LBMA

Silver Investment 2021: Report

Chapter 1

- The strength in silver ETP and coin/bar demand that characterised last year carried over into early 2021.
- Net managed money futures have returned to growth this year after declining sharply in 2020.
- In contrast, silver mining equities have eased back this year (after enjoying a very strong 2020), while silver jewellery demand (a form of investment in many price sensitive markets) should achieve a strong recovery after being ravaged last year.

Introduction

In this note, some of the key developments in silver investment are assessed, principally this year, focussing on exchange-traded products (ETPs), coins and bars and the futures market. The demand figures in this report are taken from the Metals Focus Five-Year Silver Forecast. Final investment figures for 2020, and for all other areas of global silver supply and demand, will be available in the Silver Institute's World Silver Survey 2021, released on Thursday, 22 April 2021. For ETPs and coins and bars the spotlight will be on the social media buying frenzy, and the pressure this brought to bear on the supply chain. In the futures market, the analysis looks at the impact of the pandemic on the exchange for physical premium (EFP) and the potential for this dynamic to be repeated should another widespread lockdown emerge.

The past 12-18 months have witnessed some incredible developments in the silver investment market, including a dramatic improvement in investor activity. Looking at the combined value for ETPs, coin and bar demand and net managed money positioning offers some indication of how investment has fared. For 2020, this is estimated to have risen by around 20% to around $10bn, the second highest total recorded by Metals Focus over the past decade, and bettered only by 2012. Although the above figures do not include some key elements — such as futures trading in China or India, nor over-the-counter activity — they are still representative of the overall strength in silver investment last year.

Silver Investment[1]

[1] Combining annual changes in ETPs, annual coin and bar investment, and annual changes in net managed money positions; Source: Metals Focus, Five-Year Silver Forecast

The growth was especially strong in ETPs, followed by retail investment (coin and bar). The former rose by 331Moz last year, a record performance for silver ETPs, in the process breaking through one billion ounces for the first time. With regards to bar and coin demand, according to Metals Focus' estimates, this sector achieved a four-year high of over 200Moz.

In the futures market, early 2020 saw net managed money longs record more than three-year highs. However, the ensuing travel restrictions and their impact on EFP levels as the pandemic spread had a palpable impact on Comex futures positioning during late Q1/early Q2. Since then, net longs have been partially rebuilt but still remain below those late 2019/early 2020 levels. Silver mining equities also enjoyed a strong 2020, with the Solactive Global Silver Miners (SOLGLOSI) silver mining equity index rising by 44% intra-year, although it has since weakened by some 13% (through to end-March).

Finally, it is worth highlighting the role of silver jewellery, as this is often considered an investment in some parts of the world. This applies to low margin pieces that are sold by weight in price sensitive countries. Most important in this regard is the Indian market, which is comfortably the world's largest silver jewellery fabricator, and accounts for some 25% of the global total. In keeping with many other countries, Indian silver jewellery demand faced heavy losses in 2020 as a combination of the pandemic and record high Rupee silver prices weighed on the market. However, as lockdown restrictions ease considerably and disposable incomes start to improve, this should help generate a partial recovery in Indian demand.

Turning to early 2021, the growth in silver investment has undoubtedly carried over from last year. The much-publicised social media campaigns have translated into significant gains for silver ETPs and coin and bars demand. For the former, global holdings have risen by 77Moz this year through to end-March. Compared to annual changes over the 2010-20 period, this year has already achieved the fourth largest gain. Coin and bar demand is more difficult to judge given the ongoing and persistent weakness in India, although this has been comfortably offset by significant growth in the US — the world's largest silver coin and bar market.

Chapter 2 – Exchange Traded Products

- Silver exchange-traded products (ETPs) have been phenomenally successful in the silver market.
- 2020 witnessed the largest annual increase, of 331Moz; early 2021 has seen holdings achieve a record high of 1,207Moz in early February.
- Since 2006, more than 20 ETPs have been launched. In terms of ounces under management, the US is the most important market with 622Moz at end-March 2021, followed by Canada (198Moz), then the UK (134Moz).
- In terms of custodians, London is by far the most important centre, with 725Moz allocated at end-March, with a significant gap to Canada's 198Moz.
- Early 2021 saw an unprecedented 110Moz added in just three days. Although some liquidations emerged, there were concerns that London would run out of silver if ETP demand remained at a high level.

Introduction

Silver exchange-traded products (ETPs) have enjoyed phenomenal growth over the last year or so. This period saw two exceptional spells. March-July 2020 saw holdings rise by 302Moz, and in January-February 2021 holdings increased by 109Moz. In terms of the full year figures, global holdings in 2020 surged by a record 331Moz to a new high of 1.067 billion ounces. Last year's gain was also comfortably the highest achieved since silver ETPs first launched in 2006. Investor interest in ETPs has so far been exceptionally strong in 2021, with holdings of 1.18bn oz at end-February before easing slightly in March.

The success of silver ETPs largely reflects a dramatic upsurge in interest among retail investors, having become the dominant players in this field. Prior to the launch of ETPs in 2006, retail investors looking to acquire silver had largely been restricted to purchasing coin and bars, collectively defined as physical investment. This activity has also witnessed significant growth, and although not strictly comparable, cumulative demand during 2010-15 stood at 1.6bn oz. However, ETPs have attracted a large swathe of new buyers, including those active in the stock market who might not have previously bought precious metals. As a result, there appears to be little sign of an adverse impact on physical investment by the success of silver ETPs. Their popularity among retail investors contrasts sharply with gold ETPs, where institutional players are far more prevalent. This, in turn, helps explain quite different trends in gold and silver ETP holdings. Retail investors tend to adopt a 'buy and hold' mentality, whereas institutional holdings can be more volatile.

