The Case for Silver 2004

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"It is easier to make wise decisions if someone else is developing the options" - Roger Fisher

November 2004

The Case for Silver - Introduction

Silver is one of the few remaining investment opportunities displayed on our "buy-low" wall. Its current price is approximately $6.00 per ounce (or at least it was when we wrote this). Consequently, we were intrigued by the title of a recent report from Investment Rarities, Inc., "$200 an Ounce Silver - Can it Happen?" $6 an ounce to $200 an ounce? We are not remotely advocating predicting price objectives, but before summarily dismissing the idea of large price movements consider the following:

In our opinion, silver falls into all three of the above use categories: industrial, precious, and strategic metal. Upon reflection, we have decided to share with you some of our thoughts on the possible silver opportunity.

In 1972, approximately three years after beginning to invest in commodities, I was attracted to silver. It was priced at approximately $3 per ounce. Seven years later, it sold (albeit briefly) for 2 nearly $50 an ounce. Since 1979, most commodities have risen close to or above prior historical price peaks. Not silver. Today it is priced, without adjustment for inflation, near its lowest price in 30 years. Once again, we are intrigued with silver.

Arguably a credible and certainly a succinct way to make the case for silver is to note an unusual action taken by Warren Buffet. Buffet, a self-made man, is one of the wealthiest individuals in the United States. As chairman and chief executive officer of Berkshire Hathaway, he has one of the best long-term investment records in history. Consequently, it is noteworthy that in the late 1990s Buffet bought approximately $1 billion dollars' worth of silver. What makes this most extraordinary is its departure from his normal investment

approach. This becomes even more relevant, for reasons we will develop in later letters, when you consider that for the first time in his entire career, he has accumulated foreign currencies (by some reports, in excess of $20 billion). These two decisions may reflect a serious concern for the future of the United States dollar. If correct, the ramifications for investors could be very consequential.

As much as following an expert like Buffet could conclude the case for silver, we realize serious investment require serious thought. Consequently, in future letters, we plan to address silver's structural operating deficit, the potential of panic buying, the implications should confidence in the federal government decline, as well as risks and money management strategies.

"The most valuable of all talents is that of never using two words when one will do."

- Thomas Jefferson

December 2004

Silver - Part II

The annual demand for silver dramatically exceeds new supply. The Silver Institute suggests the deficit regularly exceeds 100 million ounces. This deficit has steadily reduced above-ground supplies that have existed for hundreds (or even thousands) of years. The operating deficit cannot continue indefinitely because above-ground supplies are finite.

Demand for silver is broad and varied. Although it is common knowledge that silver is a component in silverware, jewelry, coinage, and photography, the largest demand comes from industrial uses and applications. Silver oxide batteries are critical in television cameras, watches, rockets, and missiles. Silver-coated bearings are used in refrigeration, air conditioning, and computer chips. In today's automobile, silver is found throughout the electrical system, including mirrors, brakes, locks, and other electrical devices. As arguably the best conductor of electricity, silver is found in everything from circuit switches and breakers to washing machines. We could go on and on. The bottom line is silver's industrial use is broad, growing, strategic, and critical.

The main source of annual silver supply is from gradually rising mine production. Because new silver mines are uncommon and old mines are depleting, today a majority of silver is produced as a byproduct of the search for other metals. The second and smaller source of silver is scrap. Scrap is essentially the recovery of silver from existing manufactured goods or waste.

As annual silver demand exceeds annual silver supply, it has created a deficit. One way to present the demand/supply deficit is to average ten years of data provided by the Silver Institute.

A compelling question is what is the source of supply to accommodate large annual deficits? The answer is above-ground stockpiles.

Most commodities have periods where above-ground supplies are excessive. During these times, prices fall towards or below the marginal cost of production thus reducing future supply and current inventories. Conversely, most commodities have periods where above-ground supplies are low, often caused by disease or natural disaster. In this environment, prices are high, inducing more new supply thus replenishing inventories. This cycle of excessive supply/low prices and low supply/high prices is recurring. For commodities like corn and soybeans, the time interval can be short. For others, it can take much longer.

