

March 13, 2013 – Waiting on Mr. Big

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Warren Buffett, CEO and driving force behind Berkshire Hathaway, came up with an interesting idea recently that got me to thinking (always dangerous). Even though Mr. Buffett has a rich history in the silver market, having assembled the largest single holding of silver (some 130 million oz) in 1998 before disposing of the hoard in 2005 just before prices climbed by almost 7 fold, there is no direct connection between his new idea and silver. The only connection was that I happened to be thinking along the same lines as Mr. Buffett before his announcement. Buffett's idea was to invite any credible bear on the stock of Berkshire Hathaway to present his/her negative opinion in full view at the company's annual meeting in May.

The only qualifications that Buffett put on his invitation were that the bearish analyst had some professional standing and that he/she be currently short the stock. I understand that Doug Kass, a well-known analyst and money manager, has been selected to present the bear case. The process is not of particular interest to me as I am not buying or selling the stock in any event; I just found the idea intriguing. Obviously, Mr. Buffett felt strongly enough about the prospects for his company for him to solicit an open contrary negative opinion, and I think I understand where he is coming from. That's because I had been having the very same thoughts about silver – I'd like to hear a convincing legitimate argument as to why silver was likely to go down or not go up in price appreciably over the long term. And it's not just an intellectual argument, as in my case I am well aware that many have relied upon my bullish representations in silver and the very last thing I would want would be to steer anyone wrong. If there is something wrong with my bull case on silver, I want to know what that is.

I'm most interested in hearing a strong supply/demand bear silver case. I'm not so much interested in a bearish chart interpretation, as any technician will admit that is subject to rapid change as prices fluctuate. I'm also not particularly interested in an interpretation that calls for prices moving somewhat higher and lower over the next year with no solid reasoning, other than to avoid being wrong. I already understand when the COT market structure flashes caution and how that also is temporary. What I'd like to hear is a long term bear case on silver supply and demand which incorporates all the facts that can be verified and documented. I'd like that fundamental bear case to recognize and explain why JPMorgan's concentrated short position is not manipulative to the price, rather than ignore it completely. This explanation would have the dual benefit of enabling the CFTC to conclude its impossible to resolve silver investigation, thereby assisting a federal agency while warning investors to stay away from silver. In any event, I had been wishing to hear a legitimate bear case in silver when Buffett presented his idea and that's one reason why I raise the issue today.

The more important reason for me wanting to hear the bear case in silver has to do with the fact that silver is a special commodity in that its price is driven by both industrial consumption and investment demand. If the silver fundamentals are as good as they look to me, particularly in the extremely low dollar amount of metal actually available to world investors, it will be only a matter of time before the bull story spreads to more and bigger investors. In fact, it's not so much a situation of looking for a good bear argument on silver, but more a question of why someone big hasn't jumped into silver yet. I know that long time silver observers also have this thought in mind. Since Buffett bought a giant chunk of silver in 1997-98, no one big has jumped into silver, even though it was the single best investment asset over the past decade. One would think the big guys would be descending on silver or that some credible bear case would surface.

I'm not sure if a solid bear case on silver will come into focus, but there are signs that some big guys might be warming towards silver as an investment. About a month ago, SEC year-end filings indicated a large stock and options position in SLV by embattled hedge fund SAC Capital, run by Steve Cohen. Now there are signs more hedge funds are being attracted to silver. Red-hot and influential investment fund operator, Jeffrey Gundlach, has announced that silver is one of his top three picks <http://www.theglobeandmail.com/globe-investor/investment-ideas/us-investment-manager-guru-says-silver-a-good-bet/article9579188/> It has always been my feeling that the case for silver is so good that it was only a matter of time before some type of hedge fund rush into silver would develop. I have been scratching my head, like many of you, as to why it was taking so long, but these are signs that may be changing.

In the past, I had argued that the lack of big entities buying silver was not so bad, as the strongest hands possible in any investment is a diverse a group of holders as possible. Certainly in silver, the holders of physical silver are as diverse as is possible. That's been the case in physical silver over the past decade, namely, there was no single big holder that could dump metal and cause the price to plummet. Even the Sprott organization's silver is largely publicly and widely held. There is a pronounced concentration on the short side of the COMEX paper market, but the long side of that market is among the least concentrated markets of all. What this means is that the regulators don't have reasonable grounds to force paper silver longs to liquidate, in stark contrast to what the regulators should be doing to the concentrated shorts.

