

# The Hightower Report

## *Futures Analysis & Forecasting*

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## Special Report

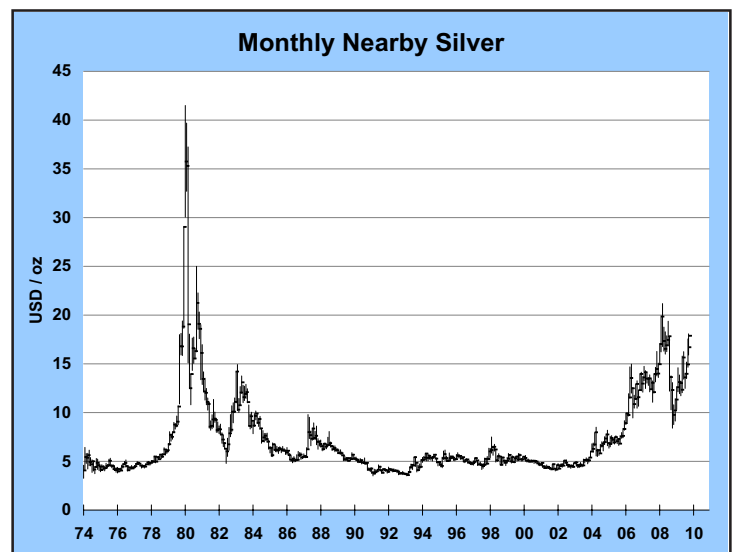
October 15, 2009

### The Silver Lining

#### Look to Silver to Capture the Next Leg up in Precious Metals Prices

With the US Federal Reserve backed into a corner by a mountain of toxic assets and soaring US deficit spending, the easy way out is to invite, foster and perhaps even beg for inflation. With the world currency markets, foreign central bankers and even US politicians seemingly willing to invite, foster and perhaps even beg for a significantly lower US Dollar, there would seem to be yet another historical inflationary building block in place.

Never in the history of modern trading have there been so many ways to invest in commodities, and record amounts of capital are already flowing aggressively toward them. We would suggest that the sub-prime crisis has also caused investors to diversify and that the allure of more traditional financial instruments and the attraction to real estate might remain damaged for years. That in turn seems to be increasing the flow of capital toward the metals and a host of physical commodity markets. In short, we see the interest in tangible hard assets continuing to soar, especially with inflation prospects and the action in the Dollar putting commodities on a very high pedestal.



With the US Federal Reserve taking great pains to communicate their intention to “leave historically low interest rates in place for a long period of time,” it will be a very interesting trick for the Fed to time the removal of the punch bowl at the exact time that the “party” manages to become self propagating. While some players might believe that the precious metals rally is already well into its move and that a top is nearing, we would suggest that several more months of rising unemployment and ongoing concerns for the

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commercial real estate threat should be enough for the Fed hold onto their guns and keep money loose even in the face of classic inflationary signals. Remember the Fed and the US Government need to see signs of sustainable growth. It's possible that real signs of inflation will be flashing warning signals well in advance of an improvement the jobs sector.

Since the Obama stimulus package was supposedly a long-term jobs creating tool and health care reform has been touted to be capable of producing 10 million jobs, one could suggest that little near term growth should be expected but that long term growth will be fantastic. However, given the amount and duration of global quantitative easing in place and the stubbornness of the UK and US job situation, one could also suggest that the US and UK will have to accept the greatest inflation risk of all.

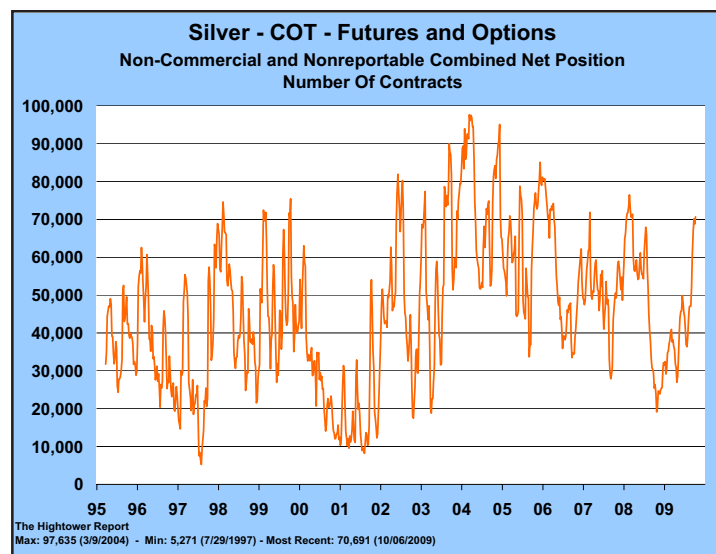
## More Gains in Precious Metals Ahead but Silver Might be Poised to Play Catch-Up

