

January 11, 2017 – Keeping It Simple

Keeping It Simple

First, here's an article I just wrote for Investment Rarities –

All too often, investors rush into investments based on the most recent price performance. This crowd behavior means getting caught up in group emotion and forgetting about historical lessons. When deciding what to invest in, the best alternative is an asset with the lowest risk and the highest possible profit. There are ways of minimizing the risk of loss, such as insured bank deposits, but the tradeoff is that returns are virtually non-existent. In order to increase the profit potential of an investment, some risk is necessary. The trick is in finding the investment that offer the best risk/reward ratio – the one that holds the lowest potential risk and the highest potential profit.

There are ways to find such investments. One way involves an age-old maxim – buy low and sell high. The key to selling high, of course, is in first buying low. Currently, buying low would seem impossible in stocks, bonds or real estate. I'm not saying such assets can't go higher; just that they are closer to all-time highs than historical lows. It's possible to profit by buying high and selling even higher, but that's very different from buying low because the risk of loss is greater in higher priced assets.

The asset that best fits the buy low/sell high profile right now is silver. No metal can go bankrupt or get caught up in an accounting scandal or simply disappear by edict, certainly not one as needed for modern life as silver. The only risk to holding silver is that the price could move lower. But because the price of silver has already declined precipitously over the last six years, it is already low – down more than 60% from its highs in 2011.

Not only is silver down sharply in price against gains in stocks, bonds and real estate, it is down relative to gold, its most comparable asset. This is reflected in the historically high silver/gold price ratio where it takes more than 70 ounces of silver to equal the price of one ounce of gold, despite there being, effectively, more gold in the world than silver. On every conceivable measure, both on an absolute and relative basis, silver is the most undervalued asset in the world, unquestionably qualifying it as the premier investment. There's a wealth of data explaining why silver is priced as low as it is. It has to do with my research pointing to an ongoing price manipulation on the leading futures exchange, the COMEX. This manipulation is largely orchestrated by JPMorgan which has been accumulating massive quantities of actual silver — some 550 million ounces — over the past six years at the depressed prices the bank itself created. Not only is silver priced (artificially) low, there's a darn good reason why it is priced so low.

But buying low is only half the equation. Even better than silver's unquestionable low price and low risk is its enormous profit potential. Whether looking backwards or forward, it's impossible to deny silver's profit potential. Just getting back to its price peaks of six years ago indicates a 300% profit from current levels. And history has demonstrated that when silver does move, it moves big and it moves fast — the 300% gain into 2011 took little more than eight months. What are the odds that stocks, bonds or real estate could triple in that time frame?

I don't believe silver should be bought based primarily upon past performance, even though history should never be ignored. The real reasons for buying silver are the current facts. Those facts include the near-certainty of a physical shortage whenever a relatively small number of world investors take a shine to the metal and attempt to position themselves in the best risk/reward equation in existence. Any such investment interest will clash with the industrial users of silver and set off a scramble for available metal which will cause prices to melt up.

This silver scramble for actual metal is unavoidable, with only the timing in question. Because the actual available supply of metal is so small, it will take only a relative handful of investors to set off the buying competition with the industrial users. It is impossible for large numbers of investors to acquire actual metal simply because large amounts of metal don't exist to accommodate them. You can be sure that this is why JPMorgan has painstakingly acquired the largest privately-held physical stockpile of silver in history. It has positioned itself for a price move in silver well-beyond any gains seen in the past, including the tripling of prices into 2011. Back then, JPMorgan wasn't positioned for a large price rise; today it is.

It's an understatement to say that silver has the best risk/reward circumstance of any other asset currently. You won't find this assessment bandied about in the daily news flow, but if you step back and dig into the facts, I believe that you will be able to grasp not only the current low risk in buying silver, but the incredible profits to be made. If you don't want to risk a lot and, at the same time, position yourself to make a potential windfall, then keep it simple and buy silver. End of article.

There has been some recent news that alleges that the creation of the gold futures contract on the COMEX in 1974, when the US legalized the ownership of the metal after 40 years, was designed to discourage physical ownership of the metal by diverting investment interest to paper futures contracts. I don't agree with the premise of such an intent from the beginning, but do very much agree that the futures markets have changed dramatically over the past four decades, morphing into a state where the paper market tail has come to wag and set the price in many commodities. But the references to what occurred when gold was legalized and futures trading commenced got me to thinking (I know, always a dangerous thing).

I was a commodity broker for Merrill Lynch in 1974, in my twenties, and had firsthand experience in what was a milestone in financial history. Of course, I wasn't thinking much about history or even the long term future back then, more or less taking every day as it came. Deeper contemplation and reflection come with age, or at least so it seems to me now.

One thing I was definitely not thinking about back then was the long term history and future circumstances surrounding the price and other relative relationships between gold and silver. I would come to discover the COMEX silver price manipulation in the mid-1980's, but was far removed from such thoughts in the mid-1970's. When I did eventually begin to study silver more intently a decade later, it wasn't long before I began comparing gold and silver relationships more intently as well.

This led to a series of findings and articles over the years in which I compared the growth in aboveground world gold inventories and the severe depletion in above ground silver inventories. It wasn't that the world was producing less silver, it was a case that it was consuming more than it produced; because silver had transitioned from being a traditional precious metal to a vital industrial material that was consumed over the course of the last century.

