

August 30, 2017 – Breaking the Stranglehold

I've been thinking (in addition to being asked) about the outside factors that could break the stranglehold of price manipulation in place on the COMEX for silver and gold. I would define the stranglehold on prices as based upon the repetitive cycle of futures contract positioning between the managed money technical funds and the commercials and other traders. Almost without exception, when the technical funds buy, prices rise and when these funds sell, prices move lower. This is and has been the primary price driver and includes the outsized role that JPMorgan plays in silver by virtue of it being the short seller of last resort in COMEX silver, as well as the epic accumulator of physical silver over the past six and a half years.

Today, I'd like to comment on what some of the factors might be to end the artificial price dominance on the COMEX. Most of these factors would be considered outside factors, but it is always possible that something could go wrong with the ongoing game in that a big commercial or two miscalculates and is forced to break ranks with the other big commercials and that is enough to crack the foundation of consistent commercial price control. In other words, the full pants down premise of Izzy Friedman, only confined to paper contract positioning gone wrong on the COMEX. While this has never happened, it can't be eliminated from the realm of possibility.

Specifically, I was asked if any of these outside factors – CFTC regulatory intervention, a stock market crash, a war event, a natural disaster, a plunging dollar, inflation, etc. – could or would cause the price of silver and gold to explode. The short answer is yes, any of these factors could prove to be the catalyst that leads to the end of the COMEX price manipulation. While I believe the odds of many of these outside factors occurring have increased recently, based upon simple observation of everyday developments, I'm loathe to start rooting for bad news to drive the price of silver higher. That said, I'd be lying if I told you that the insurance aspect of holding silver was not more attractive to me than now.

The simple answer to the question about predicting specific outside factors is I don't know. That's because any one of them could prove to be the spark to set off the price of silver under certain circumstances. The key, however, has less to do with the specific outside force and much more to do with the background circumstances in place. Additionally, predicting the timing of unexpected outside events has nothing to do with analysis and everything to do with soothsaying, at which I am particularly unqualified. On the other hand, it seems much more reasonable to measure the background circumstances. In doing that in silver, the circumstances present what I consider to be a mathematical equation for higher prices.

The main basic circumstance in silver (and gold) is that it has two price discovery processes; the one currently in force, COMEX futures positioning, and the process currently overshadowed where prices are set by physical dealings. While I spend most of my time describing the price-setting process currently determining prices, I recognize full-well that, in the end, physical silver dealings will drive prices sharply higher. While the timing of the coming physical silver price process may be as indeterminable as any future event, its inevitability seems assured. In fact, the physical silver price process is what accounted for the price run up to nearly \$50 in early 2011, as there is not the slightest hint in the public data that COMEX futures positioning accounted for the run to price highs at the time.

In essence, the question about outside factors is really a question about when the physical dealings price process in silver overwhelms the COMEX futures positioning process (again). As long as the managed money/commercial paper trading process remains as the dominant force, it would be reasonable to expect the same price pattern that has existed for years, as the commercials continue to hoodwink the technical funds. As and when the paper price process is overwhelmed by physical market forces, sharply higher prices will become the order of the day.

The good news is that just about any outside factor could prove to be the catalyst for the physical side of the ledger to overcome the paper market price control. Certainly, any factor that initiated widespread investment buying interest in the right forms of physical silver would qualify as being capable of powering physical dealings over paper dominance. I'm not talking about massive new buying of COMEX futures contracts by the technical funds, as that might temporarily goose prices, but would still leave the commercials and the forces of the paper market in place. I'm talking about physical investment buying, very much including buying in SLV and other physical silver ETFs.

The price pattern in silver and gold has been dismal for more than six years (thanks to paper market manipulation), and this is the main cause for the lack of physical investment buying sufficient to raise the price. Collective human nature being what it is, investment dollars have flowed into everything that has risen in price over this time — which, essentially, is everything else — stocks, bonds, real estate, collectables, crypto currencies, etc. Perhaps I'm a bit prejudiced, but it seems to me that only silver and gold have suffered the price losses and the resultant dearth of investment demand. (And the lack of investment demand was what enabled JPMorgan to scarf up the 600+ million oz of physical silver that investors didn't buy).

But when you step back, what has occurred over the past six years has created a unique background circumstance strongly suggestive of much higher silver prices. Because prices advanced sharply for all other assets, while silver and gold fell, precious metals are deeply underpriced relative to everything else. As an example, should it be a stock market crash that starts a rush to silver and gold buying, because stock market values are so high relative to precious metals values, it would take the smallest percentage of money fleeing the stock market to power precious metals higher. And the current relative low value of silver and gold is a feature in every outside factor that could trip off a metals investment surge.

While the lack of investment buying, due to dismal prices, seems understandable in hindsight, it is notable in another way. The dismal price pattern of the past six years has completely obscured perhaps the most bullish silver fact of all, namely, how little of it that exists or could possibly be available for purchase. Let's face it — a price drop of as much as 75% and lasting for more than 6 years is not at all compatible with thoughts of scarcity and potential physical shortage. Moreover, when I put myself in the shoes of a non-silver investor, considering the past price performance, any talk of physical scarcity or potential shortage must seem downright loony. Lunacy aside, what are the facts?

Fortunately, there are facts readily available that counter the sentiment that physical silver must be abundant and fully reflected in the price. These are not my facts, except that I contemplate them as much or more than anyone. The abundance or scarcity of physical silver is measured in two ways — how much exists and how much continues to be produced. I've further refined the equation down to the only form of physical silver that matters — 1000 oz bars.

There are between 1.5 to 2 billion oz of silver in the world in this form (even after the recently released statistics from the LBMA). Further, JPMorgan owns at least 600 million oz of the total. In dollar terms, ex-JPM's holdings, that means there are around \$15 billion to \$25 billion worth of silver in 1000 oz bar form. Not only is that a pittance in world investment buying power terms, it also vastly overstates the amount of silver that could be bought because all this metal is owned and only available at what the owners consider a fair price. No more than 10% or so would be available at prices up to \$20. That begs the question at what price a potential tsunami of world investment buying power versus a miniscule amount of physical metal availability would intersect. The world is fully capable of buying many times more physical silver than could possibly be made available.

On the current production side, no more than 100 million oz of new silver is made available to the world's investors annually, after all total fabrication demand (industrial, jewelry and small bar and coin) is accounted for. At current prices, that's less than \$2 billion yearly, or around 25 cents for each world citizen on a per capita basis. There is not a hint of suggestion that either existing or prospective physical supplies of silver are abundant or excessive; dismal price performance is clearly a function of COMEX futures positioning. Further, on a relative basis, the facts also show that, in dollar terms, there are hundreds of times more gold available for potential purchase than are available for silver, making a mockery of the currently lopsided silver/gold price ratio. No one (seriously) would suggest silver is overvalued relative to gold.

This creates the almost mathematical equation that points to any potential outside factor as being capable of setting off a surge in the silver price. In fact, it is more of a wonder that given the verifiable facts of how little physical silver exists and is available that the surge higher has yet to occur. Choose any outside factor of your fancy; when measured against what amount of physical silver could possibly be made available for purchase that outside factor could trigger the big one. Limited physical silver availability creates the background that makes a myriad of outside factors capable of triggering a silver shortage.

One outside factor previously mentioned is a possible stock market crash, particularly considering the current rich valuations, widespread participation and extreme leverage. Remarkably, the relative valuations of stocks (or anything else) compared to silver suggests that even if stocks don't sell off sharply, silver is perhaps just as likely to catch up to stock valuations in the absence of a crash. There has been an orgy of monetary stimulus worldwide for years and silver and gold have been the only assets seemingly immune from the universal asset appreciation. As I said, I don't wish to get in the habit of rooting for bad things so that silver might move higher — life is too short to contemplate negative things that may or may not occur and, besides, silver doesn't need bad news, it just needs to transform from the artificial COMEX paper price discovery process to the free market physical version.

