

THE MORGAN REPORT

Published by: David Morgan

SPECIAL REPORT

Silver Fundamentals—Fundamentally Flawed?

Gold Fields Mineral Service (GFMS Ltd) published a document on the Silver Investment Market in late April 2009. I carefully went over this report and will offer some comments, but my main analysis centers around the fundamental case for silver. Both GFMS and CPM Group will be issue their respective reports on the silver market each year.

Being a proponent of true free markets, not the version that is “spun” by way of the mainstream financial press, we only need to go to Ayn Rand of *Atlas Shrugged* fame to “check our premises” and verify that we have not overlooked something or assumed something that is not valid.

First, we must define what we are trying to prove or at least examine, and this is simple (not easy): just how “tight” is the current silver supply? Before delving deeper it is absolutely essential to define our “givens.”

Givens: The basis for this analysis

The silver bullion market will be examined

Allowing for the amount of commercial grade silver per CPM Group

Coin market will be mentioned but not pertinent to this analysis

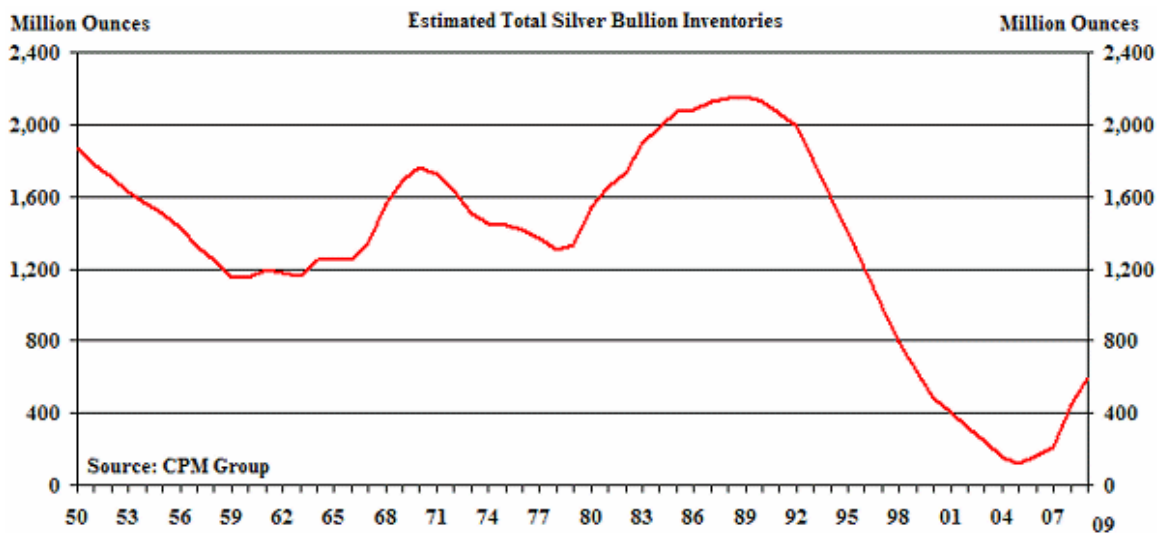
As mentioned to our readership, we examine the bullion market more carefully, because this is the market that sets the “price” for silver. Yes the coin market is an important aspect of the silver market, making up roughly fifty percent of the total, but this silver is not deliverable against a COMEX contract or London Bullion Market Association (LBMA) position.

There are two main studies on the silver market. I have both and have read them for years. One is produced by [CPM Group](#) of New York, and this year’s [CPM Silver Yearbook 2009](#). The other is sponsored by the Silver Institute and is produced by GFMS of the United Kingdom. Your editor has met and spoken with the principals of both of these organizations at a face-to-face level.

Although no one in this industry knows the true amount of physical silver bullion existing in commercial form (1000-oz. bars), we need to begin our analysis at some point. Therefore rather than give you my opinion of how much exists, let me cite the two best-known studies on the silver market.

According to this year's study by CPM in their Silver Yearbook 2008, page 17, the Estimated Silver Bullion Inventories, Year-End, were less than 400 million ounces. However, this year's study, just released, put the figure at nearly 600 million ounces. This is primarily due to increased silver production and increased recycling.

As we can see (chart on next page), according to CPM there is approximately 600 million ounces of fine bullion available. Now before moving onward, we must examine what GFMS has to state about total silver bullion inventory, and here we find a much larger number, primarily about 200 million ounces more in fact. While reviewing all the data for this segment over several weeks, it suddenly dawned on me that we can "arbitrarily" add 200 million ounces at any point in time—because this is the float of recycled silver each and every year. Specifically, the amount of silver recycled in 2008 was closer to 250 million ounces per the new CPM report.



