November 13, 2010 – Weekly Review

Weekly Review

It was a rough and tumble week that featured both new historic highs in silver and gold at the outset, followed by a significant late sell-off, particularly on Friday. For the week, silver finished about 70 cents lower, with gold dropping about $26. Despite Friday's drubbing, this was the second highest weekly gold close in history, matched by silver's second highest weekly close in 30 years. This week's volume, particularly in silver, was nothing short of spectacular in both futures and in the SLV and other ETFs.

From their last concurrent lows in late August, gold is up around $140, while silver has climbed about $8. While the gold/silver spread ratio widened slightly for the week to around 52.5, silver has still outperformed gold decisively over the past 2+ years. In simple terms, that means that silver has been a better investment than gold over that time period. Over time, the facts suggest that will continue and accelerate. The question on everyone's mind is where to from here? I'll try to get to that in a moment. I apologize for what may be a longer than normal report, but there are a number of points I wish to cover. I'll try not to be too verbose.

On the physical side, there were also some big developments. COMEX silver warehouse inventories dropped to near four year lows, at just under 108 million ounces. This drop, importantly, was accompanied with great turnover (in and out movements); highly suggestive of tightness and that the inventory is held in strong hands. On a longer term basis, COMEX silver inventories are down 60% from the 280 million ounce peak in the mid-1990's. In contrast, COMEX gold inventories are at a record high of over 11.3 million ounces, the highest in the 45 year history of the COMEX (when gold was made legal to own for US citizens). Admittedly, this is only one sub-category of reported inventories, but it is an apples vs. apples comparison, as the COMEX is the dominant market for both gold and silver trading.

The big physical news was the extraordinary deposit of 11.3 million ounces into the SLV on Wednesday, the largest one day deposit in the ETF since 2006. This brings the deposits into the Trust to over 18 million ounces in little more than a week and a half, to a new record of over 344 million ounces. This also brought the SLV-doubters out in force, who questioned how it was possible for such a large deposit to be made, as well as a very recent report questioning the validity of a new audit of the SLV'S holdings. Many people distrust the SLV, principally due to JPMorgan's role as custodian. I'm not one of the SLV doubters, as you know, but if I change my mind or develop any doubts, I promise I won't keep that a secret.

Not only do I think the doubts are hogwash, I am becoming even more convinced (if possible) that the SLV is on the up and up and is, in fact, the silver investor's best friend. I still maintain that physical silver in your possession or held in true allocated form (where you can take delivery of 1000 oz bars recorded by serial number) are the best ways to hold silver, but for those who can't do that the ETFs in general are the way to go. At the same time, however, I am becoming more concerned with many other forms of Â?paperÂ? silver where one can't get the actual bars being stored by serial numbers. Of course, I don't have the ability to personally guarantee the SLV and other publicly traded ETFs, but I can explain why I am encouraged by the inflows into SLV.

On Wednesday, I wrote that I sensed that many millions of ounces were owed to the Trust due to share short selling in the face of strong buying demand. The sudden inflow that day of over 11 million ounces is exactly what should have occurred, although I can't say I expected that much in one day. But the sudden inflow reassures me, rather than create doubts. I've written before that the new sponsor of the SLV, BlackRock, seemed to be more sensitive to share short selling of the Trust than the previous sponsor, Barclays Global Investors. BlackRock is the world's largest money manager, with around $3.5 trillion in assets under management. The SLV represents maybe a quarter of 1% of BlackRocks' total assets under management. Who would jeopardize a well-respected brand name to cheat (somehow) on such a small part of a business? I believe the SLV is more legitimate than ever because of BlackRock's sponsorship. Of course, if you have any doubts, don't buy it. There is no gun at your head. What confounds me is that the critics are not satisfied with buying some other form of silver but still insist on spreading doubt to others about SLV, even though SLV has performed exactly as advertised during its entire existence.

Away from the COMEX concentrated short manipulation, the most important factor in the rise in silver prices over the past 5 years has been investor buying of ETF-type products. Yet, despite the beneficial impact on silver prices that the ETFs have clearly had, the critics have become more vocal. It makes little sense.

One question that does arise as a result of the big inflow into SLV is where did the silver come from, especially given the evidence of an already tight physical market? That's a legitimate question, although it may not lead to the most logical conclusion. Let me see if can address the legitimate question first. We can do this by eliminating where we know the 11.3 million ounces didn't come from. We know that the 11.3 million ounces didn't come from current world mine production, which runs at slightly less than 2 million ounces a day. We know that the SLV couldn't buy the entire world's production for 6 days while the hundreds of thousands of competing silver users and investors stood aside. Therefore we know it had to come from existing unreported inventories (since it didn't come from any reported inventories). That's the best answer one can give. That leads to another question, although it still won't lead to the most logical conclusion.

