

A Blast From The

Past<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

A few days ago, I came across an Internet article which was claimed to be written recently by me. Certainly, the article was written by me, but not recently; I wrote the article more than 6 years ago. I don't spend much time reading my old articles, preferring instead to concentrate on analyzing new developments in the silver market. Besides, I confess to have written so many articles about silver that there is little time to read them all. But the re-posting of this old article prompted me to read it again.

It's a rather long article, but I think subscribers will benefit from its reproduction here. For one thing, I think it is important that analysts be judged on what they have written in the past. There's no better way to do that than by reading for yourself what was written previously. It's also important to try to recreate the overall environment in which the original article was written.

In this case, I ask you to try to appreciate the context of the time that I

wrote this piece originally. In June of 2004, some powerful undercurrents were in force in the world of silver. For one, the big COMEX concentrated silver short position was in the process of being transferred from AIG to Bear Stearns, I believe thanks to the behind-the-scenes pressure from then-NY Attorney General Eliot Spitzer. Many will remember, hopefully, the grass-roots effort back then on the silver manipulation. (By the way, most of this is in the archives section, as is the article attached today). Of course, there was no way of knowing back then that the transfer to Bear Stearns was occurring, as that name never was visible until the JPMorgan takeover in 2008. But it is amazing how little my basic story line of silver manipulation has changed over the years. New details emerge as they become known, but that new knowledge never alters my basic premise.

One very important undercurrent back then was the release, a month earlier, of the public response by the CFTC to the many hundreds of letters that were written to the Commission at my suggestion about the concentrated silver short position. Of course, the CFTC response denied any manipulation was present in the silver market, as had all previous and future official responses. The CFTC letter was particularly insulting to me on a personal basis, as even though the Commission didn't use my name, the letter concluded with a warning to be careful of my motives, as my message may be replete with half-truths. You

can read the complete response here

<http://www.cftc.gov/files/opa/press04/opasilverletter.pdf> **The official response seemed to warn of buying silver at current prices. The price of silver on the date of the CFTC response and when my article was written? \$5.70. I was pounding on the table for the purchase of silver at \$5.70, based upon the numerous factors listed below and the CFTC was telling the public to be careful of my motives. I'll leave it to you to decide who was telling the whole truth.**

TED BUTLER COMMENTARY

June 14, 2004

\$200 an Ounce Silver? □ Can it Happen?

By Theodore Butler

The other day Jim Cook, the president of Investment Rarities, asked me a question that set me back. "How high do you think the price of silver could get?" I started to answer that, as an analyst, I don't like to throw out price targets, but prefer to dissect the underlying facts and conditions in the silver market. Those facts and conditions will tell us

when silver is overvalued. Certainly I felt the current price was undervalued and I started to explain.

But he cut me off, by asking, “Do you think it could hit \$200 an ounce?” I answered, sure it could. And not only that, I continued, it could hit \$500, or \$1000. Then he asked me, “Why don’t you write about that?” At first, I said I wasn’t interested in weaving tales about sensationalized prices, as I preferred to stick to bedrock analysis and let the price unfold as it may. And previously I had written about \$50 or \$100 silver. I told him, even if silver “only” doubled, or tripled, or quadrupled, it would be a phenomenal return, especially considering the low risk at the low price of the past few years. Even a modest price rise would prove that our efforts to spread the silver story were sound and true.

But then I realized that Mr. Cook was right. If I had good reasons to back up possible extraordinary future price projections for silver, why not write about those reasons? So I have decided to do so. However, I’d like you to put what I write into proper perspective. I’m going to write about possible future scenarios in silver for one main purpose - to get you to think and prepare for what may be extraordinary price upheavals in silver in the future. The idea is to consider the possibilities, and the reasoning behind them.

I don’t normally dwell on possibilities. In silver, it’s easy to focus on probabilities and certainties like deficits, disappearing inventories and

the law of supply and demand. I see things like verified short positions and the existence of leasing and a price out of line with all other commodities. With ultra-low risk and what I believe to be a free market guarantee of eventual higher prices, why resort to what many would label outlandish price predictions? I'll tell you why - for the simple reason that those outlandish prices just may be coming, and it would be negligent of me not to discuss them beforehand. Before you scoff at \$200, or \$500, or even \$1000 an ounce silver, please hear me out.

