

January 22, 2011 – Weekly Review

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For the third consecutive week since the start of the New Year, the price of silver and gold declined. This week, silver dropped by 90 cents and gold by \$16. Year to date, silver is down by about 11% and gold by 5.5%. This follows the previous year's gains of 80% and 30%, respectively. The gold/silver ratio widened to just less than 49, reflecting silver's recent relative weakness compared to gold.

Since I haven't stood on the sell gold, buy silver soapbox very recently, let me ascend that platform once again. The recent relative weakness in silver versus gold presents a continuing opportunity for gold investors to make the switch to silver. The same goes for any possible future relative silver price weakness. I am convinced that the switch from gold to silver will be looked back upon as one of the greatest investment opportunities ever presented. Remarkably, my conviction does not stem from any bearish feelings I hold for gold. As a matter of fact, as I'll explain in a moment, the market structure for gold, according to my COT interpretation, looks quite bullish. Then why would I advocate that gold investors switch to silver, when the COTs suggest a bullish outlook for gold? Simple – silver still offers superior potential investment returns than gold, despite the bullish COT set up in gold. It's all about the getting the biggest bang for the investment buck.

I have read much recent commentary on the gold/silver spread, especially on a long-term historical basis and what changes in the spread portend for world economic conditions. Much of the commentary involves charting the gold/silver spread and comparing the ratio to past economic circumstances. I hate to disappoint anyone, but none of that matters in my analysis. I don't care what the gold/silver spread did 50 or 100 years ago, I only care what it might do the period directly ahead. Besides, how can anyone compare the price of silver and gold today to what it was 50 or 100 years ago, when the world had more silver than gold back then and the opposite condition exists today? Maybe I'm too simple, but I am not interested in the deep economic consequences of the gold/silver spread, only that you should make a heck of a lot more money in silver than you will in gold.

Most conditions in the physical world of silver appeared consistent, save one – the recent large redemptions/withdrawals in the big silver ETF, SLV. With your indulgence, I'll handle the SLV issue later, when I discuss the Commitment of Traders Report (COT). All other verifiable physical silver market barometers continued the recent trends. COMEX silver warehouse inventory turnover remained frantic, indicting tightness of supply. Retail demand for silver coins from the US Mint continued at a record pace, along with similar reports from other mints around the world. Reports of possible backwardation in silver and radical spread changes on the COMEX only added to suggestions of potential shortage in silver.

The latest COT report confirmed expectations of continued liquidation of speculative long positions, along with the reciprocal reduction of commercial short positions in both silver and gold. Trading action since the Tuesday cut-off suggests a continuation of that trend. There was a bullish set up prior to the release of the latest report that has gotten even more bullish now and since the cut-off.

In silver, the total net commercial short position declined by 1400 contracts, to a bit less than 45,400 contracts. This is the lowest total commercial net short position since March 2, 2010, when silver traded at \$16.5. Over the past two weeks, the standout feature was the reduction in the net short position of the 5 thru 8 largest traders of close to 4 thousand contracts. Importantly, the total net short position of the 8 largest traders on the COMEX is now at 51,878 contracts (remember that the big 8 have a larger short position than the total commercial short position because the raptors are long 6400 contracts). This is the lowest big 8 short position since May 2009, when silver traded at less than \$14. I'll explain what I think this means, along with the SLV connection, in a moment.

In gold, there was another dramatic reduction in the total net commercial short position this week of more than 18,500 contracts. This brings the two-week reduction in the total commercial short position to 48,000, shrinking the total to 206,500. This is the lowest total commercial net short position since March 30, 2010, when gold traded under \$1100. Most importantly, of the 48,000 contract reduction in the total commercial short position over the past two weeks, the largest 4 traders were responsible for more than 39,000 contracts of the total reduction. This indicates to me that the biggest commercial entities want off the short side of gold, as they have also demonstrated in silver. This is behavior on the part of the most influential and informed market participants that is compatible with expectations by them of higher not lower prices.

The message from the COTs is that the commercials are aggressively reducing their short positions in silver and gold. The conclusion is that the price of both gold and silver are likely to move higher, regardless of the very short term. It is important to remember that the analysis of the COTs is not price dependent. By that, I mean that the COT analysis is not reliant on the level of price, but rather the composition of the significant trading categories. I use the COTs for potential price direction precisely because they don't reflect the current price, just the current market structure. It's a wonderful compliment to analyzing supply and demand fundamentals because neither approach is dependent on the other. In simple bottom line terms, the COTs are suggesting that the market structure set up is the same as it was at sub-\$14 silver and sub-\$1100 gold.

What created this bullish COT set up in gold and silver, as exciting as it is, was not accidental or as a result of happenstance. We got to these extreme bullish readings the hard way, namely, as a result of an intentional manipulation to the downside. That downward manipulation was engineered by the entities that stood to benefit the most from it, namely, the commercials who collusively bought back a chunk of their market-controlling concentrated short positions. There was nothing coincidental about it. Only the truly naïve (and the government watchdogs) could fail to see the connection between sharply falling prices and the great benefit it bestowed on those who were trapped on the short side. This is what results in the great dilemma, i.e., the outrage we feel as citizens concerned about an ongoing manipulation and the excitement at the incredible investment opportunity that the manipulation creates. We know it is wrong and illegal that the recent price drop was due to manipulation, but we also know it suggests much higher prices to come.

