July 9, 2010 – More Good Questions

More Good Questions

I've fallen a bit behind on answering a number of good questions from subscribers, so I'll try to play a bit of catch up today. I do value greatly all of your questions, as they force me to think differently and afford me feedback on how well I am conveying my thoughts. So please keep them coming and don't be shy about asking more than once if you don't get a response. The squeaky wheel definitely gets the grease.

Hi Ted,

We have been reading some of the information on the internet regarding SLV. It is reported that JP Morgan is the custodian of the SLV silver. Is this a fact, and if it is, isn’t that just another case of putting the fox in charge of the hen house? I own a modest position in SLV and have made some money on that stock but it does not give me a warm and fuzzy feeling to think that JPM is involved. I thought that Barclays was the originator and agent of SLV. If JPM is the custodian, how did they attain that position?

Is it true that neither the SEC or CFTC exercises any oversight or audit of the GLD or SLV? Does anyone? Could the prospectus be a complete fabrication?

John and Sally

There has been a continuous stream of Internet articles warning about the metal ETFs, particularly SLV and GLD. These articles have me scratching my head, as I truly don't understand the negative vibes contained therein. Aside from the very separate issue of the short-selling of shares in the ETFs, which the articles never seem to mention, all the reasons given to distrust them sound hollow to me.

Yes, it is a fact that JPMorgan is the custodian of the SLV silver. But that doesn't mean that JPMorgan has unfettered access to abscond with or use the metal to cover its concentrated short position on the COMEX, any more than they can illegally take money out of the checking or savings accounts of its millions of customers. It is important to remember that JPMorgan has been the custodian of the SLV since its introduction in 2006, long before JPM inherited the massive concentrated COMEX short position from Bear Stearns in 2008. That timeline just doesn't support the conspiracy theories that the SLV was just a plot for the big shorts to steal everyone's silver. Truth be told, I'm sick of many of the conspiracy theories swirling around silver and gold. I think they detract from the very real issues at hand. Yes, there is a serious problem with the manipulation in silver, due to the concentration on the short side of COMEX silver and the necessary collusion between 8 or 10 big commercials to maintain the price rig. But it's not right to drag in unsubstantiated conspiracy theories at every turn. That only detracts from the real issues.

Last I looked; JPMorgan had more than 225,000 employees and many millions of customers, both retail and institutional. It is an important financial institution and it is simply wrong to imply that everything it does is illegal or that all its employees are less than honorable. My late father worked for a predecessor bank (Chemical) later absorbed by JPM and received a modest pension in his retirement. I can assure you that my Dad was as honest as the day is long and had nothing to do with silver and I'm sure the same goes for 99.9% of JPMorgan personnel. JPM was always big in the metals storage business in London and they were and are the logical choice to be the custodian of the SLV. Yes, I suppose I've contributed to the general distrust for JPMorgan with my public statements that they are involved in a criminal enterprise on the COMEX, so it's only fair I put these accusations into perspective.

Barclays was the original sponsor of the SLV until it sold its ETF business to BlackRock, the largest money manager in the world with almost $3.5 trillion in client assets on deposit. I believe that having BlackRock as the sponsor of SLV is a very good thing. The silver assets in the SLV run close to $5 billion, or less than 0.15% of BlackRock's total assets under management. No one is going to risk an impeccable reputation (which BlackRock has) and a giant successful business to sanction a scam that makes up such a small percentage of the operation. Any problem SLV ever was to have would likely be fixed by BlackRock in a heartbeat. I admit to being partial to the SLV, despite the negative views held by many. Part of my favorable opinion is still based upon Barclays agreeing to list all the weights and serial numbers of the silver held after I publicly suggested they do so. It is also important to remember that in addition to publicly listing the bar identification, there is a legitimate delivery mechanism in place at SLV to convert shares into metal. As a reminder, many popular investment vehicles, like the Central Fund of Canada (CEF), still don't list bars or have an actual delivery mechanism. Please don't ask if that means I don't favor CEF, as I do. It's just that I object to the double standard applied to SLV and not similar vehicles.

