

## March 15, 2010 – The Bottom of the Barrel?

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Recently, there have been significant withdrawals of metal from the big silver Exchange Traded Fund (ETF), SLV. Last week, the withdrawals totaled 5.5 million ounces over a seven business day period. These withdrawals are potentially very bullish.

The big silver ETF, which goes by the name iShares Silver Trust (ticker symbol SLV), was the first silver ETF introduced in April 2006, about a year and a half after the first gold ETF. In contrast to the introduction of the gold ETF, the SLV did not come into existence without controversy. A strong campaign against it was waged at the time by the Silver Users Association, who urged the SEC to deny its approval for fear it would cause higher silver prices. The SUA's fears proved to be valid. I also thought there was a good chance that the SLV would be rejected due to the impact it would have on price. There was no doubt in my mind that the SLV would be the most important factor in silver to come along in a long time. For the first time, institutional and other investors could buy and hold the equivalent of real silver in a common stock form. Because it was required to buy and hold real metal for every share purchased, the SLV created a mechanism for vast investment demand for silver.

Early on, a friend of mine, Carl Loeb, labeled the SLV as the "Death Star" because it seemed destined to gobble up all the available silver in the world. That's not far from what has occurred. Since its introduction in 2006, the SLV has accumulated almost 300 million ounces of silver. Its success has resulted in other silver ETFs being created, as well as increased demand in other funds' holdings in silver (like the Central Fund of Canada). In total, over 450 million ounces of silver has been bought in the various silver investment funds over the past 4 years, or more than 100 million ounces annually. That's a lot of silver demand. Prior to 2006, there was no net investment in silver for decades, making the surge in demand particularly noteworthy.

Combined with the holdings in COMEX-approved warehouses, just over 600 million ounces of silver are now held in the visible and recorded inventory category, or 60% of the one billion ounces of total world bullion inventories thought to exist. By way of contrast, total ETF-type gold holdings, plus COMEX warehouse stocks amount to some 70 million ounces, or 3.5% of total gold bullion inventories of 2 billion ounces. Removing the COMEX warehouse stocks from the equation, ETF-type silver holdings total 500 million ounces, or 50% of total silver bullion world inventories, while gold ETF-type holdings total 60 million ounces, or 3% of the 2 billion ounces of gold bullion inventories.

Why is there such a disproportionate percentage of total silver world inventories in ETF-type holdings (50%), compared to the percentage of gold world inventories held in ETF-type holdings (3%)? There is a greater need to professionally store silver than there is the need to store gold. Because gold has a high dollar value compared to its physical mass, there is less need to have someone hold it for you for safekeeping. One hundred ounces of gold bullion, a bar weighing 7 lbs, is currently worth \$110,000. The average person would have no trouble personally storing and safeguarding a bar of gold, or several such bars. In fact, given the principle motivation for the purchase of gold is because it is an asset that is no one else's liability, most gold holders would prefer to hold their gold personally and not have it stored for them by someone else.

However, the same \$110,000 would buy you 6500 ounces of silver, or more than 450 lbs. The average person (or institution) would have trouble storing such an amount, to say nothing of multiples of that amount. Usually I point out that this proves you get too much for your money with silver. My point is simple — because one gets so much more physical weight and bulk for each dollar invested in silver compared to gold, the need for professional storage is greater in silver. This is why such a large percentage of the world's total silver bullion inventory has ended up in the various silver ETFs.

There are two categories of world silver bullion inventories, reported and unreported. Together, they make up total world silver bullion inventories of one billion ounces. Silver bullion is defined as silver held in industry-standard 1000 oz bars, or silver that could quickly be transformed into 1000 oz bars. Prior to the introduction of the silver ETFs, the amount of silver bullion that was in the visible and openly reported category was around 150 million ounces, out of a total of one billion ounces, meaning there were 850 million ounces in the unreported category. Today, as I indicated above, there are 600 million ounces in the reported category and 400 million ounces in the unreported category. (As far as I know, my estimate of one billion ounces of total world silver bullion inventories and 400 million in unreported inventories is higher than any other published estimate. If my estimates are too high, the circumstances are more bullish than I have concluded).

In essence, there has been a transfer, since 2006, of some 450 million ounces from the unreported category to the reported category of world silver bullion inventories. My analysis is that the total bullion inventories haven't changed much from the one billion ounce level, just that there has been a massive rearrangement between the reported and unreported categories. Included in the 450 million ounce transfer was the 130 million ounces formerly held by Warren Buffett's Berkshire Hathaway.

Silver prices have more than doubled from the \$7 level since when the SLV was first proposed in the summer of 2005 (and at one point tripled). However, considering the amount of silver that has been bought in the various ETFs since 2006, I have been genuinely surprised by the relative small increase in the price versus the large quantity of silver purchased. Yes, I'm keenly aware of the manipulative impact of the hundreds of millions of ounces sold short by a few commercials on the COMEX, but I fully admit that the ETFs took in far more silver than I expected.

