

August 20, 2016 – Weekly Review

Weekly Review

Following the unusual two week identical close in the price of gold and silver, the price path of each diverged notably this week, with gold closing \$5 (0.4%) higher and silver falling 40 cents (2%). Despite gold's gain for the week, yesterday was the third consecutive Friday of sharp selloffs in each metal. It was also the lowest weekly close in silver in eight weeks.

As a result of silver's relative underperformance, the silver/gold price ratio widened out by more than 1.6 points to 69.7 to 1, also the most undervalued silver has been relative to gold in two months. Over the past year and more and certainly since the start of the year, silver has outperformed gold, but the actual relative values of silver or gold don't have much to do with changes in the price ratio. Instead, the silver/gold price ratio, just like the absolute price of each has everything to do with computer-generated trading and futures contract positioning on the COMEX.

This is a recurring theme of mine and it is not only evident in gold and silver, but increasingly, in other regulated futures markets as well. Two examples of this were the story this week in the Wall Street Journal about how computer trading had rendered CME cattle futures price changes inexplicable to long term commercial participants as there was little connection to physical market developments. It would appear, just as has been the case in gold and silver, that fewer real producers of consumers are setting the price in cattle futures, replaced by computer bots.

Secondly, this week's COT report for NYMEX crude oil showed that the largest buyers on the sharp rally were managed money technical funds buying back previously shorted contracts. Crude oil is the largest and most important commodity of all and the technical funds were the swing factor in the recent plunge to \$40 as they added more short positions than ever and are now responsible for the \$8 or so developing rally as they aggressively buy back those shorts on moving average signals. If the world's largest commodity is allowing itself to have its price set by a handful of computer-trading jocks, then I suppose it shouldn't be surprising a market as small as silver could be similarly structured.

And that's my point — prices are being set by the spread of the silver disease, the reality that real production and consumption play second fiddle to speculative traders in futures trading when it comes to determining prices. Yeah, the world is nuts for allowing this, but until the madness is rectified, the only choice is to deal with it. Primarily, this means trying to gauge how to dance around and not get run over when the technical funds rush to buy and sell. It also explains how distorted prices can get at times, including gold and silver and any price ratio of the two.

The turnover or physical movement of metal brought into or removed from the COMEX-approved silver warehouses cooled off this week to 3.3 million oz, as total silver inventories increased by 1.5 million oz to 157.5 million oz. It's not especially surprising that COMEX silver inventories have increased somewhat since we are approaching the start of the September delivery period on the COMEX, a traditional delivery month. I'm still of the mind that the key feature of COMEX silver and gold deliveries is a function of what JPMorgan decides to do.

JPM has taken the lion's share of silver deliveries in traditional COMEX delivery months for the past year and a half, generally skipping non-traditional months, like the current August delivery process. The bank took (stopped) only half of the silver contracts allowed in the July delivery month after taking the full 1500 contracts allowed in May and I believe JPM didn't want to press things due to physical tightness.

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

It's a different story in COMEX gold, where JPMorgan and its client(s) have been pedal to the metal in taking extraordinarily large deliveries for months, in traditional and non-traditional months alike. In the current traditional August gold delivery month, a single client or more of JPM appears on pace to stop as many as 5000 contracts and it looks like the other big gold stopper this month, Macquarie Futures (in its house account), is on track to take the 3000 contract limit supposedly allowed. From all the data published by the CFTC, it appears that JPMorgan is decidedly net short the COMEX gold futures market and in my estimation is currently the largest COMEX gold short, making the big gold physical stopping conflicting and problematic. But what about JPMorgan is not conflicting and problematic?

There were a couple of big deposits this week in SLV, the big silver ETF, totaling 3.5 million oz, which seemed counterintuitive given the generally subdued price action. The most plausible explanations were due to a —value— (as opposed to a technical type trader) investor or the metal was deposited to extinguish a short position. Given the reporting period schedule, if the deposits were intended as an offset to short positions in SLV, it will only apply to the short report following the one next Wednesday.

