

August 19, 2015 – JPM and Eagles/\$1billion into \$5 billion

More on JPMorgan and Silver Eagles

Regular readers know that I believe JPMorgan has been responsible for buying a large number of the Silver Eagles sold by the US Mint over the past four and a half years; perhaps more than 50% of the 190 million coins sold over that time. I based my premise primarily on the unusually large and unprecedented number of Silver Eagles purchased in the face of demonstrable weakness in overall retail buying over this time, including much weaker relative sales of Gold Eagles. This pattern persists to this day.

When I first made my premise public, late last year, that JPMorgan was a big buyer of physical silver, a number of commentators publicly disagreed with me, particular regarding JPM buying Silver Eagles (some, but not all agreed that JPMorgan was likely buying silver in the form of 1000 oz bars but in amounts less than I believed). Among the arguments against my premise was that it was unlikely that such big buying of Silver Eagles by JPMorgan could go undetected by authorized dealers from the Mint and there were no reports of JPM's involvement in buying Silver Eagles.

I felt this wasn't a strong argument, simply because JPMorgan was so well connected and influential, that if it used any of the Mint's authorized dealers, the bank would insist on confidentiality if future business were to continue. It never occurred to me that JPMorgan could be buying directly from the Mint as an authorized dealer itself.

In my defense, I did write about some type of unholy alliance between the US Mint and JPMorgan, in that JPM appeared to be abusing the intent of the law that required the Mint to produce sufficient Silver Eagles to meet demand. This law was clearly intended that the Mint not deprive ordinary coin buyers from access to collecting coins due to the Mint's inability to produce a sufficient amount. The law was never intended to allow a single large buyer to game the system and accumulate massive quantities of Silver Eagles at a price manipulated lower by that large buyer in COMEX dealings, as JPMorgan has done since acquiring Bear Stearns in 2008. Whether the Mint knew that the intent of the law was being distorted or not, at the very least, the US Mint had to be aware of the identity of its largest Silver Eagle buyer whether that buyer was an authorized dealer or not. Now there are suggestions the Mint may be going out of its way to shield the identity of the big buyer of Silver Eagles.

One of the commentators who initially rejected my premise about JPMorgan buying Silver Eagles wrote to me saying he had reconsidered. It seems for a different matter completely, he wrote to the Mint to request an updated list of its authorized dealers for Silver and Gold Eagle coins, since the list was last updated in 2010. The Mint refused and to cut to the chase, he concluded that it's entirely possible that JPMorgan had become an authorized dealer itself and could buy Silver Eagles directly from the Mint, without going through a middleman. Much to his credit, he acknowledged it could be JPMorgan as the big buyer of Silver Eagles.

<https://smaulgld.com/who-are-the-u-s-mints-authorized-purchasers-of-american-gold-and-silver-eagle-coins/>

Let me be clear Â? my premise that JPMorgan has been the big buyer of Silver Eagles is not dependent on whether they are an authorized dealer; but if they are such a dealer and it turns out that the bank has been the big buyer, there could be no clearer confirmation of my premise. Of more concern is why the Mint will no longer publish a list of authorized dealers when it has done so regularly in the past? The sudden lack of transparency is more than troublesome Â? it smacks of the Mint hiding something.

Certainly, the Mint is producing and selling Silver Eagles at a record pace, even as sales of Gold Eagles retreat from the record pace in June and July. Through yesterday (Aug 18), the Mint has sold nearly 3.3 million Silver Eagles so far in August. On a day's production basis, that comes to over 170,000 coins per day (there were no sales on July 31), well above the 130,000 coins per day I had estimated as peak production/blank supply capacity. I can't know if this is a new higher level of production capacity or just a short term spurt; but if it is somewhat permanent and if JPMorgan keeps buying, it wouldn't surprising to see peak sales months of over 5 million coins.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

I'm relying on the Mint's hard data alone and continue to note that it does not appear to be plain vanilla retail buyer driving the impressive sales of Silver Eagles. By process of elimination, that leaves the hand of a big buyer at work and continue to believe that big buyer to be JPMorgan. I fully acknowledge that JPM's buying has had a direct impact on the current scarcity and high premiums on many forms of retail silver (certainly Silver Eagles) and, in fact, hold that the bank is responsible for the tightness.

Turning \$1 Billion into \$5 Billion

Today, I will attempt to make the case for how one might go about turning one billion dollars into five billion dollars by buying silver. At first, some of my specific points might seem to be at odds with my long held argument that fully paid for positions in the actual metal at current price levels are as close to a sure thing as it gets in the investment world. But it is still my conviction that owning unencumbered and unleveraged metal is the best way to go; what's different about this article is that it is directed to any entity that can plunk down a cool billion dollars or more in buying silver.