I believe that the price of silver is manipulated downward by the obscene and concentrated short selling on the COMEX. I believe a few crooked commercials are behind the short selling. These same commercials are the kingpins of the wholesale physical market. They don't actually mine and refine and consume the actual silver, but they arrange for shipment and distribution all along the wholesale production and consumption process. So the big commercial paper shorts on the COMEX who are managing the price are also managing the wholesale physical market.

These big commercial shorts are the entities that moved the 450 million ounces of silver from the unreported category of world silver bullion inventories to the reported category over the past 4 years. Clearly, it was bullish that investment demand was strong enough to require the big commercials to transfer the silver from the unreported category to the reported category in order to satisfy ETF-type demand. But it also created the impression that these big commercials had unlimited amounts of silver in unreported holdings. In other words, if they transferred 450 million ounces in 4 years, who could say that they didn't have another 450 million ounces, or any other large amount, behind that? The feeling the large transfers from the unreported to the reported category created was that they could be maintained indefinitely.

This feeling of silver abundance created by the transfers has worked to the big commercial shorts' advantage for years. For instance, it kept the regulators and users at bay, amid rising numbers of complaints about a silver price manipulation. No problem, the big shorts could claim, we have plenty of silver remaining in unreported inventories. No, we can't show it to you, but don't worry, we have plenty. Trust us. In addition, the seemingly effortless manner by which the big commercial shorts could come up with silver from unreported inventories weighed on investor psychology. If it were precisely known how much silver remained in the unreported inventories, investor psychology would undoubtedly be different. As long as silver flowed freely from unreported inventories to reported inventories, the illusion of plenty could sustain the big shorts' bluff. But when the flow from unreported inventories ceases, the bluff is called. That's what is so potentially bullish about the recent transfers out of the SLV.

There is no question that if silver is manipulated in price and its wholesale physical movement is managed by the big commercials, as I allege, that they would prefer to conduct their operations with the minimum of transparency and scrutiny. Being able to secure and transfer silver from unreported inventories allows these commercials to shield their activities from prying eyes. The minute the availability of unreported silver inventories dries up and the commercial shorts must resort to moving around reported inventories of silver, their activities become visible.

The movement out of the SLV strongly suggests that the commercials have run out of easy access to unreported inventories of silver. Certainly, there is no evidence that the 5.5 million ounce decline in SLV holdings was plain-vanilla investor liquidation. Price action, volume and continued metal flows into the other silver ETFs argue against investor liquidation. Investor demand for silver is booming, and it makes no sense that silver is being dumped by investors in the SLV. It is important to remember that the SLV is the largest holder of silver in the world and as such is the logical place to go to when important quantities of silver bullion are needed in a hurry. While I think that the short-selling of SLV shares is an abomination, the fact that this ETF allows for its shares to be converted to metal (through an Authorized Participant and in increments of 50,000 shares/ounces), makes it a logical source of physical silver supply in a pinch.

Furthermore, the silver leaving the SLV seems to be finding its way to the COMEX-approved warehouses. The timeline for that tracks pretty closely. Approximately 5 million ounces have recently been deposited in these warehouses, in an apparent response to demand from new buying of futures contracts in the current March delivery month. This amount of silver moved into the COMEX is strongly suggestive that it came from the SLV. Such buying can only be for delivery purposes in the March contract. This new buying has been unusual and reflects immediate demand for wholesale silver quantities. Interestingly, the prime deliverer on the silver COMEX contracts this month has been JPMorgan in their proprietary trading account. Finally, the timeline of the withdrawals from the SLV and the deposits made into COMEX warehouses, if they involve the same silver, would suggest the mode of transportation is by air-freight and not shipped by boat, and further connotes urgency.

Importantly, superimposed over all this is the need to remember, whatever the actual amount of silver in the reported and unreported inventory categories, there is really only one category of inventory that matters the most. That is silver available to the market, at or near current prices. In a very real sense, it doesn't matter if there is one billion ounces of silver total inventory or ten billion ounces, if only a few million, or less, is available for current sale. More important than the total quantity in inventory is the quantity that can be bought immediately. It appears to me that very little of the remaining silver inventory, both reported and unreported, is available for sale near current prices. That's because most silver investors are long-term in nature and are looking for much higher prices before they sell. If anything, they are more inclined to buy at current prices, than to sell. This is a key price determinant in any market, even one as manipulated as silver. And considering the current low price of silver, combined with just how little may be available at this time, it wouldn't shock me if some well-heeled investor entered the market at any time, impacting the price in a big way. In fact, it's more of a surprise that it hasn't happened yet.

Admittedly, there is much speculation behind my thought process. There is also much fact. It would be safer to wait for actual confirmation of genuine shortage in the wholesale physical silver market before officially declaring that shortage. But safety has a cost, because by the time the silver shortage is visible to all, it will already be visible in the price. Therefore, by definition, if you hope to profit from the price impact of a shortage, you must be early. Yes, you can get false starts and signals before the actual silver shortage hits, but that's unavoidable. The best way to play it is with physical silver held on a long-term basis and no margin. You don't want to lose positions if what looks like a shortage developing is postponed. I don't know for certain if the recent removal of silver from the SLV signals the start of a genuine silver shortage. But it just may and I see no benefit in not sharing my view with subscribers.

Ted Butler

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