August 22, 2018 – Locked and Loaded

I donâ??t think itâ??s possible for Commitments of Traders (COT) report coverage to be more pervasive than it is currently. Iâ??ve thought this in the recent past, only to be astounded by the increasing amount of attention devoted to the market structure approach of futures market positioning. Donâ??t get me wrong – the increasing attention is fully warranted, as futures positioning is the main price driver for gold, silver and a host of other metals and markets. I guess what is somewhat unnerving is that the growing attention is perhaps about the only thing in the world that currently makes sense to me.

One thing that explains the increasing COT commentary, aside from the fact that it better explains price movement than anything else, is that the current market structures in gold, silver and other metals and markets are at record extremes in the one measure that matters most. Of course, Iâ??m referring to the current record short position of the technical funds in the managed money trader category of the disaggregated COT report in most COMEX metal futures markets.

I know this is complicated, but there is also a fairly large long position in the managed money category, particularly in COMEX silver futures, but not by the traders I call the technical funds. The main criterion for being classified in the managed money category is for the entity responsible for trading decisions to be a money manager engaged on behalf of clients. No distinction is made by how the entity trades and you wonâ??t find the term â??technical fundâ?• in official COT nomenclature. Â I use the term to describe those money managers which buy and sell on technical price signals, principally as moving averages are penetrated and as continued new price highs or lows are achieved.

Since these technical funds, essentially, buy and continue to buy as prices move higher and sell and continue to sell (short) as prices move lower, it is easy to identify them as prices move higher or lower. Currently, after ten unprecedented consecutive weeks of moving average penetration to the downside and continuous new price lows being achieved, it is simple to identify the record managed money short position as being done by technical funds. Conversely, after such a pronounced price move lower, it is just as simple to identify the managed money traders which are long as not being technical funds which sell on lower prices.

Because the technical funds are fairly rigid in buying as prices rise and selling as prices fall, their behavior is fairly predictable, while the non-technical fund managed money traders are less predictable. Of course, that doesnâ??t mean it is necessarily easy to anticipate beforehand exactly how many contracts the technical funds will collectively buy or sell on any price move higher or lower. Sometimes they buy or sell not as many total contracts as they have previously, sometimes the same amount as previously and sometimes a lot more than previously bought or sold.

However, we also know that there is a limit to the number of collective contracts the technical funds are capable of buying or selling and, based upon observable past experience, once the technical funds reach that limit what follows is always a reduction and possible complete reversal of previously bought or sold positions. Therefore, once the technical funds reach or exceed previous record collective positions, the likelihood greatly increases that a reduction or complete reversal of positioning may be at hand. The actual timing of the reduction or complete reversal is always tricky, as sometimes it is quite quick and other times drawn out, over months.

And thatâ??s exactly where we sit today, since the technical funds hold record short positions in COMEX gold, silver, copper and platinum futures. Since the technical funds hold short positions much larger than previous records, it is reasonable to assume we are close to the maximum limit and that some reversal of positions is likely. This explains the increased attention to the COT report and to the record managed money short positions. So large is the technical fund short position and so great the attention it has commanded that the only entities that seem not to notice are those entities one would think should be most concerned about the price dislocations that a record speculative short position would create. In other words, the only entities apparently oblivious to the record managed money short positions are the regulators at the CFTC and the CME Group.

Although thatâ??s par for the course, Iâ??m still left with the impression that we are locked and loaded for an upside move of great significance. In fact, I have trouble envisioning how we wonâ??t see a very large move higher in the metals, even though I understand full-well the circumstances that will prevent a large up move in price from occurring. I know that the only thing that will short-circuit a large up move in silver and gold is aggressive short selling by JPMorgan and I also know that JPMorgan is more than capable of aggressively shorting into the next price rally, just as it has on every price rally over the past ten years. Then why am I more convinced that JPMorgan wonâ??t short aggressively on the next rally?

The main reason is because JPMorgan has been able to buy back so many COMEX gold and silver short contracts over the past two or three months that it is hard to imagine it replicating its remarkable short covering feat anytime in the reasonable near future. At a minimum, JPMorgan has bought back 90,000 short gold contracts, completely eliminating its COMEX gold short position and 30,000 COMEX silver shorts. Thatâ??s the equivalent of 9 million gold ounces and 150 million silver ounces; leaving its 20 million oz physical gold ownership completely unencumbered to the upside and its 750 million oz silver physical position only encumbered by 50 million ounces of paper shorts.

Were JPMorgan to once again sell short aggressively on the next rally, it would force it to wait out another complete technical fund short covering and buying long cycle, which could take many months to complete. JPMorgan has done exactly this in the past and used the time to continue to acquire physical metal, thus improving its overall position in the end. I suppose it could do so again, but a number of things argue against this.

