

August 18, 2018 – Weekly Review

Despite a decent bounce up from the extreme mid-week price lows, prices for gold and silver fell for an unprecedented tenth consecutive week; with gold ending \$28 (2.3%) lower and with silver off by 54 cents (3.5%). As a result of silver's relative weakness, the silver/gold price ratio widened out to 80.6 to 1. Truth be told, after ten straight weeks of price declines, I would have imagined the ratio would have been a lot wider.

The price weakness extended across the metals spectrum, with this week's close the lowest in a full year or more in gold, silver, copper and palladium to ten years in the case of platinum. It was as if someone flipped a switch in early June; a switch labeled "take the metals down big." Actually, I don't think that's far from the truth and a lot closer than alternative explanations being bandied about in mainstream circles. Just yesterday, a detailed article in the NY Times described the situation in copper. Upfront, I'm an avid consumer of what many call the "fake news", having been a daily reader of the Times, the Wall Street Journal and local papers for the past 50 years (ever since my days as a commuting strap-hanger on the NY subways). Anyway, here's the NYT article I'm referring to:

<https://www.nytimes.com/2018/08/17/business/china-trade-war-copper-price.html?rref=collection%2Fsectioncollection%2Fbusiness&action=click&contentCollection=business&re>

The article explores the dichotomy between the price weakness in copper, down nearly 20% since early June, and the strength in the stock market. A big reason given for the copper weakness was the proposed tariffs and developing trade war. Much was made about copper's role as the metal with a PhD in economics, with its price as a reliable harbinger of future economic trends. But nowhere in the article was there even the slightest mention of what I consider to have become the sole driver of price: futures market positioning.

As I have covered, some 110,000 contracts of COMEX copper futures have been sold by the managed money technical funds since June 12, an amount equivalent to nearly 1.4 million tons of metal and perhaps twice that amount was sold on the LME, always a much bigger venue for base metals. There is always a fine line of no more than a few percentage points between the actual supply and demand of base metals like copper, with close to 20 million tons in annual production and consumption. So when some highly specific speculative trading comes along and suddenly sells (dumps) as much as 20% of the annual production in two months or less, is it any wonder copper prices cratered?

I would imagine regular readers understand full-well the implications of such excessive speculation on the price of commodities, but my point is that such understanding is far from widespread, since it didn't even warrant a mention in the NYT article. And I'm not picking on the Times, as similar articles are prevalent in the Wall Street Journal and elsewhere as well. Increasingly, futures market positioning is mentioned, but not as the main price driver. The bottom line is that the influence of futures positioning on price is vastly underappreciated. Heck, look no further than the regulators for verification of that finding.

For the tenth week running, the key price story in gold and silver was once again the developments in the Commitments of Traders (COT) report where spectacularly bullish results were posted. I've just

about run out of superlatives to describe the positioning which has reached other worldly extremes, but I'll try my best in a moment.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses reverted to the weekly average of the past 7.5 years as just over 4.8 million oz. were moved. Total inventories rose by 0.4 million oz to 287.6 million oz, another all-time record. An additional deposit of 500,000 oz came into the JPMorgan COMEX warehouse, more than accounting for the total increase and bringing JPM's total to 145.4 million oz, another new all-time high. Of course, what JPMorgan holds in its COMEX warehouse is a fraction of the 750 million total silver ounces I believe it holds. That fraction, of course, is more than ever held by any other entity, including the Hunt Bros in 1980 or Berkshire Hathaway in 1998.

For the first time in quite a while, I'm hearing reports of developing retail demand for silver and also gold. Not only am I encouraged that buyers have emerged at what I consider super attractive prices, but it also strongly suggests no big retail dumping of physical metal. After all, the public is either a net buyer or net seller. Certainly, no one would advance the notion that developing retail net buying is behind the paper-driven declines in price.

The new COT report was, once again, a sight to behold in the most bullish sense possible. I can't say I was surprised that there was additional managed money selling and commercial buying, as prices did hit fresh new lows during the reporting week; but the extent of the positioning, particularly on a cumulative basis over the past ten weeks, leaves me nothing short of thunderstruck. In fact, I'd gotten away from making contract predictions because we had already achieved readings far beyond previous records; but those previous records have proved to be little more than speed bumps in the lemming-like rush of the managed money technical funds to the short side of gold and silver and other metals.

