April 19, 2014 – Weekly Review

Weekly Review

In a holiday shortened trading week, gold and silver prices fell and erased the small gains of the two previous weeks. Gold fell by $23 (1.7%) and silver ended lower by 30 cents (1.5%). As a result of the flat relative performance, the silver/gold price ratio remained in the 66 to 1 area, at the top end of a year-long trading range still indicating, at least to me, that silver remains extremely undervalued relative to gold.

Of course, the longer any price or price ratio remains at a certain level that level looks more natural. That level may appear more natural through the passage of time alone, but if appearances are in conflict with the facts of supply, demand and money flows, the readjustment will still arrive eventually and most likely with more fanfare. That's another way of saying that in the long run silver will vastly outperform gold based upon the actual fundaments. You know what comes next Â? the short run is anyone's guess until the COMEX manipulation is terminated.

Turnover, or movement of metal into and out from the COMEX-approved silver warehouses cooled off a bit to the 3 million oz weekly average of the past three years, but considering it was a 4 day week, the turnover was still fairly torrid. Once again, total inventories fell for the week, this time by 1.1 million oz to 176.8 million oz. Since there are more reasons to expect total inventories to rise rather than fall, I'm not reading too much into the recently falling COMEX silver inventories. My attention is still on the movement, which does not exist in any other commodity. I continue to solicit explanations for the silver movement other than it is an indication of tight wholesale supply.

While it would appear that sales of Silver Eagles this month will fall short of March's record pace (for a Â?regularÂ? month), that's not to suggest any real cooling in demand. Year to date, the US Mint is still selling 95 times more Silver Eagles than oz of Gold Eagles, a pace heretofore unimaginable. Needless to say, whomever is gobbling up Silver Eagles believes the price of silver will rise and is putting money behind that conviction.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

The metal holdings in the big silver ETF, SLV, have been remarkably stable of late, although I had expected (and still do) some liquidation as a result of the recent price weakness, particularly after Tuesday's sharp decline. The recent price weakness in gold, which has been much stronger than silver this year, has resulted in an outflow from the big gold ETF, GLD, of 375,000 gold oz this week. That's almost $500 million worth of gold, which also happens to be the equivalent of 25 million oz of silver.

I can't help but think that if someone tried to purchase 25 million oz of silver in a hurry the impact on price would be enormous. The only qualifier, of course, would be depending on the type of silver purchased. After all, there is a big difference between actual silver and COMEX contracts, in that real silver is harder to create than futures contracts. That's why it's completely nuts that COMEX futures set the price. There was an advertising campaign back in the Stone Age for an audio tape that asked Â?Is it real or is it Memorex?Â? When it comes to silver that has become – is it real, or is it COMEX?

The changes in this week's Commitments of Traders Report (COT) for gold and silver were both as expected and as hoped for. On Wednesday I speculated that the severe and high volume price selloff on Tuesday (the report's cut-off day) could have resulted in a net change of 5000 COMEX silver contracts and 20,000 gold contracts on that day alone. Yesterday's report is not in conflict with my speculation. I am going to dig deeper than usual into the COT structure today because I believe we may be at an important price juncture for gold and silver.

In COMEX gold futures, the commercials reduced their total net short position by 14,100 contracts to 87,600 contracts. The price action during the reporting week was unusual, in that gold rose noticeably for the first four days, decisively crossing both the 20 and 50 day moving averages before dropping sharply on Tuesday. As such, the technical funds likely bought and the commercials sold thru the first four days of the gold price rise, only to sharply reverse positions on the Tuesday sell-off.

In other words, the commercials were sellers for four days and buyers for only one day, Tuesday. Considering that the commercials ended the reporting week as net buyers of 14,100 contracts, they had to buy more than that on Tuesday and 20,000 net contracts is as good a number as any. And I'm still of the opinion that there may have been reporting delays in the new COT report (for both gold and silver) since the big move down was on the cut-off day, so the commercials may have bought even more than has been reported.

By commercial category, the largest 8 traders bought back 3200 contracts of a net short position that is now the lowest in nearly a year, save for one week in December when gold was close to the eventual price low and under $1200. The bullish price implications of a very low concentrated short position of the 8 largest COMEX shorts should not be underestimated. The 8 largest COMEX gold shorts are ideally positioned for a gold price rally and that must be weighed against other indicators calling for price weakness.

