# November 27, 2010 – Weekly Review

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In a holiday-shortened week, the price of silver fell 60 cents, while gold rose approximately $9. This caused the gold/silver spread to widen slightly, to roughly 51, still the second best weekly showing for silver in more than 2 years relative to gold. Trading volumes contracted sharply in both COMEX futures trading and in the big metal ETFs, SLV and GLD. In fact, the standout price feature for the week was the sharp takedown in each, especially silver, on Friday on the lowest real volume in a while (adjusting for roll-over spread volume).

Some of you wrote to me about the sharp sell-off in silver on Friday, asking if it was a special day after Thanksgiving sale. Although I did treat it as such, it was a bit more than that. In fact, it was one the most overt examples of intentional disruptive trading on the COMEX that I have ever witnessed. On extremely light trading volume, prices were suddenly rigged lower in the early hours before the COMEXÂ?s traditional opening. (My friend, Ed Steer, reminded me that volumes for Friday were even lower than posted, as it covered two day's trading). Because volume was so low, not much forced-liquidation occurred, but it was still a blatant example of what's wrong with the COMEX, owned by the CME Group, Inc.

I know there were plenty of legitimate-sounding excuses for the sell-off (like dollar strength), but the fact that silver always seems to suffer the largest percentage declines on these days is more than coincidental, in my opinion. We've all come to accept the fact that silver is more volatile than just about any other commodity, including gold, but I would ask you to think about why that is the case. I think we accept silver's great price volatility because we have witnessed it repeatedly and have come to expect it; not because there is any legitimate reason for that volatility. Sure, silver is a small market, but there are plenty of smaller markets that are not near as volatile. Sure, silver is both an industrial commodity and investment precious metal asset, but how the heck would that account for it having such extreme volatility? I challenge you to come up with a legitimate reason why silver is so volatile, aside from we've come to expect it.

I have my own explanation for silver's great price volatility. It is the most manipulated market in the world and it is in the terminal stages of breaking that manipulation. The epic collision between the entities that seek to suppress the price of silver and the force of the free market which must break the suppression are what's behind the price volatility. Just like massive tectonic plates which collide and cause earthquakes and volcanic activity, the clashing between the forces of manipulation and the emerging free market in silver result in great price volatility, and will cause the coming price volcano. Nothing can prevent the price violence to come. All we can do is prepare for it in the most prudent manner. That involves holding fully-paid for silver tightly and taking advantage of the violent sell-offs by adding to positions where possible. Holding on margin is like building a house of straw inside the crater of an active volcano.

We can also educate ourselves as to who is behind the force that seeks to extend the silver manipulation. Here, all evidence points to the exchange itself, the CME, and the leading short seller, JPMorgan. It is very distasteful for me to continuously point to these two important US financial institutions as the silver crooks. I know it lowers the image of my country to label them as such, and I am pained by that. However, it would be more damaging to look the other way and let the criminal conduct continue unopposed.

In physical market developments, silver remains extremely tight. COMEX silver warehouse inventories have settled around 4 year lows with continued heavy turnover, a sure sign of tightness and inventories being held in strong hands. I would have thought there would have been some increase in COMEX warehouse silver inventories as first notice of delivery day approaches for the big December contract next Tuesday. Maybe supplies are tighter than even I think. The big silver inventory news, however, was yesterday's withdrawal of nearly 6 million ounces from the big silver ETF, SLV. This withdrawal comes after successive new record inflows were recorded earlier in the week, to over 350 million ounces. Trading volume and price action rule out that this was plain vanilla investor selling; this silver was taken out because it was urgently needed someplace else, either for another ETF, industrial users, or perhaps to be shipped to the COMEX for delivery on the December contracts. I don't think it is possible to view this development as other than an indication of great physical tightness.

