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Silver jumps by 7%, but a look at the gold-silver ratio suggests there's still more upside on the table

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A quick look at the comparative price charts for gold and silver over the past five years draws an interesting conclusion.

Because although the gold price has been pushing new five-year highs for some weeks now, and since January has traded consistently above where it was at five years ago, climbing all the while, the same is not true of silver.

Yes, silver had a good run last week, when it pushed through the US$18.00 mark for the first time since early 2017. Nonetheless, silver is still trading at lower than where it was five years ago, suggesting two things.

The first is that the elastic nature of the gold-silver ratio continues to hold true. Under orthodox thinking, as the two most investable of the precious metals, silver and gold should theoretically trade in tandem, rising and falling together as sentiment and the price of the US dollar changes.

What tends to happen though is that gold moves first, silver then lags for while and then suddenly rebounds to catch up fast. That's the effect that we witnessed over the week or so, when silver moved suddenly from US$17.00 an ounce up to nearly US$18.50 in short order.

To be more precise: on 22nd August gold was trading at US$1,498 an ounce. By 30 August it had risen by just under 2% to US$1,524, a nice gain for the bulls, especially since it's now consolidating above the US$1,500 mark.

Silver by comparison, was trading at US$17.04 on 22nd August, and by 30 August had moved up to US$18.38, a rise of more than 7%.

But of course that significant outperformance came after a significant period of lag, as a result of the elastic nature of the gold silver ratio.

What tends to happen is that investors focus on primarily gold, and only secondarily on silver, and it's only when the gold-silver ratio becomes significantly wider than usual that the money and the attention gets switched temporarily to silver.

Which brings us to the second point about the current silver price: it's still trading lower than where it was five years ago. The same cannot be said of gold at all, with gold now trading more than 20% higher. The obvious conclusion to draw? - there's still more upside in silver.

Or to frame the same notion slightly differently, back in early 2014 just 67 ounces of silver bought you an ounce of gold. Today, it's 83.

Still, there are some caveats to this way of thinking.

The first is of course that if the US dollar strengthens significantly in the coming months, the value of both metals will inevitably drop in dollar terms, no matter what's happening to the gold-silver ratio itself.

Another is that in terms of demand silver is a slightly more complex market, since it has widespread use in industrial applications, including photography and electronics. That extra dynamic means that sentiment towards silver can sometimes be geared towards the global economic output in the same way that copper is: the more economic activity there is, the better it is for prices.

The same is not true in any way of gold, which moves with the dollar and is highly sensitive to economic risk, volatility and negative investor sentiment towards markets in general.

Silver in a sense is the better hedge. But that's also why when the gold silver ratio widens it's always silver that's getting discounted and never gold.

And silver always comes back to gold in the end, which is why sophisticated investors watch for the elastic to stretch, and then pile in in numbers.