

Locked and Loaded<?xml:namespace prefix = o ns =
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I've used this term recently to describe how I feel about the current prospects for the price of silver. I thought I would give you the reasoning behind my feelings. Please keep in mind that there are two basic time frames, long term and short term. Long term is measured in years and is the proper way for investors to view silver. The odds are decidedly better for silver investors on a long-term basis. The long term is more forgiving as it removes time restraints and short-term price fluctuations as major factors. Best of all is acquiring or adding to long-term silver holdings at just the right time. That's investment nirvana.

The long-term demographics and prospective supply/demand and investment circumstances, coupled with the current price, strongly argue in favor of silver as a preferred investment. Just as silver has been a safe and very profitable investment over the past 5 to 10 years, it should prove just as safe and profitable over the next 5 to 10 years. Given all the facts, silver has always been locked and loaded on a long-term basis. Yes, it is true that those who have waited for new price highs before buying silver have found themselves underwater temporarily. Purchases made above \$20, for instance, do need more time to look as good as purchases made under \$5. The obvious solution is not to wait for new price highs before buying. Or conversely, if you have

purchased on former price spikes, take advantage of current lower prices to average down your cost basis.

Today, I would like to discuss the short term, which I define as the next few weeks and months. I think that there are identifiable factors present that suggest that now might be a particularly good time to lock in an attractive price for a long-term silver investment. The principal factors that I see as the likely propellants to a price rally reside in both the paper and physical silver markets.

As I have been writing recently, there has been a notable transformation of holdings on the COMEX over the past few weeks, so let's look at that aspect first.

It is wrong that the paper market on the COMEX frequently sets the price of silver due to the continuing trading battle between the technical funds and the dealers. It is also against commodity law, which holds that futures market trading should discover, not set prices. While it is wrong and illegal for silver prices to be set on the COMEX, it is also reality that it occurs. Sometimes, that COMEX silver price setting creates opportunities for investors to pick up silver at bargain prices. I believe that such an opportunity has just been created.

Over the past few weeks, the price of silver was driven down, from over \$18.50 to under \$15 on February 5. On that price drop, the big commercial dealers on

the COMEX were able to trick the technical funds and other traders into selling almost 24,000 net contracts of silver futures, which the commercial dealer community purchased. That's the equivalent of 120 million ounces of silver. That's a lot of silver. It is more silver than exists anywhere in the world in any one holding, save the big silver ETF, SLV. It makes up 12% of the world's estimated one billion ounce silver bullion inventory.

Strictly for comparison purposes, the amount of gold that the dealer community was able to trick the technical funds into selling on the COMEX was the equivalent of 6 million ounces. As I have also indicated recently, this 6 million ounce COMEX gold liquidation has created a favorable market structure set-up in gold. But there is a difference between the amounts liquidated in silver versus gold. While the six million gold ounce liquidation is a lot in terms of dollar value (\$6.5 billion) or COMEX contracts (60,000), it's not terribly large in terms of above ground gold inventories. Twenty central banks each own more than 6 million gold ounces. It is the amount the IMF still has left to sell. Six million gold ounces is 0.3% of the 2 billion gold bullion inventories estimated in world inventories. My point is that the amount of paper silver that changed hands on the COMEX, relative to world bullion inventories, was 40 times more significant (12% divided by 0.3%) than the amount of gold that changed hands.

Simply stated, the only reason silver prices declined at all was for the purpose of liquidating such a large number of contracts. Not only do I believe that was

the most obvious and plausible reason for the sell-off, I don't see any other reason. The good news, of course, is that if I have correctly identified the driving price force as COMEX trading battles, then the bottom for any silver price decline occurs when the battle is complete. In other words, the bottom in price comes when the last technical fund or other leveraged speculator has thrown in the towel and there are no further COMEX contracts for the dealer community to purchase at lower prices. Since that's what I see now, let me explain why.

Up front, I may be wrong about the last technical fund contract having already been sold. At the core, this is always just a reasoned speculation. But what I'm dead solid certain about is the formula itself, namely, the bottom is reached when the last tech fund contract that could possibly be sold, is sold. So what makes me think the last technical fund contract has already been sold, aside from the impressive number of contracts I have already described as having been sold? The answer rests in how the technical funds behave.

Technical funds and other price momentum traders buy on the way up and sell on the way down. That, in essence, is all they do. Further, they stop buying when prices stop going up or stop making new highs (and then they begin to sell). They stop selling when prices stop going down or stop making new lows (and then they begin to buy). Based upon my analysis, the tech funds stopped selling after the price lows of Feb 5, when intra-day price low was around \$14.60. (The corresponding number in gold was \$1045). The tech funds, if they

have additional potential contracts to sell, won't sell until those price lows are violated. Therefore, the further we rally away from those previous price lows, the less likelihood there is that we will violate those lows or that the tech funds will sell more.

Can I be wrong in my short-term prognosis? Of course. You never want to underestimate the treachery of the dealers, as they will do anything to benefit themselves, legality be damned. But there is a limit as to how much blood even the dealers can wring out of a stone, and once that limit is reached, it is reached. Therefore, even if I am wrong and the dealers can extract more blood from the stone, it won't last long and that will prove to be the final low. Besides, there are other compelling factors suggesting we've seen the lows.

We are moving, inexorably, to the regulatory conclusion of the silver manipulation. Sooner or later, the CFTC will hold the coming public hearing it announced on precious metals and position limits. Sooner or later, the CFTC will have to speak out on the current silver investigation, now one and a half years old. While I still have faith in Chairman Gensler doing the right thing, even if he doesn't or can't, we'll know that as well. We'll have closure on the regulatory side of this issue. This coming resolution strengthens the case for the COMEX-induced tech fund selling being complete. There is strong reason to believe the commercials wished to complete the liquidation before the public spotlight on metals position limits is lit. There is no good case to be made for the dealers to

wait for the regulatory resolution before rigging prices even lower. In fact, it has been my belief that the commercials, sensing important regulatory changes ahead, have created this latest sell-off in anticipation of a regulatory crackdown. They are getting out of short positions while the getting is good.

