

The iShares Silver ETF - Not Backed By Physical Silver?

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[Allegations](#) have popped up from time to time warning potential and existing ETF investors that Barclays' iShares Silver exchange traded fund (AMEX: SLV) is not backed by physical silver as evidenced by poor custodial controls and other features that it has in common with StreetTracks Gold Trust (NYSE: GLD). The argument seems to center on the idea that the sole purpose of these ETFs is to trick the unsuspecting public into believing that large stockpiles of precious metals are being accumulated, while in (the accuser's) reality most of the gold and silver is actually being leased or sold into the market in order to depress precious metal prices and leave behind nothing but paper promises. Thus, the warning concludes, anyone seeking the benefits of an investment in precious metals should look elsewhere because SLV and GLD are, at best, the equity market equivalents of futures contracts.

I consider these claims to be incredible in both the literal and figurative sense and I have tried hard to refute them in an equally fantastic manner. Unfortunately, all I can seem to come up with are mundane facts, boring logic and basic common sense.

INDEPENDENT AUDIT

Before I get into the alternating battle between the fantastic claims and unremarkable facts, please let me first observe that only one thing needs to be kept in mind by ETF investors when evaluating the trustworthiness of SLV's (and GLD's) metal holdings. I am, of course, talking about the unqualified report issued by PwC on the audit of SLV's financial statements (there is a GLD equivalent). Here it is from the 2006 [Form 10-K](#):

Report of Independent Registered Public Accounting Firm

To the Sponsor, Trustee and Shareholders of
iShares Silver Trust:

In our opinion, the accompanying balance sheets and the related income statement, statement of changes in shareholders' equity (deficit) and statement of cash flows present fairly, in all material respects, the financial position of the iShares Silver Trust (the "Trust") at December 31, 2006 and April 21, 2006, and the results of its operations and its cash flows for the period from April 21, 2006 (date of inception) to December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

San Francisco, California

March 19, 2007

This is the most important concept in the whole SLV debate, so let's examine this "audit report" for a moment. Notice that first sentence, "In our opinion, the accompanying balance sheets . . . present fairly, in all material respects, the financial position of the iShares Silver Trust . . . in conformity with accounting principles generally accepted in the United States of America."

Gosh, that's a lot of gobbledygook, you protest?!? Well, not really. To see why, let's take a quick look at those "accompanying balance sheets" for a second.

What's this? Hmmm . . . it says right here that the only asset of the ETF is:

Silver bullion inventory (fair value of \$1,562,765 and \$18,278, respectively)(Note 1A)

Imagine that! "Silver **bullion** inventory" of all things!

Now let's go back to the last sentence of the audit report. "We believe that our audits provide a reasonable basis for our opinion." Now, what kind of audits would you think PwC conducted with respect to an entity whose **sole** asset is "silver bullion inventory"? Well, it doesn't take an accounting genius (and no, there is no such thing) to figure out that the only possible approach that could be called an audit of silver bullion is a physical inventory, conducted in person. Could there be any other way? (Suggestion: please don't think you know the answer to that question unless you have actual experience auditing physical inventory).

Okay, now let's meander over to SLV's liabilities and footnotes to the financial statements. Any sign of leasing, derivatives or other shenanigans? Nope! Sure looks like SLV might in fact be backed by physical silver! Unless, of course, PwC was duped. Okay, let's consider that idea for a moment – a top accounting firm failing to notice a massive fraud that involves the misappropriation of thousands of tons of precious metals worth more than a billion dollars constituting 100% of the assets of an entity. Possible? I suppose, but it's about as likely as a bridge in Brooklyn going on sale.

This is really all that needs to be said on the topic, and the vast majority of you are perfectly justified and entitled to skip the rest of this commentary. On the other hand, if these fantastic allegations keep you up at night, it probably means your suspicions, paranoia and skepticism could use an intense dose of reality. Keep reading for the cure.

