CPM Group

Market Alert

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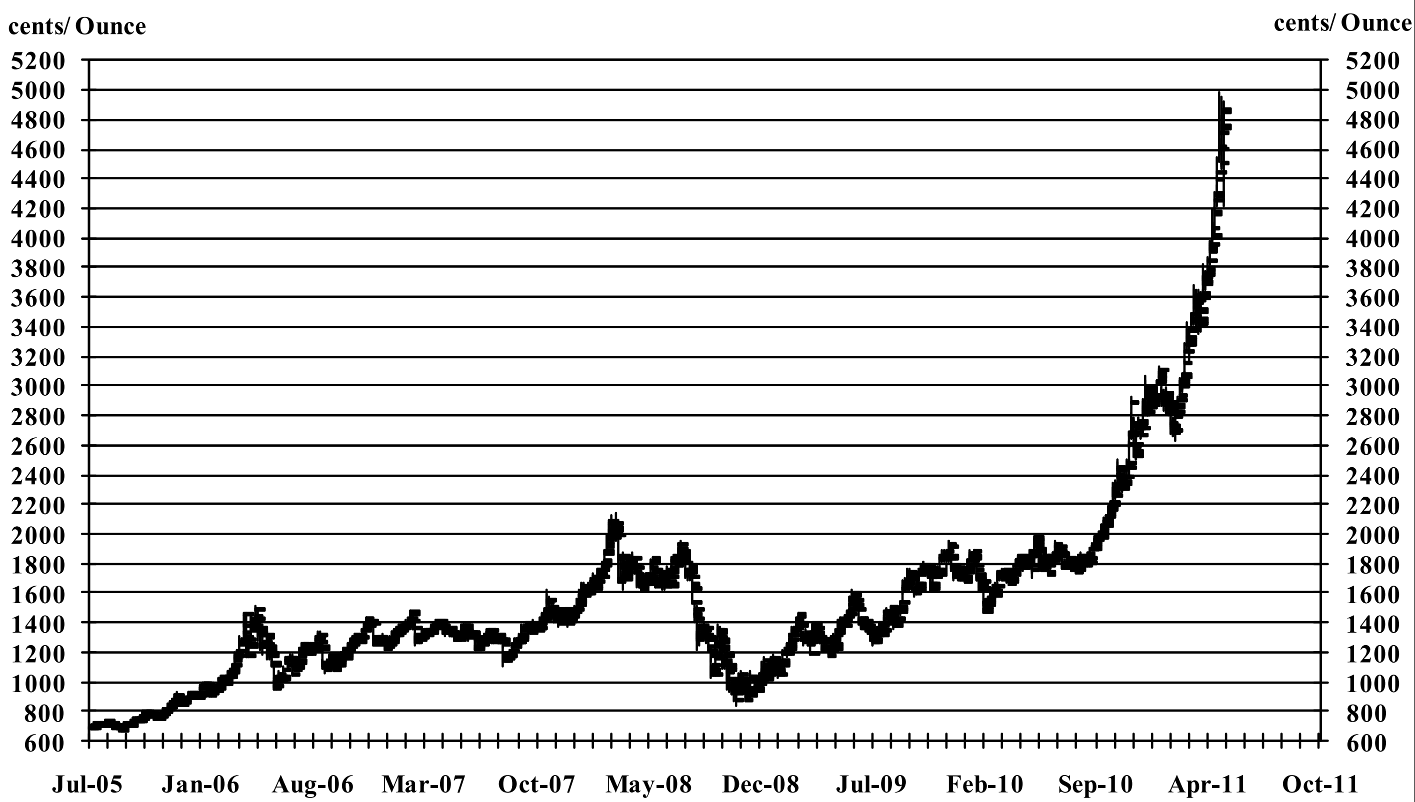
Gold Overheated; Silver In A Bubble

The following text is an excerpt from the May Precious Metals Advisory, due for release on Thursday, 5 May. Given the volatility in the market and our expectation that gold and silver prices could decline sharply between now and Thursday, we are distributing this commentary early.

Silver and gold prices have risen sharply over the past month. Prices had been expected to rise. These reports in recent months had suggested that gold could spike as high as $1,550 into May, before falling back toward $1,360 by the end of June. Silver was projected in the April **Precious Metals Advisory** as possibly spiking to $42 during April and May, before plunging back to $28 by the end of June. Admittedly, the $42 was marked up from $40 the month before and $35 in the February edition, reflecting the gathering upward pressures on silver during February and March. Gold touched $1,569.80 intraday on the Comex Friday 29 April, while silver briefly touched $49.56 intraday on Thursday 28 April.

Prices have risen for three main reasons. First, investors have been pouring into silver and gold out of concerns over the course of the U.S. dollar, which has been plunging in value back toward levels last seen in late 2009 and early 2010, inflation concerns, and other economic and political worries. Second, and more important to the rise in prices during April, there has been a tremendous surge in short-term investor buying (speculative demand, those who would deprecate short-term investors would say). The third factor, also very important, has been the roll out of the May Comex silver futures contract over the past several weeks, which has caused those trading entities that were short the May contract to either roll their May positions forward, buy them back and walk away from the futures market, or buy physical metal and deliver it into the Comex.

