

September 11, 2013 – The Silver X-Factor

In a moment, I'll present a follow up to my expectation of an inevitable physical silver shortage, but first a few comments on developments since Saturday's review.

The price action has remained volatile, with gold and silver prices falling sharply yesterday because – well because that's what JPMorgan decided gold and silver prices would do. Actually, there was probably involvement in the decline, particularly in silver, from the smaller commercials (whom I call the raptors) looking to get long the market. The raptors have been selling, along with JPMorgan, on the recent rally in gold and silver and are undoubtedly looking to re-buy more on lower prices; hence the (only) reason for sharp price declines.

I absolutely guarantee that you will drive yourself mad if you look for non-manipulative reasons for sharp gold and silver price movements. (Alternatively, if you are a market commentator or regulator pretending not to see JPMorgan's market corners in COMEX gold and silver; you are guaranteed to look like a fool or a dupe). Gold and silver prices only go down when the commercials are looking to buy. While that does appear to be a sound policy for the commercials, the catch is that the commercials first rig prices lower (through the detestable practice of High Frequency Trading) in order to buy. That turns a sound policy into an illegal scam.

So if the commercials are looking to rig prices lower in order to buy, does this mean gold and silver prices must fall? It means prices can fall, but not necessarily must fall. It depends on what happens after prices are set lower by the commercials. If the commercials succeed in causing technical traders and other momentum type traders to sell, then the commercials will likely continue to rig prices lower so that they (the commercials) can continue to buy. In retrospect, this was why we fell so steeply in the first half, namely, the technical funds not only sold and liquidated long positions, they established record or near record new short positions as well on the dramatic decline in price. Throw in the massive liquidation in GLD and that's why we dropped so much in gold (and silver). Since the technical funds kept selling, the commercials kept lowering the price and kept buying. This is how JPMorgan came to hold a long market corner in COMEX gold futures. OK, now what – do we go back to the old price lows?

What it comes down to is whether the technical funds and other speculators will short aggressively on rigged lower prices. That is the sole determinant. If the technical funds do add to short positions on lower prices, we will go lower in gold and silver prices. If they don't, prices should not move lower and will then, in all likelihood, move higher. It all comes down to new short selling by the technical funds. My guess is that the technical funds won't add aggressively to gold and silver short positions on the COMEX.

The reason I'm narrowing it down to a question of new short selling by technical funds is because data from the Commitments of Traders Report (COT) indicate that there has been virtually no build up of technical fund or other speculative new long positions on the rally in gold and silver prices to over \$1400 and \$24. In fact, that is one of the most unusual features of the rallies and something I don't think I have ever observed before. We could debate why the tech funds and other speculators haven't added new long positions, but my point is simply that since there has been no new buying (only buying due to technical fund short covering), there can be no selling of new long positions that don't exist. Of course, there could be some selling from old long positions, but logic would hold not massive amounts.

Therefore, if we do go much lower in price, enabling JPMorgan and other commercials to buy, that buying must come from new short selling by technical funds. Even if my guess proves wrong and the technical funds and other speculators do add to short positions on rigged lower prices, while painful, any build up of tech fund short positions should serve as a strong springboard for eventual higher prices. Let's face it ^? we just rallied by as much as \$250 in gold and \$6 in silver on technical fund short covering and that will be the result again if the funds do go short again.

And there is another powerful reason, particularly in silver, arguing against a big build in tech fund short positions and almost guaranteeing any build would lead to another short covering rally. That reason is the cost of mine production. Even at current prices, we are no better than the average silver price for the second quarter; a quarter that was an absolute disaster for silver mining company earnings. It's not like the rally from the lows has put the miners in a fat and sassy financial position; current prices are a nightmare for silver mining companies and there will be a proportionate drag on future mine production. Any move lower in price from here will further impact production.

There have been continued reports on JPMorgan of new legal settlements, an increase in legal loss reserves and the potential sale of their physical commodities business and departure of the bank's commodities head, Ms. Blythe Masters, before the end of the year. To my knowledge, the bank intends to hold on to its gold/silver operation; but I don't know if that's by choice or because of the potential legal toxicity of the unit. I'm still of the opinion that the successive flip of the concentrated COMEX silver short position from Drexel Burnham, to AIG, to Bear Stearns and then to JPMorgan over the past 20 years stops with JPM; although I can't be sure of how it plays out for JPMorgan.