For one, the last time JPMorgan added silver shorts aggressively was from April to early June, when it had to add 20,000 new shorts to contain the price, a much more aggressive stance than previously. Youâ??ll recall back then JPM turned into the silver short seller of first, rather than last resort; very much out of character with its past behavior. I attributed that to its strong desire to buy back gold shorts, to the point of double crossing other commercials. Having now completely covered its COMEX gold short position, JPMorgan has lost the incentive to cap silver prices so aggressively this time. Thereâ??s no doubt that the buyback of 30,000 silver short contracts since June took unusually engineered price action this time, as is evident in the unprecedented ten weeks of price declines.

And whoâ??s to say that when the technical funds move to buy back their record number of gold and silver short sales, they will then be maneuverable into another record short position as they are today? These technical funds may be as dumb as dirt, but thereâ??s no guarantee theyâ??ll be snookered again quickly back into short positions likely bought back at losses.

Finally, the explosion in COT commentary guarantees that if the crooks at JPMorgan sell aggressively short on the next rally, more are bound to notice it (you can be sure that Iâ??ll be pointing it out). What has contributed mightily to JPMorganâ??s complete dominance of silver and gold over the past decade is that few knew what these market gangsters were up to. Â It wouldnâ??t seem to be in JPMâ??s best interest to go the well yet again since more are bound to notice its activities the next time out. Of course, itâ??s hard to think like a criminal if you are not a criminal yourself, but JPMorgan has left a trail of clues pointing to its intentions.

Of course, inherent in any decision by JPMorgan not to add silver or gold short positions on the next price rally is my basis for a price explosion. There is a record smaller commercial (the raptors) net long position against the record technical fund short position and I have no doubt the raptors will be selling into technical fund buying on rising prices. But the raptors always try to extract as high a price as possible and are not much interested in capping prices as in taking as large a profit as possible. Seeing how JPMorgan resorted so quickly to short selling back in April/June suggests it will do so again or not at all. Again, seeing as JPM had the purpose of gold short covering on its mind back then and not now, Iâ??m inclined to think JPMorgan will not be selling short aggressively this time around.

In purely mechanical terms, if JPMorgan doesnâ??t add to short positions aggressively in the initial stages of a rally, the rally could come quickly uncorked given the pent up potential buying back of the record technical fund short position. Rocket fuel is the only term that properly describes the power of technical fund short covering.

As far as what to expect in Fridayâ??s COT report, gold and silver prices plunged to new lows on the first day (Wed) of the reporting week, followed by new lows early Thursday, before somewhat recovering through yesterdayâ??s cutoff. The trading volumes were much heavier on the new lows than on the recovery, so I would expect further managed money selling and commercial buying. Yet after ten straight weeks of unprecedented managed money selling and commercial buying, we must be coming close to the limits of managed money shorting. Of particular interest will be specific category breakdowns, including the new concentrated long position in silver, as well as the old reliable of what JPMorgan may have been up to in both silver and gold.

In terms of what I consider the all-important money scoreboard of the newly added technical fund shorts since the COT report of June 12, I calculated the open and unrealized profits to be $830 million as of Friday, down from last Wednesdayâ??s $950 million open profit. Please allow me to restate the formula for calculation. The managed money technical funds have added 140,000 new gold short contracts at an average price of $1235 from June 12 thru last Tuesday, Aug 14 and 48,000 new silver short contracts at an average price of $15.60. Â Iâ??ll add or subtract new contracts when the new COT report is published.

As of todayâ??s closing prices, $1202 gold (Dec) and $14.73 in silver, the newly added technical fund shorts hold a total combined unrealized profit of $670 million, still sizable, but down from Fridayâ??s

$830 million and last Wednesdayâ??s $950 million. There is little doubt that the technical funds loaded up on the short side seeking to parlay growing unrealized profits into a very large position to make even a bigger score, as is the custom of aggressive trading. At the same time, also in the aggressive traderâ??s guidebook is the precept of never allowing a large open profit to develop into a large realized loss. Therefore, how this plays out will be more than interesting.

Interestingly, while gold and silver are still below both the key 50 and 200 day moving averages in each (by a full dollar in silverâ??s 50 day ma and $35 in the case of goldâ??s 50 day moving average), those levels roughly coincide with the breakeven price for the newly added technical fund shorts. If the technical fund shorts wait until the 50 day moving averages are penetrated before beginning to cover, all the open profits will have disappeared and new short covering at that point and higher will result in realized losses (something I expect whenever the dust has finally settled).

Also of interest is that since prices started declining in mid-June, gold and silver have traded consistently below each metalsÂ 20 day moving average (now $1213 in gold and $15.21 in silver). I bring this up because sometimes the technical funds add to short positions on a small bounce after prices have plunged way below the key moving averages. They might do so this time as well, but considering how large their short positions are already, I donâ??t think they will. Instead, I imagine that should the 20 day moving average be penetrated to the upside, technical fund short covering would commence. Of course, Iâ??m just speculating, but I get the feeling the rally could get going in earnest as the 20 day moving averages are penetrated.

Ted Butler

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Silver – $14.73Â Â Â Â Â Â Â Â Â Â (200 day ma – $16.42, 50 day ma – $15.75)

Gold – $1202Â Â Â Â Â Â Â Â Â Â Â Â Â Â (200 day ma – $1294, 50 day ma – $1239)

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