

## Measuring Silver Tightness

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In any commodity that is commercially consumed, the most important price influence is always the relative balance between supply and demand. No one needs an explanation for price expectations in a severe glut versus a pronounced shortage. Like most commodities, the price of silver is mainly determined by whether supply is sufficient for demand at a particular price. Of course, there are other important considerations, like whether a market is manipulated or not, that also have a big impact on price; but nothing matters more ultimately than being in a glut or shortage. There is much compelling evidence of an ongoing downward silver manipulation. Because we know that downward price manipulations must result in a physical shortage at some point, attention is placed on signs that the shortage may be at hand.

Silver is highly unique among most commodities in that investment demand is also an important component of total demand. Fortunately, investment demand is relatively much easier to measure than other forms of demand, such as detailed silver industrial consumption by specific application. That's because there are public data sources that can help pinpoint the level of silver investment demand, including coin sales by the US Mint and other government mints and world silver ETF holdings. Because these data are fairly robust, there is little need to discuss unconfirmed reports of secret and unconfirmed reports

of silver purchases and/or delivery delays. I guess it's just in my analytical DNA to try to stick to documented data sources.

Silver investment demand is further broken down into retail versus wholesale demand, although these categories can admittedly overlap. Broadly, I'll define silver wholesale demand as demand for industry-standard 1000 oz bars and retail as including all other forms of silver. The real important distinction here is that there can be a pronounced shortage in retail forms of silver without there necessarily being a wholesale shortage of 1000 oz bars, something we've witnessed at times over the past five years. In contrast, a clear shortage of 1000 oz bars of silver on the wholesale level, whether the bars were being sought by investors or industrial consumers, would send the price skyward. We did see strong signs of such a shortage in the months leading up to May 1, 2011; when the big intentional price smash killed investment demand. The reason I harp on silver in 1000 oz bars when discussing total bullion inventories is because it is in that form by which a shortage will be defined. The reason is simple □ it makes no difference in the price calculation if a 1000 oz bar of silver is being purchased by an investor or a user. All that matters is if the combined industrial and investment demand is greater than the available supply of 1000 oz bars. As a reminder, this is a discussion on physical supply and demand; quite separate from any discussion on COT structure or other paper contract developments.

September 5, 2012 – Measuring Silver Tightness

There are now more signs that these 1000 oz bars of silver are growing tighter in availability. As you probably know, I have been amazed at the persistent and high level of turnover in the COMEX-approved silver warehouses for more than a year and a half. While the total level of silver in these warehouses has grown over this time, the real "tell" to me has been how much more silver has been physically brought into these warehouses and how much has been shipped out. This turnover has been nothing short of frantic and stands in stark contrast to normal COMEX silver movements over the past 30 years. The silver turnover also stands in stark contrast to the turnover in any other NYMEX/COMEX metal, indicating a certain uniqueness to the silver turnover. Try as I might, I can find no more plausible explanation for the frantic COMEX silver inventory turnover than as a sign of hand to mouth persistent demand with supply straining to keep up with demand.

Not only has the turnover in the COMEX silver warehouses continued unabated, recently I have mentioned a pickup in turnover in the big silver ETF, SLV. It seems now that I may have grossly understated the turnover in this important silver investment vehicle. A private web site that I have previously referenced indicates that I may have missed a significant acceleration in SLV inventory turnover which began about six months ago. While I have been marveling at the 2 million+ oz weekly turnover in the COMEX silver warehouses, there appears to have been an even bigger turnover in SLV holdings since mid-Feb 2012. While this site is private and I can't guarantee its accuracy, it sure seems legit to me. I

have corresponded by email with the author of the site, although not in months. The weekly movement figures go back to July 2010 and the changes in the total SLV silver holdings tell a story of silver price rises (with increased holdings) and silver price declines (with withdrawals); just as one would expect. I don't study this data frequently and probably because of that I missed the obvious and shockingly high turnover that began in Feb. Please look for yourself –

<http://about.ag/SLV/>

One thing that occurred to me about the SLV inventory turnover is that it would seem to make sense that if COMEX inventory turnover is high, so should the SLV inventory turnover be high. After all, the COMEX silver inventories, at over 140 million oz, are the second largest stockpile of silver in the world; with SLV at number one with over 310 million oz. If tightness is behind the COMEX turnover, why shouldn't it also be seen in SLV? Added to the COMEX silver warehouse turnover, the movement in SLV inventories would seem to paint an even tighter silver supply situation in the wholesale physical market. As I have asked on other occasions, if anyone has a more plausible explanation for the unusually high (and increasing) turnover of 1000 oz bars of silver, other than as a symptom of tightness between supply and demand, please let me hear from you. Like many other market factors, this turnover seems to be specific to silver and not to any other metal.

