

November 10, 2012 – Weekly Review

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In an abrupt reversal from the sharp losses of last week, gold and silver roared back, with gold jumping \$53 (3.2%) and silver up by \$1.60 (5.2%) for the week. Both metals are at three week highs and the most common explanation would seem to be traced to US election results. Given silver's relative outperformance, the silver/gold ratio tightened by the same full point it had expanded in the prior week, to under 53.5 to 1. It would be simple and correct to observe that it is mainly the direction of silver prices that determines the ratio. Silver mostly always rises and falls more than gold in percentage terms and, in essence, this is why a conversion of gold into silver makes sense if you expect higher precious metals prices over time. That's because higher overall gold and silver prices should mean an investor will make more on silver. Unless my eyes are lying to me, I keep seeing the signs that silver's relative outperformance will be staggering over the long term.

Conditions in the wholesale physical silver market seem to be intensifying, if that is possible. It is hard for me not to attribute the sudden price strength in silver to tightening physical conditions. It looks like the normal high turnover in COMEX warehouse stocks may be close to being back, as some 2 million oz went in and out this week, with total inventories climbing a half million oz to 143 million oz. I do believe the disruption to silver shipments due to Sandy was behind the previous week's sudden withdrawal of more than 2.5 million oz from the big Swiss ETF, ZKB. It still points to pronounced tightness that so much visible and recorded silver inventory is seemingly in constant motion.

Deposits into the big silver ETF, SLV, are also suggestive of investor demand recently. In little more than a week, close to 4 million oz have come into the Trust, the world's largest stockpile of silver. Metal holdings in the Trust have been in a fairly tight range of around 305 million oz to around 325 million oz for the past 18 months, after hitting an all time high of near 370 million oz at the price high of April 2011. The standout feature to me on the SLV silver holdings is how stable they have been during some pretty big silver price moves up and down over that time. Admittedly, the price volatility from May 2011 through today certainly cooled off silver investment demand over the past year and a half, following 5 years of uninterrupted phenomenal investment demand. But I view that cool-off as a temporary circumstance that can re-ignite in a heartbeat given silver's superb fundamentals. (In fact, there are signs that silver investment demand may have resumed.)

Plus, there's another way of looking at the great stability in SLV metal holdings since June 2011. These holdings look to be in incredibly strong and diverse hands. Certainly, there are no reported large holders, as there are in GLD, in the form of John Paulson. Institutional ownership of shares of SLV is only 16%, while institutions hold 41% of GLD, two and a half times as much. The big institutions can't sell what they don't own (shorting aside).

<http://www.nasdaq.com/symbol/slv/ownership-summary> The deliberate and unprecedented price smash of May 2011 shook out some 50 to 60 million oz from panicky SLV investors over a month or two, but no further big liquidation has occurred on subsequent price smashes. What doesn't kill you makes you stronger. The metal being held in SLV (and other silver ETFs) appears to be there for the long term; exactly as it should be held. Bears have predicted the sudden outflow from gold and silver ETFs in all the years these securities have existed. Aside from the great silver flush out of May 2011, the outflows haven't materialized and neither do they appear likely to occur anytime soon. If anything, it looks like big new buying could occur.

I won't dwell on it, but there was a decline in the shorted shares of SLV of more than 1.3 million shares, following the prior report of a 3 million share increase. With 13.3 million shares short, the SLV short position is still in the range to warrant monitoring, but little else. There shouldn't be any shares held short (except for the shortest time), but at 4% of total shares outstanding (versus over 12% at the extreme); this isn't currently a hot button issue. (May it remain that way forever). <http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

The really big physical silver story this week came from Canada, in the form of the Royal Canadian Mint launching its own ETF-type silver product, along with the announcement that Sprott was adding to its silver ETF, PSLV. The RCM bought 3 million oz, while a back of the envelope calculation for Sprott indicates around 7.5 million oz. That's more than 10 million oz of silver investment demand or more than the entire 8 to 10 million oz that I calculate is available monthly to world investors after industrial and total fabrication demand is subtracted from total mine and recycling supply. When only two entities suddenly grab the total monthly available supply of 1000 oz bars, that definitely restricts what others can buy and should cause prices to rise. Silver prices did rise, but my question is did they rise enough considering the size of the transactions? I don't think so but let me come back to this later on.

