

## October 9, 2010 – Weekly Review

### Weekly Review

It was another strong price week for gold and silver, with gold closing up \$27 and silver by better than a dollar. Both closes were historic in nature as gold again closed at all-time highs and silver at 30 year price highs. Any long-term investor who never sold core positions should feel more than satisfied with not selling to date. I think that will prove true in the future as well, particularly for silver investors. In the run up to new highs, silver has continued to outperform gold, with the gold/silver ratio closing at fresh two-year lows at a shade under 58. What this means in simple terms is that anyone who switched from gold to silver at anytime in the past two years is ahead of the game, despite gold racing to a series of new all-time highs. In the long run, I can't see how silver will not continue to vastly outperform gold.

A word about price action. It's one thing to say we should experience bone-jarring price volatility and another thing to actually live through it. We got a taste of volatility on Thursday when gold and silver fell sharply from fresh highs made earlier in the day. I know this price action rattled more than a few people. That's the problem with too close of a focus on price action. (By the way, this lecture is firmly in the do as I say, not as I do department, as not many watch the price as closely as I do). We end up mesmerized by the price action, feeling elated and empowered when prices are rising and dejected and fearful when prices sink. As natural as that may be, it is as far removed from proper investment analysis as is possible.

Too much attention to short-term price movements can lead to faulty long-term investment decisions. We start reading in too much into short-term price volatility, especially when prices have moved as sharply as they have over the past six weeks. Particularly in silver, given its past history of sudden and manipulated price drops, it is natural to want to sidestep any future sickening price smashes. This leads many to sell at the first sign of a reversal, like we experienced on Thursday. Please understand me – I don't know the very short term direction of silver prices. But neither do you or anyone else. Maybe we sell off, maybe we explode. With that admission, it is easier to analyze the facts as they develop and not where prices will be an hour from now. Fortunately, the facts in silver are lining up nicely.

In the physical silver world, the facts continue to point to tightness. The physical metal flows into the big silver ETF, SLV, are impressive indeed. In the most recent Weekly Review, I wrote that the Trust was owed 5 to 10 million ounces, based upon share volume and price action the week before. This week, 9.6 million ounces were deposited in the Trust, right at the upper-band of my expectations. While I am gratified this inflow matched my analysis, I am much more impressed that it came in when it did. I attack many large financial and regulatory institutions when I think they behave inappropriately. It is only fitting to compliment them when they do the right thing. My sense is that the timely flows of metal into SLV may be because the new sponsor of the Trust, BlackRock, is insisting on it. If I'm correct, then BlackRock deserves a tip of the hat.

Over the past 6 weeks or so, almost 30 million ounces of silver have flowed into the trust. This is equal to 37% of world mine production in that same time span, an almost unbelievable amount. This has been an impressive ten percent growth in metal deposits into the Trust, to a record total amount of more than 324 million ounces. This is the largest stockpile of silver in the world. By way of comparison, there has been no growth over the same 6 weeks in the big gold ETF, GLD. Six weeks is not enough time to form definite conclusions, but the investment flow into silver versus gold is noteworthy. My sense is that gold is much closer to being a fully-invested asset than is silver. Given that gold world bullion inventory is valued in the trillions of dollars, while silver bullion inventory is in the very low tens of billions of dollars; a sustained investment flow into silver should have a very dramatic impact on price. That's a fact hard to discern from short term price action alone.

I'm not sure what may be owed to the SLV currently. Thursday's record volume of 30 million shares may have involved liquidation, as did that day's extremely high volume on the COMEX (more on that in a bit). My sense is that any liquidation by long holders in SLV shares on Thursday was used a short-covering opportunity by those who held short positions. As such, no metal would have to flow in or out. However, I would not be surprised if we witnessed continued inflows of silver into the SLV given all the facts surrounding silver. I just don't want to put a number on it at this point, given the uncertainty of what happened Thursday. Believe it or not, I try not to make this stuff up.

There was an increase of 2 million ounces or so in the COMEX silver inventories. This always bothers some people, including my good friend and mentor, Izzy, although it doesn't bother me. My reasoning is that any silver coming into the COMEX is coming in for a purpose. It's not as if we have so much silver that we don't know where to put it, so put it into the COMEX warehouses. Izzy does have a legitimate question when I inform him of the latest flows into the SLV, namely, where is it coming from? My sense is that there was slack investment demand in silver for months prior to the end of August when the rally started. This allowed for a bit of silver to accumulate in excess of current demand during that time. Now this silver is being demanded and is flowing into the SLV and other silver investment vehicles. Therefore, the real question is how much silver is available after the recent flows into these investment vehicles. No one knows for sure, but my guess is not much.

