February 1, 2012 – More on SLV

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I realize that I harp on the data flows around the big silver ETF, SLV, especially the situation with the short position in its shares. I think my attention is warranted as this ETF is the largest holder of silver on the planet. Not to closely monitor developments in the Trust would border on analytical negligence. I'm still convinced that two of the most important factors for the future price of silver are the disposition of the SLV short position and JPMorgan's concentrated short position on the COMEX. The jury is still out on both matters.

In Saturday's Weekly Review, I indicated that I thought the SLV was Â?owedÂ? 5 million ounces or more as a result of a couple of high volume up days recently. On Monday, it was reported that there was a deposit of 3.2 million oz into the Trust, the largest deposit in months and confirming my expectations. I can assure you that there was nothing particularly profound in my assertion that the SLV was owed metal. No crystal ball, no sÃ©ance nor channeling of the spirits. It was based upon the observation that the investment community tends to buy when asset prices rise and the heavier the volume, the more that is being bought. Admittedly, this is a simple back of the envelop calculation, but it has worked consistently with SLV since this ETF was introduced six years ago. Keeping it as simple as possible is a concept I generally embrace, as too often things are made unnecessarily complicated.

A key feature of how the SLV operates (according to the prospectus) is that any net new shares purchased and issued must have an equivalent deposit of real silver with the custodian by the close of business that day. Staying with the simple is better premise, the volume in SLV on Monday and the prior Friday was on the light side and Monday was a down day price-wise to boot. Any objective observer would have to admit that the 3.2 million ounces which were deposited into the SLV on Monday were not deposited due to buying of the shares on Monday or Friday. Clearly, the share buying took place earlier; otherwise I would not have been able to state correctly that the Trust was owed silver. There are a number of conclusions we can draw from this simple observation.

One conclusion is that the prospectus is not being rigidly adhered to concerning the issuance of shares. The silver was not deposited on the actual days the shares were bought. As such, there must be a mechanism by which this can be accomplished. The only possible mechanism is that the shares must have been sold short on the actual days that the net new purchases were made in order to buy some time so that the real metal could be secured and deposited into the SLV custodian's vault (the JPMorgan Chase vault in London). Please think about this for a moment.

I want to be very clear here Â? I understand that it is a heck of a lot easier to buy and issue paper shares of a stock than it is to locate and secure a physical commodity. Even though the delay in depositing metal would seem to be in violation of how the prospectus reads, it always seemed reasonable to me that there would be some delay at times, given the differences between a paper and a physical transaction. Therefore, the delay of a few days or a week or so between when the SLV shares are sold short and when those sellers round up and deposit the metal is not upsetting to me (aside from how the prospectus reads). Particularly at times when I perceive the wholesale physical silver market to be tight (like now), I believe some allowance should be granted to SLV short sellers to get the metal.

What is very upsetting to me is when the SLV short sellers are not even trying to buy a few days' or weeks' worth of time in order to round up the physical silver to deposit, but instead have no intention of ever depositing silver into the SLV. Having no intention of ever depositing silver on shorted shares is pure fraud and manipulation. And that intention is easy to prove Â? all you have to look at short interest data for the past year. The short interest in SLV has averaged over 25 million shares for all of 2011 into today. That means 25 million ounces of silver have not been deposited and the buyers of those shorted shares do not have the metal backing their shares as dictated by the prospectus. This goes to the heart of my argument. Because the short sellers of these shares clearly have no intent to deposit the metal (otherwise they would have done so by now), they are defrauding whoever owns the shares with no metal backing (perhaps my wife). Further, if the 25 million ounces of silver that should be backing the shorted shares had actually been purchased and deposited into the SLV, the price of silver would be substantially higher. That's where the manipulation angle comes in.

