May 14, 2014 – No Surprise

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It's not every day that a 117 year old tradition suddenly disappears in full view. And seeing how it involves silver, it certainly invites comment. I'm speaking of the announcement that the London Silver Fix, in operation since 1897, is to cease activities and be disbanded on August 14. You'll remember that Deutsche Bank announced several months back that it was selling its memberships on the London Gold and Silver Fixes (ostensibly under pressure from German financial regulators). http://uk.reuters.com/article/2014/05/14/uk-silver-fix-idUKKBN0DU0IS20140514

It turned out, no doubt influenced by regulatory interest and related civil lawsuits involving the Gold Fix, that no buyer emerged and Deutsche Bank will simply abandon its role in both the Gold and Silver Fix. As one of three members in the Silver Fix (along with HSBC and Bank of Nova Scotia), the decision was made to simply close and dissolve the London Silver Fix. This raises the question of the fate of the London Gold Fix. Certainly, considering the perceptions of the term price Â?fixÂ? in our modern financial system, along with the recent investigations and crackdowns in LIBOR and FX trading, there is no big surprise in this turn of events.

To me, the demise of the London Silver Fix had more to do with its relevancy than anything else. In the world of silver price setting (legitimate or otherwise), the London Silver Fix wasn't particularly important. How else could one interpret its sudden closing and the lack of immediate price impact on silver? Not that I would be surprised if silver prices surged; just that it won't likely be related to the ending of the London Fix. It appears to me that the archaic structure of the Fix had rendered it irrelevant long ago.

It's no secret that I am suspicious of just about everything that comes out of London in connection with silver (and gold). Almost a year ago, I wrote Â?London Phony BaloneyÂ? (July 31, in the archives), concerning the LBMA and the complete lack of transparency in London precious metals trading. I wondered about those that hung on every unsubstantiated detail that emanated from London, from reported lease rates to backwardation and shortage. My point was that little in London was ever verified and documented; it was all just smoke and mirrors. I can't help but feel that the announced disappearance of the London Silver Fix supports my contention not to rely on data from London. An important pricing mechanism can't suddenly disappear without price impact unless it wasn't important to begin with.

If there is one thing that the dissolution of the London Silver Fix highlights it is the supremacy of the COMEX on silver and gold prices. Stop for a moment and ask yourself what would happen to silver prices if the CME announced it was dissolving the COMEX in a few months? All hell would have broken loose and, in my opinion, to the upside. In more ways than not, I do wish the COMEX did not exist since that is where the manipulation is centered. But the COMEX does exist and it would be foolhardy to look elsewhere for why prices do what they do. The COMEX is still the one when it comes to silver prices.

In other news, the Silver Institute released its annual report on silver today, which follows by a week or so the annual report from the CPM Group. There seems to be only two sources for silver supply and demand, GFMS (which prepares the Silver Institute's report) and CPM. Due to not much of a viable alternative, I tend to blend the two reports together and there are not many surprises from what I've seen in this year's reports.
https://www.silverinstitute.org/site/2014/05/14/total-physical-silver-demand-achieves-record-level-in-2013/

Generally, both reports this year were largely in keeping with what I've been estimating for annual mine supply (800 million oz), recycling (200 million oz), total silver fabrication demand (900 million oz) and the amount available for investment in 1000 oz bars (100 million oz).
I would like to point out that it is advisable to blend both reports, rather than to rely on either exclusively.

One thing that has always puzzled me is that there is usually a pretty wide variance between what GFMS and CPM report as annual silver mine production and this year is no different. I would think that zeroing in on world production would be one of the details in which they should come pretty close, considering production should be somewhat easier to calculate than consumption. After all, there are a heck of a lot more silver consumers than producers.

For 2013, GFMS indicates 819.6 million oz (I love the precision) were mined, while CPM indicates 741 million oz. That's a difference of more than 78 million oz or more than 10% from CPM's number. My point is to remember that there is no ultimate single source for silver statistics that can be unquestionably relied upon. World silver statistics are not as precise as some imagine. Even more important is to recognize just how little actual supply and demand matters to the price of silver compared to positioning on the COMEX.

Certainly, record breaking sales of Silver Eagles from the US Mint, both on an absolute basis and relative to sales of Gold Eagles have had little bearing on the price of silver. Normally, retail demand does not drive the wholesale price of silver, but neither is it normal for sales of Silver Eagles to be the world's largest single fabrication demand component.

The Mint reported shockingly higher sales of Silver Eagles yesterday, so much so that it appears to me that perhaps a clerical reporting error is involved. (It appears the Mint added an extra million coins in May and subtracted that amount from April sale). Regardless, sales of Silver Eagles year to date (the best measure) have expanded to more than 104 to 1 compared to ounces of Gold Eagles sold. The data will undoubtedly change, but at the time of this article, there were 20.71 million Silver Eagles sold year to date vs. 198,500 oz of Gold Eagles.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

Despite the record sales of Silver Eagles, reports from retail coin dealers do not indicate a surge in retail demand. In fact, reports from the field indicate no big retail silver demand for the past year and longer. Please remember that we have witnessed many instances of strong retail demand over the past several years, particularly for Silver Eagles, to the point of there being long delivery delays and, basically, retail silver shortages. Having had those experiences, it is easy to conclude that is not what is occurring now.