Silver has been different. Historically, it has had excessive supplies, the largest of which were government stockpiles, particularly those of the United States. It is reported that in the 1940s, U.S. government stockpiles exceeded 3 billion ounces. However, today, reports suggest that U.S. government inventories are now exhausted except for a small amount held for the future production of numismatic and bullion coins. Another major source of above-ground supplies is held by certain commodity exchanges around the world. As an example, approximately ten years ago, the New York-based Commodity Exchange Corporation reportedly had reserves that exceeded 10,000 tons. Recently these reserves have dropped below 3,000 tons, lower than any level since 1970. As the above-ground supplies disappear, the emergence of Asian demand could add a "wild card" to the silver market.

Asian economies are large and growing rapidly. China's population alone exceeds 1 billion and its economic growth rate is three times faster than the United States and Europe. As

China grows, its citizens' standard of living rises. The result is new demand for many commodities including silver. Dr. Marc Faber, a Hong Kong-based analyst, wrote in his book, Tomorrow's Gold, "China will be the largest consumer in the world for most goods and services. It already has more refrigerators, mobile phones, TVs, and motorcycles than the U.S. and it is only a matter of time before it will have huge markets for just about any product. Its resource purchases will move commodity prices dramatically."

In conclusion, annual silver demand exceeds annual sources of new supply. Above-ground stockpiles have been instrumental in disrupting the typical commodity cycle that includes 5 higher prices. At some point, above-ground supplies should be exhausted. It will be interesting, to say the least, if rapidly rising Asian demand collides with the disappearance of above-ground supplies.

"In these modern times, feelings eclipse facts."

- Cal Thomas

January 2005

Silver - Part III

Greed and fear! Assessing these two critical market drivers can never be far from the forefront of the long-term investor's evaluation process. Warren Buffett says, "We try to get fearful when others are greedy; we try to get greedy when others are fearful." In other words, if the aggregate investor class pushes prices past reason, Buffet will sell. Conversely, if the collective market participants become fearful and stampede out of the stocks, he wants to buy. This principle is simple, but profound, yet particularly hard for most people to capitalize upon.

Nevertheless, this letter is not about greed or fear, but greed and fear. Three silver market participants that can contribute to fear and greed operating simultaneously include institutional users, short sellers, and momentum players.

Institutional Users

There are numerous institutional users of commodities. Examples include processors such as oil refiner Tosco Refining, metals smelter ASARCO, retailers Starbucks and Kellogg's, and various governments. All these institutions use commodities, and occasionally, price is less important than availability. Rather than try to illustrate this point through silver, let's use a more familiar example – Starbucks.

Starbucks is a fast-growing institution that sells coffee. They have a huge investment in infrastructure including retail outlets, offices, and employees. One of the few certain things about Starbucks is they must have coffee to sell. And to have coffee to sell they must buy coffee beans. Whatever corporate problem they may face, the one thing they cannot do is run out of coffee beans. Therefore, if coffee bean prices go up high enough and fast enough, suggesting the possibility of a shortage, do you think Starbucks would (a) stop buying, (b) buy less, (c) buy more? Realizing they may be competing with Maxwell House and Folgers for the remaining coffee beans, the answer is most likely (c). If their competitors react similarly, panic buying may ensue.

Silver users can act exactly the same way. Fear may induce panic buying as institutions seek even more than their normal share of a commodity if, and arguably because, prices are spiking higher.

Governments are another example of institutional, fear-driven buying. Occasionally the leader of a country will see their grain harvest start to fail. They have the choice of not buying wheat because of high prices (risking riots and the overthrow of their government) or buying wheat regardless of the price to make sure bread is available for their people. This can certainly cause fear-driven buying.

Short Sellers

A second source of fear-driven buying can come from short sellers. This is true both in the futures and cash markets. Futures trading is a "closed-loop:" for every contract owned, a contract is sold short.

A speculative short position is essentially a sale not backed by the actual commodity, but by a promise to buy an equivalent number of contracts before some future date. There are two important problems with a speculative short. First, there is unlimited risk. While a buyer knows his worst case, a short seller does not. When prices rise, fear of the unknown enters the short speculator's equation. As prices rise, this fear intensifies. Second, there are margin calls. As prices rise, a short seller is faced with margin calls from the losses incurred and a rise in the amount of margin required per contract. The bottom line is that speculative short positions can induce fear-driven buying.