My basic case is straightforward — the price of silver is likely to climb by (at least) five times over the reasonable investment future (3 to 5 years or less), just as it did in 1980 and into early 2011. Actually, on those two prior occasions, silver rose by more than ten times from the price lows of 3 to 5 years before those price peaks. There are more reasons why silver should rise greater in price than it had in past price runs, but in the interest of brevity, I will deal only with the special circumstances confronting a billion dollar investor.

The percentage of people or financial entities in the world that could afford to buy a billion dollars' worth of anything in one shot is admittedly very small; but with more than seven billion people in the world that small percentage still translates into many of thousands of potential buyers. And if you include the number of those entities which could borrow the money necessary to buy a billion dollars' worth of silver (or anything), the number becomes simply staggering. I mention this first to establish that buying a billion dollars' worth of silver is far from impossible in terms of the number of entities potentially capable of doing so.

In fact, the real problem is not that big potential buyers don't exist, but rather that even one large such buyer would overwhelm the actual silver market; meaning there's really only room for one (possibly two) big silver buyer, no matter how many thousands of potential candidates may exist.

At current prices, one billion dollars would amount to 65 million ounces of silver (\$1 billion divided by \$15.30). Sixty-five million oz of silver is equal to one full month of world mine production. (800 million oz annually).

I don't think it is possible that any entity buying a full months' actual production wouldn't have a profound impact on the price of any industrial or consumable commodity. Certainly, no one could take a month's worth of the real world production of corn or copper or crude oil off the market without causing an upside explosion in price.

More to the point, if a big buyer did try to buy a full month's actual production of these other commodities, it would take a heck of a lot more than the one billion dollars it would cost in silver. A full month's world production of corn or copper would cost \$8 billion, while a full month of world oil production, if you could buy it and store it somehow, would cost \$140 billion. Not only is silver the most affordable and practical commodity where a billion dollars would buy a full month's world production, the cost of safely storing the metal would not exceed 0.5% per annum.

Even in the case of gold, where the equivalent of 60 years of annual world production exists in above ground inventories in some form, were someone to suddenly buy a full month's worth of actual gold production, or 8 million oz, it should jolt the price upward. Then again, 8 million oz of gold would cost \$9 billion, not the \$1 billion is silver; meaning there is much more bang for the buck in silver than in gold. Stated differently, one billion dollars' worth of gold would come to less than one million ounces, and few would hold that such a purchase, alone, would cause gold prices to explode.

Remember, I am talking about actual silver, not futures or other derivatives contracts and the key to turning one billion dollars into five billion dollars involves buying actual silver. But unlike a buyer of actual silver for amounts ranging from \$1000 to as much as \$10 million who can purchase such amounts without disrupting the market, any entity trying to buy a billion dollars of actual silver could not do so easily.

It's not as if one could just call their broker and buy 65 million oz of real silver ^{at the market} or on a limit buy order close to current prices. Or click on an online account and buy 70 million shares (one billion dollars' worth) of SLV, the big silver ETF. Clearly, there are practical restrictions on how much actual silver could be purchased when talking about a billion dollars' worth. Yet I am still convinced that anyone wishing to turn one billion dollars into five billion dollars can do so with actual silver better than any other investment asset. The trick is in how one deploys \$1 billion into actual silver in the first place.

The trick to buying a billion dollars' worth of actual silver is not to buy the metal head on, but by first locking in the price through futures contracts and other derivatives. Yes, I know I go out of my way to discourage readers from dealing on margin and to stick to real metal and now I am suggesting that a very large buyer use futures and other derivatives contracts. But the simple truth is that trying to buy a billion dollars' worth of silver in a straightforward manner would be self-defeating in that it couldn't be done without driving the price sharply higher.

In any investment, regardless of the amounts involved, the idea is to buy at as low a price as possible, not to run the price higher before one has finished investing. Admittedly, this is not a problem for most investors, most of the time; but it is a very big problem for anyone trying to buy a billion dollars' worth of actual silver. Yes, I know that I contend that JPMorgan has purchased some 400 million oz of physical silver, at a cost basis of close to \$10 billion; but it still took the bank four and a half years of consistently manipulating the price. Few have the skills and treachery of this bank and could never replicate what it has done.

So what would be my specific game plan for buying \$1 billion worth (65 million oz) of actual silver? First, I would buy 7500 contracts (the equivalent of 37.5 million oz of COMEX silver futures and the equivalent of 6000 COMEX contracts (30 million oz) in some combination of slightly out of the money call options on COMEX futures and/or on SLV. This would, effectively, lock in the price. There might be some price slippage here and that is not particularly critical to the potential fivefold price target, as ending up with 60 million oz for one's billion dollars will not change the equation.