There were also reports that the CFTC may be voting on the issue of position limits by the end of this month as well as court hearings approaching in the case where position limits were thrown out. While I'll monitor the developments, it won't be with the same intensity I displayed on the first go-around and I certainly won't be holding my breath. Let's face it — everyone should know it is wrong for prices to be manipulated by means of a concentrated market share of 15% to over 40%. That's the definition of a market corner. That two separate market corners are held in COMEX gold and silver by JPMorgan, arguably the country's most important bank, is shocking to me, even though I'm the one making the allegation. I'm encouraged by all the developments, especially the broader knowledge and awareness of JPMorgan's market corners. But most of all, I'm encouraged by the lack of legal action against me for the allegations. Let it always be so.

The Silver X-Factor

I'd like to continue on the theme of an inevitable physical silver shortage driving the price to unprecedented new highs. This is the main reason for my interest in silver as an investment. To summarize, because of silver's unique dual demand, as an indispensable industrial material and as a primary investment asset, at some point this combined demand will overcome both physical supply capacity and the manipulative efforts to suppress the price. Since predicting the exact timing of this occurrence is impossible, the best way to position for it is to buy and hold real silver on a fully-paid for basis and wait it out. No loans, no leverage, no margin.

I further believe that the price events of this year have gone a long way towards hastening the silver shortage day of reckoning. Around the turn of the year, the price of silver was near \$32 (and the gold price near \$1700). A number of short term and deliberate downward price manipulations on the COMEX succeeded in causing silver prices to fall to near \$18 and gold below \$1200 before the end of the 2013's first half. Prices have since rebounded. I use the word "deliberate" because the net result of the price decline was an historic record amount of silver and gold contracts purchased on the COMEX, by the leading commercial trader, JPMorgan. I don't think it possible for an historic decline in silver and gold prices and historic buying by the largest gold and silver trader to be accidental.

But if the price takedown in the first half was successful in terms of the number of paper gold and silver contracts on the COMEX bought by JPMorgan, it also resulted in other consequences. Let's face it; you can't suddenly lower the price of major world commodities, like gold and silver, by 30% or 40% without influencing the law of supply and demand. In terms of supply, the move in price below the cost of production, particularly in silver, caused massive financial losses to miners along with announcements of anticipated production cuts. On the demand side, the sharp price declines resulted in massive physical gold and silver buying, particularly in India and China. Published reports indicated that silver demand in India and China was running at an annual rate of 200 million oz each. Combined, these two countries account for 40% of total world silver production (mine plus recycling) of 1 billion oz. Add in the US's 200 million ounces of annual total silver demand and these three countries account for 60% of world demand.

In fact, if you were looking to construct a scenario for which a physical shortage would develop sooner, rather than later; it would have to be a sharp price drop that decreased supply and increased demand. Therefore, the engineered price drop of 2013 would appear to be the perfect catalyst for accelerating a physical silver shortage. The key distinction here is that the sudden increase in silver demand in India and China was due to an increase in the investment component of silver's dual demand profile, rather than an increase in industrial demand. Investment demand for silver is more volatile and subject to more starts and stops than industrial demand (at least until a user buyer panic develops).

I'd like to focus in a bit more closely on silver's investment demand. I've come to think of it as the silver X-Factor, as this is the key factor to the price potential. As and when the price of silver marches to higher prices and an eventual shortage, it will be investment demand that powers the march. There are two components to the X-Factor; the mechanism that triggers an investment rush and the potential force behind that rush.

To my mind, the trigger mechanism could be from many happenings, none of which are mutually exclusive. We've seen the sharp drop in price set off strong buying in India and China, but not so much in the West. At other times, political or economic developments set-off silver investment rushes in the West that have no big influence in the East. Sometimes, events can develop which stimulate worldwide buying. It's hard to predict future events with precision and that's why I try to avoid it. But I do know that various potential triggering events are out there and those events can ignite a silver investment rush without advance notice. The trick, as always, is to be prepared beforehand.