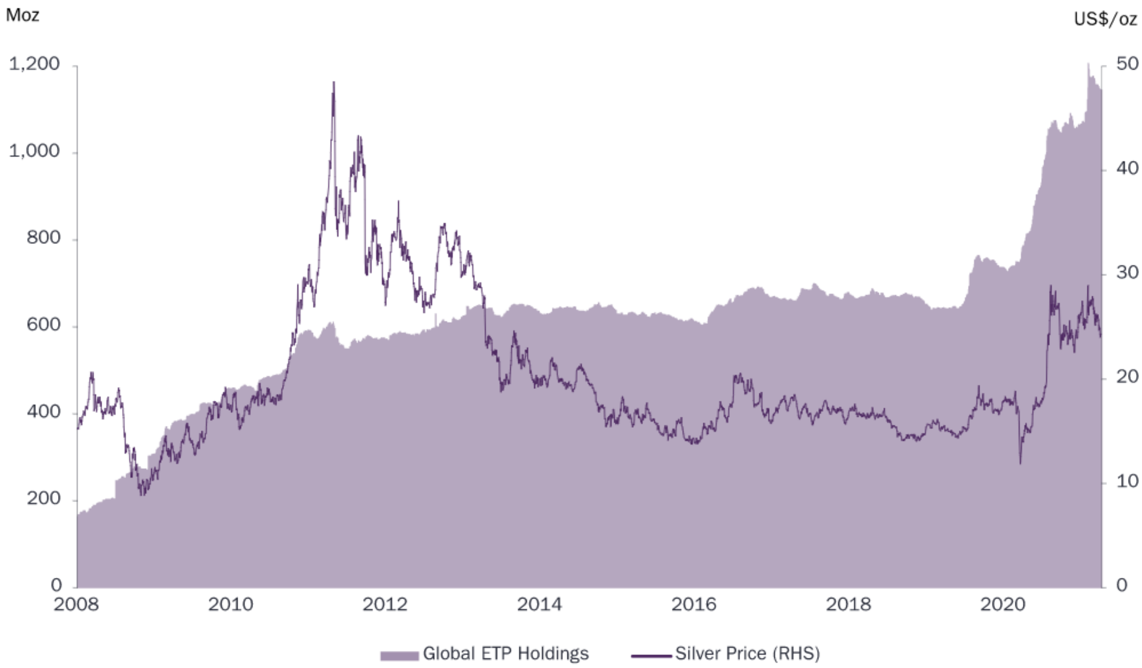
Principal ETPs

At present, there are some 20 physically-backed silver ETPs. In this section, we look at the largest products and the key issuers by location. The location often differs from where the silver is stored; for example, while the US is by far the largest market by silver ETP issuer, the UK comfortably dominates as the physical storage location of the related silver bullion.

The largest ETP, by some distance, is the US iShares Silver Trust. Launched in April 2006, and with 575Moz in trust as of end-March, this fund accounted for half of global silver ETP holdings. It is one of three products that are listed on the NYSE Arca – the other two are Aberdeen Standard products. The next most important location by issuer is Canada. Five ETPs are managed here, the two most prominent being the Sprott Physical Silver Trust (with 131Moz under management) and the Sprott Physical Gold and Silver Trust (holding 60Moz of silver). Both are listed on the NYSE Arca.

In Europe, the UK ranks third behind the US and Canada by issuer and is dominated by WisdomTree. The company manages a number of silver-backed ETPs, the most significant of which is the WisdomTree Physical Silver product, launched in 2007. At end-March 2021, this held 99m oz of silver. It is listed on six exchanges, including the LSE and TSX.

Global Silver ETP Demand



Source: Bloomberg, ETP issuers

Staying with Europe, Switzerland and Germany are also home to prominent silver ETPs. Most significant is Switzerland's ZKB Silver ETP, with 95Moz under trust. Introduced in 2007, this product is one of three ETPs that are traded on the SIX Swiss Exchange. In Germany, the Xtrackers Physical Silver ETC EUR is the largest of three silver ETPs based there. The fund holds 53Moz of silver and trades on XETRA.

Together, these five countries account for nearly all silver ETP issues. Just 1% is apportioned elsewhere, with one ETP listed in each of Australia, Turkey and Japan, for a combined total of just 14Moz under management.

ETP Holdings, by Issuer Location

Moz, end-period	2019	2020	Mar-21
US	392.5	600.1	621.9
Canada	122.5	157.4	197.5
UK	79.7	122.8	134.2
Switzerland	100.0	110.2	111.7
Germany	34.3	64.3	64.6
Other	6.7	12.1	14.2
Global Total	**735.7**	**1,066.8**	**1,144.2**

Source: Bloomberg, ETP issuers

ETP Custodians

The country where the ETPs are based, or indeed listed, and where the physical silver bullion is held can often vary. This year, the location of the custodial vaults has come into sharper focus as ETP demand has jumped, leading to concerns about the potential availability of metal.

The most important location for storing physical silver in respect of ETP funds has always been London, although its dominance has grown noticeably over the past 12-14 months. At end-2019, silver allocated in the UK accounted for 55% of the global total. By end-March 2021, this had risen to 63%. While most silver ETPs have benefited from growing interest over the past 5-6 years, most significant was the surge in buying of the US iShares Silver Trust product, much of which is actually vaulted in London.

At end-March 2021, 725Moz was held on behalf of ten ETP funds in LBMA-approved vaults. The largest of these, the iShares Shares Trust, had 472Moz held by its custodian J.P. Morgan in UK vaults, followed by WisdomTree, with 101Moz stored by its custodian HSBC, also in London. In the US, the iShares Silver Trust has a further 103Moz stored in J.P. Morgan's Comex approved depository and is the only silver ETP to be vaulted in the US. Staying with North America, vaulted ETP holdings in Canada far exceed those of its neighbour. At end-March, physical silver held on behalf of five ETPs totalled 198Moz, the most significant of which is Sprott Physical Silver Trust, with 131Moz, stored with the Royal Canadian Mint. Elsewhere, Switzerland is home to 112Moz of allocated ETP silver, the majority of which is the ZKB Silver ETP with 95Moz.

