SILVER OUTLOOK TO Q3 2021: GOLD MEDAL FOR SILVER

October 2020

After lagging behind gold in the first half of 2020, silver prices started to accelerate in July 2020 and now silver has outpaced gold in year-to-date gains (28% silver, 22% gold in the year to 25 September 2020). However, both gold and silver have experienced a sharp decline since August 2020. As we indicated in Gold Outlook Q3 2021[1] , this drawdown is likely to be temporary and we see this as an attractive entry point for both metals.

According to our internal models[2], applying the "Continued economic uncertainty"[3] scenario to silver, we expect silver prices to rise close to 40% in the year to Q3 2021 (with silver rising to US$33/oz in Q3 2021 from US$23/oz on 25th September 2020). That would outpace our internal gold forecast of 30% (US$2410/oz in Q3 2021 from US$1865/oz on 25th September 2020) over that same time frame. In the race between gold and silver, we think silver is likely to 'win the gold medal'. The gold-to-silver ratio would decline to 73, which is only slightly above the long-term average of 68 since 1990 (and below the current ratio of 83).

SILVER REGAINS ITS MOJO

For a period of time, in H1 2020 silver was out of synch with gold. Even after the gold rally had been established for several months, silver prices had not lifted. But then in July, silver made up for lost time and accelerated. Figure 1 shows the gold to silver ratio had become extremely elevated earlier this year (more than 4 standard deviations[4] above average in March 2020) but now is only 1 standard deviation above average (and had briefly dipped back to average in August 2020).

Figure 2 highlights that the 120-day correlation between silver and gold is returning to normal after being particularly subdued. In fact, silver is behaving more as we expect it to: with a high gold beta (i.e. rises more than gold when gold is rising).

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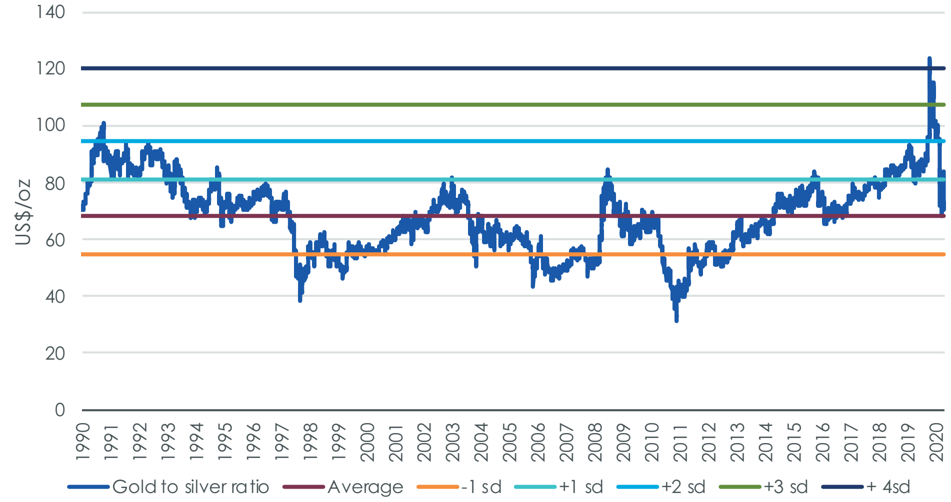
[1] See "Gold outlook Q3 2021: To regain lost ground and reach fresh highs"

[2] Based on our internal forecasts model

[3] See "Gold outlook Q3 2021: To regain lost ground and reach fresh highs"

