May 11, 2011 – The Reason for the Plunge

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Sometimes, when things evolve quickly, it's hard to grasp the significance of what's going on around you. That was certainly true in my case, as a result of what just occurred in the historic silver sell-off. But other times it hits you soon enough. I'd like to propose to you the real reason we just sold off in silver. If I am correct in my analysis, it paints a strongly bullish picture for silver.

Generally, most things occur for a reason. Those things that occur by intent must have a reason. Since I have portrayed this sharp decline in silver as being intentional and manipulative, I am required to provide a reason for why it occurred. At first, I was stumped, but then it finally hit me. What threw me off initially was that the reason for this latest silver sell-off took a slightly different form from what had been the case in the past.

Every previous dramatic sell-off in silver basically involved manipulative dirty trading tricks on the COMEX intended to scare out as many leveraged longs as possible. In the process, this allowed the commercial short holders the opportunity of buying back their short contracts. I had never seen any exception to this continuous cause and effect. You could almost set your watch on this pattern. A big silver sell-off always resulted in massive speculative long liquidation on the COMEX. But this time, there weren't excessive speculative long contracts bought before the plunge and there haven't been many reported liquidated to date. I think future COT reports will show liquidation, but they haven't yet. So the reason behind every previous silver sell-off didn't appear obvious in the latest decline. If the old reason wasn't the cause for this sell-off, then what reason was?

This time, the silver manipulators had a different goal and objective. They did use every dirty trick imaginable to rig the price sharply lower on the COMEX, but the liquidation they were after was not primarily long COMEX contracts. The goal this time of the silver crooks was to get hold of silver in the big silver ETF, SLV. And they achieved their goal. In little more than a week, the COMEX silver takedown forced 35 million ounces of silver to be sold and redeemed out of the SLV. I would bet my last dollar that the bulk of that 35 million ounces is now owned by the very criminals that rigged the price lower, which was the plan from the get go.

Many investors in the SLV are regular stock market investors and they behave accordingly. These investors, in many cases, are different from those who buy physical silver and hold it their possession. Drop any stock 25% in a week and you are going to get investors who will sell first and ask questions later. That's what just happened in SLV. When such selling occurs in a unique security like the SLV, physical silver is redeemed from the fund automatically and that silver is bought by others. That's also what just happened.

It took me a short while to connect the dots, but once connected, no other explanation is more plausible for what just actually occurred in silver. And here's the bottom line conclusion for silver investors Â? that this silver rig job took place for the purpose of taking silver from SLV investors should tell you how determined the manipulators must be to own silver. That should make you even more determined to own silver.

As I have been writing recently, I think the center of the silver world is gravitating to the physical markets and, in particular, the big silver ETF, SLV. I suppose this is natural, seeing how the SLV holds the largest stockpile of silver in the world, at over 340 million ounces. While the COMEX still trades a higher daily volume, measured in paper ounces, and is still much more of a 24-hour market than the SLV, the trading in SLV is more Â?physicallyÂ? rooted. That's because of differences in the relative structure of each is radically different. A COMEX silver futures contract rarely results in the actual delivery of silver, nor should it. Futures contracts are not principally designed for delivery purposes but to allow the transfer of risk and open discovery of price. Of course, take away the actual delivery mechanism in a futures contract for any physical commodity and you remove that contract's legitimacy.

The structure of the SLV and other metal ETFs is vastly different from futures contracts. The prospectus for each metal fund and trust calls for a specific amount of metal to be held for each share outstanding. In the case of the SLV, the prospectus spells out that there should be one ounce of silver for every share issued and outstanding. Shares issued by the sponsor, BlackRock, do have the required amount of metal backing the authorized shares outstanding. The problem, as I have written on previously, is that there also exist a significant number of unauthorized shares effectively issued by short sellers. These unauthorized shares, because they have no metal backing, are fraudulent and have a manipulative impact both on the shares of SLV and on the price of silver.

There is no provision in the SLV prospectus that permits the issuance of unauthorized shares. In fact, the great irony is that the unauthorized shares are being issued precisely because of the prospectus. Please allow me to explain.

The SLV prospectus is clear on how the trust issues and retires shares. For new shares to be issued, silver must be deposited by the close of business that same day. Shares that are sold for which there is no new buyer must result in shares being retired and metal redeemed from the Trust. The language in the Trust was written by an army of lawyers at the request of the original sponsor, Barclays Global Investors from which BlackRock subsequently purchased the I-Shares ETF operation. No investor or potential investor in SLV had any input or influence on the wording in the Trust; the prospectus was written as the sponsor and its army of lawyers dictated. Obviously, the wording reflected the sum total of all the data that were known at that time.

When the Trust first started trading in 2006, the wording about the metal being on deposit the same day as new shares were issued presented no problem. That's because there was plenty of silver available to the Trust back then. As time has evolved and more silver came into the Trust than ever imagined, plus into all the other new silver investment vehicles that were introduced, the amount of silver available for purchase has been greatly reduced. Today, more than 600 million ounces are held in the various silver ETFs and other investment funds. Incredibly, that amounts to more than 60% of all the investment silver (1000 oz bars) that is thought to exist in the world. (By comparison, all the gold ETFs and other funds hold 75 million ounces, or 2.5% of the world's total 3 billion oz of good-delivery gold bullion.) Clearly, with so much of the world's silver bullion already residing in the ETFs, the amount still available for purchase by the ETFs has been sharply reduced from what it was in 2006, when the prospectus for SLV was written.

