# Sep 27, 2009 – More Alphabet Soup

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I feel my responsibility to subscribers is to identify and explain the most important factors in silver, both short term and long term, in an effort to help them preserve and increase investment capital. The long term is relatively easy. Just as has been the case over the past 5 to 10 years, where silver and silver-related assets have been among the very best of investment choices, the next 5 to 10 years promise to be even more rewarding. The long term offers the best chance for individual investor success. Therefore, that is where your focus should be. To that end, I promise to devote more attention to long term analysis in the near future.

But rarely are the short term factors in silver as important as they are right now. In fact, this is, by far, the most exciting time I have experienced in the entire 25 years I have studied silver. Accordingly, I would be doing you a disservice not to discuss the short term factors. Here we go with the alphabet soup again. The first factor is the Commitment of Traders (COT) structure.

The most recent COT report, for positions held as of Sep 22, indicates a new record commercial short position and reciprocal technical fund and speculative long position in COMEX gold futures and also extreme similar readings in silver futures. These dramatic levels guarantee an equally dramatic resolution. Either the tech fund or other speculative long positions get smashed and liquidated to the downside, or the commercials get overrun to the upside. While either outcome is still possible, the decline in prices over the past few days suggest that the tide may have shifted against the paper longs. That's because, for the first time in weeks, prices have closed below the first line moving averages, including the 5, 10, 13 and 20-day varieties. The important 50 day moving average is less than $25 below Friday's closing gold price and about $1 below silver's closing price. A movement below those price levels will undoubtedly induce more technical fund selling. That's the essence of the game.

From the price lows in July, the speculators have bought and the commercials have sold 30,000 COMEX silver futures contracts net, or the equivalent of 150 million ounces. In addition, the equivalent of 30 million ounces of silver have been shorted in SLV shares, according to my calculations. It was the buying of these 180 million ounces of paper silver that explains the $5 price rally in the past two months. Since these paper ounces are still Â?openÂ? it will be the resolution of how these ounces are closed out that will determine short term price direction.

Please don't think I am endorsing a technical approach to the market. To the contrary, I find it unfortunate that all markets seem to be dictated by such widespread trading influences. It goes to the heart of my allegation that prices are being set in the futures and derivatives markets, contrary to the intent of commodity law. But we have to be realistic and be aware of what moves markets, legitimately or otherwise. Accordingly, subscribers should be fully prepared for whatever the COT resolution may bring. If it is resolved to the downside, be prepared to aggressively buy on that price weakness with all remaining dry powder. A price smash, should it come, will be over in a relatively quick timeframe.

The second ingredient in our alphabet soup is the SLV, the big silver ETF (exchange traded fund). The SLV, in existence for only 3.5 years, is the largest single holder of silver in the world. On Friday, it announced holdings of 276.4 million ounces, a decline of 4.1 million ounces for the day. I'd like to discuss that decline, as well as a similar decline of 5 million ounces about a month earlier, as I think these declines are very significant. First, however, I'd like to talk about other matters pertaining to SLV.

It's no secret that the SLV is the subject of much controversy, even more than its gold ETF counterpart, GLD. The specific gripe about the SLV centers around whether it holds all the silver it claims to hold, even though it publicly lists the 276,000 individual 1000 oz bars it holds, by hallmark, serial number and specific weight. (Long time readers may remember that Barclays began to list the bars shortly following my public suggestion that they do so) http://www.investmentrarities.com/ted_butler_comentary/10-29-07.html In spite of the public listing of the bars, many are still convinced that all the silver that is said to be on deposit is not actually on deposit. Further, many seem to be convinced that the SLV is being used in some fashion to suppress the price of silver, by making available or leasing actual silver for illegitimate purposes. Finally, still others harbor suspicions that the silver in the SLV is not truly owned by shareholders and/or will not be available to shareholders at a future time.

I have tried to be clear that I strongly disagree with those that hold these misgivings about the SLV. I feel all these complaints are unfounded. I think the SLV is the best thing to happen to silver since sliced bread. I suppose I could be wrong, but I look at all the misgivings very closely and after careful consideration, I don't think they hold water. However, there is one issue I do see that is very wrong about the SLV, on which I appear to be very alone. The issue is the short selling of SLV shares.

