

October 23, 2013 – A Top-Down View

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Generally, I choose to write about gold and, especially, silver in terms very specific to what I feel have the greatest impact on price. That's why I empathize easy to document statistics on physical flows, government data on futures trading and coins sales and other facts that can be verified and put into a logical context. Of course, the single most important specific is that the price of silver (and gold) has been manipulated on the COMEX by JPMorgan and other collusive commercial traders.

That is not to say that macroeconomic factors don't exert a strong influence on price, as they surely do. Things like monetary and fiscal developments and the levels of world economic activity must influence the price of everything, including silver and gold, but generally not on a day-to-day basis, as is the case with daily COMEX price-rigging. Additionally, since most of what is written about gold and silver concerns the broader macro factors, I don't dwell on those factors much because I don't believe I can contribute as much value-added analysis as I think I can bring on my more specific approach.

I'd like to break that pattern today to discuss something that I have been thinking a lot about lately, namely, the US Federal Reserves' (and that of other central banks') massive monetary expansion (Quantitative Easing). Since the financial crisis of some five years ago, the Fed has expanded its balance sheet by trillions of dollars and is currently adding to monetary reserves by \$85 billion monthly or by one trillion dollars annually. Because the world has never witnessed such a monetary expansion, no one can be certain how it will play out and that includes me.

Many are convinced the monetary expansion will destroy the dollar and ignite hyper-inflation imminently, as well as directly result in prices for gold and silver in the many thousands and hundreds of dollars per ounce, respectively. In fact, the coming dollar collapse and hyper-inflation are the prime reasons given most often for the inevitable price explosion for gold and silver. That may very well turn out to be the case, but as a "commodities guy," I look at it a bit differently. As always, it's not my way or the highway, so I'll leave it up to you to decide if there is any merit in what I think.

I don't see a universal abandonment of the dollar for some other currency in the near future and I don't expect an immediate and widespread hyper-inflation to take hold. In the case of the dollar, I just don't see a realistic payments substitute (not even gold or silver). In the case of rampant hyper-inflation, the average citizen appears to be so financially crimped that it is hard to image the masses collectively bidding up the price of everything. If the definition of inflation is too much money chasing too few goods that's not what exists today, as most people currently don't have too much money, but not enough. On top of that, medium income has been falling for the average wage earner.

Let me stop here to state that I am not assigning blame for our current state of economic and monetary affairs, because the blame goes way back and there's little good in dwelling on whom or what may be at fault. The irony is that what's at fault was mostly well-intended but misguided. The reality is that good solutions are hard to come by at this point and, barring an accident; we'll probably continue to muddle along as we have been, printing money. We're captive to the conditions that surround us, just as every human that ever lived was so captured. The trick is what to do with those inescapable conditions. From a top-down view, current monetary and economic conditions look good for gold, but particularly beneficial for silver.

Monetary reserves are exploding, but those reserves aren't reaching the man in the street. This, in essence, is the real story – much creation of new money, but that new money is going towards an increasingly narrow segment of society. Realistically, because of the narrow flow of newly created monetary reserves, it is unlikely the man in the street will have the financial capability of aggressively bidding up prices for everyday goods and services, to say nothing of bidding up asset prices (including gold and to a lesser extent silver). Instead, the great recent inflation of asset prices has been the result of the flow of monetary reserves to financial institutions and well-heeled individuals (think 1%, but somewhat broader than that).

It is because of the unprecedented monetary expansion, that important asset classes like the bond and stock markets are at record levels of valuations and market capitalizations and why real estate has recovered as well, especially in the high end – that's where all the monetary reserves have ended up. The well-off tend to put new funds into investment assets, not every day goods and services for consumption. Therefore, it's no surprise that most asset classes have appreciated in response to record monetary stimulus.

The only surprise is that the asset class largely thought to be the most sensitive to excessive monetary stimulus, the precious metals, has not only failed to rise, but in fact has suffered its largest historical price decline in history over the past year. True, gold and silver prices are higher than when the aggressive monetary expansion started around 2008, but the severe takedown in 2013 should have any reasonable person scratching his or her head about why the price collapsed this year in gold and silver, as all other asset classes still responded with higher price levels.

The answer to this puzzle comes easy to those who are convinced of the price manipulation by JPMorgan on the COMEX. Government data indicate record buying by the bank on the price decline of the equivalent of 15 million oz of gold and more than 100 million oz of silver; it is not possible such a feat could be achieved without a series of manipulative schemes and devices on the decline. Now that JPMorgan has sharply reduced its short market corner in COMEX silver and actually flipped from a short market corner to a long corner in COMEX gold, the stage is set for a sharp rebound in prices; but that is apart from the discussion today about the influence of monetary expansion on future gold and silver prices.

In a nutshell, the coming influence of monetary expansion on gold and silver prices will be due to the great inflation already witnessed in other asset classes. At some point, it is inevitable that there will be some switching of funds from bonds, stocks and real estate to precious metals. There always is such switching as asset classes come in and go out of favor on a recurring basis. Someday, something will spook the bond, stock or currency markets and there will be some rush to precious metals. Because the growth of other asset classes has been so monumental, even the smallest amount of switching to precious metals will have a profound impact on gold and, especially, on silver prices.

In essence, that's where I see the coming monetary influence on gold and silver; as a small percentage of massively inflated asset classes seeking diversification. Since wealth has been more concentrated in fewer hands than ever before, relatively small numbers of people will make the switch to gold and silver, but they will be doing so with much larger amounts of money thanks to monetary expansion. This future buying power is what will power gold and silver prices and, while not fully recognized, has already been set in place as a result of monetary growth to date.

