

August 10, 2019 – Weekly Review

While backing off a bit from Wednesday's large gains, both gold and silver ended sharply higher for the week. Gold ended \$56 (3.9%) higher and at fresh 6+ year highs, while silver jumped 71 cents (4.4%) to finish at fresh year+ highs. As a result of silver's slight relative outperformance, the silver/gold price ration tightened in by half a point to 89 to 1, still at nearly unbelievable undervaluation levels for silver.

It almost goes without saying that COMEX futures market positioning accounted for the sharp price gains, but some serious questions have arisen with what is actually transpiring in the ongoing managed money/commercial struggle on the COMEX. I'll try to lay the case out as objectively as possible when I dig into the new Commitments of Traders (COT) report in a moment, which was a blockbuster in many important regards. But first let me run through the matters usually covered weekly.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses jumped to the highest level in 7 weeks, as 5.2 million oz were moved and as total inventories rose by 0.8 million oz to 311.2 million oz, another all-time high. Those that insist that growing COMEX warehouse levels are bearish for price need to explain (if they can) why prices surged on new inventory highs, but to me that's a specious argument to begin with.

I suppose I was somewhat "disappointed" that this week's movement was back to levels barely above the average weekly movement over the past 8.5 years, since I was (and still am) speculating that the recent drop off in movement indicated that JPMorgan had enough metal skimmed off by the movement it created to let prices rise. But one week does not a trend make and, as I've indicated all along, there is no way to predict futures COMEX warehouse turnover, so I'll continue to monitor the situation. By the way, there was no movement or change in the JPMorgan COMEX silver warehouse for the sixth week running.

Nothing special to report on the ongoing August COMEX gold or silver deliveries, with HSBC the big issuer in gold and Citibank the big stopper in their respective house accounts and with customers of JPMorgan the second biggest net stoppers. In silver, a customer(s) of JPM is the biggest stopper.

https://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

The new short report on stocks for positions held as of July 31, indicated a slight drop in the short position of SLV, the big silver ETF and a moderate, but otherwise featureless increase in the short position on GLD, the big gold ETF. Since metal was coming into the SLV at a prodigious rate into July 31, I saw no reason for an increase in the short position for this report, but I didn't really know what to expect given the highly unusual surge in trading volume and metal deposits.

<https://quotes.wsj.com/etf/SLV>

Generally, the short position in SLV increases when metal is not immediately available for deposit and authorized participants are forced to short the stock. But the recent surge in buying volume through July 31 resulted in massive and immediate physical deposits of silver, eliminating the need to short the shares of the stock. The question at that time was where all the physical metal was coming from that could be deposited so quickly? The answer wasn't complicated as JPMorgan was the only entity in

the world with that much silver to spare, but the new question emerged about whether JPM was freely selling the metal or was it leasing it to other authorized participants, thus retaining ownership to the lent metal. That question remains unanswered.

I don't mean to cause you whipsaw, but very recent events have created another new question. Wednesday's sharp price jump in silver resulted in the highest trading volume in SLV in quite some time, nearly 50 million shares, resulting in at least 10 to 15 million new oz being "owed" to the trust. It's only been a couple of days, but only 3.6 million oz have been deposited into the trust, with no corresponding big deposits into the other silver ETFs. Unless we get very large deposits over the next few days, it may be that JPMorgan has turned off the silver spigot. That would mark a turnaround to tightness in the physical silver market and makes the next short report on SLV all the more interesting.

The new COT report was a blockbuster in quite a few ways. First, on a conventional basis, there was a very significant and mostly expected increase in managed money buying and commercial selling in gold for a reporting week that featured large gains and new price highs. On Wednesday, I predicted such positioning changes and noted that total open interest in gold increase by 37,000 contracts over the reporting week.

But truth be told, I didn't expect a net positioning change quite that large, or even larger as was the case in managed money net gold buying. And in silver, where I expected no big positioning change given the relative unchanged price level for the reporting week and no change in total open interest, I was nearly blown away (pleasantly so) by the sharp reduction in the commercial net short position and even sharper reduction in the managed money net long position. And this just related to the conventional headline results; wait until I get to the real details under the hood.

In COMEX gold futures, the commercials increased their total net short position by a very hefty 36,400 contracts to 324,300 contracts. This is the largest commercial net short position in nearly three years (summer 2016) and one of the few highest levels in history. On a conventional COT market structure basis, this is about as bearish as it gets. As a dyed-in-the-wool market structure analyst, I could not begin to argue with anyone who insisted gold prices are set to fall sharply, the exact timing aside. And, as you know, the current extreme bearish market structure is the only bearish factor I see in gold, everything else looks bullish.

