

Weekly Review

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In a week with extreme mid-week price volatility attributable to computer dominated High Frequency Trading (HFT), gold ended \$25 (1.9%) lower, while silver shed only 5 cents (0.2%). As a result of silver's relative outperformance, the silver/gold price ratio tightened in to 60.5 to 1, still within the broad trading range of the past two years. While I can't read anything into this week's action, it is still hard for me to imagine silver not outperforming gold on a long term basis.

It was a strange week in many ways, from political developments and stalemates in Washington that led to a government shutdown, to the actual price action in gold and silver. While the final prices for the week weren't particularly unusual, the actual price volatility was out of the ordinary. Not only did gold and silver trade in a wide price band during the week (\$75 for gold and \$1.50 for silver), the manner of trading seemed counterintuitive; down on a federal government shutdown, up afterwards. My take is that computer-generated HFT activity on the COMEX is the sole price determinant in place. It can't remain that way indefinitely, in my opinion, but predicting when it will end is impossible.

There was a slight cool-off in the torrid pace of metal turnover in the COMEX-approved silver warehouses, but the pace of movement still approached 3 million oz, as total inventories rose 1 million oz to 166.4 million oz. The turnover in silver is still highly unique (compared to other metals) and has persisted since April 2011, when the world was on the precipice of the first silver shortage in history. Wholesale tightness is still the most plausible (only?) explanation for the unusual silver turnover.

Sales of Silver and Gold Eagles from the US Mint seem to be getting off to a weak start in October, although for the year, Silver Eagle sales are exceptionally strong, especially compared to Gold Eagles. I was informed that a large investment fund (The Permanent Portfolio) sold 130,000 (one-ounce) gold coins (and gold bullion) in the second quarter and this additional supply appears to partially account for the sharp fall-off of new Gold Eagle sales the past few months. I'm not sure of the impact on the Mint's bullion coin program by the government shutdown.

Adding to the strangeness of the past week was the lack of a Commitments of Traders Report (COT) due to the government shutdown. There must have been previous occasions of no COT report, but I can't remember any such occurrences. As I indicated on Wednesday, the lack of a report doesn't equate to an absence of position changes; just the absence of clarity and confirmation of positions. We know that the commercials sell on price rallies and buy on price

weakness, with the technical funds and other speculators doing the opposite, whether government offices are open or not.

Since prices for gold and silver closed below their key 50 day moving averages for each day of what would have been the reporting week, including a dramatic and high volume down day on the Tuesday cut-off, we can safely conclude that the commercials were buyers and the tech funds sellers. My guess is that there would have been a reduction in the total commercial net short position of around 10,000 contracts in gold and 3000 or 4000 contracts in silver, since the lows on Tuesday were multi-month price lows and below the key psychological round numbers of \$1300 in gold and \$21 in silver.

While prices did snap back sharply on Wednesday, trading volume trailed off and prices remained lackluster thru yesterday. My sense is that there may have been some commercial selling on the Wednesday price pop, but we are still very constructively positioned in the COTs. There is an almost palpable feeling that gold and silver prices will get hit hard the minute (or millisecond in HFT terms) that the stalemate in Washington is resolved, but there has been no noticeable speculative buying ahead of the resolution. Therefore, it is hard to imagine any big selling from disappointed new buyers, since there was little new buying. I'd still peg JPMorgan's long market corner in COMEX gold to be near 70,000 contracts and the bank's short silver market corner to be close to 12,000 contracts.

The intra-week price volatility didn't have much impact on the metal holdings in the big silver ETF, SLV, as investors seem to be sitting tight. Gold still is flowing from the big gold ETF, GLD, as well as other gold investment vehicles, but at a rate that seems to be abating. As a result of the big price takedowns this year, more than a third of the gold held in GLD has been liquidated. In contrast, no net silver has been liquidated in SLV, despite bigger price losses in the white metal. Going beyond the last nine months, there is also a stark contrast between the changes of the total recorded holdings in the various gold and silver investment vehicles (including exchange inventories), of which GLD and SLV are the largest respectively.

For the three years from the beginning of 2010 thru the end of 2012, the total recorded amount of gold investment holdings rose by 30 million ounces, from 70 million oz to just over 100 million oz. I would contend that the buying of this 30 million oz of gold (worth around \$50 billion) was instrumental in driving the price from \$1100 to \$1700 at 2012's year end. Then, on the big price takedown this year, some 25 million ounces of gold came out of the various investment vehicles (almost 15 million oz in GLD alone). This gold certainly still exists and is owned by someone; just not the former owners. I think manipulation (by JPMorgan) was behind the price decline, but almost all the gold accumulation for three years was liquidated in the past 9 months. Certainly this gold liquidation is a prime story of 2013.

At the beginning of 2010, visible world holdings of silver bullion amounted to roughly 600 million oz and grew to 850 million oz at the end of 2012. The acquisition of this 250 million oz (worth some \$7 billion) by investors largely accounted for the move in silver prices from \$17 at the start of 2010 to \$30 at year end 2012 (and higher interim prices, same as gold). But whereas gold holdings fell dramatically this year in response to the price decline, total silver holdings grew by an additional 25 million ounces to 875 million oz, despite silver falling more dramatically in price.

What accounts for the big metal liquidation this year in gold recorded investment holdings and the lack of any liquidation in total recorded silver holdings? Asked differently, why did investors liquidate roughly \$35 billion in gold holdings (25 million oz) over the past nine months and not any silver; even though silver prices fell more? I think the correct answer to this question could offer important insight to what lies ahead. I don't pretend to know absolutely the correct answers, but the facts are clear and compelling enough to warrant asking the question.

