Objective vs. Subjective<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

As intended here, I would define objective (with assistance from Merriman) as dealing with facts or conditions without distortion by personal feelings, prejudices, or interpretations. Subjective means looking at facts with personal feelings, beliefs and desires. I'll add that it would seem to be easier to be objective with that which has already occurred and it's hard not to be subjective with what may occur in the future, as no one can speak with complete precision about what's to be.

As a general investment rule, it is better to be as objective as possible when considering all the facts, but we are also forced to consider the future, which introduces a certain degree of subjectivity. The key to me is to be subjective only after you've exhausted all data objectively.

The last six months in gold and silver have been historic, starting with the price action, perhaps the most objective measurement of all. Price-wise, it was among the worst periods in history, with gold falling 25% and silver 35%. It goes without saying that it would have been better to have sold gold and silver six months ago but it also goes without saying that there are no investment do-over's. In considering the highly objective and significant decline in price, the

only question that matters is what does the price decline mean to the investor?

There all types of metal investors (short term traders, those technically and chart oriented, etc.), but for the long term value investor a significantly lower price always makes an asset less desirable as a sale and more attractive as a candidate for purchase. Since I believe most reading this are in the long term value investor class, the big drop in price, by itself, enhanced the attraction of gold and silver for purchase. It's no secret that between the two, I believe that silver is the most attractive.

Because the drop in gold and silver was so extreme, another objective fact has emerged, namely, that the price had fallen to and below the total cost of production for many miners, particularly primary silver miners. While the cost of production varies with each miner, the avalanche of announcements of write-downs, exploration curtailments, cost-cutting and considerations of placing mines on a care and maintenance basis tell us in the most objective terms possible that we have objectively achieved a collective cost of production. Some miners still claim their individual cost of production is lower than current prices, but their actions suggest otherwise. Most amazingly, there was no such talk or actions six months ago or for years prior to that.

What makes the drop in price to and below the cost of production so important

is not the immediate impact it will have on gold and silver production. Although some miners may hold back a bit of production, short to intermediate term production of gold and silver will most likely be maintained near current levels. Longer term production would suffer if prices remained at current or lower levels. So if immediate production would not decline on the extreme drop in price over the past six months, what does it matter? Almost perversely, the likely big reaction to the drop below production costs is not on the supply side (although recycling should fall off), but on the demand side, particularly investment demand.

Supply, especially mine production, is not something that can be turned on and off like a light switch, as it requires long lead times and much expense to increase and decrease production. Demand, particularly investment demand, is very conducive to sudden spurts and halts. On the big drop in price this year, investment demand overall practically halted and in gold there was pronounced net selling by investors who previously invested in gold ETFs, like GLD. There was much less investment selling in silver and in some selected categories, like Silver Eagle sales from the US Mint, record demand has been witnessed. But it would be fair to say that both gold and silver investment demand were affected by the big drop in price.

My point is that investment demand can explode suddenly and the decline in price to below the cost of production seems likely to ignite such a new

investment demand spurt, especially in silver. As and when silver investors overcome the shock and fear about the massive decline in price this year, their thoughts will likely turn to the new opportunity those low prices have created. In a nutshell, I didn't contemplate there would be a such a massive decline in price over the past six months, but now that it has occurred the most logical contemplation has to be the opportunity inherent in having the price of silver below the cost of many primary producers.

In addition to the objective measure of what the price has done over the past six months and its relationship to the cost of production, what else can be stated in objective terms about gold and silver? Thanks to government and other verifiable public data, there is quite a lot to observe. Thanks to weekly and monthly data from the US federal commodities regulator, the CFTC, we have an accurate record of what positions traders have taken in the principal gold and silver futures market for gold and silver, the COMEX.

The data in the Commitments of Traders (COT) and Bank Participation reports are objective, but just like the price decline, indicate an historic and even shocking rearrangement of trader positions over the past six months. Since both the price changes in gold and silver, as well as the position changes have been historically extreme, it's hard not to assume they are directly related since they occurred simultaneously. It's also hard for me not to see this as price manipulation, but I'm going to set that aside for now.

Strictly in objective terms, the historic price declines resulted in (or were caused by) an equally historic level of speculative selling (both long liquidation and new short selling) accompanied by a commensurate level of commercial buying (both short covering and new buying). The amounts are quite staggering, yet still highly objective. In COMEX gold, from the peak (on Nov 27), the speculators have sold and the commercials have bought 240,000 net contracts, or the equivalent of 24 million ounces of gold. Of those 240,000 contracts, JPMorgan has accounted for more than half, or 125,000 net COMEX gold contracts bought, as the bank flipped a 50,000 contract net short position to a net long position of around 75,000 contracts.

In COMEX silver futures, from the peak on Nov 27, 2012, speculators have sold and commercials have purchased 52,000 net contracts, or the equivalent of 260 million silver ounces. Of that total, JPMorgan has accounted for roughly 24,000 contracts, or slightly less than half than the total amount, similar to their pattern in gold. JPMorgan was able to reduce their concentrated net short position in COMEX silver from 36,000 contracts to 12,000 contracts currently.

