A Valuable Lesson<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

I can't say I just learned a brand new lesson, as it was more a case of re-learning a lesson I thought I already knew quite well. Obviously, I forgot something I shouldn't have. I'm talking about assuming and how you can mess up by false assumption. A reader asked me a question as a result of Saturday's review and I knew immediately that I had been guilty of assuming that everyone would know what I meant when I wrote something that wasn't fully explained.

The question (and it was a darned good one, to boot) was asked in connection with my description of how much different things were in silver today versus in 1941, when the British cargo ship Gairsoppa was sunk by a German U-Boat. I mentioned that there were 10 billion oz of silver bullion inventory in the world back then (with the US Government holding almost 6 billion oz) and today the total world inventory was closer to one billion oz. Jon's question was "What happened to the 9 billion silver ounces that were available in the world 70 years ago? Did it just vaporize? Maybe you have written about this before, but somehow these words hit me harder and left holes in my memory."

I have written about this before but, clearly, not recently and not often enough.

In fact, this is arguably the most important consideration for holding silver. I'm just glad to have the opportunity to attempt to explain where I had only assumed before.

Yes, in a manner of speaking, the 9 billion silver ounces were vaporized in that they were taken from world inventories, never to be returned in any of our lifetimes. These silver ounces were physically removed from world bullion inventories and converted to a completely different form, like the coating of an electrical contact or a bracelet for an Indian bride. The 9 billion ounces weren't accidentally misplaced or destroyed; they were deliberately consumed or put into another and higher value physical form.

The reason that I chose to use the ship sinking in 1941to highlight the difference in the world of silver between then and now is because, by coincidence, that year approximates the key timeline of demarcation in the history of silver. Prior to the start of World War II, the amount of silver in world inventories had only grown larger. I'm talking about the history of the world civilization, when man first discovered and produced and used silver, through the thousands of years up until (around) 1941. During that sweep of time, the world added more silver to inventories each year than the year before. No, I wasn't around in 1941, nor was I present for the thousands of years before that, so let me explain what I am saying.

From the dawn of civilization, silver and gold have been coveted by man. Neither was destroyed, but only saved in various forms of jewelry, utensils and coinage. Therefore, the amount of above ground gold and silver only increased every year for thousands of years. World trade and conquest revolved around silver and gold. For instance, back in the 1500's the budget for Spain was financed for decades with the silver and gold plundered from Central and South America. I'm sure such a solution for that country's current financial difficulties would be most welcome today.

But something occurred to radically change the pattern of ever-increasing amounts of silver being added to above ground world inventories around the start of World War II. What occurred actually began well before WW II, but that's when it became clear that we were in a new world for silver. I'm referring to all the incredible inventions involving photography and electricity and the thousands of other modern industrial applications that were based upon silver's unique physical and chemical properties. These discoveries, starting about 150 years ago, reached a climax around 1941 when the world began to consume more silver than it produced. This necessitated that the metal accumulated in silver inventories be depleted in order to balance supply and demand. This was the seminal moment in the history of silver and I was negligent for assuming that everyone would instinctively know this.

It took the world thousands of years to accumulate 10 billion ounces of silver bullion in inventories. Then, starting around 1941, the world began to use more silver than it produced for the next 65 years and to the tune of 9 billion ounces. That's where the 9 billion oz went, namely, to silver consumption heaven. Starting around 2006, the world began to produce more silver by mining and recycling more than it consumed and the depletion of inventories ended. I reported on this at the time and many were worried that the ending of the silver consumption deficit of 65 years was the end of the silver investment rationale. I thought otherwise, namely, that investment demand would provide all the push needed for higher silver prices.
http://www.investmentrarities.com/ted_butler_comentary/01-22-08.html

The important point is not that the silver consumption deficit ended around 2006, but rather that it lasted for as long as it did and destroyed 90% of the world inventories that existed in 1941. That should be foremost on every silver investor's mind. The inventory damage was done and couldn't be undone quickly. All the nonsensical talk of silver surpluses and overabundance must be measured against the glaring fact of unprecedented inventory destruction. This inventory depletion should be the prism through which silver is viewed. The lessons of history are too valuable to be disregarded.

Every week I report on the gold/silver ratio and invariable conclude, no matter what the ratio is at, that I prefer silver over gold. Just like I mistakenly assumed last week, I assume that everyone understands why. Let me not assume today, especially as the gold/silver ratio has widened to the highest level in almost two years. My reason for favoring silver over gold is directly related to the 90% reduction of world silver inventories from 1941 to 2006. This is not a knock on gold, as I have been bullish on the price prospects for gold. Simply stated, there was no corresponding decline in world gold inventories as there was in silver. That's the reason I prefer silver over gold.

It is not the case that gold doesn't have excellent potential industrial applications. While gold doesn't have as many potential applications as silver, no other metal does either. In fact, industrial applications do absorb as much as 10% of annual gold production. The reason gold isn't consumed more industrially is because it is too expensive to be widely used industrially. Instead, gold is mostly used for jewelry and investment purposes. There is nothing wrong with that and those uses have carried gold sharply higher in price over time. I think that should continue.

