May 5, 2011 – Update

Update

Jim Cook from Investment Rarities asked me to write a note for his firm's salesmen about the current state of the silver market. I thought subscribers would be interested in what I wrote for them –

This is quite an unusual and historic time in the silver market. We didn't have financial television back in the Hunt Brothers' 1980 silver episode, but I'm sure there couldn't have been greater coverage than is being given currently to silver. Same with newspaper coverage. It is amazing that despite the great quantity of coverage, virtually all of it seems wide of the mark to me.

There was no bubble in silver and, therefore, there is no bursting of a bubble. Silver did not go up primarily due to excessive and widespread speculative leveraged buying. That's proven out in the only reliable measure of leveraged speculative participation Â? the Commitment of Traders Report. There is undoubtedly speculative long liquidation here, which improves the market structure; but my point is that silver didn't run up because of hot spec money. It ran up for a variety of reasons, including commercial short covering.

Why is it going down so sharply and what happens next? My best guess (from all available data) is that it is going down on margin call liquidation momentum and because of short selling in the big silver ETF, SLV. If I am correct, this type of selling will soon exhaust itself. That means, at some point, this type of selling dries up suddenly and we stop going down. It's hard to measure when that occurs precisely, but it will end suddenly. It is like a crowd of people trying to all rush through a narrow door to sell.

But if I'm correct about the short selling in shares of SLV, then the silver market will not only stop going down, but will rocket to the upside as the new short sellers try to reverse themselves and buy back their positions. I think it probable that we will then have an even bigger crowd trying to get through an even narrower door to buy.

There is no way of predicting the precise bottom of this move; but if I am correct, there is also no way to know how quickly and forcefully we turn up. There is a risk of going lower in price temporarily, as almost everyone understands. But I don't think many fully understand how quickly we could turn up. That means there may be a greater risk of missing a fabulous buying opportunity for fear of further short term declines. Buying silver here is like tossing horse shoes or hand grenades Â? you don't have to hit the exact bottom. In long-term investment, close enough is good enough. I'm convinced we will look back at this time and price in silver and marvel at the opportunity we were given to buy.

Ted Butler

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Silver – $36.40

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