HIDDEN MEANING IN SEC FILINGS

The Truly Fantastic Claim: We'll start with the suggestion, leveled by several respected figures in the gold industry, that a few imprecise statements in SLV's (and GLD's) Form 10-K and [Prospectus](#) are actually admissions that the ETF is somehow able to lease or encumber the metal held under its legal custody. These "admissions of guilt" take the form of either (1) an inadvertent confession that something sinister is happening behind the scenes in the same vein as former Fed Chairman Greenspan's infamous [slip of the tongue](#) supposedly revealed the central banks' role in gold manipulation or (2) ingeniously contrived language that provides official

cover for SLV's operators to engage in trickery without legal consequences. See [here](#) again for a sample of such an allegation as well as several others that I plan to medicate with facts later on.

The Most Boring Fact: SEC documents are prepared in accordance with specific rules and regulations and are reviewed by lawyers, accountants, auditors and other unsavory types often held in low regard by the gold community as well as the public at large. Truth be told, some of the criticism heaped on these professionals is well deserved; for example, some of them don't exactly have the best writing skills. The end result is a document that may be neither perfect nor precise but represents a compromise of esoteric principles that are beyond the grasp of the uninitiated. Accusations that SEC documents are intended to intimidate are probably not very far off the mark. Yet there is another aspect to the realm of regulatory disclosures that creates the most controversy: the line between disclosing too little or too much is not very fine, leaving plenty of room for misinterpretation. Be that as it may, the most horrendous and inadequate SEC filing will still not be so incompetent as to contain even the subtlest confirmation of corporate misbehavior. The absolute worst lawyer or accountant would spot that kind of "mistake" every time. To be precise, if SLV's promoters intended to deceive investors, it would certainly never be admitted in any SEC filing. In fact, that would be the last place to look. No forewarning of intentional fraud, either, could be found by reading the tea leaves in the SEC filings of Enron, Worldcom, Tyco, Adelphia, etc., etc.

Now let's take an in-depth look at some of the other fantastic criticism leveled against the language used in SLV's SEC documents:

"...there may be situations where the trust will unexpectedly hold cash. For example, a claim may arise against a third party, which is settled in cash."

The Incredible Claim: SLV may be involved in derivative contracts to be settled for cash, not silver, in the future.

The Mundane Fact: SLV may receive a cash settlement in a legal dispute and since the trust cannot invest in silver directly, such cash would have to be distributed to ETF holders. This could have adverse tax or investment consequences to ETF investors. In addition, no new ETF shares may be issued while the trust holds undistributed assets. Thus, ETF investors need to be aware that the trust's normal operations may be disrupted for extended periods during which time the effectiveness in tracking silver prices may be greatly reduced.

"The iShares are intended to constitute a simple and cost-effective means of making an investment similar to an investment in silver."

The Hyped Claim: It is important for each shareholder to understand the ETF is NOT an investment in physical silver. If someone is looking to take advantage of rising silver prices, that person should only consider physical silver.

The Reasonable Fact: It is simple and cost-effective to invest in the ETF to gain exposure to price movements in silver, but the ETF is not an investment in silver itself. For example, should

the need arise, an investor would not be able to exchange ETF shares for bullion other than through an Authorized Participant, and then only in baskets of 50,000 shares.

“Backed by silver held by the custodian on behalf of the trust.” [bullet point]

“The iShares are backed by the assets of the trust.” [description of bullet point]

The Stupefying Claim: The first sentence is a bullet point with no bearing in the context of a legal agreement and thus can be ignored. The second sentence is relevant but does not mention silver. The construct is meant to mislead the reader because it does not state the actual composition of the assets backing the trust.

The Clear (As Mud) Fact: The ETF is backed by trust assets consisting of silver held by the custodian on behalf of the trust, period. The inferior, but equivalent, description in the SEC documents was probably the result of re-wording (a few hundred times) before all the attorneys and accountants could agree on a superior way to state such a simple concept. The result: a horse designed by committee is a camel. Regardless, an SEC filing is not a binding legal document or “agreement” and does not include purposefully irrelevant statements, which would be a pointless exercise. Besides, SEC disclosures should be interpreted using common sense, not common law. And there is only one common sense way to interpret the above bullet points and description, which is that the trust holds assets in the form of silver bullion.