Today, on the Commodity Exchange Corporation alone, there is in excess of 100 million ounces of silver contracts sold short. Although we do not know what percent of these are speculative shorts, it is possible that the aggregate position exceeds the quantity of actual silver easily obtainable. Consequently, a rising market may force a speculative future short to buy. The process of eliminating a short position in an atmosphere of fear may drive prices higher, inducing more buying, and so on and so on.

In addition to a well-developed futures system, most commodities have large cash markets. Leasing is an example.

Recently, as oil prices exceeded $50 per barrel, public pressure was exerted on the government to sell oil from the Strategic Petroleum Reserve. President Bush said no. Realizing that he was likely to keep his word, those with a vested interest in lower oil prices began to ask that the government "lend" oil from the reserve. In other words, oil would leave the reserve and be used. In exchange, the lessee would make a cash lease payment and promise to return the oil in the future. In the oil market this may not be particularly risky because worldwide oil supplies are plentiful.

However, leasing silver may be riskier. It is reported that the process of lending silver has taken place for decades. For example, a central bank may lend silver in exchange for a lease payment.

The central bank would then receive a cash payment that would not be available if the silver was just sitting in the vault. The bank would also receive a promise to repay the silver. What happens if the silver stockpile diminishes (see The Case for Silver, Part II) and the lessee cannot secure silver? If prices start to rise rapidly, the lessor may well demand his silver back as its value becomes clearer. The buyer may fear default, break of contract, or bankruptcy and be forced to pay any price for silver. Thus, fear-driven demand can drive prices higher.

There are other forms of cash market short selling. One is forward contracting. In this situation, silver mining companies may promise users actual silver at a date specified in the future. Another is the process of issuing silver certificates. Here, the issuer of the certificate conveys ownership benefits to the buyer but may not back the certificate with the actual silver. The bottom line is short sellers play with fire. Rising prices can trigger fear-induced forced buying, which does nothing but exacerbate the upward price movement.

Momentum Players

Finally, there are momentum participants. These participants are essentially trend followers. The amount of money controlled by this group is growing exponentially. Hedge funds are a good example. Many of these participants chase performance and their mantra is taken from Physics 101: "A body in motion tends to stay in motion . . ." The higher the price, the more they buy. In fact, they often pyramid their position by using unrealized profits to buy more as prices rise.

Some producers capitalize on rising prices with essentially the same strategy as a hedge fund. A silver mining company may reduce silver sales as prices rise because “tomorrow” prices will be higher. This reduction of supply helps move prices higher. As prices rise and wealth materializes before their eyes, greed can dominate actions. In the oil industry, there is a practice referred to as a “Texas hedge:” When oil prices start rising, the companies or investors who own oil reserves will also buy oil futures.

Rapidly rising prices often promote greed and greed promotes buying and buying pushes prices higher. Rapidly falling prices often promote fear and fear promotes selling and selling pushes prices lower. Ultimately extremes are reached, and prices revert towards some standard of mean. In commodities such as silver, we believe that from time to time, conditions

can develop in which both fear and greed can act in concert. The result can be extreme price movements.

"I place the economy among the first and most important virtues and Public Debt as the greatest danger to be feared"

- Cal Thomas

February 2005

Silver - Part IV

Crisis favors silver. The bigger the actual or perceived source of the crisis, the more silver is favored. A crisis in confidence in the United States government, sponsors of the world's reserve currency, would be, suffice it to say, "big!" Although unlikely to occur, financial mismanagement and hostilities are two existing conditions that make it wise to at least consider that just such a crisis could develop.

Financial

The United States financial condition includes bad news and good news. The bad news is that its financial house, or at least critical components of it, is somewhere between a mess and the world's largest Ponzi scheme. The good news is the mess, although gaining mass, has existed for some time.

In the Contrarian Investment, LLC 2003 annual letter we said, "The dollar has declined 20% since 9/11/01. Pressures on the dollar include a rising federal deficit, which excluding a soon to disappear Social Security surplus, could approach $700 billion, and merchandise trade deficit of approximately $500 billion." Our estimates from one year ago proved almost exactly correct on the budget deficit and slightly too optimistic on the trade deficit.

