

## October 27, 2012 – Weekly Review/Central Bank Gold

### Weekly Review

Gold fell for the third week in a row by \$8, while silver managed to finish unchanged. The silver/gold ratio finished just under 53.5 to 1, about the midpoint of where this ratio has traded over the past year and even over a much longer time frame. Although it has been customary and usual to have been able to switch one ounce of gold for 50 or more ounces of silver over the past few decades, the facts suggest to me that one day we will marvel at the large quantity of silver currently generated by the switch. Later in this review I'll try to present another reason why the current price ratio offers an unusual long term opportunity to switch gold into silver. Short term, I'm still uncertain.

Even though prices were largely unchanged this week, the subdued price volatility still belies the extreme cross-currents beneath the surface. Price movement on a short term basis is mostly random in my opinion, but at some point we will get resolutions to some of the forces in place in gold and silver, including that of the extreme market structure on the COMEX. In other words, price volatility still looks like it will erupt at some point, but I am less sure of which direction, as I am on the silver/gold ratio. The long term has rarely looked better.

The turnover among the COMEX-approved silver warehouses abated from that of the previous two weeks, but remained very high on any other longer measurement. Some 2 million ounces came into and out from the COMEX warehouses this week, as total inventories fell almost 700,000 oz to 141.8 million oz. Remember, the total levels are less important to me than is the turnover. It is the rapid and persistent silver inventory movement that is indicative of physical tightness. After all, who goes to the expense and hassle of shipping metal around if it were not mandatory? The most plausible explanation for the silver movements is tight market conditions. Since a physical shortage will launch the price sharply higher, anything suggestive of a shortage is important. I haven't noticed widespread attention to the persistent COMEX silver inventory movement over the past 18 months, but neither have I heard of any more plausible explanation for it than it being due to tight, hand to mouth supply conditions.

The new stock short interest report, for positions as of Oct 15, indicated a fairly large increase of almost 3 million shares (oz) in SLV, to over 14.6 million shares.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99> This follows a decrease of 1.5 million shares in the previous report, which was somewhat surprising at the time. While the new total level of SLV shorts is within the recent confines and well off the high levels of the past, I have little doubt that the shares were sold short as an alternative to depositing physical silver into the Trust. While the quantity of silver ounces held short in SLV is a fraction of the ounces held short on the COMEX, there is a sort of multiplier effect to silver shorted via SLV in that the shares are shorted to avoid buying physical silver, where on the COMEX, it is paper buying versus paper selling (the concentration issue notwithstanding). SLV shorting must still be monitored, despite my continued doubts about the provider of the data, the Depository Trust Clearing Corp.

The headline numbers in this week's Commitment of Traders Report (COT) declined as forecast, but not nearly by as much as I expected, especially in silver. After all, we did experience notable declines in price during the reporting week (\$35 in gold and \$1.5 in silver) while penetrating the key 50 day moving average in both gold and silver. This is a text book circumstance for the technical fund selling and commercial buying that always results in a lower total net commercial short position. We got the expected lower commercial short totals, just not to the degree expected.

In gold, the total commercial net short position declined by 14,700 contracts, to 232,700 contracts, the lowest level since Sep 4. Coupled with the previous week's 19,600 contract reduction, the combined two-week commercial net short reduction of 34,300 contracts might seem significant were it not for the 133,300 contract commercial short increase build since July 24. If we were to return to that level of a commercial net short position (not a prediction), there would still be 99,000 net contracts to go. The surprise in the gold COTs (silver too) was that we didn't see more of a commercial short reduction, particularly since the 50 day moving average was penetrated to the downside for the first time in months.

By category, the 14,700 contract reduction in the commercial net short position was accomplished by the gold raptors buying back nearly 8000 shorts, followed by the big 4 buying back 5000 and the 5 thru 8 buying back the balance. This is the sixth week in a row that the gold raptors (the smaller commercials apart from the 8 largest traders) have aggressively bought back shorts whether gold prices rose or fell – a most unusual circumstance. Having commented that these gold raptors may have overstepped their resources by going short a record 55,000 gold contracts on Sep 11, I can't help but think that some of them were in big trouble as gold continued to rise in price after that date. I still think that on the next gold rally, these gold raptors will not be aggressive short sellers, whenever that rally comes, since they just had a real scare. This will remove some of the commercial price capping and put more burdens on the big 4 to sell short in the raptors' absence. Of course, this is all secondary to the question if we will fall further in price first.