Coupled with the unusual turnover in 1000 oz silver bars, there have been

unusual net changes in the level of various silver ETFs, also suggestive of tight conditions in silver supply or of increased silver investment demand. First, there was the large 4 million ounce increase this past week in the holdings of the big Swiss silver ETF, ZKB, pushing the total amount of silver held in the world's second largest silver ETF to almost 89 million oz. It is a fairly basic investment premise for investors to buy into any asset rising in price, especially after a prolonged down trend. In that regard, the increase in holdings in the ZKB made all the sense in the world. If the big increase in ZKB holdings made sense, then the withdrawal of almost 5 million oz in the SLV in the week that ended yesterday, made absolutely no sense. Just like was the case with ZKB, the holdings in SLV should have increased noticeably, especially given the high volume in SLV on the recent turn up in silver prices. Certainly, I have been expecting big increases in SLV holdings and felt that many millions of oz, perhaps 10 million or more, was owed to the Trust. So, instead of the expected big increase in SLV holdings, we got a big withdrawal. What gives?

Whenever all the facts are not visible (most of the time), one is forced to arrive at conclusions based upon logic. Given the established high turnover in silver inventories and the supply tightness that portends, the most plausible explanation for the withdrawals in SLV where there should have been deposits of metal is that the silver to deposit in SLV was simply unavailable. The only mechanical way for that to occur would be if there was a corresponding increase in the short position of SLV to satisfy the buying which appeared

apparent. The next stock short report is scheduled to be released on Sep 12. Since I have never been one to mince words or figures, I won't start now. While I reserve the right to admit I was wrong, my estimate would be for this new report to show an increase of 10 to 15 million in shorted shares in the SLV. If that occurs, I do plan on making a big stink and would request your assistance in advance.

However, there is one potential fly in the ointment concerning my prediction. Short positions on stocks come from a source I am uncomfortable with – the Depository Trust Clearing Corporation (DTCC). <http://www.dtcc.com/> This is perhaps the largest financial organization on the planet and perhaps the most secretive. The DTCC is tasked with clearing of all stock and bond and derivatives transactions (apart from exchange traded futures and options). So large is the DTCC, that unlike the US Government or other institutions, it measures its volumes cleared not in the mere trillions of dollars, but in the quadrillions of dollars or thousands of trillions (\$1.66 quadrillion to be exact). I hate to say I don't trust anyone, so let me say I am unsure of the DTCC. It is made up of big banks and financial institutions, precisely the type of entity that instinctively causes one to secure his wallet when in the same room. I can't point to any past instance where I felt the DTCC intentionally misreported a short position in a stock, but I am uncomfortable that this largely private and loosely regulated organization (owned largely by the big banks and dealers) is more opaque than it is transparent. For one thing, I can't imagine how it is

allowed that large short holders are not clearly identified, while large investors are subject to public reporting when ownership exceeds 5% of any security. If push came to shove and JPMorgan asked (or instructed) the DTCC to not report a big short position in SLV, I am unsure if the DTC would comply. Obviously, JPMorgan has closer and more influential ties to the DTC than any of you or me. I'm not wimping out on my prediction, just thinking in advance why I might be wrong about as big increase in the SLV short position.

One thing is certain; shorted shares of SLV have no metal backing and that's the problem. It is easy to see why an entity would go short SLV as an alternative to scrambling for physical silver in a tight market, especially if that entity was already heavily short in COMEX futures. Clearly, I am thinking of JPMorgan. The important takeaway here is that even the manipulative short selling of SLV, which reached previous historical peaks in 2008 and 2011 at important price highs, confirms the tight supply circumstance every bit as much as the frantic turnover in inventories. There is no better reason to short SLV aside from there not being enough metal available to secure and deposit, as there are plenty of other ways to speculate better to the downside than shorting SLV (using futures, options, etc.).

There should be no doubt that I am opposed to the shorting of SLV shares due to the uniqueness of the security itself as well as the promise of the prospectus of metal backing for all shares. This goes for all other hard metal ETFs, as well.

September 5, 2012 – Measuring Silver Tightness

Unless I'm mistaken, there is no short selling allowed in the Swiss silver ETF, ZKB, which may account for why deposits jumped so much last week while SLV's holdings declined. But I would be remiss if I didn't point out the potential bullish implications for the price of silver that could result from the shorts in SLV getting overrun. While I feel strongly that all market participants and, indeed, the market itself would be better served if no SLV and other hard metal ETF shorting were allowed, there is no guarantee that the SLV short sellers would prevail as they did in 2008 and 2011. In keeping with Izzy Friedman's Full Pants Down premise (in the archives □ Oct 8, 2009), should the physical shortage arrive, the bigger the silver short position, the better. I try to remain objective and professional about these things, but I would be lying if I said I would feel sorry to see a big silver short caught in the crossfire of a physical shortage.

It's easier to observe and comment on a physical shortage after the fact and when it's obvious to all. To hope to anticipate the arrival of a shortage is much more difficult. That's because we are forced to rely on signs of a pending shortage which are necessarily more subtle than are documented instances of delay and/or delivery failures. But one thing which won't be subtle when the silver shortage arrives will be the effect on price. An actual shortage of any commodity always causes the price to rise sharply. Compared to any other commodity, there are special circumstances in silver due to the price being manipulated by excessive and concentrated short selling. Therefore, any physical silver shortage would cause prices to move higher disproportionately

September 5, 2012 - Measuring Silver Tightness

when compared to any other commodity shortage. Needless to say, holding silver before a shortage is widely recognized will be much better than buying afterwards.

Ted Butler

September 5, 2012

Silver - \$32.15

Gold - \$1693