April 20, 2013 – Weekly Review

Weekly Review

In one of the most brutal weeks in history for a selected number of markets, the price of gold and silver were smashed to multi-year lows. Gold fell a further $75 (5%) for the week and silver was down a whopping $2.65 (10.2%). Remarkably, the price lows were established early in the week and gold was actually up $85 from the week's trading low, while silver finished $1.25 up from its trading low. As a result of silver's underperformance, the silver/gold price ratio blew out to 60.5 to 1, the highest level in more than two years.

Truth be told, had I been told or known that gold would fall more than $200 in two days, I would have assumed silver would have fared much worse on a relative basis than it did. Since, the basic premise of my switch to silver from gold mantra is predicated on relative valuations of these two precious metals, the more extreme drop in silver prices greatly increases its investment value both relative to gold and in its own right as a standalone asset.

I'll discuss the enhanced valuation of silver later, but there is much to cover in this report, including a shocking Commitment of Traders Report (COT). As shocking as that report appeared to be, there were especially noteworthy developments in the physical world of silver that bear review. Amid the price violence of the last week, activity in the physical wholesale silver market may have been overlooked.

My key indicator of wholesale physical silver tightness, turnover among the COMEX-approved warehouses, registered more frantic activity this week than any in memory. More than 7 million ounces came in and more than 5.5 million ounces were shipped out, leaving total inventories 1.5 million oz higher, at almost 166.3 million ounces. It is still my contention that the rapid movement in and out of COMEX silver inventories indicates that most of the existing inventories are not available for sale near current prices, necessitating a continued inflow of new metal to satisfy growing demand. Apparently joining the turnover frenzy this week, the big silver ETF, SLV, also exhibited frantic metal movement of 6.5 million oz out and 5 million oz in, according to a site I believe is valid http://about.ag/SLV/ While everyone is focused on the SLV total holdings being static, that's the last thing these holdings have been. In this sense, it appears COMEX inventory turnover has set in at the SLV as well.

Much attention has been focused on the fact that while gold metal inventories in the big gold ETF, GLD, have continued to flow out since year-end, very little net silver, if any, has come out of its silver counterpart SLV. In fact, while GLD has seen its holdings decline almost 17% this year, silver holdings in SLV are actually up more than 4% and basically unchanged this week (on a net basis). Previously, I indicated that if we did experience withdrawals in SLV on a scale of the pattern of outflows present in GLD even that might indicate only a transfer of metal ownership from weak hands to stronger hands. Actually, what I think I said was that nothing would surprise me concerning metal flows in the SLV in these unusual times. Even my speculation that there might be a Mr. Big emerging as a big buyer of silver is buttressed by the recent movement of metal in SLV, as the amount of metal removed fits with past withdrawals and may be to avoid SEC reporting requirements (legitimately).

But if wholesale silver movement was unusually strong this week, it actually paled against what is taking place in the retail market, which in a word is on fire. The sudden and shocking recent drop in prices has created a flat-out shortage in retail forms of silver that seems destined to intensify. Shortage is a funny word, in that it means different things to different people. To me, it's not so complicated Â? a shortage occurs when there's not enough material available for immediate delivery and is reflected in growing time delays for delivery and increasing premiums for what is available immediately.

Obviously, the US Mint can't keep up with demand for Silver Eagles placing it in violation of the law which mandates enough bullion Silver and Gold Eagles must be produced to satisfy demand. But man-made laws can't trump the law of supply and demand indefinitely. Many are still quick to point out that any silver shortage is confined to a number of retail forms of silver and not in the wholesale industry standard form of 1000 oz bars. That seems to be true, but the silver retail shortage is burning intensely and the winds are strong and the firebreak separating retail and wholesale are more likely than ever to be breached. I'll talk about this more later, but the simple fact is that these retail silver shortages have been flaring up on a recurring basis over the past few years and the current one is the strongest one yet. From everything I observe, the retail shortage is bound to intensify and I won't keep it a secret as to what is the underlying cause – the price of silver is too low.

Now to the shocking COT report. The report was so surprising to me that I can't help but think that there were some serious reporting errors, not just in silver, but also other markets like gold and copper, also traded on the COMEX. And it has nothing to do with me guessing wrong, as I have been doing this long enough not to question my calculations. Remember, any guesses to what a particular COT might show comes after the trading has occurred and is never intended as a short term price predictor (thank goodness). I wrote on Wednesday that I would analyze the report in an objective manner, no matter what the results and I intend to do that. So let me first review the report as published and then state my case for there being serious reporting errors.

Where I had expected a reduction of 40,000 contracts in COMEX gold and 10,000 to 15,000 contracts in COMEX silver and copper futures in the headline total net commercial short positions, the actual report indicated a decrease of only 2000 contracts in gold and copper and a fairly significant increase of 4600 contracts in silver. I don't recall ever be off by such amounts.

