Silver Price Motor Greased by Oil

David Ford

There definitely is a relationship between the price of oil and silver. The recent big down moves in silver have a history of being preceded by what looks like engineered down moves in oil. The delay recently is about 6-10 trading days. It could be argued that Oil moves first – then Silver follows – in both directions. Now that oil has broken out to the upside again in similar fashion to the consolidation in September I expect that Silver should also follow as long as oil continues to move up.

The chances of oil moving back up quickly are reasonable - for the following fundamental reasons….

There is reasoned speculation based on professional knowledge amongst the Peak Oil watchers (including Matthew Simmons) that Saudi Arabia's touted additional production capacity that was brought on line recently is nothing more than pumping reserves from storage caverns and simply driving the aged fields (such as Ghawar) harder for a short period by pumping sea water into the fields at a higher rate. This would have been done in response to US requests to increase supply at a critical time.

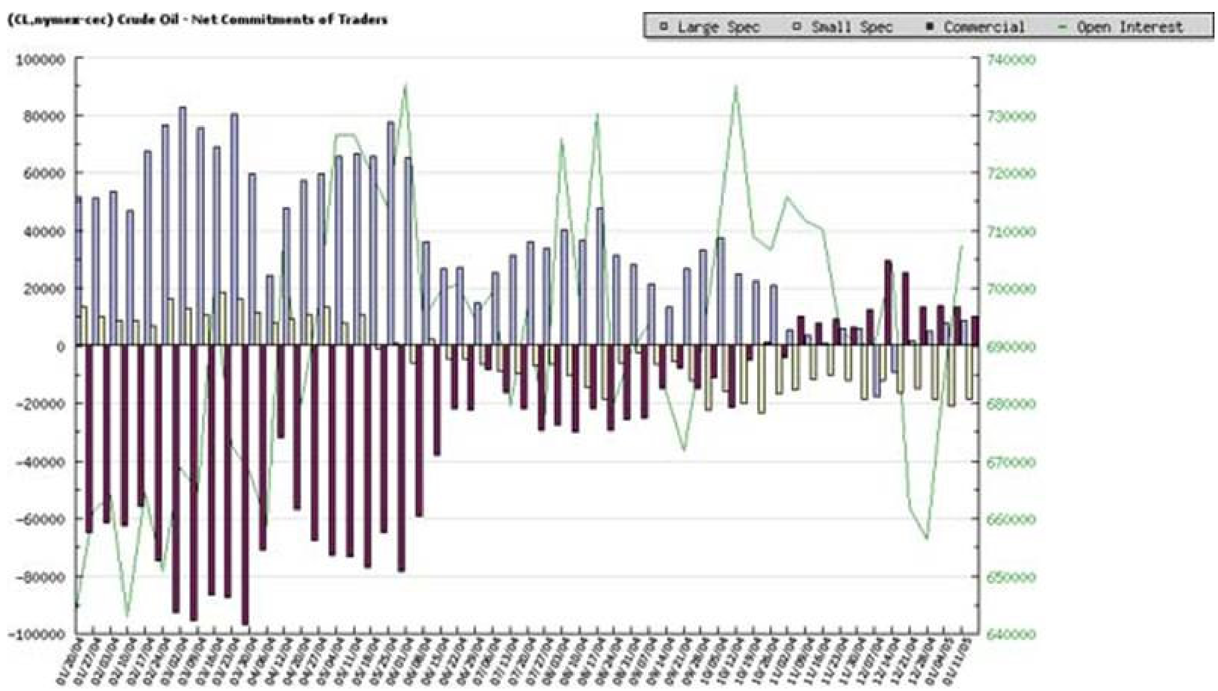
The problem is that these very old Saudi fields cannot be run at maximum for long as the pumping of sea water at an extended rate and time risks long term damage to the rock and the field's ability to produce oil at the same rate and water cut when they back off. These experts are saying that the Saudis had to cut back or they will risk this damage and consequential early collapse of the fields in question, leaving significant amounts of oil behind that can never be recovered due to that damage. Additionally, when storage caverns are pumped out there is nothing left in them until production surplus allows a refill when world demand has backed off. There is no doubt that this latter hope however has yet to be realized.

Now we are hearing of all these oil producers cutting production after the recent surge – the reason touted is that OPEC wants to maintain a high price for their benefit – but the geological realities are perhaps suggesting that we are back to the same old supply problem that induced the last oil price spike to $55. Reading through the lines and disinformation I would not be surprised that given demand has not backed off whilst production clearly had to in order to preserve the fields - we just might be reaching the point of supply problems once again and soon. This may play out over the coming months given the Saudis seem to have capped the wellheads, North Sea weather continues to challenge output, and demand in the US is still surging. The short supply can only be matched against demand through higher prices extinguishing that demand. This could well take oil in the short term up beyond the old highs to $60 possibly within 2 months based on the overall oil chart trajectory.

Graph Courtesy www.futuresource.com

The latest COT data for Oil suggest that the commercials may well be onto this and have been long since early November even when the oil price had begun to fall from $55. They are now joined by the large specs. These big fellas are taking on the small specs which could easily be the recipe for some serious upside in Oil as the fundamentals take over and the small specs get taken to the cleaners.

COT Graph Courtesy
http://www.softwarenorth.com/trading/commitmentscurrent/



	--- Large Speculators ---				------ Commercial ------				-- Small Speculators --			Open
	#	Long	Short	Bullish	#	Long	Short	Bullish	Long	Short	Bullish	Intrest
12/14/04	177	68,310	77,382	47%	157	499,748	474,358	51%	51,869	68,187	43%	704,134
12/21/04	163	69,805	68,167	51%	153	464,957	451,562	51%	52,667	67,700	44%	661,793
12/28/04	167	69,987	64,968	52%	160	469,138	455,359	51%	43,627	62,425	41%	656,458
01/04/05	169	74,567	67,020	53%	159	479,579	465,979	51%	54,883	76,030	42%	683,120
01/11/05	187	79,563	70,949	53%	161	488,223	478,166	51%	49,431	68,102	42%	707,361

Looking at the below silver oil ratio chart – resistance is clearly in the range of 0.17 to 0.2. If we assume that a run in oil to $60 over the coming months also produces short covering in the March Silver to this resistance we will have $10.50 to $12 silver within that timeframe. Even if we only make it to 0.16 Silver will be worth $9.60.

All these signs must be an enduring reason for the commercial Silver shorts to be very worried indeed as their brothers over in the Oil pits are headed the other direction.

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