

## August 12, 2015 – The Wall of Worry

### The Wall of Worry

Silver and gold prices popped upward this week and while there appeared to be ample news developments accompanying the move, in reality it got started early Monday morning, particularly in silver, before any real news surfaced (including the currency devaluation by China). As a matter of fact, during the Monday move up, there were no outside news or financial market developments that pointed to a precious metals price rise.

The move up didn't come as any real surprise and, in fact, was more a case of what took it so long, at least according to market structure analysis. After all, it had been nearly three months since gold and silver prices put in a top on May 19, and on the subsequent \$140 and \$3 moves lower in gold and silver respectively, we witnessed record managed money selling and commercial buying in COMEX futures. Over that time, the commercials bought nearly 120,000 gold contracts (12 million oz) and more than 50,000 silver contracts (250 million oz) from technical funds and other speculative sellers; establishing records that went back decades. Much of the speculative selling was in the form of new short sales and, by definition, such sales must be bought back at some point.

Thus, the stage was set for a resolution of some extremely lopsided bets, with the commercials positioned for an up move and the speculators positioned for down. If it played out like it usually did, namely, in the commercials' favor – gold and silver prices would move higher, even though the managed money shorts held substantial open profits. If the commercials folded and sold out at lower prices, the technical funds would convert their open profits into realized profits and have soundly thrashed the commercials; something rarely seen.

It is still way too soon to declare with certainty how the extreme set up will be resolved, but the rally this week has brought us much closer to the upside moving average penetrations which serve as the technical funds' sole motivation to buy. For sure, there has been significant managed money short covering so far and much of the open profits they held have evaporated on the rally, particularly in silver. I had previously reported a "snugging" of the price to the shorter term moving averages and that has continued with the result that the price of silver has now traded above most of those shorter term ma's (up to and including the 50 day ma).

While it is possible that the move up is a false breakout that will soon be snuffed out with aggressive commercial selling; it is also possible that it is not a fake out, but the start to a meaningful rally (dare I say, the big one?). The truth is that no one knows for sure and the only thing that matters is how one intends to handle it regardless of how it plays out. For me, it's easy to play the probabilities. When the commercials are heavily net short (like they were on May 19), the probabilities favor lower prices. When the commercials are lightly net short (like now), the probabilities favor higher prices and maximum long positions should be held.

That's not to say prices won't be volatile or won't sell off, at least temporarily, providing sufficient angst along the way; but there's always something to worry about. The wall of worry for the market structure approach is a deterioration in the COT positioning set up. If the managed money traders buy back all their shorts and add sufficient new longs in COMEX gold and silver and change the probabilities towards lower prices that will be a serious concern. Undoubtedly, we've had deterioration (managed money buying/commercial selling) on the rally; but not to the extent of flipping the probabilities downward.

The more than four year decline in gold and silver prices has been historic in time and depth and has been so grinding that any rally would probably be suspect. This is admittedly subjective, but it seems to me this slight move up is more doubted to endure than any previous rally. To a contrarian, that's just the sort of circumstance that favors higher prices. Let's face it, even after this slight move up, silver prices, in particular, are still stupid cheap and any move to lower prices can't and won't last for too long.

In addition to the still-favorable market structure set up, recent developments away from the COT structure may portend potential investment flows into precious metals. Perhaps as a result of currency and financial news from China, world stock markets have become more volatile and should world investors seek out refuge from stock and bond markets, the short list of alternate investments would have to include gold and silver. Since the amount of silver available for investment in dollar terms is practically infinitesimal compared to gold, money flows into precious metals directed towards silver would have an outsized effect on the price.

And considering how beat down silver and gold prices have become over the past four years, prices would have to move substantially higher before any stock market investor looking for a refuge could think metal prices were too high. In fact, as a result of the massive appreciation in world bond and stock markets over the past five years, coupled with the equally massive depreciation in precious metals, it is not an exaggeration to say the mismatch between the amount of potential money flow and what real metal could be purchased has never been more extreme.

Let anyone try to purchase \$1 billion worth of actual silver in a hurry and the 65 million oz that would amount to at \$15.50 would suddenly no longer be buyable; the transaction could only be consummated at some much higher price. And in every sense of the modern world, a billion dollars is chump change for an incredibly large number of world investors, both private and institutional. The miracle is that it hasn't been attempted yet, with the operative word being yet.

In developments since the weekend review, the new short report on stocks was released yesterday for positions as of July 31, and featured sharp reductions in the short positions of SLV, the big silver ETF, as well as in GLD, the big gold ETF. You may recall that the previous short report (as of July 15) had feature big increases in the short position of SLV (8.2 million shares) and of GLD (4.6 million shares). The new report indicated a reduction of 7 million shares in the short position of SLV, down to 14.7 million shares (ounces) and a decrease of nearly 2.7 million shares in GLD, to a total short position of 11.34 million shares (1.13 million oz).

<http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

What's up with the sharp reductions and increases in the short positions of SLV and GLD? Particularly in SLV, the short position has been alternating between big increases and decreases in an almost regular pattern. I don't think that's accidental, but instead reflects the overarching premise of wholesale tightness in the physical silver market. Simply put, any surge of net buying in SLV has resulted, more times than not, in an increase in the short position, like occurred in previous short report (as of July 15).