The U.S. budget deficit is created when the government spends more money than it receives in revenues (principally taxes). Budget deficit optimists are unconcerned about this deficit because it is lower, as expressed as a percentage of total revenues, than previous moments of crisis.

The U.S. trade deficit is created when the government and its constituents buy more than it sells from other countries. The deficit is approaching approximately $2 billion per day. Since the deficit is the largest in both absolute and relative terms in the history of our country, it is hard to find a trade deficit optimist. More threatening is that it is approaching 6% of U.S. gross domestic product. This amount is higher than what has previously triggered crisis and intervention by the International Monetary Fund in third world countries. Frankly, it is unimaginable to me, and should be disconcerting to all, that the country issuing the world's reserve currency is running a trade deficit of this size.

It is one thing for the U.S. to run huge deficits when it is the world's largest creditor, which it was only 20 years ago. It is quite another to do so today when it is the world's largest debtor. Mr. Barry Eichengreen, an economic historian at the University of California at Berkeley, recently indicated that there is no historical precedent for such a large economy being so heavily in debt to the rest of the world.

As the world's largest debtor, both the absolute and relative size of the budget and trade deficits matters because they are funded by selling debt. Major purchasers of this debt can be U.S. citizens or foreigners. However, to purchase debt you must have savings. Unfortunately, the U.S. consumer has become addicted to spending and debt and therefore has very little savings. In fact, in October 2004, the U.S. personal savings rate fell to the second lowest level on record. Consequently, U.S. citizens no longer buy all or even a majority of our debt.

Conversely, many Asians are thrifty and have plenty of capital to invest. Asians have become the major purchasers of American debt. Foreign investors today own about 43% of all U.S.

Treasury debt. Japan owns the largest share worth in excess of $700 billion, and China is catching up rapidly.

Foreign ownership of this debt is a powerful economic weapon in the possession of today's economic and tomorrow's potential military adversaries. Proverbs summarizes the risk of debt: "The borrower is the slave of the lender." Undoubtedly, some policymakers believe a different adage: "If you owe the bank a little, you have a problem. If you owe the bank a lot, the bank has a problem."

Nevertheless, if foreign investors decide to reduce their purchases, let alone sell some of the U.S. securities they own, it could drive the dollar sharply lower. The obvious policy response would be to dramatically raise U.S. interest rates. The consequences of such an action, given the leveraged nature of the U.S. consumer, are staggering.

Ominously, there are many rumblings from foreign central banks regarding this very action. Alexei Ulyakayev, First Deputy Chairman of the Russian Central Bank, said on November 23, 2004, "Most of our reserves are in dollars and that is a cause for concern. We are looking at the dynamics of the Euro-dollar rate, we are discussing the possibility to change the reserve structure." Mr. Masatsugu Asakawa, the head of the Finance Ministry in Japan, recently said, "We have heard rumors in the last few days that the Chinese guys, the Indian guys and the South African guys are diverting from dollars."

Further, on November 26, 2004, Market News International reported, "Bank of Canada Governor, David Dodge, said, "The huge accumulation of United States debt and massive buildup of the Asian reserves from financing that debt is a problem that could lead to a big crash." Finally, the U.S. Federal Reserve Chairman, Alan Greenspan, said, "A diminished [11] appetite for additional dollar balances must (emphasis added) occur at some point." Unfortunately, it is not just financial mismanagement that could trigger a crisis; there are also issues of hostilities.

Hostilities

The dictionary defines "hostility" as "deep-seated mutual ill will, hostile actions and overt acts of warfare, conflict, opposition or resistance in thought or principle." While most Americans may not be outwardly hostile towards each other, nor a "house divided," we may

not be far from either (e.g., red vs. blue states, pro- vs. anti-war, secularist vs. religious, Democrats vs. Republicans, and the ongoing cultural war about values). Americans seem angrier today than at any time since the late 1960s and early 1970s.

Unfortunately, Americans are not just unusually hostile towards each other; America is the object of hostility from abroad due to the Iraq War and events that preceded it. Global Marketing Insight recently reported that 75% of European citizens distrust the U.S. government. Further, after our recent presidential election, there was a dramatic surge in the percent of Europeans who do not trust the American people. However, anti-Americanism is not limited to Europeans.