So why am I not screaming from the top of my lungs that gold should be sold forthwith, completely aside from no one knowing what the short term holds? Let me state it this way. If we go lower in gold from here and the commercials hoodwink the managed money traders to sell, I won't be able to say I was completely shocked (after seeing this movie so many times). But there are some important things at play this time around to make me think that this time it might be different (he said with great fear and trepidation). What things?

Well for one, the current financial condition of the 7 big shorts in gold and silver (as I outlined on Wednesday). These guys are deeper in a financial hole than they've ever been. Even with some slight respite over the past two trading days, these seven traders had a very bad week, perhaps their worst in history. After sticking around the negative \$2 billion mark for the past few weeks (\$2.15 billion at the end of last week), the price rally in gold and silver this week added a whopping \$1.5 billion to the open losses, making the total combined open and unrealized loss \$3.6 billion.

That's an average loss of more than \$500 million per trader, every dollar of which has been demanded in additional margin deposits. These traders are mostly foreign banks (remember, I'm excluding JPMorgan), but even banks don't have unlimited funds (just ask Bear Stearns). At some point, the chief financial officers or treasury officials at these banks are likely to say no mas to the traders who got so heavily short should prices continue to move higher. As a subscriber pointed out this week (thanks Duran), the risk already witnessed is far out of proportion to the expected profits at the outset of the trade, by a factor of 10 to 1 (so far). A pulling of the plug on these nutso short positions would only send prices sharply higher.

Then there is the matter of which commercials are really short. As die hard a market structure analyst as I am, I also remain highly focused on JPMorgan as the lord and master of all things gold and silver. Despite a sharp increase in the concentrated gold short position this week, I detected no great participation by JPMorgan (based upon changes in the Producer/Merchant category). Moreover, the new Bank Participation report indicated a fairly significant reduction in the short position of US banks (read JPM) and an even more significant increase in the gold shorting by foreign banks over the past month.

As regular readers know, I have been detecting moves by JPMorgan over the past year and a half which indicate that it has been engineering a double cross of other commercials in both gold and silver. Thus, these recent moves by JPM seem extremely noteworthy to me. Yes, the total commercial net short position in gold is about as bearish as it has ever been, but that's not at all true when it comes to JPMorgan.

On the buy side of gold, the managed money traders bought even more than the commercials sold, in buying a massive 41,120 net contracts, comprised of 33,106 new longs and the buy back and covering of 8014 short contracts. The resultant net long position of the managed money traders of 226,833 contracts (248,687 longs versus 21,854 shorts) is among the largest in history and is certainly bearish in a conventional sense. However, if JPMorgan is in position to double cross the other commercial shorts, these managed money longs could get very lucky indeed.

I haven't mentioned it, but since derivatives are a zero sum game, the managed money traders clearly hold the same open and unrealized profits that the commercials hold in open losses. If the seven big commercial shorts don't succeed in rigging prices lower and getting the managed money traders to sell at those much lower prices, but instead fail to do so and begin to buy back shorts at higher prices, the managed money traders stand to make a fortune.

In COMEX silver futures, the commercials reduced their total net short position by a hefty 8,700 contracts to 75,300 contracts. The reduction was a surprise to me, as well as the much larger reduction in the managed money net long position, given that no key moving averages came close to being penetrated (not even the 20 day moving average was penetrated). And thanks to the release of the monthly Bank Participation report, as well as changes in this week's COT report, I'd now peg JPMorgan's silver short position to be no more than 20,000 contracts or less. That's down from the 25,000 to 28,000 contracts I estimated last week (mostly a result of recalibration).

On the managed money side of things, these traders sold a whopping 15,700 net silver contracts, comprised of the sale and liquidation of 5754 long contracts and the new sale of 9946 short contracts. I was particularly surprised by the new sale of so many short contracts in the absence of moving

average penetration. I'm sure Wednesday's surge in price featured the buyback of many of the managed money shorts just added. The resultant managed money net long position of 46,862 contracts (89,145 longs versus 42,283 shorts) is hardly bullish on its face, but nowhere as bearish as the equivalent position in gold. But if a JPMorgan double cross is in the cards, what the managed money traders' hold is secondary.

Once again, the concentrated long position of the 4 largest traders decreased noticeably, as it has for 5 of the past 6 reporting weeks. This week, the concentrated long position was reduced by 4490 contracts to 53,601 contracts. Since the highest point of this concentrated long position of 67,328 contracts on June 25, the position has been reduced by 13,727 contracts. As a reminder, the position grew by nearly 18,000 contracts from May 28 to June 25. You will recall that there was a spirited public discussion as to who the silver whale was (China or a hedge fund) when the position was near its peak, but that debate has largely disappeared since the position has been reduced by more than 75%.

