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## Still Waters Run Deep

I reported last week of recently discovering that Kitco Metals, which is currently in the process of an insolvency reorganization, holds \$260 million in precious metals pool accounts (mostly gold and silver) for clients. I found this disturbing since the ultimate backing to a precious metals pool account is the financial strength of the issuer because the metal backing the pool accounts is not specifically identified. Although I doubted any subscriber held such accounts, I still reiterated my long standing advice to switch to accounts where metal was specifically earmarked (not necessarily with the same issuer).

I also admitted that I came across the information quite accidentally in a random Internet viewing. I had written about pool and unallocated silver accounts frequently in the past and, in fact, believe I was the first to have done so; but I had lost active interest in recent years. As I indicated in one article from early 2007, the two pool account or unallocated metals programs I was most aware of were Kitco's and that of the Perth Mint.

<http://news.silverseek.com/TedButler/1170190859.php>

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I was very careful in that article not to libel or attempt to harm Kitco or the Perth Mint in any way and instead tried to show in factual terms why there would likely be a bad ending to such programs for both customers and issuers. I still feel that way.

One of the things I was never able to pin down was the exact dollar amount committed to these pool and unallocated certificate programs. Because Kitco was privately owned, no public financial disclosure was required. It was only as a result of the bankruptcy petition three years ago that such data became available. And while I glanced at the bankruptcy reports from time to time, I completely overlooked the financial disclosure on the pool accounts until last week. Better late than never I suppose.

Having my interest in pool and unallocated accounts rekindled, I decided to look again at the Perth Mint, which also had never revealed the financial dimensions of its unallocated certificate program; which was more puzzling considering it is not privately owned, like Kitco. Lo and behold, the Mint had begun to report on the size of its total unallocated holdings in its annual reports starting three years ago; just about the time I stopped looking. (What's that I always say about not seeing if you don't look?)

[http://www.perthmint.com.au/about\\_us\\_the\\_perth\\_mint\\_annual\\_reports.aspx](http://www.perthmint.com.au/about_us_the_perth_mint_annual_reports.aspx)

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In the most recent 2013 annual report (as of June 30, 2013), the Perth Mint indicated it had \$2.17 billion in unallocated gold and silver certificates (page 12). This is more than 8 times the size of the Kitco pool accounts. The Mint did not breakdown how much was in gold or silver respectively, but I would not be surprised if there was a pretty even dollar division. One fact supporting that there might be one billion dollars' worth of silver unallocated accounts is that the Perth Mint closed new deposits into silver several years ago saying it had more than enough in such deposits to support normal activities.

If the Perth Mint's unallocated certificate holdings are fairly evenly divided between gold and silver that works out to around one million oz of gold and 50 million oz of silver (remember, the Mint's figures are as of June 30, 2013 when gold closed at \$1200 and silver under \$19). In the real world of metals, one million oz of gold represents 1% of annual mine production and such a small percentage (0.002%) of total above ground gold (5.5 billion oz) that it takes me a few tries with paper and calculator to express it. In silver, 50 million oz is more than 6% of world annual mine production and almost 6% of total visible bullion holdings.

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My point is that in terms of real metal, a billion dollars is much more significant in silver than it is in gold given how little silver exists and how undervalued it is priced. Here's a quick example - an at the "market" buy order for one million oz of physical gold would likely move gold prices a few dollars, while a 50 million oz market buy order for physical silver would also move prices a few dollars and maybe a lot more (depending on the level of dirty commercial tricks). Looked at another way, there are many gold mining companies that produce more than one million gold oz annually, while there is no silver miner that produces more than 50 million silver oz annually. 50 million oz of silver is more important to the price of silver than are one million oz of gold to the price of gold.

I am not particularly surprised that there may be the equivalent of 50 million oz in Perth Mint unallocated silver certificates, since the program has existed for more than 15 years and is quite attractive on the surface. Since there are no storage costs at all (at least in the now closed and grandfathered silver program), it would appear to be an ideal way to hold silver for the long term. Most vehicles for holding allocated metal or metal where serial numbers for all 1000 oz bars held are listed incur annual storage charges of around half a percent per year (like SLV). Over ten years, payment of storage charges can reach 5% on a cumulative basis.

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It's no wonder the offer of free storage has been responsible for the immense popularity of the Perth Mint's unallocated silver certificate program. After all, what's better than free? But it is also true that a prudent person should beware of anything if it seemed to be too good to be true. That, in a nutshell, is at the core of my longstanding distrust of silver pool and unallocated accounts, including Kitco's and that of the Perth Mint. In other words, the most likely explanation for why and how no storage fees are charged is because no metal (or not enough metal) is being stored and set aside for customers holding pool or unallocated accounts.

To be sure, this question has been raised by others and there is a "story" to explain why no storage fees are charged. Kitco doesn't offer a story per se, it just insists all pool customers are backed in some manner, without providing details. The Perth Mint's version is that the metal held in unallocated accounts also serves as working inventory in the Mint's customary business of producing finished metal products, such as bars, coins and coin blanks. But I have some concerns about that version of explanation.