A more serious risk is the potential for the Iraq War to morph into a broader conflict between a part of fundamentalist Islam and Christianity. Although this view is not politically correct, it certainly is not unique in history. Today Muslims around the world see Fallujah (a city whose size is equivalent to Chicago when compared to the population of the U.S.) bombed and trampled. It does not take much imagination to envision the possibility that more and more Islamists might view America's aggression with the hostility that only religion can fuel as a reason to join the "holy war." Even the Secretary of Defense, Donald Rumsfeld, recently wondered whether we were killing more terrorists than we were creating.

While physical hostilities grow, America is simultaneously facing another foreign conflict, arguably one with more long-term significance: the battle for economic supremacy. We previously addressed (The Case for Silver – Part III) the rise of Asia and the potential for that region to become an economic superpower. However, there is also an economic threat posed by the formation of a European Union. America is no longer competing with tens of individual European countries focused on their own self-interest. The European Union, with its common currency, represents an additional economic threat to U.S. supremacy. Andrew Higgins, a staff reporter for the Wall Street Journal, recently wrote of "…Gaulist dreams of a European superpower united by hostility to the U.S."

So, what is the bottom line? Not only are U.S. financial conditions and international entanglements threatening, they are also eerily reminiscent of a recent period in American history.

In the late 1960s/early 1970s, the U.S. was involved in an international hostility (the Vietnam War), domestic cultural war (riots at the Chicago Democratic National Convention, Kent State, etc.), impeachment proceedings of President Nixon, and a second-term conservative Republican presidency. In this environment, an economic crisis developed with a collapsing dollar and the largest drop in stock prices since the Great Depression. In addition, in our opinion, policy mistakes occurred including wage and price controls and abandonment of the gold standard. These conditions help silver prices to rise from $2 an ounce to $6 an ounce (an increase of 200 percent) and later in the decade to $50 an ounce!

In the late 1990s/early 2000s, the U.S. was involved in international hostilities (the Iraq War and a worldwide war on terrorism), a domestic cultural war (angry rhetoric, divided elections, a battle over the place of religion), the recent impeachment of a president, and a second-term conservative Republican presidency.

In the spirit that "there is nothing new under the sun," we are intrigued with the following question: "Is it possible that, similar to the early 1970s, a new economic crisis might evolve associated with a new series of economic policy mistakes and a rush to once again own gold and silver?"

"No warning can save a people determined to grow suddenly rich."

- Lord Overstone

March 2005

Silver - Part V

The most crucial part of investing or speculating is analyzing the risks. The importance of doing so is embedded in Warren Buffett's two investment rules: "Rule number one: do not lose money. Rule number two: Do not forget rule number one." There is a simple mathematical reality embedded in these two rules. If an investor loses 50% of his capital, he must earn 100% to break even. This reality alone justifies the importance of focusing on the risks of an investment rather than fixating on the rewards. Keeping with our proclivity for brevity, we will only focus on four of the risks for a purchaser of silver.

The first risk to higher silver prices is if interest rates rose for the "wrong reason." Typically, interest rates rise in response to economic growth or inflation. However, economic growth would tend to spur industrial demand for silver and inflation, monetary demand, and either would tend to support prices. Although highly unlikely, there is a wrong reason interest rates could rise. It requires an environment of low inflation (as it is today), high debt (as it is today), and low economic growth (as it is today). If all of these factors existed, and then interest rates were raised to defend the dollar aggregate, demand could be reduced triggering deflation, recession and/or insufficient cash flow to service debt – or all three! If this occurred, then at least for some period of time investors might sell non-interest-bearing tangibles (such as silver) in favor of the cash flow available from interest-bearing instruments. The result could be lower silver prices.

A second risk is the misuse of leverage. Silver is traded on the futures market at the Commodity Exchange Corporation, which offers a 5,000-ounce silver contract. Silver priced at $6 per ounce has a contract value of approximately $30,000 ($6 per ounce times 5,000 ounces). The minimum margin to control this $30,000 worth of silver is less than $3,000. That's leverage! In fact, it is similar to the leverage available in the stock market before the reforms of the 1930s. Either out of ignorance or greed, many speculators misuse the leverage available in futures and suffer severe financial consequences when prices rapidly move against their positions. However, just because leverage is available, the silver acquirer does not have to use it. Paying cash for physical delivery? or capitalizing your account with a much higher percentage of the actual value has merit.

