April 13, 2016 – Surest Trade/Melt-Up?

The Surest Trade

To my mind, the second worst thing I could write is that silver is about to take off to the upside, only to see it get crushed once more in an orchestrated COMEX takedown, thus delaying yet again the inevitable move higher. The worst thing, of course, is not writing that silver is about to explode and then watching that unfold. In practical terms, I don't see how the worst thing could occur since I have written of this so often. But I would like to update the reasons why silver could jump in the near term.

Of all the themes and perspectives in which I analyze silver, perhaps the most frequent is in its price relationship with gold. There is something special about comparing two similar assets that helps objectivize any analysis much more than considering each in isolation. This is particularly true of gold and silver, given their long shared history and the fact that each are members of a rare group – precious metals.

Perhaps the biggest obstacle to objective relative analysis between gold and silver are the preconceived feelings investors hold before any analysis even begins. Many believe, for instance, that gold alone represents true money or the ultimate financial insurance which should never be sold regardless of price. I respect those beliefs, but would point out that any further detailed analysis, no matter how objective or insightful, would be a waste of time to those convinced that price doesn't matter.

My main purpose concerns which is likely to provide the best return on investment Â? gold or silver. Of course, seeing the silver manipulation end is a lifelong goal, but I never aspired to ending my days wallowing in hoards of the metal, ala Scrooge McDuck. I understand the ultimate insurance angle to gold and silver and that both are, like every other unencumbered asset, not dependent on anyone else's liability. But that quality is a bonus as far as I'm concerned. Of more concern is which one will provide the best return.

The more substantive differences between gold and silver have to do with how each has evolved in modern times. Gold is still an official monetary asset of the world's central banks and is held by most world governments; silver ceased being an official monetary asset over the past hundred years and is held by very few, if any, world governments. As such, that's both good and bad for gold's price Â? positive when it is sought for purchase, negative when central banks are net sellers.

Silver not being an official monetary asset means it is not likely to be bought as such, but neither can it be sold, since it is not held. (I suppose silver could be bought as a strategic asset by any country). Aside from no longer being an official monetary asset, silver has evolved into a vital and indispensable industrial commodity and most of its annual production is consumed in various fabrication demands. In essence, the biggest difference between gold and silver in modern times is that gold is used as jewelry and as an investment and monetary asset, while silver is consumed in a wide variety of uses, jewelry to industrial, but it also remains an investment asset.

This is all basic, but old stuff. Still, it's important to recognize that while there is more gold in existence today than ever before (due to the absence of industrial consumption), the amount of silver in existence is a small fraction of what existed 75 years ago as a result of decades of industrial consumption. Despite this fact being easy to verify, it is widely unknown or disbelieved because the price of gold has rarely been higher relative to silver than currently. Because the price of silver is so cheap relative to gold, it is impossible for the vast majority of the world's investors to believe there is, effectively, more gold than silver in the world. But it is precisely this collective disbelief that presents the investment opportunity of a lifetime.

Among the many prior occasions I have written about the opportunity presented by silver's steep and unreasonable discount to gold was back in July 2009 when I wrote of silver's pending divorce from gold when the silver/gold price ratio was 68 to 1. On the day the article was published, gold was $955 and silver was $14. The troubled couple remained together for more than a year, trading between 65 and 75 to 1, before silver left in a huff at near 30 to 1 in April 2011. Had someone bought silver at $14 in 2009 and sold it at the top less than two years later, the return would have been 2.5 times invested funds. Had someone held gold instead in that timeframe the return would have been 0.5 times invested funds. I know as well as anyone that breakup didn't last and five years later the ratio exceeded 80 to 1. But that was then and this is now. My point is that not only are we back to where we were in 2009, silver now offers an even better relative bargain and return than it did then. If there is a surer trade than switching from gold to silver at current relative prices, I don't know what that trade might be.

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The real kicker here is that even if one favors gold over silver for the long term, the current mispricing of silver relative to gold offers the gold investor an unusual opportunity to increase one's gold holdings in a very low risk manner. By switching some gold positions into silver on a temporary basis to take advantage of silver's extremely depressed relative price and switching back into gold when the inevitable adjustment in the relative price occurs, a gold investor would end up with more gold without spending new investment dollars. What's the risk Â? gold soars and silver doesn't? Has that ever happened for long at such extreme relative valuations before?

For instance switching 7 or 8 Gold Eagles for 500 Silver Eagles today should result in a doubling of one's gold holdings as and when the silver/gold price ratio returns to more reasonable levels and even more if silver does what I think it will do.

The main reason the price of silver didn't permanently divorce gold in 2011 was the actions of JPMorgan. Having made the decision to accumulate as much physical silver as it could in early 2011, it was to JPMorgan's advantage to not only suppress the price of silver on an absolute basis ever since, but also its price relative to gold. Now there are signs that silver and gold may be headed for splitsville for good, thanks to JPMorgan.