It is instructive to note that JPMorgan was able to flip from being the biggest COMEX gold short to being the biggest long now, but was not able to flip to being net long in COMEX silver; although buying the equivalent of 120 million

silver ounces on a 35% decline in price was a monumental, if manipulative, feat for the ages. Please bear in mind that these position changes in COMEX gold and silver are as objective as can be. I'll cover what that may portend after one other objective reading.

Since year end, as a result of the significant decline in price, more than 13 million oz, or more than 30% of the gold metal held in the world's largest ETF, GLD, was sold and redeemed by shareholders in that trust. By including all other gold ETFs and COMEX warehouse stocks, the total number of physical gold ounces redeemed or moved rises to 22 million ounces. This amount is roughly equal to the 24 million equivalent oz sold by speculators and bought by commercial traders on the COMEX, bringing the total amount to 46 million gold ounces or roughly $70 billion. Of course, this is the amount from COMEX futures and publicly recorded physical gold flows; it does not include the OTC market, swaps and LBMA dealings.

In a contrast most observers find puzzling and remarkable, there has been no net physical outflow of silver, either from the big ETF, SLV, or total visible recorded inventories, including COMEX stocks on an even larger price decline than was seen in gold. In fact, total visible silver inventories grew by roughly 30 million oz, with SLV up about 6 million oz. I do think that just as was the case in gold, many millions of silver ounces changed ownership hands, but that change in ownership did not result in a big net decline in visible ounces as was seen in

gold. That's not to understate the 260 million silver ounces that changed ownership in COMEX futures contracts and I believe hundreds of millions of physical silver ounces changed hands, with the principal buyer being JPMorgan. As an example, so far this month, JPMorgan has taken delivery of almost 11 million ounces of silver in its proprietary trading account.

So let's recap the last six months in strictly objective terms. The price of gold and silver fell a massive and historic 25% and 35% respectively, putting prices at or below the cost of production for many miners. Due to or coincident with those massive price declines, there was an historic repositioning and movement of trader and investor positions in COMEX future holdings and visible world inventories of close to 50 million ounces in gold and at least 260 million oz in silver (but perhaps hundreds of millions of ounces more).

Moving on to the more subjective analysis of what the objective measurements are likely to lead to, it's hard not to conclude prices of gold and silver are poised to rise sharply. The two key new developments of the first half were the move in prices below the cost of production and the positioning of the commercials, led by JPMorgan, to the long side of gold and to almost flat on silver, where they had been heavily short previously. The extraordinary price drop and repositioning has set up a potential move to the upside that not only wasn't present at year end, but was never in place for the 28 years I have studied silver closely. Again, let me be clear – I didn't predict the historic price drops

and repositioning that have occurred, nobody predicted these monumental changes. But that doesn't mean these changes can't be objectively measured and analyzed now, after the fact. These changes have been historic to the downside and promise to be equally historic to the upside.

While no one knows for sure what the commercials and, particularly, JPMorgan will do in the future, it's unlikely they will squander the profit potential they have created for themselves. In other words, it's hard to imagine JPMorgan not maximizing the profit potential imbedded in what they now hold, especially when you consider what the bank has to do in order to achieve peak profits from this point. Quite simply, all JPMorgan has to do is to, literally, do nothing or not sell aggressively when prices finally turn up.

Please think about that in order to maximize profits on their massive gold long position and more than neutralized silver short position, all JPMorgan has to do is to go on vacation, go fishing or spend time with the family; anything but sell. With an equally massive speculative short position that must be bought back (or delivered on), there is a built in buying wave present in gold and silver that must get triggered at some point. When, not if, that speculative buying wave gets triggered, if there is not aggressive selling to satisfy what will surely be aggressive buying, prices for gold and silver will soar. In this circumstance, if JPMorgan sits on its hands, prices, particularly for silver, will explode. Will JPMorgan sit on its hands and go on vacation? No one knows for sure, but I will

play it as JPMorgan looking to maximize its profits until proven otherwise.

A quick word about today's sell-off. While always disappointing, it can't be a complete surprise that gold and silver prices were suddenly smashed lower amid Fed Chairman testimony; not that anything said should have influenced gold and silver. Anyone who isn't aware that the commercial and HFT operators on the COMEX dominate and control all short term price movements has been cut-off from the rest of the world these past months and years. I was expecting deterioration in this Friday's COT report in the form of an increase in the total commercial net short positions in gold and silver as a result of price gains during the reporting week (ended yesterday). Today's high volume price smash reversed most, if not all, of that expected deterioration. That doesn't mean we will blast off from here, but we could.

More to the point is that considering the monumental nature of the changes that have occurred over the past six months, it has become nearly irrelevant as to what happens price wise in the short term. No matter how you look at it, there is an extremely low price risk given how far prices have already fallen and the cost of production and an absolutely enormous profit potential given how JPMorgan is positioned and what they have to do to maximize profits, namely, nothing. The time for fretting over continued price declines has past, whether the absolute price lows have been seen or not. All that matters is making sure you have maximum exposure to silver for the long run.

Ted Butler

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Silver – $19.30

Gold – $1275