

August 17, 2010 – More on ETFs and Izzy's Thoughts

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I received a number of comments from subscribers concerning the recent King World News Interview with Ben Davies from Hinde Capital. Mr. Davies made a forceful case against owning precious metal ETFs, like GLD and SLV, and readers wanted to know if I changed my mind about holding SLV. In a word, no, I have not.

It is not my style to rebut what others might say. Instead, I prefer to make my case and let the reader decide for him or herself how that stacks up against what others may say based upon the reasons given. Particularly in this case, seeing as Mr. Davies had some complimentary things to say about me, I am loath to "take him on." Besides, he seems like a good enough bloke. However, I don't want my silence to infer an agreement on my part, especially since I do appear on King World News regularly and a number of you asked about it. Reasonable people can reasonably disagree on certain issues. This is one of those issues.

I listened intently to what Mr. Davies had to say and read the 50 page document upon which the interview was based. While I'm not going to offer a point-by-point rebuttal, I would like to comment on his key suggestion that the ETFs were holding metal on lease from central banks that could be subject to return, to the detriment of shareholders. I'm an old hand in precious metals leasing, and my articles about leasing first appeared on the Internet some 14 years ago. I was convinced then that it was one of the most ill-conceived financial concoctions ever devised by the rocket scientists on Wall Street and I am not in the least surprised that it is fading fast into oblivion. My only surprise is in how long it lasted.

One of the screwiest features of precious metals leasing is that the true owner (usually a central bank) relinquishes all ownership claims to the metal, save a hollow promise from the bullion bank middlemen that it be returned someday. The metal being leased is always sold by the lessee to an unrelated third party on a completely unencumbered basis. Therefore, even if the ETFs do own metal (most likely gold, not silver) that was originally leased from a central bank, the actual metal comes to the ETF on an unencumbered basis. The ETFs paid cash for the metal and it is owned free and clear. Under no circumstances would such metal be called from the ETFs by central banks or anyone else. This is not a risk factor in owning an ETF.

I know many in the precious metal community are distrustful of these ETFs. That's too bad, because the distrust is misplaced, in my opinion. These precious metals ETFs are a great financial innovation that opened the door to actual metal investment by those who would never be able to buy metal otherwise. Price-wise, I think they have been the precious metals investor's best friend, as their existence is a prime reason why gold and silver prices are much higher now than they were before these ETFs were announced. As always, the great thing is that no one is forcing you to buy these ETFs. If you don't like them or trust them, don't buy them. Buy silver in a different form. It's just that I'm still puzzled by all the bad-mouthing.

Everyone is entitled to change his mind, including me. You can be sure if I do change my thinking on SLV, I will make that clear immediately. In the meantime, please don't assume otherwise.

One of the things that I seem to discuss with my friend and silver mentor, Izzy Friedman, on a daily basis is how the mismatch between silver's supply reality and the price will get resolved. At times, it gets to be like the old Miller Lite beer commercials; "tastes great, no less filling." In other words, we'll argue over differences without a distinction. Our actual disagreement revolves around what will be the catalyst that sends silver skyward, namely, regulatory changes and short covering or an actual physical silver shortage. While these discussions can get rather heated, in the end we usually both agree that all the price triggers will likely be pulled simultaneously. What there is never a disagreement on is the rapidity with how things will unfold in silver, once the ball gets rolling. On this issue, we both tend to get real quiet when we contemplate how far and fast prices will run.

Here are Izzy's thoughts on the matter –

My friend Ted Butler has been fighting the concentration of the shorts for a long time. Why won't the CFTC and the CME set honest position limits and stop letting the shorts control the market? This makes me think that the real solution will come only when a shortage in silver arrives.

I believe I understand how the shortage will unfold once it starts. It will be a sudden event that will seem to come overnight maybe with a big buyer in the Far East buying physical silver. The shorts will panic and we could wake up to a price \$5 higher. The shorts on the COMEX will panic and add more dollars to the price. I'm sure some shorts will be quick to declare bankruptcy because there will be no other way out. Then the users will panic and really add more dollars to the price. I can tell you the shortage will come overnight, but I don't know which night.

A shortage in silver will force the CFTC and CME to enforce regulations and that news will cause investors to buy more. Then jewelry stores around the world will increase their inventory of silver items. That's 200 to 300 million more ounces in inventory.

It is hard to imagine from where the silver can come to satisfy a sudden demand like this. And at what price? Looking at the future with population and world economic growth, we know more silver will be consumed and bought. Where will it come from? We are close to a shortage today before any new silver demand.

With interest rates so low you can't make a good return on money in the bank. You are forced to think of other investments. To me silver is the best investment, after a good business or a good education.

The CFTC and CME will be smart to resolve the problem today like Mr. Butler is advocating, by putting position limits on the shorts and longs in the paper market. By waiting for a shortage to arrive, it will be too late. What can they do in a shortage to pull silver from thin air?

I still believe in Silver Eagles. Investors don't need to buy thousands of Eagles. Buy what you can afford and not with borrowed money. 100 Eagles will make good money and 1000 Eagles can have a big impact on a person's financial condition. If you are fortunate enough to be able to buy even more, please remember to be charitable with all the money you will make.

Have patience waiting for the coming shortage because when it comes it will have you thinking about silver from the time you wake up until when you go to sleep. Then you will dream about it, only it won't be a dream. Some people think that just because the shortage hasn't arrived that means it won't arrive. That's just impatience playing tricks in our mind. If the facts tell you what they tell me, the shortage is coming. It's better to be thankful for this knowledge than to worry about the timing. Be happy and buy more if you have the extra money to. Israel Friedman.

A few words in closing. Silver and gold closed at the highest price levels since the beginning of July. It still feels like the big short, JPMorgan is shying away from the short side, particularly in silver. Upcoming COT reports will confirm or refute this. I still maintain this is the key price factor currently. None of us have experience with how silver will behave without a dominant and manipulative short present in the market. Someday soon, we're all going to gain that experience.

Ted Butler

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Silver – \$18.58

Gold – \$1226
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