ETP Holdings, by Custodian Location

Moz, end-period	2019	2020	Mar-21
UK	407.2	690.4	724.8
Canada	122.5	157.4	197.5
Switzerland	100.0	110.2	111.7
US	103.2	103.2	103.2
Other	2.9	5.6	7.1
Global Total	**735.7**	**1,066.8**	**1,144.2**

Source: Bloomberg, ETP issuers

Above-Ground Stocks of Silver

As touched on above, the recent jump in ETP demand has led to fears as to whether there are sufficient above-ground bullion stocks, should ETP holdings see a further sharp increase.

The first point to note is that there is a gulf between the total of silver above- ground stocks and the portion which can be quickly allocated against ETPs. In terms of the former, while it is extremely difficult to estimate the scale of above-ground stocks, a useful starting point is to look at cumulative silver mine production. As of end-2020, this was estimated at 59bn ounces. However, the stock that is held in fabricated silver products, including bars and coins, will be considerably smaller. This reflects the large scale of losses across a range of industrial and photographic products. For example, solar demand consumes around 100Moz/year, but very little of this material is recycled.

Even though above-ground stocks are difficult to pin down, there is no doubt that bullion stocks account for a small share of the total. At end-2020, identifiable holdings held in London, Comex and Chinese approved vaults, stood at a combined 1,694Moz. Furthermore, cumulative physical investment throughout 2010- 20 stood at 2.4bn oz. As a reminder, ETPs at end-March were 1,144Moz, making up 63% of the combined total. Although these stocks have been rising over time – for example at end-2017, they stood at 1,433Moz – the 18% increase over the past four years appears modest. However, is worth noting the strength of silver demand over much of this period. In particular, Indian imports have at times ramped up, with a combined 120Moz shipped from London to India during 2018-19 alone. Before looking at how much silver might be available for new ETP demand, one must consider where this silver is held.

Breaking down Identifiable Silver stocks

Looking first at bullion held in London, LBMA published that at end-March 2021, London vaults held a combined total of 1,249Moz. Some 58% of this metal was allocated against silver ETPs. This is a remarkable change in a relatively short period. At end-2019, London vaults held 1,162Moz, with just 35% of this silver earmarked against ETPs.

Total LBMA Silver Vault Holdings vs Silver Allocated to ETPs in London

Source: LBMA, ETP issuers

Looking at Comex-approved stocks, combined registered and eligible holdings stood at a near record high of 393Moz at end-February. Of this, 26% is understood to have been allocated against the iShares product. At end-2019, 318Moz of silver was held in Comex warehouse vaults, with 32% of this metal earmarked against the ETP.

Elsewhere, the most sizeable silver bullion stocks are held in China, on the Shanghai Gold Exchange (SGE) and Shanghai Futures Exchange (SHFE). At end-2020, their respective holdings stood at 130Moz and 89Moz. This represented a significant increased from the previous year, with combined holdings across both exchanges jumping by some 65Moz. None of this silver is related to ETP holdings.

Excluding these three markets, silver bullion stocks that exist elsewhere and are in a deliverable form (specifically LBMA or COMEX Good Delivery compliant) appear extremely modest. In India, for example, a number of bonded warehouses hold Good Delivery silver bars, but this is for sale into the local market. On occasions when Indian demand weakens significantly, these bars can be shipped back to London, but this is quite rare. There is little visibility on the amount of silver held in Switzerland, aside from the 110Moz allocated to ETPs, but the total is thought to be modest.

The Implications of Another Surge in ETP Demand

Global ETP holdings hit a record high of 1,207Moz on February 2, 2021. As impressive as this may appear, it does not tell the whole story. As the social media frenzy gathered pace in late January, demand for coins, bars and ETPs all jumped. For the latter, global holdings surged by 119Moz in just three days. This was concentrated in the iShares fund, where holdings rose by 110Moz. Given that most of this metal was allocated in London, fears emerged as to whether there was enough silver should demand continue at this pace.

At end-February 2021, 765Moz was allocated in London against ETPs, leaving 360Moz of potentially available metal. This suggests that had demand in iShares continued at the frenetic rate of late-January/early February it would only have been a matter of weeks before London's existing stock was used up. While it would have been surprising to see ETP demand maintain this pace of buying, the concerns were still very real. This reflects both the time required for a refinery to convert non-Good Delivery (GDL) material into 1,000oz bars approved by LBMA as Good Delivery and then delivery of this by sea freight into London.

Another way to view this is to look at combined Comex/LBMA holdings, which at end-February were 1,518Moz. ETPs vaulted in these locations stood at 880Moz, which meant that 42%, or 638Moz, was in theory immediately available to meet new silver ETP demand. However, it is not that straightforward. This does not take into account any challenges in moving metal between London vaults, nor any hurdles in being able to ramp-up ETP allocations on Comex, versus London. It does suggest that the pool of available metal should be sufficient, for the foreseeable future at least, to meet new ETP demand. This also pre-supposes there is no repeat of the social media frenzy. Should this occur, higher prices would almost certainly be triggered, which would be met by heavy selling.

As a final observation, it is worth remembering that even though silver ETP holdings are typically quite sticky, liquidations do emerge. In the wake of the early February jump in demand, some selling did materialise, perhaps taking advantage of the silver price briefly surpassing $30 for the first time in eight years. As a result, over the rest of the month, global holdings fell by a net 31Moz.

Chapter 3 – Retail Investment

- Retail investment in silver (coins and bar demand) continued its recovery last year after falling to historic lows during 2017-18.
- The sector then burst into life this year, initially as a social media buying frenzy emerged.
- However, the industry was quickly beset with product shortages, in part due to logistical restrictions, because of the pandemic, in being able to move coins and bars between locations.
- While social media discussions have abated, silver coin and bar demand has remained extremely strong, especially in the US.
- This upside has offset weakness in India where investor liquidations have continued.
- The ongoing strength in the US coin and bar market, which also reflects some supply issues, has seen product delivery lead times become extended and premiums remain elevated.

