



Why the silver market is not the same as GameStop

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With the Reddit crowd now apparently turning their attention to squeezing the "shorts" in the silver market a few pertinent points need to be borne in mind.

Silver futures & silver bullion are not the same as GameStop or any other over-shortened equity. For a start there can never be a "net" short position in silver futures as for every short there has to be a corresponding long position for a trade to take place; they MUST be always equal in number.

However, the open interest in the relevant futures contract can be broken down into categories, i.e.: commercials (bullion banks & mining companies) in one camp & speculators (large & small) in the other. The trading pattern is nearly always that the speculators are net long and the commercials are net short. But whilst the speculators tend to be directional traders betting on a (mainly) up move in the price, the commercials are virtually solely engaged in arbitrage.

This week we saw Reddit inspired buying of silver futures which led to a spike not only in the price but also the basis (i.e. the difference between the silver metal and the silver future). So once a nice arbitrage profit opened up, the commercials bought the metal and sold the future, driving back down both the futures price and the basis. So, the futures price can only be really squeezed up if there is an underlying shortage of the metal itself which prevents the arbitrage from taking place. **Unlike shares, where accurate information on short positions are published, no one knows how much physical silver the commercials can access at any one time – this is the crucial difference.** For the time being the commercials do seem to be able to source metal which will tend to cap any rise in the futures market although this can change at a moment's notice.

Secondly, when these futures contracts approach expiry both longs and shorts rush to roll over their position into the next futures contract. This is because the longs (mainly speculators) do not want delivery – the last thing they want is to take possession of a bar of silver which then has to be stored, insured etc. Likewise, the shorts find it easier to roll their position as whilst they may be "hedged" in some way (maybe a forward purchase from a mining company) they may not actually be in possession of the physical metal on the date required.

So the only way to squeeze the silver price via the futures is for a large long speculator to "stand for delivery". A large institution could do this as they could arrange storage, insurance etc whereas a small speculator could not. But if this institution actually wants physical silver and has the facility to store the metal why bother with futures - just go straight to a bullion bank market maker and buy the silver metal directly from them.

To conclude, a sustained rise in silver requires genuine physical demand to exceed physical supply which given silver's improving fundamentals is probably on the horizon anyway, especially if the Reddit crowd pile into Silver ETFs that are based on Physical Silver rather than ETFs backed by futures. Trying to ramp up the futures market in isolation will not override this basic fact of physical supply and demand. The other difference between GameStop & Silver is that whilst the Reddit crowd may bust a few Hedge Funds along the way the BullionBanks will not be unduly affected by any sharp up move in Silver (as they are hedged).

Finally, to put the market size into perspective, Silver is a 1 billion ounce annual market worth \$30BN per annum at the current price. Reddit have apparently 2.5 million subscribers on their

Wall St chat facility, if each subscriber invested \$12K into physical silver (either coins or physical ETFs) and held it for a year then Reddit would corner the entire global Silver supply for 2021 on their own.

As long term bulls of Silver in we are currently running the highest exposure of Silver to Gold in our Gold & Precious metals fund vs. the rival Gold funds at circa 60% Silver / 40% Gold due to our assessment that Silver is a very undervalued asset (again unlike GameStop). We would regard the Reddit buying as a catalyst to revalue this asset not the cause as in our view it was going up anyway.

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Important Information

The views expressed in this document represent the views of the author at the time of preparation and should not be interpreted as investment advice

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