

February 2, 2011 - The Rarest Earth

I'm enclosing a new article I just wrote for Investment Rarities as a preview for subscribers, but first I'd like to add a few comments about the current situation in silver.<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

The US Mint reported blow-out numbers for January sales of Silver Eagles of more than 6.4 million ounces yesterday. This is, by far, the strongest month in Mint history and even exceeds full year totals for a number of years in the program, which began in 1986. Combined with December's sales, it appears that the Mint has upped its production capacity to 130,000 coins per day, up from what I had guessed previously at 100,000. Whether sales continue to consume the Mint's production capacity will be monitored, but the amount of Silver Eagles sold over the past couple of years is truly extraordinary. The Mint is producing silver coins in an amount greater than US silver mine production.

Other indicators of demand continue unabated, including inventory movement in COMEX warehouses and a new withdrawal from the SLV yesterday that does not appear to be investor liquidation, but rather metal that was needed elsewhere. Continued, but unconfirmed, reports of retail shortages of various forms of silver also suggest tightening conditions.

A possible wildcard in the mix is the super-cyclone that is hitting northern

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Queensland in Australia. As regular readers know, I am not one to play up bad news or gloom and doom scenarios in my analysis of silver. Life is too short to dwell on negative thoughts and I refuse to suggest anyone buy silver because of predictions of bad news. Besides, I do have a good friend in Cairns, Nick Laird, which Cyclone Yasi is pounding as I write this. My prayers go out to Nick and his family and all the Aussies who have endured more than their fair share of bad weather lately. But as an analyst, I can't dismiss reality either. As this tracking map indicates, the monster storm seems to have a bead on Mt. Isa, home to one of the largest silver mines in the world, the Cannington, owned by BHP Billiton. I don't know if there will be any impact to the silver production there, but we should know more over the next 24-48 hours.

<http://www.bom.gov.au/products/IDQ65002.shtml>

Finally, the market structure on the COMEX bears close attention at this time. There have been several attempts to penetrate the various moving averages to the upside over the past few days, including the very important 50-day moving average (now at \$28.70). All these attempts have been rebuffed. I can't tell you when the silver moving averages will be penetrated to the upside, but I can tell you that they will be violated at some point. That is certain. When not if, that occurs, we will learn if the big commercials shorts will add to their short positions to keep the price of silver from exploding. This is what they have done for the 25 year life of the great silver manipulation. My speculation is that they won't this time around for a variety of reasons, including physical market

conditions and regulatory concerns. If they don't come in to short aggressively, then watch out above.

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Those who keep up with business news will have no doubt read about the recent developments in the category of minerals known as rare earth elements (REE's). These are minerals that are vital to modern industrial applications, ranging from lasers, batteries, alternative energy, and superconductors to all sorts of important high-tech applications. There are 17 minerals classified as REE's with exotic names like scandium, yttrium, lanthanum, cerium, and praseodymium. Don't worry, this is not a technical discussion and this will probably be the only time I write about rare earth elements.

Actually, these minerals are not all that rare, in the strictest sense of the word. Many are quite abundant in the earth's crust. What makes them rare is that they are generally not concentrated in ore bodies offering economically feasible extraction. The first rare earth mineral was discovered around 1800, in a village in Sweden named Ytterby, and several REE's are named after that village. Up until about 1950, most rare earth production came from India and Brazil. In the 50's, South Africa was a big producer, then California took the lead from 1960 through the 1980's. Then, China came to be the dominant producer by far, and currently produces 97% of world production.

Due to booming world demand, production has strained to keep pace. This was recently exacerbated by China's new export restrictions, due to falling ore

reserves and environmental concerns. This sent the price of rare earth elements soaring by hundreds of percent, prompting a world-wide effort to ramp up production. However, you just don't flip a light switch and begin new mine production. It can take years to develop a mine and begin production. In the meantime, industrial consumers must compete for available supplies by bidding up the price. This is the essence of the law of supply and demand.

Since I'm not a REE expert why am I writing about them? The answer has to do with silver. Silver shares many characteristics with the rare earth elements and there is a lot to learn from them in our analysis of silver. In fact, the purpose of this article is to make the case that silver is the rarest of all the rare earth elements.

One of the common characteristics between silver and the rare earth elements is that many REE's are mined in conjunction with other minerals, same as silver with its by-product mining profile. Mining for both tends to concentrate on the easiest to exploit properties first. Consequently, the remaining properties tend to be lower-grade and more expensive and difficult to develop. Both silver and REE's have seen the emergence of China as the chief producer of each. (In the case of silver, the production reliance includes the processing of scrap material not mined in that country.) Silver production from China is nowhere near 97% of world production, as it is in the rare earth elements, but it still is significant. Environmental issues and restrictions inhibit the production of both silver and the REE's. And with both, higher prices don't automatically guarantee immediate new production. For instance, last year on an 80% increase in price, the mine production of Peru (the world's largest miner) declined 7% or 12 million ounces. That's a million silver ounces less per month than from a year earlier. Recently, the price of REE's skyrocketed, due to China's sharply curtailed exports. Should any major silver producing country sharply restrict the export of silver, the price would soar.

In most industrial applications, there is a small, but necessary amount of silver and rare earths used which is resistant to substitution. The chemical properties of silver and rare earth elements are usually unique in the specialized industrial applications which mandate their use. Generally, the consumption of silver and rare earth elements is price-inelastic, meaning sharply increasing prices of each do little to discourage consumption, due to the lack of substitutes. As was seen recently in the rare earth elements, the industrial users panicked when the supply was curtailed. This will also happen in silver, as I have long predicted.

