December 24, 2011 – Weekly Review/Christmas Letter

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Following a particularly rotten week in each last week, the price of gold recovered somewhat this week; but not so in silver. Gold finished about $8 higher (0.5%) this week, while silver declined a further 60 cents (2%). As a result of silver's underperformance, the gold/silver ratio widened out to just over 55 to 1, still within the trading range of the past two months, but up from the 45 to 1 where we began the year. On a longer-term basis, say the last 2, 5 or 10 years, silver has outperformed gold, but that is scant comfort to silver investors this quarter or week. The overall facts still suggest to me that this is a great time to switch from gold to silver or to deploy fresh funds into silver. (This not to denigrate gold in any way, as I hope to demonstrate in a moment).

Chief among those facts remains evidence from the wholesale silver market pointing towards tightness. The actual movement, or turnover in COMEX silver inventories, continues frantic, as overall totals grew to near the 114 million ounce mark. It is the turnover that suggests tightness. In addition, this week witnessed metal movement between various ETFs, including the big silver ETF, SLV, and other silver ETFs (like the version from Deutsche Bank) unrelated to normal investor accumulation or liquidation. This also suggests tightness in physical supply. And despite the punk price action over the past number of months, investors have held onto long term positions in a remarkably resilient manner.

Sales of Silver Eagles from the US Mint continue somewhat lackluster, however, although we should hit the 40 million oz mark this year for the first time in history. Perhaps offsetting the recently softer bullion Silver Eagle sales have been strong sales among the various commemorative silver coins offered by the Mint, including proof Eagle sales.

While I usually confine my physical wholesale discussion to silver, I would like to mention gold physical off take at this time, both for what it may mean to gold, and also silver in due course. The news that Turkey increased its gold reserves over the past two months by approximately 2 million ounces underscores the turn over the past couple of years of central banks buying gold after what had been a long period in which the world's central banks disposed of gold on balance. Additionally, some major producers of gold, like Russia and China, have been absorbing all their domestic production into official coffers, meaning such gold never finds its way onto the world market. This is clearly a dramatic turnaround from the past and no doubt goes a long way towards explaining gold's overall price strength.

What occurred to me was just how differently the world's central banks' attitude toward gold has changed from the past, especially considering current world economic conditions. In past economic crises, going back over the decades, the sale or transfer of gold was always an immediate source of funding. It seems to me that may have changed, as no matter how serious a county's financial condition may become, no one seems to be willing to dump gold to get out of a jam, even in countries with large gold holdings. Any number of creative financial rescue packages are proposed and affected, but none seem to involve selling gold. Instead, more and more central banks are interested in acquiring gold.

While gold fundamentals are notoriously hard to quantify, the switch from being net sellers to being net buyers by central banks has had and will likely continue to have a profound influence on the gold price. For example, the 2 million ounces of gold acquired by Turkey over the past two months expressed in dollars terms is almost $3.3 billion. Such a purchase by a single country has to be considered price-supportive. If the world's central banks continue the trend to acquire gold, as appears likely at this point, it should continue to support gold prices. Looking down the road, I can't help but think it will eventually spill over to silver.

I don't suspect that silver will ever become an official monetary metal like gold, mainly because there isn't enough of it to go around. But if the central banks of the world continue to accumulate gold, silver is bound to come up on someone's radar screen at some point. Maybe not for monetary purposes, but perhaps for strategic reserve purposes, especially considering such strategic stockpiling is already occurring in other commodities, like crude oil (both in the US and China, among other countries). Certainly, such strategic stockpiling of silver makes sense, considering how vital it is in thousands of industrial applications.

Where it gets interesting, is when you do some simple math. For example, Turkey's 2 million oz gold purchase came to $3.3 billion. This is a large amount of money, but not to the extent it made the headlines in your local newspaper. Large organizations, like central banks and others, deal in transactions involving billions of dollars all the time. Someday, someone may try to put billions of dollars into silver in a single transaction, particularly if multi-billions of dollar transactions continue to become commonplace in gold. Guess what? I don't think anyone could come close to buying $3 billion in silver without causing the price to rocket. Three billion dollars would buy 100 million ounces of silver at current prices. That's close to all the new silver available for investment for a full year and 10% of the entire silver bullion inventory in the world. Such an amount could not be bought in a single transaction without roiling the price. Because it can't be done, I'm convinced that someday, someone's going to try.

The latest Commitment of Traders Report (COT) came in close to expectations. I was expecting some blow-out numbers and was not disappointed, particularly in silver, where historical extremes were achieved in a number of categories. Certainly, there were significant reductions in the total commercial net short positions in both gold and silver, given the steep plunge in price in the reporting week.

In silver, the total commercial net short position plunged by 5500 contracts to 14,800 contracts, its lowest level in 8 or 9 years. The raptors (the smaller commercials away from the big 8) accounted for almost 4000 contracts of the commercial buying, increasing their net long position to almost 21,000 contracts, close to the highest level in years. The big 4 (read JPMorgan) reduced their net short position by 1800 contracts to around 28,000 contracts, the lowest net short position for the big 4 in my personal records. I'm sticking to my 13,000 contract net short position guess for JPMorgan, the lowest since the Bear Stearns acquisition. Certainly, JPMorgan is in position to reduce its net short position further on a price rally in my opinion. The question remains if they will sell on higher prices.

