September 22, 2010 – Q&A

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I've received a number of very good questions from subscribers recently; so many that I'm running a bit behind. If I don't get back to you publicly or privately on any question you may have sent me, please ask again. I feel reader questions are important because if someone is raising an issue, the odds favor that issue being on many other minds.

Hi Ted,

Thanks for your informative weekly review of today Sept 18.

As you advised investors in your final paragraph, I have been closing out and have taken all profits over the last two weeks on my SLV Oct 20 calls, with the expectation to redeploy “up and out” on any potential sell off.

The options portion of my portfolio now consists of:

37% SLV Jan 2011 $20 calls
36% SLV Jan 2012 $35 calls
27% cash(the Oct 20’s just liquidated)

Under the guise of “up and out” I am considering deploying half of that cash to April 2011 calls and half to the recently available Jan 2013 calls.

My concern – and I believe that many of your subscribers will have the same – is with Jan 2013 calls and the long term viability of SLV. Of the very broad range of gold and silver analysts/commentators that I follow, you are one of a very small portion who do not express some level of reasonable concern over SLV’s holdings – that they may be inadequate (beyond just the shorting thereof) or encumbered in some way. Thus, I have some reservation over the holding of such far out dated calls.

I know that you are a man of facts and avoid speculation, but I ask you to make an exception here and give your honest opinion about the long term viability of SLV as a more than reasonable proxy for silver during the price explosion/mania phase. What is your confidence level that when that phase hits, SLV will remain credible and those calls will not evaporate?

John

First, let me repeat that options are not suitable for most investors and my mention of them was mostly intended to convey my bullishness for the price of silver a little while back. Fortunately, those bullish feelings were borne out to date. Also, my option advice was not confined to SLV, even though that's been my personal interest recently. Other call option possibilities include COMEX silver options on futures and options on individual mining stocks. Let me emphasize strongly that I am not suggesting that anyone get involved with options on silver or any other item. In fact, you are a bit crazy to even consider such a thing. Probably, sky-diving would be a safer outlet for thrills. Please accept this discussion as purely educational. Come to think of it, I suppose that would describe what I'm trying to do in general Â? educate.

Because options are a high-risk speculation, they must be treated differently than a fully paid-for position in silver, which can be held indefinitely. With options, time is your mortal enemy; you must be right not only on price direction, but on the timing as well. With fully paid-for positions, timing is not so critical. What options are good for mainly is the ability to leverage without having to go on margin and expose yourself to sudden obligations to deposit more funds on adverse price movements. Don't do margin. I'm glad to hear that you re-arranged your option holdings in the manner you described. One good rule of thumb is to try and remove your original cost if the opportunity presents itself by selling a partial position and holding the balance for Â?free.Â?

But your question is not on options, but on the long-term viability of the SLV. Will it be around and pay off for investors in the ultimate silver crunch? It seems that not a day goes by that another negative article appears, questioning the validity of the SLV. The concerns revolve around whether the actual silver that is claimed to be in the Trust is there, and how this ETF is somehow used as a tool by the short manipulators, and how the custodian of the trust, JPMorgan, or even the US Government, has plans to confiscate the metal someday, if it is actually held by the trust in the first place. You are correct that I am very much in the minority among non-establishment commentators in my support of the SLV.

It doesn't bother me to hold opinions contrary to what the majority believe. Perhaps there is something wrong with me, but I actually feel more comfortable holding contrary opinions, especially when it comes to silver. I think this is due to my many years of being in the wilderness about the silver issues that are emerging today, namely, manipulation, the concentration on the short side of COMEX silver and position limits. Being in the minority and holding a contrarian opinion forces you to examine your premise every day. You become more aware that many feel you are wrong and, unless you are looking to publicly embarrass yourself, you look closer at the facts and logic to prevent being embarrassed. In contrast, I have found that when everyone (including me) agrees on something, there is greater danger of being wrong.

I hear and read the knocks on SLV. I study them closely. I find them all unfounded. Yes, JPMorgan is both the custodian of the SLV and the largest silver short on the COMEX (thanks to my revelations). So what? JPMorgan is a huge company with hundreds of thousands of employees and is involved in a wide variety of businesses. Metal warehousing is one of those businesses. JPM was the custodian of the SLV from its inception, in 2006. That was two years before it became the largest COMEX silver short, via its takeover of Bear Stearns in 2008. There is no way that JPM knew in 2006 that it would be taking over Bear Stearns in 2008. In my opinion, the connection between JPM being the custodian of SLV and the largest COMEX silver short was pure happenstance.

I think the metal claimed to be on deposit in SLV is on deposit. The sponsor, BlackRock, one of the largest money managers in the world, would not list the serial numbers and weights of the individual bars in a fraudulent or misleading manner. They would have too much to lose and nothing to gain. Such false reporting would be so egregious that even a jury of 12 year olds would criminally convict anyone lying about such specific representations. Aside from the shorting of shares issue, I'm convinced the metal claimed to be on deposit in SLV (and other similar investment vehicles) is actually there. That being the case, not only do I believe that the SLV will hold up and perform as intended in a genuine silver physical crunch, I believe it will be one of the Â?last men standing.'

