

## November 5, 2014 – Truth and Consequences

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As I start this piece, the price of silver and gold (and other CME Group metals) have plunged to new multi-year lows; silver under \$15.20 and gold under \$1140. The silver/gold price ratio traded above 75 to 1 and another new relative undervaluation for silver. Volume overnight on the COMEX (Globex) was heavy and it would be highly unusual for there not to be margin calls (and margin call selling) from many gold and silver long contract holders. This, of course, is in addition to the pronounced perceived selling from the technical funds in the managed money category of the COT Report.

Even if these technical funds haven't added many new gold and silver short contracts in the new COT reports to be issued (as I expect they did add) their open profits continue to grow. At the price lows this morning, the technical fund shorts had open profits of at least \$800 million in silver and I would estimate an open profit on gold of close to that amount as well. These are record levels of open profits for the technical funds on the short side, particularly in silver.

I don't believe I've mentioned it, but the open profits for the technical fund shorts in COMEX silver is multiples of most historic benchmarks. Not even in the silver price smash of 2013, when silver fell from \$32 to under \$19, did the technical fund shorts achieve higher open profits. That's because their short positions are much larger now. Of course, the certain resolution and the conversion of these open profits into closed out results still lies (dead) ahead. The technical funds must buy back upwards of 40,000 short silver contracts at some point, but the timing and average price they will pay are unknowable at this point.

Make no mistake – these are historic times for silver and gold. Tired of drawing imaginary price points from which I believe silver can't possibly go any lower, instead I can only focus on the reason for the decline and knowing that whatever the low price print may be, it will be a number many will remember for a long time to come. I know all silver investors are struggling with reconciling the reality of the historic decline and why it is occurring. For me, the reasons still seem clear, although the extent of this decline was not fully expected. (Although I think I may have written in the distant past about there being a mother of all silver sell-offs arranged by the commercials in which they got every speculator to sell out or go short as was possible, right before the big price blast-off). Truth is, with the record technical fund short position already in place, I thought we had seen the big sell-off. Then again, such a sell-off, by definition, would need to exceed preconceived extremes.

I received some thoughtful emails from subscribers just this morning who, like many of you (and me), are examining and re-examining the basics of silver in light of the new low price. Johnny wrote that he understood the role of the US Government in the past in disposing of their record silver holdings (5 billion oz) for the 65 years ended in 2000 and how that disposal explained how prices could remain so low for decades despite a structural deficit consumption pattern. But he was having trouble understanding how prices could remain under the primary cost of production for many years on end. Citing the law of supply and demand, he asked if there wasn't some unknown massive stockpile of silver being disposed of to keep prices depressed for so long.

While silver prices have been declining since the peak in 2011, the price did not fall under the primary cost of production until the summer of 2013 and before the sharp plunge of the past few months. In other words, as much as silver prices have fallen over the past three and a half years, it is only relatively recently that prices are decisively below the cost of production for most silver miners. Accordingly, there has been no compelling reason that mine production would be reduced in conformity with the immutable law of supply and demand. But, in my opinion, that has changed with the recent plunge in price.

The new earnings reports for the third quarter are just starting and it is not expected that the earnings of the silver miners will make for good reading to shareholders. Now factor in that average silver prices for the third quarter were north of \$19, whereas they were \$4 lower than that this morning. I'm not joking when I say that if silver prices remain where they are (forget about going lower) for very long, the primary silver miners are toast. This can be seen in the current price of the silver mining stocks. The current price of silver is unquestionably below the average cost of primary mine production.

And let me address something that always crops up at times like this. Invariably, someone pipes up that 70% of silver mine production comes as a result of by-product production from copper, lead, zinc and gold mining and not from primary silver mine production. The implication of which is that there will be no reduction in overall silver mine production at current prices. That is the incorrect conclusion, in my opinion.

At the very least, silver's mine production profile has changed little over the past half-century and longer; so it's not some great new revelation that most mined silver comes from the by or co-production of other metals. The by-production profile, after all, didn't prevent silver from running from \$4 to nearly \$50 in the years before 2011, so why would it be inherently bearish now?

The truth is that silver's by-production profile is neither bullish nor bearish, as it is what it has always been. The correct interpretation is that silver's production profile is inelastic and fairly unresponsive to changes in the price of silver. At times, like now, the by-product production profile of silver does keep metal production level when prices are low; just as silver by-production remains level when silver prices are high. Again, not bearish or bullish, just inelastic to price.

But 30% of silver mine production is primary and that share comes close to 250 million oz a year. With only 100 million oz "left over" and available to world silver investors annually (after industrial and total fabrication demands), it wouldn't take long for cuts in primary silver mining to push us back into a true silver deficit. What's different about this sharp move lower in price is that one silver miner has spoken up and taken action against what he alleged to be a silver price manipulation on the COMEX. Keith Neumeyer of First Majestic didn't have the facts and remedy exactly correct, but the message was certainly on the mark. This is the very first time I've witnessed a silver miner speak out against the silver manipulation and that has the potential for making a profound difference if pursued effectively. With the price of silver falling at least two dollars or more from where First Majestic withheld silver production and urged other miners to do the same, one would think Mr. Neumeyer would feel even stronger about silver being manipulated in price.

