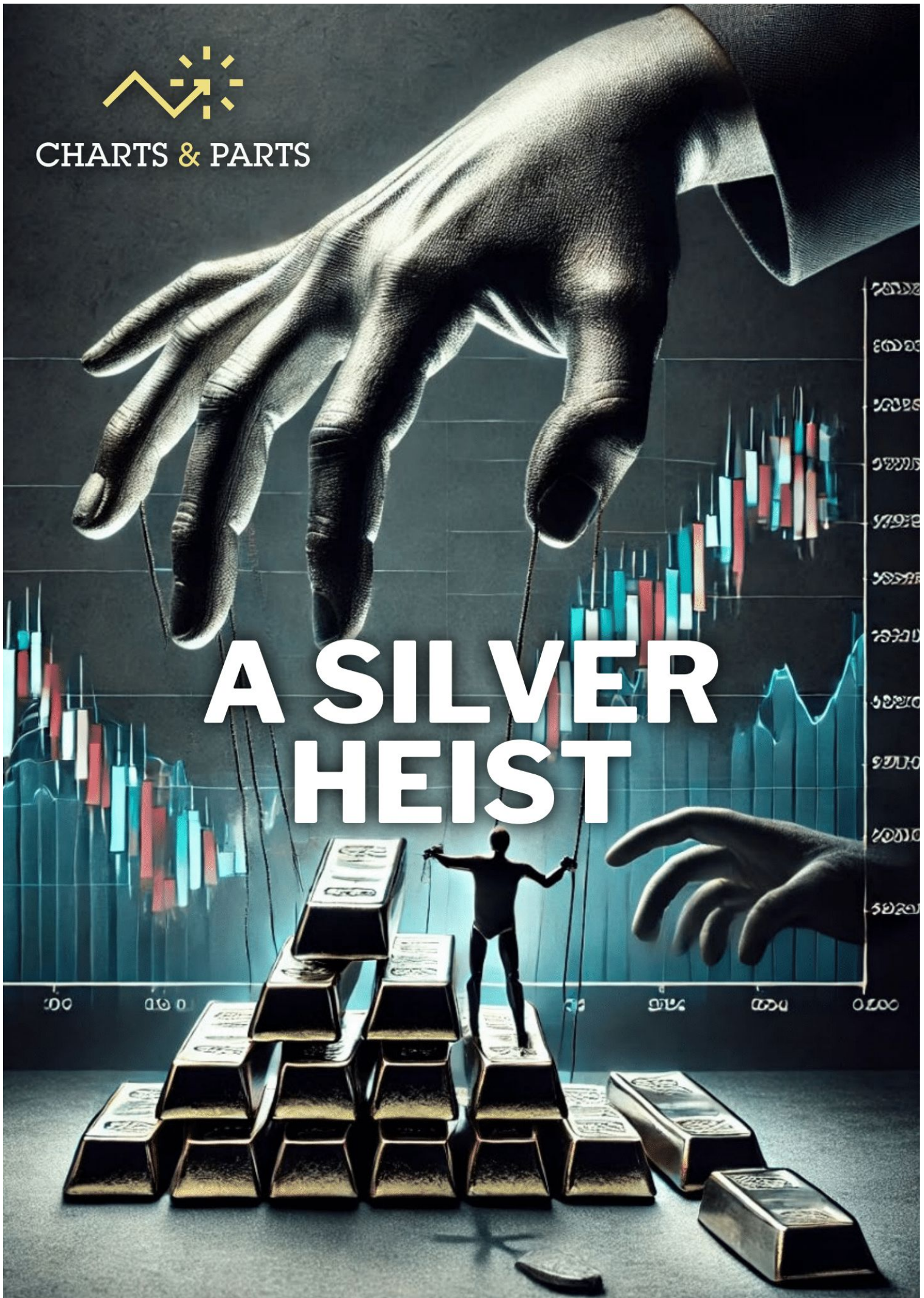




CHARTS & PARTS

A SILVER HEIST



CONTENTS

03

*The EFP
(Exchange for Physical)*

25

Appendix

08

Paper vs. Physical

30

At the Helm

18

Another Great Taking



THE EFP (EXCHANGE FOR PHYSICAL)

INTRO

We are headed down a trading rabbit hole. We'll connect a few dots and conclude there is a real chance that a large holder of physical silver will execute a rug-pull and the holders of "paper silver" are on the losing end of this great taking. The probability of this happening is north of zero, so we want to go there.

We first need to set the trading table in order to explain how a potentially problematic position can be at the center of the precious metals market. We want to demonstrate how a "risk-less" and benign position of long physical silver is being managed in a not-so benign manner. A manner that carries large systematic risk. This is a thought experiment that we like to call "Tail Talk": when we discuss the different snowflakes that can start the next avalanche.

Before we jump into the fun stuff, we need to dive in and talk about some trades and concepts that will arm you with a stronger understanding and appreciation of the potential silver heist. We'll break our missive into three parts:

PART 1: The EFP (Exchange for Physical) – explains the "risk-less" strategy of long the physical asset vs. short the paper representation of that same asset (a derivative).

PART 2: Paper vs. Physical – demonstrates the value in the physical asset.

PART 3: The Silver Heist – a thought experiment, where the paper vs. physical set-up in the market is problematic.

THE EFP - IT'S ALL ABOUT RATES

I learned about the EFP (Exchange For Physical) market when I worked on the index arb desk. This was my first seat as an assistant trader where I ran the p&ls, monitored positions, and fetched the senior trader coffee, lunch, and whatever else he wanted.

One of my favorite stories (and a lot have been accumulated after 25-years in the derivatives trenches) was the lesson I received very early on when I started on the index arb desk. My trader said, "It's all about rates. Learn as much as you can about rates." And boy was he right. There exists a dizzying amount of different rates, calculations, and nomenclature. There's LIBOR, the Fed Funds rate, and SOFR (Secured Overnight Financing Rate). Then there is the TED spread, the OIS Spread, long term rates, short term rates, and strips, collars, and caps, and on and on it goes.

