September 1, 2009 – The Super Bubble to Come

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Sometimes, a number of forces come together at the same time to greatly alter the result of an event. I'm reluctant to employ the overused clichÃ©, Â?A Perfect Storm,Â? but I am at a loss to imagine a better one to describe the confluence of forces I see converging for silver. Any one of the factors about to impact the price of silver would be formidable by itself, but in conjunction with one another should prove historic in force. So potentially powerful are the individual factors, that I won't try to list them in order of importance.

The first factor is the condition of the world supply/demand situation. Total current production (mine plus recycling) does exceed total industrial demand, but not when investment demand is included. This is in marked contrast to the 60 years prior to 2006, when there existed a structural deficit, in which total fabrication demand exceeded total production, causing world silver inventories to decline to the lowest levels in hundreds of years. The difference between the 60 years prior to 2006 and since then is that there was no world net silver investment demand before 2006. Starting in 2006, the world began to wake up to the investment merits of silver.

I remember causing much consternation to silver investors, several years ago, when I started writing that the industrial deficit in silver had ended. I know that this is a hard concept for many to comprehend, namely, that silver is not currently in the industrial consumption deficit that existed from the start of World War II until 2006, and that this is not bearish for the price. I know it sounds counter-intuitive that silver could be in its most bullish supply/demand configuration, as I contend, precisely as its industrial deficit has come to a close (at least temporarily). That's because industrial demand seems more significant than investment demand. This is understandable, as industrial consumption largely removes silver from the market completely, while investment demand apparently removes silver only temporarily, as it is thought that investment silver will be available at a future time and price. I don't disagree with this thinking in principle. I do disagree with the future time and price at which investment silver will come back to the market.

The simple explanation for why I feel silver is in its most bullish physical supply/demand situation is that the evidence suggests that investment demand is just beginning. For sure, industrial demand is not disappearing and is certain to grow in the years ahead as world economic growth and population increases kick in. But investment demand is the most immediate potent force in the silver supply/demand equation. Investment demand, not industrial demand, can spread like wildfire. Investment demand is the real wild card.

Look at the facts. After more than a half century of no world net investment demand, silver investment demand kicked in with a vengeance in 2006. That's primarily due to the introduction of new silver investment vehicles called ETFs (exchange traded funds) that allowed entities, especially institutional investors, to buy physical silver where that was not practical before. And buy they did. In the 3.5 years since the introduction of the first silver ETF, the total amount of silver purchased by these investment vehicles is around 400 million ounces. This is a staggering sum that no one ever anticipated. This is silver taken off the market. We can debate when it may come back to the market, but we can't debate whether it was taken off. And new silver ETFs seem to be created daily throughout the world, promising the trend of growing demand will continue. Never has the world seen such silver investment demand.

Please remember we are talking about a commodity of finite supply. Every ounce purchased for investment is one ounce less available today. After 60 continuous years of inventory destruction, there is very little silver inventory remaining. Every ounce purchased for investment purposes effectively shrinks the remaining inventory further. Compared to the mountain of money and credit available, the amount of available silver is miniscule. The 400 million ounces purchased by the ETFs over the past 3 to 4 years only amounts to $5.5 billion. That's nothing in terms of dollars, but immense in terms of metal. The future attempt to put that small amount of money into an equivalent amount of metal will send the price to the heavens.

Institutional buying of the silver ETFs, while dominant, is not the only part of the silver investment boom. Retail demand in newly minted bullion coins, such as the American Silver Eagle, Canadian Maple Leaf, Austrian Philharmonic, and other coin series has never been stronger. The US Mint and others have struggled for most of the past two years trying to keep up with demand. Generic coins and bars have also experienced record demand and the retail market teeters on the verge of outright shortage.

What is motivating this record silver investment demand? I think it is three things, the greatest quantity of investment funds available to purchase silver, the lowest availability of actual metal that can be purchased, and the growing awareness of what a great investment silver represents. Let's face it Â? in an investment world full of uncertainty and risk, there are not many assets that offer protection against total loss and exceptional profit potential. Silver can't go bankrupt or worthless, but can and will soar to many times its current price. The new, and some say permanent, move to frugality and savings brought about by worsening economic conditions also favors increased investment demand for silver. When savers and investors are uneasy, the appeal of holding an asset that is no one else's liability is especially comforting, particularly when such an asset can soar in value. Silver satisfies both the fear and greed aspects common to man. How many assets fit that profile?

As powerful as those forces are, they are not the factors of the true perfect storm and coming bubble that I'm referring to. A force that does threaten to profoundly disrupt the silver market is China. After 60 years of it being illegal for Chinese citizens to buy and hold silver (and gold), it has recently become legal to do so. Not only that, but the government is actively encouraging citizens to buy silver, allowing it to be sold by banks. Early reports suggest that the Chinese government is succeeding in its encouragement, with stories of bank lines developing for people waiting to buy silver. With the world's largest population, an established and ingrained propensity to save, and a historically attractive investment asset suddenly available after a void of 60 years, it's hard to imagine how an investment rush into silver won't develop in China.

In addition, reports of pending export restrictions from China, the world's largest refiner and third largest miner of silver, threaten to create a one-two price punch never witnessed before. Years ago I wrote, at the urging of my friend and mentor, Izzy Friedman, how China was likely the big silver short, depressing the price to pick up refining market share and dominance in the world production of silver. After the low price drove out world refining competition, China could then be in the position of controlling the price and driving it as high as they desired. I can't help but think that not only was such analysis by Izzy correct, but it may be about to be realized.

