October 5, 2010 – Too Far, Too Fast?

Too Far, Too Fast?

There has been a marked increase in commentary proclaiming the near-term price direction for silver and gold. That's only natural after a big price move. Some insist a sell-off is at hand, while others see us on the launch pad, with prices about to explode. No doubt the conflicting opinions are sincere and well-intended. In my opinion, however, we are only kidding ourselves if we focus solely on the short term. If it were possible for everyone to get rich by short-term price prognosis, everyone would be rich already. Don't get me wrong, short-term price guesses are unavoidable and I make them myself on occasion. But my point is that the only fighting chance that most people have for investment success is on a well-thought out and long term basis. Long term is defined as 5 to 10 years or longer.

Perhaps the biggest risk in adopting a short-term focus is that it may cause one to abandon a long-term plan. Specifically, you can't allow a long-term silver position to be sold because you think a short-term sell-off is at hand. That must be avoided at all costs. One of the biggest investment mistakes will be to sell-out silver too soon. That's not to say the price of silver can't sell off; of course, it can. But if you guess wrong and sell too soon, you may take yourself out of what promises to be the best potential investment of them all.

Most of the advice to sell or buy centers around technical indicators; charts and mechanical measurements of price behavior. Certainly, the COT structure on the COMEX indicates a sell-off is possible. But the problem I have with most technical approaches to the silver market is that such approaches are dependent on the premise that the silver market is a free market. As I've tried to make clear for years, the silver market is perhaps the most manipulated market in history. As such, it must be viewed through that perspective. For instance, I know that the technical funds will buy and sell at certain price points. What I try to determine is if the big commercial shorts will be able to rig prices enough to induce that technical fund buying or selling.

Other advice on whether to buy or sell silver centers on news developments, like general economic, political, currency and financial conditions. Others point to increased or decreased silver production and consumption or inventory changes. While I can't deny these things influence the price of silver, I'm still left with the thought that it is the manipulation that matters most. After all, what does it matter if silver production is rising or falling a bit if amounts many times that are being transacted in the COMEX paper market? You should emphasize the most important considerations. Nothing could be more important than whether the price of silver is manipulated or not.

In the past, the Commitment of Traders Report (COT) has been one of the best indicators for whether we might get a sell-off. This is not a perfect indicator, but pretty good. The silver market has rarely, to my knowledge, sold off sharply when there was a very small commercial net short position. But on those occasions in the past when I have warned of a large commercial short position in silver (and gold), I was always careful to say that the commercials could get overrun to the upside instead of succeeding in manipulating the price lower. That's because there was no real way of knowing the outcome beforehand. There still isn't.

But I think I know one thing, namely, that the standard crooked game of the commercials ripping the rug out from under the technical funds (and other leveraged long silver holders) cannot continue indefinitely. No manipulation lasts forever and the silver manipulation appears to be on increasingly shaky legs. The repetitive commercial rig job on the COMEX is becoming too widely known, both by regulators and investors to go unchallenged. I have no doubt that there will come a time, very soon, when the commercials lose control of the price of silver through their excessive and concentrated short selling. Right now the combined open losses on short positions in gold and silver on the price rally over the past six weeks are the largest they have been in history. It is possible that these losses could be the catalyst to setting off a short covering panic.

Even though the current COT structure is negative, we are too advanced in this situation to allow that to cause long-term silver positions to be sold. And the negative COT structure is the only negative I see. Quite frankly, I'm astounded that not everyone sees the real silver situation. In fact, I'm amazed at how few see the silver manipulation and its certain coming demise, along with the coming price explosion (with or without one last COMEX-induced sell-off.) Obviously, if we do get that last sell-off, it will also likely be the last load the boat opportunity. Certainly, if we do get a sharp sell-off in silver, it will be due to manipulation on the COMEX, not for any other reason.

Most incredible of all is that we have climbed so high in the price of silver without the main engines of price thrust kicking in. If you told me years ago that silver would have quintupled in price from the $4 to $5 level, I would have sworn that the three silver horsemen of the apocalypse would have been responsible. What three horsemen? My three critical factors Â? short-covering, industrial user panic and a worldwide investment rush. I am dumbfounded the price has climbed so far without these three factors exerting strong influence. To date, there has been no commercial short covering (that's why the COT is considered negative) and no industrial user panic. Some might argue that there has been widespread silver investment demand, and I would like to discuss that.

No doubt, there has been silver investment demand over the past few years, but not to the extent I envision will come eventually. A very small percentage of the investment population even knows the price of silver, to say nothing about being invested in it. For proof, look no further that the big hedge fund community. Most of the well-known names, like Paulson, Soros, Einhorn, etc., are invested in a wide variety of assets, including gold. But I haven't heard of one of them investing in silver. This is the best news possible for silver. Why? Because these money managers are too smart not to buy silver at some point. Somewhere along the way, one of the big guys will buy silver and all the rest will sit up and take notice. They'll ask their investment staffs and each other why so and so bought and take a look at silver for themselves. Then they will buy and buy with a vengeance when they become aware of the real facts (the three critical factors). That's how these things work.

Until the three critical factors kick in on all cylinders, it will be a time to buy and hold silver on a long-term basis, not sell. Until the silver manipulation has been broken, it will not be a time to consider selling long term positions. This is not about prices in the short term. This is about what the price of silver will be when these three factors are fully played out. Just be glad you discovered silver before the shorts and users have panicked and before the big guys learned the real story.

Ted Butler

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Silver – $22.50

Gold – $1338

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