August 24, 2013 – Weekly Review

Weekly Review

A sharp rally on Friday put gold and silver higher for the week. Gold ended up $20 (1.5%), closing at its highest level since early June, while silver climbed 80 cents (3.4%) and ending at its highest level since early May. In simple terms, anyone who bought and held either metal since those times is ahead; the opposite for sellers of either metal.

Along with the higher flat prices, the relative outperformance by silver pushed the silver/gold ratio down another point, to 58 to 1. This is the strongest silver has been to gold since early April. But the real story in the ratio is how sharply it has moved this month, falling from 67 to 1 at the start of August. As I've described previously, sharp moves in the silver/gold ratio are most always caused by sharp moves in silver and this month's sharp move is no exception. Longer term, I can't see how silver doesn't outperform gold handily; so even after the sharp contraction in the ratio this month, it's wise to switch gold positions to silver. Short term for the ratio? I'd rather play the lottery; but I'm more afraid of selling silver than ever before. Then again, I guess I am playing the silver call option lottery.

It's funny how price changes and the passage of time play tricks on our perceptions. Compared to prices over the past few months, $1400 gold and $24 silver feel pretty good to metal investors. But these same prices would (and did) make metal investors sick to their stomachs compared to prices at the start of the year. Since we are still down in price substantially for the year, it's hard to reconcile the good feelings. I suppose that which does not kill us makes us stronger. I think the real lesson in the extreme price volatility this year is the importance of maintaining a long term focus. If one didn't hold a very strong conviction of silver's undervaluation relative to all the facts that matter, as I do, I don't know how it would be possible to absorb the intentional price beatings this year by JPMorgan without selling.

Turnover in COMEX-approved silver warehouses cooled a bit this week, to around 2 million oz, but cooled only compared to the prior two weeks' extreme movements. On a longer term perspective, a 2 million oz weekly turnover is still extraordinary. Total COMEX silver stocks fell almost 800,000 oz for the week, to 164.4 million oz. The only reason I follow this movement is because I think it offers a window into the relative tightness of the wholesale physical silver market. My peering into that window suggests silver tightness.

However, if there is one window of silver tightness inviting a closer view presently, it has to be the lack of deposits into the big silver ETF, SLV. Based upon my running daily calculations, this trust was due 10 million oz of silver as a result of the heavy buying and price gains of the week prior. After yesterday, another couple of million oz or more is Â?owedÂ? to the SLV. The lack of silver metal deposits into the trust suggests a jump in short interest and the report, due late Monday, will be as of August 15 which includes two big up days. Regardless of what this short report shows, more shorting in SLV came in since August 15.

A quick word on how I calculate how much silver might be owed to the SLV. It's a back of the envelope and simple process. In following the daily trading of the SLV since its beginning in April 2006, a clear pattern has emerged. On flat price and regular volume days, the metal holdings don't change much, nor should they. On high volume, sharp down days, there can often be subsequent liquidations and withdrawals of metal shortly thereafter. Most always, on high volume and sharp up days, there are usually subsequent deposits or increases in the short position. While simple, the formula conforms to general investor behavior of net selling when prices go down and net buying when prices (of anything) go up. After daily observation for seven years, if I didn't see a consistent pattern, I'd need a shrink to explain my persistence. Besides, my simple and back of the envelope method usually works. After all, I'm not making short term price predictions; I'm merely observing volume and price after the fact and concluding what most likely occurred as a result.

Bottom line, much more silver should have been deposited into the SLV than has occurred over the past two weeks. Confirming this is that we saw a large deposit of gold (212,000 oz) into the big gold ETF, GLD, yesterday. The GLD, as you know, has been bleeding metal this year as investors sold shares in response to the engineered lower prices. All told, roughly a third of the gold held in GLD has been liquidated this year, in conformance with typical investor behavior. In contrast, the silver metal holdings in SLV have been steady to higher this year, despite much weaker silver prices.

Now that gold prices have turned higher it is reasonable for there to be net buying in the GLD, accompanied with new deposits of metal. With even stronger silver prices and much higher relative volume, there should be large deposits in SLV as well. The most plausible explanation for why they did not occur is that the metal is not available. I don't mean to beat this to death, but when any metal is not available for immediate delivery, that metal is considered to be in a shortage situation of some degree.