Yesterday's release of the weekly Commitment of Traders (COT) and monthly Bank Participation Reports, both as of the close on October 5, were revealing. Both indicated a slight decrease in the total and concentrated net short positions in both COMEX silver and gold futures. I believe this is significant. Very rarely do we witness the commercials not increasing short positions on big price increases. Yet this is exactly what occurred in silver and gold in both reports. In the COT, even though silver increased by one dollar during the reporting week and gold advanced \$30, the commercials reduced their total net short positions in each by a little over 3000 contracts. In the Bank Participation Report, the big US banks (read JPMorgan) reduced their short positions even though the price of silver increased by \$3 in the reporting period, while gold's price increased by \$100. This is man bites dog kind of stuff.

Let me make the obvious conclusion first, before I get into what I think transpired since Tuesday's cut-off. What the latest CFTC reports indicate is that on a strong price rally over the past reporting week and month, commercial COMEX net short positions declined. Many would take this as coincidental. Not me. This is simple cause and effect. I have alleged, continuously for decades, that commercial short-selling was artificially depressing and manipulating the price of silver. That's because, heretofore, the commercials always sold short on price rallies, capping the price. Now we have government data which indicate the commercials didn't sell, but bought modestly, and the price of silver moved to 30 year highs. Please think about this for a moment. The commercials, especially the big ones, refrained from selling and prices rose to historic levels. Is that not clear proof that they were manipulating the price previously? They sell short, they cap the price. They don't sell short and prices rise strongly. Is this too complicated for the CFTC?

I think what occurred since Tuesday's cut-off is also significant. I think JPMorgan bought back a large number of short contracts in the high-volume trading of Thursday and Friday. Let's face it Â? they have no chance of buying back large numbers of shorts in a low-volume trading environment. The only chance JPMorgan has to buy back large numbers of short contracts is in a high-volume market. We got that in spades on Thursday and Friday. I think many longs, sitting on very large profits as a result of the \$5 silver rally over the past six weeks, grew nervous that we would get a typical manipulated price smash which would wipe-out the gains. Therefore, on the first sign that silver may be topping out, these nervous longs rushed to nail down profits. (Please see discussion above on the influence of short-term price observations). I think the big commercial shorts; JPMorgan in particular, bought every contract that was offered for sale. This is speculation on my part, but is supported by pricing, volume and open interest data. If my speculation is correct, this actually improves the structure of the silver market for higher prices.

Away from the COMEX, factors are still in place that could greatly influence the price of silver. We have now passed the two-year mark of the start of the latest silver investigation. Sooner or later, the CFTC will have to say something. Here's an article to that effect <http://www.citywire.co.uk/money/silver-price-manipulation-public-deserves-answers/a437169?ref=citywire-money-featured-articles-list> Long-time readers may recall that the author, Rob Mackinlay, had previously reported on this subject. I referenced him almost two years ago in this piece <http://news.silverseek.com/TedButler/1232994713.php> Unfortunately; the link to his original story is inoperative.

And while I seem to be the only commentator raising the issue, the matter of position limits in silver has hardly gone away. We are now approaching the half-way mark in the time mandated by the new Dodd-Frank Reform Act that position limits be implemented. Soon, there will be only three months left on the six-month deadline for implementation, due in mid-January 2011. It is my understanding that Chairman Gensler intends that the law will be followed and the implementation deadline will be met. Although I know this issue is not on the radar screens of many, I believe it will be profound to the silver market, precisely because so few are aware of it. I can't help but think that the coming realities of the new law are behind the price action in silver. The good news is we should find out fairly soon if my take is accurate. Also, I am continually amazed that with so many new articles being written about silver, how so few of them deal with the most important issues Â? manipulation, investigation and position limits. As these things hit the mainstream, there could be a shock to the system of sudden awareness.

The advice to silver investors remains the same – sit tight. I don't know if we will have a sharp sell-off or not. Neither does anyone else. We can't predict or control near-term price action. All we can do is deal with it. The best way to deal with it is by looking ahead and observing the facts. The facts dictate that silver will move sharply higher as the three critical factors (short-covering, user panic buying, and investment demand) kick in. Losing long-term silver positions due to short-term pricing concerns is unacceptable. Leave margin to the gunslingers. If you must speculate on a leveraged basis, stick to options. Those who followed my previous option suggestions should continue to roll up and out (time-wise) and banking as much capital as possible for any pull-back. Certainly, no one should be behind on any silver call option activities over the past few months. Don't let price volatility get the best of you, as there's plenty more on the way.

Ted Butler

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Silver – \$23.23

Gold – \$1348

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