Sales of Silver Eagles from the US Mint continue at the slowest pace in years and an unconfirmed report suggested the Mint may have ceased production completely. I generally don't rely on unconfirmed reports, but the story makes sense, since the Mint is not going to continue to produce Silver Eagles at the breakneck pace of the past five years and more if the coins are not being purchased. Therefore, it was and is only a matter of time before the Mint cuts way back on production in response to the sharp falloff in demand.

As always, the question is what does this mean? The unconfirmed report offered a suggestion that the reason for the Mint ceasing production of Silver Eagles was a buildup of inventories at authorized dealers, but I don't think that's the full explanation. As I have been reporting for years, retail demand for Silver Eagles has generally been very subpar, based on solid sources in the dealer community. Instead sales of Silver Eagles had boomed due to the buying of a very large entity, which I claimed to be JPMorgan. After all, if there was broad and deep buying interest on the part of the retail public, that would manifest itself openly — it would be something everyone could see. Instead, the record sales of Silver Eagles over the past five years came amid a dearth of retail demand, meaning someone big had to be accounting for the record sales.

And had there been a big buyer all along, the minute that big buyer stepped aside, sales would collapse, just as they have. I'm trying not to just see things as I think they are, but what is the most logical and compelling explanation for the long surge and now sudden collapse in Silver Eagle sales. The answer to me is JPMorgan. For one thing, it's not as if JPM couldn't have pulled off this silver buying binge from the US Mint. JPMorgan has bumped up against any number of government agencies in its normal business operations, racking up many billions of dollars' worth of fines when it crossed the line.

After bamboozling the SEC, the CFTC and any number of banking regulators, how difficult would it have been for JPMorgan to use and abuse the US Mint? Try to get a list of authorized dealers from the Mint and you'll be told that is unavailable. Since when is a government agency secretive about who it is doing business with? Not that it matters to the Mint, but JPMorgan just used them to buy more than 100 million ounces of silver over the past five years and maybe as much as 150 million oz; first forcing the Mint to produce coins around the clock and now to perhaps shut down production completely. The American Bullion Coin Program wasn't designed to accommodate JPMorgan in its quest to buy as much silver bullion as it could, but that's exactly what happened.

The only question is why did JPMorgan suddenly stop buying Silver Eagles a few months back? Was it because it now has enough or does it intend to buy back the extra coins the Mint hasn't sold when prices are lower? I suppose we'll get the answer in the fullness of time, but these are the correct questions — not changes in dealer inventories.

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

The changes in this week's Commitments of Traders (COT) Report were mostly inconsequential and in tune with what was fairly flat but choppy price action during the reporting week. This week's changes may have been insignificant, as has been the case for much of the past two months, but the overall market structure in gold and silver is still very extreme. I'll go over the numbers, as always, but the important point is not to read too much into the recent weekly changes as they are nowhere near as important as the coming resolution of market structures that must be resolved.

In COMEX gold futures, the commercials reduced their total net short position by 1900 contracts to 310,100 contracts. It has now been 9 or 10 weeks we have been at or above the 300,000 contract (30 million oz) level, previously a level never breached. Despite the small overall change this week, a number of records were set in COMEX gold, including the largest and most concentrated short position on record.

By commercial category, the raptors (the smaller commercials apart from the 8 largest traders) accounted for all the reduction in the total commercial net position, in buying back 4800 short contracts. The big 4 added 2400 new shorts and the big 5 thru 8 added 500 short contracts as well. Both on a percent of the COMEX gold futures market (36.4%) and on an equivalent contract basis (208,389 contracts), the four largest shorts (all commercials) hold the largest concentrated short position in history. I would ask you to think about this for a moment.

The CFTC keeps concentration data as the front line defense against manipulation. That's because you can't have a manipulation without a concentrated market position. This reporting week, the CFTC has reported that the concentrated short position of the 4 largest traders in COMEX gold futures is larger than ever, both as a percentage of the market and also in raw contract terms. Is it not reasonable to ask, since the concentrated short position in COMEX gold has never been higher, that the likelihood of a short side manipulation has never been higher? Obviously, that's a rhetorical question made even more relevant by the fact that none of the concentrated short sellers are legitimate producers or hedgers — just speculating banks.

The most pertinent question of all is who cares if the concentrated short position in COMEX gold is more extreme and, therefore, likely manipulative than at any point in history? Clearly, not the prime federal regulator, the CFTC, or the front line self-regulator, the CME Group. The biggest problem is that those who should be addressing this situation refuse to do so or even acknowledge the legitimacy of the allegations. A pox on their house.

