December 1, 2010 – Hitting on All Cylinders

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Very recent developments in silver have been uniformly favorable, and this appears to be reflected in the price action. That's not always the case. Yesterday, we closed at a new 30-year high, with follow-through today as I write this piece. Here's an update since the weekly review.

The delayed release of the Commitment of Traders Report (COT) conformed to expectations, namely, no big changes in either silver or gold. But no dramatic change should be interpreted as bullish for both. In what I feel is the most important category, the big four net short position, the large commercial shorts stood aside as silver rose $2 in the reporting week, while gold climbed around $35. This has been the basic COT story in the three month rally Â? the dominant shorts not adding to short positions for the first time in memory. The lack of additional short selling from the manipulators is an important factor behind the price rise. It is also a further proof of the manipulation. In a nutshell, the COT structures are still favorable, especially in silver.

A bigger silver story has been in physical market developments. The first two days of delivery notices on the big December contract on the COMEX have been issued and they are the lowest in my memory, at fewer than 100. The number of contracts remaining open in December is more than 1900 (as of this morning). This number of open contracts should decline in the days ahead, but the small number of delivery notices so far is striking, as was the dramatic tightening in nearby spread trading. It is certainly suggestive that sellers are not rushing to deliver metal for some reason, in spite of historically high prices. It could be because they don't have it to deliver. I still suspect that the recent 6 million ounce withdrawal from the big silver ETF, SLV, may find its way to COMEX warehouses for December delivery purposes. Many have been quick to label these COMEX delivery developments as indicative of a looming default. While that is always possible, given how tight the silver physical market seems to be, I feel that is unproductive and the equivalent of yelling fire in a crowded theater. All should be prepared for such an outcome eventually, or even sooner, but I prefer to avoid inflammatory predictions (believe it or not). The idea here is to remain properly positioned in silver for the long run and not succumb to theatrics.

There was a slight increase in SLV holdings yesterday (500,000 oz), but based upon pricing and volume, many millions of ounces are owed to the Trust. My hope and expectation is that the sponsor, BlackRock, will pressure the short sellers of SLV shares to quickly deposit the metal or buy back those shorts. Either outcome, of course, will be bullish for silver prices. It will also be the right thing to do for BlackRock. Many have asked me about the growing discount of SLV shares to the spot price of silver, with some recent articles suggesting this is evidence of a growing distrust by investors (most likely because of the JPMorgan connection). This is simply not true. The discount of SLV to spot silver is purely reflective of the cumulative deduction of the 0.5% annual fee paid to the sponsor for the administration and storage costs involved in holding physical silver, as disclosed in the prospectus. It costs money to professionally store silver. The discount is mechanical and mathematical in nature, and to suggest it is anything else is wrong.

Where silver physical demand is particularly striking is on a head-to-head comparison to gold, the premier precious metal. On every possible measurement, silver physical demand is growing much more sharply than gold physical demand. That includes the relative demand in US Mint bullion coin products, ETF metal flows, COMEX inventory turnover and overall retail and wholesale demand. Quite simply, money is now flowing into silver at the highest relative rate in history compared to gold. This is long overdue and makes perfect sense to me, given the essence of the real silver story. This is as a result of the world waking up to silver's industrial versatility and investment profile. I believe this awareness is in its infancy and destined to accelerate. It is not too late to switch from gold into silver for the very best investment returns. And make no mistake Â? this investment flow into silver is vastly for cash on the barrel head and not on a leveraged margin basis. This makes any talk of a bubble existing in silver as appearing absurd. Modern financial bubbles are based upon excessive leverage and financial gimmicks. There is nothing gimmicky about silver investment to date. It is something we must guard against, but not every price increase is a bubble.

The other big silver story is the march towards resolution on the position limit issue. It is gratifying how more people everyday seem to be discussing and growing aware of this issue. A recent Reuters article highlights the position limit issue
http://www.reuters.com/article/idUSTRE6AS5SR20101130?WT.tsrc=Social%20Media&WT.z_smi
reuters_biz&WT.z_smid_dest=Twitter

Allow me to present my take on this position limit article. There is nothing complicated about the issue, nor any reason for delay. The truth is that in all commodities, except one, no radical or disruptive overhaul is needed. This can be concluded by looking at position limits in reverse, namely, not from what the actual level of limits and exemptions should be, or when they should be enforced, but what position limits are supposed to accomplish in the first place. This perspective has been shunted aside lately, and in my opinion leads to faulty impressions.
It is important to recognize why Congress and the President specifically mandated position limits as law in the Dodd-Frank Reform Act.

Speculative position limits exist and have existed in the commodity futures markets for 80 years. Manipulation is the most serious market crime possible. The sole and noble purpose for position limits is to prevent concentration and manipulation; nothing more, nothing less. In fact, position limits are the only effective remedy against concentration and manipulation; there is no other practical alternative. The purpose behind position limits must be continuously kept in mind in the overall debate. This is the key.

When viewed from this perspective, it should be easy to understand why this is an issue specific to silver and not to any other market. That's because there is no overt concentration or manipulation, in terms of real world production, consumption or level of inventories, currently in place in any market Â? except silver. In other words, there is no rush to implement or enforce position limits in most markets because there is no compelling concentration currently in existence. The entire discussion about position limits in commodities of finite supply is prospective in nature; the whole intent is to head off concentration and manipulation in the future. The CFTC is not under the gun to implement position limits to terminate a current concentration in most commodities.

But make no mistake Â? there is a current concentration and manipulation present in COMEX silver, where one or two US banks have held a short position greater than 25% of world silver mine production. This has never occurred in any other commodity. This is what separates silver from every other commodity. This is what makes the issue of position limits in silver different and more urgent than in any other commodity. There is no apparent crime in progress in any other commodity; just in silver. This is why the matter of silver position limits is the central issue when debating position limits in general.

To this end, an important force for the advancement of action on position limits seems to forming in the person of Commissioner Bart Chilton. This is extremely encouraging. On Sunday, fellow subscriber, Dr. Dave Janda, conducted a very informative and constructive interview with Commissioner Chilton on his radio program. I highly recommend you take a listen http://www.davejanda.com/audio/BartChilton112810.mp3

Just this morning, at the CFTC open public hearing on rulemaking, Commissioner Chilton re-iterated his concern that the Commission is dragging its heels on the enactment of position limits are required by Dodd-Frank in the strongest possible terms (I heard Commissioner Chilton's opening statement live, but it should be available soon in a recorded format at the CFTC site). While Chilton did not mention silver specifically, he didn't have to, as this is almost solely a silver issue. It's easy to criticize and find fault with market regulators and I have done my fair share in the past; I even remember directing that criticism in Chilton's direction at times. But I would much rather offer praise and encouragement when appropriate. Bart Chilton deserves much praise for his stance on quickening the pace of position limit implementation. I hope you encourage him as well, as it is certainly justified.

My only concern is that the regulators may have waited too long for establishing legitimate speculative position limits in silver because of developments in the physical market. Let's face it, when the silver shortage hits in earnest, the debate about position limits will become secondary, as will every other factor about silver. Based upon recent developments, the physical silver shortage just may be the wolf at the door. The volatility in silver is not likely to abate, but the special bullish set up that I outlined on November 17, looks intact.

Ted Butler

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Silver – $28.50

Gold – $1392

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