

January 8, 2014 - A Good Question

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I received a question from a new subscriber on an issue that I mention weekly, but that I haven't fully explained in quite some time. Every week, I write that the total silver inventory in the COMEX doesn't matter much to me, as I focus on the movement in the COMEX-approved warehouses. Having not explained why I feel that way in quite a while, it's time for a fuller discussion. First, here's Kevin's unedited email -

Ted,

Been following your work for a long time and finally decided to subscribe, as much to show my appreciation as to continue reading your work.

It would be quite helpful to me, and I am sure others, if you would help us understand how the Comex silver inventories could be at an all time high while at the same time you see that as indicative of silver tightness due to high turnover. It seems to me that if they have an all time high in inventory it is the opposite of tightness. The only conclusion I can draw is that you presume they are lying about the massive inventory and are just barely keeping the game afloat to fill deliveries by shuffling silver in and out quickly to where it is needed.

Way back when you wrote for Investment Rarities (or something like that)... I was convinced you were right and after watching silver get "too high" at \$6 and then \$8 etc, when it fell hard in 2008 I finally talked my wife into jumping in with both feet under \$10. THANK YOU SO MUCH. I will continue to pray for you and your extended family.

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**Appreciate your work and character,
Kevin**

First, it's important to put COMEX silver inventories into perspective. The best way to do that is by thinking in basic mathematical terms of sets and subsets. The grand collection of all the 1000 oz bars of silver bullion in the world is the set. Total COMEX silver inventories are a subset of the total world inventory of 1000 oz bullion bars, just as is the inventory in SLV or any other silver ETF. I have long estimated that the total world inventory of 1000 oz bars is 1 billion oz and with time that is now probably closer to 1.3 billion oz. At around 175 million oz, COMEX silver inventories are less than 15% of total world inventories.

Since COMEX silver inventories are a subset of total world inventories, changes in this category don't always fully reflect proportional changes in the total set of world inventories. Over the past two and a half years, for instance, total COMEX silver inventories have increased by 75 million ounces, or by 75%. Total world silver inventories grew by some 150 million ounces (including the 75 million oz on the COMEX), or by 20%, over the same time frame. It just turned out that the COMEX subset grew much faster than the total set. But it would be wrong to say that total world silver inventories grew by 75%, when only the COMEX subset did so.

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An even better example of the difference between sets and subsets can be found in COMEX gold inventories compared to total world gold bullion inventories. At just under 8 million oz, total COMEX gold inventories are near the same level they were some 8 or 9 years ago; yet over that time total world gold bullion inventories have climbed by 500 to 750 million oz. While COMEX gold inventories are a much smaller subset of total world inventories than are COMEX silver inventories, my point is that changes in a subset do not necessarily reflect similar changes in the total set.

This is also why I don't obsess over changes in the COMEX gold warehouse inventories, namely, because they represent such a small percentage (less than 0.3%) of total world gold inventories. The smaller the subset to the total set, the more distortion can result by focusing on the subset. The reason I believe the amount of silver in the COMEX and ETF subsets are so much greater than the gold subsets are to total gold world inventories is because the need for professional storage is much greater in silver due to the large amount of metal one gets compared to gold for the same dollar amount. \$100,000 buys you 5000 oz in silver; the same amount of money gets you around 80 ounces of gold. Not many people can personally store 5000 oz (350 lbs); many people can personally store 80 ounces (7 lbs). Therefore, it is logical that the silver inventory subsets would be a much larger component of the total world inventory set than is the case in gold.

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When discussing world inventories of silver, it is impossible not to make comparisons with gold because the history and nature of these two precious metals has been intertwined for thousands of years. Gold and silver are unique in a world historical context, more so than for any other commodities. Therefore, it is impossible to fully attain a proper perspective of world inventories without a comparison between gold and silver.

To further gain a proper perspective, it is necessary to look back. At the beginning of World War II, around 1940, the world held close to 10 billion oz in total silver inventories, with the US Government the largest holder with 5 billion oz (bullion and coins). Also around 1940, there was approximately 2 billion oz of gold in all forms in the world. Therefore, around 1940 there was five times more silver in the world than there was gold and maybe a lot more since I am only including silver bullion equivalent ounces and not the silver in jewelry and other household objects.

In 1940, it made sense for there to be so much more silver than gold since annual world mine production of silver was five to ten times larger than annual gold mine production. Up until the 1900's, gold and silver were largely used in the same manner, namely, as money, jewelry and ornamental objects □ all uses that basically preserved each metal and allowed for their accumulation. Therefore, it made sense that there would be so much more silver in the world than gold.