However, because gold is used mostly for jewelry and investment purposes that also means it never experienced the inventory depletion that occurred in silver. Whereas silver's world bullion inventory declined by 90% (9 billion oz) from 1941 to 2006, the above ground gold world inventory more than doubled over that same time span, from 2 billion oz to almost 5 billion oz. In 1941, world gold inventories were close to 2 billion oz, meaning there were five times more silver ounces than there were gold ounces. After the next 65 years that reversed completely and today there is about three times as much gold bullion in the world than there is silver bullion. This is the key fact that few recognize to this day. As more come to learn this (and I stop assuming everyone already knows it), objective investors will choose silver over gold. This should propel silver prices to move much higher, relative to gold.

I'm not going to dwell on what silver and gold prices were back in 1941 compared to today, because neither price was derived from free market factors, then or now. But relative to each other, gold and silver were roughly equal back then to what is reflected in the gold/silver ratio today. In other words, the gold/silver ratio is roughly the same today as it was back in 1941 (around 59 to 1). But wait a minute – didn't I just write that world silver bullion inventories fell by 90% since then, while world gold inventories more than doubled? I did write that and therein resides a coming price adjustment that is more than half a century overdue. As remarkable as it may sound, it is impossible for two similar items (and nothing is more similar than gold and silver) to not have a commensurate price adjustment when the inventory of one falls by 90% while the other's inventory doubles. Impossible, that is, in a free market environment; in a manipulated market, any price relationship would be possible. Yes, no matter how one looks at silver, in any variety of objective measurements, the issue of manipulation always raises its head.

Not only is silver mispriced relative to gold, it is mispriced on every other reasonable metric as well. But it is silver's mispricing relative to gold, particularly considering the drastic change in their respective inventories, that stands out most clearly to me. And it is this mispricing to gold that offers unimaginable potential for a silver investment score. Not only do few recognize the almost incredible changes in the relative silver and gold world inventories or what caused those changes; just as few recognize what this means for price going forward.

I know that JPMorgan and their collusive COMEX fellow manipulators have a death grip on silver prices on a daily basis; you can see that with your own eyes. That's why we are near a 59 to 1 on the gold/silver ratio, a ratio they control in the short term. But they are not above the law of supply and demand and relativity, nor are they above the sweep of history.

Sometimes historical changes occur with little general notice and it is only much later that those changes are recognized and more fully appreciated. I am convinced that is the case with silver and gold inventories and I am also convinced that this will come to be recognized and appreciated in time. When that recognition and appreciation come about, there will be a massive and historic revaluation in the price of silver relative to gold. Throw in all the other bullish factors lined up for silver and the investment implications are staggering. Anyway, yes, the 9 billion silver ounces were vaporized.

In a few late developments, the price action was encouraging today, but whether it signals the start of a significant move up is yet to be known. Certainly we should move higher, given the COT market structure, supply/demand fundamentals and the likely flow of investment funds. The latest short interest for stocks was just released and indicated only a slight rise of 273,000 shares held short in the big silver ETF, SLV, to a little over 11.35 million shares. You may remember the previous short report indicated a big decline, so this current increase is no biggie. At only 3.6% of shares held short compared to total shares outstanding, versus the peak last year of over 12%, the SLV short position is not the problem it had been. Maybe it had something to do with our efforts with BlackRock, maybe not; but we'll continue to monitor it. The short position in the big gold ETF, GLD, did jump more than a bit, but it too had been down substantially in the previous report. For the first time I can remember (perhaps that's not saying much at my age) the percentage of shares held short relative to total shares outstanding was less in SLV than it was in GLD (4.1%). That's another indication of how low the SLV short position has become. Let it remain thus forever. Additionally, I thought yesterday's 2 million+ oz withdrawal from SLV smacked of metal being needed elsewhere, given the low volume data. And the turnover in COMEX silver inventories continues unabated. Metal in motion is metal in demand.

http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

Finally, I heard a Republican congressman call for the resignation of CFTC chairman Gary Gensler yesterday, supposedly for the agency's failure to safeguard clients of Peregrine Financial (even though the blame should be placed more on the doorsteps of the National Futures Association and the CME Group, in my opinion). On Monday, the NY Times, in their lead editorial, called for Gensler to replace Treasury Secretary Geithner should President Obama be reelected. Were it not for him abandoning his responsibilities and the rule of law in regards to silver, I'm still inclined to favor Gensler over the assorted Washington, DC vermin. If only he would do what he knows is the right thing in silver. Wishing and hoping aside, I do find it fascinating that Gensler was mentioned by the NY Times, as I recently wrote that it is the Treasury Secretary behind the pass being given to JPMorgan in the silver manipulation. It would be something if Gensler ended up in that position and was no longer taking orders from Geithner. I'm not saying it would change things for sure, but it could. As I said, it would be fascinating.

Ted Butler

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Silver – $27.35

Gold – $1606