Recently, I have written and stated in interviews that I feel that the shares of SLV have been shorted in amounts much greater than have been publicly reported. I find this short selling wrong for two reasons. One, I believe the shorting has been largely orchestrated by those commercial interests already participating in the silver short selling manipulation on the COMEX, namely, large Authorized Participants, as defined in the SLV prospectus. I believe the short selling in SLV shares is done in conjunction with the short selling in COMEX futures, for the same manipulative purposes. Just as the commercial shorts do on the COMEX, when they rig a sell-off in prices to enable them to buy back short futures contracts, that same price rig enables the big short sellers of SLV shares to buy back the shorted shares. Killing two birds for the price of one manipulation.

The second reason I take issue with the selling of any shares short in SLV is because it is fraud, pure and simple. That's because the short sellers of such shares don't deposit metal when they sell short. Every share of SLV is supposed to have one ounce of silver held on deposit in the trust (minus accumulated fees). Yet any shares sold short have no silver behind them. How do I know this? I know this from common sense and personal experience. In the past, I have shorted shares of GLD (the big gold ETF) on occasion, before I realized the implications. My broker didn't require that I put up any metal. Nor does any other broker, in any short sale of hard metal ETF shares. Whether the shares are borrowed or not makes no difference, either. The SLV prospectus doesn't mention short sales. The prospectus makes clear that every share issued has one ounce of silver behind it. The fact is that any share sold short has a buyer. That buyer does not have silver behind the shares he bought, because the short seller doesn't deposit any silver. That's a violation of the prospectus and is fraud.

Several subscribers had written to Barclays about this. Barclays' response was remarkable. They did not deny my clear allegation. Barclays simply responded that any short selling in SLV was beyond their control. That's a cop out. They should be moving to abolish any short selling in shares of SLV on the grounds it is fraudulent and the buyers of those shorted shares are being cheated. According to the prospectus, there is supposed to be a specified amount of silver behind each share issued. The shorts are, in effect, issuing unauthorized shares. For a company like Barclays, which collects upwards of $20 million annually to administer the SLV, to look the other way is shameful.

While some may disagree with my estimate that 30 million shares of SLV may have been shorted recently, no one can deny that some significant number of shares of SLV has, in fact, been shorted. Here's a link that shows the current number of shares reported to be sold short in SLV (or any other stock). http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99 This report gets updated every two weeks. The current reported short interest in SLV shares is over 7.3 million shares. While I claim 30 million is sold short on an unreported basis, no one can argue that more than 7.3 million shares of SLV have no silver behind them.

You might ask, Â?Â?Hey, Butler, you are disagreeing with those who are saying the SLV is phony because they don't have all the silver claimed to be behind the shares. Then you turn around and make the case that the shorted shares are fraudulent because they don't have silver backing. What gives, aren't you contradicting yourself?Â?  Fair question, but I think we're talking about two different things. Let me see if I can explain that.

Those offering the general criticism of the SLV seem to be doing so out of a broad-based distrust of the financial firms behind the SLV, rather than any specific legitimate finding. Ironically, I suppose I may be somewhat responsible for that general mistrust, seeing as I have writing of a silver manipulation for many years. But when you make allegations of wrongdoing, you better be specific and offer clear and credible facts that back you up. Otherwise you risk ending up sounding like a conspiracy oddball. I don't see those credible facts behind most of the trash talk on the SLV. The short selling of SLV shares is different, in that my allegations are specific and clear.  In addition, many, but certainly not all, of the SLV critics actually promote and profit from selling other forms of silver, some without disclosure. That leaves a bad taste in my mouth, plus it undermines their SLV criticism.

Rather than me contradicting myself on the matter of the silver in the SLV, I think that the general critics of the SLV are being contradictory. In most of the reports I read that criticize the SLV by claiming the silver isn't there, the critics turn around and promote some other form of investment, such as the Central Fund of Canada or various on-line storage vehicles. I am not intending to criticize the Central Fund, as it has been around a long time and I am not knocking it. But the fact is that the Central Fund does not publish serial numbers and you can't get delivery of metal from them. Please don't ask me if I think the Central Fund is safe, as I think it is. I am just saying that the critics of the SLV seem to judge on a double standard.