Silver Melt-Up?

It's a given that big changes in the silver/gold price ratio are strictly a function of what the price of silver does. Silver is the active ingredient in the silver/gold price ratio. Therefore, whenever signs emerge that silver could move sharply higher, it pays to sharpen one's focus. I have been writing of changes, both in COMEX paper positioning and in physical market developments recently on an increasing basis and have come to the conclusion we may be on the cusp of a melt-up in silver prices, either with or without one final shakeout to the downside. You must understand that I seek to avoid the worst thing I could do Â? not warn of such a melt-up, by involving the second worst thing Â? overstating something that may not be in place just yet.

First, let's look at COMEX futures positioning, where there may be a big difference between gold and silver under the hood. More is being written on COMEX positioning and the Commitments of Traders (COT) Report than I thought possible. It is no secret that positioning in COMEX gold is at negative extremes not seen in years, with record managed money technical fund long positions and commercial short positions. This is thought to be bearish because once the maximum number of technical fund long positions have been purchased, the path of least price resistance is generally lower as these funds begin to sell.

Price action, trading volume and sharp increases in total open interest during the reporting week (ended yesterday) indicate a very sharp increase in additional technical fund buying and commercial selling in COMEX gold futures, perhaps 20,000 to 30,000 contracts more. Meanwhile, the 50 day moving average in gold (and silver) has moved higher, not just as predicted, but as mathematically mandated. Debate has raged as to whether the commercials will get run over and suffer big losses, but the jury is still out on that verdict. Should the COTs fail, as many seem to contend, it will be the first time that has occurred and I will be sure to report on this. I can't report before that occurs.

But it's important to recognize that to this point, the commercial traders in gold have been in complete control in COMEX gold futures trading and those commercials have already recorded realized gains of as much as $750 million in gold this year alone. And adjusting for the scam within a scam trading turns of late, the commercials' average price on open gold shorts is now close to $1240 and maybe higher.

All things considered, we certainly seem to be at a maximum disconnect between how well the commercials have done in COMEX gold this year and how favorably they are currently positioned and the calls for the commercials' imminent demise. Don't get me wrong, the COMEX commercials are collusive crooks, manipulating prices and the technical funds on a continuous basis and I would love to see their crooked games blow up in their faces. On the other hand, I don't see much constructive in mischaracterizing the facts. There is some merit in contentions that in bull markets the technical funds don't sell as much as they do in bear markets, but even in bull markets, some price selloff occurs after extreme positioning takes place.

That's not to say physical conditions in gold aren't tight, as is indicated in the still relatively large number of open contracts in the current COMEX April gold futures contract and recent moves to bring in metal into the COMEX gold warehouses for delivery. But many more than 100,000 COMEX gold contracts (10 million oz) have been added to the long side by the technical funds, in addition to the short covering of similar amounts this year; so 3000 contracts standing for delivery is not that big of a deal in and of itself.

Conditions in silver look different. Even assuming a significant amount of technical fund buying and commercial selling in the reporting week ended yesterday of 5000 to 10,000 contracts or more, the total commercial net short position had declined by 17,500 contracts in the two prior reporting weeks. Whereas the headline number of the total commercial net short position in gold will surge to new recent historic records, no such dramatic records should be set in silver. And much of the commercial selling in silver will be long liquidation by the raptors (the smaller commercials apart from the big 8) where in gold all the commercial selling will be in the form of new short sales since all three commercial categories were net short going into the reporting week. Selling short and selling out long positions are both sell transactions, but there just seems to be more intent with short sales to eventually rig prices lower.

The big question in silver is did JPMorgan add significant numbers of additional silver shorts? If they didn't, the silver melt-up premise is augmented, almost to the point of certainty. If JPMorgan did add new silver shorts that may delay the melt-up premise, although it wouldn't necessarily delay it for long. Silver is Boss Morgan's world and the inevitable melt-up is entirely in its hands. But it's important to remember that the silver melt-up premise in fully compatible with every action JPMorgan has taken over the past five years. JPM didn't buy as many as half a billion ounces of silver to have the price melt down from here.

In terms of COMEX futures positioning, JPMorgan is already prepared for a silver melt-up, even if it holds a significant short position, because its long physical position is so large. It is that large physical long position that guarantees that JPM will turn out OK, no matter what happens in the short term. But the same can't be said of any other COMEX silver shorts, large and small alike. Every other silver short stands likely to experience a religious experience and it seems most likely to me that the largest shorts will panic the most once they learn that JPMorgan will not function as the short seller of last resort. The question is not whether JPMorgan will someday refuse to fill the role of silver short seller at the margin, but which day.