I'm still of a mind that the big concentrated long position has come down due to a conversion of the paper long position in COMEX futures to physical silver via the silver ETFs. Certainly the timing and amount of metal converted seem to be related. First, came the establishment of the paper COMEX long position, quickly followed by big inflows into a few silver ETFs, mainly SLV, SIVR and the Deutsche Bank silver ETF. The near 14,000 contract reduction in the concentrated long position over the past month and a half is the equivalent of 70 million oz, not far from the physical inflows to date. Clearly, we are well past the 50% level and closer to 75% of completing the conversion of paper to physical.

On a different topic, I mentioned on Wednesday that I expected very large managed money selling to be reported in yesterday's COT report on copper, but the amount of selling (mostly new short selling) was astounding. In all, 33,319 net copper contracts were sold, including new short sales of 31,626 contracts. As of Tuesday, the managed money net and gross short position in COMEX copper futures hit new all-time extremes as copper prices hit two year lows. The total gross short position of the 71 managed money traders was 118,519 contracts on Tuesday, the equivalent of 1.48 million tons, close to a month's worth of world copper mine production.

Only an ostrich with its head buried in the sand could fail to see the connection between the record short selling by a relative handful of paper speculators on the COMEX and the low price of copper. Today, there is an article in the Wall Street Journal, titled, "Fall in Copper Prices Threatens to Drive Metal Shortages". The article goes on to say how roughly \$3 per pound is needed to sustain new copper mine development, far above the current price of \$2.60. At the end of the article, it is mentioned that speculative investors have sold copper futures, but no suggestion is made that the speculative selling had driven the price lower.

Upfront, I have no vested interest in where copper is priced. I own no investment positions directly dependent on copper prices and I raise the issue only because copper, like many other commodities, has caught the "silver disease" in that prices are determined by excessive derivatives speculation. As an analyst, it's not my role to oversee the futures markets that's the role of the CFTC and, in particular, its new chairman, Dr. Heath Tarbert, who recently wrote about the need for position limits to prevent market corners.

When a small group of speculators (and their counterparties) take such large and excessive derivatives positions so as to distort prices, the regulators need to step in and rectify the situation. I'm certain

Chairman Tarbert would agree and I respectfully ask him to be resolute in his mission to prevent market corners, such as currently exist in COMEX copper futures and other markets.

Getting back to the question of the moment, namely, how the extreme market structures in COMEX gold and silver will get resolved, the simple answer is that time will tell. I hope you know that if anyone could consistently predict short term price movements they would keep that advantage for their own benefit and not broadcast such moves in advance. But while it's impossible to know for sure where we go from here in the short term, the parameters are easier to outline.

Rarely has the COMEX market structure in gold been as bearish as it is currently. In the past, whenever the structure has been this bearish, it has only been a matter of time before prices get forced lower and the managed money traders sell en masse. The commercials have never, ever been overrun to the upside. Therefore, if gold prices get forced substantially lower in the future, no one should be surprised.

All that said, there is nothing that guarantees that the commercials can't possibly get overrun. Just because something has always worked does it mean it always will work. As much as I've always been a COT market structure guy (and still am), for the past decade I have also been a JPMorgan controls gold and silver guy. The actions that JPMorgan has taken over the past 8 years (buying physical gold and silver) puts it in a position to double cross the other commercial shorts and for the past year and a half, I have noticed other signs pointing to JPM positioning itself to break ranks with the other commercial shorts (as described above).

When one strongly held premise, the belief that COMEX futures positioning sets the price, clashes with another equally strongly held premise, JPMorgan being the lord and master of gold and silver, one must stake out an outcome encompassing both premises. I suppose that might mean somewhat of an adjustment in one's portfolio to weather the outcome, but in truth, when it comes to gold, that's not personal to me because my exposure is to silver.

In silver, the COMEX market structure is nowhere near as bearish as it is in gold, so the decision for me is easier, namely, to ride it out. Plus, the circumstances are different in silver in that the price is a heck of a lot cheaper than is gold's and the JPM double cross premise is stronger. In both markets I sense the 7 big shorts seem to be on the brink of failure and a big physical buyer has clearly emerged in silver. Therefore, I suppose it's possible for gold to get hit and not silver, but my sense is both will move higher or lower, at least somewhat in unison.

I guess what it really comes down to is that after so long and so much disappointment that silver prices have remained manipulated, the thought of genuinely lightening up just as prices may be on the cusp of exploding is not something I'm prepared to live with. I'd much rather take yet another punch to the gut that a severe sell off would bring and plan on loading up on cheap options yet again, than chance missing the start of the big one.

Ted Butler

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Silver – \$16.93 (200 day ma – \$15.18, 50 day ma – \$15.58)

Gold – \$1508 (200 day ma – \$1310, 50 day ma – \$1403)

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