The classic index arb trade is to trade a basket of stocks, specifically the S&P 500 stocks, against the S&P 500 futures. This trade is long stocks/short futures or vice versa. The simultaneous execution of both stocks vs. futures attempts to capture some spread between the two that is above and beyond the "fair value" to carry the position until the futures expire.

Rather than get too far into the weeds on this position, let's conclude that the index arb position all comes down to a funding trade. The trader is simply locking up a rate to either borrow or lend, depending on the position. Through this borrow/lend lens, index arb is just another funding game.

EXCHANGE FOR PHYSICAL

Another popular position on the index arb desk is the EFP. Similar to index arb, this is a market-neutral transaction where the counterparties simultaneously cross (exchange) a basket of stocks vs. the corresponding futures at some agreed upon level/spread. Again,

the spread between the futures and the index level (basket of stocks) is mainly driven by the level of prevailing interest rates.

A popular application of the EFP could be a funding trade for a mutual fund manager. In this example the client is an index manager like a Vanguard. Assume Vanguard receives inflows of capital into their index fund. Vanguard can quickly and easily put the new money to work with a simple purchase of S&P 500 futures. When some critical mass of futures have been accumulated, Vanguard can execute an EFP trade where they sell their futures and buy stocks. Here, Vanguard has used the EFP trade to replace/swap out of the futures and into the basket of long stocks, which they know they will carry for the long-term.

We know you did not come here for trading lessons, but we need to explain the basic position and market-neutral concept of stocks vs. futures. This is a critical first step down the paper vs. physical rabbit hole. In our example, the basket of stocks represent the physical assets while the futures are the paper representation of the asset. Hence, futures are derivatives.

HARD TO BORROWS

By now you may be familiar with a hard to borrow (HTB) stock - thank you GME (Game Stop). A stock is HTB when there is a lot of demand to short the company (thinking the shares will decline in price). In order to short a company's share, one must first "locate"/borrow the shares in order to sell them. GME was a classic HTB situation. We now know there were more shares short than shares outstanding, and that is what got this party started. The demand to short GME was huge. Then things broke and GME shares soared...HIGHER. This drove the demand to sell short even higher, and it did not help that holders of GME shares decided to stop lending their shares out, which drove the cost to borrow the shares higher still.

A FASCINATING DISCONNECT

It was a random market decline in 2011 when we witnessed the unthinkable: a broad-based index (IWM - The Russell 2000 ETF) became hard-to-borrow. The market decline came on so fast that the market participants got caught off guard and long. This market jolt created a mad scramble to borrow the IWM shares to short in order for the market participants to hedge downside exposure against these same smaller cap stocks/Russell 2000.

This anomaly raised our awareness to the size of the markets and its participants. The inflation, creation of currency units, and financialization has grown so large that certain players and positions are possibly out-sizing the markets themselves. This took our paper/physical curiosity to new heights. My simple conclusion was — if a popular index ETF can become hard-to-borrow, then there is some real value in physical assets. There was such a big price to be paid to short an asset via derivatives, that this actually increased the value of the physical asset itself.

CONCLUSION

You are now a pro. We covered the index arb trade, EFPs, and hard-to-borrows in order to better understand the difference and dynamics between physical and paper assets. This similar concept applies in many areas outside of stocks. We also see this in other commodities that have an ETF (Exchange Traded Funds) like oil vs. USO (an oil ETF) and several others. We also see this in Bitcoin, where we now have a host of different Bitcoin futures. And of course we see this in the precious metals space, so stay tuned for the details behind physical and paper silver and gold.



PAPER VS. PHYSICAL

INTRO

After learning about index arb, EFPs, and hard-to-borrows in Part 1, you are now a pro trader. We covered the concept of hedging physical assets with paper assets: long a basket of S&P 500 stocks against a short in the S&P 500 futures (paper derivatives). And now we will take a look at how this paper vs. physical game can be played in the precious metals markets – silver and gold. We will use them interchangeably, as most concepts apply to both.

We will now explore some of the major differences between paper precious metals vs. the real thing: the physical assets.

NAKED SHORTS ARE A CULPRIT

It starts with the precious metals prices being set by the paper markets: the COMEX (Commodity Exchange in the U.S.) and LBMA (London Bullion Market & Association). It is the paper (futures) markets that influence spot prices, which are the prices used for the settlement of derivatives, including physical deliveries. So the physical markets are driven by paper pricing.

The physical markets are a different beast. There are several ways to access the physical markets: you can visit your local precious metals dealer, you can purchase and store precious metals with online accounts, or you can exercise your futures (stand for delivery) and redeem your paper futures contract for physical precious metals.

KEY CONCEPT ON NAKED SHORTS: it is important to note that one does not need to own the physical metals (or have to borrow) in order to execute a sell order in these paper futures markets. This is different than the stock market, where one needs to borrow shares in order to short. This is called “naked shorting”, and this opens the door to funky price action.

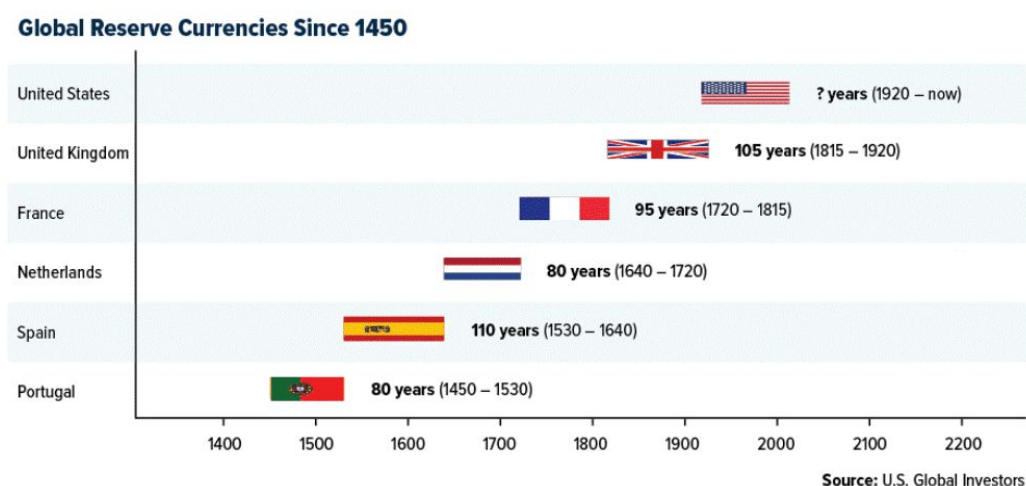
From there it is not a big leap to conclude that these paper prices are manipulated lower. The paper price manipulation has gone from conspiracy theory to fact with all the charges, subpoenas, and fines in the precious metals markets over the years. The big recent bust resulted in a \$920M fine for J.P. Morgan last year. You can read more [here](#).

