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

Both gold and silver largely erased last week's price gains, as gold fell $38 (2.3%) and silver declined 85 cents (2.6%). A rally on Friday moderated what were steeper losses through Thursday. As a result of the relatively equal performance, the gold/silver ratio remained unchanged at just under 52.5 to 1. The daily price volatility has remained quite pronounced in each, although we have stayed within the trading range created after the vicious three day price smash of last month, the second 30% manipulative take down of silver within six months. From the start of this year, gold is still ahead by a bit over 15% and silver is just barely positive.

One of my consistent themes is in trying to put things into perspective in order to gain as objective a reading on silver as possible. The enemy of an objective perspective is emotion. Since emotion is a basic human condition, there is a constant struggle to control our emotional reactions in being objective. Nowhere is this truer than in investment matters. Money and emotion are quite a combustible combination. The principle driver of emotion when it comes to investments is price change or volatility, particularly unusually large price change. Since silver has demonstrated unusually large price volatility recently, it is only natural that emotions should be running strong presently. The stronger the price change, the greater the emotional reaction – and the greater the need for proper perspective.

One observation about price and investor emotion is that lower prices, especially sharply lower prices, make people more fearful. The converse is that sharply higher prices make most people less fearful and more confident (greedy). Since we know it is better to buy low and sell high than the reverse, we must condition ourselves to fight our emotions in order to do that. When prices are falling all the bearish arguments sound reasonable; when prices are rising only the bullish arguments make sense. We can't rely on our feelings alone because then we would always be buying high and selling low based upon the latest price action. The only way to deal with emotions brought about by volatile price action and hope to achieve a proper investment perspective is by objectively analyzing the known facts. If emotion has little constructive role in investing, then it must be overcome by common sense and reasoned analysis. If successful investment only required doing what felt right day to day, we'd all be billionaires.

Please accept this preamble as my attempt in this review to address what I believe is a time of high emotion in the silver market necessarily brought about by the recent price volatility. In fact, given the price volatility in silver, if you weren't somewhat emotional there may be something wrong with you. What I hope to do is touch on some questions that have been raised about silver due to the recent sharp price declines. Because the questions raised are somewhat varied, it may feel at times that this report may read on a scattered basis. I'll try to smooth that out as much as possible by sticking to the usual format.

Conditions in the physical silver market still appear tight. Turnover, or the actual physical movement of metal in to and out from the COMEX-approved silver warehouses, continues active even though the total amount remains fairly constant (at around 106 million oz). This silver turnover is much different from years' past and not at all present in any other NYMEX/COMEX metal. The most plausible conclusion for this unusual silver turnover is that the wholesale market is tight and operating on a hand to mouth basis.

There was an outflow this week from the big silver ETF, SLV, of around 3.6 million ounces. With price action and trading volume fairly subdued, I'm inclined to conclude that much of this week's metal withdrawal was not plain vanilla investor liquidation, but rather removal of metal because it was needed more urgently elsewhere. Obviously, if I am correct, this would be another indication of physical tightness. I'd like to raise another point regarding SLV. Back during the first 30% manipulated price smash in May, some 50 to 60 million ounces were liquidated by investors and removed from the Trust. (Yes, I still believe that metal remains in strong hands). During the recent 30% price smash of a month ago, there has been no net reduction in metal holdings in the SLV. That's pretty striking to me. I realize that the recent takedown has resulted in more than a 10 million share/oz reduction in the short position in SLV shares (as intended), but it still stands out that there was no big outflow of metal from the Trust this time around as there was after the May price smash. My conclusion is that most of the weak hands in SLV had already been flushed out on the first sell-off and there was less to liquidate this go around (aside from share short covering).

Sales of Silver Eagles from the US Mint trailed off a bit towards the end of this reporting week, but the Mint's reporting can be somewhat erratic. Still, we already are at the highest level of annual sales of Silver Eagles ever, with more than two months yet to go. There is also no question that relative to the companion Gold Eagle sales, the Mint is selling more Silver Eagles compared to Gold Eagles than at any time in the 25 year history of the program.

