

April 9, 2014 – Real Silver Supply/Demand

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I know I spend most of the time discussing the COMEX manipulation because I believe that is the most important factor in determining the price of silver currently. In a nutshell, the electronic supply and demand in COMEX silver futures exerts greater influence on price than does hard metal supply/demand. Something like 50 electronic traders on the COMEX have total sway over all the real silver producers and consumers in the world when it comes to silver pricing. But that is not meant to diminish the importance of real production and consumption of silver in the long run. In fact, I only discovered the manipulation after beginning a close study of actual silver supply and demand almost 30 years ago.

Long time readers will remember how I came across the manipulation in trying to respond to the challenge by Izzy Friedman for me to explain how silver prices could be flat to lower in the face of a decades' long deficit consumption pattern in which the consumption of silver exceeded total production for more than a half century. You can't consume more of any commodity than is being produced for 60 years running with no upward move in price without a darned good explanation. The only explanation Â? price manipulation on the COMEX Â? is so good that it explains why more accept it today than ever before; otherwise it would have fallen from favor by now.

Even though the world stopped consuming more silver than was being produced around 2006, it seems impossible that we will ever (in our lifetimes) restore world silver inventories to the 10 billion ounces that existed in 1940. That's the first key point of supply and demand Â? world inventories of industry grade silver bullion are down nearly 90% over the past 75 years. In the only possible comparison of merit, world inventories of gold have tripled over that time. Incredibly, despite the radical change in relative inventories, the relative prices of gold and silver are the same today as they were 75 years ago. Just like Izzy challenged me, I would extend an open challenge for a non-manipulative explanation for how the silver/gold price ratio has remained unchanged from 75 years ago. In terms of supply and demand, inventories represent potential supply and I'll return to inventories later.

Before analyzing production and consumption, there are two key perspectives to always keep in mind when considering silver. One is that the lion's share (70%) of silver mine production comes as a by-product of the mining of other metals, such as lead, zinc, copper and gold. Only 30% of all the silver mined annually comes from mines where silver is considered the primary metal being mined. While it is true that silver's by-product mining profile makes this production less sensitive to short term price changes, this special nature of the mine production of silver continues to be misinterpreted by many. The most common misinterpretation is that the by-product silver is somehow "cost-free." In actuality, it is more about accounting preferences than it is about true cost.

Just because a copper mining company may account for by-product silver on a no cost basis, that's an accounting issue, not a true mining cost matter. Most metals have a poly-metallic composition in that no copper mine is purely copper or no gold mine is purely gold. All mines have some poly-metallic ore mix. There is a total cost and benefit in the mining of all the metals being extracted, even if individual miners account for it differently.

The key takeaway here is that silver's by-product profile is both bullish or bearish depending on other circumstances. Yes, the current low silver price being below the cost of production for primary silver miners shouldn't impact by-product output by itself. But just as was the case in 2011, much higher silver prices shouldn't result in an increase in by-product output. For someone who expects a physical shortage at some point, the price-insensitivity of the by-product profile should only exacerbate the coming silver shortage.

The other perspective that must be considered in assessing silver's real supply and demand is the dual nature of silver demand, which includes industrial and other fabrication demand, but also investment demand. And just like its by-product production profile, this unique silver demand profile is widely misinterpreted. Too often, you read statements that silver can't make up its mind whether it is an industrial commodity or a precious metals investment asset. To the best of my knowledge, silver has no mind and is incapable of deciding anything for itself. The implication that silver's dual demand aspect is somehow confusing and negative is absurd.

Because silver's unique dual demand profile makes it fundamentally different from most other metals and commodities, its real production and consumption must be analyzed differently. Whereas one might devote the most attention in evaluating prospective changes in world mine production and industrial consumption in commodities like copper, lead or zinc, such an approach has proven unproductive in silver. None of the price moves over the past 20 years or longer in silver have had much, if anything, to do with real production or industrial consumption. The clearest proof is that silver ran to almost \$50 at a time of record high world production and had also lost its leading industrial demand component in the ten years leading up to that high (photography).