JPMorgan appears to have purchased up to 2000 new long contracts, increasing its concentrated long gold position to 38,000 contracts. The biggest commercial buyers for the week were the raptors (the smaller commercials apart from the big 8) which purchased the remainder of 9000 net contracts. With buying among all the commercials it was a Three Musketeers effort of all for one, one for all in commercial buying on Tuesday's orchestrated and rigged sell-off. It's important to remember that no one buys anything not expected to rise in time and that includes the commercials.

On the sell side of COMEX gold, the technical funds sold more than 8500 net contracts, including 4200 new short sales. There was an increase of almost 3600 contracts in new shorts in the non-reporting (small) traders' category that perhaps should have been more correctly attributed to the technical funds, but that doesn't matter much as it wouldn't alter the commercials' position in any event.

The commercials have, over the past four weeks, reduced their net short position in COMEX gold futures by nearly 60,000 contracts, or the equivalent of 6 million oz. This is about half the amount the commercials sold on the $200 gold rally into February. There appears to be only one factor that will determine whether the commercials can buy back a significant number of gold contracts on lower prices.

I am going to devote more time to this point in silver, but it has a bearing on COMEX gold as well. Looking under the hood in the disaggregated report at the managed money category of gold and comparing the current technical fund position with historical levels, there doesn't appear to be much room for further technical fund long liquidation; no more than 5000 to 10,000 contracts of gross long liquidation compared to previous record low readings.
http://www.cftc.gov/dea/futures/other_lf.htm

There is potentially more substantial capacity for new technical fund short gold contracts to be added before we hit historical extremes. Therein lies the only real threat to lower gold prices, namely, can the commercials lure the technical funds onto the short side of COMEX gold? I don't have the answer to that question but I can assure you that if we do go lower in the gold price in the immediate future, this will be the only explanation for the decline. Most interesting at this time is that the potential for a significant increase in the tech fund short position in silver, oddly enough, appears insignificant.

In COMEX silver futures, the commercials reduced their total net short position by a hefty 5600 contracts to 23,300 contracts. This is the lowest commercial net short position in two months and is down 16,500 contracts (82.5 million oz) from March 4. As was the case in gold, all the commercials feasted and bought on technical fund and other speculative selling. There was no other reason behind the rigging of lower prices on Tuesday. The 4 largest shorts (JPMorgan) bought back 1700 short contracts and I would peg JPMorgan's concentrated net short position to be back to 20,000 contracts (rounded off).

The 5 thru 8 big shorts bought back around 900 contracts, reducing the concentrated net short position of the big 8 by around 2600 contracts from last week's 3.5 year high water mark. Still, at 63,857 contracts, the concentrated net short position is the largest of any regulated commodity by a wide margin at the equivalent of nearly 320 million oz or 40% of world production. It remains an oddity that the concentrated short position in COMEX gold is closer to its historical low, while the concentrated short position in silver is nearer the high.

The silver raptors continued to buy the lion's share of commercial contracts purchased, adding 3000 contracts to a net long position now totaling 40,500 contracts. This is the largest raptor net long position in silver since last July, save for one week at the February price low of under $19 (and just before a $3 price rally began). Over the past six weeks the raptors have purchased nearly 21,000 net silver contracts, or the equivalent of 105 million silver ounces. It is not possible that amount of real silver could be purchased by a small group of traders on a two dollar decline in price; this could only be accomplished in paper contracts on the COMEX.

As was the case in gold, the technical funds were the biggest sellers, accounting for more than 3500 silver contracts, including almost 3400 new shorts. Also as was the case in gold, the smaller non-reporting traders sold an inordinately large number of contracts, including more than 2200 new short contracts.

As I have been reporting for weeks, the COT structure in silver has been much more advanced in searching for a price bottom than has been the case in gold. Nowhere is this clearer than in analyzing how much closer the technical funds are in silver to holding their maximum gross short position on an historic basis than is the case in gold. Whereas the big potential for a price decline in gold lies in whether the commercials can lure the technical funds onto the short side, that potential wouldn't appear to exist in silver. After all, at more than 29,000 gross contracts held short in the managed money category of the disaggregated COT report we're only 1000 to 2000 contracts away from the historical extreme of the technical fund gross short record.