Since an inevitable metal shortage is my prime reason for owning silver, I admit to being sensitive to any clues portending a shortage. I also know that by the time a physical silver shortage is widely recognized, the price will have largely reflected that widespread recognition. My common sense suggests that early clues to a silver shortage must come from more obscure observations Â? such as overactive warehouse movements and silver deposits that are delayed.

The changes in this week's Commitments of Traders Report (COT) were expected in the increase of the total commercial net short position headline number in both gold and silver, but surprising (and welcome) in the size of the increase. Since the reporting week featured a price gain of more than $60 in gold and more than $2 in silver, to price highs not seen for months in each metal, I was resigned to massive increases in net commercial selling, particularly after the previous report's large increase in silver (10,000 contracts). My resignation turned into relief.

In gold, there was a moderate increase in the total commercial net short position of 6800 contracts to 67,700 contracts. Paradoxically, there was no new actual short selling by the commercials, as the four and eight largest shorts bought back a combined 9000 short contracts. That meant that all the selling was by the raptors, who sold out almost 16,000 long gold contracts. Nowadays, the biggest raptor is JPMorgan and it was this bank that was the largest commercial seller, selling around 10,000 contracts of their long gold market corner. I'll come back to the crooks at JPMorgan in a bit.

Under the hold, there was slightly more speculative buying than the headline 6800 contract net change in the commercial position suggested, but that doesn't indicate worrisome speculative buying given the unusual price gains in gold during the reporting week. The key managed money category of the disaggregated COT report, where the technical funds reside, did experience almost 10,500 contracts of buying, of which 6500 contracts were short covering.

It was always expected that speculative shorts, particularly technical fund shorts, would buy on higher prices and this would serve as fuel to the upside. That's why I was always encouraged with the speculative shorting. Thus, there is nothing remarkable about gold prices being pushed higher by this speculative buying. If anything does stand out, it is that given the extent of the rally in gold and silver so far and how decisively most of the moving averages have been penetrated to the upside, that there hasn't been more overall speculative buying. History suggests that buying will still occur as and when prices move higher.

In silver, there was Â?onlyÂ? an increase of 3000 contracts in the total commercial net short position, to 23,300 contracts. I say only because after last week's 10,000 contract increase, I was girded for a similar increase since the price of silver jumped about the same $2 in each reporting week. Unlike in gold, the commercial selling was evenly divided by categories. The big 4 added 700 new short contracts and the big 5 thru 8 added 800 new shorts. The raptors sold out 1500 of their long contracts, reducing their net long position to 30,400 contracts.

Under the hood and as was the case in gold, the tech funds bought back more shorts than the headline number indicated, but not alarmingly so. The tech funds did buy back more than 5000 short contracts this week and 10,000 for the last two weeks combined and that upside fuel has been consumed. Still, it generated almost a $4 rally, but I always hope for more. I am encouraged that there has not been any notable build up in the technical fund gross long position in COMEX silver as that reduces the chance of a significant liquidation of that position to the downside. While we are still witnessing manipulative HFT-inspired attempts to break prices (at least two this week), it's hard to get speculative liquidation of long positions that haven't grown much. If anything, given the sharp rise in the price of silver over a short period of time, there are more potential buyers looking to enter on a pull-back.

I was also encouraged that JPMorgan Â?onlyÂ? increased its silver short position by less than 1000 contracts, which probably totals 17,000 contracts as of the Tuesday cut-off. This is still a major key to the silver price, as what JPMorgan does or doesn't do is what determines the price of silver and gold. If JPMorgan doesn't increase its silver short position dramatically (as the bank has always done in the past), the price of silver will go higher. If the bank does sell short aggressively, the price will be contained to some extent. Just to keep it in perspective, if the physical silver shortage hits with force, what JPMorgan sells or doesn't sell won't make a difference, as the price ka-boom factor will kick in.

By my estimate, JPMorgan is holding around 66,000 contracts net long in COMEX gold futures, down almost 20,000 from what the bank held two reporting weeks ago. In selling this amount of contracts on the rise in gold prices, I'm estimating the bank made about $250 million on the closed out positions, meaningful compensation for cornering the gold market so far. Yet, despite being the largest seller by far over the past two weeks in COMEX gold futures, JPMorgan still holds an unquestioned corner on the gold market with 20% of all long positions on a true net basis (minus spreads).

