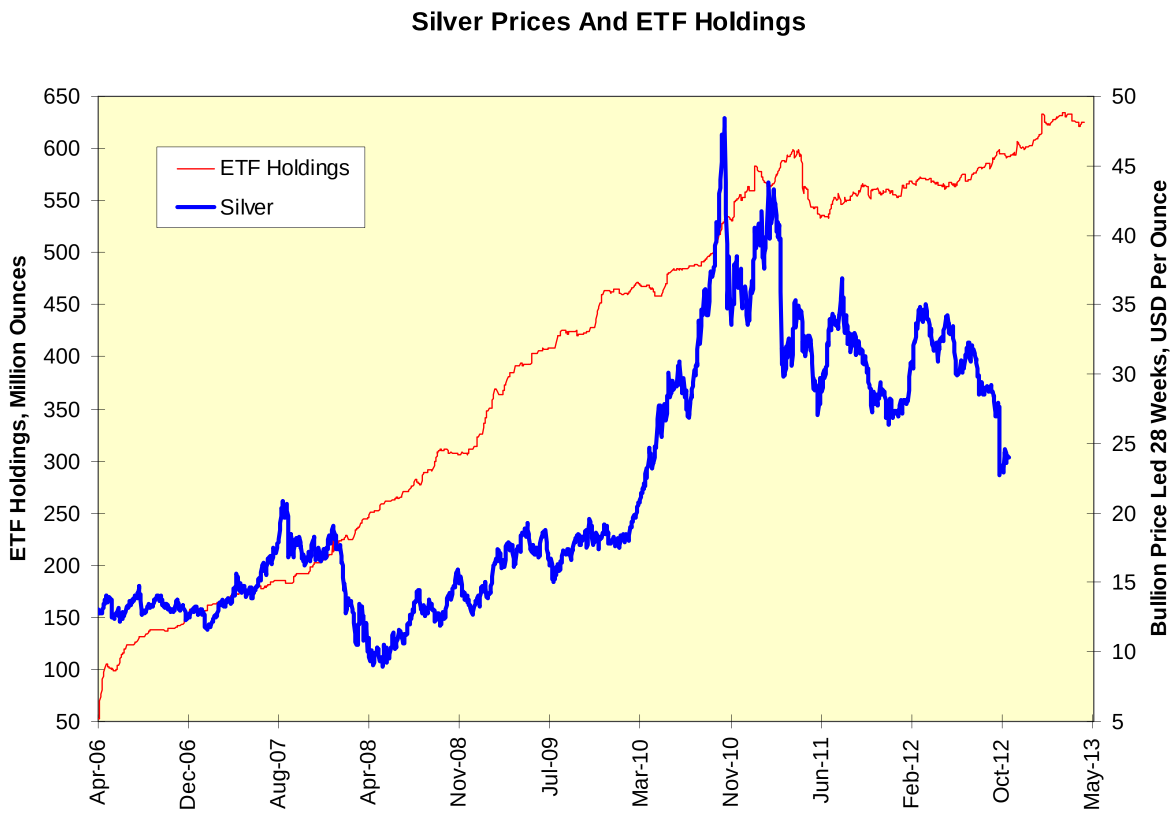
Silver ETFs Tell A Different Story

It is only mid-May, but I am fairly certain the worst analytical thread of 2013 will be the one trying to explain gold price movements with ETF holdings. I noted at the start of April and two weeks before the yellow metal's face-plant into the sidewalk how peaks in investor interest followed, but did not lead, the decline in gold underway since September 2011. Longer long-term interest rates engineered through Operation Twist is a far more robust explicator of gold prices.

Besides, gold prices have increased more than 7% since their April 16, 2013 low while ETF holdings have declined another 5.83%. Some longer-term, strong-handed buyers such as central banks have been willing to step up and acquire the metal being sold from ETFs, but only at a lower price.

What About Silver?
Silver prices have fallen by more than 50% since their peak at the end of April 2011. ETF holdings of silver, which include those of the iShares Silver Trust and the ZKB Silver ETF, amongst others, have increased by more than 5% during that period.



The relationship is not contemporaneous, though. ETF holdings lead bullion prices by 28 weeks on average. Once this lead-time is accounted for, we find the partial contribution of ETF holdings to bullion prices since April 2011 has been -0.104, a negative relationship. Restated, while investors in silver ETFs are stuffing their pockets with the white metal, prices are going lower and they do not seem to mind one bit. As investment demand for silver accounted for 15.26% of total demand in 2012, the producers of silver should be more grateful in public to these buyers than they have shown. We all need customers like this.

As the late Marvin Gaye might have warbled, what's going on? While the gold market has a buyer of last resort, the central banks, which are willing to take mine output and re-bury it in their vaults free from the burden of a profit-and-loss statement, silver lacks such a buyer. The ETF investors in gold are a weak holder in comparison to the central banks. ETF investors in silver are the acting as if they are a price-insensitive long-term, strong-handed buyer and are willing to accumulate metal at lower prices.

The behavioral finance crowd should have a field day with this: Investors who should be profit-maximizing and increasingly risk-averse in the face of growing marked-to- market losses are looking in the mirror, seeing a red “S” on their blue tights and thinking they can act as a scale-down buyer just like the central banks.

Someone should remind the silver buyers most silver is produced not as the result of dedicated silver mining but rather as a credit to copper or lead and zinc mining. A copper miner that produces 100 ounces of silver for 100 tons of copper focuses on the copper price and simply takes whatever the prevailing price is for silver.

Normally I recoil at the categorization, “smart money.” However, I think I just found its opposite.