June 12, 2013 – All Pieces in Place

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There may be no need to remind everyone just how rotten the past months and years have been for gold and silver investors (except for those looking to buy). While there were frustrating times in the past when gold traded for a time below $300 and silver remained below $5 for decades; the recent price performance is actually worse considering how much has come to be learned about the functioning of the precious metals market. But just like the prior frustrating time periods led to eventual dramatic price gains, so too will the current period lead to future strong price gains, particularly for silver.

Differing opinions and future price predictions are always prevalent; what matters most is if the reasoning is factual and logical enough to warrant the investment of hard-earned capital. Ironically, it is the recent rotten price performance that accounts the most for the current attractiveness for a precious metal investment, especially for silver. In fact, the price beating of silver is the common denominator and missing link at the heart of all the reasons suggesting now is a great time to buy silver.

If there was one thing missing from the merits of investing in silver at the price highs of April 2011 ($49) or even as recently as this February ($32) that thing was the sense that silver may not have been dirt-cheap. But sub-$22 silver does seem dirt cheap. That's not to say that silver can't go lower still in the short term, given the commercials' (largely JPMorgan's) manipulative control on price; but the beauty of buying a long term asset at dirt cheap prices is that time and the odds become your allies. Buying something cheaply enough overcomes the concern for short term price corrections.

Most important is how one determines whether the price of silver is dirt cheap. There are a number of metrics I would cite, both relative and absolute. For one, the price of silver has fallen low enough as to make many primary silver miners unprofitable. While silver is mostly produced on a by-product basis, primary silver mine production has grown faster over the past five years. Now that production growth is threatened by low silver prices, both for current mining and prospective deposits. The fall in the price of gold has not been as severe as the price decline in silver and I don't sense that many gold producers are operating at a loss due to the gold price decline. Therefore, this looks like a situation unique to silver. Something I learned many years ago (unfortunately I forget from whom) was that it was the ultimate bullish sign when the price of a precious metal was trading below the cost of production. Of all the precious metals, silver fits that profile best.

One of the most objective valuation determinations one can make is on a relative basis to similar items. The price of silver fell much more extremely than did any other industrial or precious metal and that sharper fall has rendered silver as cheaper than any other metal over the past few years. I highlight silver's relative cheapness to gold on a regular basis, but that undervaluation is present in just about every other metal as well, from copper to platinum and palladium.

The great thing about relative comparison is that it filters out all outside influences. Things like currency rates, Fed policy, inflation rates affect all commodities roughly the same and these outside factors are neutralized and removed from the equation when you compare the price of silver to gold or platinum or anything else. The idea here is that not only should you look to buy an asset class that's undervalued; it makes sense to buy the cheapest item in an undervalued group of assets. Silver is the cheapest asset in an undervalued group, making it the best relative prospective buy.

Because price is the primary influence on investor sentiment, it's no surprise that sentiment for silver is lower than for that of any other industrial or precious metal. But sentiment is always a contrary measurement, meaning the worse it is the better the prospects for future price performance. This was true when silver was $4 or $5 for years, even after gold had started to move up back then. I see that same dynamic in force today, namely, that silver's low and lagging price is pushing negative sentiment to greater extremes. Perversely, the worse silver sentiment becomes the better buy it becomes. It comes down to this Â? market tops and overvaluations are accompanied by good feelings and complacency, market under valuations are accompanied by doubt and fear.

A few months ago, I caught a TV interview with Warren Buffett where the interviewer was commenting on the spectacular long term performance of his stock, Berkshire Hathaway. In extolling the virtues of long-term investment, Buffett remarked how his stock had declined by 50% on four separate occasions along the way. Stocks and commodities are different, but I think his main point was that big price declines are advantageous times to initiate long term investments. Certainly, if the stock market had declined as much as silver has recently, value investors like Buffett would be out in droves, particularly considering why silver declined.

As is often the case, uncovering the real reasons for a significant price decline can be evasive and silver's decline is no exception. Because certain facts about silver are well-known, sometimes erroneous conclusions are attributed to price movements that don't hold water when examined closely. For instance, silver has a very unique demand profile in that it is both an important industrial consumption commodity and a primary investment asset, of which the investment side is the clear price driver. Yet I've read numerous accounts by silver commentators (mostly in the main stream press) that account for silver's big price decline as being due to a sudden softening in industrial demand. I reject that because the industrial consumption of key mineral raw materials used in a wide variety of applications, like copper, oil, or silver is largely a function of world economic activity. What determines the level of consumption for these materials, therefore, doesn't vary for one without varying for all. Certainly, a disproportionate price decline in one (silver) should have the normal supply/demand result of an increase in industrial demand, not a decrease.

Clearly, it has been the investment side of silver that has fallen off as a result of the price decline, given the normal impact to investor sentiment. But even here, not all silver investment demand has suffered as a result of the large price decline. A case in point is the level of sales for Silver Eagles from the US Mint. We're not even at the half-year mark and already sales for this year are at the fastest pace ever and are greater than any full year in the bullion coin program's 27 year history, save for the last four full years.
http://www.usmint.gov/mint_programs/american_eagles/?action=sales&year=2013

Where silver investment demand has cooled off is primarily in the holdings of the big silver ETF, SLV. It's not so much that large quantities of silver have come out of the SLV this year, as has been the case for the big gold ETF, GLD. It's more a case that the rotten price environment has discouraged momentum and other price following investors from buying. But the important point here is that this looks to be a temporary phenomenon and it is reasonable to assume this investment demand will be rekindled when prices improve.

