces in years of recession. It is important to realize that even in years of decreased silver demand, the mining supply on an annual basis did NOT meet demand. There is nothing more bullish for a commodity than such a deficit condition.

Another fact that is extremely bullish, but generally unknown, is that there is actually less silver bullion available for investment than gold! This one fact alone should alert any intelligent investor into thinking that some silver *must* be held as part of one's precious metals allocation.

According to the CPM Group's Silver Survey 2003, there are approximately 400 million ounces of silver bullion and 2 billion ounces of gold bullion available for purchase and transfer.¹

¹ CPM Group's Silver Survey 2003. CPM Group p. 15

Precious Metals Stocks as of end of 2001
(including silver coins)



Source: CPM Group's Silver Survey

Since the deficit began in 1990 the amount of gold bullion has remained essentially the same, but silver is down over 1.5 billion ounces. There is actually less silver bullion available for investment than gold. Once investors realize this fact the silver rush will begin.

Before moving on, it is important to qualify this fact. First, this comparison is between gold bullion and silver bullion. In both cases, we are not talking about jewelry or art forms of the metals. However, to clarify the point, if silver coinage was added to the silver bullion, the total would still be approximately one billion ounces. This is less than one-third of the gold supply, if we count both gold coin and gold bullion.

Gold / Silver Ratio Jan 2003 – to date



The reason most of my analysis is on silver bullion is because the price for silver (and for gold) is set in the Futures Market for .999 fine bullion. This means this subset of silver is the most critical not only for price-setting purposes but also for industry. Certainly, silver coinage does matter and the amount, although small, will play a role in determining the price of silver in the years ahead.

Many people demand proof that the silver situation is as bullish as is being presented. Many investors perhaps overlook this exercise. Gold is still held by many governments... silver is held by virtually none. China and India do have some silver inventory, but it is considered to be minimal, at best. One easily verifiable fact is that the United States government is now totally out of silver at this point in time and now must go to the open market to purchase silver to continue its Silver American Eagle coin program. Think about this for a moment: The U.S. once held 2 billion ounces of silver... and now has none!

In my opinion, silver is, by far, the more undervalued of the two precious metals. Gold has appreciated and broken out from its bottom in 2001. Meanwhile, silver generally remained in a narrow trading range of \$4 to \$5 for more than a decade. Once silver finally did move above the \$5.50 area, this unique metal began to exhibit strength. The silver market has already outperformed gold on a net basis, meaning that from the silver bottom in 1993 to the high of 2004, silver climbed from \$3.50 per ounce to over \$8.00. Gold bottomed in 2001 around \$252 and traded as high as \$465 in 2004.

The silver market is not only much smaller than the gold market physically, but it is also true monetarily.

The total amount of silver, in price terms, might equal eight billion dollars (factoring in bullion and coins), whereas gold bullion and coins would be worth well over a trillion dollars. This fact displays itself in the price action of the two metals. Silver is far more volatile than gold. However, as the precious metals markets continue to gather strength throughout this decade, just a small increase in new silver purchases could have a far greater impact on silver prices than the same amount of money invested in gold.

In studying the silver market for nearly my entire life, I have reached the conclusion there will not be a sustained or substantial increase in the price of silver until the physical supply is so small that the commercial users sense a coming shortage. At that point, silver will show

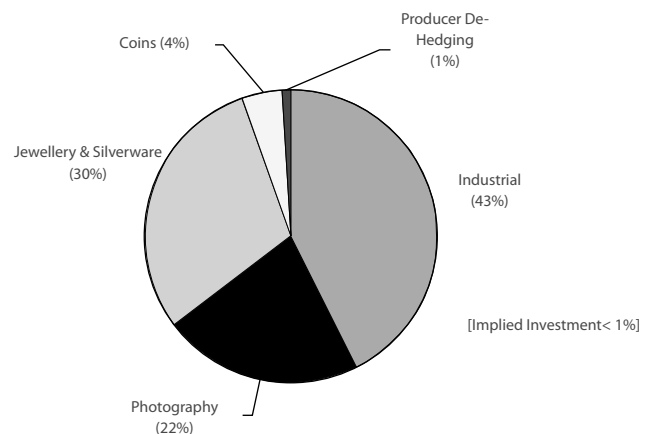
price strength that few believe possible at this point. Why? Because, at that point, silver users in the defense, automobile and electronics industries will all be competing for silver at the same time that investors will sense the profit potential. It is with this understanding that I build my case that silver offers one of the single best long-term investments today.

