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Silver Outlook is Bullish

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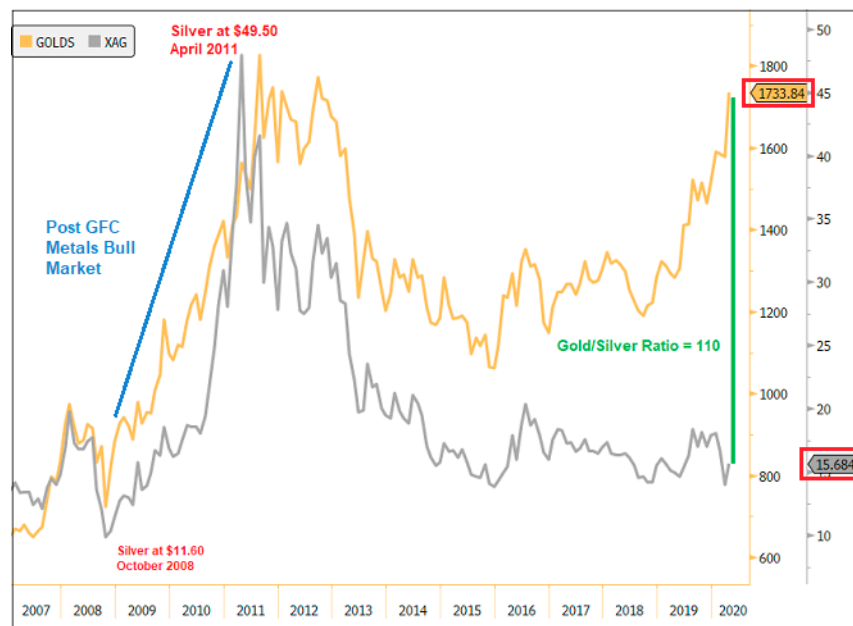
The silver market is in the throes of several changing trends as the COVID-19 pandemic upends the global economy. When the dust settles, we see a bullish case for silver prices, as investment demand ticks upward while supply constraints linger.

Silver is Lagging Gold in 2020

Silver entered 2020 with a constructive outlook. As the world economy was showing signs of slowing and debt levels continued to increase globally, central banks began turning on the liquidity taps through interest rate cuts and bond purchase programs of various kinds. Silver rallied close to \$19/oz by the end of February until the rapid spread of the COVID-19 coronavirus threatened the global economy and financial markets in earnest. Once the pandemic took hold beyond China, silver took a hit and dropped to a low of \$12/oz in mid-March, but has rallied back to near \$16/oz since then (as of 4/15/2020).

On a year-to-date basis, silver lags gold with a decline of 13% versus gold's rise of 13% (as of 4/15/2020). Though the metal has recovered somewhat, we see significant upside potential from current levels and predict a repeat of a post-Global Financial Crisis (GFC) move, as we discuss below.

Figure 1. Silver vs. Gold Prices (2007 – April 2020)



Data as of 4/15/2020. Source: Bloomberg. The gold spot price is measured by GOLD Comdty Index; the silver spot price is measured by the XAG USD Index. You cannot invest directly in an index. Past performance is no guarantee of future results.

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The gold/silver ratio is very high at 110, given that the ratio has averaged 65 since the 1980s. Silver has a strong correlation to gold, and it has the potential to move significantly if the gold/silver ratio reverts to historical norms.

How the Pandemic is Affecting Silver: Demand & Supply

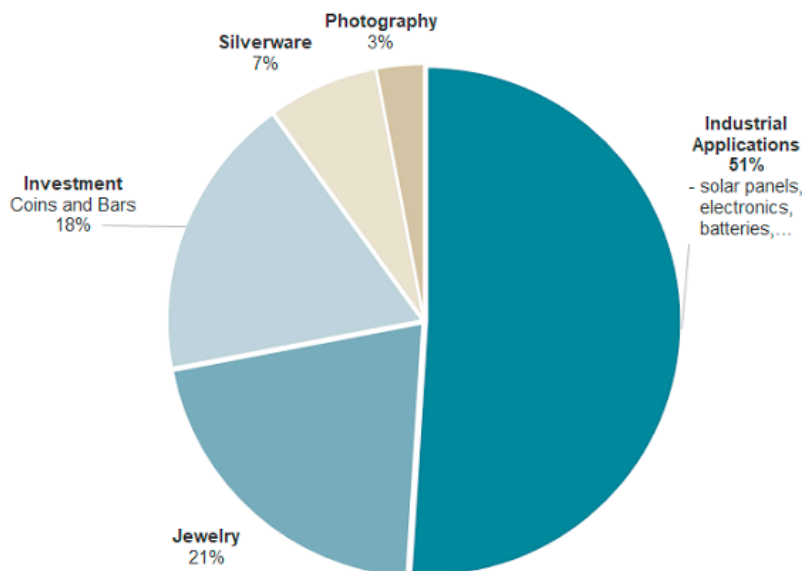
In looking closer at silver supply and demand trends, our outlook is for higher silver prices as the pressures of the COVID-19 global pandemic subside. We believe that industrial demand will recover, and that supply will come under pressure. At the same time, investor demand is just beginning to manifest itself through record-high silver ETF inflows (see Figure 4) and increased coin and bar sales. Similar to gold bullion, we expect investment demand to ramp up because of the unprecedented amounts of liquidity and monetary easing being released into the financial system in response to the current credit crisis.