If the public were buying all the Silver Eagles that were being sold, we would see clear evidence of that. It would show in exploding premiums and increased buying traffic for retail dealers. That evidence is lacking. In fact, one of the largest online dealers recently went bankrupt. No doubt Tulving was using new customer funds to pay off old customers and would have failed eventually; but if the record sales of Silver Eagles were reflective of retail demand, I'm convinced the scam would have been perpetuated longer.

I'm still convinced that in the absence of the familiar signs of broad retail demand, a large buyer is responsible at the margin for the record sales of Silver Eagles over the past year and a half. Since JPMorgan is the largest single factor in silver in every category possible, including COMEX futures positioning and deliveries, it is logical to speculate it may be the big buyer of Silver Eagles. This would also explain why JPMorgan has not allowed silver prices to run, as it gives the bank more time to acquire silver in any form.

This is not to say that broad and strong retail demand for Silver Eagles and for other forms of silver will not emerge in the future. The real silver story is so good that it appears to be only a matter of time before retail silver demand kicks in again, along with investment demand for the key wholesale form of silver Â? 1000 oz bars. In fact, the set up for physical investment demand recommencing appears in place given how much investment buying power exists and because silver is the world's most undervalued asset.

A number of subscribers have wondered if JPMorgan or whomever is the big buyer of Silver Eagles is doing so in order to melt the Eagles into 1000 oz bars. Given the minimum of a two dollar premium that would be lost, to say nothing of associated costs for such a conversion, I doubt that is the motivation for buying Silver Eagles. The simple explanation is that Silver Eagles are a great way to hold silver. But I must tell you that I hope I'm wrong, because if Eagles are being bought for conversion purposes, it is hard to come up with a more conclusive case for wholesale tightness and pending shortage.

In the Weekly Review, I indicated that the three days of lower prices since the Tuesday cut-off likely resulted in additional commercial buying in COMEX silver futures. But as I also indicated, it's hard to predict changes for the reporting week when there is a sell-off and a rally within the reporting week and we did see a rally on Monday (today's rally would not be in the report to be issued Friday). Therefore, I'm not sure if some technical fund shorts may have bought back on Monday and if they did, did they buy back what they may have sold thru Friday.

The disappointing thing about the $3 silver rally we witnessed in February was in how Â?gentleÂ? the commercials (raptors and big shorts alike) were in allowing the technical funds to buy back 20,000 short contracts. Instead of $3, it could have been $5 or $10 or whatever higher price the commercials demanded. Make no mistake, the technical funds will buy back 20,000 short silver contracts again and probably soon; technical funds never take or make delivery, they only buy or sell to close out positions. What determines the extent of the coming silver rally (regardless of whether we dip in the interim) is how much the commercials decide to extract from the technical funds.

The interesting differences at this time include a very large concentrated short position of 64,000 contracts (320 million oz) by the eight largest shorts, a very large raptor net long position (44,000 contracts) and a somewhat mysterious extra 10,000 long contracts in the managed money category that can't be held by technical funds. What this means is that if JPMorgan and the 7 other big shorts try to hold silver prices down, their short position must balloon and this will be evident and incriminating. If the raptors don't sell aggressively on higher prices and the big shorts refrain from adding big numbers of new shorts, silver prices could and should explode.

It has been such a long time since silver prices have rallied sharply that to most it feels unlikely to do so now. But silver is a funny market beast in that it more often than not acts contrary to popular opinion. And it always seems to move both much lower and higher than anyone expects. That's why it is important to look at the facts first and not the price. Like the Great Gretsky treated a puck, think in terms of not where the price may be now, but where it will be.

The set up in COMEX futures points to silver prices going as high as the commercials decide they will go. That might include further downside probes by the commercials to uncover fresh technical fund (short) selling, but then again maybe such probes are in the past. Unless and until we see some notable commercial selling and technical fund buying, the most logical approach is to expect higher prices.

Finally, I'd like to close with an email from a subscriber. I'm not much into testimonials and I was hesitant to reproduce this unedited, but I left the compliment in because removing it alters the message. It certainly applies to silver based on everything I see and I thank Jon for the kind words.

Hi Ted.

I've been reading "The Most Important Thing," by Howard Marks. I have read hundreds of investment books over the years and I often find myself substituting silver in place of 'investment' or 'asset' anytime an author presents a strategy or system. I'll bet you find yourself doing the same thing!

In summing up Chapter Four, Marks states:

"Value investors score their biggest gains when they buy an underpriced asset, average down unfailingly and have their analysis proved out. Thus, there are two essential ingredients for profit in a declining market: **you have to have a view on intrinsic value, and you have to hold that view strongly enough to be able to hang in and buy even as price declines suggest that you're wrong.** Oh yes, there's a third: you have to be right."

The part in bold is what you help us with twice a week.

Thanks.

Jon

Ted Butler

May 14, 2014

Silver – $19.75

Gold – $1305

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