We should point out that gold has already exceeded the March 2008 highs by 4% or \$38.30/ounce, while silver has yet to do so. December silver recently made it to \$18.175 per ounce versus the March 2008 highs for nearby futures at \$21.185. This is well short of the all time high for cash silver, which was achieved in January of 1980 at \$48.00 per ounce!

With the gold market recently seeing record spec and fund long position readings in the weekly Commitment of Traders reports while forging a series of new all time highs, it is clear that gold has been the primary target of the initial wave of inflationary anticipation.

Using COT data going back to 1995, the net long position held by non-commercial traders (fund traders) in *silver* reached a record 72,657 contracts in December of 2007. As of October 6<sup>th</sup> this year the funds were net long only 51,758 contracts. The *combined* small and large trader net long position reached a peak of 97,635 contracts in March 2004. As of October this year the combined net long was just 70,691 contracts. This data suggests that there is capacity for more speculative buying to enter the market in the months just ahead.

In contrast, the combined speculative net long position for gold reached a record 307,942 contracts recently, exceeding the previous record by almost 40,000. This leaves gold in an overbought condition.



If the US dollar continues to push lower, more and more investors will be interested in holding hard assets instead of paper ones. This may be yet another reason to expect increased buy-and-hold investor interest in silver.

World demand for silver has exceeded the supply (mine production plus scrap) for most of the past two decades, as jewelry and industrial demand for silver has remained strong. As the world emerges from the recession, we would expect the silver to continue to show a production deficit, as mining

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is expensive and the 2008 collapse in prices for metals brought on by recessionary demand keep the production recovery even slower than the demand recovery.

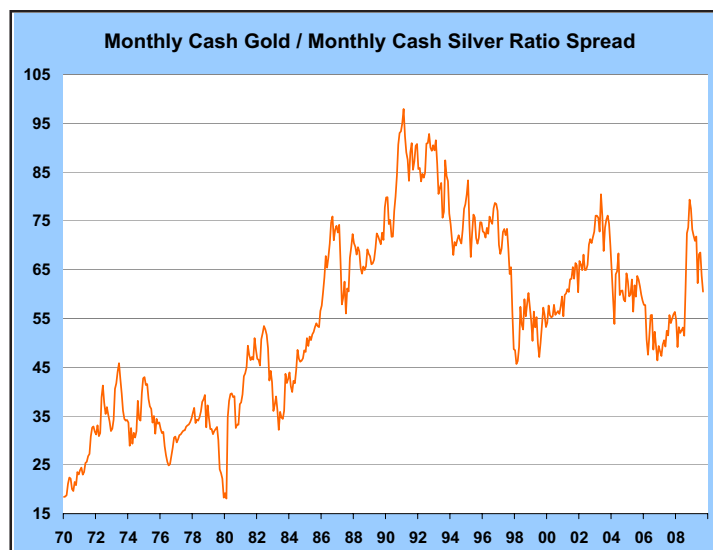
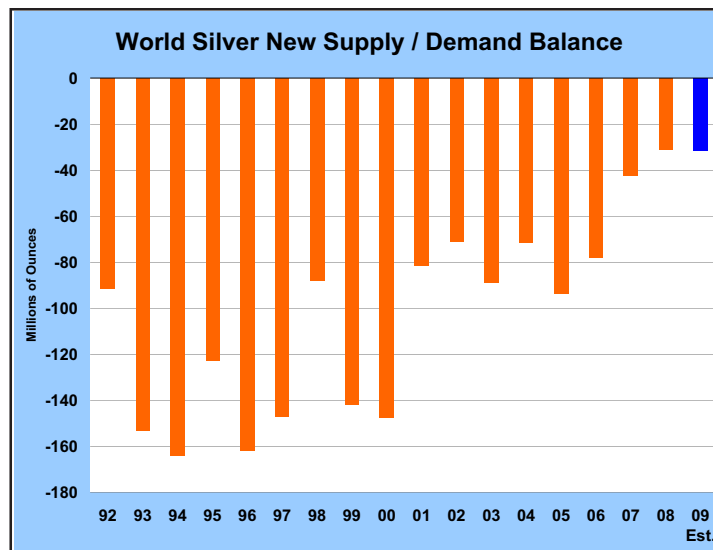
While gold has been the popular choice of investors as a hedge against inflation and against holding the US dollar or other paper currencies, the record high price may cause a shift to other assets such as silver, palladium, crude oil and even agricultural markets. Of these silver is likely to be the most popular, as a crumbling dollar and uncertainties in other commodity markets' supply and demand forces (weather, OPEC, political issues, etc.) may cause investors to lean towards a "keep it simple" approach.

