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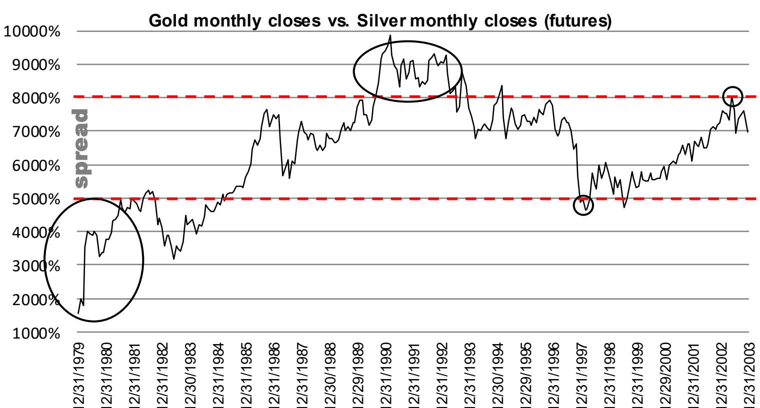
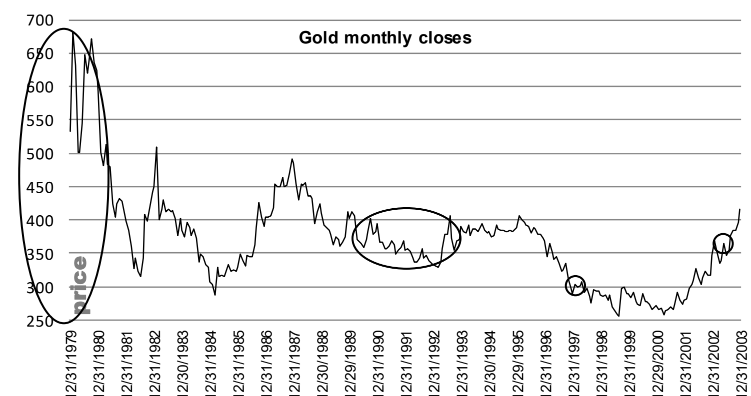
Silver—Subtle Dynamite (also the ratio between gold and silver)





The gold/silver ratio is commonly used as a tool for predicting turning points in the precious metals markets. When silver becomes extremely undervalued relative to gold, it's time to go long the category. Conversely, when silver becomes extremely *overvalued* relative to gold, it's time to *exit* longs, or so the thinking goes. The reasoning is that silver is more volatile and emotion-driven than gold, so it gets overbought in bull markets and oversold in a bear, as indicated in silver's ratio readings vs. gold.

MSA is a measured skeptic of the *viability* of this metric.

When we look at the gold/silver spread over the past 40 years, we can roughly define peaks above 80x (8000%) as the buy points (gold vastly overpriced vs. silver) and troughs below 50x (5000%) as the sell points (gold price very low in relation to silver).

MSA asks: How reliable is this indicator?

In the bull market which peaked in early 1980, gold was obviously underpriced vs. silver, and the top in both metals occurred in 1980. But not shown here is that in late 1978, well before that major bull trend reached its best levels, the price of gold was only 37 times the price of silver (3700%). Gold was trading at $227 at the close of 1978 (below the ellipse on the price chart) and silver was just above $6. Therefore, gold was at 37+ times the price of silver, or 3700%. So, despite the relationship being deeply into the lower zone (below 5000%), a level that many would regard as being indicative of excess in the precious metals bull trend and a warning of a top, it was in fact a bad metric. It would have been destructive to one's participation in the long side of that major bull trend.

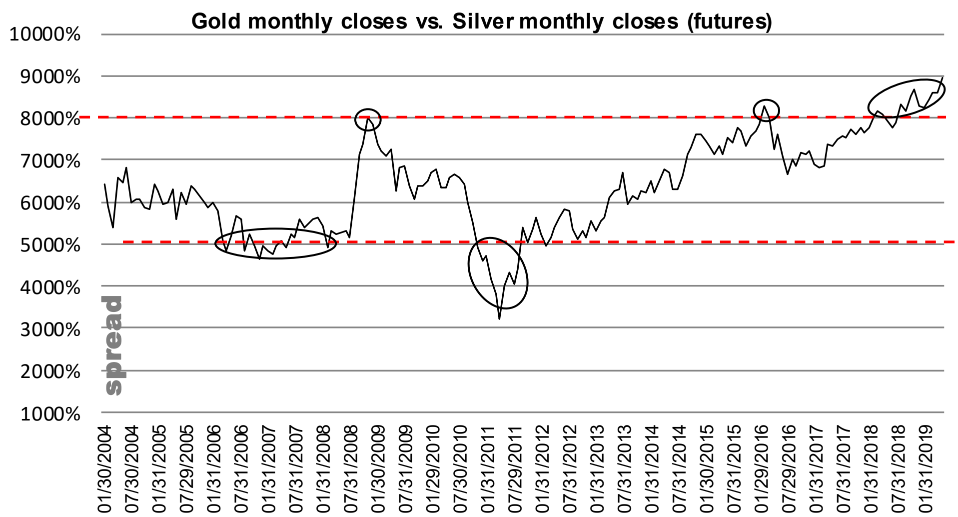
The next data point we'll examine was August 1990 where the ratio crossed above 80x, which should be a buy signal. Yet if you look at the price chart you can see that it was hardly an opportune time to buy. Gold traded sideways and down for several years after that "buy signal" and the readings remained above the 8000% level through 1993.

