

February 3, 2016 – The Supply Chain

The Supply Chain

I had an interesting conversation with my son the other day. Ross flies international cargo and since he just completed a trip, I asked him how everything went. He told me his last leg was from Quito, Ecuador to Miami, so I made a guess and asked him if he was carrying flowers. He said yes, as a matter of fact, and reminded me that St. Valentine's Day was almost upon us. Then Ross began to tell me the particulars of the trip.

His leg ended in Miami, but the plane was refueled and a fresh crew flew the flowers to Amsterdam, still the flower distribution center for the world. From there, the flowers were flown all over the world to the final points of distribution. The bottom line was that from when they were cut in Ecuador, the flowers (which have a shelf life of just under two weeks) were at their final retail point of sale within three days. Such is the wonder of modern supply chain logistics.

You can put many tons of flowers into a Boeing 747 and the same goes for asparagus from Peru and farm-raised salmon from Chile, products my son flies on a regular basis. Such highly perishable commodities have to be moved quickly and reliably and not on any slow boat to China. Certainly, non-perishable commodities, like oil or industrial metals can't be transported by air in a cost-effective manner, nor is there any need to. On one level, my point is that the distribution of goods nowadays is a true modern marvel even though the logistics are not normally considered when we go shopping.

As you know, I have been seriously contemplating the logistics behind the frantic physical movement of silver being brought into and taken out from the COMEX-approved silver warehouses. This turnover emerged nearly five years ago and has persisted to this day. The silver movement is unprecedented in that it didn't exist previously and has never existed in any other metal or bulk commodity. For that reason alone, that this physical inventory churn is unique to silver, one would think it would be widely discussed. In that case, one would be wrong.

Instead, the unprecedented and unique physical turnover in silver in the COMEX-approved warehouses is hardly discussed at all. Go figure. It's certainly not as if silver is highly perishable and must be moved before it spoils. In fact, I wrote a short public article on the physical silver turnover a few days ago and few of the many comments in response had anything to do with the issue of the inventory movement. For some reason, there is a near virtual silence on the highly unusual COMEX physical silver movement. I'd like to offer some observations on this.

I'm no stranger to witnessing the new findings that I have on silver being slow to take hold. Whether writing about metals leasing, the COT market structure approach or JPMorgan's involvement in the silver market, I'm used to a slow but gradual acceptance for much of what I've introduced. The best example is the original premise of a COMEX silver price manipulation that I formulated more than three decades ago. Not only was I mostly ignored for many years, those who took the time to consider the issue were quick to dismiss it.

Since then, however, I think I'm being fair to say that the idea that silver (and gold) might be manipulated in price on the COMEX is accepted by just as many, if not more of those who take the time to study the issue. Of course, there will always be those who reject it out of hand, probably because they can never admit to a changed opinion on anything. Also to be fair, most of these findings were complicated in nature and needed time and effort to think through; these were not conclusions that came to someone without careful consideration.

But this COMEX physical silver turnover is different in that it's not that complicated. Enormous quantities of metal have been moved into and out from the COMEX silver warehouses on a weekly basis for nearly five years. Early on I fully admitted that I didn't predict such a physical movement would develop and also admitted that it might stop at some point (although its cessation after so many years should also invite explanation). I was just reporting on a highly unusual development that was capable of being verified daily and asking out loud what it meant, offering my conclusion that it had to be an indication of physical tightness.

Just to remind you, my main, if not sole motivation in holding silver as an investment asset is because I believe it will go into a pronounced physical shortage at some point. A physical shortage is the most powerfully bullish force possible for any commodity, bar none. If I were to ignore any legitimate sign of physical tightness that could lead into outright shortage, I should be tarred and feathered.

Silver, it appears to me, is being shuffled into and out from the COMEX warehouses as if it's a perishable commodity, when we know it's not. In the absence of any rational explanation to the contrary, this physical movement suggests a tightness driven by demand of some type. Because coming up with a plausible alternative rational explanation seems difficult, if not impossible, it is more reasonable to accept the obvious explanation of tightness. Due the data being available and easily verified, I would be surprised if remains hidden in the shadows for long.

My son Ross is now 37 years old, married and raising his own son. This is the second supply chain article on silver that featured him. Fourteen years ago, I wrote an article, "Running on Empty," about how I took him shopping and related that experience to silver.

http://www.investmentrarities.com/ted_butler_comentary/03-05-02.html

The gist of that article was that thanks to efficiencies in supply chain management and just-in-time inventory practices, it was only a matter of time before some type of break in the chain or insufficient silver supply created a situation in which industrial users panicked and attempted to build physical silver inventories of their own. This would set off a price chain reaction in silver like a lit string of firecrackers a mile long. Long time readers know this has always been a bedrock belief of mine. Despite coming close in early 2011, the industrial user inventory buying panic in silver has yet to occur. But I still remain convinced that such a panic is just a matter of time.

I was reminded of my long held conviction upon reading a new article describing a current industrial user inventory buying panic in silver powder, used in various manufacturing applications including as pastes for solar panels.

<http://www.digitimes.com/news/a20160201PD207.html>

First, let me fully acknowledge that silver powder is different from silver in the form of industry standard 1000 oz bars, just as Silver Eagles are a different form of those same industry standard bars. The fact is that there are always countless examples of industrial users rushing to build physical inventories at the first signs of delayed deliveries of any commodity or product. But I think it best illustrates the likelihood of such a buying panic in industry standard bars of silver by using silver-related examples. I'm not out to trick anyone; just in using the best examples of what explains my point.