The question of retail demand and silver shortages (both retail and wholesale) comes up constantly, particularly when silver prices have declined sharply. Certainly, as discussed above, lower prices have a way of legitimizing bearish arguments. Let me try to put each issue in perspective. As far as retail sales, the recent 30% price decline did result in an immediate surge in demand that now seems to be moderating. This moderation in demand is being suggested by some as being permanent. I would disagree. Investment demand, despite my suggestion to fight emotions, is invariably driven by higher prices. When higher silver prices develop, so will stronger investment demand.

But I would like to raise some other points. For one, aside from the immediate flush out of leveraged longs on sharply lower prices, those same lower prices greatly discourage existing holders to sell. In other words, lower prices may choke off investment buying, but they also choke off selling at some point. We may have lower investment demand at the moment, but we also have little real selling (away from the crooked HFT paper variety on the COMEX). This creates a void or vacuum in the market that invariably results in eventual higher prices, if the fundamentals are sound. Any reasoned analysis of silver reveals that the fundamentals are more than sound.

The second point is that a temporary lull in investment buying combined with a lack of real selling does nothing to replenish the supply lines. If we are near shortage conditions in silver as I believe, both on a retail and wholesale basis, any lull in investment buying only camouflages shortage conditions in the short run. As soon as investment buying returns, the real tightness or shortage becomes apparent. What prompted this thought is a conversation with a large retail dealer who was simultaneously complaining about softer sales but with concurrent warnings from suppliers that if demand did exist they would not be able to meet it. The supply lines in silver may be wide, but they are not deep.

On a wholesale basis, I believe this can be seen in the data surrounding the

SLV, as described above. Demand for silver was so strong this year that it was necessary for sellers to sell short 37 million shares (oz) in the SLV because they couldn't come up with the actual metal. Without this short sale, silver would have climbed past $75, as I have concluded previously. Now that the manipulators have broken the price, not once but twice, by 30% this year and caused a liquidation of 50 to 60 million oz from SLV after the earlier price smash, we have seen no further liquidation in SLV on the recent 30% smash and the short position in SLV has only been reduced to 20 million shares/oz, still much higher than when we began the year (12.5 million shares). Here's my bottom line □ two 30% manipulative price smashes have left the silver market down, but far from out. The speculative bullish froth has been wrung out (even though it was never that pronounced) and still we are where we began the year in terms of price. However, we are much closer to a flat out shortage, as evidenced by the necessity of the short sellers to be short 20 million oz in the SLV, instead of just depositing the metal as was always accomplished previously. These short sales can temporarily mask an actual shortage, but the operative word is temporarily. In fact, in terms of the law of supply and demand, the artificial price depression brought about by the fraudulent and manipulative short selling (in SLV and on the COMEX) will accelerate the onset of a silver shortage. Granted, it doesn't feel that way when the COMEX commercial crooks smash the price, day after day, but feelings are not actual data.

There was a further improvement in the market structure of both gold and silver, as indicated in this week's Commitment of Traders Report (COT), as the total commercial net short position was reduced in each market. In silver, the total commercial net short position was reduced by a bit over 2000 contracts, negating last week's increase and putting us again at the lowest (most bullish) commercial net short position in eight years. While some fret about a repeat performance of late 2008, in COT terms, we've already exceeded 2008. The raptors bought over 1200 contracts, increasing their net long position to 19,300 contracts, while the big 4 (read JPMorgan) bought back a similar amount of shorts (the 5 thru 8 largest traders added a few hundred to their net short position). The big 4 (JPMorgan) now hold the lowest net short position according to data available to me (at under 29,000 contracts), with JPMorgan's share on the order of 14,000 to 15,000 contracts.

The total commercial net short position in gold was reduced by 9300 contracts to just under 160,000 contracts, another multi-year low. The standout feature in this week's report was that the big 4 accounted for all the decline, as they bought back more than 11,000 contracts, reducing this concentrated short position to the lowest level in a few years (although not as far back as silver). Based upon weak price action after the cut-off on Tuesday, there was likely some further reduction in the total commercial net short positions of both gold and silver. Recently, I have characterized the COT set up in both gold and silver as being spectacularly bullish. This report doesn't change that. It is always possible for the commercial crooks to rig prices lower still, thereby further improving the bullish COT set ups, but previous history shows that the big price moves that come out of such current readings will undoubtedly be up, short term timing aside.

