Is Silver or Gold Better?
by the Optimist

We have nothing to fear but debate itself

The Optimist wants to tell you about the great news that developed in the last few weeks. There has been a recent, and well publicized, sequence of articles called The Great Debate to decide whether we should buy silver or gold. This news is exciting precisely because it is an argument among precious metals bulls about how to invest for the bull market in precious metals. Just a few short years ago, we precious metals bulls were few in number, and we had to focus our energy in an almost united way on the common goal to convince mainstream investors that we weren't crazy. Our prime mission was to show that there really were good and sound reasons to make major investments in precious metals. Now that our early vision has been amply validated by the explosive bull market in world wide rising prices for silver and gold, some of our long respected writers can divert their attention to arguing about which horse will run the fastest in the precious metals race track. My view is that issues like deflation (which would be terrible for our investments if it did happen, but it won't) and confiscation (which will be terrible for our investments when it does happen, and it will) would be of greater interest to precious metals investors than concern about whether silver or gold will run faster, but if that is The Great Debate of our time, then I would like to contribute a few comments.

First, it hardly seems like the question of whether silver or gold will rise faster is a critical issue that merits The Great Debate. Surely we can all agree that for so long as the Fed can and will create additional fiat without limit, that prices of both silver and gold will rise as a result of that surplus of fiat paper. People who have a preference for silver or for gold should just follow their feelings. If one investor buys only silver and another buys only gold, then one of those two will make a bigger fortune than the other and will have bragging rights in the decades to come. Meanwhile, the "losing" investor who bought the metal that appreciated less will still be miles ahead of the masses who continue to dump their resources into stocks or bonds at current levels. New investors who do not yet have a major preference can simply buy some of both and be very happy with the results. That is so easy that it seems like an unlikely cause for a debate.

Deja vu all over again

The Optimist can confirm the rumors that there was a painful time when it was wrong to be bullishly invested in precious metals. For the two decades from 1980 to 2001, it would have been a bad investment to buy and hold precious metals. Since buying high and then selling low is unprofitable regardless of which market one tries it in, that negative example of precious metals from the 1980s through the 1990s does little to help us in The Great Debate to decide whether silver or gold will be more profitable now. Indeed, reflection on the dark ages of the 1980s and 1990s raises a more fundamental question about whether we should continue to invest in precious metals at all. The Optimist offers the positive view that economic conditions continue to favor investments in precious metals. Specifically, real interest rates continue to be negative, just as they were from 1970 to 1980 and after 2001. For so long as the 3 month T Bill rate is less than the true rate of inflation, the Optimist anticipates that both silver and gold will be outstanding investments, just as they were in the comparable past.

The question which The Great Debate focuses on is whether silver or gold will appreciate more while real interest rates stay negative. A look at the historical times when real interest rates were negative (so that one should have been invested in precious metals) can provide some useful guidance. From 1970 to 1980, silver rose from $1.75 to a peak above $52 for a gain of almost 3,000%, and gold rose from $36 to more than $850 for a gain of 2,300%. That was a hard and fast race in which both silver and gold excelled as investments, but there was no need for a photo finish. Silver was the undisputed winner. Some argue that silver galloped faster because it had Nelson Bunker Hunt for a jockey. Others, in contrast, assert that silver would have run more laps around the track if the COMEX and the Fed had not conspired to erect insurmountable obstacles in the race path. The Optimist sees the Bunker Hunt factor in the 1970s as a positive for considering silver purchases now. The same reasons that encouraged Bunker Hunt to protect the purchasing power of his family wealth by investing in silver continue to apply to many wealthy individuals and to several nations which are rumored to have a small surplus of U.S. fiat promissory notes.

Beyond the big players who can quickly drive prices astoundingly higher, there are millions of small hunters with a bunker mentality about the bad times ahead who could collectively accomplish the same goal.

In any event, we can be confident that Bunker Hunt was not a factor in the rise of precious metals from the lows in 2001 to their current heights. Let's see what that half decade tells us about the relative value of silver and gold. Silver rose from a November 2001 low of $4.02 to a February 2006 high of $9.92 for a gain to date of 247%. Gold lifted off a March 2001 low of $256.60 to a February 2006 high of $575.30 for a gain of 224%. Once again, we see that over a significant length of time in a bullish environment, gold has done great but silver has outperformed gold. I know very well that the past is no guarantee of the future. Given a free choice, however, I prefer to bet with the historical evidence that gives the nod to silver, than to search for reasons that the markets did not know what they were doing for 15 bullish years.

A recession may not be bad investment news

Rising interest rates make it an odds on bet that a recession will happen in the USA sooner rather than later. The Optimist cautions, however, that a recession may not provide a low price entry point for buying either silver or gold. Previous recessions typically increased unemployment in the marginal sectors which had deficient economic strength, and encouraged people to reduce spending to pay down excess debt. As indicated in This Time It Really Is Different, America has already lost most of its solid manufacturing jobs. Many of the jobs which remain are centered in the marginal sectors of a service oriented economy. Furthermore, debt levels are excessive for consumers, industries, and all levels of government. A full recession that 20 years ago would have been seen as a paring knife to whittle away small excesses and then leave the economic structure in a stronger position for future growth, might now more closely resemble a high power chain saw slicing through seedlings. An ignored recessionary snowball rolling down a small hill at first could now quickly grow into avalanche size proportions which threaten the entire nation with waves of deflation and economic depression worse than America experienced more than 70 years ago. As an optimist, however, I can see a much less painful outcome in which the Fed is ever alert to the obvious dangers that a serious recession could pose to our nation. I am confident that the Fed will take immediate and forceful action to prevent that snowball from rolling downhill too fast and growing too large. As soon as the Fed sees signs of economic trouble approaching, I anticipate that they will moderate the level of interest rates and will insure that the economy has abundant liquidity. Even as the economies in the USA and the world begin to slow, investors will see the reductions in interest rates and the increase in liquidity as precursors to more rapidly rising inflation. Those investors will waste little time before again bidding the prices of precious metals aggressively higher.

If my optimistic scenario plays out so that Fed support enables the USA to experience only a relatively mild recession, American consumers will still feel pressure to cut back on buying new houses and unnecessary purchases of items made overseas. Those cutbacks in America will translate into significantly slowing economies around the world. In quick reaction to the slowdown pressures, those economies will sharply reduce their purchases of base metals such as copper, zinc, lead, etc. The subsequent curtailment of unnecessary mining in the base metals will have an unintended consequence. More than two thirds of the world production of silver is from byproducts in the mining of base metals. A world wide cutback in the mining of base metals will sharply reduce the amount of silver being produced to feed the just in time industrial processes which require that silver. Even though a small recession would modestly reduce the amount of silver consumed, the sharp reduction in byproduct supply of silver could well be the ignition source for when the price of silver will explode.

Just as in the 1970s and again since 2001, the Optimist looks for silver to appreciate significantly faster than gold, though he will cover his bets by having some of both. Cheers!

result of your investment decisions. The Optimist wishes you the best of luck in whatever you decide to do or not to do. Cheers!

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http://sitekreator.com/Optimist/commentary.html
Contact: Optmst@Gmail.Com