April 19, 2010 – SLV – Recent Developments

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There have been some notable recent withdrawals of metal from the big silver Exchange Traded Fund (ETF), the I-Shares Silver Trust (SLV). Since March 3, over 18 million ounces have been removed from the Trust, reducing the metal on deposit from over 305 million ounces to under 287 million ounces. This is, by far, the largest reduction in metal holdings from the Trust in its four year existence. WhatÂ•fs behind this reduction and what might it mean for the silver market and to holders of SLV?

Many have written to me concerning this drop in holdings, with a good number particularly worried that the reduction in metal holdings might mean there is less silver backing existing shareholders. This is not the case. The reduction in total metal holdings has been accompanied by a proportionate reduction in the total number of SLV shares outstanding, as required. This means that each share has the same metal backing today as it had on March 3. First and foremost, no holder of SLV shares should be worried about a dilution of the amount of metal backing each share due to the recent metal reductions.

In fact, this proportionate reduction of metal holdings and shares outstanding goes right to heart of the SLVÂ•fs legitimacy. It is precisely because a hard mechanism exists for the conversion of shares into metal, and vice versa, that makes the SLV legitimate, in my opinion. Without this hard conversion mechanism, SLV shares would be suspect. As spelled out in the prospectus, any shareholder, working through an authorised participant (big broker), can convert his shares into metal in basket increments (50,000 shares-ounces). Just as new buying of shares should result in deposits of metal into the Trust in basket increments, shares can be redeemed and converted into metal in basket increments, without impairing other shareholders in any way. Therefore, the recent metal holding reductions in SLV do not undermine the legitimacy of the Trust.

Just so no one assumes IÂ•fve become a spokesman for SLV, let me restate here that I still think that any shorting of SLV shares is fraudulent because the hard share/metal mechanism is short-circuited. No metal is deposited into the Trust when shares are bought from a short seller. That does dilute metal backing for all existing shareholders. The sponsor of the SLV, now Black Rock, and the SEC are negligent and at fault for allowing any share shorting to exist. That said, I think the SLV (and other silver ETFs) are the silver investorsÂ•f best friends due to the metal being bought by those not likely to have bought silver had the SLV not come into existence.

LetÂ•fs get back to the reduction in the metal holdings of SLV and what it may mean for the silver market. There are a limited number of possibilities for what is behind the recent metal withdrawals. The most obvious possibility would be plain-vanilla SLV shareholder liquidation. If a sufficient number of existing SLV shareholders decided to sell their shares for any reason, such selling would result in a reduction of total metal holdings in the Trust. Is that what happened here? I donÂ•ft think so. Such selling would leave obvious footprints. There would have to be a notable increase in volume and other clear signs that such extraordinary share liquidation was occurring, like falling silver prices. That hasnÂ•ft been the case. The daily volume in SLV has been much lower than previous average daily volumes since March 3. Further, the price of silver had been climbing, not falling, during this time, indicating more new buying would most likely have occurred, not new selling. Other indicators, like speculative buying in COMEX silver futures and an increase in other silver ETF holdings, as well as an increase in gold ETF holdings, all argue against plain vanilla investor liquidation in the SLV since

March 3. Therefore, we can all but rule out general investor liquidation in SLV as the cause of the metal reductions.

So, if itÂ•fs not investor liquidation, what is it? Since the volume of trading in SLV shares during the withdrawal period was low, we can safely conclude that the shares being redeemed for actual metal were owned prior to the time the metal holdings started to decline. In other words, the metal reductions were caused by existing shareholders turning in their shares for conversion to actual metal. What would motivate such a redemption by existing shareholders? Only two things, a desire to hold metal in allocated form or the metal was needed elsewhere. I did make the public recommendation in the past (I canÂ•ft remember in which article, a sure sign of me getting old) that large shareholders in SLV convert their shares into metal, if possible, for safety and to lower the cost of holding silver (regular allocated storage being cheaper than the stated SLV management expenses). But other signs suggest that it wasnÂ•ft just a large holder rearranging his ownership of shares into an allocated metal position.

It is important to remember that the SLV is the single largest stockpile of silver in the world, by far. Roughly 50% of all the visible silver bullion on the planet resides in this Trust. That fact, coupled with the hard share to metal conversion mechanism in place, would make the SLV the logical go-to source for large quantities of actual silver needed in a hurry. I have consistently believed that, in the end, there would be a rush by industrial users to buy shares of SLV in order to secure the timely delivery of actual metal

Because much of the early withdrawals from the SLV seemed to find its way into COMEX warehouses and other silver ETFs, the most plausible explanation of the decline in SLV metal holdings is that the metal was needed more urgently elsewhere than in remaining in the Trust. This is the most bullish case for the price of silver, as it could signal the start of a shortage.

The reason the price may not have reflected a true silver shortage yet is because the SLV shares that were converted to metal were already owned and not purchased from March 3. There is a big difference between new buying of SLV shares and then immediately converting them for actual metal and than in converting shares already owned to actual metal. Had someone come in to buy more than 18 million shares/ounces of SLV during this time period, and those shares were not sold short and resulted in new metal being bought, the price would have surely have climbed more than was the case. ThatÂ•fs because there is no price impact on a conversion of SLV shares to metal, only when actual new buying or selling occurs. The mere mechanical conversion of shares to metal does not involve buying or selling.

But, if this mechanical conversion of already owned SLV shares that I am describing is what has occurred, a potentially bullish conclusion can be easily reached. If some large SLV shareholders are converting their shares into metal for removal from the Trust to be shipped to where the metal is more urgently needed, as I believe, those large holders are, in effect, subsidizing the physical silver market. They are donating metal they already own to plug holes in the dike without going out to buy new metal. Who would sacrifice their own metal instead of going out to buy new metal to plug the holes? Only someone more interested in maintaining a cap on prices at all costs. Only the commercial short crooks.

What I am saying is that I suspect this withdrawal of more than 18 million ounces from the SLV is the work of a few big commercials, or one commercial, who are short the silver market. I said that is my suspicion. It presupposes that the big shorts previously established a rainy day fund in the form of holding SLV shares in case an emergency developed where the big shorts needed actual metal in a hurry without having to go out and buy the metal and drive the price higher. ItÂ•fs an allegation the regulators could verify with a few phone calls and email inquiries. No need for another time-consuming and taxpayer-funded formal investigation.

Possible regulatory action aside, if my speculation is close to the mark, the implications for the silver market could be powerful. ThatÂ•fs because there is a limit as to how many rainy day SLV shares the big commercial shorts are likely to hold. Once those shares have been converted to metal and donated to the market, at some point new shares/metal will have to be bought to plug any further supply holes. Then, there will be an impact on price, once the donation of already owned shares/ounces has been exhausted. This is the king of exhaustion that can come quickly, as in overnight.

The important take-away here is that the silver market has always involved some type of uneconomic maneuvering by the big commercials, from documented concentrated short selling to questionable movements now of large amounts of physical silver. As always, few of these uneconomic maneuvers pass the smell test. The recent large declines in SLV metal holdings should not dismay SLV holders, and should encourage all silver investors.
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