SILVER OUTLOOK TO Q2 2021: A PHOENIX RISING FROM THE ASHES

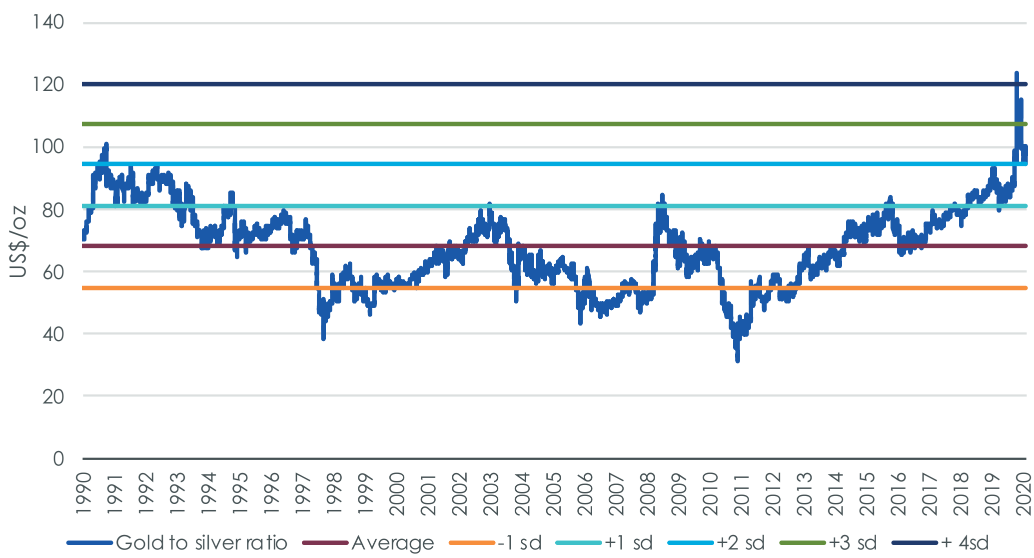
July 2020

According to our internal models[1], we expect silver prices to rise close to 30% in the year to Q2 2021[2], outpacing our gold forecast of 18% over that same time frame. It won't be enough to reset the relationship between the two metals back to 'normal' levels, but silver has clearly awoken after a period in dormancy.

SILVER IN H1 2020

After a period of underperformance relative to gold, silver is making a comeback. The gold-to-silver ratio (Figure 1) which had hit an all-time high in March 2020 at 123 (4 standards deviations above the average since 1990) has eased back to 95 (which is still 2 standards deviations above the average since 1990). We believe that silver will continue to play catch-up with gold but getting back to the historic average gold-to-silver ratio (of 68) is unlikely with headwinds from a poor industrial backdrop holding silver back.

FIGURE 1: GOLD TO SILVER RATIO



Source: WisdomTree, Bloomberg. 01/06/1990 to 14/07/2020. Data based on London Bullion Market Association PM prices. sd is the number of standard deviations away from the average.

Historical performance is not an indication of future performance and any investments may go down in value.

1 Based on our internal forecasts model

2 30th June 2020 to 30 June 2021

Looking at the 120-day rolling correlation between gold and silver (Figure 2), we observe that it is more than a standard deviation below the average of 82% since 2011, indicating silver has not been very responsive to the gains in gold we have had since the beginning of the COVID-19 crisis.

FIGURE 2: GOLD AND SILVER 120 DAY ROLLING CORRELATION

Source: WisdomTree, Bloomberg. 13/03/2011 to 14/07/2020. Data based on Bloomberg spot prices. sd is the number of standard deviations away from the average.

