April 10, 2013 – $200 Silver

$200 AN OUNCE SILVER

In 2004 I wrote an article for Investment Rarities entitled, $200 AN OUNCE SILVER? CAN IT HAPPEN? Jim Cook suggested condensing the article and following it up with a short question and answer session. Nine years is a long time and I thought it would be instructive to jump into the way back machine to when silver was $5.50 an ounce and a $50 price projection was way out. I've cut the article down a bit (available in the archives and dated June 14, 2004), but have not changed anything. I'll close with some more recent developments. Here's the original article –

The other day Jim Cook, the president of Investment Rarities asked me a question that set me back. Â?How high do you think the price of silver could get?Â? I started to answer that, as an analyst, I don't like to throw out the price targets, but prefer to dissect the underlying facts and conditions in the silver market. Those facts and conditions will tell us when silver is overvalued. Certainly I felt the current price was undervalued and I started to explain.

But he cut me off, by asking, Â?Do you think it could hit $200 an ounce?Â? I answered, sure it could. And not only that, I continued, it could hit $500 or $1000. Then he asked me, Â?Why don't you write about that?Â? At first, I said I wasn't interested in weaving tales about sensationalized prices, as I preferred to stick to bedrock analysis and let the price unfold as it may. And previously I had written about $50 or $100 an ounce silver. I told him, even if silver Â?onlyÂ? doubled, or tripled, or quadrupled (from the then-current price of near $5.50), it would be a phenomenal return, especially considering the low risk at the low price of the past few years. Even a modest price rise would prove that our efforts to spread the silver story were sound and true.

But then I realized that Mr. Cook was right. If I had good reasons to back up possible extraordinary future price projections for silver, why not write about those reasons? So I have decided to do so. However, I'd like you to put what I write into proper perspective. I'm going to write about possible future scenarios in silver for one main purpose Â? to get you to think and prepare for what may be extraordinary price upheavals in silver in the future. The idea is to consider the possibilities, and the reasoning behind them.

I don't normally dwell on possibilities. In silver, it's easy to focus on probabilities and certainties like deficits, disappearing inventories and the law of supply and demand. With ultra-low risk and what I believe to be a free market guarantee or eventual higher prices, why resort to what many would label outlandish price predictions? I'll tell you why Â? for the simple reason that those outlandish prices just may be coming, and it would be negligent of me not to discuss them beforehand. Before you scoff at $200, or $500, or even $1000 an ounce silver, please hear me out.

Let me first tell you what I am not including as reasons for triple or high triple digit silver. I am not talking about the end of the world, or the destruction of the dollar or other currencies. I am not talking about silver as money. I am not talking about virulent inflation where you see $200 silver, along with $50 for a loaf of bread or $10,000 for an ounce of gold.

I supposed that if the world's monetary affairs went to hell, those holding real silver would be protected. But that's not the basis for my silver recommendation. Bad things may happen in the future, but I refused to dwell on them or promote them as reasons for owning silver. To me, silver is a Â?good newsÂ? metal. Its many and varied uses are all about making man's condition better and improving standards of living. I won't advocate silver based on bad things happening. The great news is that nothing bad has to happen for silver to hit $200, $500 or $1000.

At the epicenter of reasons for launching silver to the heavens is the coming end of the silver manipulation. This has been my central theme for many years. Despite denials and protestations to the contrary by many, it remains obvious that silver is not priced properly. There is no legitimate free market explanation for such extremely depressed prices in the face of such spectacularly bullish fundamentals, namely, a structure a deficit and depleted world inventories. Only manipulation could explain such a perversely low price compared with the real fundamentals.

The end of the manipulation may kick off a whole host of related reactions. You can't keep the price of anything artificially depressed or elevated for decades and not expect violent counter moves when the artificial restraint or prop is suddenly removed. Considering how long silver has been kept depressed it will take an extremely high price to balance supply and demand.

There are certain factors that could come into play that could vault silver, in the years ahead, to truly shocking price levels. Just as we have remained grossly undervalued in silver for decades, it is very possible that, in the inevitable move to a market equilibrium price, we could overshoot dramatically to the upside, even if only briefly. There are several factors in place, all unique to silver, that could account for unthinkably high prices.