On the managed money side of gold, traders in this category sold a net 2525 contracts, including the sale of 4344 long contracts and the buyback of 1819 short contracts. The extremely large gross and net long positions of the managed money traders represent in totality the only real risk of a selloff, as has been the case for months.

In COMEX silver futures, the commercials reduced their total net short position by 2700 contracts, to 100,600 contracts. As was the case in gold, it has been nearly two months that the total commercial net short position in COMEX silver has been above a level rarely penetrated, in this case the 100,000 contract (500 million oz) mark. Also as was the case in gold this week, the raptors in silver accounted for the entire reduction as they bought 2700 contracts resulting in a net long position of 2800 contracts. The big 4 and big 5 thru 8 swapped 100 contracts each.

We didn't set new records for concentrated holdings on the short side in COMEX silver this week, as we did in gold, but neither were we far from such record levels of concentration. I'd peg JPMorgan as still holding 33,000 net contracts short in COMEX silver.

Managed money traders sold 5025 net silver contracts, including the sale and liquidation of 2574 long contracts and the new short sale of 2451 contracts. This is normally a large number of contracts, but in light of the current extreme readings, much less so. My main takeaway for the COT report in silver is how little of a reduction there was in concentrated short selling and that's the main thing that must be resolved. Same in gold.

A quick comment before returning to this theme. An alert long term subscriber reminded me of another thing I once knew but had forgotten about. (I sure hope this is not a recurring trend). In my article Wednesday about the coming silver user buying panic, Jim H reminded me that I left out another important recent example of an industrial user buying panic in another precious metal, rhodium. In fact, there were a number of historic price surges in rhodium, including one from under \$300 in 1983 to over \$5000 by 1991 or by a factor of nearly 20. The biggest run in rhodium took place from \$450 in early 2004 to over \$10,000 an ounce in 2008, or by a factor of more than 22.

Since there was no organized futures trading in rhodium, there wasn't much of a venue which allowed great speculation by outsiders. Therefore, it's easy to conclude that the run ups involved user buying. While I am unhappy to have again forgotten something I once knew, I am happy to be reminded of something which further makes the point about the impact that industrial user buying can have on price. Thanks, Jim.

So was Friday's selloff and the week's close the start of a more pronounced decline? Since no one who may know is telling, all we can do is speculate. We did close at the 50 day moving average in silver for the first time since mid-June and also below all the moving averages of lesser days (13 day, 20 day, etc., up to the 40 day moving average). In the past, managed money technical funds have been strongly inclined to sell as such averages were violated to the downside. Will they this time? We'll see. Gold is still above its 50 day moving average by \$16 or so, but that is also the closest it has been to its 50 day moving average since the end of June. Friday's close in gold puts it right at its 20 thru 40 day moving averages.

There is and has been only one potential negative price factor in gold and silver — the extreme market structure of historic managed money long and commercial short positions on the COMEX. More commentators and observers write of this than ever before and for good reason. Since we can't know the intentions of the commercials beforehand, we are forced to speculate on what they intend to do based upon past behavior and what is in their own best interest.

Since the commercials, and particularly the largest commercials, are extremely positioned on the short side, it is reasonable to assume that they would prefer a selloff of some type. Even more than reasonable, it must be assumed that the commercials will do what they can to rig prices lower and that the only real question is if the technical funds will sell on lower prices and by what extent. The inevitable resolution that I speak of is whether the technical funds can be induced into selling great numbers of COMEX gold and silver contracts. I can say in all certainty and without fear of contradiction that if we do experience a strong selloff, the only reason will be due to technical fund selling.

It wasn't much of a week in my ongoing financial scorecard. The commercial shorts in COMEX gold and silver were out as much as an additional \$750 million at times during the past week, but Friday's selloff and lower weekly close in silver negated any increase in the unrealized gold loss for the week. On Friday's close, the combined and collective open loss to the commercials remained at \$2.5 billion.

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Silver – \$19.35 (50 day moving average – \$19.31)

Gold – \$1341 (50 day moving average – \$1325)

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