

Dec.1, 2009 – More Extremes

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This past week has produced an unusual number of extremes in the silver and gold markets. Let me try to put some of them into perspective. The most obvious extreme is the level of price and the amount of volatility. New all-time highs have been witnessed in gold, with silver seemingly lagging and tagging along. On closer and more objective inspection, silver investors have been handsomely rewarded, as on many measures silver has done better than gold depending on the time frames chosen. But that is not meant as a detraction to gold's performance, which has been spectacular.

Since the weekly Commitment of Traders Report (COT) was released yesterday, due to the Thanksgiving holiday, I'd like to cover some of the particulars here. Lately, the COT seems kind of screwy, with the reported weekly changes in positions not seeming to fit with the price action for the reporting week. It's almost as if there is a continued delay in the report's data. I've noticed this on some occasions in the past, but lately it seems to be a regular occurrence. It doesn't alter the message from the report overall, but it does have you scratching your head a bit when the reports are released. Such was the case with the report issued yesterday.

For positions held as of the close Tuesday Nov. 24, we rocketed to a new record total commercial net short position in COMEX gold futures of more than 306,000 contracts (30.6 million oz), up almost 25,000 contracts for the week. In addition, the four short largest traders accounted for the bulk of the weekly increase, and their concentrated short position also reached the highest level in history at more than 215,000 contracts (21.5 million oz). It would appear that the largest short trader, JPMorgan also increased its short position, but we'll have to wait until the monthly Bank Participation Report is issued (scheduled for this Friday) to confirm that.

In silver, there was a notable increase in the total commercial short position by 6,000 contracts for the week, to over 64,000 contracts (320 million ounces), but, unlike in gold, the increase was due largely to smaller commercial (raptor) selling. Still, the largest 4 traders maintained a near-record concentrated short position virtually equal to the entire 320 million ounce total commercial short position. Talk about concentration. There's another new extreme in silver in this week's report, namely, the mismatch between the respective shares of the market held by the four largest longs compared to the four largest shorts. In the long form futures only report, the four largest longs held net only 11.1% of the market, while the four largest shorts held 46.6%. I don't recall such a lopsided extreme in either silver or in any other market for a commodity of finite supply. I don't know how this is not setting off alarms at the CFTC, as this is a basic, front-line manipulation warning. You can bet that if the big longs had a position more than four times the size of the big shorts' position in any major market, exchange and government officials would be all over the longs like white on rice. It is nothing short of shameful that the regulators ignore such market extremes. Someone should remind them that the rule of law applies to both longs and shorts.

What does this all mean? For starters, it means the big commercial shorts, led by JPMorgan, have not blinked. They have shown no sign of turning tail and rushing to buy back short positions on rising prices. Any suggestion that they have is simply not true. This, in spite of open market losses of well over a billion dollars on their gold positions alone, the most I can recall. The big commercial shorts have simply added to their positions as prices have risen and speculators have added to long positions. This has been the case for months now, namely, rising prices and rising commercial short and speculator long positions, with new extremes recorded regularly.

How will it end? I still don't know. But sooner or later, these open positions on the COMEX will be closed out, or significantly closed out, in some manner. Either the commercial shorts will finally (and for the first time) get overrun and caught with the \hat{A} ?full pants down, \hat{A} ? or we will get a significant enough correction to the downside to cause large numbers of speculative longs to sell out their long positions. At this point, such a sell-off, should it materialize, is likely to leave the longs with profits, due to the rising moving averages. In other words, the big shorts are likely to sustain losses even if they succeed in engineering a severe sell-off. This outcome has occurred in the past. The COT analysis has been warning of extreme high risk/high reward conditions for the past two months, as prices have remained relatively orderly. It is important to remember that there are no time constraints to COT analysis, and the analysis can appear to be not working precisely at the point it does start to reflect extreme conditions. Of course, changes in the physical market or regulatory developments can overwhelm the COT analysis someday.

What should subscribers do based upon COT considerations? The same thing they likely have been doing, namely, maintain a long exposure to silver, but with some dry powder, or at least be emotionally prepared for a sharp sell-off. With the COT this extreme, it pays to be prepared for an extreme resolution either way. It seems clear to me that either resolution in the COT will determine the big price moves ahead.

It's not just in the COTs that new extremes have been recorded. We have seen record investment flows into all the big silver investment vehicles, led by the big silver ETF, SLV. (There have been inflows into gold ETF-type vehicles as well, although not to the same extent as in silver). Yesterday, another nearly 5 million ounces was reported to have been deposited into the SLV, bringing the total holdings to more than 302 million ounces. This brings the running monthly total to more than 25 million ounces into the SLV (30 million ounces when all silver investment vehicles are considered), not far from the 30 to 40 million ounces I alleged were owed, a month or so ago, due to the naked short selling of SLV shares. Also this week, it was reported that the official short sale tally in SLV shares was increased to more than 13 million shares, up from under 8 million two weeks earlier.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

Please remember that these reported shares sold short are in addition to the unreported shares I calculate from time to time, based upon volume and price action. I think the unreported short selling in SLV that I alleged previously has been largely covered with the recent inflows of metal into the fund, but some do remain open, maybe in the 10 million share/ounce range. This is in addition to the reported shares sold short.

Whether you accept my calculations about unreported naked short selling in the shares of SLV or not, there can be little debate about the reported short sales of more than 13 million shares. This means, clear and simple, that there at least 13 million ounces of silver that should have been deposited into the SLV, that hasn't been deposited. It means that there are owners of more than 13 million shares of SLV that don't have real metal backing their shares as dictated by the prospectus. The short sellers of SLV shares don't deposit silver into the Trust. In my mind, this is fraud, period. It may be that only 4% of the shares of SLV are unbacked by real silver, but any amount is too much. When Barclays is confronted with this, they claim the short selling of shares of SLV is beyond their control. For someone collecting \$30 million a year in fees to make sure the prospectus is abided by, that is unacceptable. Shareholders of SLV should not tolerate Barclays' indifference.

Of course, the reason behind the short selling in the shares of SLV, either the reported and/or unreported versions, is simple and simply bullish. There is not enough actual silver to deposit into the Trust when new shares are purchased, so the shares must be shorted at those times. The unmistakable conclusion is that wholesale silver is tight. This is further confirmed by the usual delays in delivery experienced by the Central Fund of Canada.

I had prepared a different article for release today, but I felt the developments in the COT and the SLV were significant enough to warrant comment on today. I plan on releasing the original article tomorrow.

Ted Butler

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