For one thing, even if I'm off in my estimate of 50 million silver oz being involved in the Mint's unallocated certificates and the actual number of ounces is less, the total held in unallocated accounts would seem to be excessive to the

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Mint's working inventory requirements. I would think working silver inventory needs shouldn't be more than 5 million oz or less, given how many bars and coins are produced by the Mint annually.

More importantly, the dual purpose of backing for unallocated certificates and use as working inventory always seemed at odds to me. How can a bar of metal serve two purposes simultaneously? Unless the Perth Mint is dealing in some type of magical silver that can be in two separate places at the same time, it would seem to me that any bar of silver (or any other metal) can be owned by only one entity at a time (I suppose excepting crooked Chinese commodity collateral schemes in which the same metal is offered as collateral for many loans).

Yes, the Perth Mint is involved in precious metals in its normal course of business and the explanation of dual use sounds good at first blush, but unless the Mint has conquered the law of physics I find it impossible to think that this set up has a happy ending. This is exactly the same thought process I undertook with metals leasing almost 20 years ago. At first, metals leasing seemed like a win-win for everyone involved, central banks, miners and the bullion banks. After manipulating the price of gold in both directions, first down then up and costing the miners tens of billions of dollars, the cockeyed scheme

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has, effectively, ended and will never be resurrected. But it sure sounded good at one time.

This will also be the fate of metal storage programs that don't charge fees, in my opinion. To me, it's simple □ there are no storage fees because no metal is being stored. I don't think for a minute that Kitco or the Perth Mint deliberately embarked on a course from the beginning to end up with hundreds of millions or billions of dollars involved in these programs. Instead, it was more likely the result of unintended consequences as a result of not thinking things through completely at the outset. But whatever the actual circumstances behind the origin of pool and unallocated metals accounts, the message to investors is clear - get out while the getting is good and get into real silver or a real silver storage program.

One final thing that bothers me is that if real metal was bought at the time customers deposited real money, there would have been a legitimate and free market impact on price. But because the issuers of pool and unallocated accounts never bought the actual metal, the free market impact on price was circumvented.

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It has now been a full month in which the price of gold and silver have, basically, flat lined and have traded in a fairly narrow trading range; gold \$20 or so on either side of \$1310 and silver 25 cents or so on either side of \$21. Volatility, it was pointed out to me, is historically low. On the surface, it would appear things are quiet and in balance. But under the surface, conditions are far from being in balance. The expression that comes to mind is that still waters run deep.

In little longer than two or three weeks, gold jumped more than \$80 and silver by more than \$2, only to revert to a flat price pattern over the next 5 weeks or so, even though world events and tensions have rarely been as nerve wracking over the past month. The price pattern alone seems surreal and the explanation for the sudden lack of volatility seems to prove manipulation without a doubt. But, of course, there's a lot more pointing to manipulation than the unusual price pattern alone.

The quick jump in price, followed by the flat line, also involved one of the most dramatic shifts in market structure in history. In round numbers, some 50,000 silver contracts and 100,000 gold contracts changed ownership on the COMEX, as technical funds bought and commercials sold. That's the equivalent of 250 million oz of silver and 10 million oz of gold. Rarely have such quantities of



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COMEX contacts changed ownership in such a short time, particularly in silver. In terms of magnitude, if I were describing an earthquake or a hurricane, I would use the maximum levels of strength to describe the COMEX ownership change.

While it can be calm after a big storm blows through, the mechanics of the gold and silver market offer no such suggestion. Yes, I can see that prices are calm over the past month and there's no way I can legitimately pinpoint when volatility will return in force. But I also know that the underlying COT structure is extremely unbalanced and at some point it must be resolved. The problem is that not only can't it be determined when volatility will return, I don't see how it is possible to predict with certainty in which price direction the extreme COT structure will be resolved.

On an historical basis and given the extreme technical fund long position in silver, I will not be shocked if the COMEX commercial crooks rig it the downside. But it's also possible for an upside resolution, as occurred under similar, if not identical, circumstances in late 2010. I know some are pointing to the COT structure and pounding the table for prices to rise and others are pointing to the exact same circumstances as a reason prices will surely fall. What I do know most of all is that no one knows for sure, even if they don't want to admit that.

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At some point though, price volatility will return in force.

The CFTC announced yesterday that Commissioner Scott O'Malia has tendered his resignation, effective August 8. O'Malia, to my mind, was always a staunch opponent of regulatory reform, most particularly of legitimate position limits. Therefore, I guess I was more pleased than disappointed at the announcement, but neither did I think it mattered much in the overall scheme of things given the current composition of the Commission and the work to be done (not much in reality). It came down to me having to eventually remove him from the email addresses I send my articles to.

But even as jaded as I've become about the lack of regulatory response to the ongoing silver manipulation, I was taken aback by the report today indicating that Commissioner O'Malia had accepted a position to head the CFTC's prime opponent in regulatory reform and position limits in particular. I know there's a revolving door between industry and the regulators of industry, but this one knocked me for a loop as it shattered even the appearance of propriety.

<http://www.zerohedge.com/news/2014-07-23/revolving-door-farce-cftc-commissioner-bails-head-regulators-biggest-opponent>

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Silver - \$20.98

Gold - \$1305