September 16, 2010 – Another Voice

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I thought you would appreciate the following email exchange between two fellow subscribers (who copied me on this note from earlier in the week). I know I appreciated it, as it's always reassuring to get confirmation on minority-held opinions from someone you believe is sharp. I can assure you that the author is as thorough and independently minded as they come and not given to offering unfounded opinion. I've eliminated the names, but otherwise this is completely unedited.

Hey xxx,

I think the best way to think about this is in the big picture. And, since I'm a very fast trader, this requires me to have some patience. And, as an options trader, it can be frustrating. But, this is how I look at the current situation:

1. JPM seems to continue to have substantial short positions, despite the apparent stupidity of that choice.
2. The market is trading on above average volume, and the price is at its highest level since March 2008.
3. There seems to be healthy buying that is persistent. This buying is some combination of (a) industrial users, (b) short-term speculators, (c) long-term investors, and (d) short covering.
4. There also seems to be plenty of selling, which is some combination of (a) actual producers, (b) short-term speculator profit taking, (c) long-term investor profit taking, (d) new speculative shorts, (e) existing shorts adding to positions.
5. There is more buying pressure than selling pressure since the price continues hanging tough and making new highs.

It's clear that there is a game of chicken going on. The buyers seem to be insistent. And, I'd like to think that the sellers will run out of ammunition pretty soon, and some of them will turn into buyers (possibly aggressive buyers). It is certainly reasonable that there is some profit-taking selling at these levels, but given the increasing open interest of JPM, clearly the profit-taking selling volume is being consumed by other buyers. And, JPM is having to sell even more just to keep a lid on the prices. They shouldn't be doing that, but the evidence does suggest that they are selling more.

We are still waiting for the trigger. It might be regulatory, or it might be a big investor, or it might be a wholesale shortage. Without a trigger, we're just waiting (and hopefully drifting higher). It is hard to believe that the CFTC continues to take no action.

Recall what happened to Volkswagen stock at the end of Oct 2008. Prices had been moving up insistently all year from 250 to 350, due to the option with Porsche. Then it crossed 350 in the middle of Sep and moved up to 450 by the end of Sep. But, the short squeeze had started, and all the brokerage firms had increasing failure to locates for the stock. It got ugly, and Volkswagen traded as high as 1,420 on Oct 28, 2008 (making it the highest capitalization of any stock on the planet), and then it came crashing down with margin calls and profit taking.

The trigger was the mismatch between the paper shorts (i.e. bets) and the reality of the number of existing shares. There's only so much that a balloon can stretch. But, that whole situation with Volkswagen resolved itself with financial reconciliation, and plenty of big winners and losers.

The silver balloon is also stretched pretty thin right now. But, it can't be resolved so easily, since it's such an important physical metal. And, of course, the COMEX contract is physically deliverable (as are the LBMA obligations). And, different than 1980, the long position appears to be spread all over the place in lots of different hands. And, those hands seem to be well educated now on the reality of silver (thanks in no small part to Ted's efforts).

So, the big picture says: the trigger is coming. It feels like it'll be very soon, but as you say, it could be a long way off. Once it starts, it will get ugly very quickly. I'm sure the COMEX, and the LBMA, and the CFTC, and the Government, and others are aware of all of this. And, I'm sure they have some tricks up their sleeves. So, once the insanity starts, it will be very important to stay alert and to try to make wise choices. But, we're not there yet.

Once the short squeeze starts, the question we'll be asking will be: if you sell Silver here (fill in whatever price in USD you want), then what will you do with the USD? Keep them? Buy something else? You won't be able to get your hands easily on physical silver anymore.

I'd like the explosion to happen very soon, but that's because I have a zillion options expiring on Friday. The trigger is coming; I don't see how it could be avoided. But, as you continue to ask, are we missing something important? Perhaps a large pile of physical silver somewhere, willing to sell? It's good to keep asking.

Best regards,

Xxxx

I would like to add a postscript concerning big short position holders finding themselves in a bad place ala the Volkswagen example above. In just the last couple of days the big South African gold miner, AngloAshanti, announced that they were raising more than a $1.6 billion to close out their remaining gold short hedges. The company held these gold shorts for many years and originally sold millions of ounces of gold many hundreds of dollars below where they were and will be bought back. Just like Barrick Gold, Anglo made a monumental mistake in shorting gold in the first place and I publicly blasted them for their stupid hedging for years, actually referring to them as Â?AngloWacko.Â? Whereas it cost Barrick shareholders $10 billion in lost profits, I think Anglo's tab is closer to $6 billion. My point is simple Â? just because you are big and look like you should know what you are doing, doesn't guarantee that you do know, especially when the trade makes little economic sense. I believe we will be saying this same thing about the big silver shorts in the not too distant future.

There's much going on in the silver market, and I'll be sure to summarize things this weekend.

Ted Butler
September 16, 2010

Silver – $20.70
Gold – $1274

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