Previously, I've written that the underlying investment demand for silver bullion (1000 oz bars) on a world basis is for roughly 10 million oz a month (5 million oz for gold). That still holds, although it looks to have been interrupted in silver and gold by the price declines this year. In the interim, the lower prices have further reduced the amount of money necessary to absorb silver. Ten million silver oz now cost $220 million a month in silver, compared to the near $7 billion monthly needed to be absorbed by investors in gold. Let me state that differently Â? world investors need to expend more than 30 times as much money in gold, relative to silver to support prices of each. The fact is that based upon pubic data from the US Mint investors are putting in much more money into silver compared to gold, close to one to one currently. This also suggests that silver is way too cheap compared to gold. As a reminder, I think the bullish set up for gold is strong; but for silver the set up is shockingly bullish.

If it isn't a fall-off in silver industrial demand or particularly soft investment demand, then what accounts for the pronounced price weakness for silver? Here there appears to be only one plausible explanation Â? price manipulation. As I report constantly, the pricing mechanism on the COMEX has been corrupted by JPMorgan and other commercial traders, due to computer algorithms and other means of price control. As a result of the price control, there has been a massive switch in COMEX positions and actual metal from outside investors and speculators to JPMorgan, both in silver and gold. In fact, the recent revelations in the June Bank Participation Report set up both to rally sharply.

When that rally starts in full, the facts in silver suggest it will carry much further than for gold, although both should do well. At the end of the day, due to silver's industrial consumption and 60 years of a consumption deficit, there is just not that much silver bullion remaining in the world. With the new low prices, that inventory is worth less than it has been for years. Also as a result of the punishing drop in price, the holders of that silver have gone through the baptism of fire and those remaining are stronger as a result of the price punishment. A much lower dollar amount of inventory, held by stronger hands sets the stage for an upside price event.

A few words on some current developments. The new short interest on stocks was released last night and it didn't make for pleasant reading. The short position in shares of SLV rose by almost 4 million shares to just under 16.4 million shares (oz). This is the highest short interest in months and raises the percentage shorted relative to total shares outstanding to 4.9%. Still, the new level of shorted shares and the percentage to total shares outstanding is well below half of previous peak levels. The short interest in GLD grew much less, but as a percentage of total shares outstanding, GLD still stood out at record levels of more than 8.8%
http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

Perhaps I am mistaken, but I don't view the big current short sellers in SLV and GLD as being the usual manipulative crooks, aka, JPMorgan. It looks to me that the short sellers are of the speculative variety that has entered onto the short side of COMEX gold and silver this year. As I have been reporting, JPM appears to be firmly entrenched on the long side of gold in many markets and for it to be short GLD big would be inconsistent with those long holdings. And as concerns the SLV, the most recent (March 31) listing of large shareholders included a big increase by JPMorgan on the long side, also inconsistent with the bank being the big SLV short seller. http://www.nasdaq.com/symbol/slv/institutional-holdings If my analysis is correct, the short sellers in SLV and GLD should not be as capable of depressing silver and gold as was the case for JPMorgan in the past and they may, in fact, get caught and contribute to an upside price explosion.

There was a report out yesterday that indicated that Gary Gensler would be replaced soon by a new chairwoman for the CFTC and also that Bart Chilton may be replaced as a commissioner. I don't have a strong interest in the matter, but one thing about the story did catch my eye. http://www.huffingtonpost.com/2013/06/11/amanda-renteria-cftc-chief_n_3419039.html
It seems to be universally accepted in the story that the reason for Gensler's departure (should it come) was that he was too tough on the banks. There was a time when I would have accepted that, but that was long ago.

As I have been reporting more recently, the big banks, particularly JPMorgan, have absolutely crushed the CFTC in the agency's attempt to curtail proprietary trading and manipulation. Dodd-Frank has been the single greatest failure in regulatory history and to see the reason given for Gensler leaving is for him (or Chilton) being too tough on the big banks is as far removed from my take as is possible. Gensler and Chilton have been wimps and pushovers for the likes of JPM. Both had the chance to use the power of the bully pulpit in condemning and exposing the silver (and gold) manipulation and neither rose to the occasion as required. Worse, both let a phony and taxpayer-wasteful silver investigation persist for almost their entire time in office with no resolution. Far from being too tough on the big banks, I think both should be ashamed for dereliction of duty and for letting the citizens of America (and the world) down. In fact, I don't know how either could have performed more miserably. Good riddance.

Last, the recent price action in the US Dollar Index (traded on ICE) caught my interest and I just happened to look at the COT report, not something I usually do. The degree of concentration on the short side (presumably mostly held by those same big banks that the CFTC was being too tough on) was shocking to me Â? over 88% net short by four traders. I'm not suggesting trading currencies in any way, shape or form and there may be a simple explanation for such an extreme degree of concentration. If you know of such an explanation, drop me a line. An explanation other than the big banks rigging price levels, of course.
http://www.cftc.gov/dea/futures/deanybtlf.htm

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Silver – $21.70

Gold – $1387

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