That leads me to the SLV and the 16 million ounce reduction in holdings in the Trust since the turn of the year. I want to be very careful about not falling into the trap of seeing everything about silver as being bullish, even if bearish facts do crop up. I don't want to be blinded by preconceived notions. I want to remain an objective analyst above anything else. There have been times in the past that silver has been withdrawn from the SLV because it was needed other places more urgently. That was clearly bullish. I don't think that is automatically the case now. I think most, if not all, of the recent reductions in SLV holdings is as a result of plain vanilla investor liquidations.

Many investors are motivated by price alone. It's part of the human condition. When it comes to investments, many buy only as prices rise, whether it involves stocks, real estate or anything else. (I know I have written about this in the past.) Accordingly, when prices decline, those same investors are inclined to sell. It is not my cup of tea, or my approach to markets, but it's perfectly natural for many. Given silver's sharp price rise into the end of last year, many investors, especially those new to silver, bought as a result of that price rise. As they bought the SLV, the sellers (big commercials) had to deposit silver into the Trust as required by the prospectus. Now that the price has declined since the year's end, many of the recent buyers have sold. This has resulted in the recent decline in metal holdings in the Trust. I think this is an objective explanation for the 16 million ounce decline in SLV holdings. Now to the obvious question – is that bullish or bearish for the future price of silver?

I've thought about this carefully and I conclude it is a bullish development. As always, I will give you my reasoning and ask you to decide for yourself. Don't automatically take my word for it; think it out for yourself. Let me get the most obvious and simple reason why investor liquidation of the shares of SLV is bullish – it cleans out weak hands and those just trading on price considerations alone. That's pretty basic, but unconvincing by itself. More important is the conclusion I draw when stepping back a bit.

I know that silver is a manipulated market and this recent takedown in the price was clearly orchestrated by the big commercials for the purpose of them buying back short positions on the COMEX. As the world's largest holder of silver, the SLV is a vital component in the silver market. The same big commercials that operate on the COMEX also operate in the SLV. They also are the kingpins of the entire silver wholesale distribution process, being responsible for most of the world's silver from when it leaves the mine and smelter to when it reaches the end-user. When investors piled into the SLV late last year, it was these same big commercial interests that were forced to supply the metal to the Trust. Otherwise, there would have been a default, something that would end and expose the manipulation. That had to be avoided by the commercials, at all costs.

As a result, these commercials, late last year, were forced to bring silver into the Trust that they had to scrounge to come up with. You can see this in the delays of shipments to Sprott and the frantic turnover in COMEX warehouse movements. An additional motivation on the part of the commercials in the intentional takedown on the COMEX to cover short positions held there was to force the recent investors in SLV to sell so that the commercials could get back the silver they were forced to deposit late last year. Every transaction must have a buyer and seller, with never an exception. Clearly, there was a buyer for every share that was sold recently by investors in SLV, which resulted in the 16 million ounce reduction in holdings. It is clear to me that the buyers of SLV were largely the same commercials who rigged the price lower in order to buy back COMEX shorts. They also wanted to get back the silver they had to deposit in SLV originally. This is also known as killing two birds with one stone. Please stick with me a bit more.

As I recounted above, the big commercial are aggressively buying back COMEX shorts in silver and gold. These entities never do anything without a reason that benefits them. If you study the prices at which they likely established the COMEX silver short positions originally, even though they are buying back on their self-created sell-off, it is clear these commercials are taking big losses on the short close-outs, perhaps \$10 an ounce or more. Likewise, if you study the prices at which they originally had to deposit silver into the SLV in order to satisfy investor demand and avoid default, their buying of SLV shares means silver is coming back to them at a loss (although not the \$10 an ounce lost on the COMEX shorts).

My point is this Â? the big commercials are buying back COMEX shorts and SLV shares aggressively and at a loss. These entities worship at the altar of profit and greed. They would sooner sell their mothers than pass up a profit. That they are taking losses to close out shorts and get back silver previously sold, suggests to me they are doing so for a good reason. The only plausible reason is that they expect silver to be substantially higher in price soon. They are getting while the getting is good. They know, better than anyone, that they can't buy to the upside without sending the price of silver soaring and they are taking advantage of every leveraged long forced to sell before they have to resort to buying on the upside. I suggest you do the same. The silver set up looks good to go, better than I ever could have imaged after all these years.

On a housekeeping note, I plan to attend and speak at the Phoenix Silver Conference on February 18 and 19. This will be my third year attending this conference. I'm not much of a traveler (or a public speaker) and I confess to attending this one because it also gives me the opportunity of visiting with family in the area, particularly my special niece, Miss Mia, who joined and blessed our family by way of China, almost 9 years ago. If you are in the area, please drop by.
<http://cambridgehouse.com/conference-details/phoenix-investment-conference-and-silver-summit-2011/16>

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Gold – \$1342

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