While we think that silver is eventual going to start to play catch-up with gold, we also realize that gold remains the tip of the sword in the investment arena and that it could continue to lead silver for the months it might take for the U.S. and world economies to get back on solid turf. Therefore, we suspect that gold will continue to gain on silver until late this year, but once gold's premium to silver becomes extremely high again (perhaps 85:1 in the gold/silver ratio) or the economy shows real improvement, we would then expect silver to stop merely tracking upward with gold and instead begin to outdistance it on a daily basis. In our opinion, seeing silver begin to gain on gold consistently could be the signal that gold and silver prices have entered their final and most volatile period of the bull move.

## Strategy Over Opinion

It is our opinion that gold and silver prices are poised to move higher and that volatility is likely to expand significantly in the months ahead. Being right on the direction of a move in a commodity can sometimes be only half the battle. When asked where we think gold and silver prices will peak, we have little on which to base such an opinion. But we do think there is a continuing bullish environment that looks to have a significant amount of residual buying capacity in the wings.

The start and stop nature of the economic recovery and the highly uncertain nature of U.S. Fed policy decisions look to roil the markets in the ultimate "Inflation/No Inflation" inflection point ahead. The bull camp has a number of explosive arguments in their court, but to be fair there are also a numbers of potentially serious negative developments operating on the periphery.



In the bull camp there is historic easing, historic debt and, at least initially, the need for the Fed to hold rates low for longer than usual. In the bears' case there is the threat that the recovery will fail, that "inflation" might become "deflation" and that US regulators might spur increased speculation instead of taming it. While the trend and the fundamental bias appear to be pointing to even higher prices, the path might not be a straight line. Therefore, traders will have to be smart about in engineering the ride higher.

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While a simple approach may be just to buy and hold silver futures for the high leverage, keep in mind that commodity volatility has become very high in recent years and the right idea with the wrong timing might turn a good idea to a loss. As a result, we believe the best approach may be to buy silver futures, own a near-the-money put for protection and also sell an out-of-the-money call as a way to lessen the cost. The initial upside may be limited, but if the timing is off on your positioning, you could still be in a position to exit the call or even both of the options on a corrective break and hold the futures for the long run.

In our trade suggestions we show an example of this type of strategy, but we also include a bull call spread and a traditional long futures strategy.

## ***Suggested Trading Strategies:***

***1) Buy a March silver 17.75 put near 1.480 (\$7400). Once you are filled, buy a March silver futures contract at the market. (It should be near 17.96. \*) Also, sell a March silver 20.25 call at 0.880 (\$4,400).***

***2) Buy the March silver 19.50/22.00 bull call spread for 0.480 (\$2400). Risk the trade to 0.200 (\$1,000). If March silver futures trade to 22.00 after 90 days, the spread should be trading near 1.520 (\$7,600).\****

***3) Buy a December silver futures contract at 17.26 with objectives of 19.46 and 20.96. Risk to 16.62.***

**\*Options and/or relative futures values are based on pricing models and are not guaranteed.**

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