Finishing up on COMEX positioning, I'd like to point out one big difference between gold and silver and one that adds to the silver melt-up premise. In COMEX gold futures, the technical funds have added massive numbers of new long contracts, as mentioned above. It wouldn't surprise me if managed money long positions totaled over 200,000 contracts in Friday's report, up from 75,000 in December. (This is why gold went up so much). This will be the highest level of technical fund long positions since 2011.

While the managed money long position in COMEX silver also shows a record long position of more than 60,000 contracts, there is an important distinction in silver that I mentioned repeatedly into yearend, but haven't mentioned much this year; so let me do so now. Starting in 2014, there developed a very large core long position in the managed money category that couldn't possibly be considered as belonging to the technical funds; simply because this core long position grew at times the price of silver declined in price. No self-respecting technical fund would add long positions on declining prices.

Most importantly, this core non-technical fund long position in the managed money category Â?ratcheted upÂ? by large amounts, which could only be seen after silver prices had declined. At the price lows of December, with silver prices trading consistently below $14, the lowest the managed money long position fell to was around 50,000 contracts. Therefore, current readings of 60,000 contracts or more are not large at all once one deducts the core non-technical fund long position and suggests that long liquidation on lower prices may not be that great. In other words, there would appear to be much more potential selling by technical funds in gold than in silver on lower prices, strongly supporting the sell gold/buy silver suggestion as well as the silver melt-up premise.

Lastly, as concerns futures positioning, silver did recently penetrate its 50 day moving average to the downside convincingly (a week or so ago) while gold did not, suggesting silver was more Â?washed outÂ? than gold. Of course, if the COMEX commercial crooks succeed in fully flushing out the technical funds in gold to the downside that selling pressure may slip over to silver temporarily.

But it is away from futures positioning and centered on the physical market that the silver melt-up premise is firmly rooted. At least once a week for five years I have been reporting on the various signs of physical tightness in the wholesale silver market; from COMEX silver warehouse inventory turnover to the unmistakable evidence of JPMorgan's accumulation of both COMEX inventories and futures deliveries, to the unusual deposits, withdrawals and changes in the short positions in SLV. I would even consider the sales of Silver Eagles over the past five years to be of the wholesale variety in that retail demand has been lacking over most of that time (retail demand has picked up sharply this week according to my sources). All of this revolves around JPMorgan. In retrospect, silver was tight principally because JPMorgan was buying so much.

I haven't mentioned one thing about JPMorgan and its accumulation of 100 million Silver Eagles and 50 million Canadian Maple Leafs over the past five years (which makes up about a third of all the physical silver I claim the bank has acquired). The two previous major acquirers of silver over the past 40 years, the Hunt Brothers and Warren Buffett, bought just over 100 million oz each and made history. JPMorgan bought more silver than either the Hunts or Buffett, in the form of US and Canadian issued bullion coins alone, to say nothing about the hundreds of millions of ounces the bank acquired in 1000 oz bars.

Any melt-up in silver prices must be connected to physical market conditions, as well as include no new shorting from JPMorgan. And while it has yet to occur, any melt-up will set off a rush by both silver investors and silver industrial users alike. We came real close to an all-out physical silver shortage in 2011 driven by investment buying alone, but that developing physical shortage was nipped in the bud before industrial users began to panic and try to build physical inventories. The next time a critical enough shortage takes hold, there will be no avoiding industrial users and fabricators joining in.

The key feature to the coming silver price melt-up and user inventory panic is how quickly it may commence, because once it begins in earnest, it must burn itself out. The only way the silver melt-up ends, once it begins, is at prices so ridiculously high that investors are revolted by price and users get all the material they desire without delay. It will involve a race between price and availability that probably won't last long time-wise, but will be more evident in price. Incidentally, this is the main difference between silver and gold. In gold, there are very few industrial users and, therefore, no chance of an industrial user buying panic. That's not a knock on gold, just a statement of fact.

I suppose it is possible that JPMorgan could decide to donate its accumulated silver to alleviate a silver price melt-up and physical shortage, but I don't recall the bank ever sacrificing profits to serve the common good before. Just today, the bank reported a quarterly net profit of $5.5 billion, not a dollar of which came from giving up potential profits. Besides, aside from me, who else is even claiming that JPM holds the physical silver I allege? Certainly, there are no laws I am aware of that restrict the ownership of any physical commodity, to say nothing of any power that could force JPM to dispose of its silver.

I have no doubt that silver will melt-up in price at some point and when it does, it must burn itself out. The price setting and manipulation on the COMEX has gone a long way to creating the set up for the melt-up and will exacerbate the whole process, but in the end the COMEX will likely no longer function as we know it. Of course, I can't know the exact timing of all this, but I do know all the signs I monitor suggest soon. I also know that being prepared beforehand will be worth a great deal, whereas knowing after the fact won't be worth near as much. Being early by any measure will prove infinitely better than being even a day late.

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