

January 25, 2017 – When to Sell Silver

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Here's an unedited version of an article I just wrote for Investment Rarities –

The other day, someone professionally involved with silver and who I've known for many years asked me a question that gave me pause. He asked "what's the right price for silver?" Just to be clear, he didn't ask me at what price I would sell all or most of the silver that I own, but that's what I've been thinking about ever since. I'll tell you first how I answered his question at the time, and then get into the afterthoughts that his question set off.

There are two right prices for silver. One is what the price silver would be if it was never manipulated by paper derivatives to begin with; or the long term free market equilibrium price. This is the price which will encourage and reward producers sufficiently, while providing silver consumers with a continuing supply at a reasonable cost on a long term basis. Putting actual numbers on the free market equilibrium price for silver, I'd say somewhere around \$50 per ounce, or about triple the current price. Again, that's my best estimate for the price of silver if no price manipulation had ever and no longer existed.

That makes silver a great buy, since there aren't many assets one can buy and hold with low risk and the chance to triple in value, particularly one that had no chance of going bankrupt or worthless. But whether silver was a great buy at present was not my friend's question; the question involved the future price and I just answered that one right price was around \$50 on a long term free market equilibrium basis. But there is another right price for silver in the future that suggests potential returns that are multiples of the long term free market price of \$50. This is the price I have been thinking about ever since I was asked the question last week. In fact, I've been thinking about this other right price of silver for the past 30 years. This is the right price of silver I call the "blow off" price.

First, let me define the "blow off" price of silver. As the term suggests, this is the price likely to be seen in silver when the inevitable competition for available remaining physical metal takes place in earnest between the industrial users and new investors. Silver ran up to nearly \$50 six years ago because of physical investment demand and with no industrial user inventory stockpiling. Given the remarkably small amount of metal that exists in the key form of silver that determines price, namely, in 1000 oz bar form, it's just a matter of time before investment demand erupts again, only this time it seems more likely to set off a physical inventory scramble by users.

Even the most hardened skeptic would acknowledge silver's propensity to suddenly explode in price. Twice in my lifetime I have witnessed silver erupt to near \$50 from single digit levels not that many years before. In addition, silver has had many mini-price explosions, as well as unbelievably sharp declines. Something drives this price volatility and one reason for it is that there is not that much physical material in existence, making the metal a prime speculative play toy for derivatives traders.

It's fair to question the inevitability of the coming physical silver buying competition between investors and users. After all, if no such physical buying competition erupts, it is hard for me to visualize a blow off scenario for silver. On the other hand, if I can show why a blow off may and perhaps almost must occur, then it would make sense to try and calculate what a blow off price for silver would be. It has to do with the first right price of silver – the long term free market equilibrium price and the sequence of events required to get to that price.

Simply stated – you must believe either that silver is currently manipulated in price, placing it far below its free market price or you must believe there is no manipulation and the current price is the result of free market forces. If you believe that free market forces set the price currently, then I can't see why you would expect it to go higher or would even want to buy silver in the first place. I suppose I should only speak for myself, but I wouldn't touch silver if I didn't think its price was manipulated by COMEX futures contract positioning.

I'm not going to explain the details of the manipulation today, but its existence is why the free market equilibrium price is so far above the current price. If you accept the manipulation premise (as I do), then I would ask you to consider the manner in which the current price can reach the free market equilibrium price. In other words, how do we get from today's manipulated silver price to the free market equilibrium price at least three times higher? Do we go from here to there in a smooth and orderly manner, gradually rising with much backing and filling and no pushing and shoving? Or do we get there in a disruptive and explosive manner in which the free market price is first vastly exceeded for a time by an amount that seems shocking, only to fall precipitously back down to the \$50 level?

I'm convinced that we can't get to the long term free market equilibrium silver price of \$50 on an orderly basis and with the manipulation remaining intact because that would cause the short manipulators on the COMEX too many billions of dollars of losses. And now that JPMorgan has succeeded in acquiring the largest physical silver hoard in history, it's only a matter of time before the bank stops participating in depressing the price; at which point the remaining short manipulators will be on their own and, quite likely, up the creek.

Most importantly, the logical sequence of events points to a blow off phase before we settle down the long term equilibrium price, rather than the other way around. It seems unreasonable that we could march orderly up in price to \$50, with the tremendous damage that would do to the few large traders who dominate the short side of COMEX silver and only then blast off to much higher prices. It seems much more reasonable and is borne out throughout history that silver prices would first blow off far above the free market equilibrium price and then come crashing down to that price.

Blow off phases, by definition, involve panic and group emotion of the most extreme degree; where for a time higher prices alone beget even higher prices and greater buying panic. Silver has all the ingredients for the greatest group buying panic of all time. It is the only investment asset where industrial users and fabricators account for almost all the new material produced annually, leaving only a small percentage of new production available for investors. This is what sets silver apart from gold. There are no industrial users likely to panic and join in with investors in gold, because there are so few industrial users in gold.