MONEY SYSTEMS CHANGE

We've written about how money systems change. Silver and gold have been forms of money on and off for 5k years. And let's not forget that silver and gold are also both written into the constitution:



And here is a picture of how the world's reserve currency has changed over time:



Through this lens, we know that money systems change, and precious metals are part of the story.

PAPER SMASHES

We are concluding that somebody (let's refer to this unknown somebody as "Goliath") is using naked shorts to manipulate paper precious metals prices lower. This paper price suppression makes perfect sense from an aligned incentive perspective, as silver and gold are seen as competing currencies. A vote for precious metals can be seen as a vote against our current currency system (and government), thus Goliath has a real incentive to suppress precious metals prices. All our concepts here apply to both silver and gold. Silver happens to be a much smaller and more volatile market, but both paper markets are victims of paper smashes – when Goliath aggressively sells futures to suppress the price.

Here is a favorite chart which supports the price suppression in the paper markets. We can see that the price of gold when the US paper markets are open has radically under-performed the price of gold outside of COMEX trading hours. Trust your lyin' eyes:



A NEW GEAR

The price suppression game (market manipulation) hit new heights when the US froze Russian sovereign assets for its part in the Ukraine invasion. This act sent the world a loud message that their assets are

not safe in the West's hands. A quick reminder that commodities such as gold, oil, and others are mainly priced in dollars. For this reason, most foreign countries are holding US dollars in reserves to transact commodities. The US has already been accused of bullying and weaponizing the dollar through sanctions, but the freezing of \$300B of Russian assets was a step too far. There is only one thing that could be worse than the US freezing other's sovereign reserves, and that would be the seizing of said reserves. And yes, they did just that.

THE FREEZE: <https://www.reuters.com/world/europe/what-where-are-russias-300-billion-reserves-frozen-west-2023-12-28/>

THE SEIZE: <https://apnews.com/article/russia-ukraine-treasury-sanctions-assets-congress-0a3bc97a2d6d77ce3650c767db6ea7ed>

This shot across the bow set off a smart rally in precious metals (and another fiat alternative – Bitcoin). We noticed a few changes over the past year. Below is a graph of the GLD (the largest gold ETF) and the GLD shares outstanding. Reminder – GLD is a paper representation of gold; a paper asset and a derivative of physical gold. The freeze and seize message was loud enough to have the GLD price decouple from the GLD shares outstanding: the GLD was faced with redemptions yet the price of gold was still moving higher. It is clear that the physical demand for gold more than offset the GLD redemptions. There are other nuances to this relationship but suffice it to say – the world is watching... and acting. There are a few potential reasons for this disconnect, but the data remains the same – something has changed.

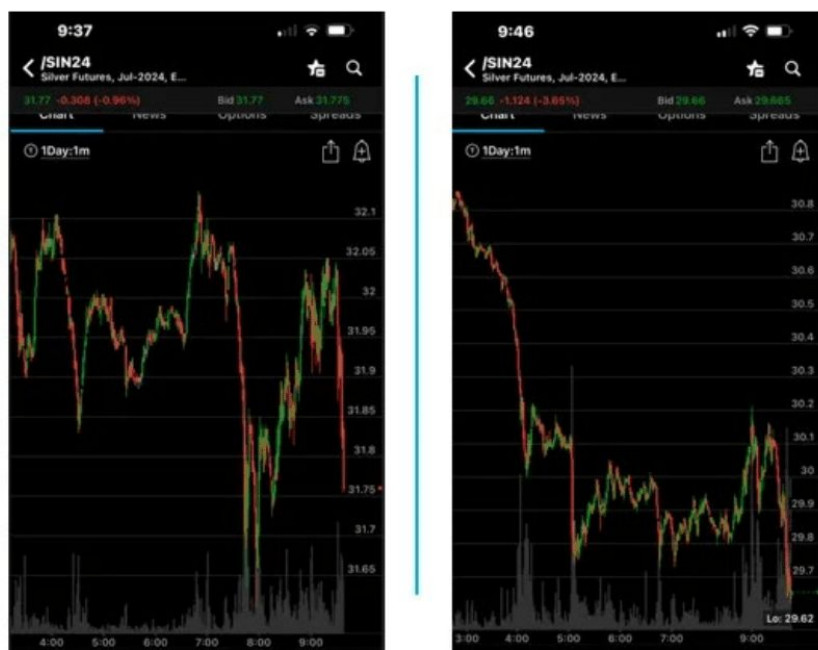


DESPERATION

We now have a problem on our hands. The blatant weaponization of the US dollar has sped up the de-dollarization process (the world selling their dollars) - that's the bad news. The worse news – the precious metals suppression game just got a lot more expensive for Goliath. With the world turning to gold, Goliath will need to dig in their heels for a much bigger fight.

To offset the new global demand for silver and gold, and to contain silver and gold prices, Goliath is forced to sell paper contracts more often and in bigger sizes. What used to be a random event is now commonplace. We see paper smashes every day and often multiple times a day (see graphs below).

