TECHNICAL SCOOP
CHART OF THE WEEK

Charts and commentary by David Chapman

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Silver Bottoming?

Charts created using Omega TradeStation 2000i. Chart data supplied by Dial Data

Much has been written about gold but fewer talk about silver. Silver has been displaying similar technical patterns as gold. And like gold there remains constant bearish chatter that silver prices have a lot further to fall. The bear reports have silver falling to $17, $15 and even lower. Silver has in the past, been a monetary metal. Canada stopped issuing coins with silver content in 1968 while the US didn't stop until 1970. Silver retains considerable industrial usage primarily in green technology, medicine, nanotechnology as well as usage in batteries, electronics, catalysts, the automobile industry and yes, even photography. Silver is also popular in jewellery and there remains strong demand for silver for investment purposes.

Historically it has been estimated that there is roughly 10 times as much silver as there is gold. That resulted in an historic gold/silver price ratio of 10 to 1 although other evidence suggests that for years the ratio was around 16 to 1. If that historic ratio is correct then today's price ratio of 62 to 1 makes little sense. If the historic gold/silver price ratio were in place today silver would be trading at about $77 using 16 to 1 or $123 using 10 to 1. It suggests that something may be "out of whack".

Others have compared the price of silver to the price of oil and suggest that there is also a relationship. For years, the price of oil and the price of silver roughly traded in sync. Back in the 1960's the silver/oil ratio was around 1.2. Even prior to the 1960's the general relationship between silver and oil was a ratio of 1.2. Even as oil prices rose in the 1970's due to the Arab oil embargo and later the Iran hostage crisis silver prices rose generally in lockstep. Throughout the 1970's the ratio increased to 2.1 on average. From 1980 to 2000, the ratio increased again averaging 3.8 with a range from 2.7 to 5.8. For years during that period silver traded in a fairly narrow range often never more than $7 and as low as $3.50. For quite a number of those years the price was primarily between $4 and $5. As oil prices rose after 2000 silver rose as well but for the period 2000-2013, the silver/oil ratio has averaged 5.2. If the ratio of 1.2 were in place, silver would be today trading closer to $75 against WTI oil.

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On an inflation adjusted basis silver has grossly underperformed gold. One could argue quite convincingly that silver remains mired in a bear market. Silver peaked around $50 in 1980. Today silver would need to be trading closer to $137 to equal that price. Stated another way silver today is about $7 in 1980 terms. By comparison, gold needs to trade about $2,400 to equal the 1980 peak in gold prices near $850. In measuring both gold and silver on an inflation-adjusted basis neither could be considered to be in a real bull market until the inflation adjusted highs are taken out. The CPI adjusted chart of silver is below.

Unlike gold COMEX silver registered stocks eligible for delivery have actually been rising in 2013. According to numbers from the COMEX, there is some 50.5 million ounces of silver stocks available for delivery. This is up from under 40 million ounces available at the beginning of 2013. Based on today's valuation of about $19.60 the value of available stocks is only about $1 billion. When one considers that the Federal Reserve is still maintaining monthly bond purchases of $75 billion the amount of available silver stocks is a pittance.

Ray Merriman of MMA Cycles suggests that silver has an 18 year long-term cycle. Grant you there is not many observations as silver has only been free trading since about 1970. The range on the 18-year cycle is 15-21 years. Silver made a major low near $3.50 in February 1991 and again in February 1993. Prior to that, the major low was seen in January 1976. 18 years from 1991 or 1993 gives us two ranges for the next 18-year cycle low. One range would be 2006 to 2012 from measured from the 1991 low and 2008 to 2014 measured from the 1993 low. In 2008, silver fell roughly 60% and was within the expected time frame for a major low so it could have been the 18-year cycle low. However, the decline only occurred over about seven months. This time silver has fallen roughly 63% but it took just over two years from April 2011 to June 2013. Merriman believes the current decline is the 18-year cycle low given that it has fallen in the time-frame measured from the 1993 low and it was a more pronounced and longer cycle decline then the 2008 collapse.

Merriman also suggests that the 18-year cycle could have a range of 15 to 21 years. If that is correct, than the low in 2013 is 20 years from the 1993 low and falls nicely in the range. The 18 year cycle could sub-divides into three seven-year cycles with a range from 5-8 years then the low in 1993 was followed by another one in November 2001 then followed again 7 years later with the low in October 2008. The low in June 2013 is only about 5 years from the 2008 low but does qualify given the 5 to 8 year range of the 7-year cycle.

Merriman also suggests that there could be 4.34 year cycle in silver which is also a derivative of the 18 year cycle given that half 18 years is 9 years and half that again is 4.5 years. The 4.34 year cycle could have a range of 3 to 5 years. Starting at the February 1993 low one can see distinct lows in silver in July 1997, November 2001, August 2005, October 2008 and the most recent one in June 2013. While cycles can contract or expand, all were generally within the range.

On a valuation and a cyclical basis silver could be poised for a strong move to the upside. However, new bull markets do not happen overnight. The expectation here is that the first quarter of 2014 might be choppy with an upward bias but the second quarter could see a test of the lows once again. Slight new lows could not be ruled out.

The recent test of the lows at year-end 2013 saw gold make slight new lows but silver did not. This may be a positive divergence. The daily chart below shows this test of the June lows and now silver is trying to rise once again. A breakout over $21.25 would suggest that silver could rise to potential objectives at $28. That would roughly be a 40% gain from current levels.

Silver would probably need to rise over $30 to confirm that the final low is in and that it has shaken off the negativity of the 18-year cycle. Until then there remains risks to the downside.

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