Assuming my top-down view is reasonably accurate, the next logical step is trying to gauge what the impact of this buying power will have on gold and silver prices. We do know that the overall size and growth in the valuations of asset classes like bonds, stocks and real estate worldwide measures in the many tens of trillions of dollars. This means that the smallest percentage of potential flows into gold and silver will measure in the many billions of dollars. (One percent of a trillion is ten billion). This is where it gets really interesting for silver.

It is widely reported that China has purchased 1000 tons of gold this year (and the number seems reasonable to me). That's about 32 million ounces of gold and at an average price of \$1400 that comes to around \$45 billion. Gold prices are down sharply for the year despite the large purchases from China, thanks to the COMEX manipulation. In the absence of that manipulation, a \$45 billion purchase would and should have resulted in higher gold prices. Now that the commercials, particularly JPMorgan, are better configured for higher gold prices, additional buying on the scale of \$45 billion most likely will have a positive effect on gold prices.

But if that would be bullish for gold, such an amount would be beyond any meaning of the word "bullish" when applied to silver. \$45 billion, as indicated, roughly equals 32 million ounces of gold, or more than 25% of total annual world production of 120 million oz (mine plus recycling) and about 1% of all the world's gold bullion (3 billion oz or \$4 trillion). No doubt that \$45 billion is important to gold. Let's consider what a \$45 billion purchase of silver would amount to in ounces and the same percentages comparisons.

At current prices, \$45 billion would buy two billion oz of silver. Therefore, \$45 billion would buy all the silver bullion in the world times two, or all the silver bullion (1 billion oz) and all the non-bullion silver (small bars and coins) - quite literally, all the silver in the world. \$45 billion would buy total world annual production of 1 billion oz (mine plus recycling) for two years running, if any of these things were possible. My point is that the same dollar amount would impact silver prices much more than in gold because there is nowhere near the amount of actual silver available for purchase in dollar terms.

What are the chances that silver buying could emerge on a scale that rivals gold? No one knows for sure, but it is not impossible. One need look no further than the data from the US Mint for their American Eagle bullion coins to see that silver could attract buying demand on a par with gold in dollar terms. After years of growing stronger demand for Silver Eagles relative to Gold Eagles, 2013 is shaping up as the strongest relative year for silver yet, with close to the same dollar amount being spent on Silver Eagles and Gold Eagles.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

I'm not suggesting the world will invest more money in silver than in gold anytime soon, just pointing out it has already happened, effectively, in one important and verifiable category. Certainly, from my supply/demand perspective silver is a more logical buy than gold given silver's relative unavailability for investment due to its high industrial and total fabrication consumption profile. After deducting total fabrication demand, there are only 100 million ounces of silver available for investment demand or less than \$2.5 billion annually. Forget \$45 billion, more than \$2.5 billion a year in investment demand will power silver prices higher.

In a world where monetary growth has resulted in asset classes now measured in the many tens of trillions of dollars, the smallest fractional flow will overwhelm the silver market. At some point that flow is inevitable and it will be this dollar flow that will drive the price of silver sharply higher.

A few months ago, I commented on the high price of crude oil and gasoline at the time being due to the record net long position of speculators and counter party record net short position of the commercials in crude oil futures on the NYMEX. I also inferred that it was likely that the commercials would rig prices lower eventually. I concluded the Weekly Review (July 27 in the archives) with the following paragraph Â?

Â?One quick and somewhat unrelated comment. As you go to fill up at the gas station and wonder why prices have jumped so much, please be aware that speculative net long positions and commercial net short positions are larger than at any point in the history of the NYMEX, much greater than when crude oil traded near \$150. I think, in the end, the commercial shorts (including JPMorgan) will prevail in resolving the NYMEX position mismatch to the downside to their advantage, but please don't take that as investment advice.Â?

It took a couple of months, but it appears clear to me that the recent sell-off in crude oil and gasoline was due to the same speculative forces that caused prices to run up in the summer. Just as it is the case in COMEX gold and silver, petroleum prices are often moved by paper trading games on the NYMEX. The trading games are the same in that real world fundamentals have little to do with price moves; this is all about technical trading funds being lured into and out from positions by the commercials (JPMorgan) and not actual oil production or consumption.

We'll have to wait for the resumption of COT report data to be sure, but the old trick of the commercials rigging prices above and below important moving averages to induce and force technical funds to buy and sell is now at play as the 50 and 200 day moving averages were penetrated to the downside in crude oil futures. What's amazing is that as important and high profile as crude oil may be, I've heard very little professional oil analyst commentary as to what's really moving prices.

This energy move down had nothing to do with real fundamentals, just like the prior move higher likewise had no supply/demand causation; unless you can call paper trading games on the NYMEX as real fundamentals. As a reminder, it is against commodity law for the futures market to dictate and set prices for world commodity markets, yet that is clearing occurring in crude oil, in addition to gold and silver and other commodities. As is the case in COMEX gold and silver, US and foreign banks are very aggressive counter parties to the technical funds in crude oil. If the regulators or Justice Department ever tried ending the big banks' continued control of futures trading, the country and our markets would be well served.

As I was preparing to send this article, the CFTC announced the schedule for catching up on COT and Bank Participation Report data. There will be reports this week, but it will take some time before reports are current <http://www.cftc.gov/PressRoom/PressReleases/pr6745-13>

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Silver \$22.60

Gold – \$1333

Date Created

2013/10/23