“The trustee’s arrangements with the custodian contemplate that at the end of each business day there can be in the trust account no more than 1100 ounces of silver in an unallocated form. Accordingly, the bulk of the trust’s silver holdings is represented by physical silver, identified on the custodian’s books in allocated and unallocated accounts.”

The Questionable Claim: The word “contemplate” is a low threshold for custodial controls; why not state “require”? The second sentence does not logically follow the first since unallocated silver is not physical silver. Instead of “bulk”, it should state “all but 1100 ounces”. If this was a deliberate mistake, it could mean that the “bulk” of the silver is not held in physical form. Once again, the whole construct appears to be an attempt to mislead casual readers.

The Most Unquestionable Fact: “Contemplate” is used throughout the SEC filings as a conjunctive (jointly binding) means of describing the various obligations of the ETF’s trustee and custodian. “Require” would be technically inaccurate since the ETF’s [Custodian Agreement](#) seems to use an industry-standard threshold of reasonable, not absolute, performance. Reasonable performance clauses are used in instances where absolute performance might result in defaults under the agreement due to abnormal conditions in the market which are not the fault of any party to the agreement. “Bulk” clearly refers to physical silver, not unallocated silver even when the most twisted logic is applied. Only a complete abandonment of logic would result in “bulk” meaning **not** physical silver. Bottom line, no more than 1100 ounces of silver are held in unallocated accounts at the close of each business day. A one-off exception to this rule is not to be considered a default under the custodial agreement, thus the proper use of the term “contemplate”. But the custodian’s willful, persistent disregard for this important provision

would constitute a default, not to mention outright fraud. No way could such criminal behavior be excused by a few words in an SEC filing.

"Redemptions may be suspended only (i) during any period in which regular trading on the AMEX is suspended or restricted or the exchange is closed (other than scheduled holiday or weekend closings), or (ii) during an emergency as a result of which delivery, disposal or evaluation of silver is not reasonably practicable."

The Commotion Causing Claim: Red flag! This statement protects the ETF against defaulting on silver redemptions because an emergency can be declared conveniently if there is not enough silver in the vault on account of it being loaned or leased out.

The Calm But Important Fact: ETF investors are hereby warned that no silver redemptions will take place when the AMEX is not in operation or in case of an emergency not allowing silver redemption to be reasonably achievable. A “reasonable” cause, by definition, precludes an “emergency of convenience” declared because silver is not available for delivery due to a crisis manufactured by a party to the contract, such as the existence of a fraudulent racket (an unreasonable development, for certain) in which **allocated** silver is being lent out the back door of the vault to third parties. The Merriam-Webster definition of “practicable” is: *capable of being put into practice or of being done or accomplished*. There are many possible **unanticipated** events that would make the ETF not **capable** of processing redemptions of otherwise **available** silver held in allocated accounts.

If you don’t believe me, please go read any account agreement, like this [one](#). Do you see any provisions excusing contractual obligations or performance in the case of an emergency? What’s that, in **two** places? Well, I’ll be a son of a gun!

In any case, this issue has absolutely nothing to do with whether or not the ETF is backed by physical silver.

"If the process of creation and redemption of Baskets of iShares encounters any unanticipated difficulties or is materially restricted due to any illiquidity in the market for physical silver..."

The High-Flying Claim: “Unanticipated difficulties” is conveniently not defined and “illiquidity” refers to there not being enough silver available to meet redemptions.

The Grounded Fact: An all-encompassing definition of “unanticipated difficulties” would be an oxymoron (how can one wholly define something that is unanticipated?) and “illiquidity” simply means that new ETF shares cannot be created if there is a shortage of physical silver in the spot market. One **anticipated** result of illiquidity in physical silver may be that ETF shares could become illiquid themselves at precisely the moment when physical silver might be exploding in price. Under such circumstances, the ETF may substantially under-perform physical silver and this is probably the most powerful argument against investing in this or any other ETF. SLV’s

attorneys and accountants have appropriately disclosed this very real risk in the SEC filings using the above language. They should hardly be criticized for being honest!

“Neither the sponsor nor the trustee has experience with a trust the only assets of which are expected to be silver.”