While it is the degree of demand and tightness in the wholesale market that will determine the price of silver, often we get important clues from the retail front. Some clues stood out this week. Sales of Silver Eagles from the US Mint got off to a particularly strong start this month, with more being sold in the first nine days, over 1.5 million, than I can remember previously. Gold Eagle sales also look strong this month, but as I have indicted before, the Mint is selling more silver relative to gold than in any year in the bullion coin program history from 1986. http://www.usmint.gov/mint_programs/american_eagles/?action=sales&year=2012

Normally I don't react strongly to retail silver sales over very short time periods, but reports from retail sources definitely caught my attention this week. There seems to be a strong connection between a sudden surge in sales this week as a result of the US Presidential election. Maybe I'm getting old enough that I can't fully remember, but this seemed to be the most divisive election of my lifetime. Certainly the rhetoric leading up to the election was sharp, as was the immediate commentary afterwards. Rarely have I seen people so worked up and divided along political grounds. As an analyst, I must consider changes in investor sentiment and how those changes may impact price. It is possible (some would say probable) that the election may have altered investor behavior in a way that will last longer than just this week. I favor silver for a wide variety of reasons that do not focus on political factors. But if investors are motivated by such factors to buy silver (and gold) I want to be attuned to it. I know it wouldn't take much to set off a silver investment rush and a sudden change could easily be set off by an election. I certainly didn't predict such a politically-inspired silver sales surge, but I want to be quick to alert you to what I've been told by those on the front lines of the retail silver scene about this week's retail silver buying surge.

The changes in this week's Commitment of Traders Report (COT) were mostly as expected, but the declines in the headline number in gold and silver were a bit less than I thought would be reported. The total commercial net short position in gold declined by 15,000 contracts and in silver by almost 4100 contracts. Last week, I guessed 20,000+ contracts for gold and 10,000 for silver based upon last Friday's high volume price decline. I made that guess before the sharp price rally on Tuesday, the day of the cut-off. Not that it matters much, but speculative buying that day may have masked a bigger liquidation on Friday.

In gold, the 15,000 contract reduction in the total commercial net short position took that position to 207,700 contracts, the lowest since Aug 28. The commercials have now covered about 62,000 short contracts from the peak on Oct 2, or almost half of the 133,000 contracts they sold in total on the \$200 gold rally from July. As such, the COT structure in gold must now be considered neutral. By category, this week it is simple \hat{A} ? the big 4 accounted for all the short covering. The sharp turn up in gold prices this week puts us closer to penetrating moving averages to the upside as opposed to downside violations of the prior week. This sets up a potential test of a premise I've been advancing, namely, that the gold raptors would be unlikely to plow onto the short side aggressively since they were burned on the last gold rally by shorting too much too soon. If my premise proves to be correct, that would require the big 4 to short more on rising gold prices, something they may not relish.

In silver, the reduction of over 4000 contracts took the total commercial net short position down to 49,700 contracts, the lowest since mid September. Unlike in gold, the big 4 (read JPMorgan) only covered a bit over 600 contracts, with the silver raptors buying 3300 contracts and increasing their net long position to 8100 contracts. As a reminder, I came to refer to the silver commercials in dinosaur terms after the movie, "Jurassic Park." The big 4 and 8 were Tyrannosaurus Rex, the king of the jungle, and the smaller commercials were Velociraptors which were smaller and faster and hunted in packs. This week, the raptors appeared to be more nimble than JPMorgan. I'd go so far as saying that it was probably the raptors that rigged the sharp sell-off last Friday for the expressed purpose of buying on the sell-off. For the past three weeks, the raptors have bought more than twice as many contracts as the big 4.

I would calculate JPMorgan's concentrated short position in COMEX silver futures to be no less than 31,000 contracts, the equivalent of 155 million oz. Because there was an increase in spread positions this week in the Disaggregated COT report, JPMorgan still holds more than 32% of the total net open interest, a monstrous and manipulative market share. The most amazing thing is how little JPMorgan has been able to cover on the more than \$4 drop in silver at the price lows. I'm certainly not surprised that prices have been volatile given the extreme COT structure that exists, but I am surprised JPM has only been able to buy back 3000 contracts so far on a short position that totaled 34,000 contracts on Oct 2. Such a large position presents a continuing danger to the market of both a manipulative sell-off and a separate danger to JPMorgan of a silver price explosion.

While I have tried my level best to motivate the regulators to remedy the dangerous situation created by JPMorgan's lopsided market share in COMEX silver, the CFTC has done squat. JPM has also ignored the issue, despite being informed of all my allegations of illegal market behavior. But as I hope I have conveyed, pressuring the regulators and JPM was never the only remedy to ending the silver manipulation; such pressure was only something constructive to do in the interim before the inevitable physical shortage hit in silver. Besides, if you don't comprehend the ongoing manipulation, you really don't understand silver, in my opinion. A physical shortage will trump any paper manipulation. A physical shortage trumps everything in that it quickly becomes the main focus -almost to the exclusion of everything else. You need look no further than the gasoline shortages that have arisen due to Sandy (and every hurricane I have experienced).