Why only 7500 COMEX futures contracts, plus options, instead of just buying 13,000 futures contracts from the get go? While the four largest short sellers in COMEX silver futures hold an average of 12,000 contracts each, the four largest longs average 7500 contracts each and the idea is not to give the regulators any reason to interfere. Back in 2004 and 2008, the CFTC was quite explicit, in denying that silver was manipulated, in pointing out there were no barriers for any long taking delivery on futures contracts (aside from the 1500 contract limit per month). By buying no more contracts than the average of what the four largest longs currently hold would seem not to establish a level of holdings the regulators could object to.

Following the establishment of a 60 to 65 million oz long futures and options silver position, the next step is to convert these derivatives into actual metal via delivery and by arbitrage. Sticking to CME rules, a conversion from futures to actuals of 1500 contracts per month would result in 7.5 million oz of actual silver each delivery month. Even if the deliveries were spread out over the five traditional COMEX delivery months in a year, it would take a full year to get delivery on the 37.5 million oz, but the cost per ounce would be assured.

As deliveries were made at the rate of 1500 contracts per (traditional delivery) month, new futures contracts could be established to replace those futures contracts delivered against or by converting option positions into equivalent new futures, up to 65 million ounces minus actual metal received. Additionally, the process could be expedited by arbitrage opportunities of converting COMEX futures and options on futures and in SLV into metal and/or shares of SLV. Any Authorized Participant in SLV is fully capable of executing an arbitrage of futures or options into shares of SLV; there would be little real slippage as this is nowhere near the same as buying new positions from scratch.

One additional advantage a big buyer of SLV would have is a unique view in assuring any new shares purchased were met with the requisite amount of new metal. A buyer of 10 million shares or more would know instantly if the required metal wasn't deposited, regardless if the short position grew, and could take measures to insist actual metal was deposited; including converting shares to metal for more secure ownership at no increase in storage costs.

The idea is to use the COMEX futures market the way it was intended, namely, to lock in prices and not to manipulate prices as is practiced today. What are the risks in someone buying a billion dollars' worth of silver as I just outlined? First is the risk of lower prices, but at \$15 an oz, what is the realistic downside in silver? Over the past year, we have slid under \$15 on a number of occasions, but have always bounced back. Prior to that, silver hadn't been under \$15 for five years.

It's certainly not the case that just because silver hasn't been this low in quite some time that it means it can't go lower temporarily; but we are now firmly below the cost of production for most of the primary silver miners judging by recent earnings reports. While silver mine production has not contracted significantly to date, there are indications production may be moving in that direction, particularly if base metal prices stay low. Certainly, the persistent low silver price has definitely impacted potential future production, which has been further limited by the rotten resource financing situation.

The best protection against further price declines in silver is the current existing low price and if the price weren't so demonstrably low, I wouldn't recommend it for purchase by those looking to invest \$1000 or \$1 billion. Every asset has a risk of going lower, at least temporarily, and the best known way of limiting that risk is to buy the asset at as low a price as is possible. We're there in silver.

What other risks does the billion dollar silver investor face? I'd be lying if I said such an investor would face a neighborhood welcoming committee from the CFTC or the CME or the existing shorts. That's why a big buyer must be careful not to intentionally try to goose prices, like the Hunt Brothers did in 1980. In fact, the desire to drive up prices through their silver purchases was their undoing. The best way a big buyer today can avoid the Hunts' fate is make the darn purchase and be done with it, save for converting derivatives into actual metal. The better model to follow would be Warren Buffett who tried his best to buy silver on dips, mostly in COMEX futures and then converting to actuals, as I suggest. Buffett bought double the 65 million oz that one billion dollars would buy today, but the principle is the same.

Finally, I suppose there is some risk that JPMorgan, should it desire, could cap prices by selling some of its massive physical silver position (at a loss). But I still think the bank's prime motivation is to make as much as possible and JPM's buying of silver is good for future prices. Big banks seem to do everything under the sun to make money, even if it means preying on their own customer base. I think the proof of this is in the amazingly large and diverse regulatory fines and sanctions against the big banks, and JPMorgan in particular.

Yet these big banks are an integral component of the financial system and the economy and to imagine what it would look like if they didn't exist, one need look no further than Greece or anywhere without a fully functioning banking system. So, even though the big banks do things that damage others, including their own customers, they are a necessary evil hard to live without. I am certain that JPMorgan will do whatever it can to cut off competition from a big silver buyer looking to buy on the cheap, but increasingly, the only sure way of eliminating completion at low prices I can envision is to let silver prices rise.

Aside from the obvious benefit of being in position to profit by fivefold (or more) on what would be, essentially, a straight cash purchase of an unencumbered real asset, there is an additional intangible benefit — the potential fame and historical recognition of doing something right that eluded both the Hunt Brothers and Warren Buffett, neither of which completed their massive silver purchase successfully. Any big buyer of silver pulling off what I'm suggesting would be recognized and remembered for the next 100 years. That's got to be appealing to at least some of the many thousands capable of buying a billion dollars' worth of silver — not that making billions of dollars wouldn't be enough.

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