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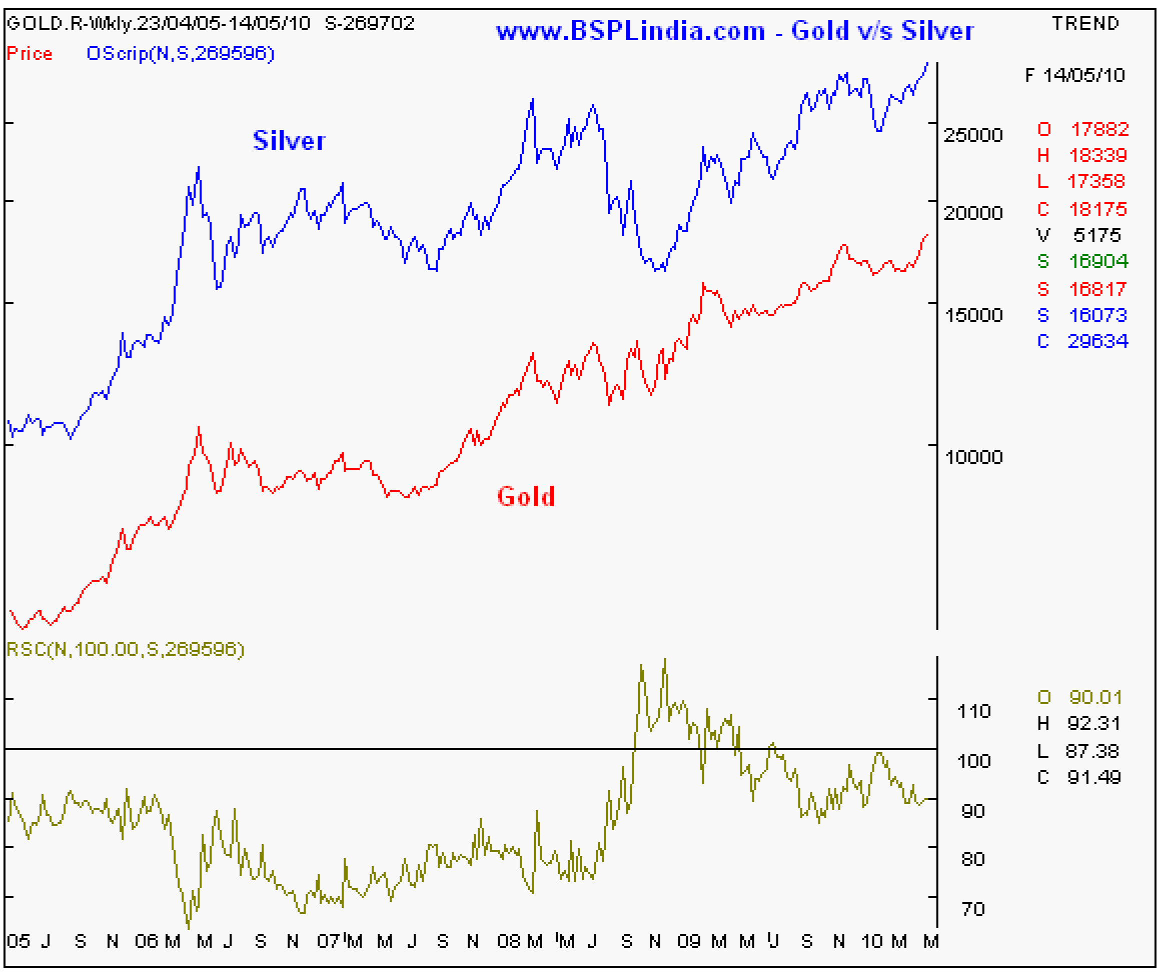
Gold versus Silver

The recent rally in bullion has been witnessing a flurry of activity, towards a "safe haven" as risk appetites shrink drastically across the globe. While many investors / traders / advisors swear by Gold as the defacto choice for investing, we feel Silver has the clear edge as the historical and chartical evidence seems to suggest. Given below is a simple computation of the returns earned by an investor commencing from Jan 2004 till date, taking the MCX prices as a benchmark. We have factored in domestic prices as an Indian investor realistically pays the domestic prices and the USD denominated price remains a statistical benchmark. As can be seen from the table below, the returns earned by Silver was marginally better than Gold and the performance of the white metal was in no way subordinate to that of the yellow metal. Barring the higher impact price paid in the case of Silver (lack of ETF's are a major hurdle to efficient price discovery in Silver), the returns would have been superior for a Silver investor.

	Jan-04	Jan-05	Jan-06	Jan-07	Jan-08	Jan-09	Jan-10	May-10	% rise
Gold	6009	6000	8166	9242	11707	14452	16200	18175	202
Silver	9629	10209	13793	19933	21676	19893	25500	29634	208

The chartical evidence



As can be seen from the chart above, the price movement of Silver and Gold is more or less identical as the close basis line graphs of Gold (red) and Silver (blue) indicate. However, what is the heart of the study is the relative strength comparative between the two, which is plotted as an oscillator in the lower window (yellow). The RSC is a measure of the relative strength between two comparable securities. The relative strength comparative of Gold vis-à-vis Silver is 90 (where 100 = base) and therefore lags behind Silver. Barring the period between Oct 2008 and May 2009 when Gold out-performed Silver by a small margin, the latter was a clear and unambiguous winner in terms of underlying strength. We feel the current euphoria in Gold will see the margin possibly narrowing in the short medium term, but will be maintained over the longer term.

The turmoil in the Eurozone will see confidence erode in fiat currencies and flight to safety towards safer havens like precious metals. However, the edge Silver has over Gold is that it's not just an investment vehicle but also finds industrial applications. That explains the small premium in relative strength comparisons. Gold also has a minor overhang by way of sales by central banks, which Silver remains relatively insulated from. In times of rallies, Silver tends to ride the up waves in tandem with Gold but has been relatively slower to decline on profit sales, in direct comparison. Therein lies the source of strength in Silver. The curbs on free flow of capital across international borders after 9/11 has seen both precious metals become the "official" currencies of the "unofficial" economy (terror, arms and narcotics trade). The appreciation in both these metals is likely to see the wealth of the unofficial / illicit economy rise in comparison to the legitimate economy, which is suffering from recession / default. That in turn will see a bigger flurry of flight of safety towards these metals, thereby fuelling the self fulfilling price rise in these counters.

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The analyst is the author of the best selling book – "A Traders Guide to Indian Commodity Markets" **–** the first technical trading guide for commodity markets in the country.