There was a standout article in the Wall Street Journal about the big gold ETF, GLD. Barry Ritholtz, proprietor of the popular blog, The Big Picture, gave an outstanding summary of the WSJ article
http://www.ritholtz.com/blog/2010/11/interesting-history-of-gld/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+TheBigPicture+%28

Among the tidbits that Mr. Ritholz listed were that the GLD had become the largest private owner of gold in the world and the fifth largest holder when including central banks. Incredibly, 60% to 80% of the buyers of GLD had never purchased gold before. One disagreement I have with Ritholz's summary was him questioning whether the various gold ETFs (not GLD) had all the gold they claimed or if they dealt in futures. Just in case anyone is wondering, I don't know who started the 100 times more paper than real gold premise, but it is patently absurd. Instead, I'd like to expand on this important subject a bit, and compare the gold ETF, GLD, to the big silver ETF, SLV.

The one thing that should not be in doubt is that the introduction and surprising success of GLD has been beneficial to the price of gold because it created a demand that would not have existed otherwise. In fact, the article attributed a $100 to $150 gold price gain to GLD since its introduction in 2004, which should be at least tripled, in my opinion. My analysis suggests a minimum of a $500 boost to the price of gold because of GLD (and other gold ETFs subsequently introduced). Along with the cessation of gold leasing and forward selling, the introduction of the ETFs has been the gold (and silver) investors' best friend. For this reason, I remain baffled by the continuous criticism by radical gold (and silver) bugs who claim the ETFs are somehow a tool of the manipulators to suppress the price. Huh? How does the purchase of many tens of millions of ounces of gold (or hundreds of millions of ounces of silver) by investors who never bought gold or silver before, result in the price being suppressed? Yes, I know I accuse the CME and JPMorgan of manipulating the price of silver, but not by creating the ETFs. Making it easy and convenient for new investors to buy gold and silver is not the handiwork of price suppressors.

If the price of gold has been elevated by $500 because of the ETFs, then the number in silver is by $15 or more, since the $7 level at the time SLV was first proposed in 2005 (not issued). But there are some important differences between GLD and SLV, and all the gold and silver ETFs. As impressive a force that the ETFs have been in the world of gold, the impact of the silver ETFs has been, and will be, much greater. That's due to some basic facts. First, the gold ETFs had a massive time-lead right out of the gate, having started almost two years before the silver ETF was introduced. But just like the great racehorse, Zenyatta, coming from behind is no problem for silver. That's because the silver story is just beginning to be learned.

More importantly, the impact of the silver ETFs is destined to have more of an impact on the silver price, than the impact the gold ETFs have had, or are likely to continue to have, on the gold price. That's because of simple supply and demand and world inventory statistics. Since the introduction of GLD in late 2004, roughly 70 million ounces have bought by the various gold ETFs (41 million oz in GLD alone). That's a lot of gold and it represents a tremendous amount of money, almost $100 billion dollars. But, in terms of total world gold bullion inventories of as much as 3 billion ounces, 70 million ounces is only 2.3% of all the gold bullion in the world.

Now contrast that with silver. There are now more than 600 million ounces of silver held in the world's silver ETFs (344 million in SLV alone). With total estimated world silver bullion inventories thought to be one billion ounces, fully 60% of all the silver bullion in the world is now locked up in the various silver ETFs after only four years of being in existence. In dollar terms, the value of this silver is $16 billion, or only 16% of the $100 billion in gold ETF holdings. Yet, the percentage of total world bullion inventories held in the silver ETFs is 60% versus the 2.3% of gold bullion inventories held in ETFs. That means that there is only a relative little way to go before the silver ETFs hold all of the silver bullion in the world. Look at it this way Â? if the silver ETFs could capture 60% of total world bullion inventories after little more than 4 years, how long would it take them to capture the remaining 40%? And how high would that send the price of silver?