Below are recent daily “tic charts” days to show the games being played. Whether it is in the wee hours of the night when volumes are light and the US crowd is sleeping, or early in the morning when the US paper markets open, we see several gaps lower in silver. These gaps are over 1% and sometimes as much as 3%. The only player to execute in this fashion is one who is not sensitive to profits and losses. After our 25 years in the derivatives trenches and running all sorts of transaction forensics, we'll conclude that this is not normal.



We can conclude that this price action is unnatural for the following reasons:

1. Nobody trades like this. It makes zero sense to dump such a large amount of contracts/notional dollars with no regard for price. The market impact of these smashes in the silver market is often well over 1%, which is an extremely costly execution. The only participants who would execute in this manner are players who are not price sensitive. Hint #1.
2. The second hint is that these price smashes often take place in the middle of the night when nobody is around, and volumes are light and early in the morning when the US paper markets open. This allows for a much larger market impact: mission accomplished.

WARNING SIGNS

We also know that the paper silver and gold markets are fractionalized, just like our fiat paper-based fractional banking system. This adds to the risk, as there are not enough physical assets to go around. The paper markets dwarf the physical markets. Unfortunately, we have no idea how extreme this out-of-balance is in silver and gold due to the lack of transparency in the derivatives markets.

We experienced an interesting warning shot during Covid. When the general market had its first major move lower (the S&P 500 declined over 30% in a month), most everything got thrown out and traded down. SLV (paper silver) was down over 35% in a few weeks. Yet, at the same time, the physical price of silver not only held steady, but there was a mini run on the physical (people trying to buy physical). There were silver shortages, and many dealers were posting delayed delivery times 3-10 weeks out... if you can even find what you are looking for. So, as paper silver traded down and physical was flat and the premium on the physical coins reached almost 100% of spot (paper).

A more recent data point shows the silver paper/physical spread on the move again. We can compare the price of Shanghai physical silver against the LBMA paper silver and see that the physical premium had widened to roughly \$4 over the past year:



THE CLOSE

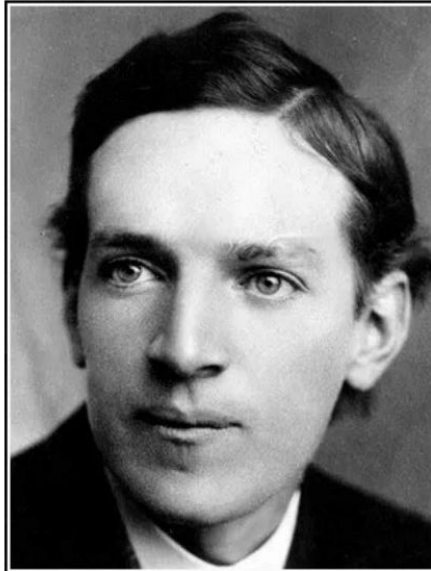
We hope you now have a better understanding and an appreciation of the difference between paper assets and physical assets. Each come with their own set of rules, different exchanges, and unique demand/supply forces.

A logical question would be to ask where the regulators are in all of this. Unfortunately, they are hiding in the bushes, just like the credit agencies did in 2008. There is a little info in the fact that Fort Knox has not been fully audited since 1974. There are several organizations and individuals that have spent a lot of time, energy, dollars, and letters to government to get to the bottom of the precious metal's secrecy, but nobody has broken through. Ted Butler was one of the great fighters in this story, and we'll honor his recent passing with a shout-out for his amazing work in this space.

RIP Ted Butler



Until we get more and better data, it is up to us to gather the info, connect dots, and determine probabilities. It is a shame that the most liquid and transparent markets are run with this level of secrecy.



It is difficult to get a man to
understand something when his
salary depends upon his not
understanding it.

— *Upton Sinclair* —

AZ QUOTES



ANOTHER GREAT TAKING

INTRO

When the Hunt brothers tried to corner the silver market 45 years ago, the regulators changed the rules overnight and halted their attempt. The brothers were fined \$124 million and declared bankruptcy. Goliath (The Powers That Be) has had 45 years to perfect a silver heist of their own, and they've done it.

CASE PRECEDENT

In Part 1, we dove into the hard-to-borrow (HTB) concept to better understand demand, supply, and potential drivers of asset prices. Interestingly, in the futures markets, a seller does not need to locate shares in order to sell. One can execute what is called a naked short. The short seller of futures can simply pound down the paper prices. All they need to do is hit the sell button...over and over again.

We've seen fireworks and chaos in the futures markets before. In 2020, we saw oil futures trade at NEGATIVE \$30, which can only take place in the land of paper prices. We also saw the Nickel futures market break to the upside in 2022. Nickel prices rose over 100% in a couple of hours, and this chaos forced the futures exchange to shut down for a week. In addition, the exchange took it upon themselves to cancel a bunch of nickel futures trades, and the litigation is still on today.



The Wolf of Wall Street – 2013 “Fugayzi, fugazi. It’s a whazy. It’s a woozie. It’s fairy dust. It doesn’t exist.”

With a better understanding of EFPs, hard-to-borrows, and the paper/physical dynamics, the stage is set to share a potential heist scenario in silver.

OPM (OTHER PEOPLE’S MONEY)

We see silver futures manipulated lower with regular paper smashes. Given their sloppy trade executions with major market impact, this seller is not sensitive to p&l. We can see the size of the paper positions, as the COMEX publishes regular reports.

It’s no surprise that JPMorgan shows up at the top of the list. It is also worth noting that JPMorgan became the sole custodian of the SLV (paper silver ETF) in early 2023: <https://findbullionprices.com/blog/jpm-now-sole-custodian-of-slv-etf-holdings/>. As sole custodian, JPMorgan is also a large holder of physical silver. But that is as far as (the lack of) transparency goes. JPMorgan is housing the position, but we do not know for whom. It could be JPM, one of their clients, the government, or some other unknown entity.

And regulators are nowhere to be found. At least they're consistent. The last full Fort Knox audit occurred back in 1974. And we also saw a regulator disappearing act in 2008 when the credit agencies handed out pristine credit ratings a bit too loosely (understatement). Therefore, we connect our own dots.