This gold market corner by JPMorgan continues to be the critical factor to the market. After all, it's pretty amazing that the bank could sell 20,000 contracts (2 million oz), booking a quarter billion dollar profit, and still hold a market corner of 20% of the world's largest gold exchange. I'm certain this gold market corner on the COMEX by JPM will be eliminated in time; although I'm not sure exactly how. And even when it is no longer in place, nothing will ever erase the fact that this gold market corner did exist. I wouldn't keep harping on this gold market corner (or the short market corner in silver by JPMorgan) if I wasn't absolutely convinced beyond any doubt.

I admit to spending much of my time in contemplating what possible reactions might come from JPMorgan or the regulators at the CFTC or CME Group to my incredibly specific and rather simple allegations. Either a long gold market corner or short silver market corner exists or it doesn't exist. If neither exists, then JPMorgan or either regulator should attest to that. If either does exist, then all three should do something about it since no other market condition could be more important or illegal. Their collective and continued silence is indicative, at least to me, that it is the big damn deal I am making of it.

This is not intended in the least as me patting myself on the back, but I have a habit of asking questions that the regulators can't answer. We are approaching the five year anniversary of the formal silver market investigation by the CFTC's Enforcement Division. This investigation was originally initiated because the agency couldn't answer a question that I asked publicly about JPMorgan holding a super concentrated short position in COMEX silver and gold being manipulative. Rather than answer directly and honestly, the agency initiated a wasteful phony investigation and allowed JPMorgan to continue to manipulate silver and gold prices for the years since the investigation was launched.

Now we have come full-circle. Not only has my question from five years ago not been answered; there's a new question and allegation about JPMorgan holding a corner on the gold market from the long side, more extreme than any market corner the CFTC ever litigated against. Their silence doesn't bother me, nor should it bother you. Knowing the facts, I don't know what they can say. The CFTC and the CME are not about to lie and deny the gold (and silver) market corner exists, because a frank discussion would open up a can of worms. JPMorgan is not about to admit guilt because that's not what criminal enterprises ever do. So all three have chosen the silent routine.

What's left for the CFTC to do is to move against JPMorgan. While I know that's the last thing the agency wants to do (based upon past experience), they may be forced to do so by two developments. One is the newfound vigor by other US Government financial regulators in going after JPMorgan. This is something none of us has ever witnessed. If, as I suspect, the new Treasury Secretary is behind the well deserved and long overdue push against JPM, the CFTC must go along at some point. The other development is the growing clarity that JPMorgan has a corner on the gold market and at some point, regardless of whether that gold corner gets resolved soon or not, the CFTC might get shamed into fulfilling its primary mission.

Particularly damaging for JPMorgan, the CFTC and the CME is that it is impossible to explain away, in legitimate terms, how JPMorgan could be net short 75,000 contracts in COMEX gold futures (20% of the market) on December 4 at $1700 and net long 85,000 contracts (25%of the market) $500 lower eight months later. I know what they want to say, namely, that it was strictly a market-making function and if JPMorgan hadn't bought so many gold (and silver) contracts on the way down, the price drop would have been much worse. So instead of accusing JPMorgan of manipulating the market and holding market corners, you should be thanking them for the buying support on the price decline, goes the manufactured response. As I said, this is what I think about.

The problem with this excuse is that JPMorgan was the principle architect of the price decline for their own benefit, as proven by the profits they accrued. More importantly, a market corner can't be excused in any circumstance according to the law. What needs to be done is to boot JPMorgan out of gold and silver (and other markets) once and for all and to finally install and reset position limits to lower levels. Yes, there will be a period of instability in gold and, especially, silver prices as JPMorgan is shown the door and the markets have to adjust to there being no prime manipulator. There's no easy way around that; a market can't go from being manipulated for decades to suddenly being governed by the free law of supply and demand with price smoothness. There has to be a violent reaction to the upside in the case of silver. After that and in the end, we will all be much better off with free markets.

Please don't think for a moment that regulatory action is the only path to a free silver price. While I am encouraged by the developments in the COT structure this week, I am more interested in the lack of deposits into the SLV where many millions of ounces are owed to the trust. This is very reminiscent of three years ago, as silver embarked on a price journey from the teens to almost $50. In hindsight, the key element in that price rise was the pronounced tightness in wholesale physical silver supplies, including metal being owed to SLV. If I am reading the tea leaves correctly, the tightness is reasserting itself currently. At some point that could lead to a flat-out physical shortage which, in turn, would render whatever JPMorgan and the regulators do as moot. In other words, the set up looks promising for the price of silver with no shortage; with a shortage, the price of silver will shock us all.

Ted Butler

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Silver – $24

Gold – $1397

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