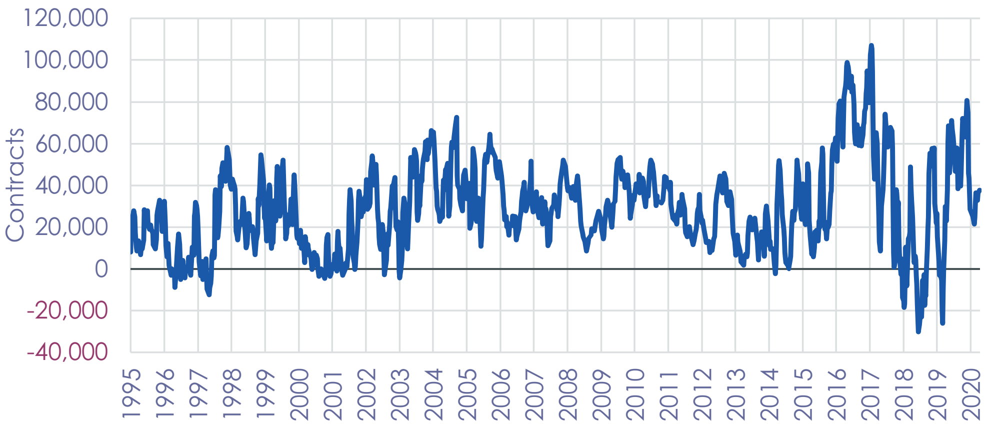
Historical performance is not an indication of future performance and any investments may go down in value.

While market positioning in silver futures (Figure 3) has been falling in 2020 (and the recent pick-up has not been that impressive), flows into silver exchange traded commodities (ETCs) have been at an unprecedented level (Figure 4). This apparent switch from COMEX[3] to ETC vehicles by institutional investors could be rooted in the issues experienced by COMEX in gold futures during the COVID-19 crisis, where obtaining the metal in the appropriate size had been difficult when flights were grounded. Although COMEX inventory of silver seemed plentiful, the exchange's ability to get hold of gold was compromised and investors may have migrated to physically backed ETC vehicles as a result.

---

[3] COMEX is the primary futures and options market for trading metals such as gold, silver, copper, and aluminium. Formerly known as the Commodity Exchange Inc.

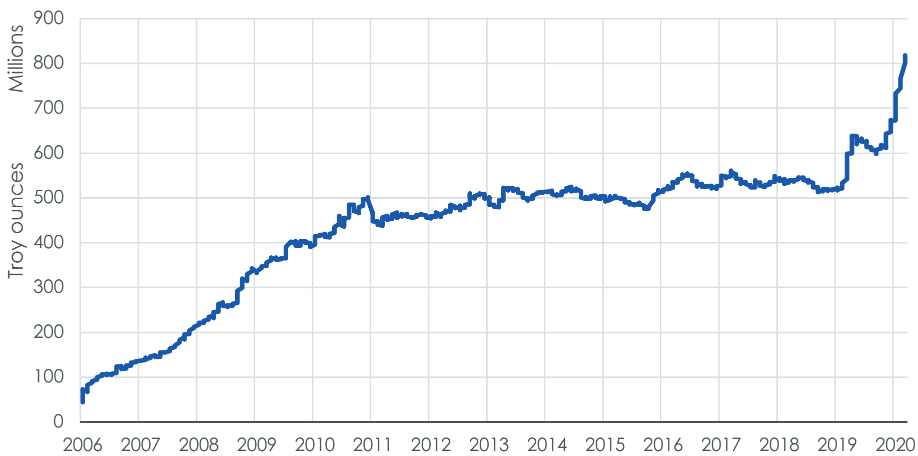
FIGURE 3: NET SPECULATIVE POSITIONING IN SILVER FUTURES



Source: WisdomTree, Bloomberg. 21/03/1995 to 14/07/2020.

Historical performance is not an indication of future performance and any investments may go down in value.

FIGURE 4: SILVER IN EXCHANGE TRADED PRODUCTS



Source: WisdomTree, Bloomberg. 28/04/2006 to 14/07/2020. Data based on Bloomberg spot prices.

Historical performance is not an indication of future performance and any investments may go down in value.

Framework

In "Gold and silver: similar, but different", we argued that silver's price performance is 80% correlated with gold. In our modelling framework, gold price is therefore the main driver of silver price. However, we also find the following variables as important drivers of silver price:

+ Growth in manufacturing activity – more than 50% of silver's use is in industrial applications (in contrast to gold where less than 10% comes from that sector). We use global manufacturing Purchasing Managers Index (PMI) as a proxy for industrial demand
+ Growth in silver inventory – rising inventories signal greater availability of the metal and hence is price negative. We use futures market exchange inventory as a proxy

+ Growth in mining capital investment (capex) – the more mines invest, the more potential supply we will see in the future. Thus, we take an 18-month lag on this variable. Given that most silver comes as a by-product of mining for other metals, we look at mining capex across the top 100 miners (not just monoline silver miners)

Gold outlook Q2 2021: On track to reach new highs

In Gold Outlook Q2 2021: On Track To Reach New Highs we laid out our forecasts under three scenarios.