Another risk is greed, and in effect, succumbing to, rather than capitalizing upon, the emotions we described in The Case for Silver – Part 2. Investors tend to ignore assets when they are at 14 historically low levels and are neither hyped by media nor the hot topic of party conversion. Consequently, purchasers are most likely to be captivated and buy when prices are rising, and media coverage is prevalent. People often buy high, hoping to sell higher. This is the way buyers of NASDAQ stocks acted for much of the last half of the 1990s. Non-professionals acting similarly to momentum participants (The Case for Silver – Part 2) is a risky, although admittedly potentially rewarding, strategy.

The fourth risk relates to the purchase price. In the last 30 years, silver has been as high as $50 an ounce and as low as approximately $3 an ounce. If a silver purchaser wanted to objectify risk and reward, he could use this 30-year high/low price range. For instance, if a buyer paid $6, silver would be $3 away from its lowest price in the past 30 years and $44 away from its highest price. This would create a potential reward/risk relationship of approximately 15:1. If however, the buyer paid $13 for silver, it would be $10 away from its 30-year low price and $37 away from its high price. This would create a potential reward/risk ratio of less than 4:1. When speculating, the risk/reward relationship is important. We believe projected rewards need to represent a significant multiple of projected risks.

As contrarians, we have long been convinced the right purchase price can overcome a multitude of post-decision mistakes and missteps. Jeremy Siegel, a professor at Wharton, reportedly compares IBM with Exxon Mobil in his forthcoming book. He shows how IBM outperformed Exxon in most areas of corporate measurement, such as revenues and earnings, but underperformed in the area that matters to investors – total return. This was due to the respective purchase prices at the start of the evaluation period. The bottom line is, regardless of the investment, the purchase price is important.

Fortunately, there is some good news regarding the risks we discussed in this letter. The last three risks are well within the control of each individual. All that is required is discipline and self-control. And although the first risk is beyond the control of anyone, should it occur, the patient, well-capitalized speculator could convert the risk into an opportunity by acquiring silver at lower prices.

In conclusion, we are reminded that Benjamin Graham (who wrote Security Analysis and taught Warren Buffett and many other outstanding investors at Columbia University) defined

speculation as “the taking of risk that appears justified after careful weighing of the pros and cons.” We add the words “and risks and rewards” to the definition to make it more mathematical. But whatever the definition, we believe a rigorous and disciplined review of the pros and cons, and especially the risks, is a critical part of the arsenal that a potential silver buyer must employ.

"Everything should be made as simple as possible, but no more simple"

- Albert Einstein

April 2005

Silver - Part VI, Conclusion

While working on a conclusion to the “silver series,” I received a marketing letter from Investment Rarities Inc. It contained an article written by Theodore Butler who is an interesting and zealous proponent of silver. His summary is a better one than I would do. Consequently, his article is repeated below, and I will take the day off!

IMAGINATION
By Theodore Butler

(The following essay was written by silver analyst Theodore Butler. Investment Rarities does not necessarily [nor does Contrarian Investors, L.L.C] endorse these views, which may or may not prove to be correct.)

Because silver is such a fascinating topic, there is a strong force that pulls us to focus on it on a daily basis. This force is normal with any issue we find interesting. Fortunately, this intense scrutiny can be profitable. I personally know many people who have made many thousands, even millions, of dollars on the price moves in silver over the past year or so. By closely studying the COTs, [Commitment of Traders is a regular report detailing position sizes of various types of market participants] they take advantage of low risk buy points. To be fair, these large gains have come from large positions in all sorts of silver investments, including physicals, highly leveraged futures and mining stocks.

Not only is silver a fascinating topic that causes many of us to monitor it daily, the opportunity to profit only intensifies that attention. Once you come to really understand silver, it’s hard not to follow it closely. The problem with this intense daily scrutiny is that it can cause one to lose perspective. It’s hard to see the forest, if you are studying individual trees. It’s hard to think years ahead in silver, when the next tick may mean serious money.