Because the SLV prospectus's wording is so clear that metal must be on deposit before new authorized shares can be issued, if no silver is available for deposit when new buyers of SLV shares emerge, only unauthorized shares can be issued by short selling. This short selling, in effect, is mandated because silver is not always available nowadays. What's the alternative? Shut down trading in SLV, or have the sponsor announce they are having trouble securing new silver? That would set off a firestorm or awareness that silver is in a shortage. That is the last thing many people connected to the SLV would ever want.

So the choice was made, violate the wording of the prospectus and keep it hidden by shorting whatever amount of SLV shares may be required to satisfy new buyers of shares. That this is illegal and fraudulent beyond any question is maddening for those who believe in the rule of law and legitimate regulation. That this fraud and manipulation is being perpetrated by leading financial companies and ignored by our regulatory institutions makes a mockery of what America is supposed to be about.

Perhaps the most maddening factor of all is that the shorting of SLV shares involves the dirtiest Wall Street trick of all, which involves setting up an investment vehicle according to strict rules of their own choosing and then ignoring those rules when it proves inconvenient. Remember, BlackRock is responsible for the wording in the SLV prospectus. That they now choose to look away and ignore their own wording is an outrage. Even though the most recent short figures indicate that the SLV short position was reduced through April 30, to a still obscenely large 28 million shares, the existence of any short position in SLV is criminal and BlackRock should be held liable for enabling SLV and silver to be manipulated. No, I haven't heard from them. http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

Let me make a suggestion for BlackRock. Change the wording of the SLV prospectus to allow for the rampart short-selling of its shares whenever sufficient quantities of metal are not available. Perhaps something along these lines Â?

Â?Whenever sufficient quantities of silver are not available when new purchasers are buying shares, we authorize any Authorized Participant to issue any amount of shares necessary by short sale to satisfy demand. This should smooth out the price of silver and keep everything orderly. At some unspecified time in the future, should the Authorized Participants who shorted shares for smoothing purposes actually happen to secure available metal, they then may deposit metal and extinguish the shorted shares.Â?

That should sound crazy to you, except that it has been occurring regularly in SLV and BlackRock has been behaving as if that is the actual wording of the prospectus. Of course, I'll be sending this to them.

As far as the vicious takedown today, it was not expected by me. In fact, as I was reading the paper and having coffee this morning prior to 7 AM Eastern Time, the price of silver was above $39 in fairly orderly trading. We then dropped nearly $4 in a short period of time. Just like last week's takedown, there was no fundamental supply/demand news to account for this. It appears that the culprit, once again, is this crooked HFT computer trading. Obviously, the CFTC has no interest to explain the price moves in silver in regulatory terms or to reign in what appears to most as criminal market behavior. Also obvious is that this undermines the collective faith in our important institutions. That is a very bad thing.

That silver investors can't depend on the CFTC to do the right thing doesn't mean all is lost. Getting the regulators to act against the silver manipulation was always a bonus or something to do while awaiting the physical market to determine the proper level for silver prices. Not only do I not regret any effort I have extended to get the regulators to act, I have no intention of stopping now. But the real hammer in the silver market has always been supply and demand and that is especially true at this time. The intentional takedown in silver prices will only bring the physical day of reckoning closer.

The trick is in how you handle it. You can't control prices, but you can handle how you deal with those prices. As always, no margin. Holding silver on margin is just making it easy for the crooks to take away your silver, which is the intent behind these sell-offs. I know these sell-offs are frightening and induce doubt as to the long term merits of silver. But lower prices will actually stimulate demand and discourage production in the long run. When the dust settles on this sell-off and the fear subsides, the next move up in silver will surprise us all.

Here's something you might do that is easy and constructive. It's something I had my wife do last week. She holds SLV in an account that was coded for margin. Even if you don't have a debit balance or have borrowed against your shares, if you hold shares in a margin account, those shares can be lent by your broker to someone looking to borrow and short the shares. Even fully paid for shares can and will be loaned out for that purpose, as sharers in an account coded for margin will be held in street name and not in the owner's name. If you hold shares of SLV (or anything else for that matter) immediately convert your account to a cash account and make sure they are held in your name and not in street name. This won't cost anything and could do a lot of good in preventing additional short selling of SLV shares.

One thought in closing that I will expand on in the future. Although it has been of the negative variety, the sharp sell-off in silver has brought unanticipated attention to the metal. Silver's been talked and written about more in the past couple of weeks than in the entire 25 years that I have followed it closely. I think this attention has put silver on more radar screens than ever before. That more people are now aware of silver could matter a lot in the next turn up. Human nature being what it is, I think more people than ever will be inclined to buy as prices climb.

Ted Butler

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Silver – $35.30

Gold – $1504

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