On the one hand, I find myself asking if these technical funds have any concept of how much collective jeopardy they have placed themselves in by shorting so heavily. Don't they see the danger they have placed themselves in? On the other hand, I believe I understand why they have positioned themselves with apparent reckless abandon, namely, they are pressing a profitable trade to the max, looking to pyramid initial profits by adding aggressively to existing short positions to make the score of a lifetime.

Putting both hands together, this is the set up for a price move of historic proportions, with only the ultimate price direction to be decided. Since I see little way the technical funds will uncover the massive selling from other traders needed to allow the technical funds to buy back at lower prices, I think the technical funds will end up buying back their massive shorts at (much) higher prices.

Further, the game of adding aggressively to profitable positions in order to make a major score is dependent on quickly abandoning the position if it starts to move against you. Therefore, I believe the technical funds will quickly abandon (or try to abandon) their greatly expanded short positions on not much of a price rally, which can come at any time. The only question is whether the commercials and in particular JPMorgan will accommodate the technical funds when they move to buy back their massive short positions. I'm holding way too many out of the money call options to believe there will be accommodation by JPMorgan.

In COMEX gold futures, the commercial reduced their total net short position by 18,300 contracts to

only 7,400 contracts. Not only is this level close to the lowest (most bullish) levels of late 2015, it is among the very lowest in modern history. The point is not how low and bullish is the commercial net short position, but how the heck did they hoodwink the technical funds to short so heavily; but I repeat myself. By any measure, the commercial short position is beyond extraordinarily low.

I don't want to spend much time on the big short categories, since the commercials currently make up so little of these categories, but for those plotting this, the big 4 bought back 600 shorts, the big 5 thru 8 added 1100 shorts and the raptors added 18,800 new longs, pushing the raptor net long position to 148,500 contracts, the largest (most bullish) in history. I was convinced before this report that JPMorgan was already off the short side of COMEX gold and now the question is how big on the long side they may be. It also shows that when it comes to double crosses, JPM is the unquestioned master.

On the sell side of gold, it was nearly an exclusive managed money affair, as these traders sold 17,208 net contracts, including the sale and liquidation of 1046 long contracts and the remarkable new short sale of 16,162 contracts. As I have been intoning recently, the remaining managed money long position of 104,803 contracts still looks unlikely to be liquidated dramatically (especially after Wednesday's smash) on further price weakness. The story is on the short side of the managed money traders.

The short position of 188,127 contracts of managed money shorts as of Tuesday is stupefying. Not only is the net short position of the managed money traders the largest in history (at 83,000 contracts), the gross short position is nearly double the level of late 2015, which led to a \$300+ price rally. I shudder to think what kind of gold price rally is baked into the cake on this go-around.

In COMEX silver futures, the commercials reduced their total net short position by 9,700 contracts to 12,400 contracts, among the lowest (most bullish) readings in history. As was the case in gold, the headline number was only the tip of the bullish COT iceberg. With the same caveat as mentioned in gold, the managed money traders are so firmly entrenched on the short side of silver that the normal category discussion doesn't apply currently. That said, the 4 biggest shorts reduced their net short position by 2900 contracts, the big 5 thru 8 also bought back 2500 shorts and the raptors added 4300 longs to a net long position amounting to 75,700 contracts. By the slimmest of margins, this was the largest (most bullish) raptor net long position in history.

I'd peg JPMorgan's silver short position to be no greater than 16,000 contracts, down 4000 contracts for the week and possibly much lower (10,000 contracts) even before Wednesday's deliberate price smash. Thus, JPMorgan has achieved what I thought was near-impossible, no short position in COMEX gold futures and the lowest silver short position in many a moon; all stacked up against a 750 million oz physical silver position and a 20 million oz physical gold position. JPM had to have channeled Houdini in this incredible accomplishment. Sure it took a master double cross in gold and a manipulation in silver of the ages, but it's what's on the scoreboard that counts (and in case you didn't know, JPM owns and operates the scoreboard).