In COMEX gold, the commercials reduced their net short position by 1900 contracts to a still-historically low 141,900 contracts. By commercial category for those keeping score, the big 4 bought back 3700 short contracts and the 5 thru 8 largest traders bought back nearly the same amount. The raptors (the smaller commercials apart from the big 8) sold out 5600 contracts of their net longs, reducing their net long position to 1400 contracts. If someone called the report ho-hum, I couldn't argue. If someone called the price action during the reporting week, in which gold fell as much as $250 on record trading volume as ho-hum, it would be grounds for a mental examination. Therein lays the quandary.

As I'll discuss momentarily, the pattern most unusual in this report for gold, as well as for copper and silver, was the (reported) behavior of the technical funds, or those traders in the managed money category of the disaggregated COT report. http://www.cftc.gov/dea/futures/other_lf.htm According to the report the technical funds in gold bought more than 9000 new long contracts and also bought back more than 9000 short contracts on the single biggest decline in gold market history. If there is anything wrong with the current COT report, it would center on the reported changes in the managed money category in all three markets.

In silver, the commercials increased their total net short position by a sizable 4600 contracts, to a still-historically low 22,500 contracts. By commercial category, the big 4 (read JPMorgan) added 3200 new short contracts, while the big 5 thru 8 bought back a significant 2000 contracts. The raptors sold 3400 of their net long contracts, reducing that net long position to 27,500 contracts. This is still the largest raptor net long position in history, save for the three previous reports. As in gold and copper, the real head-scratcher was the behavior of the tech funds, which added almost 2000 new longs and bought back more than 8000 short contracts on as much as a $6 drop in the price of silver during the reporting week. Strange days indeed.

Using the data as reported, I would calculate that JPMorgan increased its net short position by 3000 contracts to 22,000 to 22,500 contracts. If the report was correct, this proves that JPMorgan is the crook I allege them to be in silver, as there can be no clearer proof of manipulation than when an entity effectively holding 100% of the entire total commercial net short position substantially increases that short position during one of the largest price declines in history. Even if the report is in error, JPMorgan is still the silver crook of crooks, but I won't belabor the point here.

Also strange is that the report indicated behavior by the non-reporting traders in all three markets that mirrored my expectations to a tee. For instance, in silver, gold and copper, the non-reporting traders (the Â?little guysÂ?) all sold big relative quantities of long contracts and added impressive quantities of new short contracts, befitting the shocking price declines. As a result, the net long positions of the little guys are among the lowest in history for COMEX gold and silver. These little guys performed exactly as expected. But the non-reporting traders make up a much smaller market share than do the big reporting traders and the quantities of contracts sold and sold short by the non-reporting traders is overshadowed by the big traders. (That's why we need position limits).

So here we have a case of a screwy report, but there is nothing screwy about the behavior of the non-reporting traders. The strange part is the behavior by the technical funds and, if their positions were somehow transposed, that would make for certain revisions in commercial holdings. I don't recall a report so Â?offÂ? in history for so many different markets and would not be surprised if major revisions were forthcoming. It also got me to thinking about the compilation of the data for the report.

In the stone age of more than 30 years ago, I remember as a commodity broker filling out by hand and mailing via the post office daily changes in any reportable position any client of mine held. I was given thick pads of forms (I don't remember the form number, but they were a funny orange color) in which I penned in any changes in duplicate (remember carbon paper?) and mailed the forms to the CFTC in Washington, DC. It soon changed to the CFTC getting the data directly and electronically from the brokerage house and verified by the clearing exchange. My understanding is that currently the CFTC receives the data directly from the exchange, in this case the CME Group, and publishes it in the COT Report. Therefore, perhaps the CFTC has published data falsely reported to them by the CME. Whether this is true or not should come out in time, but I for one would not be surprised.

As most of you know, I have a very low opinion of the CME. In fact, I consider it an ongoing criminal enterprise and I would like to use this occasion to reiterate why I feel that way. Mostly, it has to do with the CME's role in the silver manipulation, but it goes beyond that. You may remember that the CME was the real villain in the MF Global disaster, as well as in the failure of Peregrine Financial, when the CME stood by as innocent client funds were appropriated and lost despite decades of promises to protect end users no matter what. In the silver manipulation, the CME has been prominent in fostering the High Frequency Trading scams that bedevil our markets and for protecting exchange insiders against the public. A reverse Robin Hood.

But this latest price smash in selected NYMEX/COMEX markets paints a much uglier portrait of the CME. This week we have witnessed some of the biggest price smashes in history, brought about by deliberately predatory trading practices set in place by the CME and this sick exchange has the nerve to issue a press release trumpeting the record trading volume caused by the intentional market dislocation. http://cmegroup.mediaroom.com/index.php?s=43&item=3393
One would think that the designated self regulatory organization (as well as the federal commodity regulator) would have something more instructive to say about extreme disorderly trading conditions than look at how much (dirty) money they are making. That sums up the problem here, namely self regulators and regulators that won't regulate.