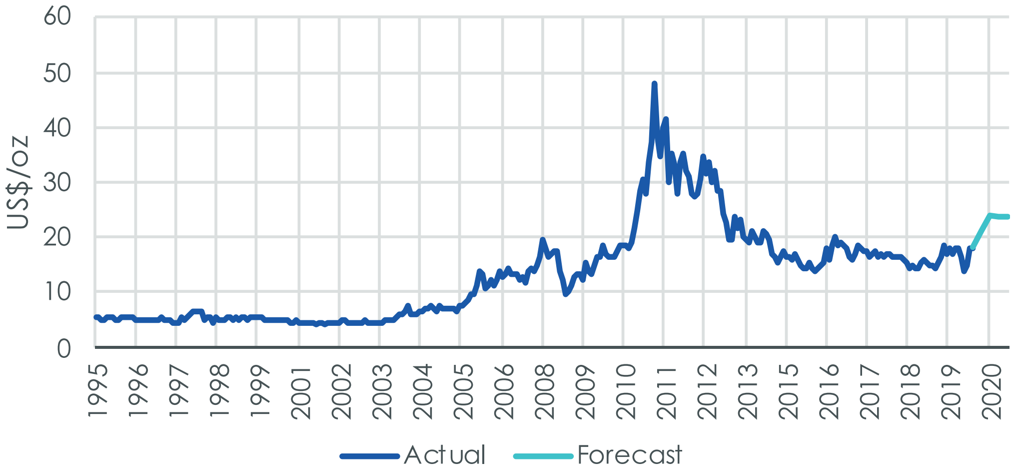
1. Consensus - based on consensus forecasts for all the macroeconomic inputs to our model and an assumption that investor sentiment towards gold remains flat at where it is today
2. U-Shaped – WisdomTree's base case, which is characterised by a U-shaped economic recovery
3. Bear – A V-shaped economic recovery with very little inflation

In our silver forecast we focus on the base case U-shaped economic recovery scenario where the gold price reaches US$2070/oz at the end of the forecast horizon and we pierce the previous all-time high reached in May 2011 (US$1900/oz) by the end of this year.

Silver forecasts

We believe in growth terms, silver could outpace gold. Despite being held back by weak industrial demand and rising inventory, silver could rise to US$23.56/oz by Q2 2021 (Figure 5), which is 24% higher than today (14/07/2020). It's not enough to bring the gold to silver ratio back to normal levels. In fact, it could still be close to a standard deviation above average. If our Q2 2021 gold forecast of US$2070/oz is right and the gold-to-silver ratio were to go back to normal, the silver price would be over US$30.00/oz. We don't think the ratio will go back to normal in the coming year given the weakness in industrial demand.

