The Critical Factors, Part 2<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

My goal in this series is to point out what I believe are the truly important price influences in silver, both now and in the future. Big picture stuff, not the day-to-day manipulative games on the COMEX. In part 1, I highlighted how the uniquely large and concentrated silver short position on the COMEX was one of three critical factors for silver. Sooner or later, this obscenely large short position had to be resolved and that resolution would propel the price skyward. In the meantime, the short position had depressed the price, creating the bargain investment opportunity of a lifetime.

Critical Factor number two in silver is the relationship between what amount of money could potentially be invested in silver versus the actual amount of physical silver available for investment. This is separate and distinct, although related, to the short position. In a nutshell, the mismatch between potential investment buying of silver and what is actually available is hard to fully comprehend because it is so extreme. You might care to think of it as trying to put ten pounds of flour into a one pound bag. The resultant mess, in the case of investment money flowing into silver, would be disorderly pricing to the upside. In no other investment asset does such a potential mismatch exist to the extent it exists in silver. It is this difference of what silver may be attempted to be purchased and what could possibly be sold that also sets the stage for an historic lift-off in price.

My first observation is that silver is capable of worldwide investment. This is not something that can be said of all investment assets. Most international bonds, or stocks, or real estate are not known to or truly available for purchase by all the world's investors. In fact, very few investments are likely to be bought by the average investor in the world. The average investor generally sticks close to home for his or her investment choices, or confines investments to known items. Gold certainly fits into a potential asset known to just about all the world's citizens, diamonds less so. Silver definitely fits the profile, given its thousands of years' history and familiarity in all world cultures. In practicality, gold and silver are perhaps the two universal investment assets, known to all people for all of history.

After concluding what constitutes a potential universal investment asset, the next step is to structure a simple mathematical equation to measure potential price impact. The two variables are the amount of potential buying versus the amount of the asset that could be bought. The collective potential buying power of the world as a whole is sufficient to overwhelm any single asset. In other words, if the world's investors decided to collectively buy any one asset, the amount of buying would be so great as to push the price of any asset dramatically higher. Magnify that potential collective buying force with the power of leverage or borrowing, and we don't need to spend much time expounding on how the world's investment buying is much bigger, measured in the many trillions of dollars, than any single investment asset.

Of more importance to our simple mathematical equation is the amount of the asset that could be bought. This is easier to quantify than the world's potential buying power, but even knowing what exists to be bought is not the same as knowing what is available to be sold. If all existing owners are not interested in selling at a particular price, the asset is not available. Still, we will try to construct our mathematical model on the two assets that represent true world investment assets, gold and silver.

In gold, there exists 5 billion ounces aboveground in all forms and 2 to 3 billion ounces of that in bullion form. Splitting the difference at 2.5 billion ounces multiplied by the current price ($1200), there is a total amount of gold bullion in existence of $3 trillion. Not for an instant am I suggesting that all $3 trillion of gold bullion is available for sale at current prices. I'm just trying to establish a simple mathematical formula that somehow quantifies potential availability and price impact.

In silver, there is thought to be one billion ounces in existence in bullion form, with some unknown, but large amount, in existence in all forms. The one billion ounces of silver bullion in existence is worth less than $20 billion at current prices. In other words, the gold bullion in existence is worth 150 times what the silver bullion in existence is worth. Stated differently, the many trillions of dollars of the world's collective potential investment buying would have a big impact on gold if the world decided to move into gold. But that same potential buying would have 150 times the impact on silver. Trillions of dollars trying to buy trillions of dollars of an investment asset would have less of an impact on price than trillions of dollars trying to buy $20 billion of a different asset.

I continually make a comparison between gold and silver because they are the two most similar investment assets, sharing a long history and universal recognition. Quite simply, silver is way under-priced compared to gold. That doesn't mean gold must go down in price. What it means is that silver must rise in price relative to gold. If gold does go higher, as I suspect, that just means silver has that much more to climb in price. How did it get to the point where silver is so under-priced compared to gold?