In some ways, it may be the worst possible case if the COT report is correct as published, rather than in error. After all, if so many different CME markets could fall so sharply with little change in the market structure, what's to prevent massive declines in any market? If the stock or bond market fell by 15% or 20% in a matter of days, you could be sure every regulatory official in and out of government would be taking every action necessary to find out why and prevent a recurrence while explaining things to the public in exquisite detail. Please contrast that to the total lack of any action by the CME or the CFTC to prevent or explain what the heck happened to so many CME markets this week. It is this continuing disrespect and contempt for the public welfare that more observers are noticing.

Nowhere is it noticed more than in silver. In fact, it's a confirmation that the silver Â?diseaseÂ? has now been transmitted to gold and copper and other NYMEX/COMEX markets. The trashing of the silver price is nothing new: what's new is that it is occurring in other markets. A case in point Â? the silver investigation of September 2008 is now more than 4.5 years old and the CFTC still can't address simple questions of market concentration. The two big silver price smashes of 2011 have been met with silence from the CME and the CFTC, when by all rights; those declines should have resulted in separate formal investigations of their own. Now it appears that the multi-market price smash of this past week is also destined to be intentionally ignored by both the CME and the CFTC, save for the braggadocios press release from the CME and some not so reassuring words from Commissioner Chilton that the agency is Â?looking into it.Â? I don't know the cause of the regulatory failure, but I do know that the CME is corrupt and based upon the continuing failure of the CFTC in regards to silver on so many occasions, I have to conclude all the Commissioners of the CFTC are also corrupt. I'd love to be proven wrong.

OK, so what does it mean if the COT report is correct and JPMorgan was the sole commercial short seller in silver to the downside, as it has been on so many occasions on price rallies? Aside from cementing the fact that JPMorgan is corrupt (along with the CME and the CFTC), does it mean the report is automatically bearish as some have been quick to pronounce? I'm not so sure based upon what the latest price smash has created in the real world of silver.

Since 1985, I have studied silver from the only perspective I was familiar with as a commodity broker/analyst, namely, a strict supply/demand analysis. That was also the perspective that allowed me to first spot the manipulation. I know that many hold silver for reasons related to inflation, the dollar and financial system insurance of some type. I understand and respect all those reasons, but in the many hundreds of different articles I have written about silver, I don't think I recommended anyone ever buy silver for those reasons. At my core, it's always been actual supply and demand when it comes to silver.

Now, more than ever, I see silver as a supply/demand sure thing. There are only three components to the law of supply and demand; supply, demand and price. Price is the fulcrum that balances supply and demand. Too high a price and the supply of any commodity will increase, while the demand will decrease until the price declines sufficiently to stimulate demand and curtail supply. Too low of a price and the law of supply and demand works in reverse. Rather than being forced to learn it from a textbook, we are witnessing the law of supply and demand real time in silver.

The deliberate price smash in silver has set the forces of supply and demand into overdrive. The current too low price of silver has created an unquestioned surge in demand and a drying up of supply. This is most obvious in the worldwide retail silver market because retail investors are more sensitive to sudden price changes than institutional investors. The reason we are in the midst of a retail silver shortage is because the price is too low.

This is not the first instance of retail silver shortage over the past few years, just the latest occurrence. From all the signposts, this looks to be a more severe retail shortage than all the previous versions. That's because the price is relatively cheaper than it has ever been. The retail silver supply network, particularly in the US, is wide, but not deep. This latest price smash has served to stimulate investment demand so much as to deplete retail dealer working inventories below any previous benchmarks. In turn, this will also stimulate further demand as retail dealers look to build up working inventories in order to do business. Since we are so early into this process, in some ways it is only a week old; the retail silver shortage could and should intensify greatly.

Just as retail dealers and investors compete to secure silver supplies, it is more likely, given the severity of the current retail shortage, to cross into the wholesale market for 1000 oz bars. In fact, I believe that we are witnessing a trail run of my long-held premise of a buying panic among silver industrial users in the current retail market. When the retail silver shortage comes to the wholesale market, the industrial users will behave just like the retail dealers and investors are behaving now. Only the industrial users won't be after Silver Eagles or bags of junk coins at any price; it will be about 1000 oz bars, which will only inflame big investor demand, especially in the ETFs.

Because I see this process as being under way, what difference does the COT make? While I will not be surprised at any continued dirty tricks thrown at the market by the crooked CME, JPMorgan or the CFTC, the law of supply and demand will triumph. The law of supply and demand is a force beyond compromise and it seems to be taking hold in silver in front of our eyes. While I consider talk of a delivery default on the COMEX as being premature, it is not far-fetched when you think things through. As and when the firebreak between retail and wholesale is crossed, it would be logical for wholesale quantity buyers, users and investors alike, to rush to the COMEX for actual delivery. That hasn't happened yet, but in the current price environment it seems reasonable and not way out there.

As I was finishing this, I had a real good question from a subscriber about the growing backlog of retail silver to be delivered as delivery times stretch out and seem destined to stretch out even more. In this case risk accrues to the investor who must lay out the funds upfront and get the merchandise much later. I'll consider the question more as time passes, but it is paramount to do business with a dealer you trust and has been in business for a while. I expect this to be a growing concern, also brought about by too low of a price for silver.

Ted Butler

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Silver – $23.25

Gold – $1405

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