Introduction

Global retail investment in silver coins and bars in 2020 is estimated to have exceeded 200Moz for the first time in four years. This was the result of higher demand in the US and Germany, while purchases in India weakened sharply. This year, it is hardly surprising to suggest that further gains are likely given how demand has already surged, principally in the US, but also in other industrialised countries. This chapter unpacks the recent, if short-lived, social media phenomenon surrounding silver that emerged in the US in late-January this year and what legacy, if any, it leaves behind. It also takes a deeper look into retail buying to understand some of the motivations for buying bars and coins and asking what drives these purchases.

Key Markets and Buying Motives

Over the past decade, the US has been the largest retail investment market in all but two years (2018-19), when purchases fell sharply. Prior to that, however, the past decade had witnessed a dramatic surge in US buying, which had risen from 95Moz to a record total of 123Moz in 2015. To some extent this reflected the impact of weak silver prices at that time, combined with occasional rising price volatility.

From mid-2011 onwards, as prices weakened and volatility rose, there was a pronounced impact on silver bar and coin demand. Although few retail investors expected to see a return to the dramatic price highs of 2011-12 — when silver initially broke through $50 and then, after it had weakened, it subsequently made several attempts to regain the $45 level, all of which were unsuccessful — significantly weaker prices led to frequent bouts of retail bargain hunting. During these periods it was quite common for product shortages to emerge, especially of the US Mint's silver Eagle bullion coin. By contrast, during 2017-19 US retail demand weakened significantly, as some believed that the economy would be prudently managed with a Republican in the Whitehouse.

During 2018-19, India occupied top spot, with retail investment in each year exceeding 50Moz. However, these pale against its performance during 2014-15, when Indian silver bar and coin demand surpassed 100Moz. In general, Indian demand has typically benefited from strong silver price expectations, with many viewing silver as being undervalued. This has often led to a surge in investment when prices have fallen. In addition, the past few years have seen a gradual shift away from gold and in favour of silver as the Indian government has clamped down on unaccounted money.

Drilling down further, there are broadly three types of consumers who buy silver in India. First, there are high net worth individuals who tend to purchase large silver bars, such as 5kg, 15kg and 30kg bars. Second, there is a large section of consumers and investors who buy small-minted bars, with inscriptions and images of gods and goddesses. These bars are either bought for investments, gifting or for rituals. Finally, there are small investors who buy 500g-1kg cast bars.

Last year India was the only key retail investment market to see weaker demand. A combination of the pandemic, which hit disposable incomes, and record high Rupee silver prices which saw liquidations emerge; a trend that has carried over into 2021.

Germany completes the top-three listing and has only emerged as a prominent market for silver bars and coins over the past two years. This is surprising because these products attract VAT, as bars stored in a bonded warehouse will attract VAT if the product is withdrawn for delivery. For EU-fabricated products this stands at 20%. However, for non-EU pieces a margin tax is applied, with the 20% VAT only charged on the coin or bar premium. In general, these products are distributed through the same retail networks as for gold and so appeal to German investors looking for a safe haven option. And despite silver attracting VAT, retail investors still prefer coins and bars to paper silver products, pointing to genuine interest in retail metal.

The Social Media Storm

The events of late January/early February this year have almost become folklore in the silver market. It is worth recalling how this emerged and its impact on retail buying even after the social media storm faded.

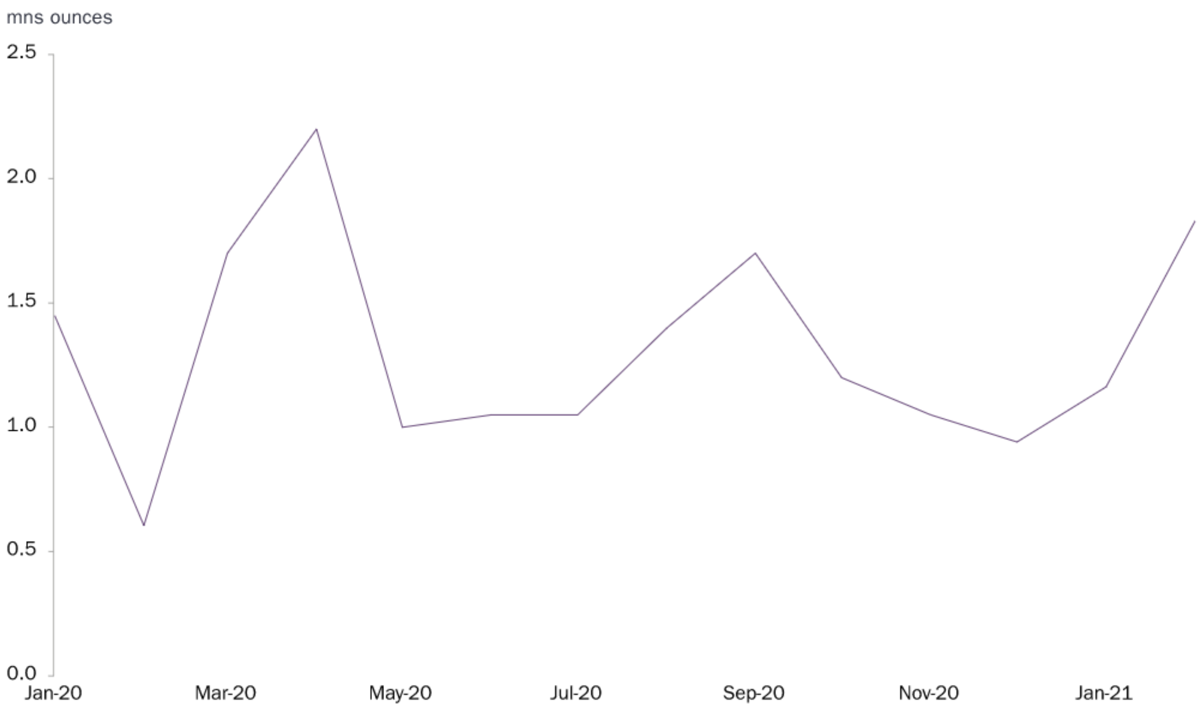
When the Reddit-inspired focus on GameStop in the US emerged there was initially no indication it would spill over into silver. Retail investors believed GameStop was undervalued, citing massive short positions held by hedge funds as evidence that its share price was being suppressed. Users of Reddit and other social media platforms argued that if sufficient investors bought the stock and could drive up its share price this would force shorts to be covered, and so drive up the price. The strategy was incredibly successful, sending the price from less than $20 in mid-January to a peak of $483 in just one and a half weeks. Although some of these gains were unsustainable, at end-March GameStop shares were still trading at around $190.

