January 7, 2015 – Important Changes

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There have been a number of changes both within the silver market as well as changes outside the direct workings of the market that have dominated my recent thinking. That's not to say that some factors haven't remained the same, such as the price being dictated as a result of dealings on the COMEX; but the changes represent a clear threat to how prices may be determined in the future. That has to be considered potential good news.

If there's one thing silver investors shouldn't fear, it is a change from what has occurred to silver prices for the last nearly four years, as no one needs to be reminded just how far prices have fallen from the peak of $49 in April 2011. In fact, the greatest fear among silver investors (myself included) is that nothing will ever change much regarding the iron-grip hold that certain big traders (led by JPMorgan) have maintained on price. Because the price has remained depressed it is natural to assume that nothing much has changed as far as the factors responsible for the extremely depressed price. But if you strip away the price and look for what might have changed under the hood, a different picture emerges.

Upfront, I admit that the game appears to being played the same as it ever was, namely, the price of silver being set by competing paper speculators on the COMEX; with the big banks selling on price rallies to technically motivated buyers with the reverse on declining prices. And I also admit this game is so firmly entrenched that it could last a while longer, despite being distinctly devoid of actual supply/demand influences and, basically, being against commodity law. However, to stop there and not recognize the changes that have occurred might be short-sighted. What changes?

One big internal COMEX change has been the unprecedented victory that the technical funds registered over the smaller commercials (which I call the raptors) in which the technical funds profitably cashed in on a massive short bet on lower prices and in which a number of raptors lost their shirts. As shocking and unprecedented as was the technical funds' victory, it is the result of that market victory that represents a truly important change in that it knocked a decent number of smaller commercials out of the game for good. Since these smaller commercials were an important provider of liquidity and smoothed out price movements (capped prices), price volatility appears to have increased noticeably. This change has also necessarily increased the burden on the eight largest COMEX commercial shorts to shoulder a greater role in controlling silver prices whenever the next silver rally commences in earnest.

I recognize that the concentrated short position of the 8 largest commercial COMEX shorts is not new and goes to the heart of a silver manipulation I have detailed for almost 30 years. But what may have changed is that the manipulation has become so increasingly well-defined that it threatens to attract buying competition from entities not currently attracted to silver. One of these days, some outside entities may become intrigued enough that someone (me) can openly accuse financial powerhouses like JPMorgan and the CME Group of being silver market crooks without any denial to cause an investigation into the facts.

It may appear as if I am saying the same thing over and over again only to be met with silence, but there is a method to my apparent madness. Every time I accuse JPMorgan, the CME and the CFTC as being behind the silver manipulation and they don't offer any denial that represents an additional incentive for a potential large investor to investigate what has always been the forbidden act of falsely accusing a financial institution of criminal behavior. Someday, someone of sufficient financial means is going to look into this unprecedented circumstance and I'm confident they will discover what I am saying is true. That day draws near.

I don't think there could be a bigger change in silver than if my speculation about JPMorgan acquiring a massive amount of physical silver is true. How would it be possible for there to be a bigger change than to go from being the world's largest silver short to being the largest long in history? Coupled with other documented and unprecedented changes in silver, such as the frantic movement of COMEX silver inventories since April 2011 (likewise in SLV inventories), record high sales of Silver Eagles compared to near-record low sales of Gold Eagles, the emergence of JPMorgan as the leading COMEX silver warehouse and its 2012 transfer of SLV-custodian inventory to Brinks, the list of changes specific to silver are numerous. What about outside changes?

The biggest outside change has been what has occurred in crude oil, as I have been discussing for the past couple of months. Crude oil is, by far, the most important commodity of all and its price decline has been nothing short of stunning, even for someone who has observed the market for as long as I have. From the summer, the decline has been more than 50% and that means that the annual proceeds to producers and expenditures by consumers have declined from over $3 trillion to less than $1.5 trillion annually.

Most stunning of all is the rapidity of the decline Â? in just the last 14 weeks, benchmark oil prices have fallen from $90 to under $50. In just the past 7 weeks, prices have fallen from $75 to under $50. And it is because oil prices have fallen so far and so quickly that it is almost impossible for most (including me) to fathom the consequences of the decline. But there can be no question that such a large and rapid decline in the world's most important commodity will have consequences of a profound nature.

Initially, the popular consensus was that the decline would be advantageous overall since more individuals and entities consumed oil than produced it (although I was concerned that the concentrated number of producers versus the diverse number of consumers would increase financial instability). The consensus optimism was reflected in the rally to new highs in the stock market through year end. More recently, however, the consensus seems to have turned more guarded Â? and I believe for good reason.