Price Inelastic

The largest use of silver comes from industrial demand, jewelry/silverware, and photography, in that order. Although photography seems to get all the attention, of the three major categories, it is the smallest. Industrial demand for silver makes up 43% of total demand, and this area is

World Silver Demand, 2004

(GFMS forecast, end-Oct 2004)



also the fastest *growing* area of silver demand. The industrial portion of the market is growing at about two percent per year. It is important to understand that in almost all instances, the amount of silver used in a cell phone, laptop computer or microwave oven is so small that it cannot be recovered. For all practical purposes, the silver used in these applications is lost and unrecoverable.

This type of demand is called “price-inelastic” by economists. The small amount of silver that is used makes it an insignificant factor in the price of the product. The

Main Uses For Silver	
• Batteries	• Electroplating
• Bearings	• Jewelry and Silverware
• Brazing and Soldering	• Medical Applications
• Catalysts	• Mirrors and Coatings
• Coins	• Photography
• Electrical	• Solar Energy
• Electronics	• Water Purification

Source: The Silver Institute

amount of silver used in the manufacture of a battery, an automobile, a computer or cell phone is insignificant when compared to the price of labor and other materials. A doubling in the price of silver would not affect, for example, what Honda uses in making an automobile. Since the price of silver has such a small relationship to the cost of the finished product, there is really no substitute. If the price of silver went to over \$100 per ounce, for example, the only possible substitute for silver would be palladium or platinum, both costing much more than \$100 per ounce silver.

Since the vast majority of silver is mined as a byproduct of mining lead, zinc, copper and gold, the price of silver can be sensitive to the amount produced as a byproduct. This, however, is a condition that has a flip-side. Since the total amount of silver produced by mining has fallen short of total demand and the price of silver has started to climb, there is little incentive for base metal miners to “rev-up” their production because the silver produced is not instrumental to their business. The ongoing commodity boom should continue, and base metal production will increase in the future, but it is highly doubtful that the increase will keep pace with the increasing demand for silver for many years.

Some very important yet almost unknown investment information is what I call the “Billionaire Factor.” Today, wise investors like Warren Buffett, Bill Gates, George Soros and Lawrence Tish have been buying silver, but the general investing public has generally ignored silver as an investment! My point is this: Silver may be the buy of a lifetime right now, but only the savviest of investors have been willing to take major positions at today’s low prices. If we adjust silver’s price for inflation, we are still very close to an ALL-TIME LOW in the price!

The world runs on energy, and this means electricity as well as oil. Nearly everyone is aware of the need to conserve. Silver will play an important role in the future as

China expands during its industrial revolution. On my recent trip to China, much discussion revolved around the need to employ superconductors in China’s electrical grid. Right now, Beijing’s power requirements are not being met. Silver-based superconductivity is almost one-hundred percent efficient, which means almost all the electrical power generated reaches the end-user. This new technology will be implemented over the next several years.

The China Factor

As China builds its infrastructure, more and more silver will be needed. In the modern cultures of the world, about one-half troy ounce of silver is used per family on an annual basis. This is a factor of seventy times what is currently used per household in China. Obviously, there is a distinct possibility that the Chinese may require more silver in the future.

From 1998 until 2003, China reported that their internal mining activity was meeting their demand for silver. In fact, China has reported *exporting* silver in those years. However, in 2004, the total mining activity in China did *not* meet their requirements. Having spent time with both the official Chinese Silver Delegation and top officials at the Mining Bureau, I know that China understands that silver will be vital for their development and is currently looking to increase silver mining activity.

The Silver Institute had this to say recently: “In an effort to cultivate China’s burgeoning silver industry, private investors are planning to build the Shanghai Silver Industry Exploitation Zone.” Led by the Shanghai Contor Enterprise Development Company, the 500-acre zone will “enhance the competitiveness and status of the Chinese silver industry in the international market,” officials said.

The development will be divided into several areas which include: production and processing of silver products,

trade, logistics, business affairs, exhibition, information, scientific research, education and other services, and other relevant industries such as silver processing machinery, sensitive materials and electronics. The production and processing area will include deep processing, producing sensitization materials for electronics such as thick films, and an area devoted to silver antiseptic products.

The trade area will encompass a technical information and research exchange, an education area, a media area to publish books and papers about silver, a silver culture museum and garden, and a management area which will have a hotel, offices and restaurant.

Currently, China ranks fifth in the world in terms of silver production... behind Mexico, Peru, Australia and the United States. China consumes 1,664 tons of silver annually, compared to 6,587 tons in the United States. With the opening of China's silver market, production and consumption are expected to rise.