Approximately half of the demand for silver comes from industrial buyers. As the pandemic constrains economic activity worldwide, industrial demand has clearly softened. Recent purchasing manager index (PMI) figures have given us the first glimmer of the damage, with the J.P.Morgan Global Composite PMI coming in at 39.4¹ for March activity. We expect that PMIs will fall further in the coming months. (Read two of my prior reports on silver's industrial role: *Silver's Critical Role in Electrification May Fuel its Rise* and *Silver: An Essential Metal for the 21st Century*.)

"Silver often lags gold in performance, as the initial buying of gold is driven by panic and fear. Silver generally catches up in performance, once the precious metals bull market is underway."

Notably, the more severe contraction is reflected in the services sector,² rather than the manufacturing sector, as global stay-at-home orders wreak havoc on normal consumer activities and the employment market. In comparison, the manufacturing sector may see less impact and a shorter recovery timeline. It is challenging to predict when industrial activity will recover. New data out of China, which is beginning to reopen some industrial operations, is relatively encouraging.

Figure 2. Industrial Buyers Drive More Than 50% of Silver Demand



Source: GFMS Refinitiv, Metals Focus, Silver Institute, UBS.

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Mine closures are offsetting the decline in manufacturing demand for silver. Pandemic lockdowns have already suspended several critical mining operations across Mexico, Peru, Argentina and Bolivia, all major hubs of silver supply (Argentina is reopening its mines after declaring mining an essential service on April 3). Most restrictions are in place through April, but we believe this date is subject to extension, depending on virus containment efforts. Silver mining is relatively concentrated, with Mexico and Peru together accounting for about 40% of global supply.

Figure 3. Potential for Long-Term Supply Disruption as Mine Production Is Suspended

A number of the world's most significant silver mining locations have halted or lowered production in response to virus containment measures.

Top 20 Silver Producing Countries (Moz)

(Red text indicates countries with mine suspensions.)

Rank	Country	2018
1	Mexico	196.6
2	Peru	144.9
3	China	114.9
4	Russia	43.4
5	Chile	42.1
6	Bolivia	39.9
7	Poland	39.6
8	Australia	35.4
9	United States	28.0
10	Argentina	26.5
11	Canada	24.8
12	India	23.2
13	Kazakhstan	19.5
14	Sweden	14.6
15	Indonesia	11.9
16	Morocco	11.2
17	Turkey	5.5
18	Armenia	5.0
19	Iran	3.6
20	Dominican Republic	3.4
	Rest of the World	21.7
	World Total	855.7

Source: GFMS Refinitiv.

We think there's also good reason to set conservative expectations around future supply. The pandemic is already forcing short-term mine closures and grounding transport lines, but these issues could persist long after the initial health crisis has passed. The longer the pandemic impacts global health, the more likely it is that mining companies and the supply chain face viability issues.

Depressed commodity pricing makes it even less profitable to mine, lowering the incentive for companies to take the risk of restarting operations or exploring for new silver deposits. Mine supply has been declining since 2015. A lack of new ore discoveries combined with the disruptions caused by the pandemic do not bode well for this supply trend to turn around. Also, silver's continued price weakness has a significant impact on the metal's scrap market: silver scrap supply is price-sensitive and has been in a declining trend since the price of silver peaked in 2011.