To be sure, the number of COMEX contracts already liquidated and the promise of regulatory resolution are not the only factors suggesting the sell-off is over and we are locked and loaded for prices to the upside. Paper silver trading and regulatory enforcement are two very important factors, but there exists an even more powerful force for higher prices in the short term. What could be more powerful than the cause of silver manipulation (COMEX trading) or its termination (if the CFTC acts)? Only one thing - the physical silver market.

There are clear signs emerging that the physical silver market is either in, or about to enter, a shortage condition. By definition, a commodity shortage is a condition in which delays in normal delivery times become widespread. It doesn't mean there is no availability at all, or at any price; it just means you must wait longer than normal and often have to pay a premium over what was usually charged for the commodity. I see signs of pending physical tightness in both the retail and wholesale segments of the silver market.

On the retail side, the US Mint is clearly struggling to fulfill its congressional

mandate and produce Silver Eagles in sufficient quantities to satisfy public demand. While the Mint has sold more Silver Eagles in the first six weeks of this year than they have sold in the entire years of 1995, 1996, 1997, or 1998, they still can't keep up with demand. I hear from informed sources that allocations to participating primary Mint distributors are way below requested amounts. Delays in Silver Eagle deliveries are widespread and premiums have risen. In turn, tightness in Silver Eagles is now spilling over into other retail investment forms of silver.

The overall retail scene is highly reminiscent of what occurred exactly two years ago, when retail supply/demand tightness appeared for the first time in history, first in Silver Eagles and then to other forms of retail silver. It took many months for supply to satisfy demand and for premiums and delivery delays to return to normal. Are we set-up for a replay of that? Could be. My sense is that even though tight retail supply conditions abated after the shortages that appeared two years ago, it wasn't due to tremendous new supply becoming available or retail demand collapsing completely. It was more like a temporary cease-fire and uneasy truce in a retail supply/demand war. Conditions were still tight and tense, just that there were no big flare-ups. Until now.

I can't help but point to my friend and mentor, Izzy Friedman, as the person most responsible for the continuing insatiable demand for Silver Eagles. His article, a bit more than two years ago, extolling the virtues of Silver Eagles is

what set off the buying binge. His reasoning is as valid today as it was back then, if not more so. To think that a retired great-grandfather could set off a run on Silver Eagles amazes me to this day.

The conditions in the retail side of silver then are eerily similar to conditions today. Then, like now, there was a sharp sell-off in the price of silver. Both sell-offs were due to paper trading games on the COMEX. Enough people recognized this, or intuitively grasped that silver was undervalued, that the low prices set off a retail buying binge, resulting in increased premiums and deliver delays. Please remember, this is the very definition of shortage. This is also a strong factor in me surmising that the paper sell-off on the COMEX is now complete. Now that the commercial crooks have bombed the price, the low price has set off a retail buying binge. A buying binge is not conducive to continued low prices.

Also similar to two years ago, conditions in the wholesale physical market appear to be tight. Back then, we witnessed COMEX delivery delays, short-selling in SLV shares in lieu of metal delivery and delays in silver delivered into the Central Fund of Canada. These conditions have been witnessed recently, as well. In addition, there are new silver ETFs, absorbing new quantities of metal. Yes, we did experience, over the past two years, some price shocks to the downside and financial and economic crisis that in the interim disrupted silver industrial consumption growth. Silver mine supply was not similarly disrupted.

Yet, wholesale (and retail) investment demand in silver more than compensated. Not only was no silver sold from the combined silver ETFs of the world over the past two years on balance, more than 250 million ounces were added.

A hint as to the true state of how tight available wholesale silver has become is apparent in the quantities residing in COMEX-licensed warehouse totals. Over the past two years, COMEX silver inventories have declined by 25 million ounces, to under 110 million ounces. This is the lowest level of COMEX silver inventories in three years and is down 60% from the all-time high levels of the early 1990's. In contrast, COMEX gold inventories are at all-time high levels, up 40% over the past two years and up 1000% from 2002.

Both retail and wholesale physical silver conditions appear to be tight. It wouldn't take much to push silver into a pronounced and obvious shortage. Maybe something as simple as continued low prices may do the trick. If this occurs, at some point the industrial silver users will panic. This is the one class of physical silver buyer that will not and cannot tolerate delays in silver deliveries. Such delays can put them out of business. They will fight that by attempting to build physical silver inventories. When, not if that occurs, the silver price free-for-all will have commenced. This also may have prompted the big COMEX commercial recent price rigging.

The key question remaining is what the big commercials intend to do on the next price rally, which may have already begun. If they reestablish big short positions, it may signal the usual manipulative game is in place. If they don't replace their big short position on the rally, the price will surely explode. You must be positioned correctly in order to take advantage of that potential outcome.

One last note in closing. The recent manipulative sell-off hit silver harder than it hit gold. This is usually the case. This caused the gold/silver ratio to widen out. This has created a special undervaluation of silver relative to gold. I think gold has a nice COMEX set-up and should rally on that basis. Not only does silver have a terrific COMEX set-up, it also has unique position limit characteristics that may be addressed shortly by the regulators. In addition, it sure feels to me that silver could be entering into a true shortage stage. Because gold is not an industrial commodity, it is hard for me to envision how it could go into a true shortage, for instance, with industrial users buying gold to keep their assembly lines open. In this important regard, silver has the clear advantage. If money is no object, buy both gold and silver. If you must choose between the two, choose silver.

Ted Butler

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