Daily Comex Nearby Active Silver Prices Since July 2005



Virtually all of the resolution of the high May contract open interest going into April has been through traders and speculators rolling their positions forward. Very little of the positions have been held into the May delivery period, which began Friday 29 April, and no metal has been delivered into Comex depositories to meet the delivery requirements.

This suggests that silver prices have been in a bubble-like spike over the past few weeks, and are extremely vulnerable to a sharp decline. Gold also could fall back sharply. How far could silver decline? Silver could fall $12 or more, to around $37 or lower, very quickly. Such a sharp retracement seems more likely than not at this point. No asset in history has risen so sharply so rapidly and retained most of its price appreciation. Silver has no immunity to the laws of the markets.

Insofar as much of the buying during April appears to have been technically driven by shorter term speculative activity, one can look to technical price patterns to discern how far prices could drop. The first significant piece of technical support is at $37, fully $12 below last week's high. Additional technical support exists at $31, $28, and at lower levels.

There are other indications that much of the recent buying, during April, has been by shorter term investors who reasonably may be expected to sell once prices stop rising and start falling. Many of these investors have been momentum based traders, technically based traders, and short-term investors. Buying in the silver exchange traded funds (ETFs) has not been spectacularly great over the past month. Nor have there been reports of exorbitantly large silver purchases in the physical markets. The premium over wholesale spot prices for the one-ounce Silver Eagle was 8.7% on 29 April, while the premium for the Silver Maple Leaf was 5.3%. Neither of these premia are particularly high, suggesting that there is no great tightness on silver coin supplies due to heavy buying by investors. The Silver Eagle premium was 9.3% on 31 March, and the Maple Leaf premium was 6.5%, both higher than at the end of April. At the end of January, when silver prices had been pushed lower by investor selling, the Eagle premium was 9.3% and the Maple Leaf was 8.0%, even higher. Clearly, there is no price pressure from heavy coin buying. One dealer said it was covering roughly 90% of its new silver coin sales with silver coins being repurchased from investors selling into the higher prices during April.

The price implication of this is that prices have been pushed sharply higher during April on thin buying volumes by shorter term oriented market participants and by congestion in the May Comex futures contract. This suggests silver prices are vulnerable to a sharp downward correction when, not if, these short-term buyers decide to stop buying, or perhaps decide to sell.

It is possible that some of these shorter term investors might take any price dips, such as was unfolding in the Asian markets on Monday morning, as buying opportunities. It seems more probable that many of them would dump their recent purchases. Other investors may well wait to see how low silver prices fall before starting to buy again. Silver was at $37 only a month ago, and below $34 two months ago, so investors may feel that they can wait for a major decline before stepping back in as buyers. In 2008, at the height of the financial crisis, investors stood aside while silver fell from $19.25 in July 2008 to $9.33 in October before stepping back in as aggressive buyers, even though some investors were buying all the silver and gold they could afford at the time.

In Silver, It Has Been A Comex Phenomenon

Silver prices rose 29% over the course of April, from a settlement price of $37.73 on 1 April for the May Comex futures contract to $48.58 on 29 April. Open interest in the May Comex futures contract dropped from 360 million ounces on 1 April to 10 million ounces last Friday. There was no coincidence between the fact that 350 million ounces of silver was bought back in the May contract and sold forward in July and other contracts, on the one hand, and that spot prices rose sharply during this period. The roll was perhaps one of the major factors pushing prices higher over the past month. So, too, the appearance of a small backwardation between spot prices, where the shorts were covering, and the forward prices, where they were selling back into the market, should be no surprise or mystery to anyone.

Another thing that also should not surprise anyone is the fact that almost all of that enormous May open interest was rolled forward: Despite the bluster from those who would conspire to squeeze the silver futures market about taking delivery, virtually none of the metal positions were held to maturity. There was no group of silver conspirators trying to 'bankrupt' the silver market; it was just business as usual on the Comex. Open interest across all Comex futures contracts surged from around 700 million ounces to 743.2 million ounces on 14 April, reflecting the wave of shorter term investors pouring into silver, following the price higher and driving it higher with their own actions. After that day, when silver settled at $41.66, investors began rolling out of the May contract rapidly, and liquidating long positions across the contract months. Between 14 April and the end of April 95 million ounces had been liquidated across all contracts. This reflected profit-taking by longs. Registered inventories declined, as consumers, dealers, and investors continued to mine Comex-registered stocks for physical metal. Most of the silver remained in Comex registered vaults, however. Total inventories declined 3.3 million ounces over the course of April, while registered stocks declined 8.4 million ounces. The other 5.1 million ounces was shifted to eligible stocks, but remained in the same depositories.These trends do not suggest a massive rush into silver by long-term investors, and they show no evidence that the silver conspiracy crowd has had any success in mounting an assault on Comex inventories.

Silver ETFs Have Seen Only Modest Buying

Meanwhile investors also have not been particularly voracious buyers of silver in ETFs. Silver held via ETFs rose from 601.6 million ounces on 1 April to 612.7 million ounces on 25 April, but fell sharply thereafter to 604.4 million ounces by 29 April. The main silver ETF, the iShares Silver Trust listed on the New York Stock Exchange, rose from 358.1 million ounces on 1 April to 366.2 million ounces on 25 April. As silver prices rose further last week, the SLV holdings dropped back to 354.3 million ounces as of 29 April.