Let me first tell you what I am not including as reasons for triple or high triple digit silver. I am not talking about the end of the world, or the destruction of the dollar or other currencies. I am not talking about silver as money. I am not talking about virulent inflation where you see \$200 silver, along with \$50 for a loaf of bread or \$10,000 for an ounce of gold. While I can't guarantee that those things won't take place, they are not among my reasons for triple digit silver.

I suppose that if the world's monetary affairs go to hell in a hand basket, those holding real silver would be protected. But that's not the basis for my silver recommendation. Bad things may happen in the future, but I refuse to dwell on them or promote them as reasons for owning silver. To me, silver is a "good news" metal. Its many and varied uses are all about making man's condition better and improving standards of living. I'm a commodities guy and an optimist. I won't advocate silver based on bad things happening that cause price

appreciation. Life is too short. The great news is that nothing bad has to happen for silver to hit \$200, \$500, or \$1000.

At the epicenter of reasons for launching silver to the heavens is the coming end of the silver manipulation. This has been my central theme for many years. Despite denials and protestations to the contrary by many, it remains obvious that silver is not priced properly. There is no legitimate free market explanation for such extremely depressed prices in the face of such spectacularly bullish fundamentals, namely, a structural deficit and depleted world inventories. Only manipulation could explain such a perversely low price compared with the real fundamentals. The good news is that since this manipulation is dependent upon the continued uneconomic dumping of government inventories (from the People's Bank of China), it is just a matter of time before those finite supplies are exhausted, and the price of silver is set free.

The end of the manipulation may kick off a whole host of related reactions. You can't keep the price of anything artificially depressed or elevated for decades and not expect violent counter moves when the artificial restraint or prop is suddenly removed. History bears this out. So it is logical to assume that when the silver suppression ends, we will get a severe jolt to the upside. As I have long maintained, it is the manipulation itself that creates the exceptionally low risk and high profit potential. When the manipulation ends, we must move to a price

point where supply and demand balance without government inventory dumping. Considering how long silver has been kept depressed, it will take an extremely high price to balance supply and demand.

But this is old news for regular readers, and not the point of this article. Under normal conditions, I do not think it would take \$200+ silver to balance the deficit. It would take a much lower price. However, it's unlikely that normalcy will prevail in the future. There are certain factors that could come into play that could vault silver, in the years ahead, to truly shocking price levels. Just as we have remained grossly undervalued in silver for decades, it is very possible that, in the inevitable move to a market equilibrium price, we could overshoot dramatically to the upside, even if only briefly. There are several factors in place, all unique to silver, that could account for unthinkably high prices.

At the heart of the unique set of silver factors is one common denominator - human emotion and group behavior. People are motivated by price. Ironically, it is only high and rising prices that causes great numbers of people to buy in unison. Low prices discourage mass buying. (That's why silver is not on the mainstream radar screen yet.) If you study the history of investment extremes, or bubbles, it is the rising price itself that is at the heart of the cause for the move. The big problem is that the masses, excited by the price

rise, come in late and stay too long.

I think silver is a prime candidate for a future price explosion that is historic and worldwide in scope. Given its universal usefulness, appeal and stature, and its current low price, any significant price movement is likely to excite the world investment community. Its long term depressed price means that less than 1% of the people currently hold silver. No one knows if a silver price bubble will develop, but here are the reasons why it could.

1. A Short Squeeze On The Futures Market

For 20 years, there has been an outsized silver short position on New York's Commodity Exchange, Inc. (COMEX). This paper short position has been unique, in that no other commodity but COMEX silver has had a futures and options short position larger than world production and world known inventories. This has been one of the keys as to why silver has been depressed in price. But shorting is a two way street. While the shorts have had their way with the price of silver for a long time, when those shorts are bought back or covered, the price effect of shorting is reversed and it becomes bullish.

A shortage of real silver would cause the shorts to buy back their positions. We are seeing signs of delay in physical deliveries, a precursor to shortages. Also, before a short-covering panic develops, we should also see signs of a reluctance to take on additional shorting

by the commercial dealers. Those signs are emerging. In fact, there could be sharp upward movements in the price of silver on just the lack of new shorting.

Actual, panic-driven short covering hasn't been seen in the silver market for more than 20 years, due to the ironclad control on the market that the dealers have maintained. A short covering panic appears unavoidable at some point, because the size of the short position, measured in the hundreds of millions of ounces, dwarfs comparable known real deliverable inventories. If this uniquely large silver short position on the COMEX enters into a panic covering phase, it could create triple digit silver all by itself.