The most immediate potential force in silver is an issue that has dominated my attention for the past 25 years. The ongoing silver manipulation, caused by an unprecedented concentrated short position on the COMEX, appears to be racing towards a resolution. The main driver behind the pending resolution is the new chairman of the CFTC, Gary Gensler. After only three months in the position, he has grasped and articulated the concept of concentration. I think he may use the term more than I do, as hard to believe as that may be. He has mastered the concept of the role of legitimate position limits in commodity law and has effectively communicated this concept. He is passionate and proactive, rare qualities in a public servant. It is an understatement to say he is the best CFTC Chairman ever.

Even if Chairman Gensler fails to live up to my high expectations in the Commission's future actions, he may have done enough already to bring the silver manipulation to an end. He has elevated the issue of position limits and concentration to such a level that it guarantees that questions must finally be answered about the unusual short side concentration in COMEX silver futures. He has received many hundreds of public and private messages about this specific issue. He can't and won't ignore the questions and demands from the public. He will address them in some way.

We are now at the one-year anniversary of the current ongoing silver investigation by the CFTC. This is the third silver investigation in five years. The current silver investigation came into existence as a result of articles written by me about the revelations in the August 2008 Bank Participation Report. This report showed that one of two US banks (most likely JPMorgan) held a short position equal to 25% of total world silver mine production. This is an unprecedented concentration, never witnessed in commodity market history. I asked the public question Â? how can such a concentrated position not be manipulative to the price of silver? Instead of answering, the CFTC decided to launch another investigation. This is what a government agency usually does when it can't answer a simple and direct question.

But the new chairman of the Commission has not displayed the characteristic of evading direct questions on the important matter of concentration and position limits. He wasn't the chairman when the question of concentration was asked last year. He wasn't the chairman when silver was investigated three times in five years. There is a big difference between then and now. That Gary Gensler is the chairman now is all that matters. He will soon address the questions in silver, in my opinion.

Aside from the issue of concentration on the short side of silver, there is also the question of the short side without concentration. Recently, I indicated that I thought JPMorgan had covered its big concentrated short position on other markets, like the OTC market. In other words, it is my speculation that JPMorgan passed the silver short hot potato to unsuspecting entities. Please remember, this would be a transfer of the short position and its inherent risk to other parties, not an elimination of the position and its risk. It doesn't really matter if JPMorgan transferred the risk, as far as the market is concerned. The short position exists.

On just the COMEX alone, including all futures and call options, but subtracting all spread positions, there is close to 500 million ounces of net silver short positions. I don't care who holds it, this short position exists. Given the current and future realities in silver, this is an incredibly uniformed short position. It is not backed by real silver. Given how much silver exists in good-delivery bullion form and who owns it, there is a severe mismatch between that available silver and the amount the shorts have obligated themselves to deliver someday. The short holders have no prospect of securing real silver, except to buy it in the open market, thus driving prices higher and hurting themselves in the process. The collective COMEX short position stands to lose $500 million for every dollar that silver climbs in price. Silver is about to climb many dollars in price. My point is simple. Forget who owns the COMEX short position; just remember they don't realize what a precarious position they have placed themselves in. That they will panic and rush to buy at some point is guaranteed.

On top of all these powerful forces set to launch a super price bubble the world has never witnessed before, looms what I think is the most powerful force of all Â? the coming industrial user inventory buying panic. As I recently wrote in Â?A Date With Destiny,Â? it is almost impossible for the users not to panic, once tightness in the silver market results in delays in shipments to industrial consumers. Such delays will threaten the very existence of many users continuing as ongoing concerns. No such user will cease to exist without a fight. That fight will involve buying silver, at any price available. This will feed on itself, until it burns off in a frenzied panic. Investors will panic and buy when silver prices soar, but no one will panic more than the users, with the possible exception of the shorts.

Price bubbles are rare. We throw the term around quite loosely nowadays, having recently experienced two bubbles, the Internet stock bubble ending in 2000 and the housing bubble. But bubbles remain the exception, not the rule. There are some characteristics common to all bubbles. One, you have to start with a good underlying story or investment premise, like a brand new technology or a belief that housing prices only go up. The story is usually legitimate to start with, but everyone gets carried away and higher prices eventually outstrip the underlying story. But the price rise creates fortunes for those that know when to exist. The silver story is more compelling than in any prior bubble. So will be the overrun in price to the story.

You can only have a bubble if wide numbers of people participate and there is widespread borrowing to buy the bubble asset. At the end, people are buying only because prices are rising. I believe this will occur in silver as well, and we must be on guard to exit when that takes place. But the point is that we are so far away from those excesses that it would be imprudent to worry about them now. For now, I think it is wise to put the coming silver super price bubble into proper perspective. We're not close to it yet.

And please keep this in mind Â? in no other bubble did we have these conditions present; a large and concentrated short position, a looming physical shortage, a downward manipulation that might be attacked by regulators, the entry into the investment equation of the most populous nation on earth, and a prospect industrial user inventory buying panic. It is hard to imagine how silver won't be the largest bubble in history. And you've just been given an invitation to participate beforehand.

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