Look Out!
The ETFs Are A Trap!

By Franklin Sanders
The Moneychanger

Something just doesn't smell right. Since 2004 several Exchange Traded Funds in gold (since 2004) and silver (since 2006) have been offered to the public, and they've boomed. Total silver in the three ETFs amounts now to 321 million ounces (9,998 metric tones), while total gold in ETF hands is almost 42 million ounces (1,305.65 tonnes). (A metric ton equals 32,105.8 troy ounces or 1,000 kilograms).

The road to hell is paved with laziness. The ETFs were offered as an "easy" way to invest in silver and gold. No heavy, dirty bars or coins to mess with. No tiresome registered mail. No dangerous storage conundrum. Just send us your paper dollars and we'll buy the silver or gold and hold it for you. No, you can't actually take delivery of it, but you'll be able to buy and sell the shares of the ETF and profit just the same.

Demand for silver & gold has been re-routed into demand for ETF shares, which is not the same thing.

Where is the ETF Gold & Silver

The devil is in the details, and James Turk, editor Freemarket Gold & Money Report, showed long ago that the ETFs had no transparent method of reporting their holdings. Under the terms of their offering, the silver or gold might be stored with any number of custodians, in any number of places, unaudited as to actual existence.

Now in all fairness, a gold and silver dealer might temporarily owe more silver and gold that he actually has in hand, counting on orders placed with other dealers to be delivered. That is a product of ordinary turnover, as in any business. But what if the dealer is agitating something other than ordinary turnover? What if he is shorting massive amounts of silver, selling paper silver, hiding behind his size and the burdens of delivery and ease of electronic settlement and derivatives?

Enter The Conspiracy

Add more: what if sound suspicion exists that large bullion banks have been working with the US Treasury for years to manipulate gold's price down, or keep it from rising, as part of their cover for inflating the US dollar money supply? After all, gold is the chief alarm that sounds to the world when inflation is ruining a currency. Gold races upward against the currency, and announces to everyone what is happening. I blow off as ignorant objections those who respond to this allegation with shouts of "Crazy conspiracy theory!" Anyone familiar with the meticulous research of the Gold Anti-Trust Action Committee (GATA) and LeMetropoleCafe.com knows that since 1996 they have documented a heavy case that the US Treasury and the bullion banks have done just that. Denials notwithstanding, since the 1935 Gold Reserve Act the Treasury has had statutory authority for a secret slush fund, the "Exchange Stabilization Fund," specifically created to manipulate the price of gold and other currencies to protect the US dollar's exchange rate. Certainly, the means exist, as well as a motive.

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old available to manipulate will get to be an
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instrumentality that would soak up that demand for silver and gold? That would promise to be backed by silver or gold, but never be forced to pony up the actual physical product? And that would look just like, well just like the ETFs!

But what is the motive for manipulating silver's price when you're trying to manipulate gold? Simply this: gold traders watch the gold/silver ratio. If the price of gold keeps on dropping while silver remains unchanged, the market will smell a rat. Besides, as a much smaller market, silver is easier to manipulate than gold, so it makes sense to hit the silver market hard and stop up the market's nose when you want to suppress gold.

Call me a conspiracy nut, but I think that's just what has happened. Of course, as long as the Fed and the US government are inflating the dollar, this manipulation is doomed to failure, just as the US government's clumsy manipulation in the 1970s was doomed to fail. (The Treasury held "gold auctions" in the mid-1970s to contain gold's price, and to give the Arabs a means to recycle their petro-dollars by buying US gold on the cheap. The auctions suppressed gold's price for a few days, but failed in the long run to stop gold's inexorable rise to $850 in 1980).

Numbers Don't Add Up

Here are some back of the envelope calculations on supply. I haven't spent hundreds of hours digging these out, but they're roughly accurate. Dave Morgan of The Silver Investor keeps up with these things, and he graciously supplied these figures.

Barclay's iShares silver ETF claims 270,000,000 oz; Zurich Cantonal Bank 44,000,000, and ETF Securities Holding 17,000,000 oz. That totals 321 million ounces (Moz). Add to that Central Fund of Canada's (CEF) 60,000,000 (which most likely really is in their vaults), and you come to 381 Moz.

Oddly enough, CPM Group, which publish a yearly silver supply/demand analysis, estimates total available silver stocks at 400 Moz. So we are asked to believe that the ETFs among themselves, plus CEF, hold 95.25% of all the available silver stocks in the world.

Hmmmm. There's a problem. If the silver ETFs really do own the all silver they claim, then they have already soaked up most of the world's readily available silver supply, not to mention the one billion plus ounces that disappeared during the decade of silver production shortfalls in the 1990s and 2000s. Pretty soon, all those folks who use silver for industrial production are going to have a problem, too.