Even though industrial demand, combined with all other fabrication demand, makes up close to 90% of the total silver annual production of one billion oz (mine plus recycling), this demand does not exert a proportionate influence on price. It is the other 10% of silver demand, in the form of investment in 1000 oz bars that typically moves the price. I think the key to understanding real silver supply and demand is to focus on the 10% investment demand component. After deducting the 900 million oz total silver fabrication demand (industrial, jewelry, the minting of coins, etc.) from the billion oz of current total production, the remainder of 100 million oz available for investment in the form of 1000 oz bars will determine the price of silver.

No other metal or commodity (excepting perhaps platinum and palladium) have such an investment demand component as silver. Gold, on the other hand, is primarily driven by investment demand as industrial consumption accounts for only 10% of total demand. Although it may sound strange at first to think that the price of silver is primarily driven by its 10% investment demand component, once you think about it, the apparent strangeness disappears. There is very little hedging taking place by silver producers or industrial consumers and even if there were more hedging its impact would diminish over time.

Truth is the world's silver producers and consumers, just like their counterparts in other commodities, mostly accept current prices, whatever level they may be at. What real choice do they have? While price is a most important aspect to both producers and consumers, individual producers or consumers exert very little influence over price. Not to veer off into the manipulation angle, but it is the inability of any individual producer or consumer of commodities to impact price that creates a vacuum that sets the stage for someone not a producer or consumer to unjustifiably influence price (like JPMorgan).

The reason silver prices climbed to near \$50 in April 2011 was due to strong physical investment demand, predominantly in the various world silver ETFs. The reason prices have declined and stagnated since then is because of weak physical silver investment demand. Therefore, the key to the future silver price depends upon physical investment demand. That's why I wouldn't put mine production or industrial demand under a microscope Â? it will be investment demand that will matter.

A clear distinction must be made between electronic investment demand in silver futures contracts on the COMEX and investment demand in physical silver (which includes many silver ETFs). While aggressive buying of paper futures contracts on the COMEX will cause the price to rise temporarily; invariably that type of buying ends with aggressive selling, particularly when the original buying was by the technical funds. Over the past 30 years, every time the technical funds have purchased electronic contracts aggressively, the commercials have sold short enough contracts to eventually cap the price and turn the technical funds into sellers. That's the essence of the manipulation.

The enabling feature of the manipulation is that the technical funds weren't interested in buying real silver, just in trading leveraged paper or electronic contracts for short term profit. The problem is that there is an unlimited potential supply of electronic silver contracts that could be sold to the technical funds. Real silver is both scarce and rare by almost every measure; COMEX silver contracts are neither scarce nor rare by any measure.

During times of subdued overall physical investment demand for silver, like now, it's understandable that prices could remain weak with direction determined by electronic trading of COMEX contracts (and dictated by JPMorgan). But it would be a mistake to assume that paper contract control will last forever. The reason for that is while the commercials can sell short unlimited quantities of paper silver contracts, there is no practical manner of selling short physical silver (other than short sales in SLV). As and when physical silver investment demand revives, only the sale of real silver will satisfy that demand, not paper contracts.

Therefore, one must attempt to measure how much real silver exists or could be supplied to meet future physical investment demand. There are two sources for future physical supply Â? the amount left over from current production after all industrial and total fabrication demand is met and potential sales from existing inventories. As I indicated previously, there are currently available around 100 million oz annually for investment demand at the margin.

At current prices, 100 million oz is the equivalent of \$2 billion. To think that only \$2 billion of newly produced silver is available to the world's investors annually should set you back a bit because that is an incredibly small amount of money by world standards. On a per capita basis, it comes to less than 30 cents for each of the earth's inhabitants. Numerous individual members of the world's financial elite could write out a check for that amount and alone absorb all the new silver for a year. Just because no one has recently tried to acquire a big chunk of silver, doesn't mean no one will try. In fact, history suggests it is only a matter of time before someone big does move on silver. Most telling of all is that the amount of physical silver available for purchase today is much less than what was available when the Hunt Brothers or Warren Buffett bought silver years ago.

