

Values and Scofflaws<?xml:namespace prefix = o ns =  
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There are two aspects to the recent manipulative takedown in silver. One concerns what the suddenly lower price means in terms of the pure investment implications. The other aspect is what the price smash means in terms of the much broader issues of societal and rule of law considerations. I freely confess to being more concerned with the latter and I will speak briefly on that in a moment; but let me first address the investment implications.

Let's face it □ it is a real kick in the teeth to witness a sudden 30% decline or more in any core holding. In silver, this is the second time investors have had to endure such an outsized drop this year. The pain and fear that comes with the sudden loss of a big chunk of one's assets is not to be minimized. That the pain and fear were deliberately created, I will discuss separately. The key question now is how should silver investors react to the sharp decline in non-emotional terms? Quite simply, the answer is that the brutal takedown is perhaps the single most bullish thing that could have occurred in silver. Don't get me wrong □ I'll have plenty to say about the illegality of the price smash, but the main concern for investors is what to do now. Given the inherently bullish impact that the price drop is likely to have, silver investors should be holding tight and buying more. Let me try to explain why I feel that way.

Basically, it has to do with the immutable law of supply and demand. All things considered, a lower price for any commodity will increase demand and reduce supply. This is the cornerstone of the free economic system and what we hope, at a minimum, our children will learn in school. Of course, the law of supply and demand is long term in nature and does not apply to short term volatility. But it is important that any long term investment be in conformity with the law of supply and demand. In simple terms, the law of supply and demand works in the long run, but may be unreliable as a short term guide. I would remind you that the big money in silver has largely been made by those investing on a long term basis and that is likely to remain the case, in my opinion.

It is impossible for a sudden 30% haircut in the price of any world commodity not to increase demand and discourage supply of that commodity. Of course, silver is unique in that it is not only a vital industrial material, but also a precious metals investment asset. Investment assets can and do have different behavior patterns compared to pure industrial commodities. As I have written previously, certain investors will buy an asset simply because it goes up in price and then will sell as prices decline. Admittedly, this investment buying on the way up in price is contrary to what the law of supply and demand may hold and must be monitored. Speculative buying on the way up, no doubt, has occurred in silver in the past, although the evidence doesn't suggest to me that speculative buying interest was at a fever pitch just prior to the recent

takedown. My point here is that I am aware that investment demand can operate not in accordance with normal industrial supply and demand, but only in the short run.

What does occur when the price of a world commodity changes sharply is that all sorts of justifications and extrapolations are then given to "explain" the price move. The public demands an immediate and reasonably-sounding explanation for sudden price moves and there is an entire financial reporting industry standing ready to provide the explanation. That the explanation given is often completely wrong is beside the point. The recent sharp move lower in silver is a case in point. Most of the reasons given to explain silver's fall had to do with crumbling world economic activity and loss of industrial demand, led by a collapse in China and elsewhere, an outbreak of deflation, the bursting of a speculative bubble, etc. Since these reasons seem to explain the decline, they are accepted. Yet, there is little factual evidence supporting these reasons as being behind the decline. I admit that it "feels" like these reasons might make sense, but analysis doesn't rely solely on feelings.

The facts show that there was a monumental liquidation of leveraged long positions on the COMEX and elsewhere (SLV), accompanied by commercial short covering and other buying to the tune of perhaps 150 million ounces. Most of this liquidation was of the paper variety and is easily verified in CFTC data and industry publications. This is why silver (and other commodities) declined

so sharply in price; in order to accomplish this commercial buying. Yet, I have not seen or heard this explanation given in the popular press or television.

Several subscribers have asked me to comment on silver supply demand fundamentals, with some asking me to lighten up the manipulation angle. The first, I can do; the second, probably not. It's important to recognize that the supply and demand fundamentals of any world commodity can't change radically in the short term, or if they do change, that change must be immediately visible to all. The annual production and consumption of silver is a 24 hr/7 day/365 day type affair, just like any other world commodity. There is little seasonality or unpublicized variances. There is no peak harvesting time for the silver apple crop. Industrial consumption is strictly a function of world GDP. There are only gradual changes in silver world mine and recycling supply and in industrial consumption. I am aware of no important changes in silver supply and demand recently and for that reason I have not seen the need to discuss the non-changes. I monitor these statistics as closely as I ever have and at times I have been tempted to mention some changes (like the production of silver in Peru, the world's largest producer, falling sharply), but I didn't want to risk reporting selectively on bullish developments.