The reason just about all industrial users begin to panic and attempt to build their own physical inventories at the first signs of delivery delay of any necessary ingredient or component is, first and foremost, because people decide such things and there are people behind the users' decisions. When a hurricane or snowstorm threatens to hit and disrupt supermarket or gasoline supplies, we all know how people will behave.

But collective human instinct is magnified when it comes to industrial users facing a disruption in supplies because such a disruption could threaten an enterprise's basic mission and continued operation. The very last thing corporate managers would tolerate is having to shut down assembly lines due to the lack of a single ingredient or component. That's the reason, as I explained to my son 14 years ago, why the Ford Motor Company panicked and bought palladium in the late 1990's, driving its price up tenfold. Not only is there a compelling logical explanation for what drives an industrial user to build inventory in a time of shortage, historical and contemporary real life examples abound.

It doesn't matter whether I use products comprised of silver or a different precious metal to illustrate the likelihood of a coming user panic in the main industrial form of silver. Such a panic could occur in any material or product. Any form of any product that is industrially consumed is capable of slipping into a shortage and resultant user buying panic as and when demand exceeds supply. By that definition it is at least possible for silver in the industry standard form of 1000 oz bars to develop into a tight enough supply circumstance to trip off a user buying panic.

But there is so much more to it than that. The user buying panic in silver powder is not accompanied with the separate outside force of investment buying demand for silver powder. In the case of Silver Eagles, currently being rationed by the US Mint, there is also not present any widespread investment demand for the coins, as JPMorgan is simply sucking up what the public isn't buying. In sharp contrast, as and when investment demand returns to silver in general, that demand must translate into 1000 oz bar form of silver and that investment demand will collide with an inventory buying panic. It doesn't matter which trips off the other, either investment or industrial demand, a rush to one will result, most likely, in a rush for the other.

This is not a circumstance common to any other commodity. Even in the case of palladium and the Ford Motor Co, some hedge fund buying helped goose the price, but there was no general palladium investment demand at the time. Silver is very special and unique in this regard. In practical terms, it is the only commodity to have both industrial demand and potential broad and general investment demand. No other industrial metal, including platinum and palladium, has broad investment demand. Gold, certainly has broad investment demand, but is lacking a strong industrial consumption demand.

It is the very special and unique dual demand profile in silver that sets it apart from other commodities. No other commodity has both the general investment and industrial demand that exists in silver in its most critical and prevalent form. 1000 oz bars. Considering how small the visible world inventory of 1000 oz bars is, less than 820 million oz or \$12 billion, any true competition and scramble for available supplies would set prices on a course destined to reach the heavens. I challenge you to imagine a realistic price at which either investors or users would quit in their quest for silver in the form of 1000 oz bars should delivery delays commence. I'll give you a clue. Think of the prices appearing in the case of war time shortages, but add the industrial user buying panic component.

A few words about today's price surge. In penetrating its 200 day moving average, gold now has most of its important moving averages underneath its current price and there is little reason for technical funds to be short and not be long. Silver is still below its 200 day moving average, but at its 100 day moving average and above all shorter moving averages. Gold has definitely been leading the way up until today, but both it and silver hit price highs not seen since early November. This gold and silver price surge is similar to moves in platinum, palladium, copper, other base metals and crude oil, which is in the general sense of my expectations.

As far as predictions for Friday's COT report, there didn't appear to be radical position changes through yesterday's cut off in COMEX gold and silver, but it would be safe to expect some slight deterioration or technical fund buying and commercial selling. Today is a different matter, of course, and I can't help but think it's not entirely coincidence that any positioning changes for today won't be available until a week from Friday. I can't say I'm not suspicious about what the commercial crooks on the COMEX might have up their sleeves, but that's a constant.

I would imagine there was heavy technical fund buying and commercial selling today, but also that it is not likely that one day's trading would flip the market structure to bearish. Even if it did, it would be real hard for me to part with silver at the still depressed current price. So I will remain fully positioned until I see a completely different market structure, circumstances or much higher price. Knowing how crooked the COMEX game is, I will try not to be terribly surprised at whatever may unfold.

Up until now, things have progressed largely within the expectations garnered from the COMEX market structure set up. It's taken a bit longer than typically for the rally to unfold and gold has clearly led silver, also a bit out of character, despite some pretty strong actual supply/demand factors in each, including indications of physical tightness. In gold, the physical tightness is reflected in the increasing holdings in GLD and COMEX deliveries and narrowing spread differentials. In silver, COMEX physical turnover and a decline in the holdings in SLV on steady prices suggest a big buyer is still accumulating clandestinely.

Therefore, it would seem the prudent approach in silver is to expect continued COMEX price shenanigans in the short run and anticipate an eventual shocking upward revaluation in price when the inevitable physical clash between investors and industrial users occurs. In fact, I'm convinced the price hesitancy emanating from the COMEX is designed to delay the inevitable day of investor/user silver buying competition.

Ted Butler

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Silver – \$14.65 (50 day moving average – \$14.09)

Gold – \$1140 (50 day moving average – \$1082)

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