On the sell side of silver, it was mostly a managed money affair as these traders sold 8313 net contracts, comprised of the sale and liquidation of 930 long contracts and the new short sale of 7383 short contracts. As was the case in gold, the managed money long liquidation was notable in how small it was and the added shorts were nothing less than enormous. As hinted at in the small number of long liquidation by the managed money traders, there was even lower liquidation by the new concentrated longs who arrived on the scene starting in April.

The big concentrated silver longs in the managed money category liquidated only 550 contracts, holding 57,849 contracts as of Tuesday. I wouldn't be surprised if more of these contracts were sold on the Wednesday price blood bath, but I am still impressed with how few were sold thru Tuesday. If all the selling from this category is now largely complete, as I suspect, it's hard for me to see where big new selling on lower prices will come from.

I realize the managed money technical funds could always add new shorts from here (or past Wednesday), but in the same vein by about as much as I imagine trees can actually grow to the sky. We are, after all, already at Sequoia tree levels in terms of managed money shorts in silver and gold and other metals and any more would put trees into the stratosphere.

One thing that caught my eye as a long term observer and student of the COT reports was that the concentrated long position of the 4 largest traders (24.1% of total open interest) nearly matched the concentrated short position of the 4 largest traders (24.5%). This is the closest these concentrated positions have been in history. I remember distinctly the times when the concentrated short position in silver was three and even four times the level of the concentrated long position and I can't help but sit up and take notice of figures I never imagined witnessing. Of course, this underscores the absolutely remarkable market structure in silver and gold in ways that words fail me in describing. Except, of course, words related to the master market crooks at JPMorgan who are solely responsible for the near unbelievable turnabout.

In closing, let me update the managed money scoreboard that I discussed on Wednesday. That day, I calculated that the newly added 125,000 managed money shorts in gold (from June 12) were ahead by \$55 per contract (\$1240 average selling price compared to the \$1185 closing price that day) or close to \$700 million. Combined with the \$250 million profit from the 40,000 new short contracts added at an average price of \$15.75 compared to that day's \$14.50 close, the technical funds were ahead nearly \$950 million on Wednesday's close. Clearly, it was the large open and unrealized profits that persuaded the technical funds to add aggressively to their record short positions.

As a result of the new short sales added over the reporting week ended Tuesday, I would now calculate that the managed money technical funds now hold 140,000 newly added gold shorts at an average price of \$1235, leaving them with \$630 million in open gold profits and 48,000 newly added silver shorts at an average price of \$15.60 or \$200 million open profit or \$830 million on a combined gold and silver basis. (Please remember that additional short sales at lower prices reduce the average shorting price). Thus, on a closing basis and adjusted for the additional shorts, the technical funds are ahead \$830 million on yesterday's late closing prices versus my calculations of \$950 million on Wednesday.

While \$830 million is still a large open and unrealized profit in pure dollar terms, this is more a reflection of the large size of the newly added technical fund short position of 14 million ounces of gold

and 240 million ounces of silver. In terms of dollars per ounce, \$45 per ounce in gold and 82 cents in silver doesn't seem particularly large all things being considered. Among the considerations that seem relevant to me is that the technical funds are only ahead as much as they are as a direct result of them plowing onto the short side in classic lemming-like fashion and the fact that JPMorgan is more poised to make a score to the upside like never in history. A price move of \$45 up in gold and 82 cents up in silver and the technical funds have no profit and I would assume, are starting to think that the short side may no longer be the big time score it appeared to be.

At some point, and I think soon, whether we are completely finished to the downside or not, the managed money technical funds will be switching over from offense to defense and trying to extract themselves from their historic venture on the short side. It will be only then that we will be able to judge how things turned out. This is very much a two-act play and the first act may be over or close to being completed, but act two hasn't even started.

Ted Butler

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Silver – \$14.78 (200 day ma – \$16.44, 50 day ma – \$15.83)

Gold – \$1191 (200 day ma – \$1295, 50 day ma – \$1244)

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