[2] according to the Metals Focus Five Year Silver Forecast; final 2020 data will be published in the Silver Institute's World Silver Survey 2021 on April 22, 2021.

Buoyed by this success, social media discussions soon focused on silver, and in particular long-held conspiracies that financial institutions were holding significant short positions. For many, the resemblance to GameStop was all-too apparent, albeit erroneous. Buying of silver bars, coins and exchange-traded products (ETPs) quickly ramped up. This chapter focuses on the first two, with ETPs already covered in Chapter 2 – Exchange Traded Products.

However, it was not long before product shortages started to emerge. This was largely predictable for several reasons. First, flight restrictions meant it was often difficult to quickly move coins and bars to where they were needed. Second, many dealer stocks were quickly depleted. In the US, silver retail demand in January had been relatively quiet, in contrast to gold, and so for some dealers the focus was on securing gold bars and coins. A related point is the limitation on how much product some dealers can hold, given that this requires financing. In other words, if poorly selling stock is held for too long, the cost of financing this inventory can quickly eat into the premium, making any subsequent sale to retail investors unprofitable.

Perth Mint Coin and Bar Sales



Source: Perth Mint

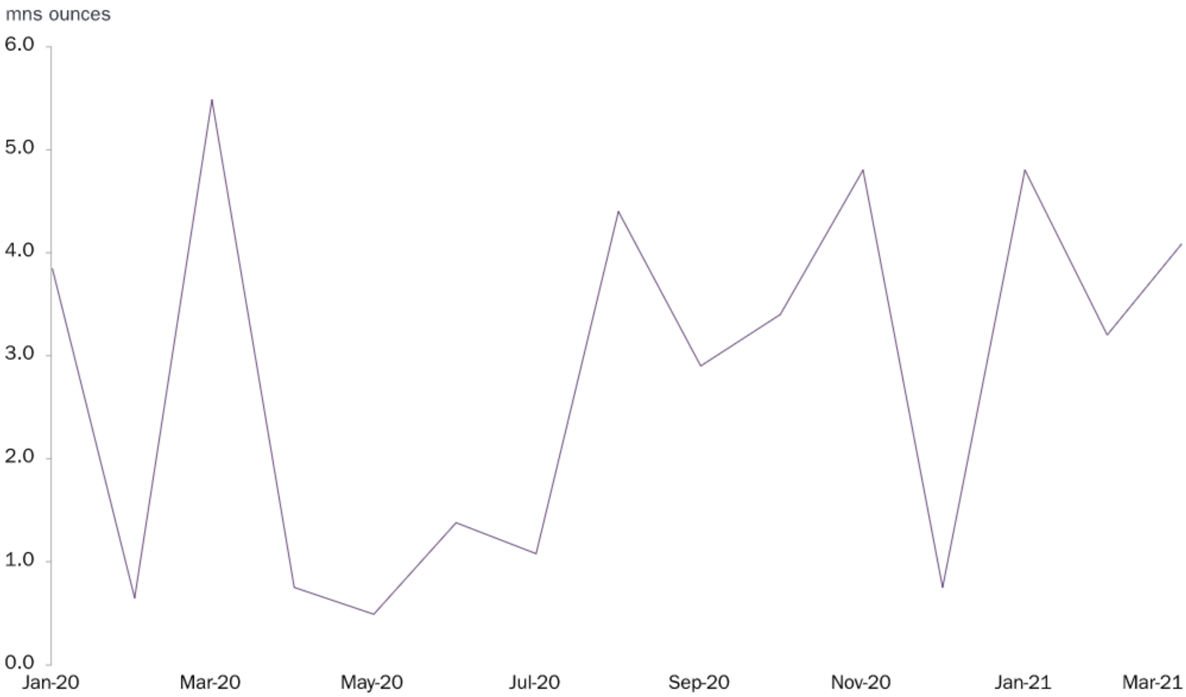
Although the silver price achieved a six-year high of $30.10, the social media frenzy quickly faded – dynamics in the silver market are quite different to those behind the GameStop trade. In essence, there were no massive short positions in silver to force out. Furthermore, GameStop's market capitalisation was small prior to the buying spree, at a little over US$1bn, compared to the value of global silver ETP holdings at end-2020 of over $28bn as just one example of silver investment.

This was by no means the end for silver retail demand. As the social media frenzy was picked up by the mainstream media, silver benefited from widespread news coverage, particularly in the US. Importantly, the rationale for a 'short squeeze' appears to have carried little weight. Instead, concerns about the Biden administration and especially its stimulus measures were reported to have resonated with retail buyers.

As dealer inventories were depleted the emphasis shifted to silver coin and bar manufacturers. Although many fabricators quickly ramped up production, three issues emerged. First, social distancing and other lockdown restrictions affected how much they could respond to the jump in demand. Second, the increase in retail sales was so great that delivery lead times grew. These factors added to concerns about a shortage of silver, which further boosted sales. Finally, the US Mint will switch this year to a new design for the gold and silver Eagle coins (the Buffalo and platinum Eagle are unaffected). Although the launch date is still to be confirmed the US Mint will now switch production over to the new design and therefore scale back minting of the current

Eagles. Given that the US Mint dominates retail precious metals demand in the US this change is already having a pronounced effect on the market.

