

Mid-Year Check List

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Considering just how bad the first half and, particularly, the second quarter of 2013 have been, it is more important than ever to review all the pertinent facts, both price and all relevant verifiable data. Of course, I'm going to highlight what I feel are the most significant facts influencing the prices of gold and silver. Price is visible and easy to record and was painful for existing gold and silver investors, while it is now attractive for new purchases. Gold was down 26% for the first half of 2013, falling from \$1660 to \$1233. Silver was down 35%, falling from \$30 to \$19.60 at the end of June. As a result of silver's relative weaker price performance, the silver/gold ratio widened from just over 55 to 1 at year end to 63 to 1 at the end of June.

One would think that with such rotten price performance there would be significant investor selling out, or liquidation, of existing positions. In gold, that was certainly the case as metal liquidations and outflows from the world's Exchange Traded Funds (ETFs), deposit programs and exchanges (primarily the COMEX) were the steepest on record, in accordance with usual investor behavior. For the first half, more than 20 million ounces of gold (worth some \$30 billion) were withdrawn from gold ETFs and the COMEX warehouses, which totaled 100 million ounces at year end. Some 12.4 million oz of that was withdrawn from the biggest gold ETF, GLD, or a 28.5% decline in gold held from

year end. This was quite fitting and reasonable for an asset that declined 26% in price over the past six months, even though the reason for the price decline was decidedly unreasonable. All told, the \$427 price drop in gold shaved more than \$2 trillion off the total value of the world's 5 billion ounces of gold, reducing the total worth of all the world's gold from \$8 trillion to \$6 trillion.

Apparently, someone forgot to tell the world's silver investors that they were supposed to liquidate metal holdings on the large 35% price drop in the first half because total ETF, deposit programs and exchange warehouse stocks for silver actually increased by some 20 million ounces from year end to 845 million oz. The increase was largely due to a 17 million oz increase in COMEX warehouse inventories; but the actual standout feature was a notable lack of liquidation in the holdings of the big silver ETF, SLV, where metal holdings were only down 2 million oz (0.6%) in the first half to 320.3 million oz. (as of July 2, 2013).

Just to be clear □ I'm using the changes in total reported gold and silver ETFs to measure investors' willingness to sell or hold; but that is not everything that can be gleaned from the data. The metal that came out of the GLD and other gold inventories was, obviously, bought by someone (I contend that JPMorgan is the prime candidate). There are two factors here □ investor liquidation in GLD (and not in SLV) and, separately, the requisite purchase of the shares or the metal by counterparties. The reason so much gold came out of the GLD was that by

buying it as metal first converted from shares of the ETF, JPMorgan could buy it without publicly reporting ownership, as they would have had to do if they purchased the shares of GLD that were sold. In SLV, there was metal bought by JPM on liquidations, just nowhere near as much (in dollar terms) as the gold that was liquidated in GLD.

I would contend that the liquidation from GLD was one of the big surprises of the first half (which is why I write about it so much). While much had been written about a potential liquidation in precious metals ETFs since the time of their origin (2004 for GLD, 2006 for SLV), I don't recall predictions for this big GLD liquidation immediately before it became evident this year, only after. In any event, now that the big gold liquidation has occurred, it must be factored into objective analysis. As the facts change, one's thinking should reflect that change. While I am still expecting a bullish resolution to the current extreme gold COT market structure and the accumulation of physical metal by the big commercials (JPM), I don't think the big liquidation in GLD and elsewhere should be disregarded, as it may offer food for thought.

When the GLD liquidation first became evident, it was initially thought by some to be shareholders converting shares to metal for greater safety purposes, rather than it being plain-vanilla shareholder liquidation to reduce exposure to gold. But amid the constant media drumbeat of the gold price deterioration and poor outlook, it looks to me that a good number of investors succumbed to the

downbeat prognosis and then sold and abandoned gold. Certainly, there is scant evidence of widespread conversion of GLD shares to metal by existing investors. Let me be clear, I don't see or sense net liquidation by gold investors holding physical metal in their own possession; just fairly widespread selling by financial holders of GLD.

If I have framed this matter correctly, my next thought concerns how this may impact the price of gold going forward. Specifically, if this was the widespread GLD investor liquidation it appears to be, how likely are those that liquidated to reenter the market and buy GLD when prices rally? While this is obvious speculation, my sense is that some may re-buy at certain times and prices and some will not, particularly those who liquidated with significant losses. Rather than change my outlook that gold prices can rally sharply due to market structure issues, this GLD liquidation issue confirms my broader and longer term concerns about gold due to how large an asset class gold is relative to other asset classes. I still see gold as quite capable of adding hundreds of dollars to its price, but I am troubled with projections of increases of thousands of dollars, particularly in light of the significant GLD liquidation just witnessed.

You should be asking yourself, if prices fell more in silver than in gold, why was there no liquidation in silver holdings while there were record liquidations in gold holdings? That's a key question, as is what the obvious answer portends for future price expectations for gold and silver. Let's keep this simple – investors

didn't liquidate SLV and other silver investment programs because they see the price of silver as more likely to climb than to fall at this point. Taken one step further, it would be reasonable to assume that means silver investors will be more likely to buy and add silver at the new low prices than gold investors are likely to add.

This greater willingness to buy and hold silver more aggressively than gold based upon ETF liquidation comparisons can also be seen in other data series, such as from the US Mint in the form of relative demand for Silver and Gold Eagles. Demand for Gold Eagles is strong, but demand for Silver Eagles is at record levels, despite being handicapped by production capacity restrictions due to insufficient silver blank supplies throughout much of the first half. While this may change, it appears at this point that the most recent declines in price have stimulated greater silver retail demand than gold.