In summary, I like the SLV, in general. I despise the shorting of SLV shares. The silver world is much better off because the SLV has come into existence. The SLV would be much better if Barclays would get off its butt and do something about the short selling of shares, like take the matter to the SEC. Barclays has shown it knows how to do the right thing in the past. It did so when it agreed to list the bars in the SLV. I was very quick to publicly acknowledge that http://www.investmentrarities.com/ted_butler_comentary/01-07-08.html

Barclays has another great opportunity to do the right thing in regards to the shorting of SLV shares. I promise I will praise them to the moon should they do the right thing again.

Now, to the matter of the decline in SLV silver holdings on Friday of 4.1 million ounces. In my opinion, this decline, as well as the 5 million ounce decline a month ago, was not a liquidation of shares due to investor selling. These silver deposit declines were only as a result of silver being removed from SLV because it was badly needed someplace else. Maybe the silver needed to be shipped to another ETF, or to an industrial consumer, or to a large investor. It is not possible to know who the silver was shipped to. It is most probable to conclude that it was taken from the SLV due to it being needed more elsewhere, rather than by investor liquidation.

There is no question that investors have been aggressively buying shares of SLV over the past few weeks. The volume was much higher than normal on the impressive price rally. This virtually guarantees that metal should have been added to holdings. The fact that there was no net increase in SLV silver holdings during the price rally, means that the shares must have been sold short. This is the only plausible explanation. So, instead of silver holdings being added to the SLV due to investor buying, we witness a sudden significant withdrawal. What this means is that the wholesale physical silver market may be as tight as a drum. When you take silver from the SLV, the whole silver world sees it immediately. You don't do that unless you have no other place from which to take the metal.

It is the ability of SLV investors to immediately withdraw physical metal from the Trust, in exchange for shares, that is the SLV's most important feature. It is the one feature that the SLV critics overlook. In fact, since the time when the SLV was first introduced, the minimum incremental amount of silver that could be deposited or withdrawn was reduced from 500,000 ounces to 50,000 ounces. This made it easier to convert metal to shares and vice versa. Let m explain why the ability to withdraw silver immediately from the SLV (through an Authorized Participant) is so important, particularly for an industrial silver consumer.

When the long anticipated wholesale silver shortage hits in earnest, industrial users will scramble to secure real silver, to keep their production lines running. Otherwise, many will risk a complete shutdown of operations. Where can they turn to get actual silver in a hurry? Certainly not from the Central Fund of Canada, or from the various internet storage programs. (Let me repeat myself. I am not saying anything bad about the Central Fund. I am saying you can't get physical metal delivered from it, either now or in the future). Silver may not even be available from buying COMEX futures contracts, as restrictions to converting futures contracts into actual warehouse receipts will most likely be enacted in a shortage. COMEX warehouse certificates will be fine, provided you own them before the crunch hits and restrictions on converting futures takes place. This where the SLV comes into play.

Because the language of the prospectus is so clear, and conversion of shares for metal is spelled out, the SLV will be one of the few vehicles available for an industrial user to get real silver in a hurry. For that reason, I would expect that any premiums that would develop for immediate delivery in a shortage (a true backwardation) would be fully reflected in the price of SLV shares. In other words, any big premium in physical silver would translate into big premiums in SLV share prices. The ability of converting shares into metal is what makes the SLV legitimate, despite widespread carping by critics. The short selling of shares that I complain about does not negate that legitimacy.

The reason that the withdrawal of silver from the SLV is so potentially important is because it may be an early signal that a wholesale shortage is beginning. Also, the fact that silver has been reported as withdrawn would seem to suggest that the silver had to be there in the first place. Why would anyone involved in a short manipulation intentionally send bullish signals?

If the withdrawal of silver from the SLV is signaling tightness, then this short term development is important because it could break the manipulation. No way can a silver price manipulation exist in a wholesale shortage. The COT and the SLV are two components of the alphabet soup. The most important remaining short-term component is the coming CFTC-CME showdown on position limits. This promises to be a doozey. I had planned to discuss some new insights of mine on this issue, but this piece has run a bit long, so I'll continue it as a separate report in the next few days.

**Date Created**
2009/09/27