

## August 28, 2013 – Why I Own Silver

Before I publish an article I just wrote for Investment Rarities, I'd like to discuss a few related topics. One has to do with the recent price action. Over the past three weeks, we've rallied \$150 in gold and more than \$5 in silver. Additionally, gold is up \$250 from its low at the end of June. By all measures, these have been strong rallies, pretty much expected given the massive beating to the downside which preceded them and the extremely bullish COT readings. With these rallies has come greater price volatility which is not about to disappear.

Since I am convinced that accurately predicting short term price movements is near impossible on a consistent basis, I don't have any suggestions for what happens next. I will note that the deterioration or increase in the total commercial net short positions in COMEX gold and silver in the COT market structure has not been extreme to date. Longer term, silver still looks greatly undervalued and I am going to continue to focus on the future price peak as a great mountain in the distance and not on the volatile journey leading to that peak. That means holding positions and suffering through price drops and being willing to add positions on those price drops with new funds (or as option positions expire). But admitting to ignorance in predicting short term movements is not the same as being unable to explain the price rallies to date.

In gold, it's a pretty simple story, as the price rally is attributable to one fact – JPMorgan's corner on the COMEX gold futures market. Everything about the gold price this year, both down and up can be attributed to JPMorgan; the \$500 engineered price decline to the 50% retracement to the upside. The evidence is stark – a 20% market share and corner on the short side by the bank at \$1700 in December to a 25% market share and corner on the long side near the lows of \$1200. Market corners are all about price control and that's what JPMorgan is all about in COMEX gold and silver. What's simply amazing is that this crooked bank seems to turn up as being corrupt in just about every line of business it is engaged in (judging by recent government actions); yet the most obvious proof of wrongdoing in gold and silver is ignored by the CFTC. It doesn't matter what definition is used to define a corner on the market; JPMorgan's COMEX gold (and silver) positions, both long and short, would meet that definition.

On the gold price rally, JPMorgan has been liquidating its long market corner at a profit and that will be the measurement to watch in future COT reports. Short term volatility aside, it would appear that JPMorgan has a way to go in pulling off their perfect market crime of selling their gold market corner at a profit and that argues for higher gold prices to come. It must be remembered that this current gold market corner is the sequel to the bank's perfect market crime on the short side of gold, in which they pocketed \$2 billion. What I find most fascinating is that no one has even tried to refute my allegation that JPMorgan has cornered the COMEX gold market (in both directions).

Silver is different in that there is no long market corner in place; instead there is a short market corner by JPMorgan. That makes silver's stronger relative price advance than gold all the more unusual. With gold, the price rally is strictly COMEX trading and positioning by JPMorgan; with silver, while the price is set on the COMEX, I get the feeling something else is influencing the COMEX price setting. The short COMEX silver corner is much less than what JPMorgan has held in the past, but it still is the mirror image to the long market corner in gold. In gold, the metric is in the manner in which JPMorgan sells its long market corner; in silver, how much more JPMorgan sells short is all that matters. I'm encouraged that COMEX silver volume has been on the light side and therefore suggestive that JPMorgan has not been selling short aggressively, but future COT and Bank Participation Reports will tell the real story.

I'm more tuned in to the possibility that the wholesale silver market is tighter than generally perceived. Yesterday's deposit of almost 1.5 million ounces in the big silver ETF, SLV, was the first in a week and is still a fraction of the 10 million oz I believe are "owed" to the trust. There was almost no increase in the short position of SLV as of August 15, contrary to my expectations of a large increase.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99> How to account for the discrepancy? Let me first admit that I may have been wrong in my prediction, or that existing holders of SLV were the primary sellers to new buyers of shares through Aug 15.

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Aside from that, the most plausible explanation for why no big deposit into the trust or no increase in the short position is that the short report wasn't timely enough and failed to account for the high-volume big up day on the 15<sup>th</sup>. We've seen this on occasion in the COT report when big changes occur on the cut-off date, yet are delayed in the report. The answer to that should come in the next short report in a fortnight. I don't want to revert to conspiracy theories, but I am sensitive to one other possibility, which I've written about previously. The keeper of short interest on stocks is the Depository Trust Clearing Corp (DTCC), one of the largest and most secretive financial organizations in the world. Since JPMorgan may be their most important member, I tend to reach for my wallet for safeguarding when I hear the name DTCC (or JPMorgan). Let's wait for the next report or future metal deposits into SLV.

The reason I'm sensitive to the SLV deposit/short sale increase issue is that it goes to the heart of silver tightness and possible shortage, which as the following article explains, is my main attraction to silver as an investment. Despite the sharp rally over the past few weeks, silver still looks cheap in terms of many important measures, including its cost of production and relative to gold and other commodities. Even though I wasn't looking too hard for a new measure of silver's undervaluation, I think I found one.

