

August 1, 2015 – Weekly Review

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Silver managed (barely) to end its 5 week string of lower closes and finished the week higher by 5 cents, while gold made it 6 consecutive weeks it finished lower, but only by \$4.

As a result of silver's very slight relative outperformance, the silver/gold price ratio tightened in a bit to just over 74 to 1. While the price ratio indicated silver has slightly outperformed gold over the past 6 weeks, it is more accurate to point out the price ratio is in the middle of a one year trading range. Eventually and perhaps soon, I still expect silver to markedly outperform gold, but I also expect both to move higher.

Over the past 11 weeks, both gold and silver have finished lower in nine of those weeks. Since I hold that the primary, if not sole price force currently in place is futures contract positioning on the COMEX between managed money traders and their commercial counterparties, there's nothing about the price decline since May 19 that looks unintentional or due to market happenstance.

It's a stone cold fact that managed money technical fund traders have sold gold and silver short on the COMEX in historic amounts over this time and if there is any other single fact that explains the price drop, I am unaware of it. Of course, these short positions are very much open transactions and how they are closed out (as they must be at some point) will determine future prices. Based upon the same technical motivations that prompted the managed money traders to go so heavily short over the past 11 weeks, there are now strong suggestions all that shorting might be set to be unwound in the near future. More on that in a moment.

Turnover or the physical movement of metal coming into or departing the six COMEX-approved silver warehouses came to nearly 4 million oz again this week, as total inventories fell 2.1 million oz to 175.7 million oz. I'm more concerned with the movement than with the total level of COMEX silver inventories, but would note that COMEX silver inventories are down 8 million oz over the past 4 weeks, putting them very close to the 175 million oz level that has prevailed for the past year and a half. Over that same time, close to 400 million oz of physical silver has either been taken off trucks and brought into the six COMEX silver warehouses, or has been taken out of these warehouses and put onto trucks, with the destination mostly unknown. Please allow me restate why I think this turnover is important, even while it remains conspicuously unreported on.

The unprecedented and still unique physical movement in COMEX silver suggests wholesale tightness in that why, considering the cost of movement, would it occur if it wasn't necessary? Secondly, the movement began and has remained consistent since April 2011, which has come to be the most important time period in the history of the silver market for many reasons. It was then that JPMorgan made the decision to acquire as much physical silver as possible and I have come to conclude that the cumulative movement of physical silver in and out of the COMEX warehouses of close to 800 million oz, allowed JPM to "skim" and divert a couple of hundred million oz for its own possession. And I'm starting to think my guesstimate of 350 to 400 million oz of physical silver owned by JPM is very much on the low side.

I'm going to switch gears a bit here and talk about some unusual developments in gold. As in silver and other metals, the primary driving force for price in gold is COMEX positioning, which is strongly suggestive of an impending rally. I am struck by the continued liquidation or decline in holdings in the big gold ETF, GLD. I had been thinking that the reduction in metal holdings in the trust was plain vanilla investor liquidations in reaction to the decline in price and unusual outburst of negative gold commentary.

Yesterday's 240,000 oz withdrawal from the GLD gives me pause and suggests that a large buyer may have deployed a tactic I have reported on repeatedly in SLV, namely, someone converting shares to metal to avoid SEC reporting requirements. Obviously, a large buyer seeking to accumulate gold without notice is not a bearish development and does fit into the very constructive setup existing in gold currently.

In addition, the start of the big August COMEX gold delivery period must be considered unusual at this point in that very few deliveries (259) have been issued against a rather large (8000+ contracts) remaining open after the first two days of deliveries. I had previously reported that spread differentials between COMEX trading months looked tight and that spread tightness continues. Further, total COMEX gold inventories look "low" particularly after yesterday's 270,000 oz withdrawal. Generally speaking, it is more usual for warehouse inventory levels to increase going into a major COMEX delivery month as participants prepare for deliveries. Therefore, a big decrease in inventories coupled with a small number of deliveries in the first two days and a large number of contracts still open in the delivery month raises one's eyebrows.

I'm not particularly concerned about a COMEX delivery default in gold as that would and should spell the demise of the exchange (be still, my beating heart); but what makes the prospect of a short squeeze in gold loom larger than normal is the fact that the commercials are less short and the managed money traders are more short than ever. That means that there has never been a better time, for the commercials, to rig gold prices higher under the cover of physical gold tightness. It's the backdrop of record managed money shorting in gold that accentuates the various details of the current delivery. I probably wouldn't mention the details without that backdrop.

