

## February 5, 2011 – Weekly Review

### Weekly Review

Silver closed higher for the second week in a row, with gold joining in on the rally for the first time in 2011. For the week, silver gained about \$1.15, with gold adding almost \$14. Silver's relative outperformance tightened the gold/silver ratio to 46.4, within spitting distance of the year end close of 46, which itself was a multi-year low-water mark for this measurement. Moreover, a few more ticks lower in this ratio (silver continuing to outperform gold) will put us into multi-decade extreme readings.

Once again, I ask you to step back from thinking about the gold/silver ratio itself (even though I just brought it up), and instead focus on what the tightening ratio means in practical terms. What it means is this: anyone who switched from gold to silver at almost any point over the past 28 years would have been better off (made more money) for having done so. And considering recent developments, I believe that a switch from gold to silver continues to make sense. Here's a chart depicting the ratio (courtesy of a sharp Internet blogger who goes by the name Frustrated)  
[http://stockcharts.com/h-sc/ui?s=\\$GOLD:\\$SILVER&p=W&st=1980-08-01&en=\(today\)&id=p63529565057&a=207193228](http://stockcharts.com/h-sc/ui?s=$GOLD:$SILVER&p=W&st=1980-08-01&en=(today)&id=p63529565057&a=207193228)

Please remember that this does not mean I am bearish on gold, as the gold COT's are quite bullish. It just means that I think that silver will continue to outperform gold. I also know that so much more money is tied up in gold than in silver (by a factor of 150 or so), that no great switch to silver has taken place yet. If and when the smallest percentage of gold money does try to flow into silver, the price of silver will soar. I believe that will occur at some point in the future.

The main reason I continue to suggest that silver will outperform gold resides in the fact that silver is much more of an industrially consumed material than gold. For sure, both are precious metals desired by world investors for a wide variety of reasons. But silver's additional role as an industrial commodity creates the possibility that it could find itself in short supply, particularly if silver industrial users attempt to build physical inventories. Long-time readers know that I harp on this point. One of the signs of an impending shortage in a traded commodity is the appearance of a market price structure which features a premium being placed upon nearer delivery dates than on more deferred delivery dates. This is a price pattern known as an inverted market or backwardation. Although there have been some temporary anomalies in the past, backwardation has never truly occurred in gold or silver, given the large above ground supplies of each thought to exist. As you know, I have questioned the premise that large above ground supplies of silver still exist, due to the 60-year industrial consumption deficit, which lasted until a few years ago.

Now there are signs emerging that silver may be moving into a backwardation price structure on the COMEX. It is not a pronounced backwardation pattern just yet and it may prove to be temporary in nature, but it is notable, particularly when compared to the pricing pattern in gold. In any event, it is not a pricing pattern in silver that I have ever observed before, and I thought it important enough to bring to your attention. This is especially relevant since there are separate supporting factors suggesting the physical silver market is tight and tightening. I've written recently about the COMEX silver spreads tightening, with the nearby months gaining relative to the back months. This has continued, to the extent that there is now a slight premium (but a premium nonetheless) on the July 2011 contract and all successive COMEX deliveries. While the most actively traded months of March and May have picked up relative price strength to all other months recently, they are still at a discount to July. I think this may be due to the large number of roll-overs still to be transacted in the March contract prior to first notice of delivery day on February 28. You can visualize this by looking at the "Settle" column of this COMEX price chart and observing that the July 2011 contract is now more expensive than the successive contracts, which in turn are also more expensive to the others

[http://www.cmegroup.com/trading/metals/precious/silver\\_quotes\\_settlements\\_futures.html](http://www.cmegroup.com/trading/metals/precious/silver_quotes_settlements_futures.html)

By doing the same exercise with gold, you can see a different pattern emerges, namely, the normal price pattern of each successive contract month being more expensive than the closer in deliver dates.

[http://www.cmegroup.com/trading/metals/precious/gold\\_quotes\\_settlements\\_futures.html](http://www.cmegroup.com/trading/metals/precious/gold_quotes_settlements_futures.html)

It is clear that the COMEX pricing pattern is suggesting tightness and a looming potential shortage in silver, but not in gold. We will have to monitor whether this pattern continues to intensify in silver. But there are other factors supporting the tightening, such as the continued heavy movement into and out of the COMEX-approved silver warehouses. I know I mention this factor repeatedly, but I don't know if I've properly conveyed why I feel this is an indicator of physical tightness. I think what it comes down to, besides never having noticed this pattern before in 20 some-odd years of close observation of COMEX warehouse movements (until eight months or so ago), is me not understanding why anyone would engage in the expensive practice involved in these physical movements unless the silver already in the COMEX wasn't available. I believe there is a need to bring in new supplies to the COMEX because the stuff already there is not available and new demands for silver can't be met otherwise. If any of you have a different explanation, please send it to me.

A number of readers have asked me if the recent withdrawals from the big silver ETF, SLV, are legitimate. I think the silver that was removed earlier in the month, as prices were declining, represented plain-vanilla investor liquidation. I do think, however, that the last two or three million ounces removed in the past two weeks was not investor liquidation, but rather intentional movement of physical silver to places it was needed more. This also is legitimate, in my opinion, as the only way to remove silver from the Trust is to turn in shares, as proscribed in the prospectus. It is precisely the share for metal delivery mechanism in the Trust that gives it legitimacy. This is the same as the delivery mechanism on the COMEX, where one can take physical delivery on a futures contract that gives that market its legitimacy. Take away the physical conversion mechanism of either and the legitimacy is gone. Until and unless that occurs, the question of SLV withdrawals should not be alarming.