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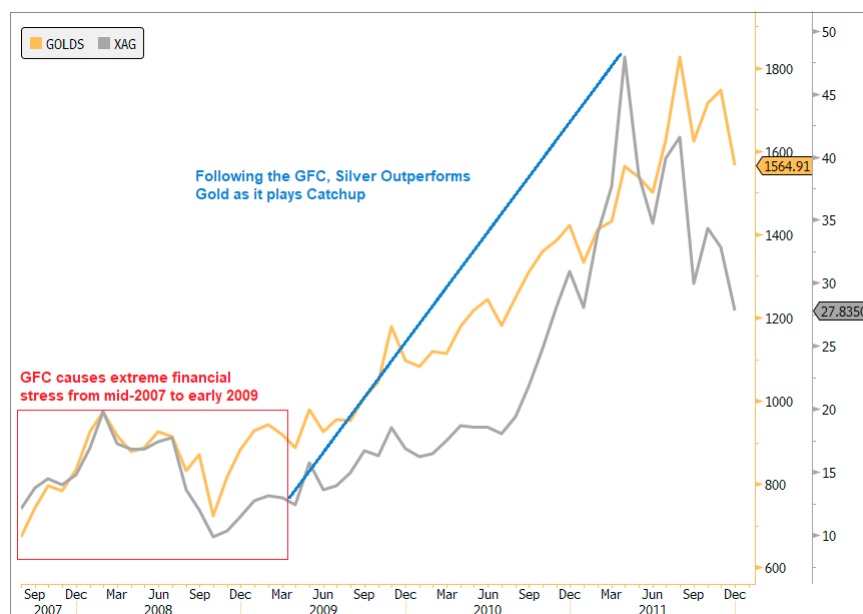
The Upside in Investment Demand

We see the current phase as a window of value for silver thanks to growing investor demand for the metal. We see two critical buyers poised for higher investment demand: global mint buyers and ETFs as agents of demand for safety-seeking retail and institutional investors.

Silver does have important industrial uses. However, it also has a central role as a monetary asset with close ties to the value of gold. Investors have historically used both metals as a store of value and an option for safe haven investing during windows of volatility and uncertainty. Silver was the first metal used as a currency, more than 4,000 years ago, in the form of ingots for trade.

Thus far in the COVID-19 crisis, we are experiencing the same investment demand trends that drove both gold and silver bullion significantly higher after the GFC of 2007-2009 (Figure 1). Following the GFC, gold and silver staged a significant bull run that extended for years, with silver appreciating 440% from its trough in 2008 to its \$48.44/oz peak in 2011.

Figure 4. Silver Outpaced Gold in Post GFC Bull Market (August 2007 to January 2012)



Source: Bloomberg.

It is important to note that silver often lags gold in performance, as the initial buying of gold is driven by panic and fear. Silver generally catches up in performance. During the GFC, the gold-to-silver ratio skyrocketed from ~50:1 to more than 80:1, eventually bottoming at 32:1 in 2011. In other words, the panic selling at the end of 2008 hurt silver more, but as the markets recovered, silver outperformed. As of this writing, the gold/silver ratio is historically high at 110:1.

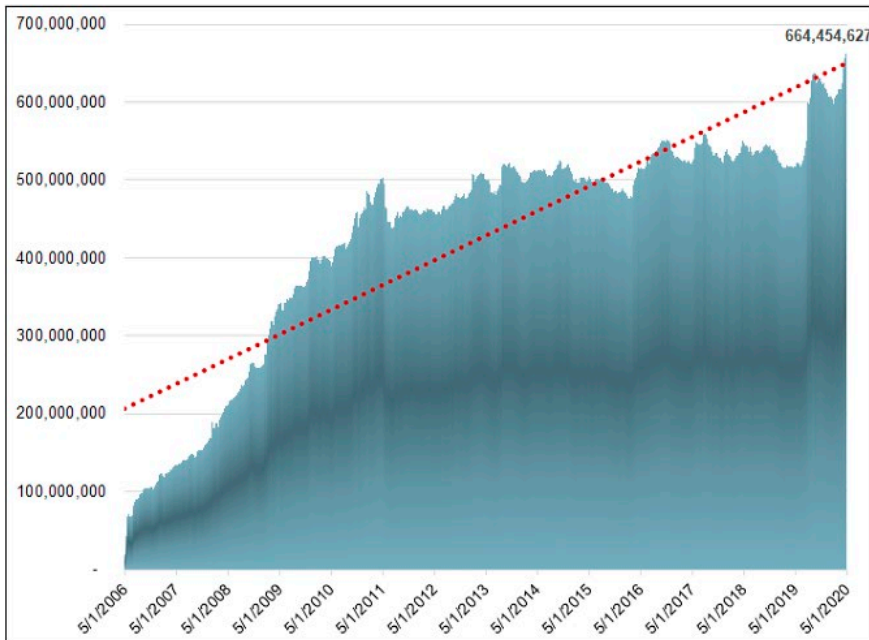
“Unlimited” Levels of Quantitative Easing (QE) Support the Case for Precious Metals

We already see a resurgence in investment demand: it started last year when the Fed and other central banks resumed their monetary easing by lowering interest rates. Total silver ETF holdings grew 16% or 82.7 million oz. in 2019. The onset of the COVID-19 pandemic only spurred demand further when numerous governments took measures to resuscitate their economies through monetary and fiscal stimulus. ETFs added 42 million oz in Q1, of which 30.3 million oz were added in March and are at all-time highs (Source: Bloomberg).