Our simple conclusion is that the other side of the large silver paper short position is an offsetting position of long physical silver. Makes perfect sense. Although Goliath may be p&l agnostic with the regular paper smashes, a naked short futures position of this magnitude does not make any sense. Especially when we now know the real value is in the long physical, as we explained in Part 2. So the large short paper silver futures are offset with physical longs.

THE CHERRY ON TOP

This ever-expanding position of long physical silver vs. short paper futures is a winning position. Not only does the holder have control of the commodity, it gives them a valuable option if things were to break in the silver market. And given the precious metals leverage, lack of transparency, and fractionalization, there are many other ways the silver (and gold) markets can snap. If and when things break, we know that the holders of the physical asset are on the winning side of the chaos.

And if the breakage were severe enough, we shouldn't rule out that the paper derivatives (SLV, silver futures, and others derivatives) could call a Force Majeure:

Force majeure is a legal term for unexpected events beyond the control of parties in a contract, preventing them from fulfilling obligations. These events, like natural disasters, war, or government actions, can relieve the parties from liability or contractual duties.

KEY POINTS:

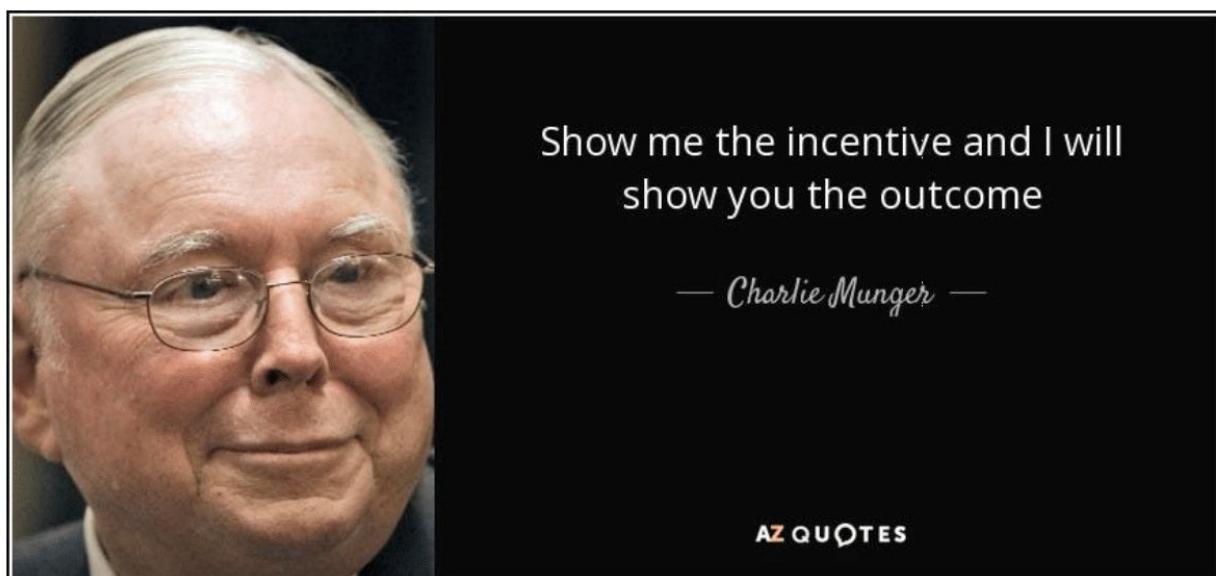
1. **Unforeseen Events:** Includes natural disasters, war, terrorism, pandemics, etc.
2. **Contract Clause:** Often specified in contracts to define what qualifies.
3. **Exemption from Liability:** Frees parties from penalties for non-performance due to these events.
4. **Duration:** Can temporarily suspend or permanently end obligations.

EXAMPLES:

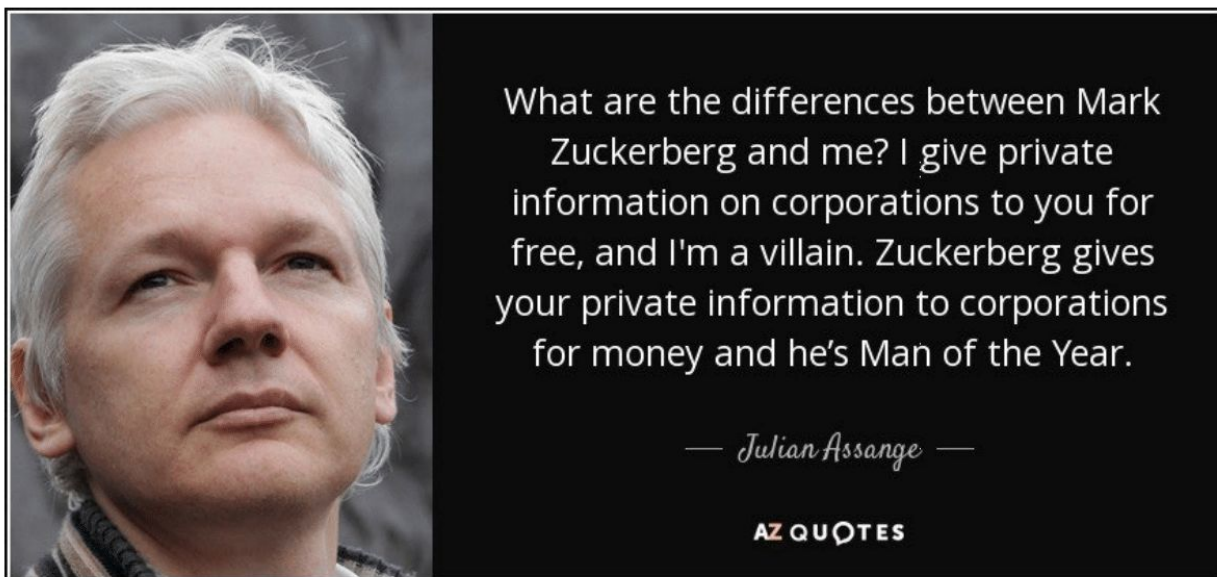
- **Natural disasters:** Earthquakes, hurricanes.
- **Human actions:** War, terrorism.
- **Government actions:** New laws, embargoes.
- **The Force Majeure is at the crux of the heist.** It is this event that could settle all the paper contracts at a cash price (i.e.: prior night's closing levels), just as the price of the physical metals become "unobtainium" and "unaffordium" (hat tip Mike Maloney).