To my knowledge, it is not the responsibility of the SEC or the CFTC to audit ETF holdings; recognized auditors perform that duty. Again, we must rely on common sense. Would it make any sense for BlackRock to sanction a scam, considering the stakes involved? (The same goes for State Street, the sponsor for GLD). Yes, I know the prospectus can be confusing and unnerving; every prospectus I've ever read is confusing and intimidating.

In many, but certainly not all, cases, criticism of SLV comes from those promoting competitive products. That's not right. Look, I understand that SLV sucks money away from other forms of silver investment, but fair is fair. I am an analyst first and foremost, and in examining all the facts, I think the SLV (and GLD) is fine. Further, I think these EFTs have been the gold and silver investor's best friend. I understand the distrust, I just don't agree with it. The beautiful thing is you don't have to buy the SLV or GLD if you have any reservations; buy the metal is some other form. But the unfounded criticism of these ETFs is unwarranted. If any critic feels that strongly of wrongdoing, he or she should take that complaint to the regulators; that's what I would do if I suspected fraud. Finally, if the choice is between buying 500 Silver Eagles or 500 shares of SLV, buy the Eagles. If the choice is between buying 500 shares of SLV or nothing at all (due to account type restrictions), buy the SLV.

Dear Mr. Butler,

I am confused, to say the least, at the recent gyrations in the price of silver. They seem to be increasing in both intensity and frequency, with monstrous and rapid highs and lows. Do you think this is the death throws or could it be something much more sinister?

If you can spare the time, I should be most grateful for your thoughts on, what appears to me, to be a worrying state of extreme volatility.

Yours sincerely,

Edward

Thanks for your note. Volatility does seem higher than normal (whatever normal is). Some of it has to do with the price having increased over the years. A 50-cent or one dollar move today is equal, in percentage terms, to a 15-cent or 25-cent move when we were at $4-5/oz. More importantly, I think the recent volatility is due to a growing illiquidity in COMEX trading due to a withdrawal of more traditional overnight traders. These short-term position traders have been replaced by super fast electronic traders who hold positions for minutes or even seconds. Thus, volumes can look normal or high, but there is no real depth to the market. We saw this recently in the Â?flash crashÂ? in the stock market.

For sure, the tech funds and big dealers are still the force they always were, which is why we declined so much in the past few trading days into today (as the funds got flushed again – which is good). But when the funds put on and take off positions, the new high frequency type traders step aside and we get sharp price moves in brief bursts. The bottom line is that this isn’t bad or something to be worried about, as the short term gyrations should be looked at like “noise” that we can’t obsess over. We don’t need liquidity to get to the very high silver prices that I believe are to come. We just need for the manipulation to be terminated. In fact, the lack of liquidity can actually aid in us getting there more quickly. I admit that’s tough to accept on sharp down days, but in the longer term picture, short term volatility doesn’t matter a whit.

Finally, this is something we have to live with, as this volatility is most likely to increase in the future. I haven’t written about this very recently, but I have mentioned growing volatility in the past. Based upon your note, it is probably a good idea for me to do so again.

Apart from these good questions, I thought I would preview what I expect in today's Commitment of Traders Report (COT). The Bank Participation Report has already been released for July (for positions as of July 6), and indicates a slight increase in the net short position of the big US banks in both gold and silver from a month earlier. I don't mean to confuse you, but this suggests to me that we should see a sizable reduction in the net commercial short positions for both gold and silver in the weekly COTs. (Remember one is a monthly report and the other is weekly.)

The only reason for the recent sharp sell-offs in gold and silver was to force speculative long liquidation in gold and silver and that objective was achieved. Aside from the clear manipulation that took place, the success by the commercials (which should be evident in today's COT report) makes the market structure much healthier. These painful sell-offs do have a constructive side, as once the liquidation is complete, the price bottom is achieved. The liquidation does feel complete at this point, but I'll know more after today's report, which I'll comment on in tomorrow's King World News Interview.

Ted Butler

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