The Suspicious Claim: Why say “expected to be silver” and not “are silver” if SLV is truly backed by silver?

The Innocent Fact: The ETF operators have no experience with a commodity-backed trust (who really does?) and may not always take the best course of action. The assets of the trust are expected to be silver but may be cash or other property based on possible, but unexpected, circumstances (such as a legal settlement; see above). Once again, this is an honest disclosure pointing out the inherent problems faced by SLV that requires no additional criticism in order to be a powerful argument against an investment in the ETF.

“Unallocated” — Silver is said to be held in unallocated form at a custodian when the person in whose name silver is so held is entitled to receive delivery of silver in the amount standing to the credit of that person’s account, but that person has no ownership interest in any particular silver that the custodian maintaining the account owns or holds. In contrast, silver is held in “allocated” form when specific bars of silver held by the custodian are identified as the property of the person holding the “allocated” account.

The Stretched-Out Claim: Since “Allocated” is only defined within the definition of “Unallocated”, not separately, it could mean whatever the custodian wants it to mean.

The Well-Fitting Fact: Definitions of technical terms and industry jargon are provided for the reader’s benefit in an attempt to comply with the SEC’s plain English requirement. Such definitions place no restrictions or limitations on the rights of investors and are not intended to explain contractual terms, although the SEC does permit issuer-specific terminology to be defined in the same manner (e.g., “Authorized Participant”). In any case, “allocated” and “unallocated” are industry jargon and not contractual terms, and therefore, they cannot take on more or less restrictive meanings based on the manner in which they are (or not) defined in an SEC filing.

“According to the LBMA, these accounts are opened when a customer requires metal to be physically segregated and needs a detailed list of weights and assays.”

The Reaching and Grabbing Claim: Allocated accounts are not defined but rather stated as being “according to the LBMA”, implying that allocated accounts function in a certain way yet giving no legal basis for the reader to conclude thusly. This curious treatment appears to be purposefully deceptive.

The Polite Fact: The terms “allocated” and “unallocated” are being given context after having been defined (see above). The term “according” is merely an attribution to the LBMA’s

convention for allocated storage. Namely, allocated accounts “according to the LBMA” are physically segregated. This is relevant in terms of understanding the SLV’s custodial controls because not all allocated accounts are physically segregated – for example, COMEX warehouse receipts represent allocated silver but the bullion is not stored on a segregated (physically separate) basis. Moreover, some allocated accounts do not involve a “detailed list of weights and assays,” such as certain segregated storage accounts containing “mixed” bullion where the vault permits the accountholder to merely declare, but not verify, the weight and purity of the bullion (when it is required solely for the purpose of calculating storage fees). A bit confusing perhaps, but where is the deception?

“The custodian and any of its subsidiaries and affiliates may from time to time purchase or sell iShares for their own account, as agent for their customers and for accounts over which they exercise investment discretion.”

The “Big Discovery” Claim: The trustee and custodian are clearly not neutral fiduciaries and presumably can sell the SLV short.

The “It’s Always Been There” Fact: The ETF’s trustee and custodian are not restricted from trading **in** the ETF just like virtually all other trustees and custodians are not restricted from trading **in** the financial instruments they may hold in trust for clients. Note the obvious but important distinction between trading **of** the actual securities -- custodial bullion in the case of SLV -- held in custody, which is a huge no-no, and trading **in** the same class of financial instruments consisting of bullion on the spot or futures market.

“Neutrality” is not a requirement for functioning in a fiduciary capacity. Rather, the requirement is that investor confidence and trust be maintained in both fact and appearance. This is the intent of even the most draconian provision of the Investment Company Act of 1940. There is no mandate in that legislation for the creation of neutral fiduciaries.

In contrast, the fact that Authorized Participants can also trade for their own or their customers’ accounts is a possible source of market abuse since these participants are insiders, market makers, customers, fiduciaries and financial service providers all rolled into one. That’s a major difference from stockbrokers that make a market in certain stocks since Authorized Participants can freely trade **both** the ETF and the underlying asset itself. That would be like a stockbroker making a market in a company’s stock and also being the major consumer or vendor of that company’s products or services. Or having the right to issue new shares or repurchase them for the company’s treasury. In the case of stocks, that would clearly make the stockbroker an insider and severely limit its ability to trade. The major regulatory shortcoming and possible future death-knell for ETFs is that the same rules don’t seem to apply. Of course, if they did, nobody would want to be an Authorized Participant and thus the ETF market would never exist in the first place. What a racket!