US Mint Silver Eagle Coin Sales



Source: US Mint

As a result, February and March 2021 have seen retail silver investment demand remain exceptionally strong in the US. That said, demand can be quite volatile, so it is difficult to predict if this upside will continue and for how long. One positive development later this year will be the launch of the new Eagle coins, which should generate considerable interest among US retail investors and collectors.

Chapter 4 – Futures Trading

- Early 2020 saw net managed silver positions strengthen, building on the positive investor sentiment which had emerged during late-2019.
- On 18th February, they rose to 330Moz, their highest since September 2017.
- As the EFP crisis unfolded net positions slumped to just 52Moz by early May, their lowest since June 2019.
- For a brief period, the silver EFP jumped to over 65 cents from a more normal level of 1-10 cents.

Introduction

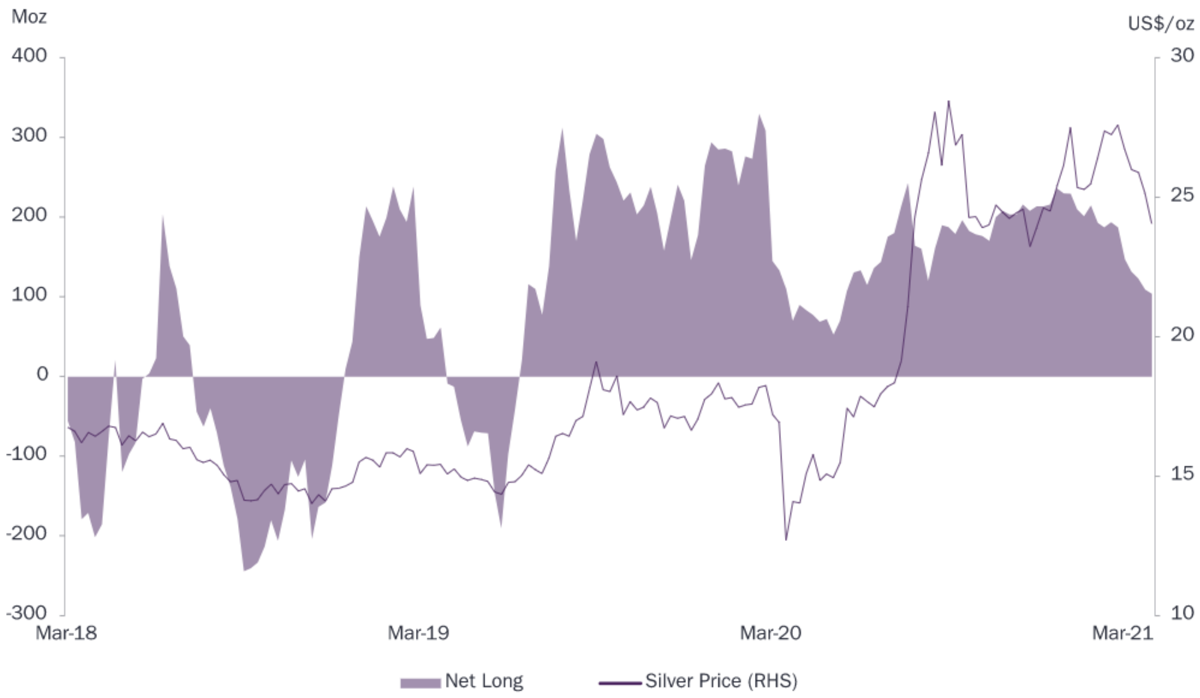
Futures trading in silver has grown in importance in recent years, particularly with increasing investor participation in China, both on the Shanghai Gold Exchange and Shanghai Futures Exchange. However, Comex remains the most important trading platform for silver futures. The spotlight on New York was even more pronounced last year, and the lockdown restrictions brought about by the pandemic had a pronounced impact on futures activity on Comex. As a result, much of this chapter focuses on that episode and asks if history can repeat itself.

CFTC Positioning

The trend in managed money positioning can offer a useful guide to institutional investor sentiment towards silver. Looking first at the trend in net exposure over the past 1-2 years, this strengthened in August 2019 and remained elevated until late February 2020. This was indicative of a gradual improvement in sentiment towards silver, even though the price remained at around the $17-18 level.

However, the onset of the pandemic hit the silver price hard as a deteriorating economic outlook encouraged investors to reduce their exposure to industrial metals, including silver. As a result, exposure towards silver was already in decline as the exchange for physical (EFP; see below) crisis emerged in March. It is therefore quite difficult to say with any certainty how much the EFP issue weighed on investor positioning towards silver at that time. That said, while gross shorts have risen from their end-March 2020 low (a level last seen in November 2017), they remain subdued. This will also reflect the improving sentiment towards silver as prices strengthened during late 2020/early 2021. Some hesitancy may still exist towards building futures positioning in silver, given the lack of growth in net long positioning so far this year as silver prices have improved.