Moreover, the dollar amount of actual silver readily available for investors and users is small, no more than a billion dollars' worth at any one time (compared to hundreds of billions of dollars in gold). The limited availability of physical silver, combined with the coming dual buying force of investors and users, is guaranteed to amplify the buying panic and collective emotion. Once it starts, the silver blow off phase will have to burn itself out at prices almost too high to contemplate. How could anyone assign a reasonably calculated price to the completely unreasonable situation of a world-wide buying panic in silver by users and investors alike?

While I've done everything I could to end the silver price manipulation for more than 30 years and don't regret the effort, when it comes to personal investments in silver I fully intend to sell into the coming blow off phase. I know I will likely start to sell at a price that will prove to be way too low for a time, but hope to space my sales to capture as much of the blow off phase as possible. That's been my intent for decades. Whether I succeed or change my mind along the way, only time will tell. But one thing is certain — the set up for participating in any potential price blow off in silver appears to be at hand. The sole requirement for participation is to own silver. End of IRI article.

Another Unique Blow off Factor

In addition to the coming inevitable fight for physical silver supplies between the world's investors and industrial silver users and fabricators, another separate and quite unique factor exists that promises to push the price of silver far higher than most can imagine. This is the factor that first dawned on me more than 30 years ago and, quite remarkably, has now reached its most extreme extent ever. I'm speaking of the set up and mismatch between paper futures contract long and short holders on the COMEX.

There should be no question that daily price changes in silver are exclusively driven by computer-generated futures contract trading on the COMEX. This is as obvious as the dawn of each new day and explains why more follow the data emanating from the COMEX than ever before. Since virtually none of the trading in COMEX silver futures is directly related to the metal itself or is conducted by actual producers and consumers of the metal, there exists a price artificiality that is almost palpable. Those most active in COMEX silver futures trading are banks, hedge funds and computer jockeys, not miners or actual metal consumers.

Essentially, this means that those most active in trading COMEX silver futures are not trading the metal itself, but rather short term changes in the price. There's no other plausible explanation for short term price movement. Admittedly, this is something that has come to exist in most derivatives markets, thanks to the advent of High Frequency Trading, but there is something about silver that sets it apart from other commodities. Embedded in the frantic and artificial paper price trading is a force guaranteed to be resolved which will further ignite the price of silver.

A couple of years ago, in my ongoing study of data in the CFTC's Commitments of Traders (COT) Report, I discovered an unusual phenomenon — a large and gradual buildup of COMEX paper silver long positions by traders in the managed money category. These new long silver contract holders were clearly quite different and separate from the technical funds in that same managed money category, which always bought as prices rose and sold as prices fell. The new managed money longs bought as prices fell and then held on to those positions. I identified them as core non-technical fund longs because their behavior was completely different from the typical technical funds.

The buildup of long positions by these core non-technical funds began in late 2013, following what had been a brutal price decline that took silver down from over \$30 to under \$20. From near the end of 2013, the managed money core non-technical fund long position rose from under 25,000 contracts to 40,000 contracts by the late summer of 2015. This core long position now appears to be close to 60,000 contracts (300 million oz). My basic definition of the core non-technical long position is the long position that remains near the bottom on any price cycle after the technical funds have liquidated completely.

Please understand that there was plenty of managed money technical fund positioning occurring over the past few years, as I hope I have chronicled on these pages, and which greatly influenced price over this time. But there is big difference between the buildup of the core non-technical fund managed money traders' long positioning and the garden variety positioning by the technical funds that drives price. And I want to emphasize that the non-technical fund buildup of long positions is unique to silver. Whereas there has been a buildup of core long positions in the managed money category in COMEX silver over the past three years, from 25,000 contracts to 60,000 contracts (a double and a half), there was no such similar buildup in the managed money category in COMEX gold futures (although the managed money long position in gold has grown from year ago levels).

What prompted the core non-technical fund managed money silver long position to grow from the equivalent of 125 million oz to 300 million oz over the past three years? The most reasonable answer is that the buyers thought the price of silver was too cheap, having fallen from over \$30 and higher to under \$20 and, therefore, represented an attractive investment opportunity. Moreover, since the core long position has grown while prices had continued to fall the past few years, it's also reasonable to say that these longs appear ready to stick around and wait out higher prices. I'm not trying to trick anyone — why else would these traders have bought that much of a long position and held on? It had to be related to the perception of silver's undervaluation. Certainly, if anyone has any other explanation, please send it along to me.

More specifically, what prompted the managed money traders that did buy silver to buy it in the form of COMEX futures contracts, instead of silver in some other form, such as in ETFs or direct ownership of metal? The most plausible answer that I can come up with is because of the leverage afforded by holding any futures contract, silver included. Generally, because futures trading rests on a margin basis, it is mostly operated on a 10% deposit on any long or short bet. One can hold a million dollars' worth of COMEX silver with equity (cash) of \$100,000, which not only affords much bigger returns (or losses) on invested capital, it frees up funds for other purposes.