While I have consistently focused on the COMEX warehouse movements and deposits and withdrawals in the silver ETFs for signs of physical tightness, I have been taken back by the new signs of tightness that appeared this week. Returning to the silver investment demand from Sprott and the Royal Canadian Mint this week and the reports of the sudden investment demand associated with the US election, these are precisely the types of events that could quickly blossom into a full-blown silver shortage. The first thing to remember is the mechanics behind how quickly a silver shortage could unfold. Quite literally and just like the current gas shortages in the NY metropolitan area (and my heart goes out to everyone there, including family and friends), such shortages seem to come overnight. The minute the supply of a vital commodity runs short, demand increases disproportionately. It's just collective human behavior, whether the behavior is by an individual motorist or a corporation trying to ensure a vital manufacturing ingredient. There is no buying force greater than panic buying in a perceived shortage.

Thanks to decades of over-consumption, there's just not that much silver around, particularly in the industry standard form of 1000 oz bars. I calculate around a billion ounces or so. Every single ounce has an owner and only those owners will determine if it is available at any particular price. Based upon the steady level of the amounts of silver in the various ETFs, only a very small percentage is available to the market currently. The only other source of metal available to investors and silver users is from current production, both mine and recycling. As I indicated earlier, the monthly amount of silver available to the world's investors runs about 8 to 10 million oz, or 100 to 120 million oz annually. The vast bulk of new silver produced each month, around 75 million oz, is consumed by industry and other fabrication demands. If someone comes along (like Sprott and the RCM) and suddenly grabs the entire monthly investment supply, other investors will be deprived until enough new supply is made available in time. But time seems interminable in a shortage, because timely delivery is what is least available. Instead, it becomes a case of I want or need it now and price is secondary.

The line between enough supply and not enough supply is fine. The perception alone that supply may be insufficient is enough to create a shortage if enough buyers share that perception. I don't want to be an alarmist and I am not given to sensational short term predictions (although I do have some sensational predictions about silver in the longer term). That said, the Sprott and RCM purchases and the potential for further investment buying due to the election, on top of the drumbeat of physical tightness emanating from the movement in COMEX warehouses, could be enough to push us into a genuine physical silver shortage. In some ways, I am scratching my head to see how a silver shortage can be averted based upon the developments this week.

For one thing, I'm puzzled how these events haven't translated into much bigger price gains already. I think I know that a sudden 100 million oz or a 30 million oz demand for physical silver would send the price flying, but the sudden demand for 10 million oz should have had more of a price impact than witnessed. The best explanation I have is that this market is as crooked and manipulated as I have maintained and only artificial and temporary price rigging can explain the subdued price reaction. The analogy that comes to mind is that of an old fashioned bank run where the only real chance of averting a panic is by shoveling out as much money as possible in the hopes the depositors' fears dissipate before the amount of bank money remaining. The sudden physical demands for silver this week were quickly satisfied with no big impact on price in order to give the impression that there is plenty more silver behind it. The only problem is that an objective reading of all the known data does not point to plenty, but a tightness already verging on shortage before the Sprott and RCM purchases.

So what am I saying? I'm saying that silver investment demand may have come to life exactly as supplies rarely looked tighter; a set up conducive for a genuine shortage developing. I'm also saying that the COT structure is still extreme because of JPMorgan's bloated short position and the crooks at JPM may still be able to rig a sharp sell-off. I suppose that taken to its natural conclusion, we had to end up at this point; one or the other. The thing to remember is that when we get to that genuine silver shortage, nothing that the CFTC, the CME or JPMorgan says or does will matter because in a shortage nothing matters except securing supply.

In closing, I just have to pass along a comment from the unnamed subscriber who I've previously identified as a Swiss money manager. You may recall his thoughts when he suggested that I point out to BlackRock that short sales in SLV cheat the firm out of management fees nearly a year ago. I think that went a long way to getting the company to crack down on SLV short selling and prevented them from legally biting my head off. He's come up with a spectacularly bullish observation about silver that I had overlooked. It seems there is a move underway in the Rare Earth Elements space and for other vital minerals where industrial users are looking to vertically integrate their supply lines by purchasing producers of those minerals. Just yesterday it was announced that the Precision Castparts Corp agreed to purchase the Titanium Metals Corp for almost \$3 billion in order to assure future raw material supply requirements. My friend included a note that a technology company was exploring participating in a joint venture to develop a silver mine to secure future needed supply. This is very much in keeping with my long term opinion that it will be the silver industrial users who will blow the roof off the silver price when they rush to build inventories in a shortage. It seems to me that the very best thing that silver industrial users could do would be to buy as much physical silver as possible today while it may be available, rather than wait in gas lines later.

Ted Butler

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Silver – \$32.50

Gold – \$1730

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