Finally, sales of Gold Eagles and Gold Buffaloes from the US Mint have exploded to the highest levels in years, starting in June and continuing through July, joining the surge in sales of Silver Eagles. The Mint continues to ration sales of Silver Eagles and it would not surprise me that if the buying surge continues that it may soon have to ration sales of gold coins as well.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

But here's what I find so unusual about the surge in sales of gold coins \hat{A} ? I don't think it results from broad based retail demand. As has been the case in Silver Eagles over the past four and a half years where a single big buyer (JPM) was responsible for record sales, that now seems to be the case with gold coins over the past two months. I just don't see strong evidence that the public has embarked on a gold buying binge and, instead, other evidence (such as mining stock performance) suggests the public is unloading other forms of gold.

Clearly, someone is buying gold (and silver) coins from the Mint and if it isn't the public, then it must be much bigger buyers. The pattern of sales of gold coins, if it is the work of a big buyer, would fit in perfectly with the details above about GLD and the August COMEX delivery pattern, all united behind the backdrop of a record managed money short position.

The changes in this week's Commitments of Traders (COT) Report came within my general expectations, although I made no specific prediction. Price action during the reporting week suggested some additional commercial buying and managed money selling, but after so many weeks of such activity, I questioned how much more the managed money traders could sell. The answer appears to be only a tiny bit more in gold and not any more in silver.

In COMEX gold futures, the commercials reduced their total net short position by an additional 6300 contracts to 15,300 contracts, making the headline number the lowest (most bullish) in more than 13 years. The last time there was a lower total commercial net short position was back in early 2002, when gold was under \$300. Since May 19 (and \$1220 gold), the commercials have reduced their total net short position by 117,000 contracts, the equivalent of 11.7 million oz and \$13 billion. Can anyone seriously doubt that this was purposeful and deliberate?

Despite the fairly large 6300 contracts of commercial net gold buying, managed money traders only accounted for less than 1100 contracts on the sell side, including an additional 1064 contracts of new short selling. Of course, since last week the managed money short position was at a record level, a new record of 120,917 short contracts was established this week. The majority of the selling this week in gold was by other large reporting traders and smaller non-reporting traders.

The net short position of the smaller non-reporting traders is within a whisker of setting a 15 year extreme. I think it's a tossup between which category of traders, managed money or smaller non-reporting traders, is more inclined to rush to buy back short positions on a price rally; but, mathematically, more buying power potential rests with the managed money shorts since their short position is nearly three times that of the smaller traders.

Interestingly, the long position of the managed money traders remained nearly intact at 106,284 contracts. I continue to believe this level is largely immune to further selling on lower prices and combined with the very modest increase in managed money shorts, I can't help but think there isn't much, if there is any, further selling in gold coming from either the long or short side in managed money. That, effectively, is another way of saying the price lows in gold are in.

In COMEX silver futures, there was a slight increase of 900 contracts in the total commercial net short position to 12,100 contracts. This is still one of the lowest (most bullish) headline numbers in history and it would be appropriate to stop there and not read anything into this week's minor increase. The commercials have bought back a net 50,000 contracts since May 19 and unless I'm missing something very basic, any time the commercials buy the equivalent of 250 million ounces of silver in eleven weeks, good things are likely to occur in the price of silver.

The managed money traders did buy back 1667 short contracts and as much as I would prefer to see them stay maximum short until much higher prices occur, the 53,636 short contracts still open is far from insignificant. Prior to the last four weeks, there has never been an occasion in history where the managed money shorts held more than 50,000 contracts short. In other words, there is more than enough rocket buying fuel in the silver tank to propel prices sharply higher.

I noted with interest that the managed money long position increased by 89 contracts to 40,641 contracts, still (ever so slightly) above the core non-technical fund long position of 40,000 contracts I've mentioned over the past year. As was the case in gold, with silver prices hitting five year lows amid masterful price salami slicing, at some point there must be no further long liquidation by managed money longs. Considering what has occurred price and commentary wise, if the managed money longs in gold and silver have not liquidated completely by now, they are unlikely to do so on lower prices ahead. With both managed money longs likely fully sold out in both gold and silver and with managed money shorts fully committed, it's hard to imagine prices moving lower.

That's another way of saying it's easy to imagine gold and silver prices moving higher. And, as it turns out, there are even technical fund factors that point to aggressive buying dead ahead, both of the short covering and new long varieties. As you know, the managed money technical funds (along with the non-reporting smaller traders) buy on higher prices and sell on lower prices, most typically as dictated by moving average penetrations. One unavoidable consequence of a steady 11 week price decline is the certain arithmetic reduction in various moving averages.

