

April 20, 2011 – Structural Change?

Structural Change?

I've received a number of questions from new subscribers asking me if I thought this was a good time for an initial investment in silver. If I could, I would pretend I didn't get these questions because I'd prefer not to answer. It's not because I don't think silver is going higher in price, because I do. But how the heck do you tell someone, whose personal finances and investor temperament you can't possibly know, that it's OK to buy something that has risen 10-fold from its decade low? Even if I do think it can climb a heck of a lot more.

The problem is that I spent a lot of time and effort over more than a decade dreaming up every possible way to convince people to buy silver when it was much lower in price. I didn't have to dream up the reasons to buy silver, just how to craft the words and phrases to encourage them to pull the trigger. (Remember "dimes to the downside, dollars to the upside"?) I wasn't concerned so much then about folks' personal finances and investment temperament because I knew the ultra-low risk at single and low double-digit silver would prevent anyone from hurting themselves. Now, however, we have entered a phase where the price swings should be much greater. Accordingly, I intend to concentrate on analyzing the facts in silver and refrain from telling anyone to buy or sell, as I indicated in a recent article. For most subscribers the question has become when to sell. The answer is not yet. I am a silver analyst, not an investment advisor. If you do buy, please do so on a fully-paid basis and if you do speculate on a leveraged basis, make sure it is on a debit, no margin call basis (like call options).

The facts still suggest higher silver prices, although sharp sell-offs must be expected (whether they are realized or not). The facts still point to silver to greatly outperform gold. Therefore, it still looks like the switch from gold to silver is a go. The facts still strongly suggest that silver should be held until the three critical factors are played out or clearly in force. The three critical factors are widespread silver investment, the dissipation of the concentrated silver short position and the coming silver industrial user inventory buying panic.

While there has been a notable pick up in investment interest in silver, it still appears to be in its early stage. I have yet to see a big hedge fund name revealed as a silver investor. The commentary about silver has exploded, to be sure, but most of that commentary still appears to be warning of a top and not to drop everything and rush to buy silver now. I see absolutely no signs of any type of widespread leveraged buying of silver. That tells me we have much further to go in silver investment. As far as the third critical factor, an industrial user buying panic, I see no sign that has even started yet.

However, the second critical factor, the dissipation of the concentrated short position, is showing signs of developing into a silver price force. I'll know more when the new COT is released on Friday, but my sense is that the commercial shorts have been moving to cover in silver (including JPMorgan). I don't have that same sense in gold, where I believe the commercials are adding to their short positions. In fact, in addition to the existing bullish factors unique to silver relative to gold, I think their relative COT structures now favor silver decidedly. As I said, the new COT will help clarify the structure set ups in each.

It is the structure on the COMEX that has always been the key to the silver market. The decades' worth of concentrated commercial short selling was the cause of the depressed price. The depressed price, in turn, so altered the real supply/demand equation that it appears to have brought us to the brink of a silver shortage. When that concentrated silver short position no longer exists, the price will no longer be depressed and the market will no longer be manipulated. That's why the recent price changes with no increase in the commercial short position are so potentially profound. It suggests a structural sea change.

The pattern of technical fund buying/commercial selling on silver price increases lasted for more than two decades, up until late last year. Since then there have been signs that the pattern has been altered. On many occasions recently the commercials, including the very largest, have bought at higher price levels than they had sold short. Likewise, the technical funds have sold out long positions at higher prices than they would have in the past. If this turns into the new pattern in the future, then that would be a structural change of the highest order in silver. While there are signs that this may be happening in silver, I detect no such change in pattern in gold as of yet.

One of the longest running premises I have held in silver is that the real move up would come with higher prices amid a flat to declining level of the commercial short position. The reasoning was that this would indicate the commercials were no longer able or interested in capping the price of silver. It would also mean that no net new speculative longs were entering the futures market and that the price was moving for reasons other than speculative buying, such as physical tightness and commercial short-covering. This did occur in the most recent COT and I am hopeful that pattern is continuing.

Just yesterday, I spoke with an old friend for the first time in a long while. We had originally discussed silver going back more than 25 years ago. He mentioned that something I had told him back then had stuck with all these years, namely, my observation that there was a short position greater than all the silver in the world. He hadn't forgotten that. What I find amazing is that my observation took so long for so many to come to appreciate. I think there is a reason for that as well, as suggested to me by another friend.

As obvious and verifiable as the COMEX silver concentrated short position has been, in order to grasp it you must also accept that it was wrong for it to have existed. Such a concentrated position would, obviously, have had to have impacted the price. In other words, this would be a clear price manipulation. But because it would be unthinkable for such an obvious price manipulation to be occurring in real time right in front of the whole world, the obvious was quickly rejected by those in the business and, especially, by those in a position to fix it. No one wanted to step up and admit to the obvious, as that would raise all sorts of embarrassments and recriminations. That the allegations were coming from someone outside the establishment (me), made it safer to just label the allegations as unfounded conspiracy talk.

I'm pretty sure that the resolution of that unfounded conspiracy talk for over two decades is what is behind the current price action. The commercials finally appear to want out from the short side of silver, after so many years. If my hunch is correct, the prospect of a continued structural change in silver is super bullish for the price.

Last week, I indicated that I had a feeling in my bones that we might see a \$10 or \$20 or more pop in the price. We have seen as much as a \$5 rise since then (he said, as he looked over his shoulder). While the current lofty price levels do allow for a sell-off of significant proportions, the underlying facts and market structure also indicate a melt up is also possible. The financial pain to the silver shorts has been immense and, as a result, the odds of a short covering panic have increased. The odds still favor higher silver prices.

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Silver – \$ 45.00

Gold – \$1501

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