

February 14, 2011 – Hedging Insanity

Hedging Insanity

A number of subscribers have questioned me about the story in today's Financial Times of London concerning an increase in hedging by silver miners. Most wanted to know if this was bearish for the price of silver, as the article stated. The answer is no; actually it's quite bullish. That's because the impact on price is only felt when the sell hedge is established. Since the selling has already occurred, there would be no bearish impact on price afterward. There could be upside price pressure if the hedges are attempted to be bought back at some point. I think that's a likely prospect.

The FT article estimated that the silver hedging totaled close to 100 million ounces, a many fold increase from the total amount held in mid-2010, when the total ran 15 to 20 million ounces. One company, Minera Frisco, is said to have hedged 70 million ounces of silver last year. Separately, a reader sent me a link to Minera Frisco's hedge book (scroll down to last frame)
<http://www.infomine.com/index/pr/Pa985230.PDF>

I don't think I have ever seen such a dangerous hedge book (and I have seen plenty). By my calculations, the company is already in the whole for upwards of \$600 million on all its metal hedges (with silver accounting for \$300 million of that total). Its additional exposure will be many times that amount if prices move higher as expected.

I had come to believe (or maybe hope) that the miners had learned their lesson by hedging. Clearly, I was wrong. This is very reminiscent of the hedges put on by Barrick Gold and Apex Silver years ago. The hedging experience cost Barrick \$10 billion in total and put Apex into bankruptcy. This Minera Frisco situation is remarkable similar to the feelings I had when I wrote about Barrick and Apex. I don't see how it ends well for Frisco's shareholders.
http://www.investmentrarities.com/ted_butler_comentary/01-03-06.html

Lastly, on a profoundly sad note, I learned this morning that my good friend and mentor, Izzy Friedman, lost his wife of 55 years. Gabby was a warm and strong woman, always a delight to talk with. She was cherished as a wife, mother, grandmother and great grandma. She made the world better by her presence and leaves it lessened by her departure. I was honored to know her. Please join me in wishing Izzy and his family comfort in their time of sorrow.

Ted Butler

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