A WIN-WIN FOR GOLIATH

We now see Goliath winning to the price suppression, AND they win if they break the paper markets. This is exactly what makes this scenario so believable.



It is also worth flagging the recent release of Julian Assange. Wikileaks' cables included classified information about the US gold suppression policy. The game has suddenly become a bit more interesting. Julian Assange is a great example of someone people either love or hate. Some view him as a hero for exposing Goliath's crimes and others see him as a criminal for putting our country and people at risk. Either way, the one thing the lovers and haters have in common is that they are responding to Julian Assange's truth bombs. And the Wikileaks' cables show that the US and Europe's intention is to weaken precious metal's function as an international reserve currency.



The COMEX and the paper markets are getting exposed. We cannot be surprised to see a global run on the physical precious metals markets. Predicting timing is a mug's game (guesswork). But we see data that support an increase in the probability and speed of a silver heist. We should go into it with eyes wide open.

APPENDIX

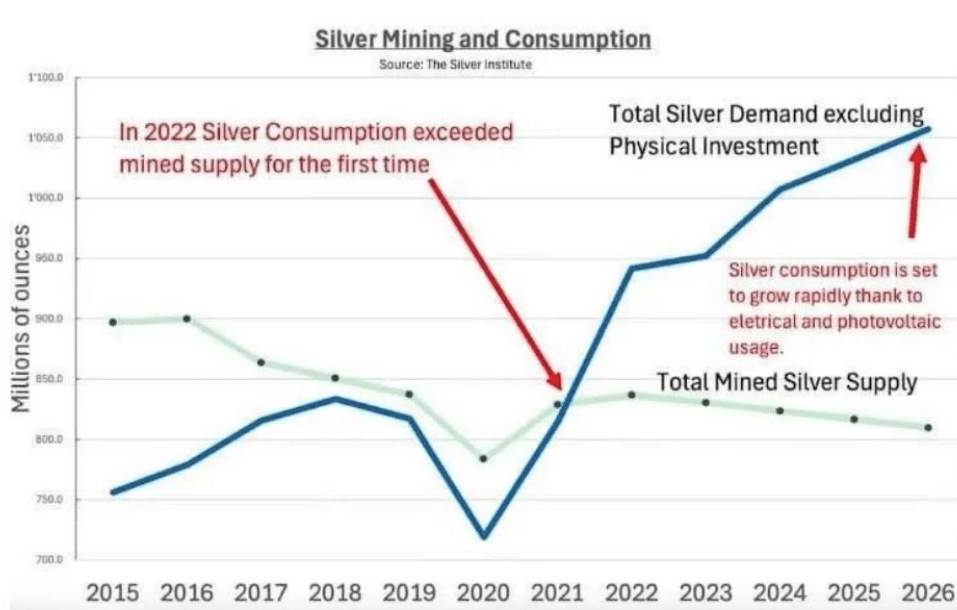
Below we highlight various “Charts & Parts” as anecdotal evidence and a tailwind to a heist.

SILVER IN STRUCTURAL DEFICIT: demand has outweighed supply the past three years and this was BEFORE the seize and freeze of Russian assets.

Silver Supply and Demand												
Million ounces	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023E	Year on Year 2022 2023E
Supply												
Mine Production	845	882	897	900	864	851	837	783	829	837	820	1% -2%
Recycling	179	160	147	146	147	149	148	166	175	179	181	2% 1%
Net Hedging Supply	0	11	2	0	0	0	14	8	0	0	0	na na
Net Official Sector Sales	2	1	1	1	1	1	1	1	2	2	2	13% -4%
Total Supply	1,026	1,054	1,047	1,046	1,012	1,000	1,000	959	1,006	1,018	1,002	1% -2%
Demand												
Industrial	460	450	457	489	526	524	523	509	559	584	632	4% 8%
Photography	44	41	38	35	32	31	31	27	28	27	26	-1% -4%
Jewelry	187	193	203	189	196	203	202	151	182	235	182	29% -22%
Silverware	46	53	58	54	59	67	61	31	41	74	39	80% -47%
Net Physical Investment	301	283	309	213	156	166	187	205	274	333	263	21% -21%
Net Hedging Demand	29	0	0	12	1	7	0	0	4	18	0	409% na
Total Demand	1,067	1,021	1,065	992	971	999	1,004	923	1,087	1,270	1,143	17% -10%
Market Balance	-41	34	-19	55	40	2	-4	36	-81	-253	-140	212% -45%
Net Investment in ETPs	5	0	-17	54	7	-21	83	331	65	-126	-40	-294% -68%
Market Balance less ETPs	-46	34	-1	1	33	23	-87	-295	-146	-127	-100	-13% -21%
Silver Price (US\$/oz, London price)	23.79	19.08	15.68	17.14	17.05	15.71	16.21	20.55	25.14	21.73	23.10	-14% 6%

