June 15, 2011 – Perspective

Perspective

One of my recurring themes for silver is to try to put the real facts in the proper perspective. It's easy to get sidetracked and focus on things that may not be central. The intent of this piece is to apply that thinking to some recent developments in price and inventory changes and regulatory concerns.

The price of silver crossed the $34 mark for the first time in 31 years on March 1, 2011, three months ago. From that point it ran up to over $49 before April was out. Starting on Sunday evening, May 1, the price collapsed, dropping below $34 intraday on Friday, May 6. Since then, we've traded roughly between $33 and $38. Obviously, silver investors most likely enjoyed the time following the first upward breach of $34, rather than the time after the May 6 downside version.

As might be expected, such big price gyrations attracted widespread media attention. After all, silver had closed 2010 at $31, up from under $17 at the end of 2009 and $11 at the end of 2008, making it the best practical investment over that time. I am still struck by the lack of objective reporting in the mainstream media behind the silver price surge and recent collapse. In particular, the notion that silver ran up on frenzied speculative buying stands out as being especially wide of the mark. All objective evidence (the CFTC's COT data) demonstrates that speculators were selling into the top at $49, with the buyers being the big commercial shorts.

On a more immediate basis, the price activity in silver has come to be dominated by manipulative high frequency trading (HFT) on the COMEX. It was this corrupt trading that deliberately caused the price smash that started on Sunday night, May 1. I haven't seen a clearer instance of manipulation than this intentional takedown in all my years. About now, I would normally go into my recent rant about how outrageous it is that neither the crooked CME Group nor the CFTC has even mentioned what happened that Sunday evening. But, in a speech by Commissioner Bart Chilton before the European Commission yesterday, the silver price crash was finally mentioned openly. http://www.cftc.gov/pressroom/speechestestimony/opachilton-49.html

First, let me commend Chilton for publicly breaking the ice and mentioning the silver price crash. He had done so previously in private responses to those who had emailed him. That said; let me respectfully disagree with some of what he said. I'm going to focus on Chilton's comments on High Frequency Trading, as the Massive Passives he refers to are not applicable to silver in that there is no massive index fund long position in silver futures, as there are in other commodities.

Commissioner Chilton refers to the HFT traders as Cheetahs, because they are so fast. It is more appropriate to refer to them as Cheaters, because in addition to being fast, they are also deliberately causing uneconomic price movements. Quite simply, these high speed Cheaters are ruining our markets. They serve little practical purpose other than to disrupt markets whenever they desire. They did it in the stock market a year ago and in natural gas last week. Even though the criminal CME has staked its future on catering to these high speed cheats, all other market participants are diminished by their presence. The little added liquidity they provide is offset by increased volatility and the loss of collective confidence in our markets. We should all ask ourselves if our markets would be better off if these traders ceased to exist.

I also object to Chilton's characterization of the silver takedown as a Â?mini flash crash.Â? There is nothing mini about a 12% takedown in 15 minutes and a 30% takedown in a week. That's as Â?maxiÂ? as it gets. Also, it is objectionable to compare the silver crash to the flash crash in the stock market or in natural gas, as stocks and natural gas quickly recovered. In silver, there were repeated HFT operations to not just make the price go down, but to keep it down. The biggest and most obvious difference between silver and stocks and natural gas was the clear intent to accomplish a great liquidation of COMEX silver contracts and in holdings of the big silver ETF, SLV.

I further commend Chilton for noting the obvious in that the silver and natural gas crashes took place in after hours trading and on no fundamental news. It's also good to hear that the Commission is examining both, as should be the case. But what does Â?examiningÂ? mean when it comes to silver and when will the Commission say or do something of substance? After all, it took six weeks for the first public comment to be issued concerning the most egregious manipulative takedown in history. Billions of dollars were lost by the public because of the deliberate silver takedown. And, it's going on three years for some explanation for why JPMorgan holding short 25% of the world silver production isn't manipulative. The CFTC exists to protect the public. When is it going to start?

There is another, more general aspect to regulation that I'd like to put in perspective. I hope I have never created the impression that I thought Commissioner Chilton's or Chairman Gary Gensler's main objective was to clean up the silver manipulation, or that Dodd-Frank was ever centered on silver. The truth is that the thrust of the regulatory effort since the financial crisis, as far as commodities are concerned, is to eliminate excessive speculation on the buy side, primarily in energy and food. The government is not interested in speculators causing the price of commodities to rise. That goes for silver as well. Any thought that anyone in government is interested in enacting regulations to cause the price of silver to rise is misguided. Then why do I obsess about regulatory matters in silver?