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Figure 5. Silver ETF Holdings Reach All-Time Highs (2006-2020)



Source: Bloomberg; ETSITOTL Index. Data as of 4/15/2020.

Silver Coin and Bar Demand is Surging

Global coin and bar demand are also rising sharply. While last year saw moderate growth at 4.7%, this year is expected to be stronger with predictions of 24% growth to 261 million oz (Source: GFMS Refinitiv). When the silver price hit a 10-year low this past March, silver coin sales at the U.S. Mint surged and there were reports of shortages in multiple markets with premiums for retail products spiking.

“American Eagle silver coins rose by 4,832,500 ounces in March, marking gains of 643.5% from February’s total of 650,000 ounces and 468.5% from the 850,000 ounces moved in March of last year. American Silver Eagle sales for the year so far at 9,328,500 coins are 34.7% higher than the 6,925,000 coins sold through the same time in [2019].” (Source: Coinnews.net. Gold and Palladium Surge in First Quarter 2020; U.S. Mint Bullion Sales Explode in March.)

Australia’s Perth Mint also reported having to increase the production of its popular 1-ounce Silver Kangaroo coin to meet a backlog of orders, with significant stock going to Europe and the U.S. where demand “went through the roof.” (Source: Bloomberg. Top Mint Ramps Up Silver Coin Output After Demand Surges.)



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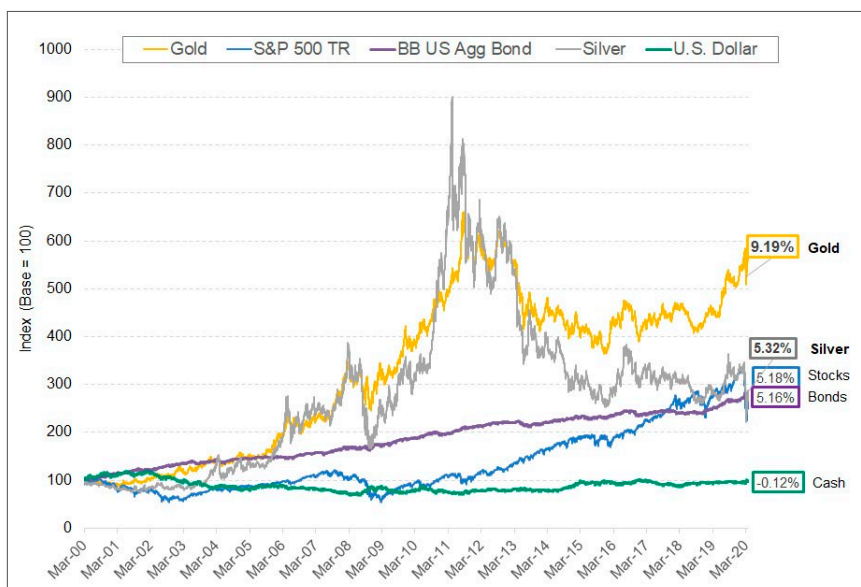
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An Unexpected Turn but Thesis Supporting Silver Is Unchanged

The pandemic has conveyed new risks to a portion of the silver market: as manufacturing activity comes to a standstill, industrial demand is lacking. In the short term, markets are likely to continue to be highly volatile, and the silver price may follow. However, our thesis is that silver has significant upside stemming from higher investment demand with buyers seeking protection from the devaluation of fiat currencies around the world. As governments seek to stimulate their respective economies, silver — like gold — offers a safe haven. Although the silver market is small in size, it has the potential to move higher quickly when conditions are supportive and to outperform more traditional asset classes.

Figure 6. Both Gold and Silver Have Outperformed Stocks, Bonds and USD over the Past 20 Years

(Average Annual Returns for the Period 12/31/1999-4/13/2020)



Source: Bloomberg. Period from 12/31/1999-4/13/2020. Gold is measured by GOLD Comdty; US Agg Bond Index is measured by the Bloomberg Barclays US Agg Total Return Value Unhedged USD (LBUSTRUU Index); S&P 500 TR is measured by the SPX; and the U.S. Dollar is measured by DXY Curncy. Past performance is no guarantee of future results.

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For more information, please visit sprott.com



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¹ The J.P.Morgan Global Composite PMI provides the first indication each month of worldwide economic business conditions.

² Source: COVID-19 outbreak causes unprecedented collapse in consumer services.

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