April 21, 2012 – Weekly Review

Weekly Review

As has mostly been the case for the past six weeks, the price of gold and silver moved narrowly this week. Gold finished $17 lower (1%), while silver rose 15 cents. As a result of silver's outperformance this week, the gold/silver ratio tightened in slightly to just below 52 to 1. I'm planning on making the case for silver being a better investment than gold (no knock on gold) soon, so I'll save that for a separate report.

Price volatility has come in sharply and a few comments are in order. Speculative activity in gold and silver has been reduced and that is no doubt reflected in softer overall investment demand. Weaker retail investment demand for precious metals has been obvious for some time. The real question is if the investment demand cool-off is temporary. I think it is, particularly for silver. It is no secret that investment demand is the price driver for silver, just as it has always been for gold.

Investment demand is a funny creature in that it is self-reinforcing. The higher an investment asset climbs, the more investment demand is generated (until ridiculous valuations are achieved). Flat to lower prices on an investment asset do not generate wide investment buying interest. If there is a magic formula for long-term investment, I suppose it would include buying when the asset appears undervalued, misunderstood and out of favor and selling when speculative fever has pushed prices to extreme overvaluation. The trick is in gauging correctly the point of the final overvaluation and not succumbing to a temporary price peak.

To me, all the evidence points to the silver price peak of a year ago as being a temporary peak and not the final price high. That evidence centers around the price manipulation on the COMEX still being in place and other conditions remaining unfulfilled (like a true investment bubble and an industrial user buying panic). Yes, silver investment demand has cooled off recently in response to the orchestrated take down in price of a year ago, but it's always about putting things in proper perspective. Silver investment demand appeared for the first time in decades only six years ago with the introduction of the first silver ETF. It seems premature to me for anyone to pronounce worldwide silver investment demand to be over when, in historical terms, it is still in its infancy. Certainly, no one can argue that the real silver story had become so well-known as to have become over-embraced. It's simply amazing how so few of the world's investors are aware of the true circumstances in silver.

Conditions in the wholesale physical silver market also continue to amaze me. I think it has been more than a year now that I have been focusing on the movement of metal into and out from the various COMEX-approved silver warehouses. That turnover started out of the blue and has persisted and even intensified. COMEX silver warehouse statistics were, for many years, the only daily statistics available. For decades, the silver in the COMEX warehouses represented the largest stockpile of metal in the world. (Now, due mainly to the various silver ETFs, there are many daily stats to monitor and the SLV alone holds twice as much silver as the COMEX). It is easy to understand why close attention is devoted to the COMEX silver warehouse data by many observers, including me.

Unfortunately, it is just as easy to misinterpret the COMEX silver warehouse data. That's because despite providing the daily statistics in incredible detail, there is always vital information not provided, such as who actually owns the metal or how much is actually available for sale at any particular price. Just because metal is in the JPMorgan warehouse, for instance, doesn't mean it is owned by JPMorgan. It may be, but that is unknown. In fact, the whole process of analyzing the silver warehouse data is a bit of a tease, in that you know up front that you are never going to get all the way there. Still, since the COMEX has always been at the heart of what is important in silver for more than 40 years, you must consider all COMEX data closely, including warehouse statistics. But you must do so with the filter that no matter what there are going to be unanswered questions and a difficulty, therefore, in reaching definitive conclusions.

As I have written before, in studying the COMEX silver warehouse stocks for more than 30 years, I have never been able to decipher a connection between the warehouse data and price. But always in the past, large increases or decreases in COMEX silver inventories were eventually explained by other public developments. Invariably, increases in COMEX silver stocks are interpreted bearishly in that a surplus is the most logical conclusion and the opposite for inventory reductions. But there are too many variables for there to be only those black and white conclusions and past price history renders them invalid anyway. All that said, I am still taken back by the turnover in COMEX silver inventories.