In reality, the recent price decline in silver had little or nothing to do with real world supply and demand, which can't change that quickly. The perception of world supply and demand can, of course, change and no doubt these

perceptions have changed somewhat. But unless those perceptions are based upon actual fact, they will not stand the test of time and will change again. That's the problem with forming opinions based strictly upon the most recent price change; one gets bullish and overconfident on sharp price rallies and despondent on sharp price declines. If there is a lesson here it is probably to look to sell some when things look great and force yourself to buy when things look bleak. I know this is easier said than done. I also know that the recent price decline, as have the sharp declines before it, has brought out the usual chorus of "I told you so's" from those who never grasped the real silver story to begin with. Like mosquitoes after a heavy rain, the doubters must be tolerated.

But there is one true silver supply/demand fundamental that I can address. In fact, it is the one fundamental that I have emphasized for the past few years - investment demand. If silver mine and recycling production and industrial consumption can only change glacially, silver investment demand can change dramatically in the short term. Silver investment demand has driven the price since 2005, shortly before the introduction of the big silver ETF, SLV. The many hundreds of millions of ounces bought by investors is hands down the biggest single factor in the supply/demand equation for silver. This is likely to be the case over the next five to ten years as well. Therefore, if someone wants to look at silver supply/demand fundamentals, one must consider silver investment demand above all other factors. What are the prospects for future silver investment demand?

Whatever the prospects may have been a few weeks ago, the sudden price decline of 30% has altered those prospects for the better. Yes, there was share liquidation in SLV on the big price decline in response to the suddenly lower prices that went along with COMEX selling, but margin and fear induced liquidation is necessarily a short term phenomenon. Once the fear-induced selling squall has passed, the investment landscape then adjusts to the reality of an attractive asset discounted in price by 30%. As prices stabilize and begin to move higher, the fear is forgotten and is replaced by the attractiveness of a genuine bargain. If you study what occurred after the big price breaks in the price of silver over the years, you can't help but notice that buying after such big price declines was the best investment opportunity for large returns. I don't think it will be different this time, although no one has a lock on short term movements.

The most compelling argument to me about this price decline is how attractive it has rendered silver compared to other assets, most notably gold. Back on March 30, in an article titled "Silver Investment Supply/Demand" (in the archives, please review), I described how much money was required to come into silver monthly in investment dollars to maintain the price. I did the same with gold. Back then, with silver at \$37 and gold at \$1400 an ounce, I calculated that it would take a monthly world investment flow of \$450 million in silver and \$5.6 billion in gold to support the net 10 to 12 million oz of silver and 4 million

oz of gold made available by production minus consumption. Back then, it took 12 times as much money flowing into gold than into silver to maintain the current prices, even though there was much more money flowing relatively into silver at that time..

The price adjustments since then have made the ratio much more favorable to silver. Now, at \$30, no more than \$360 million dollars in monthly world investment flows must come in to maintain the price, whereas it now takes \$6.5 billion in monthly investment flows to maintain gold prices. What was 12 times more money coming into gold compared to silver in March is now 50% greater at 18 times more. Forget the conventional gold/silver ratio which I comment on weekly; think in terms of how little money is needed to maintain and drive silver prices from here. The new low price of silver, especially compared to gold, requires much less of world investment capital to maintain and increase the price of silver now than it did back then.

Also take a moment to revalue the worlds above ground bullion inventory of silver and gold adjusted for the new prices. World silver bullion inventory of one billion ounces is now worth \$30 billion whereas gold world bullion inventory of 3 billion ounces is now valued at \$4900 billion (\$4.9 trillion). All the gold in the world is worth 163 times more than all the worlds silver bullion is worth, even though silver is much more rare than gold. I would suggest that is absurd and silver is destined to climb sharply in value, both on an absolute basis and

relative to gold.