Shanghai was chosen as a silver center because of its strength as a center of business and finance. The development will be supported by an existing infrastructure including telecommunications, roads, communications, gas and electricity. The first phase of the project is scheduled to end in 2005, with completion of the entire project by 2008.

The industrial demand due to China's rapid growth will only add to the pressures that industry already exerts on dwindling silver supplies. The use of silver in the electrical grid, the demand for TVs, computers, cell phones, batteries and other electronic devices will continue to grow at a rapid pace. This does not account for any *investment* demand from the Chinese populace. The Chinese have already embraced gold investing. As has been mentioned in other reports, "whatever is good for the gold market, will eventually spread over into the silver market."

Another positive factor for silver is that China will be host-

ing the 2008 Olympics, and silver coin sets are produced for all modern Olympic events. Although perhaps a small factor, if the silver coin sets became popular among the Chinese people, with a population of 1.4 billion people, this could have a greater effect on the silver market than most realize.

Digital Cameras: Bullish for Silver?

Wall Street analysts often make the argument that the demand for silver will disappear, due to the advent, popularity and growth in the digital camera market. The Silver Institute recently completed a study on digital photography which showed that there would be an impact, but that it should be very slight indeed.

In February 2004, The Silver Institute made this bold statement:

"Despite the emotional reaction to the sales decline of film in photography, we do not foresee any major shift in the need for silver in producing silver halide products over the next five years."

Many facts are ignored when the photography argument is presented. The color photography market uses no silver, because all silver on the film is brought back out into solution when the color print is made, and all this silver is recycled. The amount of silver recycled through photographic processing is truly worth noting.

Take a look at the supply chart on page 6. Twenty two percent of silver supply is brought to the market each year as scrap. "Scrap" is the code word for silver from photo recycling. Certainly, there is very little in the way of people sending in their used silver items to be smelted down. Yes, some of this does take place, but it is insignificant. Almost the entire "scrap" market comes from film recycling.

Another point seldom discussed is how most people use their digital cameras. If email is used to send or receive

photos, then a computer is required, and the computer uses silver. Additionally, if one decides to store the images on a CD, the CD is a piece of plastic with a very thin coating of silver so the laser can read the information.

Kodak and Fuji have invested heavily in China for silver halide processing plants. This large capital expenditure would not take place if the end of silver halide processing were imminent.

So does digital photography impact the silver market? Yes, in the areas of graphic arts and radiography, it does impact the market. The Silver Institute estimates that over the next three years, considering all types of photographic demand, silver use will decline by approximately three million ounces.

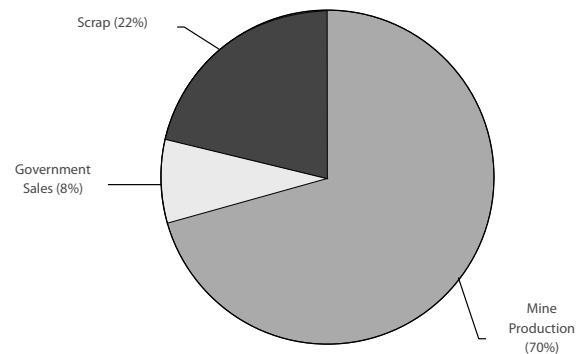
The amount of silver lost to the digital world will *not* kill the silver market. There are more patents issued for silver on an annual basis than for all other metals combined. In other words, more uses are discovered all the time for silver. Silver reflects light better than any other element. It also is a very good conductor of electricity. In fact, it's the only element that, as it oxidizes, still conducts the same amount of current. Silver is one of the best "technology stocks" you can buy, because silver is used not only in photography, but in many high-tech applications that continually have outstanding demand... plasma screen TVs, for example.

On the environmental front, there is legislation in the U.S. to study the use of silver as a biocide in wood. This application alone could eventually use 80 million ounces of silver on an annual basis.

In one of my recent reports, I quoted a Wall Street analyst who said that the only solution to this nation's power grid problems is to implement the superconductor model. More demand for silver, more stress on already-diminishing supplies. How much? Millions upon millions of ounces, I suspect.

World Silver Supply, 2004

(GFMS forecast, end-Oct 2004)



Silver kills bacteria, and it's a clean way to do it. For example, in a water supply, you can use silver to filter and purify water. Most of the large municipalities in this country and across the world use a chemical process of some type, be it chlorine or some other toxic chemical. With silver, you don't have that toxicity problem. I can foresee the day where populations will *demand* some type of silver or some type of non-toxic filtering system. Additionally, the properties that silver possess will be utilized more and more in the future in other medical and health applications.