1. A Short Squeeze on the Futures Market

For 20 years, there has been an outsized silver short position on New York's Commodity Exchange, Inc. (COMEX). This paper short position has been unique, in that no other commodity but COMEX silver has had a futures and options short position larger than world production and world known inventories. This has been one of the keys as to why silver has been depressed in price. But shorting is a two way street. While the shorts have had their way with the price of silver for a long time, when those shorts are bought back or covered, the price effect of shorting is reversed and it becomes bullish.

A shortage of real silver would cause the shorts to buy back their positions. We are seeing signs of delay in physical deliveries, a precursor to shortages. Also, before a short-covering panic develops, we should also see signs of a reluctance to take on additional shorting by the commercial dealers. Those signs are emerging. In fact, there could be sharp upward movements in the price of silver on just the lack of new shorting.

Actual, panic-driven short covering hasn't been seen in the silver market for more than 20 years, due to the ironclad control on the market that the dealers have maintained. A short covering panic appears unavoidable at some point, because the size of the short position, measured in the hundreds of millions of ounces, dwarfs comparable known real deliverable inventories. If this uniquely large silver short position on the COMEX enters into a panic covering phase, it could create triple digit silver all by itself.

2. Industrial Users Panic

Silver is used in thousands of industrial applications. In fact, aside from petroleum, silver is used in more applications than any other commodity. Unlike petroleum, the amount of silver used per application, while vital to the finished item, is a tiny percentage of the item's total cost. For this reason, silver is considered to be price-inelastic for much of its industrial demand. This means that industrial users will not readily substitute other materials for silver in a price rise. If the price of silver jumps significantly, they will be more inclined to build inventories than eliminate silver.

But it won't be price alone that causes industrial users to rush to build silver inventories. It will be availability that could set off a panic. The 25-year experiment with Japanese-developed Â?just-in-timeÂ? inventory management has caused the inventories of all commodities and materials to be sharply reduced. Thanks to computerization, modern manufacturing and transportation efficiencies, holding extra inventories has become expensive and old fashioned. If a manufacturing or transportation disruption occurs, industrial production is more threatened by having lean inventories.

When the inevitable silver shortage hits the industrial users, it will be only a matter to time before some will try to protect themselves from those delays (and price increases). They'll do this the only way they can Â? by buying extra silver as a buffer. They will build, or attempt to build, inventories of silver that they never held before. This is a logical reaction to silver delays and price increases. After all, you don't risk the shutdown of an assembly line for want of a single, low-cost component.

The problem is that what may be reasonable for one industrial user puts pressure on the silver supply. As individual users try to immunize themselves from assembly line shutdowns by buying more real silver for inventories, other industrial users are automatically denied silver. If extraordinary demand for inventory building by some users occurs, it will make the supply tighter for other users.

This is how panics occur. The price of palladium rose to over $1100 an ounce because industrial users (mainly For Motor Company) panicked and built inventories, because they feared they would have to shut their assembly lines due to a lack of palladium. Silver is used in many more applications than palladium. That increases the chance that silver users will panic at some point and try to build inventories. If a user inventory panic does develop, there is only one known cure Â? it must burn itself out at extremely high prices. I have a hard time envisioning how a user inventory panic doesn't occur at some point.

3. Missing Silver

Generally, if you're paying for real silver, you should insist on getting real silver. That means knowing where the silver is held and getting the serial numbers (if held in bars). If you are holding silver that you have paid for and you don't have the serial numbers of the bars (1000 ounce bars), you should investigate. If you are not paying customary storage and insurance charges, don't assume you are getting a bargain Â? assume there are not storage charges because there is no real silver being stored.

There are many forms of paper silver where the real silver does not exist to back up the paper. These forms would include pool accounts, leveraged accounts and bank silver certificates. Like futures contracts, they re a convenient and low cost way of playing silver certificates. Like futures contracts, they are convenient and low cost way of playing silver. However, there are important and critical differences between these forms of silver and you are making two bets Â? one, that silver goes up and two, that the party backing the pool account or certificate is good for the silver. In other words, you are taking on additional exposure as to the future creditworthiness of the issuer.

These accounts offer cheaper commissions and storage fees (since there is no real silver backing). Likewise, since many investors have purchase their silver, over the years, in these forms, there is a tremendous amount of these pool accounts and certificates in existence. I would estimate that there is well over a billion ounces of silver held in this form. This billion ounces of silver is separate futures short positions. It is another unique reason as to why we could panic and look to limit losses. What's the only way for them to limit their losses? Buy silver. This is another reason for an epic bubble price and it is also unique to silver.