In silver, the total commercial net short position only declined by 1600 contracts, to 55,500 contracts. I say "only" because the price decline of \$1.50 during the reporting week also included three daily closes below the 50 day moving average versus only one such close in gold. There "should" have been more commercial short covering in silver given the price pattern. All commercial categories bought in silver, with the raptors adding 900 contracts to their net long position (3300 contracts) for the first time in 4 weeks. Admittedly, these are not big numbers but it may suggest that the raptors are still interested in buying silver contracts below the 50 day moving average. This would seem to confirm my recent speculation that the raptors will provide some buying competition to JPMorgan on any further takedown in silver prices. The raptors will likely be collusive in trying to rig prices lower, of course, but may provide buying competition nonetheless.

By my calculations, JPMorgan holds 32,500 contracts net short, down slightly from their recent peak of 34,000 contracts. Because there was an increase in all three categories of spread positions in this week's disaggregated COT, the total net open interest for COMEX silver futures was reduced to 98,691 contracts when spreads were removed. This means that JPMorgan's 32,500 contract concentrated short position is still 33% of the total market. Let me just take a short time-out here to try to put this obscene market share into perspective.

The real reason I can get away with labeling JPMorgan as crooked and have the bank remain silent is because a 33% market share by one participant in any futures market is against every concept of commodity law and US antitrust policy intent. Do you remember past days of the discussion of position limits and how disappointing it was when the CFTC ignored thousands of public requests for a position limit of one percent (of either world production or total open interest) and established a formula instead calling for 2.5%? The agency further wimped out and sided with the CME in goosing the formula to as much as 5% for markets the size of COMEX silver (how convenient). Please think of those proposed numbers — 1%, 2.5% and 5% and compare them to the 33% that the crooks at JPMorgan now hold in silver. And just so I'm clear, without JPMorgan's manipulative position in silver, the price would now be well over \$100 right now. It is not possible to make that assertion in any other market.

The big question is still how will the extreme COT structure in COMEX gold and silver be resolved? The lack of big technical fund long liquidation so far does raise the possibility that it may play out differently this time and we won't get the flush out to the downside. Then again, that technical fund liquidation may have been merely delayed and is yet to occur. I don't know. How one uses the COT structure is personal. Long term silver investors should largely ignore it, save for minor adjustments like timing additional purchases when the readings are extremely bullish or trimming positions when the readings are the opposite. Long term investors should not get all-in or all-out just because of the COTs. But for me, as an analyst, it is somewhat different. I can't pound on the table when the COTs are extremely bullish and ignore them when bearish; that would eliminate the purpose for following them at all. Analysis is not the same as cheerleading. Away from the COTs and the manipulation, however, there are reasons to expect eventual silver prices that any investor could cheer.

## Central Bank Gold

As a silver analyst who tries to rely on public data combined with a logical approach, most often I find myself thinking about the same information available to all, but sometimes forming an unusual interpretation. It's been that way since the very beginning, back to when Izzy Friedman first challenged me to explain silver's low price in the midst of a documented supply deficit in 1985. Looking at the known data from different perspectives can yield interesting conclusions.

The most recent news in the precious metals community has been centered on reports of potentially "missing" central bank gold and calls for repatriation of the metal to safer quarters, particularly in Germany. There are suspicions that not all the reported central bank gold is actually on deposit due to concerns that much has been "leased" out. The leasing of gold and silver has been a topic of interest for me for more than 15 years. In fact, I first started writing ~~on the Internet because of gold and silver leasing. From the get go, I labeled such leasing as one of the most destructive and idiotic creations from Wall Street, even comparing the concept to the movie, "Dumb and Dumber"~~ <sup>Fundamental and Expert Analysis of the Gold and Silver Markets</sup>

[http://www.gold-eagle.com/gold\\_digest/butler816.html](http://www.gold-eagle.com/gold_digest/butler816.html)

Today, precious metals leasing is largely a thing of the past, as one of the main participants in the leasing scam, the mining companies, have abandoned the practice. I'd like to take credit for being among the first to write about the follies of leasing and convincing the big miners, like Barrick Gold and AngloGold, to cease wasting shareholder assets and quit the forward selling/leasing before the eventual disaster. In truth, no matter what I or others said, the fraudulent practice of metals leasing continued for years thereafter. It was only after Barrick and AngloGold lost \$10 billion apiece that they finally quit the doomed game. I guess the morale of the story is that sometimes those in high position should listen to others, but I fear that lesson will never truly be learned.

Even though the mining companies are largely no longer in the leasing game and have closed out forward positions, it is possible that all the central bank gold may not have been returned. This is a developing situation and auditing procedures have been said to have been agreed upon in principle. This is the gist of the current reports. And it's hard to see how it wouldn't be bullish for the price of gold should it be confirmed that much official gold is missing and/or non-returnable. After all, the total gold holdings of central banks are reported to be around 30,000 tons, or one billion ounces, out of total world above ground gold inventory of 150,000 tons or 5 billion ounces. A large amount of the central bank gold missing should impact the price in a rational world.