Having tried to address the investment concerns for silver, please allow me to turn to why we fell so sharply in price. Rather than rehash the whole manipulation argument, let me deal with the most upsetting aspect of the manipulation; the role of the CFTC and its failure to right an obvious wrong.

I just watched (most) of the new Ken Burns documentary series on public television on The Prohibition, the 14 year period from 1920 to 1934 when alcoholic beverages were outlawed in the US. My main takeaways were that it was essentially not a very well-thought out amendment that was also never enforced evenly. In fact, so many ordinary people, in addition to the bootleggers and other criminals, disregarded the law that the origin of the term scofflaw (those that scoff or disregard the law) came from that era. Since I tend to think in terms of silver, it dawned on me that scofflaw was a perfect term for the crooks at JPMorgan and the CME Group in regards to silver. These crooks laugh at the law.

The big difference between the scofflaws back during the Prohibition was that a significant percentage of the population disregarded the law. Today, the scofflaws in silver are very few in number, as the vast majority of silver investors play by the rules. That the CFTC can't or won't deal with the few



crooks that are ruining the market and making a mockery of the rule of law is shameful. Another observation I took from the series is that it took great numbers of citizens to first get the amendment passed and then great numbers to have it repealed. I suppose it's easier to attract public interest on matters related to having a drink or not, versus a market manipulation. But the CFTC has one mandate and that concerns market manipulation.

Finally, I ran across a short piece, written by Ned Naylor-Leyland of Cheviot Asset Management of the UK. In it, the author castigates the CFTC for not cracking down on the silver manipulation despite strong reason to do so. He compares the CFTC's failure to be on a par with the SEC's failure to spot and terminate the Madoff Ponzi scheme, despite prior notice by Harry Markopolous. <http://www.scribd.com/doc/67350783/Silver-Gorillas-CFTC-Etc-1>

While I am most appreciative of Mr. Naylor-Leyland's kind personal mention of me and I am not opposed to his comparison of the silver manipulation and the Madoff rip-off, I would like to point to several key differences between the two crimes. One is that the silver manipulation is much worse in the sense that market manipulation is the worst market crime possible. That's because it impacts even those who don't directly participate on the COMEX, like silver exporting countries and others in the industry. Madoff never traded anything and therefore couldn't manipulate any market; he just stole a lot of money.

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The second observation is that there was no public warning by Markopolous of the scam, just like other whistleblowers at Enron and WorldCom. Therefore few were warned of the dangers. Don't get me wrong, I think what Markopolous and others did was great and informed analysis. It's just too bad that more weren't alerted and able to sidestep great losses. In silver, I have always made my allegations public, in addition to alerting the regulators, as well as the perpetrators. Many tens of thousands of investors have taken advantage of my public analysis.

If you think I am just trying to pat myself on the back, you would only be correct to the smallest degree. My real point is different. If you feel you are better off as a result of learning of the silver manipulation, perhaps you might consider returning the favor to others and lending your voice to the effort of ending it. Even if you have written to the regulators before, please consider doing it again. If you have never written, there's no better time to start. Perhaps the CFTC is as corrupt as many of you suggest. Perhaps they just don't have the guts to stand up to the crooks at JPMorgan or the CME Group and need a little persuasion. In any event, I see no downside in the few minutes it would take you to drop them a line. At the very least, when this silver crime in progress unravels, the more public complaints that were filed beforehand, the better.

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To the Commissioners at the CFTC, particularly Chairman Gensler, let me respectfully remind you of your own words. This is an issue about market integrity and transparency. Integrity and transparency are two-way streets; important to the markets, but especially important for the government. It's time for the agency to demonstrate some integrity and transparency. Many thousands of silver investors have petitioned the Commission on very specific issues, such as position limits and concentration and manipulation in silver by JPMorgan and others. The Commission has not seen fit to address those petitions for years. This undermines the public's trust in the agency and the rule of law. Twice this year alone, silver investors has been victimized by 30% deliberate takedowns while you have sat by and done nothing; not even commenting on something that should be impossible. It's long past the time for you to be transparent and to demonstrate some integrity. At the very least, if these allegations and specific issues are without merit, then it is time for you to explain why.

Ted Butler

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Silver - \$30.15

Gold - \$1635

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