Instead and in direct contrast to the technical fund structure in gold, in silver it would appear that the only real potential for a silver price decline is if the managed money gross long position in silver gets liquidated, rather than if new technical fund silver shorts are added. I hate to drill down to such detail because I know it can be confusing to many, but I have been observing a strange pattern in silver for months that I feel I must mention. Before I do that let me try to define the managed money category in detail.

The managed money category of the disaggregated version of the COT report includes professional money managers which trade on behalf of the outside investors in a futures trading fund. Commonly called CTA's (registered Commodity Trading Advisors), the traders in the managed money category are just that Â? money managers. All the technical trading funds of which I write are in this managed money category; but you don't have to be strictly a technical fund to be in this category. The key to inclusion in the managed money category is whether you manage others' money, not how you manage it.

In other words, if you manage money using other than technical price signals, say on a fundamental value basis, you would still be included in the managed money category. Most traders in the managed money category are technical funds but that is not a requirement for inclusion.

I have noticed an unusual pattern in the managed money category in COMEX silver since October that I have been wrestling with since. While the technical funds have behaved as they always have in terms of adding to or closing out short positions depending on the price direction, some traders on the long side of the managed money category have definitely not been behaving as they have in the past. In the past, new long positions were only established as prices rose, as we all know that the technical funds buy to the upside.

Since October, around 10,000 contracts have been added to the long side of the managed money category in silver almost regardless of price direction. Stranger still is that even on some pretty sharp price declines over the months that 9,000 to 10,000 contract long position has not been sold. What makes it so strange is that technical funds always buy on the way up and sell on the way down. However, the strangeness disappears when you realize that it can't be technical funds behind the new 9 to 10,000 long contracts, but traders buying silver contracts for some reason other than technical price signals.

In simple and absolute terms, you are either technically motivated (charts and moving averages) or fundamentally motivated (supply/demand and value). Clearly, the 10,000 new long contracts in the managed money category in COMEX silver since October are definitely not technical motivated, otherwise they would have been sold ten times over given price action since then. By default, these new long contracts would appear to be a value bet on silver, similar to how I and most of you approach silver. When you invest in a commodity because you feel it is undervalued, you don't sell it if it gets more undervalued. That would seem to be the only plausible explanation behind the new long silver contracts.

If my interpretation is correct, this would introduce a new dimension to the COT structure in COMEX silver. In the latest silver COT report, the long side of the managed money category hasn't been below 25,000 contracts in two years and now sits at 34,000 contracts. If the long side does now hold the 9 to 10,000 contracts by value motivated money managers and those contracts are netted out, we would be at near historic low levels of long contracts in this category, in addition to being at near historic high levels of technical fund shorts. That's a fancy way of saying there doesn't appear to be much potential selling in this category, either in liquidating longs or adding shorts. That's also another way of saying this could be a very important price bottom in silver. I should also point out that I don't anticipate this new value-oriented silver long position in the managed money category to be sold without a significant rally in the price.

I suppose it's possible these new longs could still end up selling at even lower prices, but anything is always possible even if it is unlikely. Taking everything into account, including a near record raptor net long position, a near record technical fund short position and what may be a fully liquidated technical fund long position, that is a compelling list of buy signals. I know that the concentrated and manipulative short position of the big 8 shorts is way too high, but between the raptors and what now looks like new value players on the long side of the managed money category, it's just possible those concentrated shorts may have met their match. If we do rally at some point in the short term, it will be interesting to see if the big silver shorts add aggressively from current holdings and expose themselves to greater criticism.

In anticipation of what this new COT report might indicate I did top off all personal silver positions on Thursday (SLV), including beginning to venture onto the long side of silver call options (June and July). I say that not to entice anyone to throw money away on options, but as a reflection and confirmation of what appears to be a very attractive buy point in silver. If silver does move lower from here, it will most likely be due to further gold price weakness and will create a more compelling value and even better silver buy point.

Since I spend so much time and effort on the COT structure, I would be negligent in not pounding on the table when it was as favorably configured as I believe it to be currently. Incredibly, this is all in addition to the compelling fundamental set up. At what is a most religious and reflective time of the year, let me offer the very best wishes to you and yours.

Ted Butler

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Silver – $19.65

Gold – $1295

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