Rarely are we presented with the unique vantage point, like the view from the top of a mountain or from the air, to actually see the whole forest, or the years ahead in silver. For that, we need imagination. We don’t need wishful thinking that leads to fantasy. We need

common sense and bedrock verifiable facts. I have consistently implored people to rely on common sense, and the available facts, to determine whether they should invest in silver. Now, more than ever, common sense and the facts are what matters. But to look successfully into the long 16 term, I think you have to use your imagination as well. I think it is very hard, or impossible, to achieve a long-term goal without vision or imagination.

The imagination I am going to ask you to employ is simply a conscientious effort, on your part, to peer deep into the future. I am trying to get you to develop your own long-term silver vision. I think it is very important that you have your own long-term silver vision, and not rely on anyone else to hold your vision for you. In fact, what I'm asking you to do, in essence, is to blot out everyone else's opinion of the long-term future, including mine, and create your own. Read everything you can and study the facts and arguments but strive to be in control of your own vision.

In addition to blotting out other opinions in the quest of developing your own, you must also try to remove any other influence that may distort your long-term vision. The chief influence most likely to cloud your long-term vision in silver is the current price. The price is the primary destroyer of long-term vision and imagination. Nothing damages the ability to peer correctly into the future than the current conditions and price. You must disregard the natural human emotion of assuming the current price equals the true value of silver.

Price and value are two different things. Sometimes they coincide, sometimes they don't. Sometimes the price overvalues, undervalues or fairly values an asset. That's what investment analysis is all about. The point is obviously to buy undervalued assets and sell, or avoid, overvalued assets.

How does one do that? There is only one way as far as I am concerned. Always assume the price is wrong. Then, having disregarded the price, study the underlying facts to determine what the real value is, in order to determine how the current price compares. If the price is low compared to the real value, then you have a good candidate for investment. If the price is high compared to the real value, stay away. Look at the value first; price always comes second in legitimate analysis. Admittedly, it's hard to do, because we see the price first, long before we even attempt to decide value.

I’m not trying to imply that long-term vision and imagination is a walk in the park. The vast majority of people can’t even hope to guess the future correctly. How many foresaw the 15 to 20-fold increase in real estate over the past 30-40 years? How many foresaw the 25-fold increase in crude oil over the past 30 years? How many foresaw the 40-fold increase in silver from 1970-1980? It’s obvious just how rewarding such insight would be to you. The reason I am harping on the long term is because that’s the only real chance the average investor has for meaningful gains.

Nothing but The Facts

OK, now you’ve disregarded the current silver price and the price action for the past 2 decades. You’ve also attempted to blot out and ignore all opinions by me and everyone else. This is about your money and your imagination and your vision. You must now take a critical look at the facts and let those facts dictate you vision. It is the facts that you must let your imagination work on.

What are the facts in silver? I’m going to give you the facts as I see them. I will warn you, up front, that I will present them in a manner designed to influence your vision. So be on guard. But I also promise you that I will only present what I truly believe to the complete and verifiable facts.

Silver is a material known, mined, used, and valued since the dawn of civilization. It will be used and valued until civilization ends. For the past 150 years or so, tremendously varied and new uses were discovered for this age-old material, which contributed to the progress and modernization of our society. This came about because silver is the best conductor of electricity and heat, the best reflector of light, is integral in the photographic process and has important health benefits. Because of all these new, growing and unanticipated uses of this material, demand has greatly exceeded production for more than 60 years. This has necessitated the draw down and consumption of almost all the silver that was mined and accumulated for 5000 years. Every measure of total known world inventory in the past half-century show declines of greater than 95%. The facts clearly indicate that silver has been in a structural deficit for 60 years. No commodity has a similar profile.

Added to this known elimination of almost all above ground inventories, we are given credible evidence that we may be exhausting underground inventories as well. This in a time

period that's a tiny fraction of silver's known years of production history. What is a couple of decades compared to 5000 years? If you are letting your imagination work freely, you should be starting to ask yourself – what kind of price should be assigned to a vital commodity that faces both above and below ground depletion?

If looking ahead 20 to 30 years seems difficult, then try looking back that amount of time. 25 years ago (almost to the day) silver hit a price over $50, up from a buck and small change 10 years earlier. I know it was manipulated up by speculators, but there are not many things that have increased 40-fold in less than a decade. It doesn't mean it will happen again, but it also doesn't mean it can't happen again. Let us look at the known facts since then.