What about the claim that shorting creates multiple shares of an ETF and thus not every investor’s long position is backed by physical silver? The observation is valid but only becomes relevant at the exact moment when every single ETF investor demands conversion of ETF shares to silver. As noted above, however, only the Authorized Participants can convert ETF shares to

physical silver in baskets of 50,000 shares (nearly 500,000 ounces), so unless the short position gets very outlandish there will always be enough small ETF investors to offset the desire for withdrawal of silver. Still, it might be a good idea to monitor the size of the short position in SLV because unwinding it may require Authorized Participants to go directly to the silver market and buy silver, thus boosting physical demand.

THE “SHOCKER” OF AN AGREEMENT

The Deadly Electric Jolt of a Claim: The Custodial Agreement between the Bank of New York (SLV’s trustee) and JPMorgan Chase (SLV’s Custodian) apparently contains corroborative, ominous signs that something is amiss and allegedly cinches the case against trusting that the silver ETF is backed by physical silver.

The It’s Only A 9-Volt Battery On the Tongue Fact: Just as a wayward “analysis” of SLV’s SEC documents might fail to consider the overwhelming and unambiguous language explaining the contractual obligations of the ETF’s trustee and custodian, so would a spurious legal examination of the Custodial Agreement favor a few isolated, farfetched notions at the expense of weighing the contract in its full context and entirety.

Let’s take a peek at a few examples, shall we?

“to open and maintain for you [i.e., SLV’s trustee] the Account...and to provide other services to you in connection with the Account.” [ETF Custodian Agreement]

vs.

“JPMorgan Chase Bank has agreed to hold Bullion for the Trustees and to provide other services in connection with Bullion.” [“Boilerplate’ JPMorgan Chase Allocated Bullion Storage Agreement per James Turk]

The Heart-Stopping Claim: The introductory language in the standard JPMorgan Chase account agreement for allocated bullion and the ETF’s Custodian Agreement do not contain verbatim statements of custodial responsibility and therefore the agreements must be fundamentally different.

The Slight Tingly Feeling Fact: All custodians have a basic responsibility to hold assets in safekeeping and therefore there is nothing fundamentally different between various custodial agreements regardless of how the contractual responsibility of the custodian is described. A standard ‘boilerplate’ custodial arrangement intended for an investor can in no way encompass the complexity of a situation like SLV and therefore it should not come as a big surprise that a custom agreement would be drafted to deal with such a unique case. This does not make the basic custodial responsibilities fundamentally different.

“2.7 Substitution of Silver: With your prior approval (in consultation with the Sponsor), we [i.e., Morgan Chase] may substitute other Bullion for Bullion held in the Allocated Account, provided that there is no change in the total number of troy ounces of Silver held in the Allocated Account.”

“‘Bullion’ means any Silver held by us or any Sub-Custodian in the Allocated Account from time to time.”

The Contractual Electrocutation Claim: A True Shocker! What can one make of such language? Is it truly possible that bullion stored at JPMorgan Chase is allocated while bullion stored at sub-custodians is unallocated?

The Would You Kiss An Electric Outlet? Fact: The modifier “other” in “other Bullion” is not capitalized and therefore it does not have a meaning specific to the agreement. Thus, “other” simply means “not the same” as opposed to being something completely different from the definition of “Bullion”. Furthermore, the custodian and sub-custodian do not have different contractual obligations, nor does the contractual definition of “Allocated” or “Unallocated” differ based on whether the “Bullion” is being held by the custodian or a sub-custodian. This provision simply allows the custodian to exchange “Bar ABC” for “Bar XYZ” as long as the silver content is the same. The circumstance where this might be useful is the shifting of silver between Allocated Accounts held at the custodian and a sub-custodian, or between two sub-custodians. One instance that might necessitate this would be when a sub-custodian ceases to be an LBMA-approved vault. The ability to substitute should, in theory, avoid the expensive and logistically-difficult step of actually shipping physical silver between two locations. Instead of a tool for subversion, this substitution provision appears to be the result of some smart planning and foresight.

