October 2, 2010 – Weekly Review

Weekly Review

In a somewhat repetitive manner, it was another good week for gold and silver price-wise. Repetition is not always bad. Gold gained around $22 for the week, closing at a new all-time high of $1318; while silver added 65 cents, closing at a new 30-year high of $22.08. Over the past six weeks, from August 23 (the most recent date of their coincident price lows), gold has climbed about $90 per ounce (7.3%), while silver has gained around $4 (22.2%). That's not far from the range of the $5 to $10 pop I had speculated about back in July-August. Measured from gold's price low in late July, gold has advanced $150, or 12.9%.

For the week, the gold/silver price ratio narrowed in to just under 60:1, near to a multi-year low and close to the mid-50 range commonly in place for most of past decade. Over the past two years, silver has outperformed gold as an investment. As such, it may appear to many that the price of silver is back to a reasonable, or even a high value relative to gold, given its recent outperformance. I feel strongly otherwise. In fact, I don't like quoting the gold/silver ratio because it forces observers to think in terms of price. Sound investment analysis demands that you should consider price last, not first, in any situation. Or at least, don't look at price alone for determining value and investment merit. For long-term purposes, you must consider the fundamentals and facts in investment decisions. When one does that in comparing the facts in gold and silver, the simple conclusion is that silver is still vastly under-valued compared to gold.

Let me digress a moment from the weekly review and comment further on the relative investment values of gold versus silver. I make no secret that I have been a consistent proponent of owning silver, not just in addition to gold, but instead of gold. Just to be clear, I have also recommended that one should own silver instead of any other investment, not just instead of gold. Considering the results of the last decade, I'm happy I don't have to apologize for that advice, seeing how silver is up 5.5 fold from the $4 low. Just to put it into perspective, silver has climbed by $4 in the past 6 weeks. Actually, gold's performance has been more of a surprise to me than silver's. If you told me at any time in the past that gold would be over $1300 and asked me to guess what the price of silver would be, I would have guessed a much higher price than $22. That's not a knock on gold, as nothing could be better for higher silver prices than higher gold prices. I'm happy that gold investors have such great investment returns to date and hope they continue. I'm happier that silver remains so undervalued to gold. I'll save for another time the explanation for why I still favor silver for the long term over gold or any other investment. As always, we can't be sure of what will happen price-wise in the short term, but in the long-term, silver should still be way ahead of the pack.

In weekly physical developments, the big silver ETF, SLV, took in a total of 5.5 million ounces, a million more ounces than I reported in Wednesday's article. Given the week's volume and price action, my analysis indicates that at least 5 million more ounces is Â?owedÂ? to the Trust and perhaps double that amount. It will be interesting to see if and when that silver comes in. While I focus on the SLV, since it's the largest such silver investment vehicle, please remember that there are 200 million more ounces in other silver ETF-type programs, in addition to the SLV's 314 million ounces. There was continued good turnover in COMEX-approved warehouses, highly suggestive of tightness. My take when reviewing all the flows of wholesale silver is that same overall sense of tightness. Retail is still a question mark, but wholesale seems tight.

The most recent COT report was a mixed bag. Gold deteriorated, or saw its net commercial short position increase by 9400 contracts to almost 303,000 contracts (30.3 million ounces). Almost all the increase was in the big 4 category. Considering the continuous climb to record prices and increased total open interest, the commercial short position could have increased even more. We are now close to the highest commercial net short position of 308,000 contracts in December 2009. On a COT-basis alone, we are at very negative extremes in gold, although I don't detect continued deterioration in the days since the Tuesday cut-off, despite the march to new highs.

In silver, the net commercial short position was largely unchanged, in the total and big 4 and big 8 categories. In fact, the total commercial short position hasn't changed much in a few weeks, as prices have climbed to new highs. Like gold, I don't detect any deterioration in silver since the cut-off. While not as close to the negative extremes as in gold, the COT structure in silver cannot be considered positive on normal conventional measurements. Certainly, the concentrated nature of the short position remains intact, with the 8 largest traders in COMEX silver futures holding the equivalent of almost 50% of world mine production. If the 8 largest traders in any other consumable commodity of finite supply held 50% of the world production, they would go to jail. For example, if the 8 largest short traders in COMEX copper futures held 50% of the world annual copper mine production, that would amount to 600,000 contracts, not the less than 64,000 contracts these traders actually hold short. The degree of concentration on the short side on the COMEX dwarfs any other short position. Why aren't the regulators making these comparisons?

There is no change in my outlook. If we get a sell-off, it will only be because the commercials were able to rig the market lower on the COMEX and induce tech fund selling. However, the shorts have been under extreme financial pressure due to the rising price of silver (and gold). In the past, the commercials have always been able to manipulate prices lower to get the desired liquidation. But that's not written in stone. Even though it has yet to occur, the commercial shorts could get overrun, especially in silver. That's because a physical shortage will render additional paper short selling ineffective. More paper won't satisfy physical demands at some point. I am still more worried about missing the certain big move to come on the upside, than I am about enduring a temporary (although painful) short-term sell-off, which may or may not come.

Finally, I'd like to comment on the just-released joint study by the SEC and CFTC on the May 6 stock market Â?Flash Crash.Â? In essence, the study found that a single large sell order of 75,000 E-Mini S&P futures contracts set off a chain reaction that resulted in the tremendous volatility that day. There was no finding of any intent to manipulate prices.

In a previous article for subscribers back on May 20 (please see archives), I concluded basically the same finding as the regulators, namely, an unfortunate and unintentional high-frequency trading debacle. I compared the stock market flash crash to silver, noting that the main difference was that in silver, it was a regular and intentional event. I still feel that way.

Further, the new joint study confirms other things that I have written about silver. The study clearly demonstrates one of my principle silver observations, namely, that given a large enough paper trade, prices in the real world are set by what happens in the futures market. In this case, no one would dispute that without the large single sell order there would have been no stock crash on May 6. This proves that stock prices were set by trading in the futures market. This is not how futures markets are designed to function. Futures markets are supposed to discover prices, not set them. If trading in the derivative futures markets is so excessive as to dictate prices to the host markets from which they are derived, we will see more flash crashes and manipulation. The only effective means of restricting excessive derivatives trading is through legitimate position limits.

Of course, the exchange on which the excessive stock futures trading occurred, the CME Group (owner of the COMEX), was quick to point out that the big ill-placed sale was a legitimate hedge and how the exchange was blameless, no matter what. What else were they going to say – yes we were negligent in allowing such unrestricted selling and please sue us for damages? This should show that this exchange is not interested in anything but unrestricted trading of any type and why exchanges should have little to say in regulating trading. This exchange wants increased trading regardless of the damage it may bring to the rest of us.

The difference between the stock market flash crash and the many flash crashes we have seen over the years in COMEX silver and gold is the issue of intent. The mutual fund organization responsible for the mishandled sell order didn't want the stock market to crash. It stood nothing to gain and a lot to lose when the markets reacted so violently. The commercial crooks on the COMEX have had nothing but their own selfish interest in mind every time they have collusively caused the price of silver and gold to crash. They intended that prices would crash and did what they could to bring that about. You would think someone in the regulatory structure would notice this.

Ted Butler

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Silver – $22.08

Gold – $1318

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