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But in the 1900's the world witnessed a remarkable change via an industrial and technological revolution that changed mankind in ways never imagined. New inventions and technologies arrived that quite literally changed the world. And it turned out that silver had so many chemical and electrical properties needed in many of the new inventions that it began to be industrially consumed in ways never contemplated. Gold had many modern industrial attributes as well, but due to its relative high price, it continued to be used mostly in monetary and jewelry applications which allowed for world gold inventories to continue to grow and accumulate.

Not so in silver, where due to its low relative price and abundant inventories, the metal was voraciously consumed to the point where total annual mine production alone could not satisfy all the new industrial demand and it became necessary to take silver from existing inventories in order to balance demand.

Due to a deficit consumption pattern that lasted for nearly 65 years, world silver inventories were depleted and fell to less than one billion oz around 2006. From that time, the consumption deficit ended and world silver bullion inventories began to be replenished, slowly at first and now those total world inventories grow at a rate of around 100 million oz a year. Let me stop here and make a few observations.

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When I first reported that the silver structural consumption deficit had ended after 65 years, many readers were concerned that the best reason for owning silver had also ended. I didn't see it that way as I tried to explain in several articles. My reasoning was that world silver inventories had already been depleted to such an extreme degree that the silver deficit couldn't persist that much longer due to the simple fact that there was so little silver left in world inventories. The remaining inventories wouldn't be able to provide the supplemental source of supply to mining and recycling production.

http://www.investmentrarities.com/ted_butler_comentary/03-20-07.html

With the passage of time, I believe my reasoning turned out to be correct for factors not yet available at that time. Simply put, the silver structural deficit ended by 2006 (when inventories began to grow), yet prices (under \$10) would still climb to nearly \$50 five years later. Therefore, just because world silver inventories are growing and no longer shrinking, that doesn't mean prices can't rise and rise sharply. That's lesson number one.

A while back (I can't remember exactly when), I wrote that growing inventories for a precious metal does not mean that prices can't rise substantially and that things needed to be put into perspective. The best example is gold. Total world inventories of gold have grown every single day for the past 5000 years and

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that inventory growth alone hadn't prevented the price from moving higher over time. Therefore, those concerned about inventory growth would never invest in gold, as world inventories have done nothing but grow over the centuries. Yet few investors even think about growing world inventories in gold. That's because the amount of people (prospective gold investors) and buying power have grown as much or more than actual gold supply and inventories have grown.

The same metric must be applied to silver. Yes, the world depleted silver inventories non-stop for more than half a century and world inventories have now begun to grow after 65 years of depletion to near-exhaustion. But any precious metal that has investment demand must be considered differently than a commodity with no investment demand. While that's clearly the case with gold, the circumstance is even more critical in silver. The reason for that has to do with relative dollar comparisons.

Each year, the world produces (mining plus recycling) 100 million new ounces of gold, of which 70 million ounces must be absorbed by investment demand (including jewelry investment demand). At current prices, the 70 million ounces come to \$85 billion in new gold investment annually. In silver, close to one billion ounces are produced by mining and recycling, but after industrial and other fabrication, around 100 million oz must be absorbed by investment demand. At current prices, this 100 million oz of "left-over" silver comes to \$2

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billion, or less than 2% of the \$85 billion required in gold.

So yes, silver is no longer in a structural deficit (just like in 2006), but so what? The \$2 billion in world investment needed annually to absorb the silver left-over after all industrial and total fabrication demand is satisfied is peanuts compared to the \$85 billion needed yearly in gold. And the real world doesn't seem to follow the \$2 billion versus \$85 billion investment cash flow formula anyway, putting much more into silver than the formula calls for; sometimes (like in sales of Silver Eagles vs. Gold Eagles) putting in close to equal dollar amounts. This should and will be reflected in the price of silver over time (and when the manipulation by JPMorgan ends).

Despite the massive amount of investment money needed in gold compared to silver, I happen to be bullish on the immediate price prospects for gold for reasons you should be familiar with, starting with JPMorgan's long market corner in COMEX gold. But when I compare gold and silver in terms of the investment cash flow needed in each and relative comparisons of inventories, it's hard not to foam at the mouth over the bullish prospects for silver.

Bringing inventory numbers up to date, there are probably 5.5 billion ounces of total gold in the world (with more than 3 billion oz in bullion form). The 5.5 billion gold oz are worth \$6.7 trillion at current prices. I believe there are 1.3

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billion ounces of silver in bullion form (1000 oz bars). I believe there are probably another billion ounces of silver in small bar and coin form, but I don't include these ounces in my future supply/demand projections, as I'll explain in a moment. The 1.3 billion oz of silver in true bullion form is worth around \$25 billion at current prices. The important comparison to me is the \$6.7 trillion worth of total gold in the world versus the \$25 billion of silver in true bullion form. In dollar terms, all the world's gold is worth 268 times more than the \$25 billion in true silver bullion. Please think about that for a moment.