The price decline over the past 11 weeks has now resulted in a "snugging" of a number of moving averages in gold and silver to the extent that it wouldn't take much of a price rise to set off a large move to the upside. While it's true that the key 50 day and 200 day moving averages in gold (\$1160 and \$1194) and in silver (\$15.69 and \$16.33) are still a decent, but hardly unachievable distance above current prices, those aren't the only moving averages that will cause the technical funds to buy due to upward price penetration. These funds react, in varying degrees, to other moving averages such as the 10, 13, 20, 30 and 40 day moving averages; maybe not with the same number of contracts that might be deployed on a 50 or 200 day moving average penetration, but with some number of contracts.

While the 50 and 200 day moving averages are still above current gold and silver prices (although not by much on an historical basis), the shorter moving averages have really snugged down to current prices. For example, the 13 day and 20 day moving averages in gold (\$1105 and \$1124) and in silver (\$14.75 and \$14.97) are much closer, particularly in silver since the weekly close was right on the 13 day moving average.

My point is that strictly based upon existing positioning and how the technical funds are programmed to respond, even the slightest rise in price from here is bound to trip off some technical fund buying. As and when that occurs, unless the commercials plan on never allowing gold and silver prices to move even slightly higher, the buying at the more "minor" moving averages is likely to lead to still higher prices. This could and should result quickly in the major moving averages being penetrated and the full force of managed money buying being unleashed. Nothing to do with China, Greece, the Fed, other central banks, the dollar or any plan by the world powers that be to enslave us all – just plain vanilla technical buying. Same as the managed money selling that brought prices lower – no more no less.

In fact, I can't help but think that the close proximity of the minor moving averages to current prices as being akin to lighting a string of firecrackers and having one set off the rest until all the stored energy is expended. One moving average penetration leads to the next penetration until managed money buying is exhausted. This is the way it always has been and is built into the current market structure. As such, eventual technical fund buying is a certainty and only a matter of time. In that sense, it is not a variable. The only variable is how aggressive the commercials will be in selling into that certain managed money buying to come. I believe I've mentioned that in the past to the point of – enough already.

What I haven't mentioned, but have been thinking about a lot are the current unrealized open profits of the managed money shorts and how much, if any, of those open profits will be realized and booked in the end. This is back of the envelope reasoning based upon the continuing flow of prices, the COT data and the average price that the managed money traders received in assembling their massive and historic short position in both gold and silver. From May 19, the managed money sold a little over 60,000 new gold and 43,000 new COMEX silver contracts short. I'm ignoring the 30,000 gold and 14,000 silver long contracts that the managed money traders sold and liquidated on the price decline, no doubt incurring significant realized losses after being way ahead at the price top then.

I would calculate the new 60,000 gold and 43,000 silver short contracts added by managed money traders as prices moved lower (in fact, causing prices to drop) are at an average price of \$1160 in gold and \$15.80 in silver. Simple math suggests, therefore, that the technical funds are ahead on an unrealized and combined basis around \$400 million in gold (60,000 x \$6500 per contract) and around \$225 million in silver (43,000 x \$5000+ per contract). However, I can't say that the managed money traders' counterparties, the commercials, are holding an equivalent unrealized loss simply because much of the commercial buying was short-covering at lower prices than originally established and closed out at a profit. Any new long positions bought by the commercials since May 19 are held at an open loss, but much less than the managed money open profit.

I contemplate the size of the open profits of the new managed money traders short in gold and silver in guessing how that current open profit will look when the positions are closed out, as they must be. It seems to me that the open profits for the managed money shorts is not that large relative to the number of gold and silver short contracts held. I can't imagine the commercial longs, as well as other strongly held long positions (think managed money longs) being in any type of panic or trouble, as occurred last October to several smaller commercial longs in silver.

Instead, all I can imagine is how quickly all the managed money shorts' open profits will evaporate completely on a \$65 up move in gold and a dollar jump in silver. And I'm just speaking of the technical funds losing their open short profits. The commercials are in a unique position (by their historically low total net short positions) to really put it to the managed money (and other speculative) shorts and all they have to do is, well, literally nothing. If the commercials don't rush to sell aggressively into the certain managed money buying ahead, the price of gold and silver will jump dramatically. Not selling is doing nothing. Let the commercials do nothing and dancing days will be here again.

Ted Butler

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Silver – \$14.75

Gold – \$1095

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