It's not just some managed money traders holding COMEX futures contracts as the preferred form of silver, for leverage and other reasons, but others as well; including subscribers reading this today. Because of my professional background (as a former commodity broker) and as an observer of all things silver, I've haven't encouraged anyone to speculate in silver futures in a very long time and never publicly. There's a good reason for that — the leverage afforded is a two-edge sword that usually cuts deeper than it rewards. No matter the intentions at the outset, invariably a margin call will clash violently with the strongest long term convictions. It's part of God's Law — silver margin calls come when least convenient and when one is most illiquid.

That said, not only do I understand the pros and cons of holding COMEX silver futures as the silver form of choice, I recognize that such positions exist, namely, there is a verifiable amount of such holdings. Let me be clear in what I'm saying — while the core non-technical fund managed money long position in COMEX silver futures is, by far, the largest long term holding, it is not the only one. There is also a core non-technically motivated and passive long term holding of such positions in other trader categories, including the other (large) reporting traders and the smaller non-reporting traders. It seems impossible for the long term silver long positions in these two categories to be less than a combined 20,000 contracts and possibly significantly more. I'm not guessing here — I know some of these holders as personal acquaintances friends.

Therefore, there is now a minimum holding of 80,000 net long contracts held in COMEX silver futures that are held on a long term basis and as the preferred form of silver. That's the equivalent of 400 million ounces of silver. It's not real metal that is owned; it involves contracts to buy real metal on a small down payment or deposit basis, if the holders agree to full cash payment and decide to turn the paper contacts into real metal. Except under some highly unusual circumstances (which stand a decent chance of occurring), I doubt very much if many or any of these paper contacts are currently intended to result in fully paid for delivered metal.

Just to be fair, it is reasonable to assume that timed correctly and with everything turning out as expected, the core long term holders of COMEX silver futures contracts do stand to make all the gains offered by a rising price of silver, on a highly leveraged basis. However, there a number of potential problems with the collective core non-technically motivated long position held by managed money and other traders.

For one thing, the position is enormous. While not the entire net silver position on the COMEX, 400 million oz is staggeringly large. I try to make it a habit to talk about the important things in silver and that includes the important amounts of silver in every form. Those important amounts include my estimate of the total silver in the world in the form of 1000 oz bars, or 1.5 billion oz (925 million oz of which are verifiable), the 550 million oz of that total physical silver that I claim that JPMorgan has acquired over the past six years, and the 100 million oz of silver that is available from new production for investors worldwide after industrial and other fabrication is satisfied.

The 400 million ounces of paper silver held by long term investors on the COMEX must be viewed in the context of how much actual metal exists in the world and how much could be secured from new production. The problem is that the numbers don't match up. I understand the functioning of the futures market very well and know that physical material need not exist to match up and cover open futures contracts. But that's not what exists in COMEX silver futures, where we have a distinct mismatch between what is held by traders thinking they own silver and the amount that exists or could possibly be considered available.

Let me see if I can make the point by comparing the situation in COMEX silver futures with the circumstances in COMEX gold futures. On a best efforts basis, I would estimate the core total non-technically motivated long position in COMEX gold futures be around 150,000 contracts or the equivalent of 15 million gold oz. The dollar value of the core gold long position is \$18 billion, much greater than the \$6.8 billion value of the core silver long position (400 million oz x \$17). Dollar value aside, no one would argue that, at some price, 15 million oz of gold would be available from the 5.5 billion oz of gold said to exist in the world. Even if you limited the amount of gold in the world to the 3 billion oz that exist in bullion-equivalent form, the 15 million oz that are held in core COMEX holdings are only equal to one half of one percent (0.5%) of the total gold bullion.

In silver, the COMEX core long position of 400 million oz is more than 25% of all the silver bullion in the world and nearly 50% of the visible portion of that total. And with no more than 100 million oz of new silver available from mine production each year, how the heck could you draw 400 million oz from that? I know how futures markets are supposed to work and the numbers in silver say it can't possibly work. In other words, it is at least conceivable that enough actual gold metal exists to satisfy and back up the core long position in COMEX gold futures. It's not even close in COMEX silver.

So, if there doesn't exist the conceivable amounts of real metal in the world to back the contracts held by the core long holders in COMEX futures, then what exactly is backing those contracts? The answer is 8 large short traders on the COMEX. That's because CFTC data show in the last COT report that 8 large traders held 86,888 net contracts short, the equivalent of just under 435 million oz. Not one of these 8 short traders is a mining company, although one of the short traders, JPMorgan, is protected against the loss of rising prices by virtue of its 550 million oz actual silver holding. Removing JPM, only 7 large traders, holding around 70,000 contracts short are backing up the core long position.

It's easy to see why there would be a large core long position in COMEX silver, given the low

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