The other question is how much is left in unreported inventories that still can find their way to market? Let's face it, it's only human to see such a large chunk of silver come into the trust and think how much more is yet to come? Another 11 million, or 110 million or a billion ounces? Unfortunately, unless you have Superman's x-ray vision and can see all the world's vaults simultaneously, there is no way to know how much is left in unreported inventories. And I guarantee that you will make yourself crazy if you persist in trying to figure out the amount remaining. So don't even try. Instead, stick to the facts and reach the most logical conclusion possible. Don't look at the inflow and try to guess how much is left, focus instead on the glaring fact that there is now 11.3 million ounces less in unreported inventories that can be transferred into the reported category. Mathematically, that makes the physical market tighter. And do that not just with this particular inflow, but with the cumulative transfer of silver from unreported into reported inventories over the last few years.

Since the SLV was introduced in April 2006, more that 550 million ounces have been transferred from unreported silver into reported world inventories, including the SLV and all other similar programs. Currently there are more than 716 million ounces in total world visible silver bullion inventories. That's a very big chunk of my long-time estimate of one billion ounces in total world inventories (unreported plus reported). While I may have to raise my billion ounce total estimate a bit, given the excess of silver production over industrial demand of 100 million ounces a year or so, that's not a big deal. The bulk of the 550 million ounce increase in reported inventories over the past 4.5 years is as a result of transfers, not the Â?surplus.Â? The way to look at that, in my opinion, is that there are 550 million ounces less that can be transferred in the future. And the long-term rise in price would seem to confirm my thinking.

Since the rally began at the end of August, almost 50 million ounces have been deposited into the SLV, a 16% increase in holdings. During that same time, the holdings of the big gold ETF, GLD, have actually declined slightly. There has been a noticeable shift to physical silver investment demand, perhaps from gold investors, although I still believe it's in the early stages. Additionally, US Mint sales of Silver Eagles are particularly strong relative to Gold Eagle sales, further confirming what may be a growing investor preference for silver over gold. Given how little silver exists relative to gold, if this trend continues, the influence on silver prices should be profound.

As I indicated on Wednesday, the COT report will be delayed until Monday afternoon. My sense is that Monday's report will continue to show no increase in commercial short selling. What's more of interest is what occurred in the volatile sell-off since the cut-off. I'm convinced that since Tuesday's cut-off for the report we have experienced a significant reduction in the commercial short position, particularly in the big 4 and 8 concentrated net short categories. In fact, this short-covering is why we had such a vicious sell-off on Friday. Same as it ever was.

The story over the past few months has been a dramatic increase in the price of silver, primarily due to a lack of additional commercial short selling on the COMEX. It was the absence of additional commercial short selling, particularly by the big concentrated shorts, like JPMorgan, that allowed the price to climb as much as it did. On the rally it became obvious that the shorts were experiencing great financial stress, being forced to deposit many billions of dollars in margin calls, especially when combined with gold. This should be taken as further proof of the manipulative role that the big shorts exerted on the price of silver.

The problem for the big shorts was that not only were they experiencing financial stress due to the rising price, they were unable to reduce their short position, thereby leaving the source of their problem intact. That was a circumstance that threatened to result in financial ruin if permitted to continue. Faced with financial ruin and the growing awareness by many of the predicament the big shorts were in, they resorted to their only alternative to that ruin Â? create a large and dramatic sell-off. That was what we began to see on Tuesday, with the CME's criminally timed silver margin increase and the collusive vicious sell-off on Friday, under the cover of general commodity weakness.

Make no mistake – the sell-off in silver did not occur for any real supply/demand factors, it was strictly a function of do or die for the big shorts. They pulled out every dirty trick in their manipulative bag to get this done, because it had to be done. It was either that or financial ruin. There is no doubt in my mind that the big commercials bought back short positions on the sell-off, as they always have in the past; only this time it was done with an urgent necessity.
As painful as these intentional manipulative sell-offs may be, especially to late-entering margin longs, they do improve the market structure, which wasn't that negative to begin with. Now it is better as a result of the intentional sell-off and flush-out.

The question on everyone's mind is what's next? In the short-term, the only honest answer is that no one knows for sure. It comes down to how much additional long liquidation the big shorts can engineer. We are still above all the critical moving averages, so there does exist the possibility we could go lower to get the technical funds completely flushed out. For sure, if we do go lower, it will be because JPMorgan and the other COMEX crooks are successful in tricking the technical funds into forced selling and not for any other reason. But there has been significant liquidation already, so it is just as possible it could be done or nearly so. Certainly there is nothing in the real world of silver that would account for further selling.

It is important to recognize that the uncertainty of what will happen next should only be asked in a short-term context, as the long-term direction for silver can be answered more forcefully, namely, up and up sharply as soon as this damn crooked sell-off is over. The sell-off itself confirms that conclusion as the degree of brazenness and urgency on the part of the commercial short crooks to buy back short positions should tell you what they think of the future prospects for the silver price. They wouldn't be buying so aggressively if they thought silver was overvalued.

Another question is where the heck is the CFTC while this manipulative take down is under way? Alternatively, is this just another smack down in a long and continuing series of intentional sell-offs to come? Has anything changed or will the silver manipulation last forever? I have some thoughts I'd like to share on these questions.