Source: Metals Focus

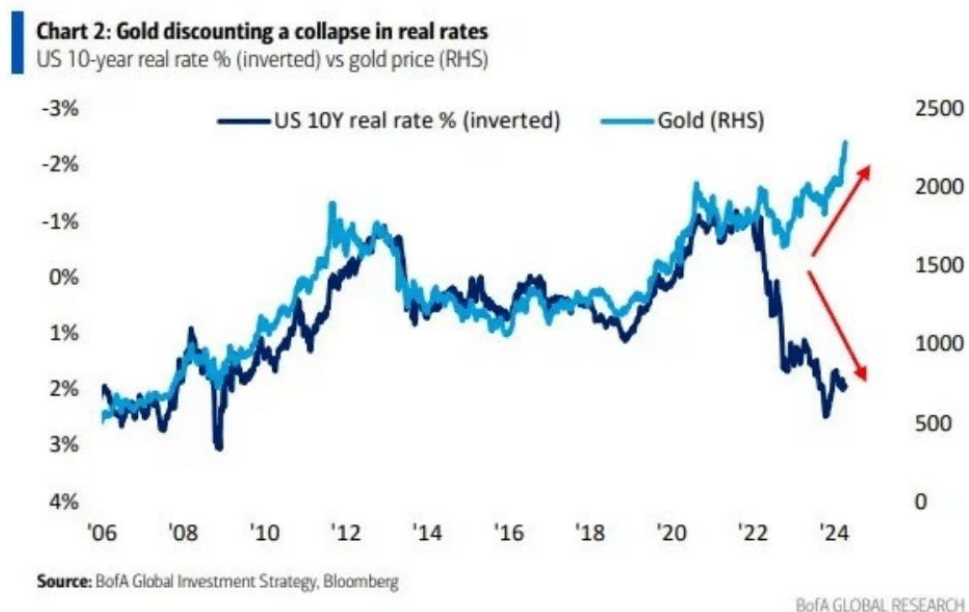
IT'S SIMPLE MATH: this game is completely unsustainable.



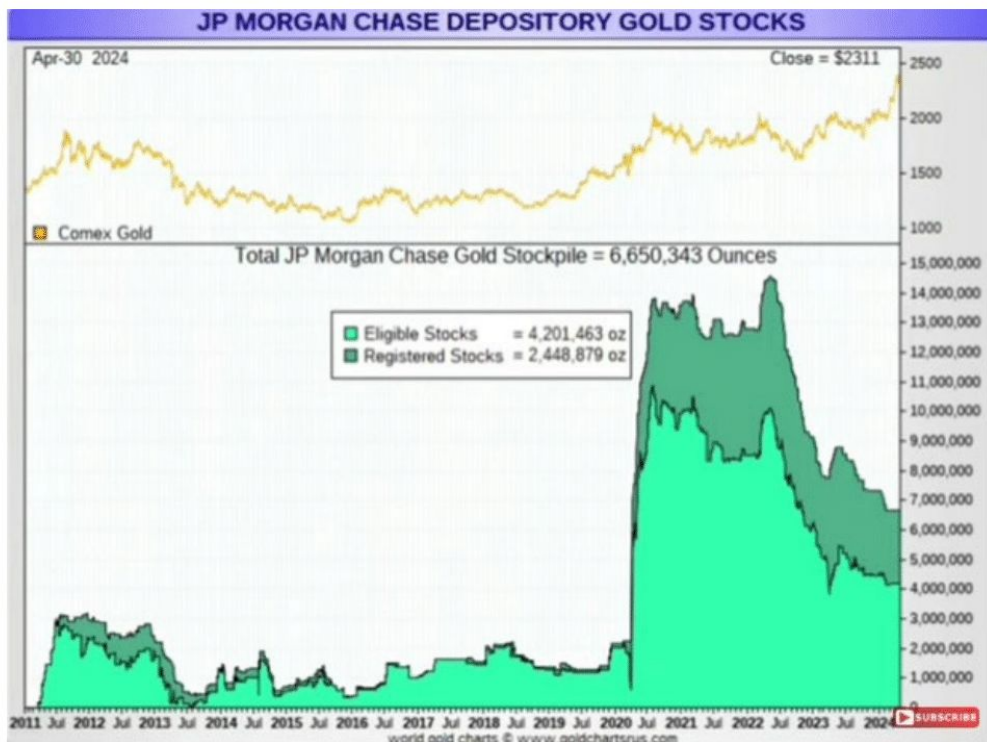
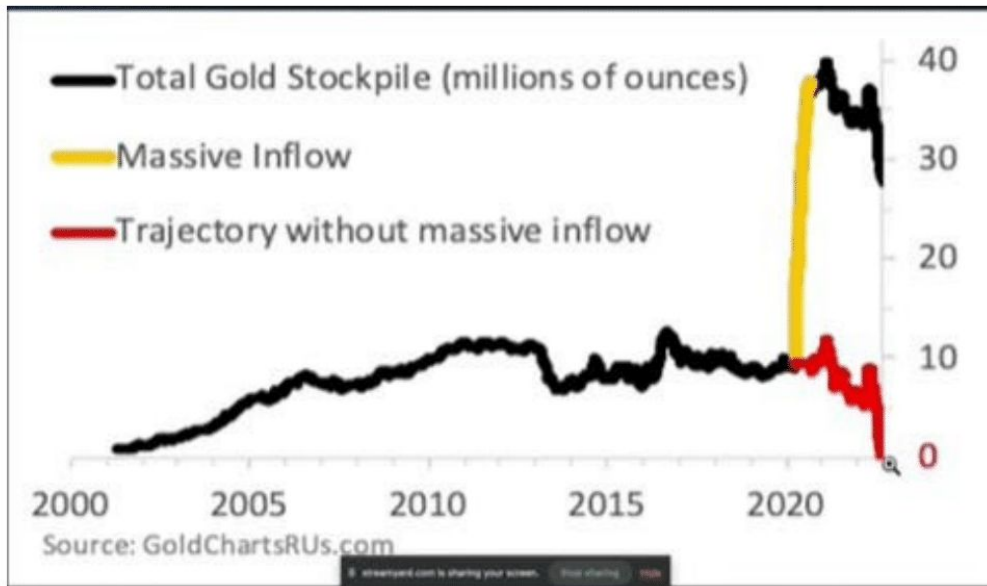
CHINA GOT THE MEMO A WHILE AGO: forget what they say and watch what they do. China is casting their votes with their wallets.



MORE SIGNS OF BREAKAGE – THE DIVORCE BETWEEN GOLD AND REAL YIELDS: new demand/supply forces are overpowering traditional relationships.