I remember writing over the past year or two about the discovery of a silver cache in a ship sunk in World War II by a German U-boat. The SS Gairsoppa was discovered in 2011 and salvage efforts have been underway since. It made the news a month or so ago, as silver bars were raised to the surface amid the glare of TV cameras. In a little-noticed story and buried at the end, the recovery efforts were recently not extended due to concerns that the price of silver was too low. [http://www.thisisthewestcountry.co.uk/news/cornwall\\_news/10625306.Silver\\_salvage\\_work\\_stops\\_](http://www.thisisthewestcountry.co.uk/news/cornwall_news/10625306.Silver_salvage_work_stops_)

Hey, it's one thing when the price goes below the cost of production, but you know silver is really cheap when it goes below the cost of recovery as sunken treasure.

### Why I Own Silver

Ask a hundred different precious metals investors why they hold gold or silver and, while you may not get a hundred different answers, you'll certainly get more than one. That's because there are many different reasons why people own precious metals. Among those reasons; protection against inflation, bank or financial system failures, currency turmoil, unsustainable government debt and money supply growth, stock or bond market collapse and perhaps some combination of all these reasons.

While I can understand these reasons and don't have any real dispute that they may prove to provide the protection desired; all are far removed from the reason I hold and continue to buy silver. I own silver because I feel it will perform better than any other investment I am aware of, including gold. Although I am not driven by a desire for money at all costs; I am convinced that if you are going to make an investment, it should be the best investment possible. Quite simply, I believe that silver will make more money, by far, than any other investment almost regardless of future circumstances.

It is one thing to say that silver will be the best investment over the next several years, but yet another to back that up and explain why I expect that to be the case. The simple reason is because I think silver will go into an extreme physical shortage on a wholesale level. If there is anything that can drive the price of a commodity to the stratosphere it is surely a physical shortage. War time, peace time, any time there has ever been a shortage of any commodity, the price has soared to levels that ration remaining available supplies. The price of silver will behave the same way when a wholesale shortage hits.

The inevitable shortage was the thing that first attracted me to silver 25 years ago. Some might say that's a long time to wait for a shortage, but there are some very special circumstances that explain why the timetable for a silver shortage has been drawn out. For one thing, silver has been mined and produced in great quantities for many hundreds of years and tremendous inventories were accumulated above ground. It's hard to conceive of a shortage in the presence of massive inventories. Certainly, throughout history, there has never been a silver shortage, so if a silver shortage develops, it will be unprecedented and that will add to the emotional and panic-buying intensity that accompanies any commodity shortage.

Starting around 100 years ago, the world developed an insatiable appetite for silver as an industrial material once it was discovered that the metal had physical and chemical properties more varied and vital than any other metal. Those properties included silver being the best conductor of electricity, the best transfer agent for heat, the best reflector of light, the most diverse medical properties and chemical properties that ranged from making photography possible to use as a catalyst for other important chemical production.

So great was the industrial demand for silver that for 65 years running, until around 2006, much more silver was consumed than was mined and recycled annually. At the start of World War II, the world had more than 10 billion ounces in silver bullion inventories, with the US Government holding about half that amount. It's hard to conceive of a shortage with 10 billion ounces of silver in world inventories. But so much more silver was consumed than was produced through 2006 that world inventories of silver bullion (in the form of 1000 oz bars) have fallen to a bit more than one billion ounces today, despite the ending of the consumption deficit. Obviously, it's easier to envision a shortage when the inventories of a commodity decline by 90%, while the population of the world (and resultant demand) grew from 2.5 billion to 7 billion.

I look at silver as a commodity destined to go into a shortage because that's what the facts point to. My professional background revolves around supply/demand analysis, having begun my working career as a commodity broker for Merrill Lynch more than 40 years ago. I didn't set out to conclude there would be a silver shortage or any such thing, but in 1985 a client and my eventual mentor, Israel Friedman, challenged me to explain why silver was stuck at \$5 an ounce when demand exceeded production and inventories were being drawn down year after year. Thanks to Izzy's challenge, I came to discover that the price of silver stayed low because it was manipulated by excessive short selling on the COMEX, the principal world precious metals exchange. Since that time, I have petitioned the exchange and the federal regulators to end the manipulation. I have not been successful on that score to date, but many thousands have come to believe that silver has been manipulated in price. The key point here is that nothing invites a shortage more than a prolonged artificial low price and its affect on the law of supply and demand.

Any industrial commodity is capable of going into a shortage. All it takes is for industrial demand to exceed total production or come close to that circumstance. Such shortages seem rare, but then again just about every industrially consumed metal or other commodity has gone into a shortage situation at some point over time. Copper, nickel, lead, zinc and a whole host of grains and foodstuffs and energy products have experienced shortages of varying degree. Considering silver's tremendously diverse industrial consumption base and the growth of world population and economic development, it's impossible to exclude silver as a potential candidate for shortage compared to every other industrial commodity.

But wait a minute Â? didn't I just say that total production of silver started to exceed industrial consumption around 2006? How the heck can there be a silver shortage if total production exceeds industrial consumption? Well, for starters, silver total production doesn't exceed industrial consumption by much; say by 100 million ounces or so annually on a billion ounces of total production. And one could argue that with the recent price drop below the cost of production for many silver miners, that it is just a matter of time before industrial consumption exceeds production due to falling mine production. I think that the silver deficit could return in time, unless prices rise; but I have a different reason for expecting a silver shortage before a decline in mine production triggers the shortage.