The winners in the oil price decline may be many, but those winners are not the potential problem; financial instability will only come from the losers on the oil production side of the ledger Â? the companies and countries which produce oil and the participants Â?longÂ? the oil market. This applies particularly to holders of oil derivatives, the largest commodities derivatives market of all. And even if an entity is positioned correctly with a short oil hedge, the extent and rapidity of the oil price decline raises the question of the ability of the counterparty long to fulfill its financial responsibility that backs the hedge.

The quickest and surest path to widespread financial panic and contagion is the growing perception that a counterparty might not be able to fulfill contract responsibilities. If there is anything learned from the financial crisis of 2008 and the bailout of AIG it is that a counterparty derivatives failure can rock the financial system to its roots. Very few Â?bodiesÂ? have floated to the surface as a result of the stunning decline in crude oil, but it would be naÃ¯ve to think that there aren't some very large victims yet to surface. And just like the financial crisis of 2008, you didn't need to be directly involved in credit default swaps sold by AIG to be affected when they defaulted. Likewise, defaults in oil derivatives will be felt by many with no direct involvement.

In addition to potential and some might say unavoidable counterparty failures, the nature of this oil price decline seems problematic in that there is little anyone can do to alter its course. I don't doubt for a moment, for instance, that government sponsored intervention occurs when there are adverse moves in the stock or bond markets for the sake of maintaining market stability. It always seemed to me like a pretty simple thing to do Â? just buy futures contracts since most are cash settled. But if the oil plunge is due to an actual (and intentional) surplus, I'm not sure government intervention of buying futures contracts could do much good.

Increasingly, the decline seems distilled down to Saudi Arabia's determination not to lose market share; a determination instilled in the kingdom's DNA as a result of its attempt to maintain prices by cutting production in the 1980's. I still don't think Saudi Arabia tripped off the oil price decline, but that doesn't matter much at this point, as it appears firm that it will not cut production. But oil production will get cut eventually and it looks at this point that the cuts will occur in North America and this sets up for some very hard times for shale and oil sands producers.

Worse, the oil price decline already seems to be working its supply/demand Â?magicÂ? in that an increase in consumption appears in the cards according to reports of sharply increased sales of trucks and SUV's in response to lower gasoline prices. This sets up the possible double-whammy of an eventual shortage when oil production is cut and the effects of increased consumption are sufficiently in place. As and when that occurs, then it will be the many adversely impacted by the increase in oil prices. This will take some time to play out, but considering how quickly oil prices have declined, the clock is ticking loudly. No one predicted this epic plunge in oil and few can know fully all the eventual ramifications. It's as if it came like a thief in the night and then chose to move in permanently.

What does this change mean for silver? I think a lot based upon where we've been and where we are today. Stock, bond and real estate markets are sharply higher than where they were in April 2011 and silver, I don't need to remind you, is sharply lower. So sharply lower is silver that it is clearly below the average primary cost of production. And while silver mine production hasn't declined to date, you can be sure that enough potential production was mothballed or killed as a result of low prices that future production has been curtailed and delayed, perhaps indefinitely.

With interest rates so low Â? the lowest in most of our lifetimes Â? and stock and real estate markets never higher, what is likely to happen in the event of the potential financial instability caused by the stunning decline in oil prices? With stock and bond and real estate market valuations at extreme historic highs, where is the safe haven refuge to which to run? And even if great numbers of market participants don't initially run to the age old refuge of silver and gold, in a zero interest rate world won't some eventually be drawn to the profit potential offered by a precious metal (silver) trading below its primary cost of production?

As you know, my normal song and dance routine concerns the actual supply/demand situation in silver and its great undervaluation relative to every other asset because the crooks at JPMorgan and the CME have intentionally depressed the price. And I am fully resigned to that overt COMEX manipulation continuing for a while longer given the great power of these criminals. But the changes both within and outside the silver market seem to be leading to a different (for me) conclusion Â? the prospect that a rush of safe haven buying may be at hand. And while safe haven demand will undoubtedly benefit gold, because there is such an infinitesimal relative dollar amount of silver available for purchase, even the smallest amount of safe haven demand for silver will send the price skyward. If there's one thing that can overcome the COMEX crooks it is a sudden burst of physical safe haven buying.

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Silver – $16.55

Gold – $1213

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