This week, turnover in COMEX silver inventories was more frenzied than ever. There were two days of net withdrawals of more than 2 million ounces. For the week, total COMEX silver stocks were down nearly 3 million oz to 138.7 million oz. I am not celebrating the reduction, but highlighting the overall turnover. The Â?churnÂ? in inventories is what has my attention. Why is so much silver being moved in and out of these warehouses? Coincidently, there was also a big reduction this week in the holdings of the big silver ETF, SLV, on the order of 3 million oz that did not look at all related to plain vanilla investor liquidation. The most plausible alternative explanation is that the metal was more urgently needed elsewhere. Here's an interesting factoid Â? just as commentaries concerning the record increase in COMEX silver stocks have circulated, over the past 4 weeks, the combined total silver holdings in the COMEX and SLV have declined by 2 million oz. My point is not the total level of silver inventories, but the movement.

My conclusion is that the unusual movement is reflective of a combination of larger than appreciated demand and not as much available supply as thought to exist by virtue of rising inventories. A recent thought of mine is that someone big may be acquiring silver quietly without disturbing the price. Certainly, there is no mad rush by the investing public into silver currently. So, by process of elimination, if anyone is buying silver in significant quantities, it has to be a big entity. The big physical movements in COMEX and SLV inventories imply both buyers and sellers of physical metal. Yet there is no indication in any public reports of concerted buying. I can't prove it, but it Â?feelsÂ? to me that the buyers will prove more determined and successful in the end.

The latest Commitment of Traders Report (COT) indicated little change in the total commercial net short position in gold and silver. This was in keeping with the subdued price volatility during the reporting week. In gold, the total commercial net short position increased by 5000 contracts to 176,100 contracts, still near the recent bullish extremes. This was the lowest weekly change in gold in months. The raptors (the smaller commercials apart from the big 8) accounted for just about all the change, increasing their net short position to 12,700 contracts. The big 4 only increased their net short position by 800 contracts and still have close to their smallest net short position in years.

In silver, it would be hard to be closer to unchanged than in the past week, as the total commercial net short position increased by around a hundred contracts to 26,500 contracts. By category, all the changes were in the hundreds of contracts and not worthy of intense examination, as this was not a week for important changes in market structure. While I hadn't expected much change given the lack of price movement in the reporting week, I wasn't sure, as total open interest climbed a sharp 7,000 contracts during the reporting week. As it turned out, almost the entire increase in total open interest could be attributed to spread transactions, of which the economic rationale escapes me. My point is that it has become difficult to rely on daily changes in open interest as the principle data source to guess changes in market structure because of spread trading. I would continue to calculate JPMorgan's concentrated net short position on the COMEX to be around 18,000 contracts.

While there were no radical changes in this week's COT, that means we have remained in bullish territory. The lack of change in market structure amid the reduced price volatility doesn't mean that we won't see a resolution that is explained by changes in market structure. In other words, changes in market structure are not time sensitive; they occur when they occur. Sometimes we get important price changes within a week, even before a new COT report is published. Other times, the resolution drags on for many weeks and months. Futures contracts don't really expire (like options) as there is usually a low-cost roll-over feature available. Time is not a critical consideration in COT analysis.

The current bullish market structure in COMEX silver and gold will eventually resolve itself on higher prices, but there is no way of knowing for sure whether the collusive commercials can rig one last sell-off. As useful as I find the COTs to be, you must still remember that silver is very much a market manipulated on the COMEX. We must always view the silver market as manipulated (until it's not) and approach it accordingly. That means to hold fully paid-for positions that enable you to ride out the deliberate take-downs.

Speaking of market manipulations, there was a development this week that I would call your attention to. The CFTC announced a settlement resolution to charges they filed in July 2008 against the Dutch trading firm Optiver for manipulating certain energy markets in 2007. The standout feature of the settlement was the apparent severity of the fine ($13 million) versus the amount of profit disgorged ($1 million). The good news is that the CFTC came down hard on the violators; as well they should for such serious market offenses.
http://www.cftc.gov/PressRoom/PressReleases/pr6239-12

But I would like to discuss something that I don't consider to be good news about this case. That something concerns selectivity. While it's always good for the regulators to prosecute manipulation, they must do so uniformly and in keeping with the greater public good. No doubt that the traders from Optiver did something wrong, but what about the manipulation in silver? Clearly, many more members of the public have been damaged by the silver manipulation than were damaged by Optiver in energy. Additionally grating is that the press release from the CFTC makes mention of the great cooperation given by the NYMEX (owned by the CME Group) in this case.