I'm still inclined to think that JPMorgan is in perfect position to buy and cover more of their manipulative silver short position to the upside, by buying from the raptors. So far, JPMorgan and the silver raptors have behaved as they have in the past, by collusively buying from the non-commercial and non-reporting trader selling that was created by HFT and other dirty trading tricks. While lower prices have caused stress and feelings of doubt among silver investors, a cold look at the facts indicate that the commercials have been gorging themselves by buying everything they have been able to scare from liquidating longs. I know it feels improbable given the recent rotten price action, but the commercial buying actually greatly enhances the chance of a strong move up in price. That's the basic difference between how the market feels and what the evidence indicates.

This has everything to do with the psychology of price. Put the price down and everything looks bearish; put the price up and everything looks bullish. With the price of silver down, our perspective gets altered; we put on the bearish sunglasses. We question industrial demand, imagining silver being used in smaller quantities, although the evidence only exists in our minds. If anything, the industrial uses for silver in electronics would appear to be exploding around us with new electronic device demand continuing strong. Yes, real estate and construction are in a funk, but people still camp out to get the latest Apple product.

By looking at silver through the bearish price sunglasses, we overlook some real constraints in place on the supply side. Despite being at price levels previously thought that would open new mines on a daily basis, in reality silver mining output growth has been stagnating. Despite prices that for sure would have caused silver to come out of the woodwork for scrap melting, we all still await the great melt to come. Certainly, as expressed above, there has been no net unloading by long term silver investors, despite prices having risen eight fold in as many years. My sense is that these investors are more inclined to buy more and not sell at current price levels. As soon as the fear of immediately lower prices evaporates, my guess is that the buying will commence.

In Wednesday's article, I discussed the historic vote by the CFTC to approve hard position limits in silver and other commodities for the first time in decades. I characterized the vote as bullish long term for silver, although I was an agnostic on how prices would react short term. I still feel that way and will have more to say on position limits in the future. However, I have not taken leave of my senses and I fully recognize that the silver manipulation is still with us and that we are confronted by a genuine crime in progress. With position limits now having passed, I intend to explore and attempt new measures for ending the ongoing crime. Undoubtedly, I will be calling on you to help with those new measures. I would ask you to consider the vote on position limits as but one step in ending the silver manipulation. I'm more convinced than ever of the price prospects for silver and the inevitability of the manipulation's demise. A new development may auger well for those objectives.

The US Senate, by unanimous vote, confirmed Mark Wetjen as a new commissioner of the CFTC. This represents the first change in the composition of the Commission in two years. There has been much change with commodity regulation over the past two years, perhaps the most ever. More change will undoubtedly occur in the future. Hopefully, Commissioner Wetjen will help bring about change that will benefit the markets and serve the public interest. He replaces Commissioner Michael Dunn who left the Commission on the highest note possible, by voting for position limits. I think Chairman Gensler's announcement struck the right tone
http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement102111

You never know what to expect from a new commissioner. Commissioners are appointed by the President and confirmed by the Senate to be independent voices in running the affairs of the agency to which they are appointed. While appointed along political party lines, in my experience, it is often wrong to assume you can judge how a new commissioner will perform or vote based upon past credentials and background or political affiliation. Sometimes we (the public) get lucky; other times not so much. More than anything, it will come down to how the individual speaks and votes on the important issues; actual performance being the only true measurement. On that basis and in my opinion, the public interest has been well-served to date by Commissioner Chilton and Chairman Gensler. As I recall, there was nothing indicating beforehand how Chilton would perform and in the case of Gensler, much to indicate that he would never stand up against the interests of the big banks, given his past efforts on deregulation and Wall Street background. Even after the position limit vote, I suppose many will assume he is still in the back pockets of the big banks. Here's to wishing Commissioner Wetjen a tenure in which the public will be well-served and he will highly distinguish himself.

Ted Butler

October 22, 2011

Silver – $31.40

Gold – $1642