The answer is simple. I have known that silver has been artificially depressed in price, due to a short side manipulation, for more than 25 years. I have written about it and have tried to end it during all of that time. Thanks to the Internet and private mailings from Investment Rarities, I have managed to convince many of the facts about the silver manipulation. Now, many write about the silver manipulation. But the real game changer has come with the appointment of Gensler as CFTC chairman and the subsequent passage of Dodd-Frank. Suddenly, everything I carried on about, like concentration and position limits, were elevated to the forefront. Not because of me or because of silver; but because of oil and grains and other commodities. When the politicians pressure the Commission, that pressure is exclusively about preventing commodity prices from rising. That's what resonates with the electorate.

By enacting regulations making it harder for anyone to manipulate the price of these other commodities, the proposed regulations inadvertently exposed the key issues in silver. The unintended consequence of discussing concentration and the need for legitimate position limits on the long side of commodities, led directly to the concentration on the short side of silver. Commodity law is clear when it comes to manipulation Â? it is not allowed on either the long or short side. So make no mistake Â? the current regulatory thrust is to contain prices, not to increase them. It's just that the statue of Lady Justice is blindfolded for a reason, namely, the law is intended to apply to all equally. If you eliminate concentration and enact legitimate position limits, it will apply to both the longs and the shorts. My guess is that the regulators probably wish they could avoid dealing with silver at all, but the issues are so darn clear.

Silver inventory changes have been in the news recently. Thanks to a 2 million ounce withdrawal from the COMEX inventories, the total level of holdings dropped below the 100 million ounce mark for the first time in many years. Over the past two days, 8 million more ounces have been redeemed from the SLV. That brings the total amount of silver redeemed from the Trust to 55 million ounces from the end of April. As I have previously written, I think there has been a massive shift in ownership of physical silver from weak hands to strong hands, as well as a monumental shift in COMEX contracts (as evidenced in the COT). I believe this holds extremely bullish implications for the price of silver.

In keeping with the theme of this piece, I would like to portray the changes in silver inventories in a different perspective. It's easy to succumb to the temptation of micro-analyzing the changes in published inventories, particularly sub-categories, like registered and eligible on the COMEX. Instead, I would invite you to step back a bit and look at silver inventories in a different light.

For many years, I had estimated total world silver bullion inventories (1000 oz bars or near equivalent) to be around one billion ounces. Admittedly, I had picked a much higher number than others, mainly because I wanted to be conservative (in this case, the higher the number, the more conservative for a bull). This was at a time (around ten years ago) when reported inventories were around the 150 million oz level (mainly the COMEX inventories). So, in essence, I was saying that there could have been 850 million ounces in the unreported category, in addition to the 150 million ounces we could see.

Then along came the introduction of the silver ETF, SLV, and all the other silver ETF equivalents. In just a few years, starting in 2006, the recorded and visible world silver inventories jumped from 150 million ounces to as much as 750 million ounces. The 600 million ounce increase didn't come from an excess of production, but was mostly a transfer from the unrecorded category to fully recorded and visible. Out of the shadows and into the sunlight, as it were. Still, despite the five fold increase in visible world inventories, as long as the number didn't greatly exceed one billion ounces, my estimate for total (recorded plus unrecorded) inventories was not exceeded. No, I am not patting myself on the back for my guess; I have a different point to make.

My point is that the recent reductions in the level of world recorded silver inventories of more than 65 million ounces (COMEX + SLV+ all other) make the one billion ounce estimate more valid than before. At the peak in silver inventories late last year and earlier this year, there was clear evidence of tightness (the delay in the Sprott ETF getting silver comes to mind). The subsequent run up in price amid significant commercial short covering also points to there having been no readily available silver around. So it seems to me that if there weren't any great supplies of silver available, then total world silver inventories were certainly no higher than one billion ounces and maybe were actually less than that, say 800 to 900 million ounces. After all, with prices up 15 fold from the lows years earlier, one would think such prices would draw silver from the moon. Such prices should have greatly increased recorded world inventories.

So here's my takeaway Â? total world silver inventories appear no greater than the one billion ounce level I had long guesstimated and may, in fact, be significantly less. That's one billion ounces (or less) in a world with almost 7 billion souls. I'll do the math for you Â? there is less than 0.15% of one ounce per capita. In dollars, that comes to about $5 worth of silver per capita. Just for comparison purposes, the per capita dollar value of gold bullion (3 billion ounces) comes to $650 per head, or 130 times more than silver. If that doesn't auger well for silver outperforming gold in the future, I don't what does.

Pay attention to the daily changes in recorded silver inventories, but not to the point of losing track of the big picture. The big picture shows there is an incredibly small amount of silver in the world, much less than just about anyone realizes.

Ted Butler

June 15, 2011

Silver – $35.50

Gold – $1525

Date Created
2011/06/15