Silver Net Managed Money Positions



Source: CFTC

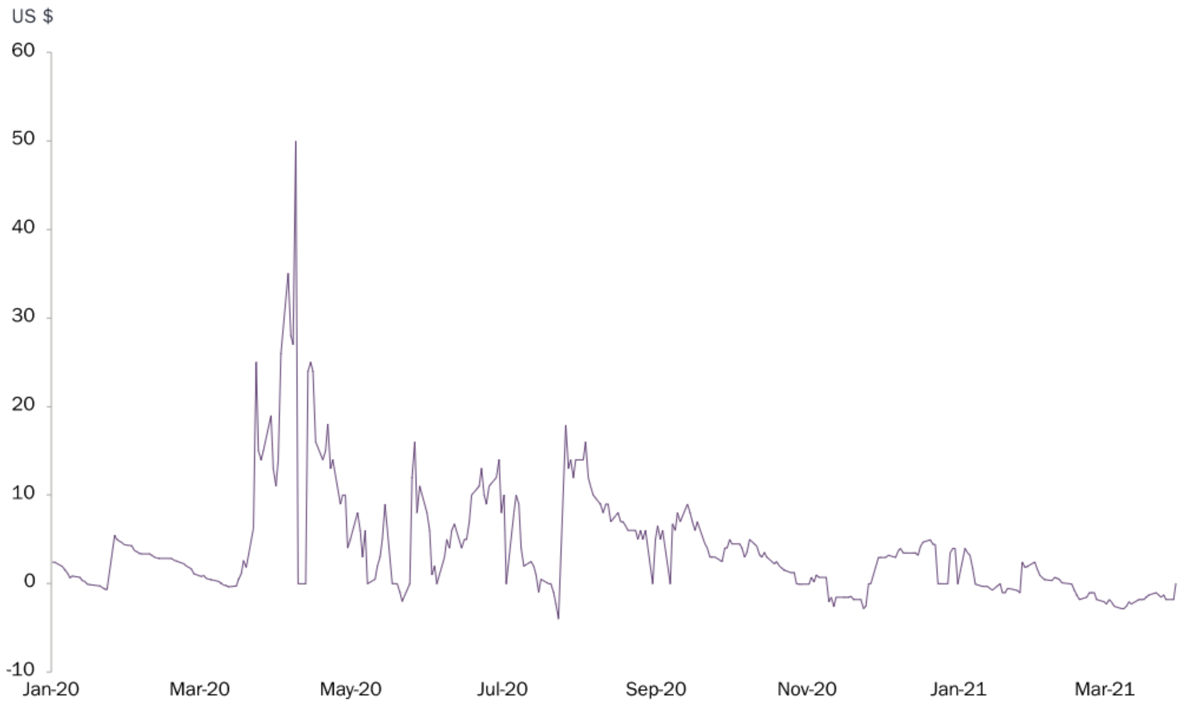
EFP Crisis

One impact last year as the pandemic emerged, was the dramatic rise in both the silver and gold EFP premiums. This, in turn, had a pronounced effect on gold and silver futures trading on Comex. As such, it is helpful to cover the issue by looking at both metals in some detail, even though this report focusses on silver investment. As a starting point, it is worth looking at the definition of the EFP.

According to the CME Group:

"EXCHANGE FOR PHYSICAL (EFP) ALLOWS TRADERS TO SWITCH GOLD [OR SILVER] FUTURES POSITIONS TO AND FROM PHYSICAL, UNALLOCATED ACCOUNTS. QUOTED AS DOLLAR BASIS, RELATIVE THE CURRENT FUTURES PRICES, EFP IS A KEY COMPONENT IN PRICING OTC SPOT GOLD [OR SILVER]."

Indicative Gold EFP[3]



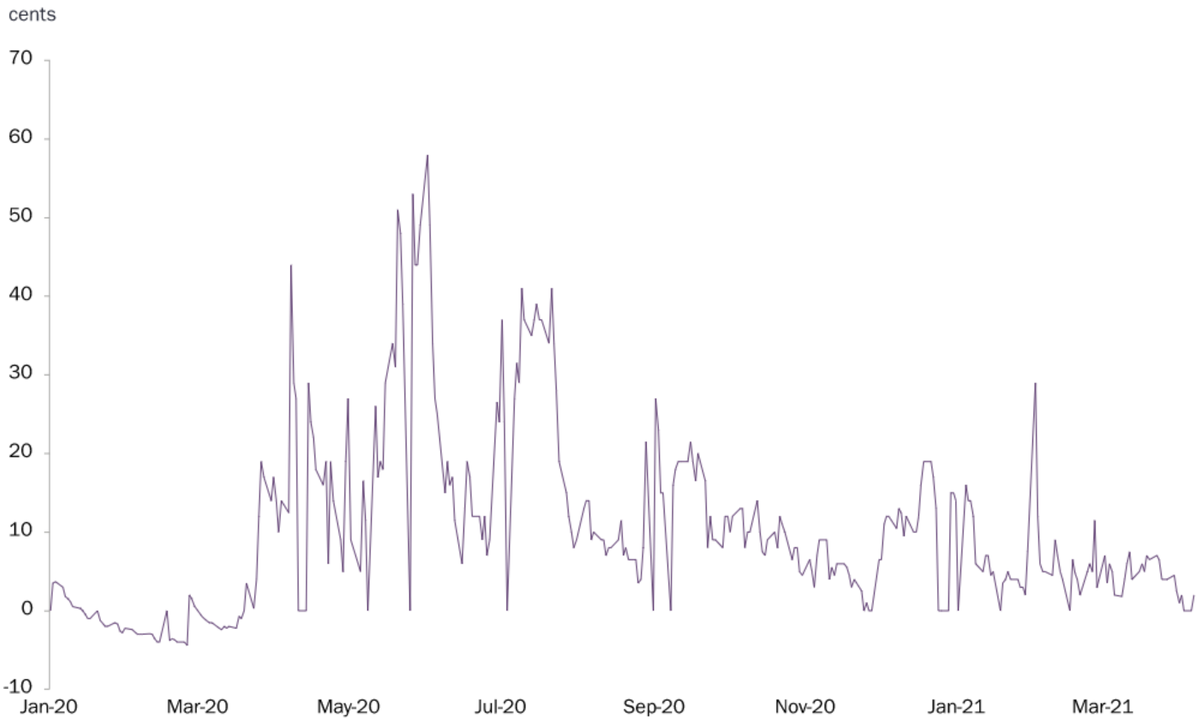
Both gold and silver EFPs will typically trade at nominal values. However, in March last year both premiums surged to unprecedented levels. This initially reflected the impact the pandemic had on passenger flights which were heavily curtailed. At the same time, three Swiss refiners were forced to temporarily close as lockdown restrictions tightened domestically. As result, it became increasingly difficult to deliver metal into New York. Although sea freight was available, this was not a viable option, given the time required for delivery.