This week's COT reports in silver and gold was somewhat uneventful, except in one regard. The total net commercial short position in silver increased by 1700 contracts, due to raptor selling of long positions by that amount. In other words, the big 8 did not increase their short positions, despite a more than \$1.50 increase in price during the reporting week. In gold, the total net commercial short position declined by roughly 4300 contracts to another multi-year low. I freely confess to not fully-comprehending gold's fundamentals, as I'm strictly a commodity supply/demand guy, and with gold so many outside considerations come into play. But on a COT basis alone, gold is structured as if it were much lower in price. Therefore, the COT's in gold look very bullish to me, notwithstanding my suggestion to switch from gold to silver.

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The one standout in this week's reports concerned the monthly Bank Participation Report in silver, which was also as of the Feb 1 cut-off date for the COT's. Based upon relatively little change in the big 4 concentrated position in the weekly COT's for all of January, I had been expecting little change in the Bank Participation Report for the big US banks (read JPMorgan). Instead, the BP report indicated that JPMorgan sharply reduced its silver short position by a further 3000 contracts to around 19,000 net. This is, by far, the lowest short position JPM has held on the COMEX since they acquired Bear Stearns' short position in March 2008.

Since the Bank Participation Report had been issued early Friday morning, well in advance of the COT, I had assumed that the COT would indicate that the big 4 concentrated short position would have declined sharply, reflecting the reduction in the BP Report. Instead, the big 4 short position in the COT didn't decline at all. Since the CFTC calculates both reports from the same data and on the same date, the only mathematical conclusion is that the other three members of the big 4 (other than JPM) increased their short positions as JPM was reducing its short position. Since we also know that the big 5 thru 8 traders had previously reduced their collective short positions by 4000 over the course of the month, we had the unusual configuration of the biggest single trader and the fifth thru eighth largest traders on the short side reducing, with numbers two thru four increasing. At this point I don't have a strong conclusion on what that might mean.

However, I am struck by the latest reduction by JPMorgan. This month's reduction of their COMEX silver short position to 19,000 contracts from 30,000 on November 2 means that they have reduced their short position by 11,000 contracts, the equivalent of 55 million ounces. There is no doubt that JPMorgan has been opportunistic and manipulative in this reduction. I am sure that JPM has been behind the sudden and uneconomic sell-offs in silver over the past few months, all created to induce others to sell so that JPM could buy. It is almost impossible for the sell-offs to have occurred otherwise.

Still, JPMorgan has incurred big losses on the covering of their silver short positions from their original sales some \$10 or so lower. But such losses are the least of JPM's problems, as getting out of their uneconomic and manipulative silver short sales is all that matters. These losses matter little when compared to the potential legal liability of them having to be found guilty of manipulation, the most serious market crime possible. I note with interest that this big push by JPMorgan to buy back their silver shorts over the past few months coincided with the filing of the civil lawsuits against them alleging silver manipulation and the outcry on the Internet about it. This is hardly a coincidence. JPMorgan is a big and aggressive financial institution, perhaps the most aggressive of all, and would not take allegations of wrongdoing quietly without good reason. They have good reason to be silent in the face of the allegations of silver manipulation.

Just this week, details were released in the Bernie Madoff bankruptcy lawsuit against JPMorgan which indicated that they knew or should have known that Madoff was running a Ponzi scam and that Morgan, as Madoff's banker, enabled the scam to continue. JPMorgan was vocal about denying culpability and will fight the suit to the bitter end (and then probably settle as quietly as possible). But the silver matter is much different and more serious for JPMorgan. For one thing, the Madoff con is history, in that the scam is over. Now, all that remains is picking up the pieces and putting it to rest. No manipulation took place because Madoff never traded anything. Silver is much different, in that it is a crime in progress and considering the serious nature of market manipulations.

First things first. JPMorgan must first rid itself of its silver short position before it says anything about it. To do otherwise will risk bringing undue attention to the silver market and complicate matters by perhaps unintentionally inviting others to buy. That's why JPMorgan is so quiet about the allegations of silver manipulation, namely, it is still manipulating the price of silver. Much later, when it is done with the manipulation, it can take its time and drag it out in the courts. That's how these big financial crooks behave. The problem for JPMorgan (and the CME Group) is that their behavior is documented in government data and it is a current ongoing crime. But it is also a crime that is ending and that's the best news of all for silver investors.

Be prepared for price volatility, as the big short crooks will pull out every dirty trick in the book in the days and weeks ahead. But also know that the tide is moving against them. The one thing that they can't overcome is the realities of the physical market. Too many signs point to a looming physical silver shortage. It's going to take a lot more than dirty market tricks and an army of lawyers to prevent a silver shortage from impacting the price. The great irony is that the manipulation has brought about the very shortage that will end the manipulation. That's how the law of supply and demand works. Keep a price too low for too long and you end up with a shortage every time.

Ted Butler

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Silver – \$29.10

Gold – \$1349

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