
SILVER: SET FOR A REBOUND?

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Silver has had a poor run in recent months, with its price falling from over US\$17/oz in mid-June to just over US\$14/oz in September. The ‘hybrid’ metal has come under pressure for several reasons: its strong correlation with gold (which has also fallen) has dragged it lower, while the sell-off in industrial metals has exacerbated market pessimism towards all metals.

So, what does the future hold for silver? Is the silver price likely to fall further in the near term or is it set for a rebound?

Poor sentiment

Sentiment towards silver is poor at present, with speculative positioning in the metal having fallen to its lowest level since futures data became available in 1995. Moreover, silver is trading at its deepest discount to gold since 1993¹. We can offer two main explanations as to why sentiment is so poor right now:

First, with developed market equity benchmarks such as the S&P 500 enjoying an excellent run, investors appear to have lost interest in silver. As silver is a hybrid metal that has both cyclical and defensive traits, it is often a forgotten asset class.

Second, the recent sell-off in industrial metals has cast doubts over all metals with industrial traits. Investors are concerned that burgeoning trade-wars may result in demand for industrial metals falling.

oversold

However, looking at silver’s price decline, we believe that the metal is oversold, and that recent pessimism is excessive. Using the framework described in our article [Silver outlook: Searching for a silver lining](#), our analysis leads us to believe that silver prices have the potential to rise in the near term, driven by a recovery in the price of gold. Based on our model forecasts, we expect silver prices to rise to around US\$16.3/oz by Q3 2019, up from approximately US\$14.2/oz at present.

Gold’s price has also fallen in recent months, however, if gold makes a recovery, which we believe it will (see [Gold outlook: upside correction overdue](#)), we expect silver’s price to rise too.

We would also expect silver to potentially outperform gold in this scenario, as silver has historically risen faster than gold when precious metals are rising, and silver’s deep discount to gold could provide added momentum.

Furthermore, we also believe that if silver's price begins to move higher, a short-covering rally is a possibility given the high level of short interest that exists at present. Short-covering activity tends to exacerbate price gains, and this could potentially act as a tailwind, and set in motion a rally in the price of the metal.

Strong structural support

Looking further out, our medium-term view on silver is also positive.

As a hybrid metal, silver is used in a wide range of applications, ranging from electric cars to solar panels, and its unique attributes make it nearly impossible to substitute. With mine supply of the metal likely to remain tight, we believe that demand will be structurally supported over the medium term.

Constraints

Of course, there are risks to our investment thesis.

Although Global Manufacturing Purchasing Managers' indices (PMIs) are above 50 and likely to remain above 50 (indicating growth in global manufacturing), they are declining, which indicates that the pace of industrial economic growth is moderating. This could potentially cap gains.

Silver exchange inventory levels, which have been increasing recently, are another issue to keep an eye on as rising inventory levels could also act as a constraint.

Positive view

However, overall, we are positive on the outlook for silver both in the short term and the medium term. With silver's price having fallen significantly in recent months, we believe a rebound is likely. A short-covering rally is also a possibility given the high level of short interest that exists at present. With gold poised for a rebound, we think silver is likely to ride gold's coattails higher if a recovery in precious metals takes place.

Source

1 Bloomberg, WisdomTree, 28 February 1990 to 21 September 2018.

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