The next signal, what should have been a sell, came in December 1997 where the ratio plunged below 50x. But by then, gold had already collapsed into the high $200s from its over-$400 high a few years earlier. A little late to be useful as a sell indicator.

In May 2003 the ratio briefly popped above 80x again. As it happens, this was the *first successful signal* that this gold/silver ratio had given on this set of charts. Even so it didn't exactly pinpoint the bottom, which was made in 1999 with a low monthly close of $255.80. So—the signal was 4 years late, and gold had already gained $100 from its 1999 low.

This next set of charts covers the period from **2004 to the present**.

The first signal shown here was that of April 2006 when gold closed at $651. The problem is that the ratio remained glued to the "sell signal" zone around 50x for quite some time (April 2006 to February 2008), and during that time gold traded up from $651 to a peak monthly close of $972 in Feb 2008. This indicator alone would not have told you when to sell, and if you had sold as soon as it hit 50x, you would have missed out on a significant portion of the upside. Yes, ultimately in late 2008 came a sharp downside thud for gold and silver, but long after excess readings had warned.



The second signal occurred in November 2008, when the ratio hit 80x (a buy signal). This is one of the few instances of a clean, accurate buy signal. It was fairly coincident with the bottom in gold.

The third signal came in November 2010 with gold closing at $1385. Major problem here: it was obviously *very early* because gold went significantly higher and the ratio continued to plunge lower. So the question is, using this indicator alone, how would you know when it has actually reached its ultimate peak or trough? Just because it's at 50x or 80x doesn't mean it can't go even lower or higher, and in most of these cases the prior trend persisted well beyond the signal.

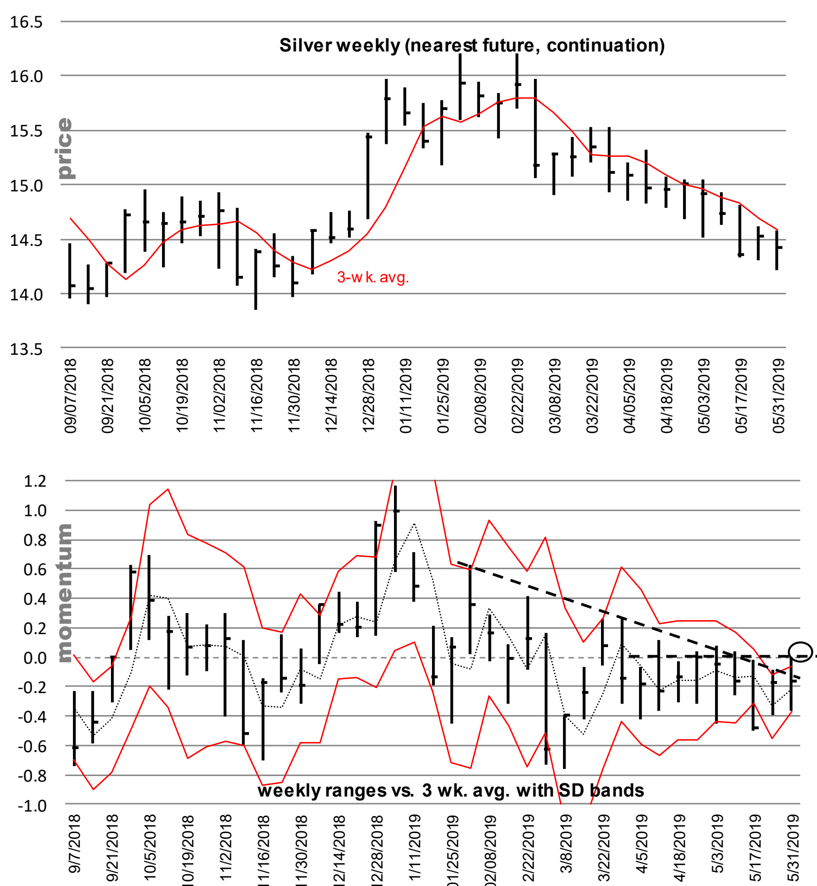
The last signal was February 2016 with gold closing that month at $1233. That was coincident with the month of our annual momentum buy signal, though our structural breakout signal came early in the month as price moved above $1140.

Once again the gold/silver ratio had pushed beyond 80x, signaling a time to buy precious metals. But that signal is a couple years old. True, gold price was holding steady, but so far not an explosion.

MSA suspects that the gold/silver ratio is on the right track with its current readings, implying that upside in gold (and silver) will be revealed in a more obvious way.

But we are forced to conclude that the gold/silver ratio has been only *roughly* accurate, and frankly only since 2003. It's what we would call a *wet-noodle* indicator. Yes, it's a general indicator of extreme weakness or strength in silver versus gold but hardly a timing mechanism.

