
April 13, 2011 – Heating Up

Heating Up

I sense that the temperature in the silver market seems to be rising. Maybe it would be better to say that the pressure seems to be rising on many fronts. Whatever analogy one chooses, it looks like some turbulence is ahead for the price of silver.

As previously reported, the current "high" silver price creates the possibility of a downdraft. To that end, the flow of bearish stories seems to be accelerating to the highest level in my memory. The common denominator in all these stories predicting a substantial sell-off is that the price is too high. As an analyst who reads virtually everything available on silver, I am actively looking for substantive flaws in the bull case. But I don't think the subjective opinion that prices are too high is reason enough, no matter how widespread that opinion may be. Besides, it seems to me that most of the articles telling you to sell are coming from those who never told you to buy silver in the first place. Aside from acknowledging that we can sell-off despite what the collective opinion may be, I'll keep looking for real bear facts.

A number of readers sent me the recent story about big put option purchases on SLV, asking for comment. The manner in which the transaction was presented suggested a big fall may lie ahead for the price of silver. As an experienced options trader, the story's implication seemed subjective to me and wide of the mark. It would likely be coincidental if the market sold off sharply due to this options transaction, not causal.

While I remain nervous due to the recent price path and level of silver, I would be more nervous being out of the market. In fact, I'm getting one of those feelings in my bones that I get periodically about an upside eruption in silver prices. This time, my bones are suggesting a pop in price on the magnitude of 10 or 20 dollars or more. The only question in my mind is do we get the big up move forthwith or after a quick shake out. Price action over the past few days are making me think we may have already seen the shake out. My feelings revolve around perceptions of physical tightness, market structure on the COMEX, and regulatory developments.

Let me highlight one of several clues pointing to physical tightness. Yesterday, the SLV reported a withdrawal of almost one million ounces. This flew in the face of (my) expectations of an inflow of several millions of ounces due to the volume and price action over the past week. When the stuff is taken out, when it should be going in, the most plausible explanation is that silver is in very short supply. Additionally, the new short interest figures were released and indicated that the short position in SLV only declined about 1.5 million shares (ounces) where I had previously written that it should have declined by close to six million ounces (due to the large deposit a couple of weeks ago). At 22.6 million shares short, most plausibly this means the shorts are having trouble securing physical.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

The thing to remember is that if my readings on physical silver conditions are correct, that goes a long way to explaining why I think the price pop could be big. Few of us have much experience with pricing in a shortage in general and especially in silver. Therefore, it may be hard to grasp just how strongly prices can react in a genuine shortfall. The best example currently is in the rare earths, where prices have moved by unprecedented amounts recently. I'm not trying to be sensational in projecting price; I'm just trying to point out that in a genuine commodity shortage, the price action must be sensational.

As far as market structure, the enormous volume on Monday's and Tuesday's sell off, both in SLV and on the COMEX, as well as in silver mining shares, appears constructive to me. It suggests selling by nervous longs and buying by those suspecting much higher prices (including shorts). This is something that can be said almost all the time, but what made it notable to me was the extremely high level of the volume of the trading. Also, I could not help but be impressed with how well silver performed, relative to gold, on the sell-off on Monday and Tuesday. Normally, gold sneezes and silver catches the flu. So far, that's not the case either this time or for many months. I think this may be suggesting that things are about to heat up in silver.

On the regulatory front, the signs point toward resolution ahead on the important silver matters of the day, like position limits and manipulation. I suppose more people would prefer to watch Lady Gaga, but yesterday I had the opportunity to watch a live webcast of the Senate Banking Committee hearing on derivatives, featuring CFTC Chairman Gary Gensler. It was an interesting meeting, especially considering special mention was made of position limits. As usual, Gensler mentioned the magic words "manipulation and concentration." He also indicated that he had to revise his earlier (that day) testimony on the number of public comments received on the issue of position limits. Yesterday, the CFTC doubled the number of public comments it received on position limits to almost 12,000. This is truly a staggering number.

<http://comments.cftc.gov/PublicComments/CommentList.aspx?id=965>

While I plan to write on these public comments in greater detail coming up, let me throw some things out now. Of the nearly 12,000 comments, more than 99% urged the Commission to adopt position limits, with less than 1% suggesting otherwise. Yes, the 1% came from the exchange and their assorted lackeys. A very large number of the comments were cookie cutter responses on high food and fuel prices from different consumer groups. But an extraordinary number of comments, from 4,000 to perhaps over 5,000, came from those urging the Commission to adopt a 1500 contract limit in silver. That is the suggestion that I put forward. I am gratified that more people than ever wrote to the Commission asking that a 1500 contract limit be established for silver.