4. Depletion of Silver Inventories

Over the years we've seen systematic and persistent sell offs of world government stockpiles of silver, especially by the U.S., the largest former historical holder of silver. That means there is very little, or no real silver left that is available to dump on the market in case of a price emergency to the upside. Unlike gold, which world governments can still sell, they canÂ?t sell silver to contain a price rise, even if they wanted to. This is true for the first time in history. Never before have the government silver coffers been so bare. If the government fire trucks are called to put out a fire in the silver price, there won't be any water to pump. This may not be a reason for silver to explode, in and of itself, in and of itself, but it certainly is a reason to expect that a silver rise will have to burn itself out, and will not be easily put out. In fact, given my observations for how governments react, it would not be terribly surprising to see some governments buying silver at exceptionally high prices, now that they have none left. They would finally realize just how vital and strategic this material is.

With government stockpiles exhausted, the only legitimate sellers of inventory will be those individuals who had the foresight to buy real silver in the first place. And these sellers, according to all free market principles, will be striving to get the highest price possible for their property, not seeking to cap the price rise. I am not saying to hold all your silver until it reaches $200, or $500, or $1000 an ounce, although those prices may be achieved. I am trying to explain what I see as valid conditions that may result in those price levels being hit. Any one of the reasons I mention could result in the price of silver hitting levels that will be talked about forever. Amazingly, all could kick in simultaneously. These conditions are peculiar and unique to silver. They don't exist in any other commodity, nor have they ever.

5. Too Much Money, Too Many People, Too Little Metal

Because of the long-term structural deficit in silver, stretching back to World War II, we have consumed inventories for more than 60 years. Inventory data suggests that we have consumed over 95% of the world silver inventories in that time, some 10 billion ounces in total. This means that world silver inventories are at the lowest levels I hundred s of years. To make the point more graphically, if you use cumulative world production data, and subtract a generous one billion ounce total (known and unknown) remaining silver inventory we have the smallest amount of aboveground silver than at any time since 1300 AD I'm not making this up Â? there is less above ground silver bullion equivalent today than at any time in the past 700 years.

How can this be? Simple, up until the past 50 to 100 years, we never used silver for anything but for jewelry, utensils, coinage and investment. It was just like gold. Then came modern technologies that made use of silver in a wide variety of applications. We use silver for jewelry, coinage, light and heat transfers, electrical, electronics, catalysts and medicine. The cumulative silver production of thousands of years was consumed in less than a hundred years. The accumulated world silver inventory is gone at precisely the time of greatest demand in history.

Against the disappearance of the world's silver inventories, we have the largest amount of people, money and credit in history while the supply of available silver shrinks. It's a problem that, at some point can launch the silver price to the heavens.

Q: What would you change in this article today nine years later?

A: Obviously, we no longer have a structural deficit and declining world silver inventories, thanks to the five-fold increase in price since that article was written. Offsetting that, for the first time in many decades, there is strong world investment demand for silver and that has compensated for the end of silver deficit consumption. Everything else that I envisioned seems present.

Q: Sounds like the most bullish factors are still intact. Are they?

A: Absolutely. And even though world silver inventories are growing at a rate of 100 million oz or so annually, investment demand has gobbled it up and looks set to increase. The remarkable thing is that world silver bullion inventories are probably the same now as they were in 2004, at some 1 billion oz or so.

Q: Why hasn't more of what you talked about happened yet?

A: At the price peak in 2011, we were up nine times the level of 2004 and you're asking me why it wasn't more? You're a hard guy to please.

Q: I'm not complaining about the price run up, I guess I was asking why we haven't seen a short-covering and industrial user buying panic.

A: That we haven't yet is still the most bullish price factor unique and specific to silver. No one knows how close we may have been to a COMEX short-covering and industrial user buying panic when we approached $50 in 2011, but my sense was very close. It is this coming one-two knockout punch that will take us to the crazy numbers.

Q: Are we going to have to wait another nine years?

A: I don't think so, but silver should be viewed as a long-term investment. When you become obsessed with when, you set yourself up for frustration. Relax, in more ways than not, silver looks better than it did in 2004.

Nine years ago, we didn't have silver ETFs (which hold the bulk of the world's investment silver bullion), the knowledge that JPMorgan would become the big concentrated COMEX short, or the spectacle of a 4.5 year-old silver investigation by the CFTC designed to go nowhere. I'll let you decide if my presentation of the facts and reasoning in 2004 was solid. Now on to some recent developments: