

## August 27, 2014 – Meaningful Comparisons

### Meaningful Comparisons

There have been recent reports on silver inventories on the Shanghai Futures Exchange, as well as reports over the past few years about new precious metals exchanges emerging that might break the COMEX's manipulative grip on prices. Since nothing could have a greater impact on silver prices (aside from a physical shortage) than whether the COMEX remains in control of prices through large futures positioning, it is a topic worthy of discussion.

I don't usually discuss metals exchanges away from the COMEX because I have no hands on experience in other exchanges. Additionally, I am conditioned to be distrustful of statistics from command economies, like China's, where commodity data have always been disseminated as sensitive in the past, if not as state secrets. Let me comment first on the reports of silver inventories on the Shanghai Futures Exchange.

Trading in silver on the Shanghai Futures Exchange began in the summer of 2012 and by the start of 2013 total exchanger silver inventories climbed to nearly 1200 tons (38 million oz) from zero at the outset of trading six months earlier. Since early 2013, silver inventories there have declined significantly to only 103 tons (3.3 million oz). On July 1, Shanghai inventories were 234 tons, so these inventories are down more than 90% from early 2013 and down more than 50% over the past two months. I sense the decline is related to a 17% VAT on silver, but since I don't know for sure, I'm not going to spend time here on the explanation for the inventory decline; but rather to put the inventory reduction into proper perspective.

As you know, I continue to be fascinated by the remarkable frantic movement of physical metal into and out from the COMEX-approved silver warehouses. I have been more than perplexed by the lack of comment and attention devoted to this most unusual and unprecedented physical warehouse turnover. So let me compare that physical COMEX silver movement with the movement (out) on the Shanghai Exchange.

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Silver inventories on the Shanghai Futures Exchange dropped by 4.2 million oz since July 1 and 35 million oz over the past year and a half. Suffice it to say, with only 3.3 million oz remaining, there can be no similar physical declines from current levels. What about the COMEX? Since July 1, some 35 million oz have physically been brought in or taken out of the COMEX silver warehouses, or almost nine times the amount removed from the Shanghai Exchange. And over the past year and a half, more than 300 million oz of physical silver have come into or have been removed from the COMEX warehouses, also nine times the amount removed from the Shanghai inventories during that time. One would think, in a rational world, that the COMEX silver warehouse inventory turnover would command many times the attention placed on the turnover in Shanghai silver inventories, since the COMEX turnover is so much larger.

I don't doubt that China produces (mine plus refining and recycling) and consumes more silver than perhaps any other country and is, therefore, incredibly important to the world of silver. In my mind, China, India and the US roughly account for 200 million oz each of annual silver consumption. My point is different. When it comes to exchange dealings in silver, be those dealings in paper terms (futures trading which controls the price) or in physical warehouse movement terms, the COMEX is still it. I am resigned to remaining puzzled why the COMEX silver warehouse movement remains unnoticed (or at least not commented on).

I don't think anyone would advance that the Shanghai Futures Exchange silver inventories have had much to do with price movement as the 90% decline in inventories over the past year and half has coincided with a 40% decline in the price of silver. And while it's true that the frantic turnover in the COMEX silver warehouses hasn't had much to do with price on an outward basis, the same cannot be said about COMEX futures positioning which has dictated and explained every silver price move over the past 30 years. I never once alleged that COMEX warehouse movements had much to do with short term pricing, but that COMEX paper trading sets prices. It's just that the Shanghai inventories look a lot less important than does the COMEX silver warehouse turnover on an objective comparison.

On a more general topic, there have been reports over the past couple of years to this day about new metals exchanges starting up, mostly in China, but elsewhere in Asia as well. One recurring theme of the proposed new metals exchanges is that they will be fully physically backed; much different than the highly leveraged and largely paper-traded COMEX futures contracts. Whereas very few (less than 3%) of traded COMEX futures contracts ever result in actual delivery of metal, the proposed new exchanges will only deal in full metal backing at all times; meaning you can't sell if the physical metal isn't in place for immediate delivery and you can't buy unless you deposit the full value of the contract and take physical delivery. This sounds good at first, but in thinking it over, it makes no practical sense. At least to me.

Maybe it's due to my background and experience in futures trading, but I don't understand the rationale behind fully backed metals trading or why such trading would supplant the COMEX version. Please don't misunderstand my point. I'm certainly not opposed to owning silver on a fully-paid for and physical basis and I hope that I have conveyed that from the beginning. I don't think I've ever encouraged anyone to hold silver on a margin basis. But that goes to my point, namely, owning physical silver (or gold) on a fully paid for basis is not conducive at all with rapid and active trading, the hallmark of any precious metals exchange.

