THE HIGHTOWER REPORT

Futures Analysis & Forecasting

SPECIAL REPORT

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Metals Market Update

Silver - A Return to Precious Status

While our bullish view toward silver is primarily rooted in its historically cheap price level, this argument is given added credence by the fact that positioning in silver as per the Commitments of Traders report has recently posted a series of record spec short readings. Positioning by swap dealers near the end of 2018 was also net short, which indicates even professional funds were bearish toward silver. Thus the market appears to have factored in a moderately bearish case going forward at a time when some big-picture internal forces are showing signs of change.

Recent studies by various metals market analysts have suggested that the entrenched global silver deficit pattern that has predominated since 2007 will expand. This is likely as production declines further and industrial demand increases from new and preexisting applications. Silver analysts for at least three major banks think lower production in 2019 is likely because of the low average price of $15.00 from 2018 has put pressure on miners that are reliant on silver-only production. (Fifty-seven percent of silver mine production is a byproduct of copper, lead and zinc mining.) To be fair, some industry groups think silver production will rise. Industrial usage accounts for more than 50% of total silver demand, so the ebb and flow of the global economy should continue to be a major force in determining prices.

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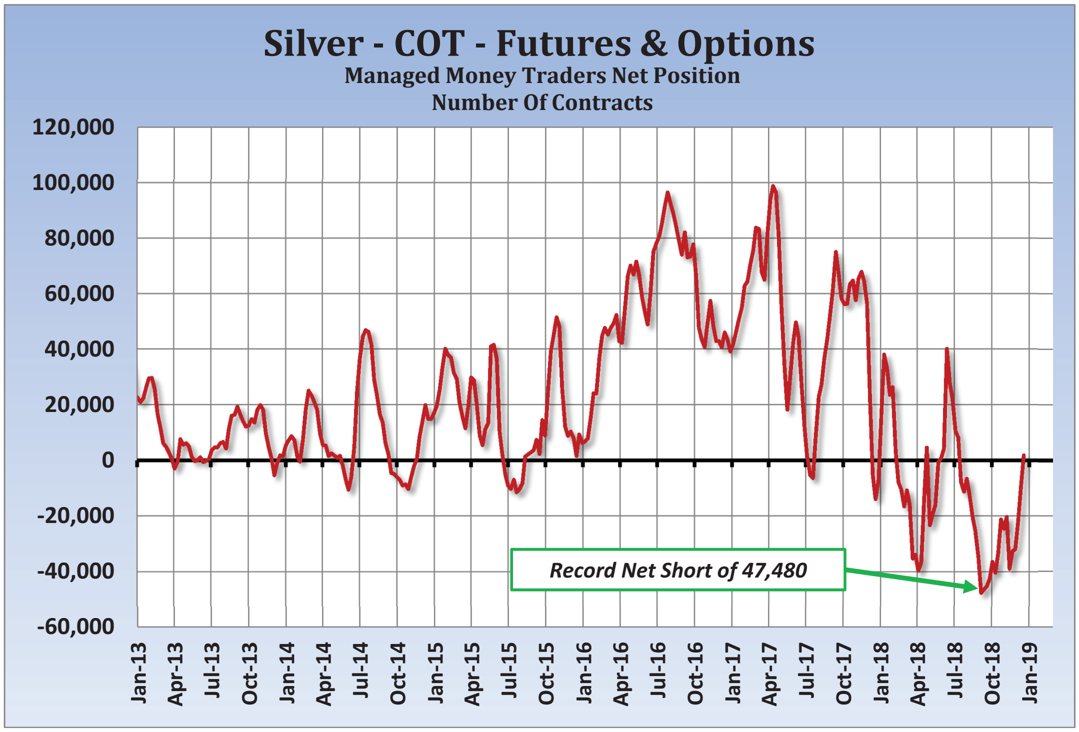
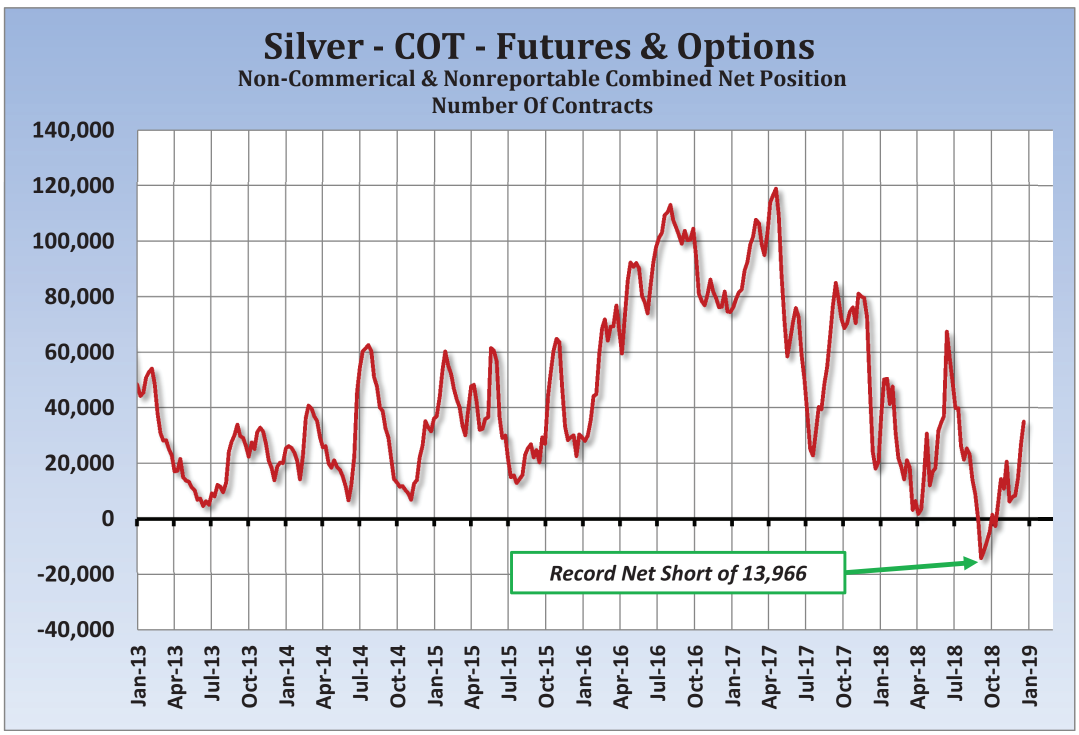
Outside Market Forces Turning in Favor of the Bull Camp?

