August 29, 2012 – More on SLV

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I received some interesting feedback from readers on Saturday's review, pertaining to my comments on SLV, the big silver EFT (Exchange Traded Fund). At the center of the feedback was my description of the automatic purchase of actual metal that results from any net new buying of shares of SLV (and other open-ended silver ETFs, like SIVR and ZKB). Closed-end silver funds, like PSLV and Central Fund of Canada, are structured differently and only buy actual metal on new public offerings. Since the feedback I got was meaningful, I thought I would expand the discussion.

I know there is animosity and distrust of the SLV by many in the silver community (including subscribers) and perhaps for that reason I have shied away from overly endorsing SLV (aside from disclosing family ownership). I think I perturb enough people without annoying subscribers. While I am convinced that all the metal claimed to be in the SLV and other silver ETFs is there (shorted shares aside), I can't personally guarantee that and if someone is uncomfortable, don't fight your feelings and buy another form of silver. I also know that JPMorgan is the custodian of the Trust and I am on record as calling the bank the silver crook of crooks. But in our modern financial world of banks being too big, it's hard to completely avoid such conflicts. Besides, JPM was the custodian of SLV from its introduction in 2006, long before it became the big COMEX concentrated silver short in 2008.

As a silver analyst, it is impossible to legitimately exclude the influence of SLV on the silver market. In little more than six years it has grown to be the largest single holding of silver in the world with more than 300 million ounces on deposit. The success of the SLV has further encouraged competitors and the total combined metal holdings of all silver ETF-type funds is now more than 600 million ounces. That's an extraordinary amount of silver, seeing how it represents more than half of all the industry grade metal in existence. If I had to pick just one reason for the big run up in silver prices from 2005 (when the SLV was proposed), it would have to be the combined silver ETF metal buying pressure. You can't buy more than 50% of the world inventory of anything without profoundly impacting the price. Now that I think of it, I don't recall any similar buying event in any other commodity. Just for comparison purposes, the combined gold ETF buying of more than 80 million ounces, now worth some $140 billion, was also behind the rise in gold prices from 2004 (along with the end of gold leasing and miner forward sales). But whereas the amount of silver bought by ETFs was more than 50% of total world bullion inventories, the 80 million gold ounces purchased represented only 2% of the 3 to 5 billion gold oz said to exist. My point is that the influence of SLV and the other silver ETFs is much stronger on the silver market and its price than the gold ETFs are on the gold market by a wide degree. That stronger relative influence will continue and you can't legitimately analyze silver by ignoring SLV. Please remember, because you get so much more metal for your money with silver compared to gold, the storage arrangements are much more critical in silver than in gold and also explain the much larger holdings of silver in percentage terms relative to total inventories.

The incredible influence of the SLV and other silver ETFs comes as a result of a good idea, namely, making it easy to buy silver. Yes, the best way to hold silver is in your personal possession and control, but that requires more effort than buying a share of stock. Please don't interpret this in any way other than as intended Â? analyzing what will influence the price of silver. Even if you own only Silver Eagles or bars or other coins, that doesn't make the price of silver any less influenced by SLV and the other silver ETFs. I thought the idea of a silver ETF was so good; I had initial doubts as to whether it would actually be allowed to come into existence. My doubts were based upon there not being enough silver available at the then-current price of $7. I was only half wrong in that there was enough silver, just not at $7, as the price doubled into the launch and climbed much higher over the years.

Early on I knew that the SLV was going to be big deal if it came because the process of buying silver was simplified. I remember writing how a friend, Carl Loeb, nicknamed it the Â?Death StarÂ? as it was structured to acquire much of the 1000 oz bars of silver in the world at some point. What I felt then and tried to describe Saturday was the idea that the SLV and other silver ETFs were the perfect silver accumulating machines. As investors bought net new shares, new metal had to be mechanically secured and deposited into the Trust(s). And that's the way it has largely worked for the past six years as silver ETF holdings have exploded along with the price. And neither am I concerned that the silver ETFs have proved too popular because while much metal is held in the combined silver ETFs, the true ownership of this metal is extremely diversified. There are no big concentrated holdings in SLV or the other silver ETFs according to the data. What this means is that all this silver is held in the most diversified and public manner possible. It will be the public, therefore, which decides on when it should be sold. You can't have a better free market circumstance than that.