A GOLD RESTOCKING – JUST IN TIME: the demand for physical metals surged during Covid, necessitating a major restocking by COMEX to avoid running out.

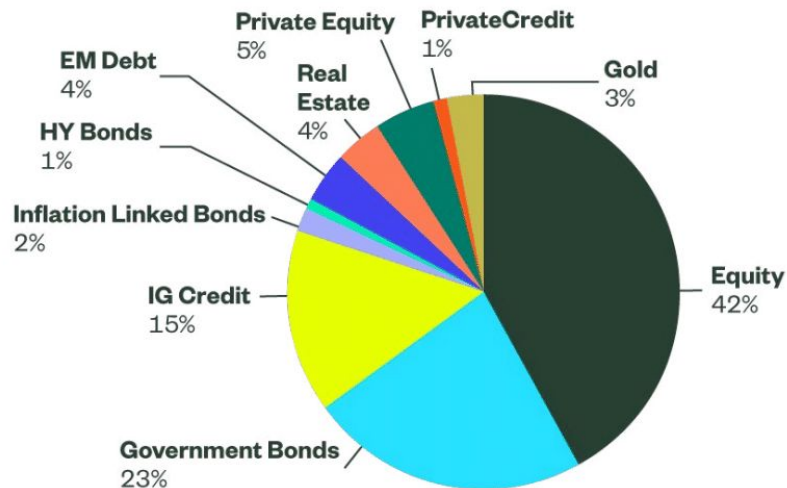


SILVER'S MARKET CAP: it does not even register on the charts.

** The number is shockingly small at roughly \$1.5T.

** There are many COMPANIES with a higher market cap.

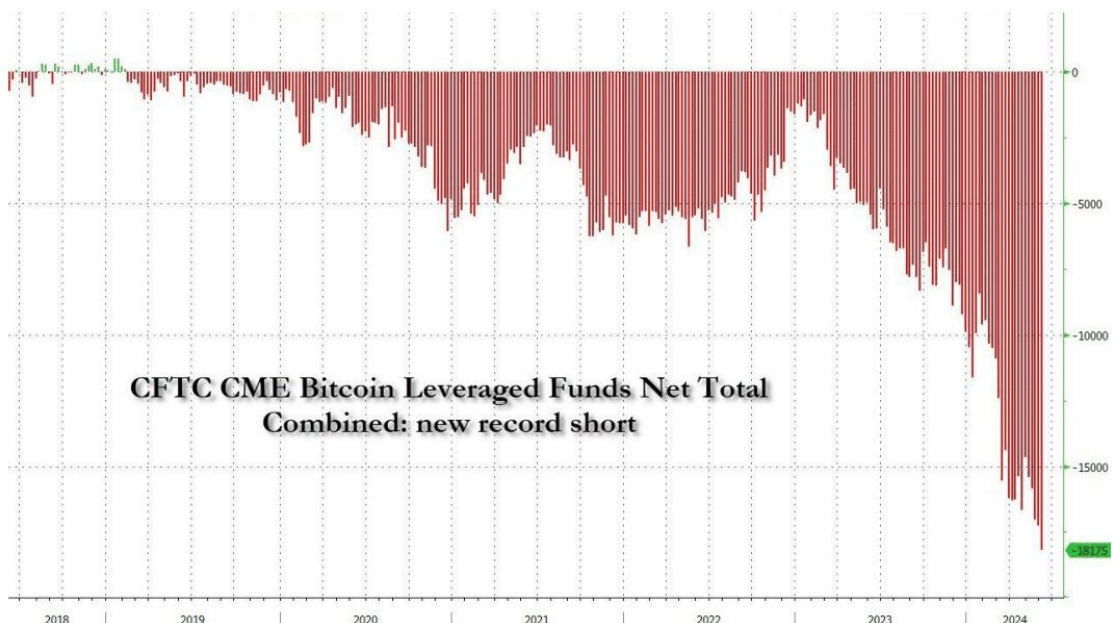
** Much of this is already spoken for (held as collateral) against the paper ETFs.



Note: Valued at USD 164.5 trillion as of the end of June 2023. Weights are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

Source: Thomson Reuters, Bloomberg, PreQin, World Gold Council, State Street Global Advisors, as of June 2023.

BITCOIN: A PAPER VS. PHYSICAL RED FLAG: it is not just precious metals that are subject to the paper vs. physical risk factor.



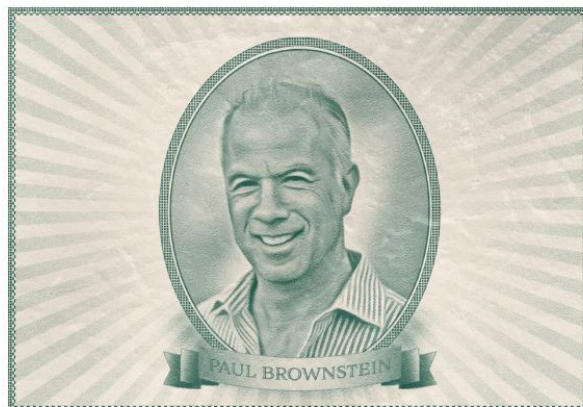
DARK HUMOR TO SOFTEN THE BLOW: lots of talk how precious metals have moved from the west to the east.



AT THE HELM



Daniyal Inamullah



Paul Brownstein

WHAT WE DO: Charts and Parts is a markets channel focused on RISK FIRST with an eye on solutions. We believe that a risk-first approach is critical for successful investing, and we strive to provide you with the necessary tools and knowledge for you to make informed investment decisions.

WHO WE ARE: We believe in transparency and giving our readers an in-depth understanding of the risks and opportunities involved in the markets. Our team has decades of combined experience in the financial markets, where we studied, taught, and managed risk. Charts and Parts is dedicated to helping investors achieve their financial goals by helping them ask the right questions.

We welcome fresh thoughts and ideas:
research@chartsandparts.com

October 2024