FIGURE 5: SILVER FORECAST

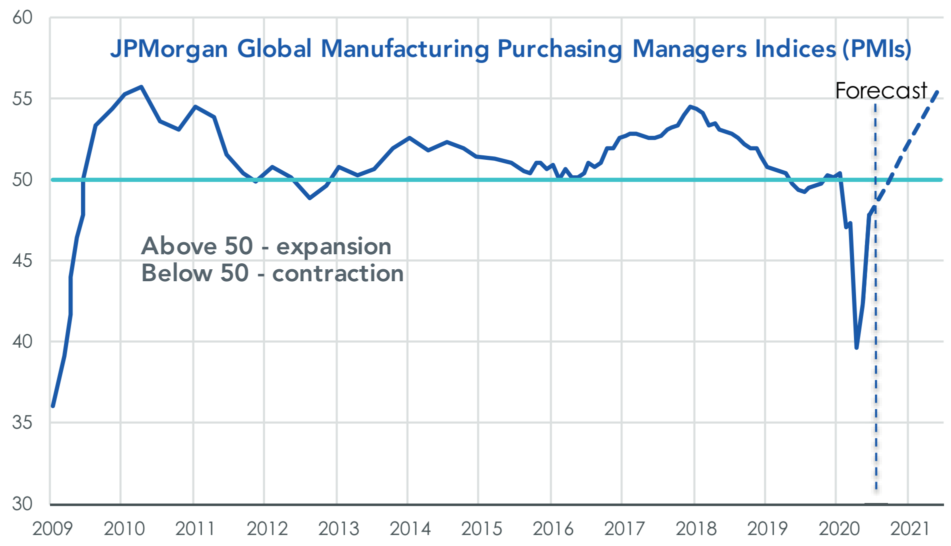


Source: WisdomTree (forecasts), Bloomberg (historic data), data available as of close 14 July 2020.
Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

Industrial demand to face a slow recovery

Manufacturing Purchasing Managers Indices (PMIs) have risen strongly in the past few months and the global index did not fall as deeply as it did in the depths of the Global Financial Crisis that started in 2008. That has taken us by surprise given the extent of damage to industrial production and supply chains. Given accelerating cases of COVID-19, we believe the pace of recovery in PMIs will slow. We are seeing lockdown measures being re-imposed in many cities/states across the world and the pace of easing lockdowns is decelerating in others.

FIGURE 6: GLOBAL PMIS



Source: WisdomTree, Bloomberg. 05/02/2009 to 14/07/2020.

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

Mining supply could expand

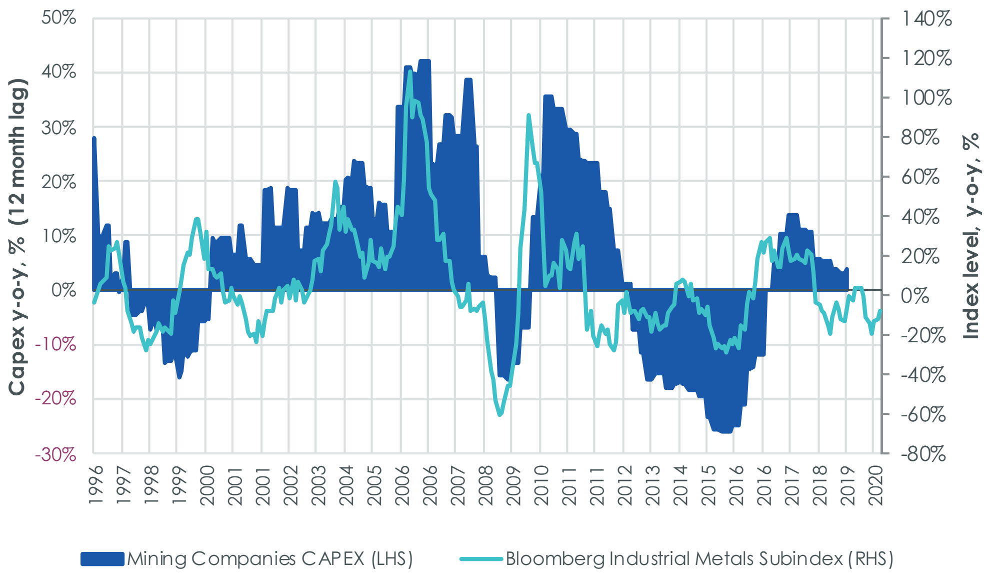
Mine supply of silver has been declining for four years. Declining ore grades at several large primary silver miners, lower silver production at copper mines and notable disruptions at major silver mines were the main drivers.

In our model framework, one of our proxies for supply – the amount of capital expenditure in mines – while having slowed down substantially in recent months, had been rising 18 months ago (Figure 7). In our model we apply an 18-month lag on this data to reflect the time it takes before an increase in capex turns into a material increase in supply. For now, as we live in the shadow of that rising capex, supply could take some of the potential price gains for silver away.

However, assessing the micro-situation, there is a case for mine supply to decline this year. Due to COVID-19, mining activity has been temporarily suspended in major silver producers including Mexico, Peru, Bolivia, and the Province of Quebec in Canada. Metals Focus, for example, are forecasting a 7.2% year-on-year (60.3 million oz) reduction in silver mine output as a result of COVID-19 disruptions, particularly in Peru and Mexico[4]. That could lead to a rare period of a market supply deficit in silver. So, while in our model framework we point to supply increases being a potential headwind, there is an upside risk to price if the COVID-19 related disruptions take place.