A few years ago, a friend of mine, Carl Loeb, coined a great descriptive term about the SLV. He called it the Â?Death Star,Â? destined to gobble up all of the world's silver. I didn't think he was off then; and I certainly know he's not off now.  Like the great white shark, the SLV is the perfect silver eating machine. In fact, it's too perfect; so much so, that I predict it will have to be altered at some point to control its voracious silver appetite. The day will come when the SLV will be converted from an open-ended fund to a closed-end fund. This will benefit, not harm investors in SLV, as a share premium should develop when the conversion takes place, if not sooner. SLV will still be the world's largest deposit of silver and silver users and investors will continue to flock to it, due to the ability of converting shares to metal. Undoubtedly, I'll write more on this in the future.

Not a week goes by that some new article knocking the SLV comes out. Invariably, worried readers send me the article to ask if it changes my high opinion of the SLV. I have read and will continue to read these negative articles closely, whether readers send them to me or not. It is my job and profession. I promise you I will not delay in reporting any change in my opinion about SLV, or silver ETFs in general. So far, the negative articles have only convinced me that the writers of these articles are very wide of the mark. That said, if you don't feel comfortable holding the SLV, the remedy is simple Â? don't hold it. What's really amazing is how widespread the unease about the SLV (and other ETFs) is, at the same time it is gobbling up all the silver in the world. I think the bottom line is that it confirms the point of the Wall Street Journal GLD article about new investors being attracted to the ease and convenience of metal ETFs.

As an analyst, it's my responsibility to report the good with the bad, even regarding the SLV. The one negative I have always raised (not to the point of panning it overall) was the shorting of the shares. The funny thing is that very few of the SLV critics touch on this issue. Although the share-shorting issue has improved tremendously under the new and highly-respected sponsor, BlackRock, it still exists. My gripe is that no share of any metal-backed ETF should be allowed to be shorted because the short sellers of shares don't deposit metal, which means any buyer of shorted shares has no metal behind the purchased shares. The latest short interest report from the New York Stock Exchange has just indicated a big jump in the shares shorted in SLV to almost 18 million shares/ounces, from under 13 million. Hopefully, BlackRock will continue to stay on top of this and insist the short sellers bring in the metal quickly to extinguish these shorts. It also highlights continued tightness in the wholesale physical market as these shares were sold short precisely because the silver wasn't available to deposit quickly into the trust. That is very bullish for silver. http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

As I indicated previously, the COT report will be released Monday. I wasn't expecting any dramatic changes, but will report soon if there were any big developments. Next week promises to be eventful in regulatory matters, as there will be an open CFTC public hearing on Wednesday, December 1, that can be viewed live via webcast. (See the cftc.gov site on the day of the hearing for details). The agenda does not list position limits as a topic, but they may be mentioned. If not then, position limits should be discussed at the tentatively-scheduled open hearings on December 9 and 15. As you all should know, this is all about silver, even though most are reluctant to say so. Everyone has had a great deal of time to come up the rationale for any level other than 1500 contracts in silver, and I am looking forward to hearing all the excuses why that can't be done. It reminds me of the line from the Eagles' song, Â?Hotel CaliforniaÂ? Â? what a nice surprise, bring your alibis. At least it should commence the serious debate on the matter. Also there's a listen-only (no webcam) public roundtable on disruptive trading practices by CFTC staff on Thursday, December 2. Wouldn't it be great if they brought and discussed the trading tickets from the early Friday low-volume smack down in COMEX silver? I know, I know – I'm just fantasizing about the CFTC doing the right thing.

Despite the orchestrated takedown on Friday, the conditions still support the special set up that I wrote about on November 17, when silver was trading at $25.25. We blasted up more than $2 shortly after that article and even after this latest sell-off we are still about $1.50 higher. Contrary to popular belief, I am not any smarter when prices go up, nor am I any dumber when silver prices decline. It just seems that way. The overall risk/reward set up still strongly suggests a major move to the upside soon regardless of what the crooks at the COMEX may be able rig in the very near term. The COT structure will only get better if we do sell-off, although it does not need to get any better than it is already. The physical market, especially the withdrawal yesterday from the SLV, combined with the increase in the short position, is tighter than I have ever seen. With this in mind, not to be aggressively long here would be something hard for me to comprehend.

Ted Butler

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Silver – $26.71

Gold – $1365

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