Underscoring all this is the towering presence of JPMorgan and the more than 600 million oz of physical silver it has acquired over the past six years. Not only was the physical silver accumulation a (criminal) masterstroke, destined to make a great fortune for the bank; it further points to the inevitable circumstance of an outside factor tripping off an investment buying surge in silver. I can assure you that while I never imagined JPMorgan (or anyone else) buying as much physical silver as it has, its purchase validates the entire silver price explosion premise like nothing else and makes any outside factor that may trigger it all the more potent.

On to developments since Saturday's review or, in other words, a return to the world of the paper market price discovery process. Gold and silver prices surged on Monday and into yesterday's cutoff day for Friday's COT report, before selling off into the close. At the highs yesterday, gold was up more than \$40 for the reporting week, while silver was up by as much as 60 cents at yesterday's highs. COMEX trading volumes were enormous in both, but silver's total trading volume was wildly inflated due to rollover switch and spread volume — meaning true net volumes were very high in gold, but decidedly not so in silver.

There was also a very large increase in total gold open interest over the reporting week (38,000 contracts) as gold made decisive new highs extending back nearly a year. Silver, by contrast, only achieved multi-month highs and its total open interest fell by more than 4000 contracts, no doubt due to spread contract liquidation into tomorrow's first notice day. Silver did decisively penetrate its 200 day moving average to the upside after nearly three weeks of failing to do so. If bulls respond to red flags, technical fund bulls respond to these strong price signals by buying more.

All this strongly suggests another marked deterioration in this Friday's COT report. A reasonable guess would be that there was additional managed money buying and commercial selling along the lines of the increase in total open interest in gold (35,000 contracts or so) and maybe another 5,000 to 10,000 contracts in silver.

On Saturday, I re-initiated my money game financial calculations, opining that on Friday's close, the 8 largest commercial shorts in COMEX gold and silver futures were out a combined \$ 1 billion, exclusively by virtue of the 25.5 million gold oz they were short. As way of reminder, the net concentrated short position of the 4 and 8 largest traders is a very clean number, derived by simple multiplication in every long form COT report to the nearest contract.

Since the smaller commercials (the raptors) were still net long as of last week's COT report, the net short position of the 8 largest traders in both COMEX gold and silver was larger than the total commercial net short position. According to COT data, just 8 traders in each market held an unusually large and concentrated short position (compared to other markets). In COMEX gold, the 8 largest traders (all commercials) were short 254,725 net contracts (25.5 million oz) and the 8 largest commercials shorts in silver (undoubtedly there is some overlap) were short 84,439 contracts (just over 420 million oz).

At yesterday's price highs (up \$35 from Friday in gold and 50 cents in silver), the 8 largest shorts in gold and silver were out an additional \$1 billion, pushing total open losses to as much as \$2 billion, before the late selloff brought total open losses closer to \$1.5 billion. The previous record for total combined open losses for the largest commercials was around \$4 billion last summer, so at yesterday's price highs, we were already half way there. Since these open losses were held by just 8 traders, on

average that comes to \$250 million per trader, hardly an insignificant amount. The large exposure both increases the urgency of the big shorts to get prices back down and the chance that they may fail to do so.

And considering that JPMorgan, most likely the biggest gold and silver short, is fully protected from higher prices by virtue of its massive physical silver position, subtracting JPM from the financial equation lowers the per trader average loss, but leaves the remaining 7 shorts all the more exposed.

I would also ask that you consider the apparent recklessness and regulatory negligence in allowing so few traders to constitute the entire net commercial short position in both COMEX gold and silver. These are important markets in many ways and the thought that the entire short position is held by just a handful of traders seems both foolhardy and manipulative. If being short silver and gold was such a good deal, why do only 8 traders hold the entire net short position?

I don't know of any way to accurately predict when the paper price discovery process will be overwhelmed by the physical price process, just that it happened before and seems destined to do so again. In the meantime, it does no good to ignore the paper price process or not be in position for whatever outside factor sets the price of silver on fire.

Ted Butler

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Silver – \$17.38 (200 day ma – \$17.04, 50 day ma – \$16.54)

Gold – \$1313 (200 day ma – \$1234, 50 day ma – \$1260)

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