First, it's important to keep things in perspective. The price of silver is up significantly over the past few months, despite coming down sharply from the highs this week. Looking at the facts present in silver, I would not expect a protracted decline like we witnessed after the highs made in March 2008. Conditions are much different now than they were then. We didn't know JPMorgan was the big short back then or that the CFTC would begin a formal investigation by the Enforcement Division; now it is universal knowledge and the subject of just about every analysis one reads. We've added 300 million ounces to reported silver inventories since March 2008 as a result of investment demand with the prospect of more investment demand as far as the eye can see, as more become aware of the real silver story. The repetitive and manipulative COMEX takedowns are known and expected by many more market participants now than they were then. All these things argue against many more rigged silver takedowns. It's more reasonable to expect that this sell-off could be the last one, whether it is completely over or not.

Unless this latest sell-off gets extended in time and price, I don't think we should criticize the CFTC just yet. Of course, a deep and prolonged decline will force me to change my mind. But based upon what has occurred over the past few months, I would be inclined to give the Commission the benefit of the doubt. The enactment of the Dodd-Frank financial reform act almost coincides with the impressive recent rally and was a big factor in my anticipation of the $5 to $10 rally I had envisioned back in July-August. I think the new law had a primary role in the rally. It also may argue against a deep or prolonged sell-off. Something dissuaded the big silver shorts from adding aggressively to short positions over the past few months. I sense it was related to the CFTC.

Let's face it Â? this is not your father's old CFTC; a federal agency woefully out of touch with the important issues and ineffective against a powerful industry's demands. The CFTC is, effectively, a Â?newÂ? agency. It is more transparent and open to public input than at any time in its history. It appears to be butting heads on important issues with an industry to which it used to be subservient; and doing it with professionalism. This is partly due to the new law, but more specifically due to Chairman Gary Gensler. I have been effusive in my praise of Gensler from the moment he took office in May 2009. While I don't know him personally, he has created a record of statements and actions that are easy to evaluate. He has brought out the best in his fellow Commissioners and staff. If you doubt what I am saying, please check out the public hearings which are available on the Internet. I'm a pretty good judge of human character and I still have high expectations for him. I admit that it is possible I will be proven wrong, but I haven't been proven wrong yet. The key test lies directly ahead on the issue of position limits.

The new law mandates that position limits be in place for energy and metals contracts by the middle of January, 180 days after the law's signing by President Obama on July 21. That leaves a bit more than two months. From watching the public hearings to date, there is no way that position limits will be up and running and actively enforced by that date; that's just not going to happen. But that's OK. What is likely to happen by the mid-January timeline (and probably within a month from now) is that suggested limits will be proposed by staff to the Commission on energy and metals contracts, including silver. Details will also likely be forthcoming on how to handle the all-important matter of exemptions to whatever limits are proposed.

I'm expecting that this could be a seminal event for silver. As you know, I have made a big deal of this issue for more than 20 years. Remarkably, I have read absolutely nothing to date in the way of public analysis or commentary on silver position limits, except the all-important comments submitted by many of you. The lack of any analysis by others does not diminish my expectations. After all, there was a time when no one else discussed the excessive and concentrated silver short position or JPMorgan's role in the silver manipulation other than me. I know that the industry (particularly the CME and JPMorgan) have lobbied the CFTC aggressively on this issue. I even sense that were a vote taken today, three of the five Commissioners would vote against a reduction in silver position limits or cracking down on exemptions in any way because of that heavy industry lobbying. And certainly there has been no lobbying by any organizations promoting a big reduction in silver position limits and the disallowance of phony exemptions. It's just been you and me. Still, I'm optimistic that meaningful position limit reform will come to COMEX silver.

I base my optimism on the actual merits of the case for a sharp reduction in silver position limits and the egregiousness of allowing big banks the ability to sell unlimited quantities of COMEX silver contracts. My sense from reviewing the hearings to date is that the staff at the CFTC who will make the proposals are knowledgeable about the issue and will be professional in their presentation. Even if I'm dead wrong, the matter of position limits will be opened up and will then become a matter of public debate. Given the open and transparent manner in which the CFTC has been operating recently, a fair and open debate should be enough to settle the matter.

I believe that this silver position limit discussion may have a direct bearing on the direction of silver prices, even on a short term basis. I can't help but think the matter of silver position limits is on the minds of the big shorts as well. It may be a strong influence on why we have sold off so sharply yesterday. Putting myself in the big crooks' shoes, I'd want to reduce as many silver short positions as possible before this issue comes up for proposed rulemaking. The issue of silver position limits may have, perversely, contributed to the current intentional takedown. If so, that's an additional factor favoring this being the last manipulated smack down of the price.

The advice to silver investors is to hang tough. Don't get cute, thinking you can time the market and enter and exit without peril. It's no fun watching the price get illegally sold off, but the temptation to step aside temporarily to avoid a loss of profit could easily lead to taking yourself out just before the market explodes. As painful as it is to watch the value on your silver investment profits erode in the short term, the pain of missing out on the historic up-move to come may be unbearable.

Ted Butler

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Silver – $26.05

Gold – $1369

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