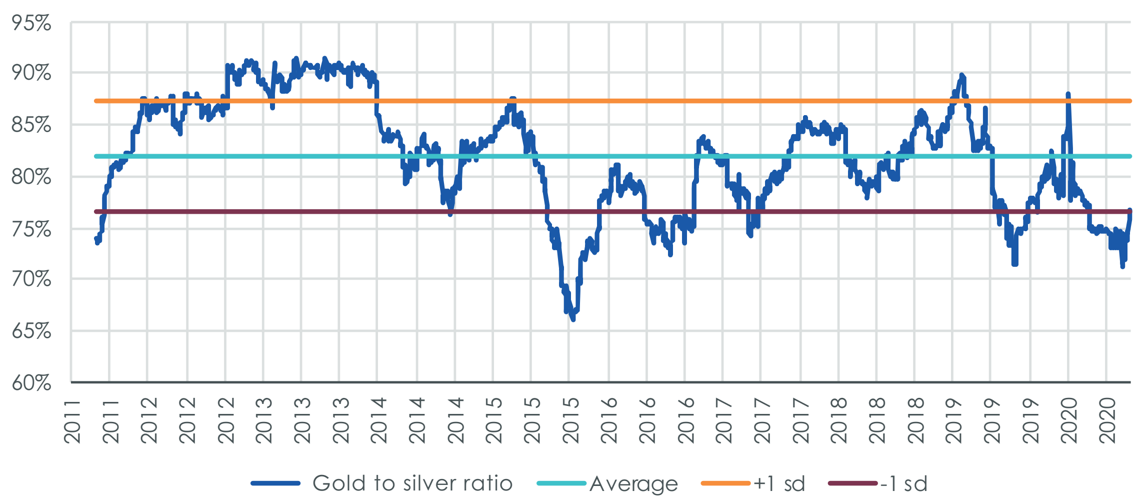
[4] Standard deviation is the amount of dispersion from the average

FIGURE 1: GOLD TO SILVER RATIO



Source: WisdomTree, Bloomberg. 01/06/1990 to 25/09/2020. 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.***

FIGURE 2: GOLD AND SILVER 120 DAY ROLLING CORRELATION



Source: WisdomTree, Bloomberg. 13/03/2011 to 25/09/2020. 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.***

Investors in silver exchange traded products (ETPs) have been very bullish this year, accumulating more silver than in any year since these products were available (Figure 3). There was strong buying when silver was under-priced relative to gold earlier in the year. However, that buying has slowed and in recent weeks we have seen some redemptions. This pull-back is unsurprising after a strong rally over the summer of 2020 as we expect tactical investors are likely to take some profit.

FIGURE 3: SILVER IN EXCHANGE TRADED PRODUCTS

Source: WisdomTree, Bloomberg. 28/04/2006 to 25/09/2020. Data based on Bloomberg spot prices.

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FRAMEWORK

In our blog, "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 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%[5] of silver's use is in industrial applications (in contrast to gold where less than 10%[6] 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)

5 Source: Silver Institute

6 Source: World Gold Council

GOLD OUTLOOK Q3 2021: TO REGAIN LOST GROUND AND REACH FRESH HIGHS

In our Gold outlook Q3 2021: To regain lost ground and reach fresh highs we laid out our forecasts under three scenarios.

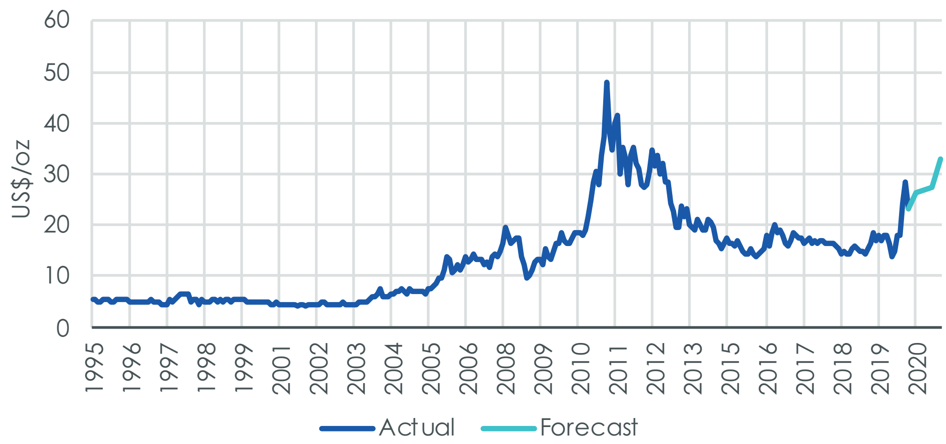
1. Consensus - based on consensus forecasts for all the macroeconomic inputs and an assumption that investor sentiment towards gold remains flat at where it is today
2. Continued economic uncertainty – Further monetary intervention – possibly through yield curve control – limits Treasury yields and the US dollar continues to weaken, while investor sentiment towards gold strengthens
3. Hawkish Fed – despite having adjusted its inflation target, the Federal Reserve (Fed) behaves hawkish and Treasury yields rise substantially, the US dollar appreciates back to where it was in May 2020 and inflation remains way below target. As US dollar debasement fears recede, positioning in gold futures declines.