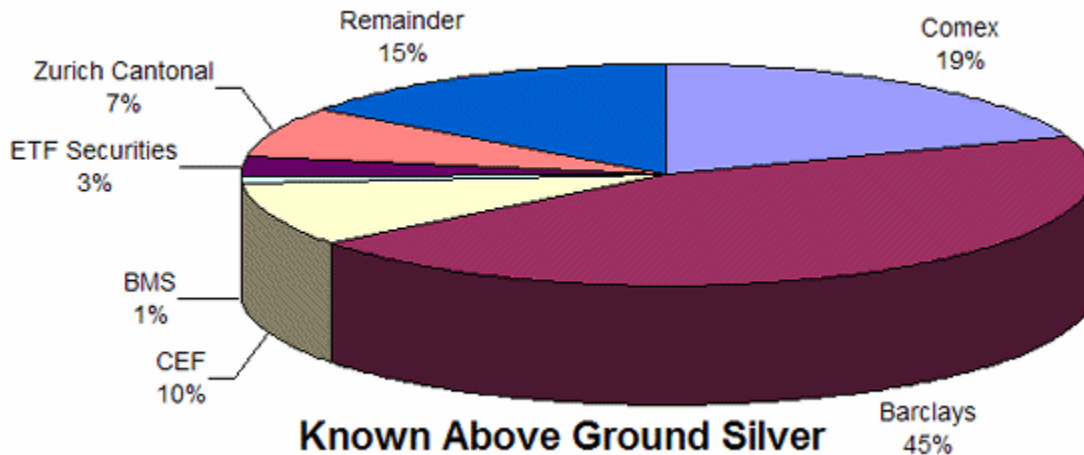
So, it does not make either of the studies right or wrong; it just helps to explain a wide fudge factor in the data. Let me be very clear: this is "my take" on the matter and is NOT that of GFMS. I only wish to keep this discussion as fair and open as possible without resorting to "bookkeeping" entries of silver. In other words, a great deal of silver—over 200 million ounces—is always in the recycling pipeline as film, scrap, or as many may not know—liquids.

Going a bit further, people who are very studied on the silver market may recall that in March 2006 an article was penned about the debate between Jeffrey Christian of CPM Group and Philip Klapwijk of GFMS concerning silver inventories. Without going into all the details, the GFMS survey has maintained that more silver is available than the CPM Group but cannot point to it, and my bias is to that which can be proven.

For the purposes of my analysis I will take the "best case" scenario and use the 600-million-ounce case of commercial grade silver. Again, you can use any number you wish. The purpose is not to determine exactly how much silver exists in commercial form, and the main purpose is to give a strong indication of just how tight the silver market is at present.

Known:

Barclays ETF, 283 Million Ounces
Zurich Cantonal Bank, 50+ Million Ounces
ETF Securities, 17 Million
Central Fund of Canada, 58 Million
Bullion Management Group, 5 Million
COMEX, 118 Million
Total: 530 Million +



Basically we have very little silver that is not accounted for as investment silver. This gives us a very clear message that the market must be very tight presently. COMEX is only about 20% of the total market yet it has a huge influence, as does the LBMA, because of the massive amount of paper contracts bought and sold on a daily basis. Additionally, two new silver investment vehicles were added recently, Silver Bullion Trust and another Silver ETF. On top of that bullish news, China has recently started to offer silver bullion investment to their general public. Can you imagine what will happen if ½% of over a billion people discover the fundamental value of silver?

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If we look forward we must consider that if new purchases of silver are going to continue, and that is a very reasonable assumption, at what point do we start to see delivery delays and/or price increases?

The first Silver ETF was introduced in April 2006, so in three short years we have gone from 130 million ounces (what SLV began with as their projected "allotment") to 350+ million ounces. This yields a total increase of 220 million ounces in three years' time. If the silver demand continues unabated for three more years at a similar pace, where will the silver come from? (Note: 350 is the total of Barclays, Zurich, and ETF Securities combined.)

Central Fund of Canada recently added another \$210 million in mid April to purchase more gold and silver bullion. Additionally, all the others mentioned above—Barclay's, Zurich Cantonal, and ETF Securities—added to their holdings the past two months. Increased investment demand is expected to continue for several years into the future as more people seek silver to diversify their holdings into precious metals including silver.

As the founder of Silver-Investor.com I have devoted most of my life to studying the financial markets, money, metals, and mining. You are all welcome to visit the website daily as new news items are posted on a regular basis. Further, for those "Silver Bulls" you might consider our free list and that way you are certain to stay informed on this dynamic market.

Remember Get Real, Buy Real

Sincerely,

David Morgan

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