2. Leasing Repayment Demands

The second component of what has been a 20 year silver manipulation is the fraudulent practice of metals leasing/forward selling. Under the guise of hedging, actually silver metal was removed from various central banks and sold on the open market. This was how we could have a deficit for decades with no increase in the price and no actual shortage of metal. I would estimate many hundreds of millions of ounces of silver, perhaps over a billion ounces cumulatively, were dumped over the past two decades due to leasing. This silver dumping was structured as a lease (even though it was a pure sale), with the silver due to be returned eventually to the central banks from which it originally came. The problem is that this silver was industrially

consumed, and therefore, no longer exists in bullion form that can be returned.

While it appears to be a physical impossibility for the central banks' leased silver to be returned, that doesn't mean some individual central banks might not press for the return of their silver. If this occurs, it would set off a buying spree similar to the paper short covering on the COMEX. The main difference is that demands to return leased silver would involve physical buying, rather than the paper buying on the COMEX. Make no mistake; this leased silver represents a separate and unique short position that exists in addition to the COMEX short position. Because it would represent physical buying, rather than paper silver purchases, any attempted buyback of leased physical silver would have a much more potent impact on price.

In fact, it is my opinion that there will be no return of any central bank leased silver because they can't get the silver to return. They won't even try to get their silver returned. There will be negotiated resolutions involving some type of cash payment. (It will be quite bullish for the market just to see an end to leasing.) In the event I am wrong, and some individual central bank presses for the physical return of its loaned silver in sufficient quantity, this factor alone could account for \$500 silver.

Even if the central banks quietly accept negotiated cash settlements in lieu of their actual metal being returned as required, that does not

mean all the parties to this fraudulent leasing experiment will escape. The parties who borrowed and agreed to return the silver (miners, users, and bullion banks), all have unknown liabilities in a leasing crunch. Any number of them could panic and try to buy themselves out of these toxic derivatives. And the central banks, who leased out the silver that can't be returned, will certainly try to get as strong a financial settlement as possible as compensation for the loss of their metal. That compensation will be based upon the price of silver. That also will determine the liability to the borrowers of the leased silver. Astute borrowers will look to limit their liability by buying silver, which means more buying pressure.

3. Industrial Users Panic

Silver is used in thousands of industrial applications. In fact, aside from petroleum, silver is used in more applications than any other commodity. Unlike petroleum, the amount of silver used per application, while vital to the finished item, is a tiny percentage of the item's total cost. For this reason, silver is considered to be price-inelastic for much of its industrial demand. This means that industrial users will not readily substitute other materials for silver in a price rise. If the price of silver jumps significantly, they will be more inclined to build inventories than eliminate silver.

But it won't be price alone that causes industrial users to rush to build silver inventories. It will be availability that could set off a panic. The

25-year experiment with Japanese-developed “just-in-time” inventory management has caused the inventories of all commodities and materials to be sharply reduced. Thanks to computerization, modern manufacturing and transportation efficiencies, holding extra inventories has become expensive and old fashioned. If a manufacturing or transportation disruption occurs, industrial production is more threatened by having lean inventories.

It is not just normal silver production or transportation disruptions I am referring to, but something else. Since we are in a pronounced and documented deficit, silver shortages must come at some point. It is a miracle that it hasn't happened yet. When the inevitable silver shortage hits the industrial users, it will be only a matter of time before some will try to protect themselves from those delays (and price increases). They'll do this the only way they can - by buying extra silver as a buffer. They will build, or attempt to build, inventories of silver that they never held before. This is a logical reaction to silver delays and price increases. After all, you don't risk the shutdown of an assembly line for want of a single, low-cost component.

The problem is that what may be reasonable for one industrial user puts pressure on the silver supply. As individual users try to immunize themselves from assembly line shutdowns by buying more real silver for inventories, other industrial users are automatically denied silver. If extraordinary demand for inventory building by some users occurs, it

will make the supply tighter for other users.

This is how panics occur. The price of palladium rose to over \$1100 an ounce because industrial users (mainly Ford Motor Company) panicked and built inventories, because they feared they would have to shut their assembly lines due to a lack of palladium. Silver is used in many more applications than palladium. That increases the chance that silver users will panic at some point and try to build inventories. If a user inventory panic does develop, there is only one known cure - it must burn itself out at extremely high prices. I have a hard time envisioning how a user inventory panic doesn't occur at some point. Whether we're talking about individual investors or corporate buying agents, all are subject to similar emotions and fears.

4. Unbacked Silver Bank Certificates