“Upon at least ten days’ prior notice, during our regular banking hours, any such officer or properly designated representative... will be entitled to examine on our premises the Silver held by us on our premises pursuant to this Agreement and our records regarding the Silver held hereunder at a Sub-Custodian...Unless we have received at least ten days’ prior notice and reasonable assurances (in our sole discretion) that any costs and expenses incurred in connection therewith will be indemnified to us, we shall not be required to move to our premises any Silver held at a Sub-Custodian for purposes of making it available for inspection as provided herein.”

The Barn-Burning Claim: The custodian does not have to prove that silver held by a sub-custodian actually exists.

The Unvarnished Fact: The allegation is demonstrably incorrect. Section 8.5 of the Custodian Agreement unequivocally states: “***Access and Inspection:*** We will not entrust Silver held in the Account to any Sub-Custodian unless that Sub-Custodian grants rights of access and inspection to records and Silver that are similar to those granted by us under this Agreement.” The true meaning of the “10 day notice” provision cited above is that the custodian will not be required to move silver held by the sub-custodian to the custodian’s own facilities in order to inspect it. The reason why should be obvious.

“‘Sub-Custodian’ means a sub-custodian, agent or depository (including an entity within our corporate group) appointed by us to perform any of our duties under this Agreement including the custody and safekeeping of Bullion.”

The Subverting Claim: Several provisions of the Custodian Agreement taken together indicate that JPMorgan Chase may be lending the ETF’s silver to an entity within its own corporate group. Perhaps the “other Bullion” is really an unallocated account at a sub-custodian that, in actuality, is a JPMorgan Chase shell. Instructive is the special purpose entity (SPE) called Mahonia, set up on behalf of Enron to keep loans of its books. There have been allegations made in the past that JPMorgan Chase was actually behind Mahonia ([TheLawyer.com](#)) as well as court testimony supposedly implying the same thing ([CFO Magazine](#)). In light of this dubious history, an obvious question is whether the ETF’s disclosure documents were deviously crafted in order to conceal JPMorgan Chase using a similar ploy to lay bare the ETF’s silver vaults?

The Unavoidably Logical Fact: According to Section 8.1 of the Custodian Agreement: “Any Sub-Custodian will be a member of the LBMA.” Only a handful of [LBMA members](#) are not easily recognizable by name and it is highly unlikely that any of them are SPEs set up by JPMorgan Chase to bilk SLV of its physical silver. Besides, it is hard to believe that after paying almost \$3 billion in Enron-related legal settlements (some deserved, some probably excessive) JPMorgan Chase would allow something similar to happen (at least so soon).

2.6 Reversal of entries: “We [i.e., Morgan Chase] at all times reserve the right to reverse any provisional or erroneous entries to the Account with effect back-valued to the date upon which the final or correct entry (or no entry) should have been made.”

The Fanciful Claim: Never encountered similar language in a legal document! A correction to an honest accounting error does not require an authorization by contract. This seems to be an open invitation to back-date financial records in order to conceal something. For example, what is to prevent a custodian from making provisional entries showing silver being loaned out and no longer in the vault, then reversing such entries when the auditors examine the books?

The Banal Realm Fact: The term “reversal of entries” has a very specific meaning in that a reversal maintains a proper audit trail whereas a correction does not necessarily imply that both the **original** and correcting entries are documented for posterity. Financial institutions all over the world use the reversal method almost exclusively – for example, an incorrect entry to a bank account doesn’t simply get erased but rather both the original entry and the reversal entry are shown in the bank ledger and bank statement. Interestingly, this concept is rarely spelled out in the U.S., but it appears to be a standard provision for many foreign banks as a simple [Google](#) search will quickly demonstrate. So it should come as no surprise that SLV’s custodian agreement, which is subject to British law, would have such a provision. With respect to never having seen similar language, perhaps we should re-acquaint ourselves with GLD, whose [Allocated Bullion Account Agreement](#) contains the exact same concept in Section 2.5. The bottom line is that no words are going to stop someone intent on committing fraud, and a warning is always unnecessary when the stated intent of the contract is to defraud somebody.