If my opinion that the metal that is claimed to be on deposit at the SLV is correct, then the SLV shouldn't suffer in the volatile and high price environment that a silver shortage will bring.
I see the likelihood of a default or delivery problems at the COMEX, for instance, to be much greater than any problems in the SLV. That's because there is no known leverage to SLV holdings compared to the COMEX, where contracts can be created with no regard to physical supplies. Going further, I can easily envision a circumstance in the future where the industrial users and others desiring secure physical silver supplies would turn to the SLV for the actual material. In such a circumstance, I believe we will see a large premium in the shares of SLV to other forms of wholesale silver. Given its position as the largest single repository of silver in the world, SLV will turn into the last resort for those needing physical silver, in my opinion.

Of course, my opinion could turn out to be wrong. I cannot guarantee that my vision will be correct. But as you indicated, I do try to rely on facts and logic. My gut feel is that worrying about the future viability of the SLV is a waste of time. Certainly, anyone suspicious of the SLV should not deal in it. The good news is that there are plenty of alternatives, with the best being physical silver in your own possession. Regardless of one's opinion on the SLV, a serious student of the silver market must be aware of what's going on in it, as much as what's happening at the COMEX, the fountainhead of the silver manipulation. Yesterday's 4.1 million ounce deposit in the SLV tracks perfectly with what I was expecting to be deposited given last week's volume and price action. The volume yesterday and today suggest another 4 to 5 million ounces is now newly owed.

One last note. You asked me to speak freely and give you my opinion. It bothers me very much that most, although certainly not all, of the SLV critics, seem to have, quite conveniently, an alternative investment vehicle to offer that personally benefit the critics. I find this utterly disgusting and highly unethical. I don't have any such alternative investment to offer. Whether anyone buys the SLV makes no difference to me. Be wary of buying any silver investment vehicle where the seller is knocking the SLV.

A number of readers asked me about the article in the Wall Street Journal last Friday, which quoted a study by Barclays that there is a 4,000 ton surplus in the silver market.

This is mostly a matter of semantics. Undoubtedly, Barclays is classifying silver investment demand as a surplus (for some reason). Regular readers should be aware that the long-term industrial consumption deficit in silver ended several years ago, after 60+ consecutive years of an inventory-depleting deficit. I reported on this often, both at the time and since then. World silver inventories are no longer being depleted and, in fact, are growing. But because silver investment demand kicked-in, precisely as the industrial consumption deficit was ending, prices have climbed. All indications point to that continuing. We're just going to have to get used to hearing of a silver surplus amid rising prices. It should be easy to do.

Hi Ted,

My questions for you are how much are the bullion banks “in the hole” from their incessant shorting on both silver and gold. Isn’t there a point where the losses become overwhelming? Don’t they have to report these losses in their statements? Or in the overall scheme of things, are the potential losses only a blip on their quarterly earnings such that constantly adding to their short positions (possibly at the direction of the US govt sponsored entities) to continue the price suppression scheme isn't so damaging, especially with an implicit govt backstop against such losses?

Steve

This is an important matter. Over the past month, the largest 8 short traders on the COMEX, at $21 silver and $1290 gold, are out around $3 billion ($1 billion in silver and $2 billion in gold). I am unclear of the reporting and earnings implications, given the complexities of financial accounting. But given the realities of the marketplace and the clearing structure, this $3 billion adverse move for the 8 large traders had to have resulted in $3 billion in margin calls. This is about the largest amount the 8 biggest traders have been out in my memory. It makes the current circumstance critical. These are significant amounts, averaging $375 million per trader on a combined gold/silver position.

On the one hand, such an adverse move might strengthen the resolve of the big shorts to rig a sell-off and reverse their recent financial beating. One cannot underestimate the treachery of the large commercial crooks. If we do get a sell-off, it will only be because these crooks managed to manipulate the market lower.

On the other hand, it is not hard to imagine that the big shorts misjudged their ability to manipulate prices and might be hooked badly (Izzy's full pants down thesis). With such near-term losses and margin calls, some of the big shorts might find it impossible to fund future margin calls and finally call it quits and rush to cover. There's no way to say for certain which way it will play out

What I can say, once again, is that this circumstance is shameful and dangerous. The regulators from the CME and the CFTC should be all over this, like white on rice. This is a potentially market destabilizing situation that should not been allowed to exist. The problem is with the concentration on the short side. Just like AIG never should have been allowed to hold the concentrated position they held in credit default derivatives, neither should the big commercials have been allowed to hold the concentrated short positions they hold in silver (and gold). The CFTC is to be given very high marks for the regulatory reforms they are in the process of implementing; but for what they have allowed to exist in silver and gold, no high marks can be given.

Believe it or not, I have more questions to answer at a later date.

Ted Butler

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Silver – $21.05

Gold -$1291

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