But the most relevant comparison for how tiny is the amount of money necessary to buy all the newly produced silver for a year is in the comparison with gold, the metal most similar to silver throughout the ages. Where it takes \$2 billion to buy the 100 million oz of new silver for a year, the 100 million oz of new gold available for investment takes \$130 billion, or 65 times more, because gold's price is so much higher than silver's. And when you witness certain instances where the investment dollar demand for silver is even greater than the investment dollar demand for gold (such as in the American Eagle program by the US Mint), you must come away convinced that this can't continue forever without a sizable mark up in the price of silver.

The other potential source of supply for real investment silver is existing inventories. Of course, the 1.3 billion oz of silver bullion in the world (1000 oz bars) is already owned and only those owners will decide at what price they may be willing to sell. Certainly, at any point in time, only a very small amount of existing inventories of anything are available for sale, silver included. But silver's current low price makes even the total value of the world's bullion inventories miniscule. It's hard to believe that \$25 billion could buy all the silver bullion in the world (if it were for sale).

Once again, it is necessary to make a relative comparison to take in the full measure of how little silver there is in the world in dollar terms. And once again, the most relevant comparison for silver is gold. Whether you use all the world's gold (5.5 billion oz) or just the gold in bullion form (3.5 billion oz) the comparisons with silver are staggering. All the world's gold is worth over \$7 trillion and the bullion portion is valued at over \$4.5 trillion. In other words, world gold inventory is valued from 180 to 280 times more than world silver bullion inventories. Rarely has the value mismatch between gold and silver inventories been more extreme than it is today. Since success in long term value investing is enhanced when an asset is purchased at a time of undervaluation that would suggest this is a great time to invest in silver.

I have addressed the amount of new physical silver available for investment annually and the amount of existing silver inventories on an absolute and relative basis compared to gold. The only thing missing is what's on the other side of the equation, or how much potential investment buying power could come into physical silver. This may be the most exciting factor of all.

Potential world buying power has never been higher. That's because we are at record valuations for just about everything in the world. Collective stock, bond and real estate values have never been higher, in the tens and hundreds of trillions of dollars collectively. Someday and maybe someday soon, a portion of this record collective valuation will migrate to other investments, including silver. As a true world commodity, silver should not witness any geographic or cultural barrier or lack of recognition as an investment.

The key to everything I have written today is in the physical aspect to what is available and what exists. Real silver supply and demand. I hold that physical supply and demand will dictate prices in the future. Of course, that is not the case presently. Today, the price of silver is determined by crooked paper and electronic dealings on the COMEX. The evidence is so clear that I have been able to specifically label JPMorgan and the CME Group as the main price manipulators with no rebuke from them.

One reason why I am convinced that real silver investment demand will win out in the end (just as it has in the past) is because participating on the COMEX is starting to look real dumb if you're not a crook. That includes both technical funds and others who speculate in COMEX contracts. The quicker market participants come to realize that the COMEX is one continuous rig-job on silver (and gold), the quicker we can get to free market pricing. Based upon what I observe, in matters related to silver, the reputation of JPMorgan and the COMEX (CME) is sinking. The main victims on the COMEX, the technical funds, appear to be in retreat and it's hard to imagine new funds entering the rigged game. The recent uproar over high frequency trading in stocks may shed more light on where the real crime of HFT is in helping to manipulate silver and gold prices.

Fortunately, there are genuine alternatives to dealing on the COMEX. Everyone is capable of buying Silver Eagles or shares of physically backed silver ETFs. In fact, the only antidote to the price rigging on the COMEX is to position oneself in physical silver. Here's one warning I've given privately recently to those holding speculative positions in COMEX futures and options that I'd like to share. If it does turn out that silver prices do soar and the shorts that are on the hook happen to be JPMorgan or other important COMEX members, do not expect these crooks to honor their contractual obligations. If JPM gets hooked on the short side of silver, be certain that the COMEX will default in some way designed to cheat the longs and protect the crooks. Stick with physicals or select ETFs.

I'm still concerned about one final cleanout to the downside in which the COMEX commercials lure the technical funds into more selling before the physical day of reckoning is upon us. But I could be wrong if things develop sooner in the physical silver market. In time, the real silver supply and demand equation will win out and this alone warrants a silver investment. Any further cleanout will result in silver being a better investment.

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Silver – \$19.85

Gold – \$1310

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