That leaves the other component of the silver X-Factor, the potential force, or buying power, of any silver investment rush. Fortunately, unlike the triggering mechanism, we can better measure potential force on an absolute and relative basis. Making matters easier is that we have a pretty firm handle on the amount of new physical silver available in 1000 oz bar form to the world's investors annually, around 100 million ounces. This amount is derived from what's left over after 900 million oz of total industrial and all other fabrication demand is subtracted from the total annual world supply of one billion oz.

If 100 million new silver ounces are what is physically available to the world annually, how do we measure the potential amount of investment buying? We do this by looking at what is available in total world potential investment buying power. Certainly, no single investment asset could absorb the world's total buying power; but by relative comparisons we may get a sense of the force of that buying power. The total world buying power is so enormous as to defy quantification beyond being in the trillions of dollars; but it still can be measured in relative terms. And please remember, we are talking about a limited amount of physical material available for purchase by an unlimited amount of buying power.

In fact, this is the basic investment case for gold, namely, unlimited and rapidly increasing amounts paper and electronic credits versus limited and slowly increasing amounts of physical material. And I agree with that case. Look around the world — every government is increasing money supply, from the US with \$85 billion in Fed asset purchases monthly, to varying amounts of similar actions in countries around the globe. Against this unlimited money and buying power increase, the amount of gold in existence grows by less than 2% annually. It's hard to argue with buying gold in a world of unlimited and increasing buying power. Hard to argue with, that is, until you introduce silver into the equation.

Roughly 100 million new ounces of gold are mined and recycled annually, which must be absorbed by world jewelry and investment demand. At current prices, that comes to \$140 billion annually. Considering the trillions of dollars of buying power created each year, the world has absorbed all the gold that has been produced at generally increasing prices over time and will likely do so in the future. This is gold's X-Factor and it is a powerfully supportive influence on the price.

A certain percentage (x percent) of the world's continuous and newly created buying power will find its way into gold and other investment assets, including silver. It is in the relative comparisons of each asset's X-Factor that the potential force of investment buying demand can be calculated. In gold, \$140 billion in new investment demand is required at current prices. For silver, less than \$2.5 billion is needed to absorb all the 100 million ounces of actual metal available for investment. Even though we are talking about the same 100 million ounces of actual metal that is available for investment in gold and silver annually; because the price of silver is so much cheaper than gold, silver only needs less than 2% of the investment demand that gold requires yearly.

Every investment asset and asset class has an X factor. Because the amount of buying power required in silver is miniscule compared to gold (or other investment assets like stocks, bonds or real estate), this makes silver's X-Factor the most extreme of all. In other words, the tiny amount of buying power required in silver relative to every other investment asset makes silver the most likely to climb the most. It's quite simple — the less money that is required to goose the price, translates into that asset having the greatest potential to rise in price.

What happens when more than the required amount of buying power comes into an investment asset is that prices rise. In most cases, the rise is gradual and longer term. That's not usually the case in silver, where large price gains normally occur in very short time frames. The reason for that is because silver's X-Factor further indicates there is no large amount of real metal readily available to meet a surge in investment buying that would be considered small in gold or other investment assets. The example I've used in the past is like the mess made when you try to put 10 lbs of flour into a 5 lbs bag. When too much buying power comes into silver (as has occurred and appears inevitable) the mess made is a price eruption to the upside. That's because the buying power needed in silver is much smaller than in any other asset.

Looming over the coming overwhelming surge of buying power into silver is what happens next. Because of silver's unique dual demand nature, an investment buying surge will only ignite and inflame the industrial silver users to buy more than they would normally, in an attempt to build inventories and avoid delivery delays. Thus, an investment buying surge in silver will set off a separate buying surge by those who use or fabricate silver. This statement cannot be made for gold or stocks or bonds or real estate; it is unique to silver.

The facts here are basic and easy to confirm. If you keep an open mind and investigate further, the odds are good you will buy silver. The only obstacle remaining will be to do so before the investment and user buying surge commences.

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Silver – \$23.15

Gold – \$1363

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