In our silver forecast, we focus on the 'Continued economic uncertainty scenario' where according to our internal models the gold price reaches US$2410/oz at the end of the forecast horizon.

SILVER FORECASTS

We believe in growth terms, silver could outpace gold, reaching US$33/oz in Q3 2021 (Figure 4). We explain the other drivers to this forecast below.

FIGURE 4: SILVER FORECAST

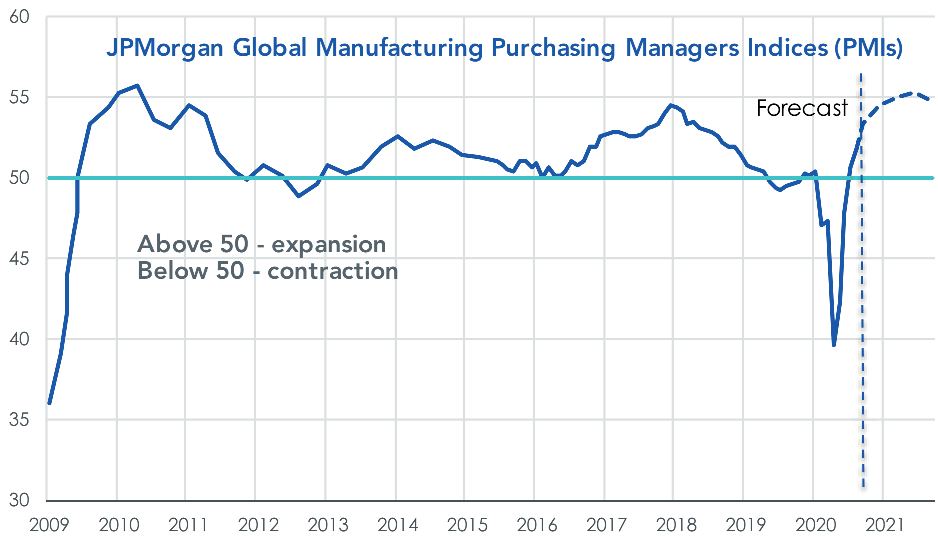


Source: WisdomTree (forecasts), Bloomberg (historic data), data available as of close 24 September 2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.***

INDUSTRIAL DEMAND TO CONTINUE TO RECOVER

Manufacturing Purchasing Managers Indices (PMIs) have risen strongly in the past few months and are now in the expansionary post-50 region (Figure 5). Coming from a period of tight lockdowns, it's unsurprising that the relative recovery from spring 2020 levels for the PMIs was strong as lockdown conditions eased. We expect the manufacturing recovery to continue. But as with most historic recoveries, the pace of rebound is likely to slow in coming months. However, peaking at over 55, the PMIs indicate plenty of industrial demand for silver to be expected.