The Dollar and Metals

Investors are concerned with profits, but more importantly, with security. Investing in most cases is all about increasing or maintaining one's lifestyle through one's "golden years." Any rational, thinking person understands that to rely on government programs for your security is tenuous at best. In fact, recently the U.S. government has basically admitted that the Social Security System will need to be modified in order to remain solvent.

But what about something even more fundamental than saving and investing for the future? What about the core

issue of money itself? Most precious metals investors have a far better sense of what money is than the average investor. Contemplate the statement below for a moment.

“We are completely dependent on the commercial banks. Someone has to borrow every dollar we have in circulation, cash or credit. If the banks create ample synthetic money, we are prosperous; if not, we starve. We are absolutely without a permanent money system. When one gets a complete grasp of the picture, the tragic absurdity of our hopeless position is almost incredible, but there it is. It is the most important subject intelligent persons can investigate and reflect upon. It is so important that our present civilization may collapse unless it becomes widely understood and the defects remedied soon.”

*-- Robert H. Hemphill, Credit Manager of the
Federal Reserve Bank, Atlanta, GA*

Although this statement seems harsh, it is accurate. In fact, the main problem with modern money is that it does not constitute a store of value. From the founding of the Federal Reserve System, today’s “dollar” is worth less than a nickel. The only two assets that are money, and do not rely on credit, are silver and gold.

Certainly, being prudent with one’s investments applies to the precious metals as well as any investment idea. An appropriate portion of one’s assets in precious metals has provided a good level of diversification for investors in times past, and should continue to in the future. While this cannot be guaranteed, it is, in my mind, a very safe bet.

Conclusion

We know that the supply of silver is dwindling. We have a US Dollar that has been in steep decline and will likely fall down further. What will happen if people lose confidence in the US Dollar and other paper assets? Even a

minor world event could have a major impact on silver and silver prices. Silver is absolutely a very, very tiny market, but one that holds immense potential.

Silver needs to regain itself as a monetary metal. For silver to shine, it needs much more investment demand. I am confident this will happen because as the dollar loses more value, and at a more rapid pace, people all over the world will turn to gold first, and then to silver. Since silver is a smaller market, and it is far more affordable to the masses than gold, this new monetary demand will force silver prices to move to staggering heights by today’s standards.

Many financial authors explain that silver is simply a commodity and, as such, lacks monetary or investment demand. I like to remind such people that the word for silver and the word for money are identical in fifty-one countries. Just because Americans or Canadians do not think silver is money, does not mean the rest of the world thinks the same way.

However, if we did look at silver as a mere “commodity,” perhaps one should then study the historical price activity of palladium. This commodity moved from well under one hundred dollars per ounce to over one thousand dollars per ounce, strictly on industrial demand. The point is, whether silver is money, a commodity, or somewhere in between, the potential for price appreciation is vast.

Finally, all fiat currencies eventually reach the dustbin. Throughout monetary history, people have sought alternatives to currencies to protect their savings. This action takes place as more and more people wake up to the reality of a credit based monetary system. When enough people wake up, silver will no longer be a sleeping opportunity, but one of the brightest (and smartest) investments one can own.

About the Author

David Morgan is a precious metals aficionado armed with degrees in finance and economics as well as engineering, he created TheMorganReport.com website and originated The Morgan Report Newsletter, a monthly that covers economic news, overall financial health of the global economy, currency problems, and the key reasons for investing in precious metals.

David considers himself a big-picture macroeconomist whose main job is education—educating people about honest money and the benefits of a sound financial system.

As publisher of [The Morgan Report](#), he has appeared on CNBC, Fox Business, and BNN in Canada. He has been interviewed by The Wall Street Journal, Futures Magazine, The Gold Report and numerous other publications.



Mr. Morgan's interest in precious metals led him to publish the "[The Morgan Report](#)", a research report that has grown in popularity and is today seen as one of the pre-eminent reports on how you can make money investing in the natural resource sector.

The report looks at all the precious metals sectors each month and also explores the commodity markets, the general stock market and is devoted to help you make money by investing in this exciting sector. An overwhelming number of the companies outlined in his model portfolio are higher than the original recommendation.

This publication is dedicated to investors wishing to build and preserve wealth.

More information about us is available at our site www.themorganreport.com

Contact: support@themorganreport.com

For more information on gold and silver, and how specific gold and silver investments may be used to protect yourself or profit from adverse economic conditions, please contact:

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