The answer lies in some simple observations. For one, very little gold is consumed industrially, so that just about all new gold mined is added to aboveground inventories. Over the past 100 years, silver has been so widely consumed industrially, given its physical properties and low price, that virtually all mine production has been consumed. In addition, silver consumption has been so extreme that 90% of world aboveground inventories have also been consumed over the past 60 years. As a result, there is now less silver bullion in the world than there is gold bullion. Maybe one in 10,000 of the world's investors are aware of this fact. How did we get to this bizarre circumstance?

The answer lies in the large COMEX silver short position and the ongoing silver price manipulation. As a result of the depressed silver price, gold is more closely followed than is silver. Given the 150 times greater value assigned to gold bullion than to silver bullion, it is no wonder that more investors are interested in the higher valued asset. A case in point is the recent behavior of the world's leading hedge fund titans. A long list of distinguished hedge fund managers, including but not limited to the likes of John Paulson, George Soros, David Einhorn, Paul Tudor Jones and others have invested in and extolled the virtues of gold. To my knowledge, not one of the well-known recent mega investors in gold has invested yet in silver. The operative word is yet.

Please think about this. These big investors have plowed billions of dollars in an asset, gold, that is worth trillions. Their buying, starting around the $900 price level in gold has caused the price to rise almost 40% at its highs. What do you think will be the impact in silver if and when they try to invest their billions in a market worth only billions in total, not trillions like in gold? These investors are too smart not to discover silver soon. It's somewhat of a miracle that they haven't discovered silver yet. Lucky for you, especially those who have taken advantage of silver when it was much lower in price.

How could it be that we have reached the implausible situation where a major world investment asset, silver, has been so overlooked by the top guns of the investment world? I don't have a definitive answer for that, except to say that if you don't look you won't see. I doubt very much that these ultra-sharp investors have taken the time to study silver. I think it is just a matter of time before something attracts their attention to silver. Maybe it will be a regulatory development, or clear signs of a shortage, or maybe it will be a simple price jump that causes them to look critically at silver for the first time. Whatever causes them to look, if it drives them to look deep enough, I guarantee you that they will buy silver, or try to buy it.

Currently, my sense of the silver supply/demand equation is one of tightness. By that I mean that after industrial and non-investment demand is subtracted from total current supply, there is silver available for investment on the order of 50 to 100 million ounces annually. Many would refer to this amount as a "surplus" but that surplus is being handily absorbed by current investment demand. Since I am convinced that existing current investment demand is likely to continue, given financial and economic conditions, this surplus is easily absorbed at current prices. Instead what I see is that any new surge in silver investment demand that hits a market with little available supply is bound to greatly impact prices.

This may be hard to quantify, but my sense is that in addition to there being so little silver bullion remaining in the world, those holding this silver will be particularly tenacious in holding on to their silver until very high prices are achieved. These existing silver investors (many, undoubtedly, among my readers) have come to grasp the real silver story and are not about to part with their holdings until they are offered what they consider to be a fair price. I don't want to go so far as to classify these existing investors, or myself, as rabid; but if you can see through the COMEX and JPMorgan scam, you are not about to sell anywhere near current manipulated price levels. I don't sense this death-grip mentality exists as strongly in any other investment asset, including gold. If my supposition is correct, this magnifies the effect of how little silver may be available to the market.

The simple fact is that there is so much potential world investment demand versus so little silver that can be bought, that not all who decide to buy will be able to buy, especially at prices they are willing to pay. In the end, remarkably few will be able to ever buy silver, once the price starts to fly. There is too much money and not enough silver. Couple that with the introduction of various silver ETFs and other investment vehicles and you have set the stage for many thousands of big investors and many tens of thousands of smaller investors all trying to get through a very narrow silver doorway at the same time. There's no way all will be accommodated at reasonable prices. The only way you can assure yourself you won't be crowded out in the coming silver rush is to buy before the masses start to buy. Like now.

Ted Butler

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Silver – $18.00

Gold – $1215