In the past 25 years, we have used up 2.5 billion ounces in world silver inventories. Stated differently, there is 2.5 billion ounces less in the world today than there was in 1980, when 18 silver hit $50/oz. I think there is less than a billion remaining, and no one can show more than 150 million ounces in verified bullion form. In that same time, the world has removed 12 billion ounces from the earth (using an average world production of 480 million ounces a year.) At the current world-mining rate (600 million ounces), we will extract another 15 billion ounces over the next 25 years. The U.S. Geological Survey, chief geological statistician for the U.S. Government, projects the earth may contain only 8.5 to 18 billion ounces.

Current world silver demand runs 900 million ounces a year. Assuming no growth in demand (in other words, forget that China and India exist), in 25 years that comes to 22.5 billion ounces. Even allowing for a scrap recovery component of 5 billion ounces over the next 25 years, here is what we face – the exhaustion of all possible silver everywhere. What is your imagination telling at you about the future price?

Although you should not need additional facts to stoke your imagination, I must present one more. Silver has the largest short position ever seen in any item. From COMEX, to leasing, to banks and brokers selling unbacked silver certificates, there are billions of ounces sold on paper that don't even exist. Billions of these ounces must be bought back by the sellers, lest they get consumed in a significant price rally. The fact is this giant combined silver short position exists and it dwarfs the verifiable silver currently above ground. Someday there will be a scramble for silver that will be talked about for centuries.

Logical Comparison

In order to put these silver facts into perspective, it would be useful to compare them to other commodities. The most comparable material to silver is gold. Not only do they share a common 5000-year history and association, they are joined in the minds of most, much like, “love and marriage” or “horse and carriage”. I don’t know a better match to compare silver’s facts than gold.

(Let me interject here that I am not putting a knock on gold. As my recent articles have hopefully conveyed, I think gold is, or has, formed an important bottom and could easily rise $50 or more in the next COT-driven rally, with a much greater equivalent rally in silver. But this article is not about my person price expectations, but about using real facts to determine your own vision.)

Gold is also a material mined, used and valued since the dawn of civilization. It too will be with us forever. While it has many potential varied uses in the modern world, due to its high price, it is principally used (as it has been through the centuries) as an investment and jewelry item. Because so little gold is lost in modern industrial applications, it can be said that most of the gold ever mined still exists.

Since 1980, world gold production has added 1.5 billion ounces to above ground gold “inventories” for a total of 3 to 4 billion ounces. Looking out over the next 25 years, current annual production will add another 2 billion gold ounces, bringing above ground stocks to 5 to 5 billion ounces. The U. S. Geological Service also predicts a severe depletion in below ground gold reserves.

The important point here is that at the end of the next 25 years, there will be a significant increase in gold in existence, while silver above ground will certainly have been exhausted long before that. One is priced above $400, the other is priced below $7.

What price do you put on an item marked for extinction? Maybe the best calculation is not even to pick a price. Maybe it’s best to let your vision focus on time, and not price. Maybe you should let your imagination set a long enough timeline and ignore the daily, weekly, monthly and yearly price changes. That certainly would have been the right approach in real

estate and oil. If the silver price rise becomes too compelling, then take some money off the table. Just be sure to remain true to your own vision.

I've tried to present the facts clearly and objectively, but also provocatively. I want you to use your own imagination and form your own vision, in the hopes that you can cope with the long-term in silver the best way possible. As for me, I have my own vision on which I will rely. I have my own price and timeline, and you should have yours. I will tell you that even after 20 years of analyzing silver, not only do I find my premise about silver constantly reconfirmed, the more I think about it and let my imagination run freely, I still tremble with excitement about the certain conclusion I see ahead. The more I study silver, the more an extreme situation and future price resolution comes into focus.

In closing, there is one thing I further ask you to consider. If you decide to buy and hold silver, make sure it's in the right form. I have been hearing disturbing news stories that people are still buying unbacked bank silver certificates and unallocated pool accounts. If there's one thing I can see destroying a legitimate silver vision, it's buying the wrong type of silver. Here's a simple rule – if you're not holding it in your own possession, or don't have the serial numbers, weights and specific descriptions of all stored silver, you don't have silver".
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