The key to appreciating why, among all commodities, silver is capable of developing quickly into a shortage situation, even if production exceeds total industrial consumption, is in understanding that silver is the most unique of materials in that it has a special dual aspect in its demand. Not only is it a vital industrial material, but it is an extremely popular investment asset. To my mind, this elemental fact of silver's dual demand is vastly underappreciated, but it lies at the heart of why I own silver.

Sure, there are times when big investors buy copper, oil, grains and other commodities for a speculation, but the regular investor rarely buys physical copper or crude oil or corn as a long term investment. If the regular investor buys any commodity, it is usually only gold and silver. Since little gold is used for industrial purposes and the metal is considered primarily a pure investment asset, gold does not have a dual demand aspect. That's not to say gold can't rise in price, but it won't be due to a shortage enflamed by panicky industrial user buying. Only silver, of all commodities, has a bona fide dual demand circumstance.

Because this dual demand factor is, effectively, unique to silver, it sets the stage for a very unique potential shortage. Normal commodity shortages come slowly and as a result of a gradual insufficiency of supply in meeting demand over the course of years. After all, most world commodities have many participants, both producers and consumers and changes in production or consumption are glacial-like and grindingly slow. Only when long and consistent delays in delivery occur do the effects of the commodity shortage become apparent. But there is a very big difference between industrial consumption demand and investment demand. With industrial consumption, the users buy what they need; with investment demand, the buyers buy what they want and can afford. And collective human nature being what it is, investment buyers often behave in unison, all trying to buy or sell at the same time. This holds special significance for a silver shortage.

Total silver fabrication demand (industrial consumption plus jewelry, coin and all other such uses) consume 90% of total supply (mine production plus recycling) of one billion ounces. This leaves around 100 million ounces (in the form of 1000 oz bars) to be absorbed by the world's investors, or \$2 to \$2.5 billion annually. In terms of typical world investment flows, this is a piddling amount. For instance, \$100 to \$150 billion is needed annually to be absorbed in newly-produced gold by the world's investors. Since investors tend to move in unison and the dollar amounts are so small, the 100 million oz of new silver available to world investors annually could be snapped up in a relative instant. Sure, existing silver investment holdings could also be sold, but remember that world inventories of silver are down 90% from 70 years ago, so not that much silver exists in investor holdings.

The dual demand factor in silver will also likely be a self-reinforcing mechanism. The silver story is so good that it is only a matter of time before investors buy sufficient quantities to tighten supply, particularly considering how few relative dollars of silver are available for purchase. When that investor-induced tightness hits, it will inevitably cause tightness for the industrial consumers as well, creating delays in delivery to the silver users. Faced with delivery delays that will shut down assembly lines, the industrial users will do what has always been done throughout history — they will try to buy even more silver to build their own inventories and eliminate future delivery delays. This is just normal human collective behavior — just like panic buying of bread, ice and gasoline when a hurricane warning is issued.

You might ask if this is inevitable (as I suggest) — then why hasn't it happened yet? The truth is that the world was on the cusp of its first shortage of silver three and a half years ago, when the price almost touched \$50 an ounce. At that time, investors throughout the world had purchased enough quantities of silver, including many hundreds of millions of ounces in the newly created Exchange Traded Funds that prices were pushed up and severe tightness was evident throughout the wholesale supply chain. Remember, the ETFs buy the exact same form of industrial grade silver (1000 oz bars) as do the users. But before the industrial users began to build personal inventories, prices were dramatically rigged lower on the COMEX and within a week, the price of silver was smashed for more than 30%. This immediately cooled off investor demand; creating instead investor selling and preventing an industrial user buying panic.

Looking back, I believe that we averted an all-out silver user buying panic by the thinnest of margins in the spring of 2011. But the close call back then did nothing to change the underlying circumstances of the inevitable coming silver shortage; it was simply a temporary postponement to what will recur and with greater force. Frankly, I can't see how a silver shortage won't occur at some point; so the real question is one of timing. Fortunately, even if we can't predict the precise timing, it can be made into something largely under our control. It all has to do with how you configure a silver investment.

If you become convinced, as I am convinced, of the likelihood of a future silver shortage, don't try to time it at all. Put yourself in a position where the timing doesn't matter; only the shortage itself. The way to do that is to buy real metal for cash on the barrel head, put it away and wait it out. No margin or borrowing to buy paper forms of silver, no in and out short term trading; stick to real metal in your own possession until you reach the point where you have so much metal that you need professional storage. By not having to worry about the timing, you put time on your side.

In asserting that silver will be the best investment of all, it would be more appropriate to say that silver will once again be the best investment of all. Up ten-fold from levels five and ten years earlier at the price peaks three years ago, silver was, in fact, the best investment of all, beating the returns of every conceivable alternative investment, including stock, bonds, real estate, other commodities and gold. That was no accident and the over-riding reason for it was the developing shortage. The price set back and postponement since then is a rare second chance for the investment opportunity of a lifetime. All the other potential reasons for buying silver are icing on the cake; the only thing that matters to me is the coming silver shortage.

Ted Butler

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Silver – \$24.40

Gold – \$1422

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