It's no secret that I hold the CME in the lowest regard possible and anything they do I would regard suspiciously. I can't help but feel that the NYMEX, COMEX and the CME always advance their own agenda and do not advance the public's best interest. It strikes me that this Optiver case pitted one group of big traders against other big traders more closely aligned to the CME. This wasn't a clear case of Optiver screwing the public because the public didn't deal much in the types of contracts alleged to be manipulated. This sounds more like a personal vendetta where the exchange chose sides and used the CFTC to settle scores. If the NYMEX, COMEX and the CME are so interested in rooting out manipulation as is suggested in this case, why have they remained silent on the allegations of silver manipulation?

Almost a year ago, perhaps the most egregious and blatant market manipulation in history took place in silver trading under the supervision of the CME. Starting on Sunday night on May 1, the price of silver dropped $6 within minutes due to crooked and collusive Globex trading. By the end of the week the collusive COMEX commercial crooks had put it down by nearly $16 (35%). At the end of September, the crooks did it again. It is impossible for a world commodity to fall 35% in a matter of days without a legitimate explanation. Barring some obvious supply/demand explanation, such a decline must be considered to be manipulation. I have never heard any explanation from the CME or the CFTC for the two giant manipulative takedowns in silver last year. That's shameful. You'll forgive me if I refrain from offering great congratulations on the Optiver settlement.

No doubt the CME extracted some inside revenge in the Optiver case, but when it comes to matters involving the public, the CME couldn't care less. Not only is this evident in silver, it is also evident in the case of MF Global, where the CME abandoned the public and its previous promises of making customers of a failed clearing member whole. We are approaching the six month mark of the MF Global bankruptcy and the CME still refuses to step up to the plate and do what's right for the tens of thousands of former MFG customers. This is not how a legitimate self-regulatory organization is supposed to behave. This is not the type of organization the CFTC should be praising in the Optiver case. I suppose the takeaway here is if you are a big trading firm, make sure you have the CME on your side. If you are a member of the public looking for the CME or the CFTC to do the right thing, good luck.

Finally, I'd like to direct your attention to a recent video interview with Commissioner Bart Chilton. Let me state upfront that I consider Chilton to be one of the good guys. He has championed the issue of position limits more forcefully than anyone else. It is because of him that we have an ongoing investigation in silver. He is tireless in presenting the agency's role in public appearances. So I hope he and you take what I am saying constructively, as that's the way I mean it. First, here is the interview (click on 4-19-12 segment)
http://www.bnn.ca/Shows/Commodities.aspx

I have two constructive suggestions for Commissioner Chilton. First, the statement about a 10% position limit in any market confuses me and may confuse many others as well. The formula that the CFTC is advancing for position limits is for 2.5% of the total open interest, with only the first 25,000 contracts subject to a 10% limitation. For markets that have a total open interest near 100,000 contracts, like silver, this effectively boosts the position limit from 2.5% to closer to 5% (which is way too high). For larger markets that have total open interest levels closer to 1.5 million contracts, like crude oil, the position limit stays much closer to 2.5% of total open interest. In no case does the formula suggest a position limit of 10% of total open interest and I feel Chilton is confusing the issue. By the way, JPMorgan's 20%+ share of the COMEX silver market looks and is more extreme when compared to 2.5% to 5%, than 10%.

The second suggestion I would respectfully ask Chilton to consider is that when he uses the extreme concentration in silver as an example of what he is talking about, that he explain that the unusual concentration in COMEX silver is on the short side and not the long side. Generally, the interviews are about rising gasoline prices and what the regulators can do about preventing excessive speculation and manipulation. By mentioning silver in the discussion about high oil prices, I'm sure the average viewer assumes that any big concentration in silver must be on the long side and is causing silver prices to be higher than they would be otherwise. If Chilton would include the fact that the concentration in silver is on the short side and how that would depress the price of silver, the case would be made more accurately. If the silver concentration is to be mentioned (and it should be), then it should be pointed out on which side of the market it exists. As you know, getting the true story out on silver is important.

Ted Butler

April 21, 2012

Silver – $31.70

Gold – $1643

Date Created
2012/04/21