As a result of 65 continuous years of silver inventory depletion, there are now less silver ounces in the world than there are gold ounces; where formerly there were five times more silver ounces than gold ounces. While world silver inventories are down 90% since 1940 to just above one billion ounces, world gold inventories are up from 2 billion oz to 5.5 billion oz. Yet, despite the stunning about face in relative inventories and with silver, in effect, becoming rarer than gold, the relative price of silver compared to gold is the same as it was 60 years ago. In other words, in 1950 the silver/gold ratio was near the same 63 to 1 ratio that it is today.

How can that be? How can one comparable commodity lose 90% of its inventory and another comparable commodity have its inventory almost triple and there be no change in relative price? There is no free market explanation for what I just described. The only possible explanation is price manipulation, which is why

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I devote so much time to the subject. Price manipulation is not the focus of this article, but it's never far away when discussing silver and gold. In fact, the relative inventory change in gold and silver over the past 60 years with no change in relative price is proof of manipulation on its face. It also means that silver is much more manipulated in price than in gold and an incredible investment opportunity.

Since I haven't written about it in some time, I'd like to explain why I focus on the world's inventory of 1000 oz bars of silver and tend to downplay the billion ounces or so of silver in small bars and coins. It has to do with silver's dual role of industrial and investment demand. Since very little of gold is consumed industrially, this may be the biggest difference between gold and silver.

The industrial demand and wholesale investment trade in silver is conducted in the form of 1000 oz bars. Throughout the world, from the COMEX to silver ETFs to industrial consumption and smelting and refining, the wholesale silver trade is in 1000 oz bars. This is the standard industry unit of trade. Because so much silver trade is conducted in 1000 oz bars, this form of silver takes on special meaning.

Simply put, it will be a shortage of silver in 1000 oz bars that will constitute a true shortage. After all, over the years we've seen any number of shortages in

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various forms of retail silver (rarely if ever seen in gold), but never a shortage in 1000 oz bars. I think we came razor-close to a shortage of 1000 oz bars in April 2011, but the crooks at JPMorgan and the COMEX saved the day for themselves by rigging prices 30% lower within a week. I'm still convinced that was a trial run that will break out again in the future.

The coming shortage of 1000 oz silver bars rests on the premise that this is the form of silver over which investors and industrial users will fight. In fact, the largest of silver investment funds, SLV, is restricted to dealing in this form of silver, along with just about every silver ETF and investment fund in the world. The COMEX only deals in 1000 oz silver bars, both for paper trading and delivery purposes. Any industrial silver buyer will deal exclusively in 1000 oz bars as and when they move to build physical inventories to combat delivery delays. Industrial users and ETF investors alike will bid for 1000 oz bars of silver, not Silver Eagles or small bars. The price of those forms of silver will rise, but not because the big guys are bidding for them in a panic.

This is also the greatest difference between silver and gold. In gold, there can't be an industrial user buying panic for the simple reason there are so few industrial users in gold. In silver, it is hard to see how a user panic can be averted when investment demand surges (as it has and will). Throw in the 65 year inventory depletion due the structural silver deficit and it's hard to pick a price that silver couldn't surge to when the shortage hits.

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Kevin asked a great question that deserved more than a simple off the cuff answer. Rising silver inventories are not a head wind to price considering all the facts.

A few words on the rotten price action this week. It appears to me that we're enduring a typical COMEX rig job to the downside designed to induce those technical funds who bought contracts in Monday's COT report to sell once again. That can only be achieved on sharp sell-offs. I'd lay the blame squarely on the crooks at JPMorgan because the bank did sell both gold and silver in the latest COT. More seem to be noticing the blatancy of the deliberate sell-offs, but the real question is why more don't see the manipulation, particularly after it's explained to them.

I think with today's price take down a sufficient number of technical fund contracts were sold to bring those funds which bought in the latest COT back onto the sell side. Of course that's only a guess on my part. What's not a guess is just how crooked are JPMorgan and the CME Group, owner of the COMEX. While we have retreated from penetrating the key moving averages to the upside, that just delays the process and what JPMorgan does when the moving averages in gold and silver are penetrated remains the key issue. It certainly doesn't feel that way today, but we are still structured for an upside surprise.

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Ted Butler

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Silver - \$19.50

Gold - \$1225