It now appears that action in gold, palladium and the dollar are becoming sources of support for silver. Palladium has exploded to record highs, and although this was thought to be highly unlikely by a large portion of the market, the trade remains confident that supply tightness will continue to lift prices even higher.

Historically, gold has been the most influential force for silver, and it looks like it will be in a position to lead silver higher over the next few quarters. With the US Federal Reserve backing off from tightening, geopolitical uncertainty present in numerous situations, and signs that China and Russia are rotating central bank holdings away from US Treasury instruments, gold should get a lift from a number of forces. Even the dollar could become a positive force for metals, as it looks ready to turn lower after its 11% rally in 2018, especially if the US economy posts poor first-quarter growth results due to the trade conflict and the US Government shutdown. The dollar could spiral lower if the US economy slows and the Fed becomes patently dovish.



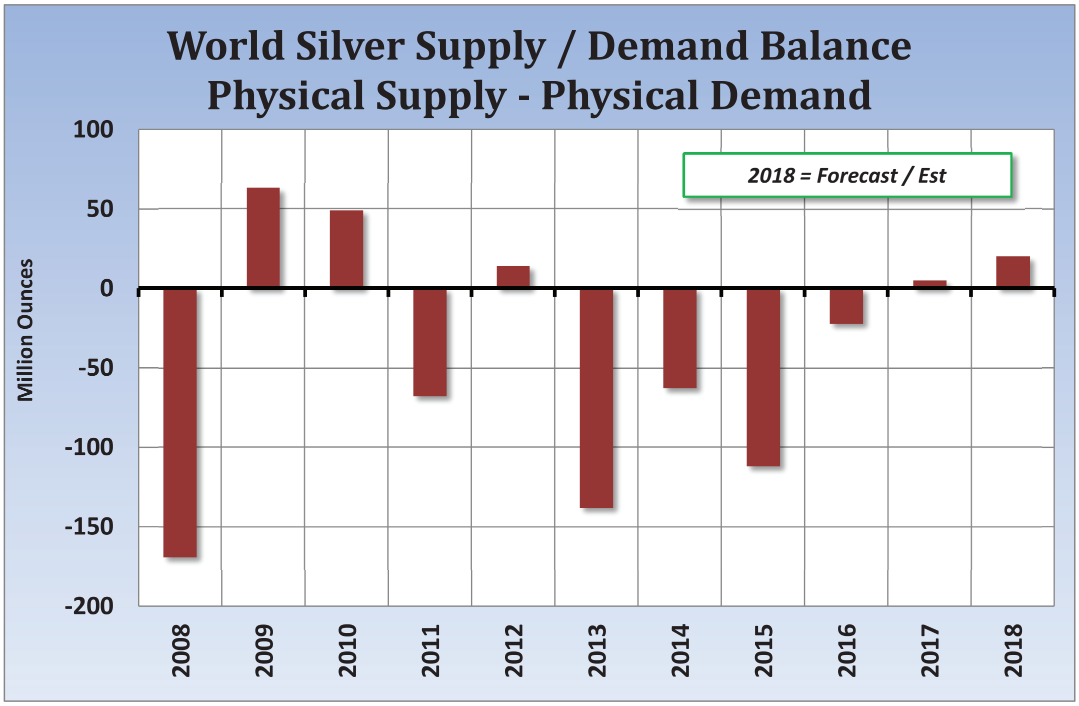


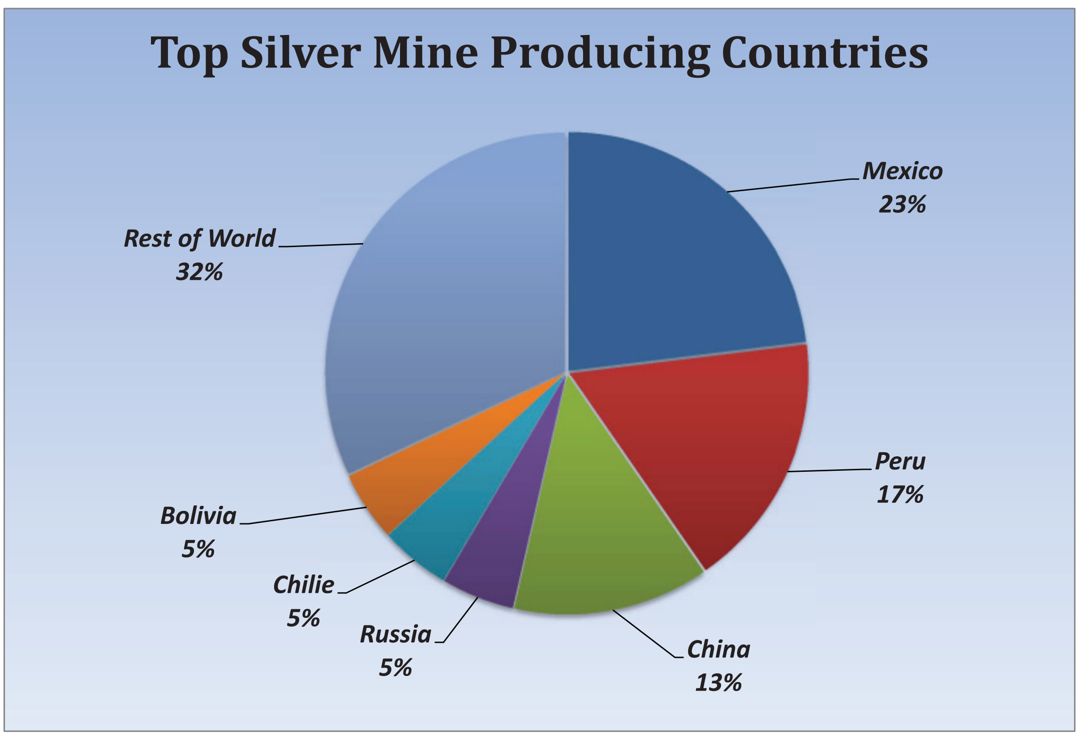
It is also possible that a solution to one or more of the major issues of trade, Brexit and the US Budget battle could yank a significant amount of safe-haven premium from the dollar. While some will argue that a decline in geopolitical safe haven conditions could trip up gold and silver, we think both markets will continue to take most of their direction from the currency markets.

Investment Demand Could Be Poised to Improve

Certainly the investment component of silver has been bearish over the last two years, with silver derivative holdings declining since the second quarter of 2017. Still, despite that decline, holdings are still 104 million ounces above their levels from February 2016 and 400 million ounces above their levels from 2008! We expect the silver market to see some revitalization in investment demand in the months ahead as a result of the developing bull stories in palladium and gold.

We highly doubt that inflation will be a catalyst for gains in silver prices, but we do think that an extension of the price appreciation rate from December will put the silver story in trade headlines. Still, it could take significant gains in





gold and palladium to stoke widespread investor interest in silver as an “alternative investment” to the much more expensive gold and palladium. Historically, seeing significant investment interest flow into a commodity is a sign of a mature and perhaps overdone bull market. From that perspective, silver would seem to have plenty of buying capacity in reserve. Another signal of investment interest returning would be if silver derivative holdings climbed above 617 million ounces.

Long-Term Trade Strategy

BUY a May Silver $16.00/$17.00 bull call spread at $0.29. Use an objective of $0.61 on the trade, and risk it to a close below $0.18.

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