The real interesting feature of this current report was who the silver sellers were in the reporting week, since the raptors and the big 4 were the standout buyers. The sellers were the speculators, of course, but the spec selling was mostly new tech fund short selling, rather than the long liquidation that it had been up until this week. In other words, the commercials were successful in luring new speculative short sellers into silver. Normally this is a highly bullish development, as tech fund speculators on the short side of silver are prone to run quickly if prices start to rise. If the silver COT market structure was spectacularly bullish before the report, as I have been proclaiming, it is much more bullish now. I know that the silver price action stinks, but it stinks for the sole reason of tricking speculators into selling so that the commercials can buy. If the silver market was already locked and loaded to the upside before this report; new weapons have been added to the arsenal for higher prices.

In gold, there was a not insignificant reduction in the total commercial net short position of 21,700 contracts, reducing the total commercial short position to just under 165,000 contracts. This is close to the level that existed after the price plunge of late September. I would remind you that after that late September clean out, gold did rally $200 quickly. This set up looks better to me, because we took out the 200 day moving average on this recent price plunge, something that didn't occur in late September.

The big 4 accounted for almost 10,000 contracts of the 21,700 net commercial contracts purchased, in the process reducing their net short position to near historic lows for the past few years. But just as was the case in silver, the gold raptors did most of the buying, accounting for more than 16,000 contracts (the big 5 thru 8 gold traders, just like in silver added to shorts). As a result of the gold raptor buying, they swung to a net long position of near 10,000 contracts (something I did expect); the first time the gold raptors have been net long since November 1. Certainly, the gold raptors and the big 4 will buy more if they can induce speculators to sell, but such selling will likely only occur if new price lows are seen, something that runs against the strong central bank physical buying.

The gold COT structure is back to bullish, although not as extreme as the silver set up. Both could get even more bullish on lower prices in each, but we are really stretching the rubber band here, particularly in silver. The current COT set ups in gold and silver are very supportive for a sudden price spike to the upside of major proportions. Please remember that this is not accidental as both gold and silver were engineered lower for the express purpose of getting speculators to sell so that the commercials could buy. Prices came down for no other reason.

This is the time of the year for reflection. Tomorrow is Christmas. I wasn't planning on writing anything special for today because of it, but over coffee yesterday morning, my wife asked me to read a column in the woman's section of the local newspaper. (I realize that few call it the woman's section anymore). It was about a request from a grandfather seeking advice on how to fulfill one item on his eight-year-old grandson's Christmas wish list. In addition to the usual toys common to that age, the grandson also wished for a note from God. The request was forwarded to the paper's God Squad and was answered by Rabbi Marc Gellman. Since it was a syndicated column, I was able to find a link http://www.arcamax.com/religionandspirituality/godsquad/s-1016971

Best of all was the actual advice given to the boy in the letter from God. It was advice for all of us to live by. Know that I (God) made you special and because of that to be kind, thankful and giving at all times. God, through the Rabbi, urged the boy to be a good Christian, especially on the day of Jesus' birthday. There was special emphasis in the letter from God to always be truthful, reminding the boy that the only thing that matters is your good name. Cheaters and liars have abandoned the only thing He gave to them that they can't buy or replace. God promised the boy that if he always did the right thing, everything would always work out for the best. It was particularly uplifting and timeless advice.

I can't help but think that being truthful, or the lack thereof, is at the root of everything important in the adult world as well. Nowhere is this more evident than in the world of silver. I believe that almost everything bad about silver is due to dishonesty and that everything good about silver can come from a turn towards the truth. Accordingly, I'd like to offer my own letter from God to those in the world of silver who could use a touch of the truth. I'm sure you can compose notes better than these –

To the managers at JPMorgan, the CME Group and others Â?

Stop abusing your current position of power to cheat others and unjustly enrich yourselves. That is not honesty. Maybe you think you can continue to manipulate the market indefinitely and walk away from your obligations to others, but that is not true. In the meantime you have lost your good name with many and that is the greatest loss of all, as it transcends time itself. But it is never too late for redemption and only you can restore your own reputation. Honesty is always to best policy.

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To those at the CFTC Â?

You have sworn under my name an oath of office to uphold the law and to serve the people. This is not something you can do selectively and at your own leisure. To those who are given great authority comes also great responsibility. Since you are in the position to determine what is honest and fair, you must not be timid or tardy in that determination. Thousands of your fellow citizens have petitioned you for relief from unfair silver dealings, yet you pretend not to hear or feign an inability to act. You cannot speak the truth in silence. By delaying for years a silver investigation you have only encouraged those with evil intent to commit even greater misdeeds. Do not let the complexity of the overall task distract you from the simplicity of doing what is honest. But it is never too late to restore dignity to your personal reputation and that of the office you swore to uphold.

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OK, it's the season of the year associated with feelings of good tidings and peace to men of good will. Perhaps there aren't quite enough such men of good will in position to end the silver manipulation just yet, but it is also the season of hope. And even if we can't depend on a turn towards honesty, we still do have the fundamentals of silver supply and demand and a terrific COT structure to fall back upon. Merry Christmas and Happy Holidays to all.

Ted Butler

December 24, 2011

Silver – $29.15

Gold – $1608

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