When the Shorts Come Off

-J. Kevin Meaders, J.D., CFP®, ChFC, CLU*

July, 2017—Pulsars aside, the most powerful explosion in the universe is the death of a star. Depending on the mass of a star, its death could happen one of three ways. A star the size of our sun will eventually just fizzle out into a white dwarf. A super massive star much larger than the size of our sun will collapse on itself beyond the bounds of space-time and create a black hole, with a gravitational pull so strong that not even light can escape.

If a star has between 1.35 and 2.1 times the mass of the Sun, it doesn't form a white dwarf when it dies; something more interesting happens. When the star's fuel supply has been depleted, the ever-present strength of gravity will cause it to collapse in on itself fusing elements into denser and denser ones, until it reaches iron.[1]

The star then has but seconds to live before an immense explosion called a super nova occurs. This explosion has the effect of fusing the Iron into even heavier elements: Copper, Silver, Tin, Iridium, Platinum, and of course, Gold, just to name a few. In fact, ALL of the heavier elements in the universe are created in this way.

Thus, every single piece of gold or silver on our planet was created billions of years ago when a goldilocks-sized star finally ended its life by going super nova. Not an easy thing to duplicate. Interestingly, you contain some of these heavier elements in your body, particularly your brain.[2] So in a way, you are yourself, star stuff.

But it is the shiny metals created in these super novae that have always held special value for us earthlings. The main reason that these metals are valuable is because they are rare, and cannot be created by humans. Whereas, Dollars, Euros, Yen, Pesos, Rubbles, Yuan… you get the idea.

This is why the price of gold and silver soared after the unprecedented money printing with TARP and all the Quantitative Easing (QE) going on during the Great Recession of 2008 – 2009.

So Why Has the Price of Silver Gone *Down*?

Great question. But before we talk about what has happened and continues to happen to the price of silver, we need to explain what a futures contract is. Imagine a farmer selling his August crop to a grocery store in March, say at $50/bushel, before the crop has even begun to fruit.

When August rolls around, the farmer is obliged to deliver his crop at the preset price of $50/bushel even though the current market price has risen to $70/bushel due to a dry season. Had it been a wet summer, the market price would have fallen to $35/bushel. In either event, though, because of the futures contract, the farmer's sales price is locked in: $50.

If you ever saw the movie "Trading Places" with Eddie Murphy and Dan Ackroyd, this was what was going on with orange juice. As the movie dramatically portrayed, futures contracts are bought and sold (and valued) based on the expectation of the future price of the underlying commodity and thus the contract itself can change price dramatically, both creating and destroying fortunes in moments.

There are parties—large international banks that must remain unnamed—that have sold over one billion ounces of silver short on the futures COMEX market. That is, they sold almost a billion ounces of silver that has not yet been mined, and may not even exist. Laws of supply and demand will of course drop the price.

The problem is, these silver contracts don't have a finite delivery date, but delivery on demand, and so long as the interest carry is being paid, the silver never actually has to be delivered. It's a good thing too, because that silver is still in the ground somewhere if indeed it even exists. Sean Geddart of Seeking Alpha sums it up well; just Google "Silver Manipulation" to see his articles.

> Adding up the total amount of paper silver traded on a single day from both exchanges yields 963 million ounces of paper silver traded. You can see that more paper silver is traded in a day than is mined in a year. If you annualize the total daily open interest of silver futures contracts on March 7th [2017] you get 351 billion ounces of paper silver. Now you can get some scale of the silver derivatives market, and understand why silver's fundamentals have a negligible effect on its price. The physical market is 0.0055% the size of the derivatives market.[3]

Thus, certain parties have sold enough of this paper silver "short" to force down the price of the physical stuff. It appears that these same parties are currently buying up massive amounts of the physical bullion—at artificially suppressed prices. A cursory search on the internet should reveal the culprits easily enough. This explains (at least partially) the drop in the price of silver, but still doesn't answer when the reversal will occur. The only reasonable answer is: "when the shorts come off."

Will the Real Inflation Rate Please Stand Up?

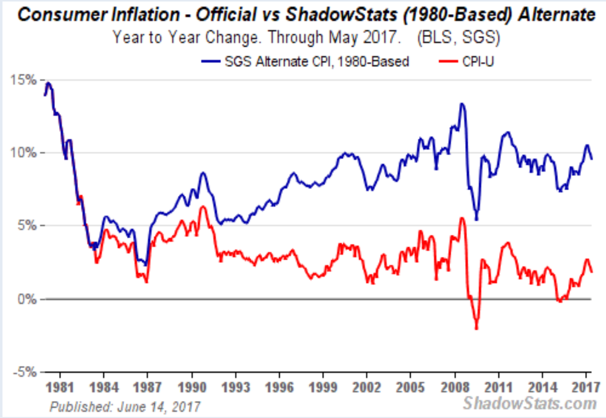
Interestingly, and perhaps suspiciously, the price of silver (and gold) has historically been a good indicator as to the rate of inflation. It is certainly one of the headline indicators that the Federal Reserve follows. A sharp decline in the precious metals market would indicate that inflation is low or perhaps flat. Conversely, a sharp increase in precious metals would indicate a concern of rising inflation.

The official inflation rate, called the Consumer Price Index (CPI), is formulated and issued by the U.S. Bureau of Labor and Statistics (BLS), a government agency. It is curious to note that the formulary for this Index was adjusted in 1980, and again in 1990. It was adjusted because no one liked what they saw.

A specialist in government statistics, John Williams, continues to track and report the results of the old formulas on his site, Shadowstats.com.

Here is the 1980 based CPI formulary compared to the one used today.

It's pretty obvious that if we were still using the 1980 formula, inflation would be closer to 10%. This may be more consistent with your real world experience with line items such as groceries, tuition, and healthcare costs.



Once you realize that the CPI is the number used to base social security cost of living increases to the millions and millions of social security recipients, it becomes understandable why the government would want to finagle with the numbers. But is that really fair to all of those who paid into the system all during their working life and now depend on it for sustenance during their retirement? Indubitably not!

We believe inflation will become worse in coming years, and those precious metals will soar in value vis-a-vis the ever-devaluing dollar. If things get bad enough, à la Weimer Republic or Venezuela or the like, then those precious metals may become a temporary currency until the dollar can be replaced, most likely with the Special Drawing Right (SDR), but that's for another letter.

In the meantime, I think you can see that there is a good case for holding silver, both as an investment and as an inflation hedge. We don't know when the price of silver will spike, only that it will. It could be that the impetus will be the coming market crash.

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[1] https://map.gsfc.nasa.gov/universe/rel_stars.html
[2] https://www.mendability.com/articles/our-brain-and-metals/
[3] https://seekingalpha.com/article/4054626-part-1-silvers-price-manipulation

About J. Kevin Meaders

Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC). **kevin@magellanplanning.com**

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4170 Ashford Dunwoody Rd. NE, Suite 480
Atlanta, GA 30319
404-257-8811