The thing that struck me the most about the comments on position limits in silver is that whether they were just one sentence or many paragraphs, they all seemed highly sincere. While they all asked for 1500 contracts, they were not some mindless repetition of what someone else told them to say. These were comments which you could sense that people were serious about. While I admit to suggesting that people write to the Commission on this issue, I hardly went over the top. I laid the case out in a couple of articles to subscribers and in one public article and basically hoped for the best. Some others did promote writing in (for which I am grateful), but I wanted the Commission to know that this wasn't some kind of self-promotional campaign on my part; that people wrote in because they found the issue important and had merit. As I said, I will write about this in the future, but I can't see how the Commission can avoid dealing directly with silver position limits real soon. This is a factor that also goes to the feeling in my bones about silver prices in the short term.

I'm going to step back from the microphone and turn it over to my good friend and silver mentor, Izzy Friedman, followed by a letter sent to Jim Cook of Investment Rarities that he forwarded to me.

The Tune Makes the Music
By
Israel Friedman

The tune making the music in silver is higher prices. People who look at investments are influenced by what the price is doing. That's just human nature. When prices are rising they become more likely to buy.

Silver did very well in 2010 advancing 83% and gold prices only 29%. So far in 2011 silver is ahead 32% and gold 3%. Based on those numbers the funds are starting to nibble in silver so as not to be left at the station, when the bullet train takes off. Those who never invested in silver are starting to give attention to this market because they see the advance and especially the ratio change to gold. They are asking themselves – why this is happening?

China, a net silver exporter for decades, became a net importer plus the Far East investors seem much more interested more in silver than in gold. Gold as commodity has a big problem not many speak of. Gold is sold by weight and karats. It is hard for regular people to figure out when buying jewelry what kind of gold purity you are getting. Is it 24 karats or 18 karats or 14, or 10, or 8 karats? Or is it gold plate? It is confusing and I believe that is one reason why Far East investors are buying more silver than gold.

Nobody knows how high silver prices can go, only time will tell. But I personally think that all the bearish talk that we read lately is coming from people who sold out their silver and are hoping to buy back cheaper. Hope is generally not a good investment characteristic.

Mr. Butler has an excellent point that you need \$5.5 billion monthly to sustain the gold prices and only \$450 million to maintain silver prices. If for 3 months the funds will change strategy and invest only in silver not in gold then we can see silver over \$100. In a situation like this the naked short sellers will bleed to death and the US Government's hands will be tied by not having physical silver to bail out the naked shorts, like they did in 1980.

The only way that the government can help to save the shorts and give the last opportunity to the industrial users to buy physical silver is by convincing the longs to sell their silver with big tax advantages of under 10% taxation. Silver over \$100 will cause a coordinated effort between the users and the naked short sellers to scream manipulation by the longs. But there has been no big silver buyer who has been driving up the price, as was the case in 1980. This time it has been lots of little buyers and when lots of little guys buy, they don't call that a manipulation; they call that a free market.

But still the shorts will complain. Let them. I can see the irony that the happiest person on earth will be Mr. Butler, as he is going to send them to the CFTC and CME to complain.

Here's the letter sent to Jim Cook by one of his firm's clients. It is a copy of a letter originally sent to Chairman Gensler of the CFTC which, like almost all of the public comments on position limits, just stands out as being sincere. Â?

Dear Mr. Gensler:

Periodically I receive James Cook's "Market Update," where he and Theodore Butler, a consultant to his organization with 25 years expertise in following silver, have alleged repeatedly that J.P. Morgan has and continues to manipulate the silver market with their concentrated short position in that commodity. Mr. Butler estimates that JPM's short position may now equal as much as 25% of the world's production. If that is only approximately true, this would allow JPM to control, or at the very least, to materially affect the price of silver "clearly in violation of commodity law.

Along with what I understand to be another 3,000 others who have appealed to Commodity Futures Trading Commission on this matter, Mr. Butler has proposed a position limit in silver of 1,500 contracts, or 7.5 million ounces. Whether that exact number should be slightly more or less might be debatable, but 1,500 contracts (about 1% of the world's production) would seem to be a reasonable cap.

I have learned that this issue has been brought before your Commission for investigation, but also that the CFTC has faced strong opposition from the COMEX. So far as I know, there has been no resolution.

I certainly do not profess to be an expert on matters of markets nor finance "or, perhaps, more to the point, on politics. So my question is simply this: Why is it that the Commodity Futures Trading Commission cannot immediately determine whether or not these allegations are true, and if so, take appropriate corrective action? (Or, if not, put the matter to rest.)

If the allegations require further investigation, won't you please issue a statement as to when the issue may be resolved? I look forward to hearing from you.

Thank you, Mr. Gensler. You and your fellow Commissioners will be doing a great service to your country, to your economy and to your fellow Americans by using your position power to act on this very important issue.

D. S.

Ted Butler

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