It is worth remembering that Comex market makers tend to hedge loco-London, while physical delivery is extremely rare. However, during March/April 2020 dealers who were short Comex were exposed to the risk that counterparties would not roll over their positions. This led to a rush to buy back short positions and close loco-London long positions. This in turn led to extremely high demand for the EFP, which is effectively a long Comex/short loco-London position.

As a result, both silver and gold traders were forced to buy back contracts because they could not make delivery and so EFP premiums on both metals jumped. For silver, the EFP remained volatile and, at times, heightened from March to July, on occasion exceeding 60 cents. In the gold market, the EFP briefly reached around $70 in early April 2020.

Following the late March/early April peaks, both EFPs remained elevated for a considerable period. This reflected two key issues, ongoing and heightened risk concerns and a growing arbitrage opportunity. Taking each in turn, even though Swiss refineries re-opened and logistical companies were quickly able to deliver metal (both from Switzerland and other locations) into New York, banks' risk departments continued to limit the ability of their trading desks to issue contracts. This had the effect of tightening their supply and, in turn, kept futures prices higher for longer.

Indicative Silver EFP[4]



Second, the attraction to deliver both gold and silver into Comex depositories reflected the growing arbitrage opportunity at that time. In essence, as futures became increasingly expensive market makers were able to short these contracts and then deliver less expensive physical metal against these futures contracts.

The requirement to deliver metal into Comex vaults resulted in gold and silver arriving from both Switzerland and a range of other markets. In particular, gold arrived from Singapore, Hong Kong, Canada and Australia. For silver, metal was brought in from Poland, Kazakhstan and Russia.

As a result, both gold and silver stocks rose to unprecedented levels. Comex gold stocks have typically remained below 10Moz, but these gold depositories now hold over 36Moz. For silver, Comex stocks rose from an already sizeable 320Moz or so before the crisis to around 370Moz at the time of writing.

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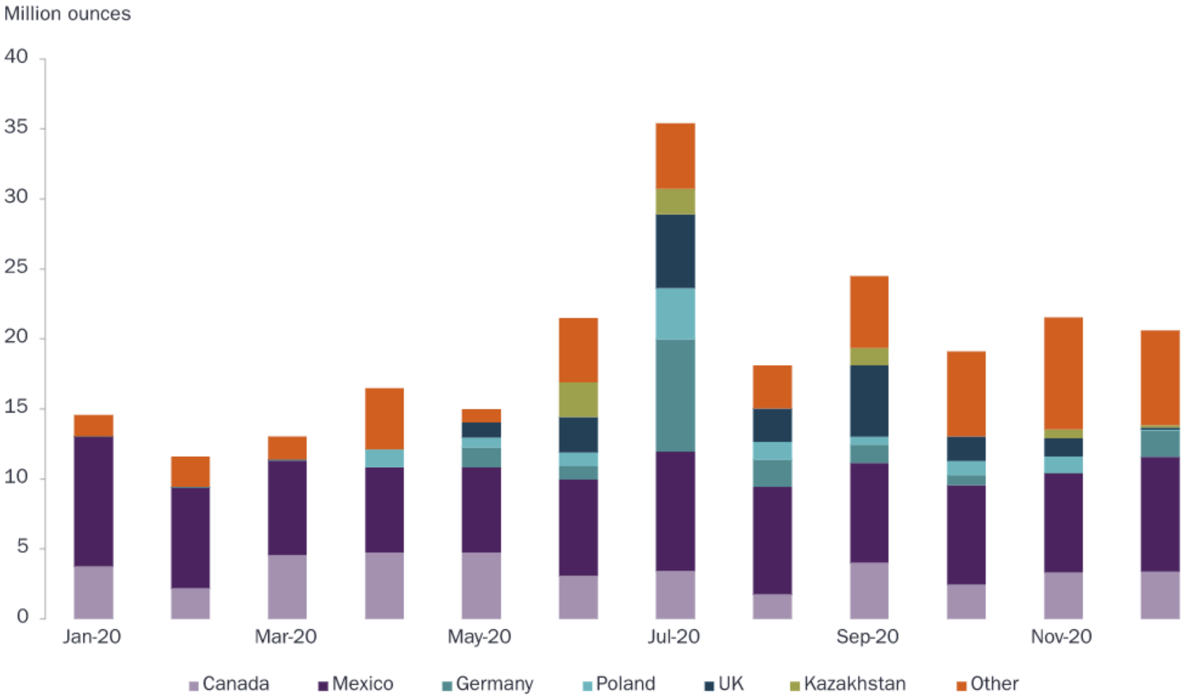
[3] Morgan Stanley Gold EFP Bid. As the EFP is not publicly quoted, stated EFPs will vary by institution, and so this chart is provided for illustrative purposes only. Source: Bloomberg

[4] Morgan Stanley Silver EFP Bid. As the EFP is not publicly quoted, stated EFPs will vary by institution, and so this chart is provided for illustrative purposes only; Source: Bloomberg

US Silver Bullion Imports



Source: IHS Markit

Looking ahead, one key question is whether this dynamic could return. This is very unlikely. The COVID-related conditions that culminated in the explosion of precious metals EFPs last year were at the time unprecedented. The probability that such extreme frictions and capacity constraints re-emerge is extremely low.

This is particularly the case in a world that is now used to functioning relatively smoothly, in spite of the pandemic. Crucially, as the risks that drove the drying of liquidity never actually crystallised, it is unlikely that dealers' risk departments will have to take such an aggressive and conservative view in the foreseeable future, something that was instrumental in both the extent to which EFPs rose and the duration for which they remained elevated.

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