Before the SLV started trading in 2006, the Silver Users Association petitioned the US Securities and Exchange Commission to prevent its introduction because the SUA claimed there was not enough silver to supply it without causing prices to surge. The SEC took the unusual action of formally reviewing the matter and decided that the SUA's fears were unfounded and approved trading in SLV. Despite the SEC's intense review (complete with a public comment period), the matter of short selling in the shares was hardly considered. The only reference to short selling in the final rule was on pages 13-14 under the topic of liquidity of the shares. An objective reading of that reference connotes an understanding that any short selling in shares of SLV would be temporary until the short sellers could quickly deposit silver.
http://www.silverusersassociation.org/pubpol/Final_Ruling.pdf

No one, including me, contemplated the effects that a large and permanent short position in SLV might have on shareholders and the price of silver. Today, six years after the SEC's final ruling, the effects have become clear. In addition to potentially defrauding large numbers of SLV shareholders, the large and permanent short position has enabled two massive 35% takedowns in the price of silver in 2011. Make no mistake Â? these takedowns would not have occurred, in my opinion, had there been no excessive short position in SLV. Despite all this, I am still convinced that this fraudulent and manipulative short position in shares of SLV will be rectified in time and that shareholder and silver investors will be amply rewarded when that time of rectification comes.

Now, on to some other matters. Recent press reports have indicated that the trail to the missing customer money in the MF Global bankruptcy is growing cold and hopes for full restitution for all commodity customers have grown dim. My heart goes out to all these customers, but I am also saddened that proper perspective appears to be amiss as to the root cause and solution for this tragedy. As I have written previously, I believe that the customer money was already gone by the time the firm declared bankruptcy. I used the example of the game of musical chairs, where there just weren't enough chairs (or money) to go around before the music stopped.

The reasons there wasn't enough money at MF Global for all the commodity customers was because its true financial condition was misjudged and certain large creditors (like JPMorgan) were given precedence over rank and file customers. At the center for blame for the miscalculation of MF Global's true financial condition lies the CME Group, the Self Regulatory Organization responsible for basic auditing of all clearing members. But the CME's failure was much worse than that. After failing in its auditing function, the CME went on to renege on its promise to make customers whole in the event of a clearing firm collapse. Hopefully, the CME will be held responsible for its monumental failures and it will be recognized as folly to have a for-profit organization regulate itself. The MF Global disaster would have largely retreated by now had the CME performed even one of its basic functions.

There was another thought that occurred to me after reading an article on the MF Global mess in today's NY Times. The article pointed to the growing anxiety of customers about the slow pace of the ongoing investigation and the return of their funds. There was a quote from Commissioner Scott O'Malia of the CFTC who said in a speech yesterday, Â?Futures customers Â? including farmers, ranchers and manufacturers Â? have been suspended in excruciating limbo, wondering when they will receive their funds. This situation is intolerable and unacceptable.Â? http://dealbook.nytimes.com/2012/01/31/mf-globals-missing-money-is-slowly-being-tracked-down/

It's hard not to agree with Commissioner O'Malia. But I can't help but think that if a 3 months' limbo is intolerable and unacceptable in the MF Global affair, then what words are appropriate to describe the Commission's current 41 month investigation into silver manipulation. And as bad as I feel for all MF Global customers, I must point out that this is a done deal, a bankruptcy that has already occurred, accompanied with a necessary forensic examination after the fact. The silver investigation, lasting now more than 12 times the duration of the MF Global examination, involves an alleged crime in progress. That makes all the difference in the world.

When the Fire Department or any public protector responds to a call, it responds in priority fashion; temporarily skipping past the house that has already burnt to the ground in order to save the house where the fire has just broke out. The CFTC should investigate MF Global thoroughly, but it should also step lively on the silver manipulation before all investor and market confidence is burned to the ground. It is beyond intolerable and unacceptable that the Commission has taken so long to end the silver manipulation or to explain fully why silver is not manipulated. After all, preventing manipulation is their primary mission. Just like I didn't write the prospectus for SLV, I didn't give the Commission its mission to prevent manipulation. If they don't intend to fulfill that mission, they should step aside and let someone else do so.

Finally, I thought this email yesterday from a subscriber to be appropriate –

Hello Ted,

I hope this finds you well. With all the news about the pending Facebook IPO to occur tomorrow, with an estimated valuation of between $75 and $100 billion, I can't help but make the value comparison of this electronic media company that didn't even exist in January 2004, and that will most likely not exist by 2020, to the total value of Silver on Earth, which has been around since the beginning of civilization, and will survive post civilization.

If I were Facebook, I would take every penny of the IPO and invest in Silver. THEN they would have something substantial that would last. The Silver IPO hasn't even come close to starting yet, and when it does it will far exceed Facebook's value. Thanks again for all that you do. Cheers! Rick

That was nicely put. Thanks Rick

Ted Butler

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Silver – $33.75

Gold – $1746

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