Now the backwardation in silver on the London Bullion Market in January begins to make sense. Now the huge backwardation in retail silver products begins to make sense as well. (A "backwardation" occurs when the price of a commodity for immediate delivery rises higher than the price of that commodity for future delivery. Usually the cost of carrying that commodity in inventory until some future date adds a premium called "contango" to that price. A backwardation, then shows a supply shortage exists).

Gold Is Suspicious, Too

The inventory figures for gold ETFs leave one curious, too. As of 14 April 2009, TheBullionDesk.com shows the holdings of all gold ETFs at 41,977,900 ounces. That's 1,305.65 metric tones. Remembering that all the central banks in the world together claim to hold about 25,000 tonnes, the ETFs since 2004 have stacked up 5.2% as much gold as all the world's central banks spent 100 years gathering.

Hmmmm. That's also quite a bit of gold demand that the ETFs have soaked up off the market, selling those paper shares in a pile of [supposedly existent] gold.

Now if I were the Nice Government Man tasked with manipulating the price of gold, I would be pretty pleased with these big sinks for gold demand, sopping up all that gold-hungry money I couldn't otherwise reach and stretching the available gold supply.

... vs. Silver's

...litation on the slenderness of silver's supply compared to gold's. The CPM group estimates total available silver stocks, those ready to come to market, at 400 Moz or 12,459 tonnes. The largest identifiable gold stocks in the world are the central banks' claimed 25,000 tonnes.

Right. Total available silver stocks are only half of total available gold stocks. Sort of makes you wonder why it still takes 70 plus ounces of silver to buy one ounce of gold. Sort of reinforces the notion that silver has a lot further to rise against gold, too, doesn't it?

Now I have to suspect those number are somewhat short of the true amount of silver that might come to market as prices over US$20 an ounce. In 1992, Charles River Associates published a report on world silver stocks that estimated that in all human history, about 38 billion ounces had been mined. Of that, they estimated that about 19 billion ounces remain, most of which was unavailable to the market because it was tied up in religious artifacts, sterling silver, jewelry, etc., unlikely to come to market at any price below $50 an ounce, if ever. (1980's $50 means 2009's $178.56, adjusting for inflation).

During the decade of the supply shortages, something over one billion ounces of silver was consumed, but much of this had come onto the market as surplus during the preceding decade, so that overhang was consumed by the later shortages. Call that a wash. Still, we are left with two mysteries. First, where did all the silver come from, and where does it continue to come from, to make up the supply shortfalls? Second, how much silver really is out there in the world that might in fact come to market when the price tops $50?

I have no answer to either of those mysteries, and I don't think they can be answered. I am, however, confident that most of the up-to-$50 silver in the world was coaxed out during the 1970s silver boom, and into the early 1980s. Huge amounts of that "attic silver" came to market then, so it isn't around now to rush to market. What are we left with? That the available silver supply - the silver that we can see - is about half the amount of available gold, Oh, throw caution to the wind. Say the available silver amounts to twice as much, the same as the available gold. That still yields a silver supply much smaller than most analysts believe, and it argues that silver stands to gain much more out of this bull market than gold. Much more, since silver is a smaller market than gold, and much more undervalued than gold. Meanwhile, as monetary demand crashes into the silver market, industrial silver demand keeps on ticking.

What's the Bottom Line?

So I am left with my old conclusion, that silver will rise much faster than gold. In fact, if the gold/silver ratio is to return to that 16:1 mark it reached in three bull markets in the 20 the century, silver ought to rise about four times as fast as gold.

Yes, I know that puts me out on a limb. I know that 125 years of monometallic gold standard has made silver the red-headed step child of the precious metals, and littered the landscape with gold only bugs. Yes, I am pretty lonely contending that silver is a monetary metal, but I also have the strong wind of 6,500 years of history at my back, and the faithful U.S. government and the Fed feeding monetary demand those body-building protein shakes in the form of huge inflation.

So I think I'll stick with silver. I just won't buy it in the form of silver ETFs, though, thank you very much. I will stick with physical silver, in my own hands. I'll be a lot less nervous that way.

P.S. Since this bull market began, I have expected a different outcome than 1980, when paper silver traded at a huge premium to physical silver. Rather, this time around I have expected to see at some point a large issuer of paper silver - a commodity exchange, a storage scheme - to be exposed as a fraud, without sufficient physical silver on hand to back up silver owed. I'm not saying this will be the ETFs, only that some such failure will take place, and drive physical silver to an even higher premium over paper silver.

Editor's Note: Franklin Sanders is editor of *The Moneychanger*, P.O. Box 178, Westpoint, TN 38486, 1 year, 12 issues, $149. The Moneychanger's goal is to help

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nklin's *10 Commandments for Buying Gold*

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