FIGURE 5: GLOBAL PMIS

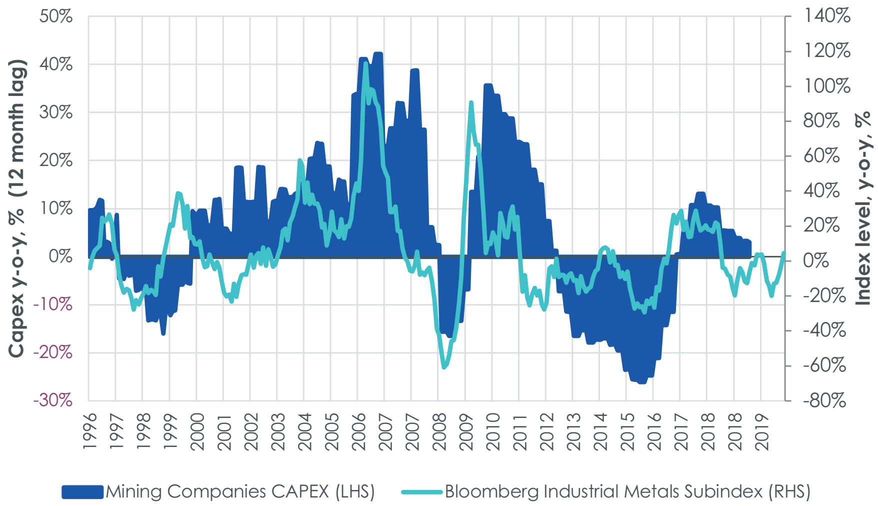


Source: WisdomTree, Bloomberg. 05/02/2009 to 24/09/2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.***

MINING SUPPLY COULD EXPAND IN 2021

Our model approach uses the capital expenditure in mines as a proxy for future silver supply. While capital expenditure growth has been positive (Figure 6), it has been decelerating and if its historic relationship with industrial metal prices continues, capital expenditure is likely to decline. However, given the lag that we apply to this input, the rising capital expenditure acts as a headwind for silver prices in our model approach.

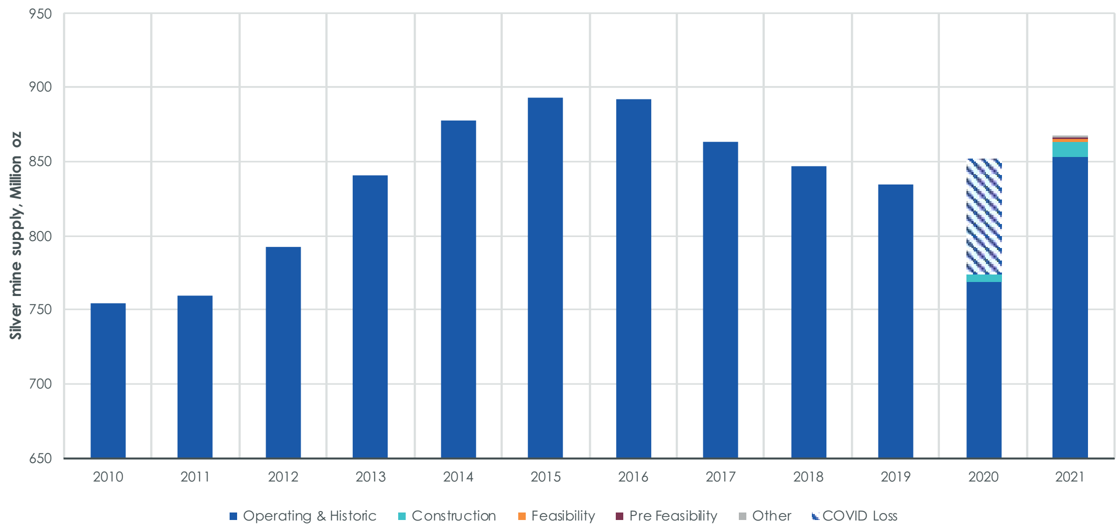
FIGURE 6: MINING CAPITAL EXPENDITURE



Source: WisdomTree (forecasts), Bloomberg (historic data), data available as of close 25 September 2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.***

We know that earlier this year many mines were unable to operate at full capacity due to social distancing and therefore silver mine production has been lower than it would have otherwise been. Figure 7 shows how much these COVID-19 related losses were estimated to be by Metals Focus. Assuming we don't see lockdowns reintroduced in 2021, we are very likely to see mine production of silver rebound.

