

August 13, 2011 – Weekly Review

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In one of the most turbulent weeks in financial market history, the price of gold finished at new record highs climbing \$83 (5%) despite a sharp late-week sell-off, while the price of silver rose 80 cents (2%). As a result of gold's relative strong outperformance, the gold/silver ratio widened out to almost 45 to 1 or almost to where it began 2011. Silver is still outperforming gold year to date as well as over the past few years, but there was little question that this was gold's week to shine. (No pun intended).

Since I stood atop the switch to silver from gold soapbox last week, I'll spare you that sermon today, except to note that gold's stunning performance this past week makes it more attractive to switch gold positions into silver. Instead, I will try to more fully explore just why gold surged so much this week when we get to the important changes in the latest Commitment of Traders Report (COT). Gold's stunning price performance and outperformance to silver matched stunning changes in the COT, well beyond my expectations.

First, however, there were the usual and some new unusual changes to report on away from the COT. Conditions in the wholesale silver market continued to suggest physical tightness. The turnover or physical movement into and out from the COMEX silver warehouses continued at a frantic pace. This suggests to me a hand to mouth demand for wholesale quantities of industrial-grade supplies of silver, a precursor to higher prices. Sales of Silver Eagles from the US Mint appeared to continue at the maximum production capacity rate, as has been largely the case for the past few years or since Izzy Friedman wrote so enthusiastically about them. (I'll have a short new piece from Izzy early next week).

The most unusual developments this week were in the big silver ETF, SLV. There were significant recent outflows in metal deposits in the Trust, I think due to a combination of investor liquidation in response to weak prices and redemptions due to a conversion of shares to direct metal holdings by shareholders. But the standout change was in the reported short position in shares of SLV as of July 29. The latest short position declined by more than 7.3 million shares/oz, to just under 24 million shares.

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

As recently as two months ago, the short position in SLV was over 37 million shares or over 11.5% of all shares outstanding, truly an obscenely large and manipulative level. While the current short position is still large and manipulative to the price, at 7.5% of shares outstanding, it is at least moving in the right direction — down. And down pretty big — by 35%. The latest short position marks three straight reported declines in the SLV short position and I am hopeful that this trend will continue. Let me try to explain why I think this is important.

As you know, I have been making a big deal out of the short position in SLV, alleging it is manipulative to the price and inherently fraudulent because no real metal backs the shorted shares. I have conveyed these allegations to the CEO of BlackRock, the Trust's sponsor, and have encouraged you to complain as well. Many of you have heard from BlackRock and they reported they weren't responsible for the short position and couldn't do anything about it. This is exactly how I expected BlackRock to react, namely, to deny there was a problem and even if there was one, that it wasn't their job to fix it. After all, this is always how large financial institutions react.

However, what I also expected, in addition to BlackRock denying there was a problem and their responsibility to remedy it, was for them to quietly work to get this monstrosity of a short position reduced. In other words, for them to deny a problem existed, but to privately agree that there was problem and to work to fix it. That's usually how things work in the real world. I am hopeful that that is the case here. Supporting my hope is that the smaller gold ETF that BlackRock sponsors, IAU, also reported a significant percentage reduction in its short position, while the much larger gold ETF, GLD, sponsored by a different organization, State Street, reported a small increase in its short position. (You can verify this by using these stock symbols in the link above). My speculation is that BlackRock, as a result of our complaints, saw that there was a problem with the large short position in SLV even though they would never admit it and worked behind the scenes to get it reduced, along with the short position in IAU. (State Street, the sponsor of the GLD, never received any complaints and remains clueless as the danger of the big short position in that Trust.)

Perhaps I am all wet and BlackRock had nothing to do with the reduction in the short position in SLV and that we will witness large increases in that short position in the future. In that case, I plan to redouble my efforts to get the manipulative and fraudulent short position eliminated. It is important to remember that the only reason for any short position in SLV is because the short sellers can't get real metal to deposit and that's an end-run around the intent of the prospectus. Also please remember that had the large short position in SLV not existed in April, silver prices would have climbed much higher than the \$49 recorded.

I apologize for over-using the word, but the changes in this week's COT reports were stunning and there is much to report and analyze. First, let me report the changes in as factual a manner as possible and then speculate as to what the changes portend. There were very big improvements or reductions in the total commercial net short positions of both gold and silver, but under starkly different circumstances. I'll cover gold first.

There were more than 38,000 COMEX contracts (3.8 million oz) bought back by the commercials in gold in the reporting week, reducing the total commercial net short position to 249,200 contracts, a price-neutral level by recent COT standards. I had expected there was commercial short covering, as I hope I had conveyed, but not to this extent. What makes any reduction in the commercial short position so unusual is that gold prices rose by \$75 to a new all-time high in the reporting week. For the COMEX commercials to buy on such price action is like a "man bites dog" headline; it is unprecedented. Let me state it another way - it is also unprecedented in gold for the technical funds to sell on such a large price increase. And the tech funds sold out at massive profits while the commercial gold shorts bought back at equally massive losses. To my knowledge, this has never occurred before in gold.