Now that silver has developed into a widely diverse (free) market on the long side by mostly smaller investors and a manipulated market on the short side, the stage is set for the entrance of some big investors. Markets are made at the margin and silver's diverse investment base makes the margin tighter and more sensitive to big new investment. Based upon every legitimate signal from the physical market, including COMEX warehouse turnover of metal, to relative and absolute inflows into the SLV and other silver ETFs, to record US Mint sales of Silver Eagles, there doesn't appear to be much physical available silver around. Therefore, the backdrop of little available silver precisely just when big investors are getting interested in its purchase creates an explosive circumstance. I don't know why the world's big investors largely ignored silver up until now, but the impact of any move by them into silver now will have more of an influence given how little silver is available for investment. It would seem any number of large investors could single-handedly acquire the 100 million ounces of silver, valued at less than \$3 billion at current prices, available for a full year for investment.

The key to large investors moving into and influencing the price of silver is for them to recognize the difference between physical and paper silver. My definition of physical is metal in hand or professionally stored, including most silver ETFs (excluding those based upon futures contracts). My definition of paper silver is COMEX futures and option contracts and any other IOU for real silver. About the only thing a large investor would need to do to prove successful in a silver investment is to stick to physical silver. This requirement has been made measurably easier since the introduction of the silver ETFs of the world.

Turning to the markets this week, a choppy and featureless price pattern seems to be prevailing. Volume has been low and my sense is that there is not much true liquidity in gold or silver trading. That means that even a relatively small buy or sell order (on the COMEX) can move prices more disproportionately than usual. You should already know that the commercials control all short term pricing and this means they can cause prices to rise or fall with little effort. This short term price control must be put into proper perspective as it matters little in the long run. With potential interest from large investors, any deliberate sell-offs should prove counterproductive.

There may be further deliberate price stabs to the downside, but there doesn't appear to be many technical funds left to sell according to the COT market structure. At this point, regardless of short term price fluctuations, the path of least resistance and greater price magnitude is to the upside. The continuous nature of the sharp sell-offs wear on investor sentiment and dulls the spirit, but there has never been an important price-bottoming process that didn't crush sentiment.

The news flow continues to astound in its bullish silver implications. I was relieved to read the latest short interest data for the SLV which indicated a drop in short positions of 300,000 shares to just under 8 million shares, as of the end of February.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99> This indicates no big problem presently and warrants no alarm at this time. I do think that a good amount of the 20 million ounce deposit into SLV since the beginning of the year occurred because of the big short covering deposit of January, but that does not lessen the bullish impact of zero metal liquidation on a price decline.

In contrast, the big gold ETF, GLD, continues to lose metal via investor liquidation and to add insult to injury, the short position in GLD did jump noticeably, by 6.4 million shares to 25.8 million shares. I certainly don't sense that the shorting of GLD was due to an inability to secure metal to deposit, as is usually the case with the SLV. If anything, the liquidation of nearly 3.7 million ounces from the GLD since the first of the year would create ample supply of metal and eliminate any need to short GLD due to tightness of metal. And this does not make me bearish on the shorter term price prospects for gold. The increase in the GLD short position conforms to the same technical fund short piling on seen on the COMEX. As such, the short position increase in GLD holds bullish implications for the gold price. I'm much more bullish on silver, but gold seems set up for a good sized pop to the upside as well.

COMEX silver inventories continue to churn and burn and the US Mint has been pedal to the metal in Silver Eagle sales and production. SLV has added 20 million oz this year on lower prices and over 1.8 million oz yesterday alone. I don't recall such inventory increases in the past on silver price declines and I am left with the thought that if silver investors aren't liquidating and are adding to holdings on lower prices, what will they do when silver prices turn to the upside? I can't help but think, along with the rotten sentiment that we are entering into the sweet spot of the price cycle in silver (and gold). Throw in the possible entry of a hedge fund or two and it's hard to see prices staying low for long. The funny thing about hedge funds is that they tend to mimic one another. The real silver story being sanctioned by just the right hedge fund will have more impact than ten thousand research reports.

One final thought – large investors nowadays are incredibly sharp and always on the prowl for new investment ideas. If a movement begins into silver for the right reasons, namely, an appreciation of all the facts, I'll make one last prediction. If a few big investors plow into silver and we remain captive to the ongoing price manipulation by JPMorgan, I would expect these new investors to raise a ruckus. I base that on the experience to date. Please consider the Sprott organization. After assembling a large holding of silver (now held mostly by investors in PSLV, the Sprott silver ETF), the organization has been extremely vocal against the price manipulation in silver (and gold). This is normal and healthy, considering that these markets are manipulated. As and when new big investors buy silver, they are unlikely to remain quiet victims of the manipulation for long. Look around – many of these big investors are strong activists for change. Without knowing who might buy silver, if it turned out to be someone like a David Einhorn, Bill Ackman or even a Carl Icahn, you can be sure that they would not sit by, but would communicate to the world that JPMorgan was manipulating the price. I remain convinced this ongoing silver price manipulation cannot stand real scrutiny; which is precisely what it will get with the right Mr. Big.

Ted Butler

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Silver – \$29

Gold – \$1590

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