The only fly in the ointment was something that I had not anticipated in 2005-2006 (and neither did anyone else). I had never contemplated the role of short selling in shares of SLV in circumventing the mechanical design and intent of the Trust. Never, that is, until I observed in first hand in 2008. That's when I calculated that the short position in SLV had climbed to the equivalent of as many as 50 million oz. http://www.investmentrarities.com/ted_butler_comentary/06-16-08.html With the benefit of hindsight, I should have done more than what I did (writing publicly and to Barclays, the sponsor at the time). Looking back, I am convinced that JPMorgan (which had just acquired Bear Stearns' short position) was the big SLV short seller and that contributed mightily to the brutal 50% price smash in late 2008. This same situation and outcome occurred in 2011, as the reported short position in SLV grew to 36 million shares and prices were soon smashed lower with JPMorgan's influence.

A reader grasped what I was saying on Saturday by telling me that I must more fully explain the real significance of SLV short sales versus COMEX short sales of futures contracts. Because COMEX futures contracts are paper contracts bought and sold on a small amount of margin money to bet on the price of silver, only a small percentage of these contracts are settled by actual delivery of metal. But in the SLV, all the buyers of shares pay in full in some manner and the prospectus represents that those buyers should have actual silver deposited into the Trust and backing all shares. Clearly, the short sellers of SLV don't deposit silver. I would go so far as saying that in the case of JPMorgan, it sells SLV short because it doesn't have the silver and chooses not to buy it because that would cause the price of silver to rise. This makes short sales of SLV more Â?potentÂ? and manipulative to the price than short sales of COMEX futures contracts by a factor of around 10 to 1. Because all the buyers of SLV are entitled to have metal on deposit backing all their shares, short sales completely negate the requirement to back all shares with metal and the whole purpose of the Trust. A 10 million share short position in SLV is equal to a 100 million ounce COMEX short position (20,000 contracts) by my rough calculation.

Why this is so important at this time is because I sense the short position in SLV may have risen sharply. I hope I'm wrong, but as I indicated Saturday, I had been expecting big deposits of metal into the Trust, on the order of several million oz, as a result of the high trading volume and price increase of the past week. Instead, there was close to a 2 million oz withdrawal from the SLV over the past couple of days. The most plausible explanation is that there has been a notable increase in short selling in SLV. We won't know that for a couple of weeks, as the cut-off for the next report isn't until Friday, Aug 31 with a report release date of Sep 12. But I'm jumping the gun a bit, because if the short position in SLV has risen sharply, I'm going to attack it (and the whole manipulation) stronger than I have in the past.

There is no doubt that the COMEX total commercial net short position has risen sharply in both silver and gold. This creates the risk of a sharp sell-off. It doesn't mean we must sell-off, just that the risk of that has increased. Seeing how the big 50 day moving average in silver is $3 below the current price, it's not hard to grasp the dimensions of a potential sell-off. If the commercials do collusively rig prices lower, that will be the number they will be gunning for and lower. If the manipulation is successful, it will bring additional shame on the CFTC, particularly Chairman Gensler and Commissioner Chilton, for not protecting the American people and for not honoring their oath of office, even when warned in advance. The Commission can bring as many enforcement cases as it desires; but until it addresses the flagrant silver crime in progress, its reputation will remain in the gutter.

But a sell-off isn't guaranteed either. The one thing that could derail a manipulative paper induced sell-off on the COMEX is, of course, a further tightening in the wholesale physical market. Ironically, the thing that has me so concerned about a potential increase in SLV shorting may mean such a physical tightening is at hand. In other words, any big increase in SLV shorting most likely is because enough silver to buy and deposit is simply not available. It may be easier for JPMorgan or others to sell SLV shares short as the only practical alternative to buying real silver in a tight market. This potential increase in SLV shorted shares, particularly when combined with frantic silver warehouse movements, paints the very picture of extreme tightness and potential shortage, the one development that would surely launch the price of silver.

It comes down to will the COMEX commercial crooks be able to rig one last sell-off before the physical silver crunch hits in earnest? It's important to keep current market conditions in proper perspective. We may witness the patented COMEX scam sell-off in silver yet again, but we will witness the physically induced price surge at some point for sure. The sell-off is a maybe; the eventual price surge is a near certainty. For me, that means gritting my teeth and focusing on the long term. And not letting up on pressing the crooks at JP Morgan and the CME Group and the negligent regulators at the CFTC.

Ted Butler

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Silver – $30.75

Gold – $1660

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