FIGURE 7: SILVER MINE SUPPLY



Operating – mines that are currently operating, Construction – mine is being constructed, Feasibility – a detailed feasibility study has taken place, Pre-Feasibility – a preliminary feasibility study has taken place, COVID Loss – estimated loss of production due to virus. Source: Metals Focus. Forecasts from 2020.

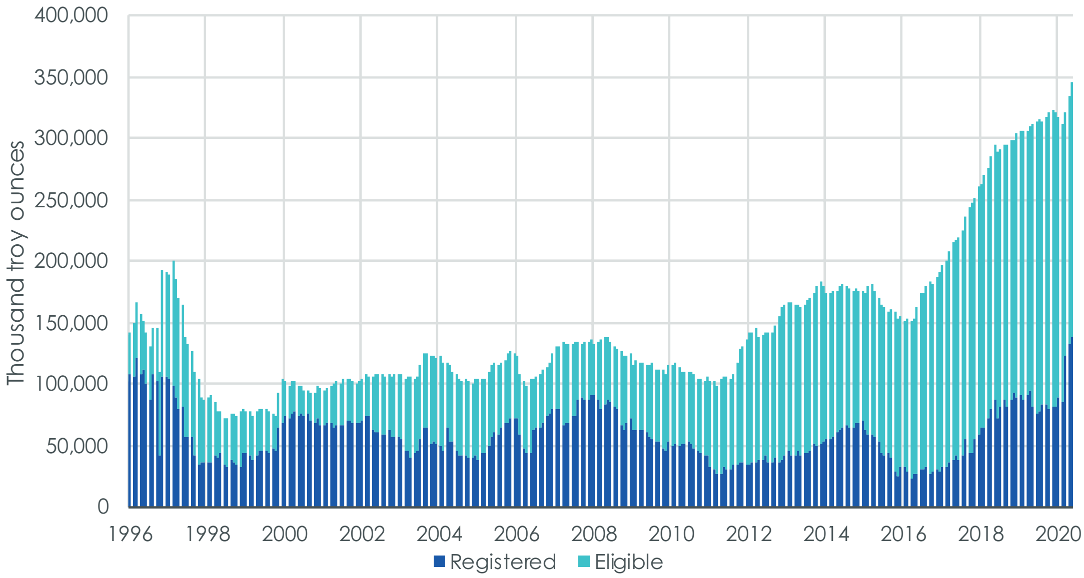
Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

SILVER EXCHANGE INVENTORY RISING AGAIN

Silver inventory in Comex warehouses took a dip earlier in 2020 as sourcing metal became difficult under COVID-19 related operational hurdles (including flying metal from refiners in Europe, which became very difficult during lockdown). However, the supply of silver at the futures exchange was always plentiful and did not experience as sharp a dislocation from the over-the-counter spot bullion market as gold did. In recent months silver inventory on exchange has resumed its upward trajectory. We expect this trend to continue, adding some headwinds to silver price.

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 in recent years 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 rising inventory to continue to have this effect in the future.

CHART 8: COMEX SILVER INVENTORY



Source: WisdomTree, Bloomberg. 30/01/1996 to 25/09/2020.Comex is a futures and options trading market, now owned by Chicago Mercantile Exchange. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Although silver faces some headwinds from potential supply increases, its correlation to gold should act as a strong tailwind. Silver has more than caught up with gold and its historic high gold-beta should continue to see it outperform gold when gold is rising. In addition, as industrial demand continues to improve, silver demand should rise. The metal benefits from both its cyclical and defensive qualities.

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