Net new buying of shares requires a like amount of physical silver being deposited immediately into the trust to back the new shares issued. The only alternative to depositing actual silver on net new buying is if sellers sell short shares instead. Then after the buying subsides, available metal can be deposited into the trust to extinguish the shorted shares or, alternatively, the shorted shares can be purchased on the open market and closed out. It looks like this is what occurred in the new report, namely, the 8.2 million shares shorted into July 15 were bought back to the tune of 7 million shares in the new report. I say this because there were no big deposits of metal into the trust recently.

If my analysis is correct, the main takeaway is that 7 or 8 million oz of actual investment grade silver is not readily available on a moment's notice and rather than bid the price of physical silver up when net new buying occurs in SLV, the sellers have grown accustomed to shorting shares instead in order to buy time to round up the physical silver or buy back the shorted shares at their leisure. This is certainly not a new theme of mine, as I have been writing on this for years.

What's different now is that the short sellers appear intent on closing out any newly short sales as quick as possible and this is evidenced in the sharp reductions in the short position immediately following big increases. In addition to confirming that physical conditions in the wholesale silver market are tight (because why short shares in the first place if metal is readily available?), it also suggests the shorts don't wish to be short on an extended time basis. In this sense the new shorts in SLV appear to be reluctant shorts; not wanting to be short for long and eliminating the short positions as quickly as possible. It also suggests to me that a truly big surge of new net investment buying in SLV might see those shorting up until now stand aside from shorting completely, allowing prices to run to the upside.

The report of sales of Silver and Gold Eagles from the US Mint continues to fascinate me. After truly blockbuster sales for June and July, particularly for Gold Eagles, sales so far for the month of August have taken a markedly different turn. It seems that sales of Silver Eagles have remained peddle to the metal with sales even greater than what I had estimated to be the Mint's full production/blank supply capacity, at least through yesterday; but with sales of Gold Eagles falling off sharply.

[http://www.usmint.gov/about\\_the\\_mint/index.cfm?action=PreciousMetals&type=bullion](http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion)

Please understand that I am relying on the stats from the Mint as my primary data source and seeing how erratic the sales reports can be, my analysis is also subject to change. As the data change, so will my analyses. Sales of Silver Eagles have been sky high for more than four and a half years, averaging more than 40 million coins annually and, aside from a few months from time to time, demand has kept the Mint in mostly a rationing mode for the entire time. Since no great retail buying surge has been evident over this time, I had come to conclude that a big buyer (JPMorgan) was responsible for much of the buying. More than ever, I remain so convinced.

Sales of Gold Eagles had been mostly lackluster over the past four and a half years (compared to prior years), so a real dichotomy became apparent in the relative sales of Silver Eagles compared to Gold Eagles, further confirming my premise that JPMorgan was buying Silver Eagles (and not Gold Eagles). But that changed during June and July of this year as sales of Gold Eagles exploded out of nowhere, with sales over those two months as much as five times greater than in the months immediately preceding the sales surge. The surge in sales of Gold Eagles was so dramatic that I concluded that the Mint's available inventory of Gold Eagles may have been wiped out.

Since there was no corresponding evidence collaborating that the surge in sales for Gold Eagles in June and July was plain vanilla retail buying demand, by process of elimination that meant that a big buyer or two had come into buying Gold Eagles. By collaborating evidence, I would include no notable buying of shares of mining stocks or small trader buying on the COMEX (in fact, small traders set new record short positions). It's almost impossible for retail traders, as a whole, to be big net buyers in one area and big net sellers in another closely related area simultaneously. Armed with feedback from extremely reliable sources on the retail front, the recent big buying in both Silver and Gold Eagles, does not appear to have been primarily retail oriented.

The bottom line on all this is that based upon the latest sales report from the US Mint (thru yesterday 8/11) indicating 7500 oz of Gold Eagles sold and more than 2.1 million oz of Silver Eagles I now conclude that the big buyer of Silver Eagles is still buying as many as the Mint can provide; while whoever the big buyer(s) was in Gold Eagles during June and July has stepped aside. Again, this is subject to change on an almost daily basis as the Mint releases new data, but none of this should be considered bearish in any way. No one, big or little, buys that which is not expected to increase in price. And the spurt of buying suggests the buyer expects prices to climb soon.

Yes, we've had deterioration in the market structure as the increase in price this week was derived primarily from managed money buying, just as managed money selling brought prices to five year lows. Silver prices have penetrated to the upside all moving averages including the important 50 day moving average and all shorter term moving averages. Gold is a bit behind silver's moving average penetration pace, but has exceeded all the shorter term moving averages up to and including the 30 day moving average. The important 50 day moving average for gold is at \$1145.

I always hope and expect prices to soar when the moving averages are penetrated to the upside and I would be lying if I didn't say I'm somewhat disappointed with the orderliness of the move higher until now. That said and all things considered, the factors suggesting higher prices appear much more firmly in place than do the reasons pointing to lower prices. At the very least, the move up so far demonstrates that we can move higher and appears to have stifled for the time being the chorus of (uninformed) daily commentary declaring that gold and silver could only move lower in price forevermore.

Ted Butler

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Silver – \$15.50

Gold – \$1124

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