Try as I might, I can't grasp how a precious metals exchange could survive by trading fully backed metals contracts because I can't see where sufficient trading volume would come from. I understand why someone would buy silver for the long term and I even understand why someone would sell it (needing the money, for example). What I don't understand is why anyone would buy silver (or gold) on a fully paid for and physical basis only to turn around and sell it quickly. I also don't understand why anyone who deposited physical metal for sale and received the full cash proceeds would immediately turn around and repurchase what was just sold.

I can't see how any exchange that relied on the fully-backed with physical metal model could generate enough trading volume to remain in business. Exchanges exist to exchange or trade something and I can't see the need for actively trading fully paid for and physically backed contracts. Futures trading is different; it's not so much about delivery or fully paid for positions, but for locking in prices by hedgers transferring risk to willing speculators. There has to be a legitimate futures contract conversion to physical delivery mechanism in place, but not every contract must be fully backed and delivered against. The evolution of futures trading over the past 150 years rested upon paper trading backstopped with the option of actual delivery.

The problem with the COMEX is that the price discovery process has been high jacked by large speculators to the extent that little if any trading is done for legitimate hedging purposes. The COMEX has become a speculative playpen which, because it involves such enormous paper quantities has become the dictator of price to the real world of metals. This is so clear and easy to substantiate that it enables me to point out that this speculative trade is corrupt and the main agents of the corruption are the CME and the CFTC, along with JPMorgan.

The purpose of this piece is not to suggest that pricing control will never be lifted from the COMEX, because that will surely come. But it's not likely that a new exchange, dealing exclusively in fully paid for and physically backed contracts, will be the cause. Certainly, the two main culprits in the COMEX manipulation are the technical funds and their collusive commercial counterparties and I see nothing likely to cause either to switch to a foreign physical only trading platform. I think it more constructive to put things into proper perspective than to rely on false hopes. I can't help but believe that if, as and when more concentrate on the actual mechanism of price control, the COMEX, the quicker that control will be ended.

In other developments, the short position in SLV did decline, as expected, but not to the extent expected. A bit more than 1.5 million shares were reported covered, reducing the total short position in SLV to just over 15.8 million shares (oz). There had been metal deposits of 4 million oz during the reporting period when deposits would not normally occur (due to lower prices and tepid trading volume), so it was most plausible to conclude the short position would decline more. <http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

Still, this is mostly a case of getting the direction correct, if not the precise number and I find that encouraging and conformational. Having things unfold in the general sense of expectations would be important in any analytical premise. It's no different in the premise that silver is manipulated in price on the COMEX. If the majority of specific expectations were consistently wide of the mark, from guesses on the COT to the short position in SLV that would cast doubt on the premise itself. Yet, that is so far from the truth that the opposite must be true — such guesses are so consistently close enough to expectations so as to validate the premise.

Since there was an additional 3 million silver ounces deposited into the SLV after the reporting period cut-off and because silver prices and trading volume have been weak and light, it is reasonable to conclude further reductions in the short position in the next short report (all things being equal). A declining short position in SLV is good, but only if it doesn't increase again on the next silver rally. In the past, big increases in the short position in SLV have been an important ally in containing the price of silver and extending the manipulation, so this matter remains open. It's just that it's hard to complain about it as the short position declines.

As far as the upcoming COT report, based upon the trading action since the previous cut-off thru yesterday, it looks like the total commercial net short position and net long position in the managed money category has declined in both COMEX gold and silver and has increased in copper. As far as specific numbers, I'd guess a 20,000 contract reduction in gold; 4000 contracts or so in silver. In copper, the technical funds bought and the commercials likely sold 10,000 contracts or so. COMEX copper had been the most advanced in the liquidation of technical fund long positions and new short selling, so its recent sharp rally above key moving averages was not that surprising; nor would it be surprising if the commercials lured the technical funds into selling copper contracts on a rigged price decline.

The probabilities still suggest that further technical fund selling to continue in COMEX gold and silver, but that is not written in stone. In fact, on a short term basis, anything could occur because the collusive commercials still appear to be in complete control. If the commercials want to ring the cash register further and buy gold and silver contracts on prices rigged lower, they will. If the commercials want to see the technical funds buy more contracts first, the commercials will rig prices higher. Not for an instant do I think it will remain this way forever, but it looks that way for the short term. In the interim, if we do experience a final COMEX commercial flush out, I intend to treat it as the final flush out.

Ted Butler

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Silver – \$19.40

Gold – \$1284

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