[4] Metals Focus Silver Five-Year Forecasting Quarterly July 2020. Metal Focus is a leading precious metals fundamentals research house and who create the supply and demand statistics for World Gold Council and the Silver Institute

FIGURE 7: MINERS CAPITAL EXPENDITURE GROWTH



Source: WisdomTree (forecasts), Bloomberg (historic data), data available as of close 14 July 2020

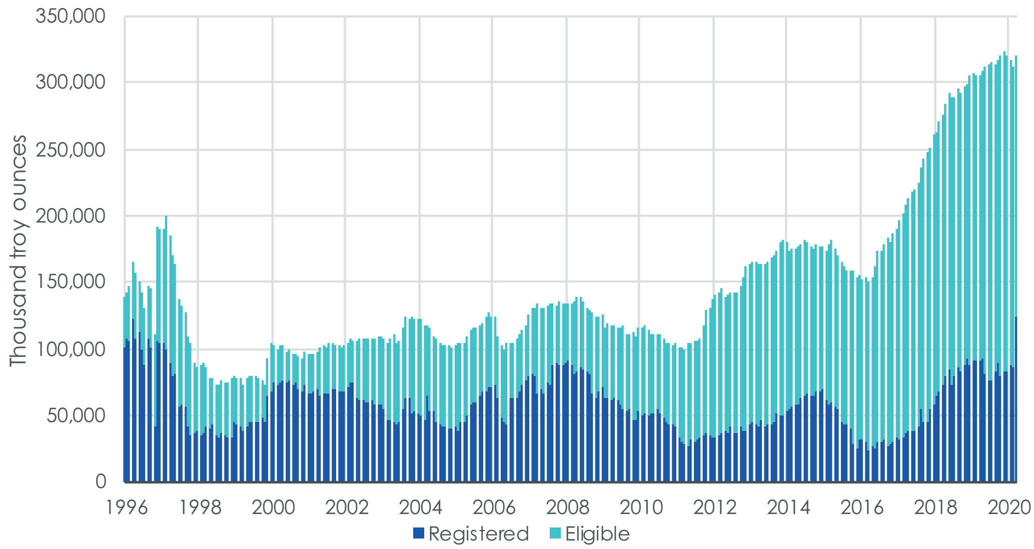
Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties

Silver exchange inventory rising at a slower rate

Turning to another supply indicator – silver inventory – we are handicapped by the poor data in global inventory and so we rely on futures exchange inventory as a proxy (Figure 8). Futures exchange inventory has been rising in the past few years. Although that is hard to square with the falling mine supply in recent years, it does help account for the relatively weak prices of silver. However, the pace of inventory growth has slowed considerably in 2020, we expect silver inventory growth to remain positive but considerably lower than in the past few years. The possibility of more silver ending up in vaults for ETCs rather than in COMEX vaults (if investor preference for the former continues) complicates the use of this indicator.

We should note that there is a distinction between registered and eligible inventory. Eligible means the metal meets exchange's requirements but has not been pledged as collateral against a futures market transaction. Registered means the metal meets requirements and has been pledged as collateral for futures market transactions. Eligible can easily be converted into registered, and that is why we look at the aggregate. However, most of the gains have come in the form of eligible rather than registered. That could simply be the choice of warehousing more in COMEX warehouses rather than other warehouses. Nevertheless, the greater source of visible inventory has had a price dampening impact on silver. We expect this to continue as a headwind against prices.

FIGURE 8: COMEX SILVER INVENTORY



Source: WisdomTree, Bloomberg. 30/01/1996 to 30/06/2020.

Historical performance is not an indication of future performance and any investments may go down in value.

CONCLUSION

Although silver faces some headwinds from declining industrial demand and potential supply increases, its correlation to gold should act as strong tailwind. While silver's correlation with gold has been poor in recent months, it does appear in the past few weeks that it is regaining. We could find that our assumption on supply increases based on the model's treatments of capital expenditure increases is misleading. Mine supply may in fact remain tighter due to COVID-19 restrictions. So, the risk for silver price could be to the upside.

IMPORTANT INFORMATION

Communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding current expectations or beliefs with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. However, back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance.