

April 9, 2011 – Weekly Review

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It was another week for the price record books. Silver exploded by more than \$3 (or over 8%) to 31-year highs, while gold surged by more than \$45 (or over 3%) to another all-time high. Due to silver's relative outperformance, the gold/silver ratio tightened into a new multi-decade extreme of close to 36 to 1. From the year end, silver is up 32%, while gold is up almost 4%. From the bottom of the late January price correction, silver is up 50%, while gold is up more than 12%. That was ten weeks ago.

I'm rattling these numbers off just to help frame the proper perspective. In the investment world, these are significant percentages. Here are some other numbers. From the price lows within the past decade, silver is now up more than ten-fold, while gold is up almost six-fold. Compare those returns to any asset class widely available to the average investor (stocks, bonds or real estate) over that time span. Precious metals investors, especially silver investors, have much to celebrate. I believe they will have much more to celebrate in the future.

Apart from celebration over such price gains, silver investors also face serious contemplation about what to do with such out-sized investment returns. On a strictly mathematical basis, the potential amount of a short-term price decline from over \$40 is much greater than it was from \$4 or \$5. With sharply higher prices comes higher price volatility. That's a nice way of saying the size of the coming price moves, both up and down, should increase. Therefore, the coming increased price volatility must be factored into the thinking of every silver investor.

I am a silver analyst, or at least, that is what I try to be. I don't run a timing service telling you when to buy and sell silver (although I do try to identify low-risk entry points). I am not anyone's investment advisor. I don't know your personal financial circumstance, nor, quite honestly, do I wish to know. I have enough on my plate trying to keep up with my own family's financial welfare. Only you are responsible for your family's financial welfare. You know what your important financial goals and objectives are. I know that some of the gains that many silver investors have are enormous. Back on March 9, my good friend and silver mentor, Izzy Friedman, wrote an article (in the archives) that contained what I feel is sage advice. He suggested that if you have some important financial goals that can be achieved by taking some silver profits, you should consider doing so. Such goals, along the lines of housing, or education, charitable deeds, or retirement are too important to ignore. Generally, the objective behind any investment should be to achieve such goals. If you can accomplish such goals by selling a portion of any super successful investment endeavor, Izzy's advice is hard to ignore. And just so you know that Izzy's advice was well-thought out, here's an article from 8 years ago where I highlighted his advice in advance http://www.investmentsrarities.com/ted_butler_comentary/03-18-03.html

This is not a sell recommendation for silver. In fact, silver has never looked better in many ways than it does now. I'll highlight those factors in a moment. It's just that the driving force behind investment should not be the accumulation of capital for the purpose of accumulation alone. Do some good with it, for yourself, your family and the world at large. It's a very big deal to identify beforehand a ten-fold increase in a basic commodity within a decade. I have been very fortunate (actually the luckiest guy in the world) for having pounded the table on silver from the dead price lows all the way up. As much as I live and breathe silver, it is unlikely that I will come as close to identifying the ultimate top as I did the bottom; although I will do my level best. It is your responsibility to handle your personal finances prudently.

Conditions in the physical world of silver still continue to suggest tightness. The silver movements in and out of the COMEX-approved warehouses quieted down this week, but there was a resumption of deposits into the big silver ETF, SLV. The SLV added almost 3 million ounces over the past week or so, and almost 28 million ounces since the lows of early February. Since the year end, SLV has added 10 million ounces of silver. Contrast that to the big gold ETF, GLD, which is still down 2 million ounces (\$3 billion) from the year end. US Mint sales of Silver Eagles still seem pegged to maximum capacity.

Let me correct something that I previously reported. I try hard to make sure that what I write as fact is accurate. An alert subscriber informed me that the Central Fund of Canada's recent offering only resulted in the purchase of 1.75 million ounces of silver and not the more than 4 million I reported last week. (Thanks, Paul). I had assumed that the dollar amount of the offering (\$360 million) would have resulted in the 4 million oz purchase I stated, because I overlooked that the formula used by the Central Fund was impacted so much by the rise in gold and silver prices. You know what they say happens when you assume. (You make an ass out of u and me).

This week's Commitment of Traders Report (COT) was a mixed bag. In silver, I was quite relieved that the commercials only increased their total net short position by 1100 contracts. Because the price had climbed by more than \$2.30 in the reporting week (Tues to Tues) and total open interest had increased by 4500 contracts, I thought we would see a much bigger increase in commercial shorting.

In fact, in the important managed money category (home to the tech funds) there was no increase in their net long position. This means that the price of silver wasn't driven higher, in the reporting week, by tech fund buying and dealer short selling. I find this constructive because it doesn't suggest that silver is being driven higher by speculative buying or that the commercials will have an easy time forcing the tech funds to liquidate on an engineered sell-off.

The monthly Bank Participation Report had been released earlier on Friday and confirmed a slight decrease in the US bank category (read JPMorgan) short position by 500 contracts to 24,500 (122.5 million oz). This was expected as the COT reports had indicated no change in the big 4 category for the past month, including the latest COT. It is notable that since JPM increased their silver short position by 6,000 contracts in February and stopped adding, the price has risen by more than 6 dollars. In my weekly review of March 5 (which I also excerpted in the public domain <http://news.silverseek.com/SilverSeek/1299509764.php>) I stated the following –

This is the key point – what would have happened if JPMorgan hadn't sold short the additional 6,000 silver contracts (30 million oz) when they did? Asked differently, in the current market conditions, what price would have been required to induce other market participants to sell the 6,000 contracts if JPMorgan hadn't sold? My guess is that would have taken a price over \$40 or \$50 to attract that much legitimate selling. The fact that JPMorgan was the sole seller is the clearest proof possible that silver has been manipulated.

The fact that with JPMorgan refraining from selling additional contracts short we have now quickly exceeded \$40 may not be conclusive proof, but is highly suggestive of the role that they play in setting the price of silver.

In gold, the commercial net short position increased by roughly 18,000 contracts, to almost 259,000, the highest level since year end. On the buy side, it was largely tech funds and small traders; on the sell side, it was mostly the gold raptors, but the big 4 stepped in to add 5,000 new shorts as well. This was during a reporting week in which gold rose by \$40. Since the cut-off, I suspect there has been more gold commercial shorting and speculative buying (I don't think as much in silver). If I'm correct, we've moved from the neutral COT range in gold to the negative side. I think we're still neutral in silver, COT-wise.

This doesn't mean that gold must go down, but the gold set-up appears different to me than does the silver set up. In gold, it seems to me that the primary price driver since the late-January lows has been speculative buying on the COMEX. Gold rallied more than \$165 due to 65,000 COMEX contracts (6.5 million oz) being purchased by speculators and sold by commercials. I can't verify any other important source of gold buying. If, as it appears to me, that gold's price rise was due to speculative buying on the COMEX and not much else, then the prospect of a manipulated move down in gold starts to loom larger. Please remember, I'm trying to be objective here and would remind you that into the lows of January, I was quite positive on gold precisely because the COT set up at that time was constructive to me. It no longer is.

Silver looks to be a different story. While there has been a 13,000 contract increase in the total net commercial short position from the lows in January that increase was in place by the middle of February. Since then, there has been no real increase in the speculative long/commercial short position on a more than \$6 increase in price. What this tells me is that the rise in the silver price from the middle of February, unlike in gold, is not attributed to COMEX speculative buying. What is the silver price rise attributed to? A little bit of this and a little bit of that ^ buying in the SLV certainly, and other physical buying.

I think it's good that we can't attribute the price rise in silver to strictly speculative buying on the COMEX, as is the case in gold. That lessens the likelihood of a speculative flush to the downside. Of course, it doesn't eliminate the chance of that occurring. I know many assume that if gold gets taken down by the commercial crooks, silver will surely tag along. I'm not so sure. Yes, it could happen, but it should prove harder in silver due to the lack of recent speculative COMEX buying.

I can't help but think of the plight of the COMEX silver shorts. Unlike the longs, the shorts have nothing to celebrate, nor can they consider using profits to fund financial goals. The shorts have taken a beating. I'm not saying this in any way to gloat or cheer the shorts' misfortune. Life's too short to waste on such emotions. Strictly as an analyst, I am trying to factor in the shorts' likely behavior. I confess to being nervous about the present price of silver; nervous because the gains have been so great. But what the heck are the shorts feeling? They are being punished with giant losses and continuous margin calls. The total net short position in COMEX silver futures (net of spreads) is over 100,000 contracts, or over 500 million ounces. Every dollar up the shorts are collectively losing and must deposit \$500 million. Since August, that comes to \$11 billion. Just this week, the shorts are out and must deposit \$1.5 billion.

Yet data in the COT and Bank Participation Reports indicate the shorts have remained largely intact. Of course, some shorts (and longs) have covered and left the silver market and have been replaced by new shorts (and longs). But by my calculations, the bulk (80% or more) of the shorts and longs have held their positions over the past eight months. Why they haven't run is a different question. In the case of the biggest shorts, like JPMorgan and the other big 4 and 8, I think the answer is that they are trapped. There is no one to take their place at close to current prices. This is the prime danger of concentration and why the regulators should be concerned about it. Considering the level of concentration in silver on the short side, the regulators should be unable to sleep.

I know we are over-bought in silver and in a normal market the price should correct sharply. But this is as far from a normal market as you can get. This is a manipulated market where the manipulation is in the process of ending and in which the manipulators appear to be in trouble. That means the charts and previous price patterns may not matter. It is very easy to imagine some important shorts throwing in the towel in their weakened financial state. In fact, it may be what we are witnessing now.

Let me give you an example of a short that may be in trouble. Back on February 14, I wrote a short article titled "Hedging Insanity." In that article, I provided a link for the hedge book of one Mexican silver miner, Minera Frisco. I commented that it looked like one of the most dangerous hedges I had run across. At the time, the price of silver was around \$30 and the hedge book was underwater to the tune of \$300 million. At \$41, the 25 million ounce swap is now underwater to the tune of \$550 million. More ominous is that the out-of-the-money calls covering an additional almost 50 million ounces sold at a strike price of \$39.70 have now gone into the money. As a result, every dollar up from here will cost the company (or its bankers) a total of \$70 million. At \$50, the hedge book will be underwater to the tune of \$1.25 billion (for silver alone). Some might say everything is fine because the company will eventually mine the silver. I say that I've seen this movie before. I say there is a mismatch in duration, as the company (or its bankers) is staring at a big near-term liability matched with a potential long term asset. This is the kind of structure that precipitates great financial crises in banking circles when there is a clash between short-term liabilities and long term assets. Just to put this in perspective, the 70 million ounces is equal to 14,000 COMEX contracts. By my calculations, if the position was held on the COMEX and not the OTC market, that would make the miner the second largest COMEX short <http://www.infomine.com/index/pr/Pa985230.PDF> scroll to the last frame.

In summary, we may be "too high" in price and there may be increased silver production in the years to come, but in the interim the resolution of the giant silver short position should dominate the price. It's just hard for me to see how the resolution of the short position won't cause prices to explode. That it hasn't already is remarkable to me. I may be a nervous long, but I'm sure glad I'm not a silver short.

I've fallen behind on email responses to some great subscriber questions. The irony is that the more thoughtful the required response, the greater the chance of being delayed, as I save them for later. The market gets exciting and I never get back to them. If I haven't answered an email question, please send it again.

Ted Butler

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Silver – \$40.90

Gold- \$1474

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