Now we turn to our momentum structural charts of silver to explain why we argue that dramatic upside in that seeming dog metal is now ripe to unfold.

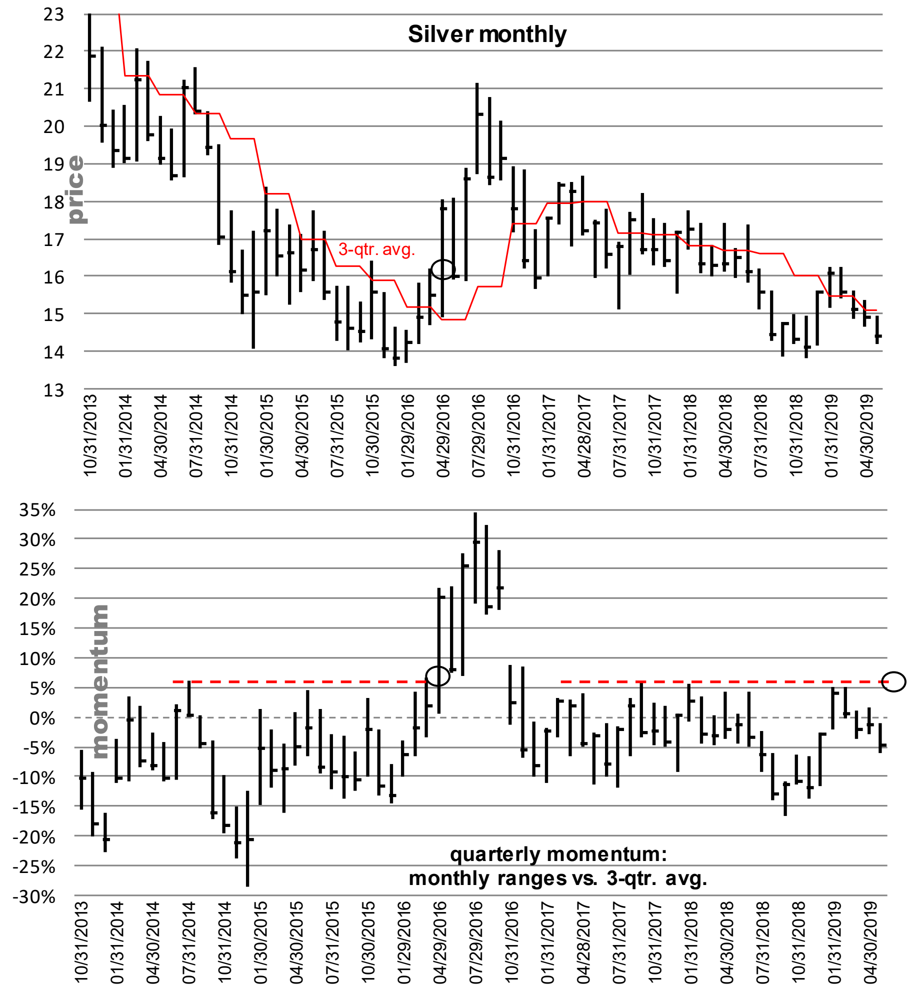


First layer to watch is weekly momentum.

The action on this intermediate trend oscillator is certainly well-structured, with a downtrend through three intraweek highs going back to February, and a flat structure at the zero line/3-wk. avg., with no weekly closes over that 3-wk. avg. in the past ten weeks (this week still an open question). Close out this week over **$14.58** is a breakout. Next week the 3-wk. avg. is projected to drop to **$14.46**. The July silver future is now the front month contract and its official settlement price Wednesday was **$14.41**. Does not take much to shift this trend picture to upside.

Also note that the upper weekly momentum standard deviation band dropped below zero line (oversold reading) with the action of two weeks ago.

Firming momentum action since then. Cross the zero line and it should change tone to more vigorous upside.



Long-term momentum is more than well-structured for commencement of a major move.

Note the quarterly momentum action between 2014 and early 2016. No such orderly and clear structure was evident on price, but for momentum a ceiling at a shallow level was hyper-clear to us. It was broken through when price traded up to $16.10 in March 2016.

Now we have an even wider structure set overhead. Treat it as you would a horse in the starting gate.

Last quarter's oscillator peak reading was just short of 5% over the zero line. $15.86 traded this quarter or as of next quarter a trade to $15.76 will exceed that reading and likely inject sudden upside into long-term trend of silver.

But to err on the side of further breakout evidence, one might also want to see it take out the red horizontal by trading to 6% over the zero line. During this quarter that means tag $16.01, or trading up to $15.91 in Q3.

We think that a weekly oscillator breakout (prior page) will create an upward surge that challenges this long-term oscillator's trigger level.

See the quarterly momentum breakout and expect a very large and sudden advance in this market, a market that has no doubt toned everyone down in terms of positive expectations. Too many investors are tied to the tape of the price action. MSA is wired to the momentum structures. They argue something far more dramatic than what price seems to suggest.