Previously, I have always highlighted the line of demarcation when world silver inventories peaked and began to decline as 1940, the start of World War II. That was when silver inventories hit the 10 billion ounce mark, while world gold inventories were less than 2 billion oz. In 1940, the silver/gold price ratio was around 70 to 1, not far from where it is today, even though silver inventories, in the form of 1000 oz bars, have declined to 1.5 billion oz, while total above ground stocks of gold have increased to 5.5 billion oz. I have always concluded that the unchanged price ratio was absurd considering the decline in silver inventories and growth in gold inventories and prima facie proof of price manipulation.

I certainly stand by my previous findings, but in looking to shoot holes or find weaknesses in my own premise (something I do on a consistent basis), the recent commentary about the legalization of gold ownership by US citizens and the advent of COMEX futures trading in 1974, provides a reason for a slight revision. Because the price of gold was set by government edict until the immediate years before 1974, it's not quite fair to compare the silver/gold price ratio when the price of gold was fixed. Also distorting comparisons of the silver/gold price ratio was that the price of silver was fixed by the US Government until the mid-1960's. It doesn't change the fact that world silver inventories plummeted since 1940, while gold inventories rose; just that the price of each wasn't driven by the free market.

But seeing as the prices of both metals were trading freely (or at least without overt government dictate) when gold was legalized in 1974, it now seems reasonable to me that that is when the comparisons should be dated from. In 1974, the total above ground inventory of silver was close to 6.5 billion oz (down from 10 billion oz in 1940) and the amount of above ground gold was 2.8 billion oz (up from under 2 billion oz in 1940). The silver/gold price ratio in 1974 averaged 32 to 1 (gold's average price was \$160 per oz and silver's price was \$5 for the year).

Today, there are 1.5 billion oz of silver in the form of 1000 oz bars (double this amount if you want to include metal that may come to market above \$50 or \$100) down from the 6.5 billion oz in 1974. In gold, total world inventories are now over 5.5 billion oz, close to double the 2.8 billion oz in 1974. Despite the depletion of most of the world's silver inventories and the doubling of world gold inventories over the past 42 years, the price of gold has doubled relative to silver as reflected in the silver/gold price ratio widening from 32 to 1 in 1974 to more than 70 to 1 today.

How can that be? How is it possible for the amount of actual silver in existence to decline precipitously, while the amount of its most comparable counterpart to double and for the relative price of the now rarer precious metal to fall by half? Prior to 1974, I suppose one could contend the dilemma could be due to artificial government pricing of each. But since 1974, direct government price setting is much more difficult to prove. Then what set of circumstances could possibly explain a set of actual inventory facts and relative price performance that defies any conformity with the free law of supply and demand?

The only such explanation that comes to mind, since the inventory statistics are easily documented, is that there must be something "hinky" about the relative price. That something is the manipulative price setting on the COMEX, where a few big paper traders dictate prices to the rest of the real world of metals. And it is a world where the financial powerhouse and crook extraordinaire, JPMorgan, has come to own fully a third of the 1.5 billion ounces of above ground silver inventory, setting up the most explosive potential price rise in history.

If anything, since the advent of gold legalization and COMEX futures trading in 1974, because the price of gold has far surpassed silver's price on a relative basis, even though there's a heck of a lot more of it now than silver, it would be much closer to the truth to say that a much lower price for silver was the intended aim, if there was a nefarious objective at play. As always, this is not intended as any knock on gold or me implying that it won't rise in price. As I hope you know, I have been quite favorably disposed to gold as a result of recent COT market structure changes, although I remain convinced that in the long run, silver will vastly outperform.

On to the recent developments in COMEX market structure; still the overriding price driver. I have read some recent commentaries suggesting other forces (in China and elsewhere) are exerting much more influence on price; but I don't see it. In gold and silver and other commodities, the price-setting domination of the managed money and commercial futures traders looks stronger than ever. In other markets, like crude oil, copper, sugar and the grains, the big banks are not the commercials, as they are in precious metals; but price is still a managed money/commercial arrangement.

I do have some trepidation for this Friday's COT report, as it is easy for me to envision a significant increase in managed money buying and commercial selling through the cutoff yesterday. Both gold and silver rose in four of the five trading days of the just concluded reporting week, with gold finishing more than \$22 higher and silver by 45 cents for the week. In addition, both gold and silver penetrated all the moving averages up through the 40 day moving average during the reporting week. This is the standard prescription for managed money buying and commercial selling. Further, trading volumes were very high, although so high as not to be strictly attributable to managed money/commercial positioning (there seems to have been inordinately large HFT and other computer day trading). Plus, I still have uneasy feelings about the prior week's COT report understating the full deterioration in market structure due to holiday time delays.

Certainly, the recent rally in gold to six week highs and in silver to four week highs is completely consistent with what I had been describing as an extremely bullish COMEX market structure in each. What drives prices lower, is also what drives prices higher Â? it can be no other way if one is talking about the main price driver. So how much of a deterioration are we likely to see in Friday's report?

Complicating matters, in addition to very high trading volumes, is that total open interest increased by 20,000 contracts in gold and only by 1000 contracts in silver. I consider this a complication because we already had a large managed money gross short position and low gross long position in gold, meaning that very large managed money buying in either category would tend to cancel each other out in terms of changing total open interest. For example, in the managed money traders bought 10,000 new gold longs and also bought back 10,000 existing shorts, that trading alone would result in no change in total open interest (depending on what the commercials d

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