While I had expected commercial short covering (but not to this extent), I had expected the buying would occur in one of the commercial categories. Instead, all three categories of commercial shorts, the big 4, the 5 thru 8 and the raptors all bought back aggressively. Simply put, the commercials in COMEX gold collectively panicked and bought back at great loss for the first time ever. Let me be as clear as possible - this commercial short-covering panic was the main propellant to the recent gold price explosion. The gold price rise was not primarily due to a massive worldwide rush to buy; it was primarily due to commercial short covering on the COMEX. It certainly wasn't due to speculators rushing to buy new long positions; the data indicate the tech funds were huge sellers on the price rise. What brought this unprecedented circumstance into being and what can we (and the regulators) learn from this?

I think I know why the tech funds sold and the commercials bought into this gigantic gold price rally. The tech funds, seeing gold prices explode and the price get so far above the moving averages as to indicate great potential loss in a sell-off, decided to take the great profits suddenly presented to them. But why did all the commercials buy and take massive losses in the process? I think because the mark to market losses and daily margin calls grew to be overwhelming and the treasurers and risk officers of the commercial shorts said "no mas" to the traders holding short positions and instructed them to close out a good number of short positions. (By the way, this also supports my recent suggestion that the US Government had no involvement in the manipulation, because if it did, it would have just extended whatever margin money was required).

The lesson we can learn from the orgy of commercial short covering in gold is that these commercials are not all-powerful and can miscalculate on a massive scale. This goes directly to my warnings of the danger created to our markets by commercials pretending to be hedgers when, in fact, they are just speculating their butts off. I hope the CFTC realizes that this action by the commercials in gold proves categorically that they are not legitimate hedgers, just wild-eyed gamblers. Real hedgers don't rush to buy back shorts in a panic; real hedgers would simply deliver what they were hedging. Only gamblers who had bet wrong would cover in the panic that was evident in the COT reporting week. The problem is that these commercial crap shooters are jeopardizing our markets with their outsized and manipulative brinkmanship. How much proof does the CFTC need? Do I have to translate this into some language other than English for them?

In silver, there was also a massive reduction in the total commercial net short position of some 9300 contracts, or the equivalent of 46.5 million ounces, one of the largest weekly reductions ever. The raptors (the smaller commercials apart from the big 4 and the 5 thru 8) accounted for 7500 contracts of the total weekly reduction (80%), with the big 4 (read JPMorgan) responsible for 1400 of the 9300 total contracts bought back. Not that we were at bearish extremes in the silver COTs to start with, but this puts us squarely back into bullish territory. Based upon the extreme opposite movements between gold and silver prices in the reporting week, I am certain that a significant number of long silver/short gold leveraged spread trades were blown out, adding to the big decline in silver speculative long positions.

Just like occurred in gold, the tech funds sold in silver as the commercials bought. But that is where the similarities end. Whereas gold experienced a stunning rally in the reporting week, silver had a sharp loss of more than \$3. In gold, the commercials panicked as they bought back; in silver, it was business as usual in that the commercials rigged prices deliberately lower to induce speculative long liquidation. Here as well, there are important lessons for the regulators. In addition to the obvious collusive pattern of the commercials trading in unison, it is clear that the silver raptors forced the silver market sharply lower through HFT and other dirty tricks for a highly visible purpose. Silver suddenly dropped \$3 for a very specific purpose — so that the raptors could get long silver, which they did by increasing their long position from 1500 contracts to 9000. It can't be any clearer that the silver raptors collusively rigged the price artificially lower for the sole purpose of buying thousands of contracts. I'm trying hard not to insult the regulators for not seeing this, but it's difficult not to.

Once the gold commercial shorts finished buying back in a panic to the upside and the tech funds sold a significant quantity of long contracts at extraordinary profit, it appeared a temporary market vacuum developed and gold prices fell sharply at the end of this week. This appears to be normal and it is hard to tell which way from here for gold prices. Nothing should surprise us in the way of short-term gold price movements. But the giant take away from this week's gold COT is that the commercials are not all-powerful; they can and have screwed up badly in gold. They are not legitimate hedgers, but merely wild-assed gamblers skirting on the edge of disaster. It is up to the regulators to stop dawdling and prevent their speculative excesses from creating a systemic nightmare.

The big price takedowns in the reporting week greatly improved the COT structure in platinum, palladium and copper (although there was less than a stunning improvement in crude oil). As a result, these markets are better positioned for upside movements. But only in gold did the improvement come from commercial short covering panic.

In silver, we are still on familiar ground with the deliberate take down and resultant decline in speculative long positions on the COMEX. I was hoping for such a decline and got it in spades. There are no guarantees for short term price movements, but this is a bullish development for silver. Same goes for gold, but for somewhat different reasons. The bottom line is that silver is set for a moon shot, based upon fundamental and COT considerations. Whether that moon shot occurs immediately or after further commercial rigging to the downside is unknowable. All we can do is position ourselves accordingly and continue to press the regulators to confront a manipulation that becomes clearer with every passing day. We just concluded a week of historic volatility in many financial markets. Get set for volatility in silver that will knock your socks off.

Ted Butler

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Silver – \$39.10

Gold – \$1746

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