Where do I get off with the statement that silver is the rarest earth element of them all? This point is the easiest of all to make and should prompt you to rush out to buy silver immediately. What separates silver from the REE's is the one stark factor which is unique to only silver. You can actually buy and hold silver in its purest elemental form, unlike other rare earth elements. Try calling some dealer to invest in pure yttrium, or promethium or gadolinium. And if by some miracle you can find someone to buy from, try to imagine how you could possibly sell or determine a fair price?

The thing that separates silver from all other REE's is that you can invest in it directly. Sure, you can buy stocks in companies that mine silver or REE's, but only silver has the dual role of basic investment asset and industrial material. That's what makes silver the rarest of the rare. What separates silver from any other natural resource is thousands of years of primal attraction, held by man as a form of wealth, and simultaneously a vital and strategic industrial material necessary to modern life. It's just not practical for the average investor to buy a pound of a rare earth, a barrel of oil, or a bushel of corn for investment purposes. I suppose a case can be made about investing in platinum or palladium, both important industrial metals, but there has never been any evidence of a world-wide rush to buy these metals as there has been in silver. Buying or selling an ounce or a pound of actual silver is as easy as falling off a log. The United States Mint sells Silver Eagles by the millions of ounces every month. And while many invest in gold, it doesn't have that investment asset

and industrial material dual role unique to silver. That's what makes silver so rare.

The amazing thing is how few of the world's potential investors appreciate the uniqueness of silver's rare dual role. The ease of investing in silver is taken for granted by the world. Just a few decades ago, silver was in common coinage. This explains why people have difficulty comprehending how such a formerly abundant material could be considered rare today. How many people know that world silver stockpiles are down 90% since 1940? That's precisely what creates the investment opportunity of a lifetime □ seeing something before the crowd.

It seems preposterous that a material like silver, which the common man carried in his pocket for bus fare or a newspaper, could somehow transform itself into a rare material about to enter into a profound shortage. That shortage is virtually guaranteed by silver's unique dual role. The coming rush into silver by investors seeking profits and industrial users looking to stockpile a vital manufacturing component makes a shortage almost certain. There is no way production can ramp up nearly as quickly as the combined force of investment and user demand.

For all intents and purposes, silver has been the best investment over the past decade. Those investors who studied the facts objectively and bought silver, have reaped multiples of their original investment. Silver will likely be the best investment of the next decade as well. Those who study the facts and act on them by buying silver will be generously rewarded. There is no way anyone can turn the clock back to single digit silver. Those days are long gone. But in some ways, the more exciting time lies ahead.

Ten years ago, it was difficult, to convince people to buy silver. The stock market was flying high and real estate was just entering a major bull market.

Crude oil was sliding towards \$20/barrel and most commodities were flat. Silver was under \$5, gold under \$300, and the term rare earth was mostly unknown. Anyone investing in natural resources needed to have their heads examined. Even though silver was in a deficit consumption pattern, there was little interest in buying it as an investment.

Today, things are different. Natural resources are more widely appreciated, in light of burgeoning world populations and the growth in living standards. Now it is a question of which natural resource will experience the next supply and demand crunch, rather than will there be any crunches.

In the last decade, silver rose due to the cumulative effect of a 60 year deficit and the start of net investment demand. This decade, it will be investment demand driving silver higher, along with the end of the short selling manipulation. This termination appears underway. Thanks to great price performance, more investors will be drawn to silver. Thanks to the Internet, a great manipulative force that restricted the price cannot last much longer. While it may be hard to achieve the 7-fold increase in price from the extreme lows of ten years ago, the gains will still be spectacular and should come quickly. At some point the buying momentum will overwhelm those shorts trying to hold back the tide. The big shorts look tired of the manipulation and appear ready to stand aside on the next big rally.

How many neighbors and friends and relatives and fellow citizens do you know that have made a serious investment in silver? I doubt you can discover one in a hundred, or one in a thousand. Despite the impressive price gains over the past 5 or 10 years, silver is still vastly under-owned and under-appreciated. The investment flows into silver, compared to any other investment class, have been tiny. However, the amount of real silver available for investment is so small that the small investment flows to date have been sufficient to power silver higher. As more investors become aware of the silver story, the money

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coming into silver will only increase, propelling the price to levels once thought impossible. Importantly, the money flowing into silver appears to be for physical buying and not margin. Bubbles only occur when people are so enamored of an investment that they recklessly borrow to buy as much as possible. We're a very long way from that in silver. That's yet to come.

There are now \$2 trillion in assets in hedge funds, (the pre-financial crisis levels). This is hot money that comes into any promising investment theme in a flash. It is big money always on the prowl for a good investment idea. To my knowledge, there has been no rush yet into silver by the hedge fund sector. Remarkably, silver recorded an 80% gain last year and a 170% gain over the past two years with no visible participation from the biggest and hungriest investors of all. There is no doubt in my mind that before the silver price saga is finished, the hedge funds will have come into silver in a big way. If silver can climb 80% and 170% without them, what can it climb with them knocking down the doors to get in? The silver story is just getting out. Please take the time to study the facts and act before the big surge.

Ted Butler

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Silver - \$28.30

Gold - \$1335