The expected reaction here would be to focus on the price of gold. However, looking at things through a different perspective, I think the real message might be for silver. Although silver has not been mentioned in the metal missing from central banks, when you step back a bit, it's easy to see why, namely, the central banks of the world have completely dishoarded silver long ago. Whereas in gold, there are suspicions of some gold being missing from the central banks; in silver there are no such suspicions because it is a fact that there are no central bank holdings in silver anymore.

When I started writing for Investment Rarities twelve years ago, one of my themes was that there was less silver inventory in the world than gold. While many have come to accept this statement, the vast majority still find that silver couldn't possibly be rarer than gold, given that gold is more than 50 times the price of silver. It's not just the price ratio alone that makes it impossible for someone to believe silver is rarer than gold; there is a much longer actual history when gold was rarer than silver. In fact, as recently as 70 some-odd years ago, gold was much rarer than silver throughout the world. Just before 1940, there were 10 billion ounces of silver bullion in world inventories and 2 billion ounces of gold. Most of both metals were held by governments, with the US Government alone holding nearly 6 billion silver ounces. Since then, world silver bullion inventories have declined by 9 billion ounces, while total gold holdings (bullion and other forms) have grown to 5 billion ounces. Let me repeat that. In 1940 there were 10 billion oz of silver and 2 billion oz of gold; today there are a little over one billion oz of silver (bullion) and 5 billion oz of gold (bullion plus other forms). In 1940 the US Government held 6 billion oz of silver; today it holds zero.

How this great reversal in relative holdings occurred I have discussed before and can be explained in the simple fact that silver has developed into a strategic and vital industrial material that has now been over-consumed, while gold has largely remained a material for jewelry and investment. What I don't think I have ever discussed is how, in the craziest coincidence possible, the governments of the world agreed early last century to demonetize silver and not gold. It was the demonetization of silver a hundred years ago that led to the dishoarding of silver by every government to the point where virtually no silver is officially held. This is what freed up all the silver that was eventually consumed for industrial purposes at incredibly low prices.

In historical terms, 70 years is not such a long period of time. In fact, my point is that 70 years is such a short time frame for what happened in the silver and gold reversal of relative inventories that it occurred too fast for most people in the world to notice even though it can be documented. The most amazing thing is that for the centuries before 1940, when silver was much more abundant in government inventories than was gold, these same governments (including the US) assigned a value of silver to gold of 16 to 1 for monetary purposes. In other words, when the governments of the world owned much more silver than they did gold, they set a relative rate of exchange of 16 oz of silver for one oz of gold. Now that no world government holds silver, but all do hold gold, silver is being valued much cheaper (53.5 to 1). You have to think about that for a moment because it suggests the less that exists of an item, the cheaper it becomes, which is quite absurd.

Getting back to the gold that might be missing in central bank vaults, no doubt it can have a bullish impact on the price. But there are a few distinctions I would make to put it in perspective. For one thing, even if the gold is gone thanks to it being previously leased and not returned, that doesn't mean the metal doesn't exist. I am aware of no secret gold-eating microbe that has caused the leased gold to disappear. An individual central bank may have lost their gold by foolishly leasing it out; but someone else owns it rather than the metal ceasing to exist. In such a case, the world inventory of gold wouldn't change, just who owns it. Maybe the original central bank is on the hook for leasing out the gold, but whoever does own it can sell it if desired.

That's a lot different than what occurred in silver over the past 70 years. Not only does no central bank own any silver, the metal that they formerly owned and dishoarded no longer exists. In gold, maybe the central bank doesn't own it, but somebody does. In silver, no one owns the ten billion oz of 70 years ago because none of it exists any longer. It is this difference that points to silver rising sharply in price relative to gold over the long term. This is the difference that comes to my mind when I read of the concern that central bank gold may have been leased out. There is a big difference between the ownership of something or whether it exists.

How many people in the world do you think grasp this distinction and the history of the past 70 years and are aware that silver is rarer than gold? My guess is very few. If many understood what had occurred, the price of silver would not have grown so cheap relative to gold as silver grew much rarer in existence. Based upon these facts, I am amazed how little gold has been converted into silver to date. Yes, the silver market is still manipulated by the crooks at JPMorgan and the CME and is subject to deliberate price smashes. Yes, the CFTC has failed in its most important mission of protecting the public and our markets from manipulation. But in looking at history and the facts as objectively as possible, it is only a matter of time before the rarity of silver is recognized and fully reflected in the price.

Based upon the latest track of the big East Coast storm, I'm not anticipating a publishing interruption next week, but one never knows. Stay safe and dry.

Ted Butler

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Silver – \$32.10

Gold – \$1712

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