NINTH INNING: TWO STRIKES-OUTS AND A BUNT

All of the fantastic claims made against SLV and GLD are intended to buttress three end-game warnings to precious metal investors. The first is that SLV, like GLD, should be viewed purely as a trading vehicle in a similar fashion to how one would use futures to speculate on gold and silver prices. To the extent this advice deserves some consideration, it needs to be supported by allegations that do more than perpetuate the myth that “the gold/silver isn’t really there!” The burden of proof is on the accuser and is nowhere near to being met. Despite this, there are at least two reasons, as I pointed out above, why precious metal ETFs should not be considered as a substitute for the crisis insurance created by holding (and I mean “holding”) silver and gold bullion. After all, SLV and GLD are not silver and gold but rather securities that trade on the AMEX and NYSE. Simple concept, but critical to understand.

On the other hand, the agitators against SLV and GLD completely miss the boat when they fail to consider the portfolio diversification and optimization that these ETFs can provide to investors in precious metal mining stocks. Indeed, the safest and most conservative mining company faces immensely more serious and complex risks than even the most ill-conceived ETF. So go ahead, call yourself a hypocrite if you see no problem investing in mining stocks but yet you hesitate to put money into SLV or GLD simply because of a nagging suspicion they are not backed by physical metal. **Strike Three, You’re Out!**

The second warning is rooted in a highly conspiratorial viewpoint: SLV may somehow be the ultimate source of the physical silver allegedly being used to rescue the concentrated, naked, commercial shorts on the COMEX. You see, the concentrated naked shorts in silver apparently have a problem. They are deep in the hole with no silver and they cannot simply go to the market to cover their short positions because that would exhaust what little supply is available while driving silver prices sky-high. The result would undoubtedly be a classic short squeeze similar to the day of reckoning recently witnessed in nickel on the LME. So instead, the silver shorts have hired the SLV custodian to steal the ETF’s physical silver and leave behind only an IOU in the form of unallocated accounts secretly held by that bad boy of banking, JPMorgan Chase, masquerading as an “SPE” of the Enron kind. Thus:

“SLV’s physical silver can be used to help the shorts manage their overwhelmingly large short position, while at the same time investors in SLV mistakenly believe that this ETF is backed by physical silver.

What’s more, the custodian can back-date and reverse their storage record in order to conceal the true status of SLV’s silver.”

- A well-known detractor of PM ETFs.

The fatal flaw in this argument, of course, is that the ETF obtains its physical silver from the Authorized Participants, which consist of none other than the silver shorts themselves! Thus, one might legitimately wonder why the shorts need to create a fraudulent racket when they seem to have no problem obtaining all the silver needed to cover their short positions! Unless of course, the entire silver market is a fraud and all the physical silver being traded – and mined for that matter – is just a mirage. **Strike Three, You’re Out!**

The final warning proclaimed by anti-SLV crusaders is that the SEC has failed to protect investors and is ultimately to blame; if only the silver ETF was subject to the Investment Company Act of 1940, the public would be protected against things like transactions with affiliates and prohibitions against a suspension of silver redemptions. Well, the simple truth is that no ETF could ever be approved under the rules meant to regulate investment companies; that's the reason they had to dream up the ETF structure in the first place. So the issue really comes down to whether or not ETFs are a net benefit to investors. If the answer is yes, as I would meekly affirm, would it be possible to have effective regulation of ETF shortcomings, such as imposing restrictions on the currently unlimited ability of market insiders to abuse the system in their omnipotent role as Authorized Participants? This is a real question that should be asked then answered, and all attempts should be welcomed with open arms. But not in the narrow context of trying to expose a non-existent fraud in a single (or two) ETF's asset backing, which would be about as pointless as Barry Bonds bunting with nobody on base and two outs in the bottom of the ninth. **Who's coming to bat?**

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