My overall sense is that the markedly different behavior between gold and silver investors confirms my longstanding belief that gold is more expensive relative to silver, particularly in the dollar valuation of the total holdings of each. If

investors thought silver were more expensive relative to gold, it stands to reason that they would have sold more silver than they did over the past nine months. After all, there was a previous time when investors did liquidate silver much more aggressively than gold. Back when silver hit the price peak near \$50 in April 2011 and prices were then smashed lower, there was a notable liquidation in silver holdings (primarily SLV) and no discernible gold liquidation. Looking back, silver had been more expensive relative to gold than it had been in decades, so the silver liquidation makes sense on a relative price basis.

That is not to say that gold is expensive in absolute terms. In fact, many factors, such as the favorable COT structure (including JPMorgan's long market corner on the COMEX) and the proximity of the current gold price to the true total cost of production, makes gold look cheap in absolute terms. But the fact is that there was an extraordinarily large liquidation of holdings in gold investment vehicles this year while there was no such liquidation in silver investment holdings. And while I agree that Indian and Asian investors bought much of what was liquidated, they only did so because western investors liquidated at progressively lower prices. It's not as if buyers from the East initiated the transaction, because had they done so gold prices would have escalated, not fallen sharply.

Because gold does not appear to be overvalued on an absolute basis and because it has already undergone a dramatic price reduction and investor

liquidation, it appears to be well-positioned to fulfill its primary investment mission of preserving capital on a long term basis. Certainly, there can't be much hot money still positioned on the long side of gold. Looking at the world as a whole and the respective valuations of assets that compete with it (stocks, bonds and real estate) gold appears better positioned than ever to be a protector of future purchasing power. In a very real sense, you don't hold gold to get rich, but to protect wealth, or stay rich.

Silver is different, at least to me. The reason to invest in silver is to get rich, or to make an investment score. To be sure, because the current price is even lower than gold in terms of true production costs, silver should handily serve the role of preserving purchasing power and maintaining wealth in the long term. But those roles are almost beside the point; silver should be bought to achieve a financial windfall. Buying silver is like buying a lottery ticket that never expires and where the odds of winning are actually in your favor. I suppose one could look at silver as a way to make enough to then buy gold to protect what may be made.

I think the facts and events of this year, plus observable investor behavior point to silver as the coming investment star. As a real, elemental asset (like gold) in a world of unsustainable debt and valuation extremes, silver can't go bankrupt or worthless and can, therefore, be held as long as necessary to offer protection from a modern financial world littered with excessive leverage and debt. Forget

that silver is down 60% from its price high of two and a half years ago and at or below the true cost of production; the growth of financial excess in the interim is reason enough to warrant purchase.

What makes the disparity between the behaviors of investors in liquidating gold and not silver this year even more extraordinary is total dollar comparisons, something I admit to harping on. For years, I have highlighted the extraordinary difference between gold and silver in terms of how much of each, in dollar terms, exists in the world. The total dollar value of the all the world's 5+ billion ounces of gold comes to close to \$7 trillion (7000 billion). The one billion oz of silver bullion is worth around \$22 billion; double that amount to include coins and small bars and it is still less than \$50 billion, or less than one percent of what all the world's gold is worth.

While I didn't predict the great price takedown this year, I think the amount of gold liquidated and the lack of silver liquidation is in keeping with my thesis of the remarkable disparity in the dollar valuations of each. Because total world gold is valued in the trillions of dollars, while silver is valued in the low tens of billions of dollars and because investors are more inclined to hold silver at current prices than they were gold over the past nine months, I think that will be instructive in the future as well.



I'm bullish on gold, but predictions of gold prices thousands of dollars higher necessarily implies the total value of gold being marked up by many trillions of dollars. It's hard for me to envision enough new gold investors (or existing holders adding to positions) continuing to bid the price of gold higher to justify the many trillions of dollars increase in total gold valuation. In silver, a move to \$100 would increase the total value of the one billion oz in bullion form to \$100 billion, or one-tenth of a trillion dollars. And, in the event I am wrong and gold musters the requisite buying force to rise by thousands of dollars in price from here, then the sky's the limit for silver and \$100 silver would be very low.

The funny thing is that conditions favor a gold price rise, as the US and the world seem embarked on a paper money creation journey that almost defies imagination. As past experience has shown, silver tags along with gold on big price moves, so there is no reason to expect that to change. But, as always, silver has a kicker that can and will ignite any price rise that is completely lacking in gold. That kicker, apart from the infinitesimal dollar amount of silver relative to gold, is an industrial user buying panic on top of an investment buying surge. Unless gold suddenly develops industrial and total fabrication demand that accounts for almost all of its current mine production, as is the case in silver, the potential for a gold shortage eludes me.

Although I have made the case for switching gold into silver for all the reasons discussed above, because of current circumstances, the case appears stronger

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to me than ever before. Regardless of how and when the current political stalemate in Washington gets resolved, I can't see how it hasn't undermined overall confidence in the political process and in the financial system. That will be damaging in the future, no matter what happens in the short term.

Many markets (stocks and bonds in particular) seem overextended and over leveraged and, therefore, fraught with risk. There will come a time when some investors in those markets attempt to exit positions in a hurry. Traditionally, a certain percentage of the money extracted from stocks and bonds will find its way into precious metals. Because stock and bond valuations are the highest in history, the percentage that flows into precious metals will likely be large as well. Gold should do well in that event, but silver should perform spectacularly, due to how little exists for purchase and the silver industrial users waiting in the wings. Then, all the HFT games and market manipulation, as well as the regulatory negligence won't matter a bit.

Ted Butler

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Silver - \$21.75

Gold - \$1311