[http://www.usmint.gov/about\\_the\\_mint/index.cfm?action=PreciousMetals&type=bullion](http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion)

Returning to the price, the most important aspect to the weak first half and second quarter performance is that we ended the half at or below the real cost of production for many primary gold and silver miners. On a relative basis, the damage seems to be more acute for the primary silver miners given the steeper drop in the price of silver, but that is not to say that the gold miners aren't suffering immensely. Silver has and had many bullish facts in place suggesting

a big jump in the price, but having the price now below the primary cost of production is perhaps the most bullish of all. Don't get me wrong – I didn't want or predict the price would drop as low as it has; but now that it has it virtually guarantees that the price must rise above the cost of production at some point. If the silver price doesn't rise and rise soon, the impact on future mine production should be profound. While I stand by my allegations that the law of supply and demand has been set on its head by the price manipulation of JPMorgan on the COMEX, the crooked low price will still have a big impact on future mine production. In fact, it already has.

I mentioned the largest gold miner in the world on Saturday, Barrick Gold, and how the gold price at end of the first half would take away most of its profit should it continue. Apparently, we haven't had to wait long to see the consequences of the artificial low prices of gold and silver. Due to the low price, Barrick has just announced a two-year postponement, to mid-2016, for expectations of production at their giant Pascua-Lama gold/silver mine bordering Chile and Argentina. This mine is expected to be one of the largest producers of gold and silver in the world, accounting for more than 850,000 oz of gold and 35 million oz of silver annually. The crooks on the COMEX knocked the price down in order to lure speculators to sell and sell short and as a consequence (intended or not) giant mining projects get delayed and possibly mothballed. This goes to my point that even though the setting of gold and silver prices on the COMEX is as crooked as can be, it still has real

consequences on the supply/demand equation.

<http://finance.yahoo.com/news/barrick-slow-construction-mountain-gold-023621271.html>

Having disagreed with Barrick starting 15 years ago for their aggressive hedging, or short-selling, of gold and silver, one might think I have little sympathy for what the company is going through currently.

[http://www.butlerresearch.com/the\\_death\\_of\\_hedging.html](http://www.butlerresearch.com/the_death_of_hedging.html) That may be true as it applies to senior management; but as far as mining company rank and file employees and, particularly, for shareholders, I have nothing but sympathy. The truth is that the crooked pricing on the COMEX, thanks principally to JPMorgan, is responsible for the mine employee and shareholder misery. If only mine management would wake up and realize why things are suddenly so bad; they are bad because crooked pricing on the COMEX has lowered gold and silver prices too low for them to produce at for a profit. But mine management has their heads stuck in the sand; right next to the regulators at the CFTC.

If the record price decline is the big story of the first half, then what caused that decline has to be equally important. I've tried to demonstrate what the cause wasn't as it wasn't inventory liquidation or lack of retail demand. Nor was it overproduction from the mining community or a big fall off in silver industrial demand, as demand for minerals of all types has been steady. By process of elimination, it comes down to trading activity on the COMEX. Some might insist

that trading in London might be the culprit, but when you look for documented evidence to back such an assertion, you come away empty-handed. All you need to verify the COMEX is responsible for the price smash this year is review the weekly Commitments of Traders and monthly Bank Participation Reports from the CFTC. There are no verifiable data from London.

I won't beat it to death here but around 250 million oz of COMEX silver paper contracts (from February 5) and more than 22 million oz of COMEX gold paper contracts (from November 27, 2012) were bought by commercials and sold by speculators (tricked into selling by the commercial buyers) through last Tuesday. The commercials (led by JPMorgan) were able to buy such gargantuan quantities on sharply lower prices because that was their main intent and they executed flawlessly in rigging prices lower by means of HFT computer algorithms and other dirty price-fixing gimmicks.

As I explained on Saturday, the commercials on the COMEX have completely mastered short term control of the price mechanism and have succeeded in distorting the law of supply and demand. But while JPMorgan and the commercials have demonstrated that they can distort the law of supply and demand through overt price manipulation, that's not the same as mastering the consequences of the distortion. Quite to the contrary, the reaction by Barrick Gold and countless other gold and silver miners to come in dealing with sudden unprofitability because gold and silver prices have been manipulated lower will



be the final word.

The story of the first half of 2013 is that JPMorgan has distorted gold and silver prices for their own selfish benefit and in the process has destroyed the financial viability of the mining industry. But the end of the half is not the end of story; in many ways the story is only just beginning. It's almost impossible for what happened in the first half to gold and silver prices to recur in the future. That is what is so great about the law of supply and demand, namely, it adjusts to every distortion in predictable manner. In this case, there is no question that the price of silver must be adjusted upward, either immediately or after enough mine production is shut in. Given that JPMorgan is favorable positioned for the upside; logic suggests prices move higher sooner, rather than later. But to the investor, the timing of the up move is secondary to the certainty that silver and gold prices must move higher given the predicament of the miners and future mine supply.

Prior to the most recent down move in gold and silver prices I had been observing that silver looked better than ever before, or at least in a very long time, for a variety of reasons. This move below realistic production costs for a wide swath of producers puts the icing on the silver investment potential cake. We still await the upward penetration of key moving averages, brought even lower by the latest price smash and the nature of the inevitable rally will be determined by how aggressively JPMorgan returns to the short side (if at all).

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But we now have a force for the upside that wasn't in place previously □ a silver production cost that sits above current prices. I hate how we got here, but who couldn't love what that portends for future price action?

Ted Butler

July 3, 2013

Silver - \$19.75

Gold - \$1253