And to those primary silver miners boasting of a lower production cost than the average, you are only hurting your shareholders by not speaking up about a manipulation that has become more blatant with every passing day. Either the issue of manipulation exists or it doesn't and should be addressed regardless if an individual miner is losing money or not. Even if a primary silver miner can manage to produce at a profit while others can't, that's no reason to look away, as the manipulation is at the very least preventing full profits from accruing to shareholders.

As far as Johnny's concerns of massive unknown stockpiles of silver existing and being used to manipulated prices indefinitely, I understand that is as a result of the extreme sell-off. When prices move in an extreme counterintuitive manner, it is normal to question one's premise. The only way a silver investor wouldn't question what's going on is if he were on life support or worse. But that demands an even further reliance on the known facts and that which can be documented.

I don't compile and publish statistics on silver; I rely on the same sources and statistics as I have for the past three or four decades. I often have different opinions and interpretations than others about what the accepted data may mean for the price, but you'll rarely, if ever, see me arguing about the validity of the data. Now, more than ever, the accepted data on silver supply and demand from the usual sources (GFMS, CPM and mining companies, publicly traded ETFs and exchange statistics), as well as government published data (the COT reports), must be relied upon. Start second-guessing the accepted data and substituting wild speculation in its place is a sure path to losing one's way.

Besides, it's not necessary to rely on the unknown to explain why there is such an upheaval in the price. The facts of silver's supply and demand are well-known and easily substantiated. There are one billion ounces of silver in the world in the form of 1000 oz bars; the form desired by industrial users and large investors. At current prices, that comes to little more than \$15 billion, or an absolutely tiny amount of money on any legitimate basis or comparison. There are one billion oz in total annual silver production, including mining and recycling, but only 100 million oz of silver are left over and available to the world's investors, or \$1.5 billion. In addition, physical silver has been moving in and out of the COMEX warehouses at a rate never witnessed before in any commodity to the point of indicating an extreme tightness.

There has been little to no net selling of real silver from any known (or unknown) source and all the data indicate net buying or holding (Silver Eagles and ETF flows). The only selling of silver that can be confirmed is the selling and short selling by technical funds on the COMEX over the past few months. At a minimum of 50,000 contracts (250 million oz), the selling by no more than 40 speculative traders in the managed money category equals the entire world production of the primary silver miners.

It is not necessary to imagine unknown sources of silver selling when the US Government has openly certified that no more than 40 speculative traders have sold in a few months more than what the world's primary silver miners produce in a year. Quite frankly, were it not for this certification, I couldn't begin to explain this sell-off in silver or in any of the other CME metals. I'm not talking about predictions and speculation; I'm talking about the only explanation possible.

Because the technical fund selling is the only possible explanation for recent price behavior, it is necessary to focus closely on this certified phenomenon; failing to do so misses everything important in silver. Even put aside my contention that the technical funds have been lured onto the short side by the collusive commercials, led by JPMorgan. Why the technical funds have sold record amounts of silver short is separate from the undeniable fact that they have sold such amounts. I'll admit that the technical funds have sold short more COMEX silver contracts than I ever imagined and that's why prices are lower than I would have imagined. How much more they can sell from here can only be known in hindsight.

In addition to the firm knowledge that the technical funds have sold the outrageous amounts certified in the COT reports, driving silver prices below the cost of production and any free market price level, another certainty exists – all of the short silver contracts added by the technical funds since July must be bought back at some point. Short (and long) positions in COMEX futures contracts must be closed out at some point by delivery or by an offsetting purchase (or sale). In the case of the technical funds' short positions, the delivery option does not exist since the technical funds are not capable of delivery of any meaningful amount of physical silver.

Please allow me to state categorically that there is no "cash settlement" option on any COMEX futures contract where the long holder of any silver contract demands delivery and puts up the necessary funds. If a long futures contract holder advances the money, the physical delivery must occur; otherwise a contract default will occur. Such a delivery default would, in effect, lead to an abandonment of trust in the COMEX as a viable venue for any type of trading and lead to litigation and the ultimate closing of the exchange. They don't call them futures "contracts" for nothing.

Therefore, it is certain that the technical fund shorts in COMEX silver must buy back their short contracts. When and at what price may be unknowable, but the buying is certain. If silver prices remain low enough through the coming big December delivery cycle, it is possible that the technical funds will "roll-over" their open short contracts to a more deferred COMEX delivery month, but that just delays the inevitable buying back of the short contracts; in no way does rolling over render the buy back as unnecessary. I'm still convinced that technical fund buying to close out their massive short positions will result in a price surge for silver and other CME metals and my conviction will be shown to be right or wrong in the relative near term. There's nothing imaginary about the current setup and the limited manner in how it will be resolved.

As promised, here's the interview I did with Chris Martenson last Friday.

<http://www.peakprosperity.com/podcast/88558/ted-butler-silver-nightmare-will-over-soon>

Ted Butler

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Silver – \$15.46

Gold – \$1145

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