

December 17, 2011 – Weekly Review

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It was a particularly bad week for gold and silver investors (except, of course, for those looking to add to positions), as prices fell sharply. Gold finished \$112 (6.6%) lower, while silver lost \$2.50 (7.8%) for the week. The gold/silver ratio did widen out a bit, to just under 54 to 1, reflecting silver's slight underperformance. Truth be told, it was somewhat surprising that silver didn't fare worse, as big sell-offs like we just witnessed usually feature much more pronounced weakness in silver relative to gold. I think the prime reason silver didn't decline more is due to its relatively much stronger COT structure than had existed in gold.

Regarding the gold/silver ratio, I'd like to share a new thought that has been bouncing around in my head trying to attract the right words for expression. It's an observation about the behavior of the gold/silver ratio over the past year and a half that highlights the overt manipulation in silver relative to gold. I've always been interested in the relative performance between commodities, going back to my days as a commodity broker when I was involved in spread trading to a large extent. One key aspect to spread trading is that it tends to filter out macro-economic events and distills down to pure relative performance, i.e., the changes between different months of the same commodity or the changes between two different commodities. The changes in these differences can tell a completely contrasting story than what has occurred to the flat or overall price.

My new thought involves the behavior of the gold/silver ratio or spread. In August 2010, the ratio was around 68 to 1, which was about the mid-range of where the gold/silver ratio had traded for the year before that. Starting in August 2010, the ratio gradually tightened over the next 8 or 9 months to 32 to 1, at the peak of the silver price in late April 2011. In other words, over roughly 35 weeks, the ratio tightened in silver's favor at the rate of one point per week. Not in every one of those 35 weeks did the gold/silver ratio move in silver's favor, but most weeks featured a move favoring silver. Thirty five weeks, one point per week. Then in one week, the first week of May 2011, the ratio suddenly widened by twelve points to 44 to 1, as silver prices were manipulated lower by more than 30%. After that the gold/silver ratio remained in a trading range around 44 to 1 for the next 21 weeks to the end of September. Then silver was deliberately manipulated lower in price by 30% (again) and the gold/silver ratio suddenly widened by 11 points in one week to 55 to 1. The ratio has remained in this new range for the next 12 weeks, up thru today.

Here's my point Â? this is not legitimate free market behavior. Or, at least, it would not be legitimate free market behavior absent of some very visible macro-economic news to justify such a discontinuous spread price event. World commodities don't exhibit this type of relative price performance for no good reason. It is not normal and demands a clear explanation to describe how a relative price comparison can experience such shocking price disruptions out of the blue. Don't misunderstand me Â? I can easily give you the correct explanation for the two sudden discontinuous price events in the gold/silver spread; it's just that I can't give you a legitimate explanation. The real reason, of course, was that the COMEX commercials rigged the silver market lower to reduce their total net short position by 25,000 contracts or more (125 million oz) on both occasions. Not only was the silver manipulation confirmed twice this year in the 30% takedowns of the flat price, but the manipulation is even more visible in the behavior of the gold/silver spread. Any spread trader should tell you these ratio price movements were even more abnormal than silver's highly unusual multiple 30% flat price declines.

Conditions in the wholesale physical silver market continue to look tight to me. COMEX silver warehouse turnover continues active, which is my key indicator. Total warehouse levels have moved up to almost 112 million ounces, a new one year high and up by more than 3 million ounces in a month. I know that many will look at this increase as negative to the price of silver, but I would disagree. The total level of silver inventories at the COMEX must be put in perspective. Even a further 10 to 20 million ounce increase would not be of particular concern to me. These are small amounts relative to the one billion ounces of silver bullion in the world and the hundreds of millions of paper ounces traded on the COMEX. Additionally, there are any number of reasons for silver to come into the COMEX warehouses that are not reflective of the knee-jerk conclusion that this is silver that is not needed or in excess. I have studied the movements and total levels of COMEX warehouse silver inventories each day for almost 30 years. In all that time, I have not been able to uncover a relationship between the movements and totals compared to price action. I have a standing joke with my good friend and silver mentor, Izzy Friedman, which holds that on a daily basis, increases in inventories are more likely to result in higher prices the next day, than in price declines. In actuality, it's more random than that, sort of like the odds on tossing coins. The total levels don't mean much to me, but the turnover does as that suggests tightness. The turnover continues to suggest tightness.

The biggest surprise to me this week was the relatively small withdrawals of metal from the two big metal ETFs, SLV in silver and GLD in gold. Sometimes there can be delays in reporting, especially in the SLV, but considering the price pounding just witnessed, a very small amount of metal was redeemed in each. SLV lost a bit over 800,000 oz while GLD was down around 500,000 oz. While I think it possible that SLV could lose more metal in the days ahead, the amounts so far are a drop in the bucket. I think, without a doubt, that this confirms my usual take that big sudden price moves in gold and silver are almost always attributed to paper activity on the COMEX and not to developments in the real world of supply and demand. This, of course, is contrary to US commodity law, which holds that futures trading should discover prices following developments in real supply and demand and not set or dictate prices to the real market. The law is clear and it is equally clear that it is not being enforced.

I'm also impressed with the very small withdrawals from SLV on a longer term perspective. In the 30% intentional price smash of May, there was an eventual liquidation and withdrawal of 50 to 60 million ounces into June. (Yes, I still believe that metal found its way into strong hands). But on the late-September 30% deliberate price smash, no metal has been effectively withdrawn. Yes, it's quite true that investors haven't been rushing into silver since the spring and this has allowed the commercial crooks greater ease in manipulating prices. But neither have investors been dumping silver, away from paper contracts on the COMEX. Let's face it — investors generally buy as prices are rising and silver prices haven't been rising. Someday, hopefully soon, silver prices will surely rise again and investors are then very likely to plow into a market that I believe is tighter than many realize.

Sales of Silver Eagles from the US Mint still seem subdued. The Mint has sold more so far in December than was sold in the full month of November, but the sales still look slack to me. If the weak sales persist that will have to be taken into account. For now and the immediate future, however, I doubt it is having an impact in the real world of supply and demand. That's because the Mint has struggled to keep up with Silver Eagle demand for the past few years, coming under pressure from Congress and others for not fulfilling the Mint's mandate of supplying bullion coins to match whatever demand exists for them. I would imagine that the Mint is sensitive to future congressional complaints and is still producing at capacity in order to build up some inventory to stay ahead of future spikes in demand. At some point, if demand stays low, the Mint will adjust their production levels lower, but that is not likely in the very near term.

There were no big surprises in this week's Commitment of Traders Report (COT) in gold or silver. Both markets recorded reductions in their total commercial net short positions in accordance with the decline in prices during the reporting week. Of course, Wednesday's dramatic high volume sell-off in each came after the Tuesday cut-off, so we must wait until next Friday to measure what should be further declines in the total commercial net short position.

In silver, during a reporting week that featured price declines of more than \$2, the total commercial short position decreased by 2200 contracts to 20,300 contracts. The raptors (the smaller commercials apart from the big 8) accounted for the entire decline in the total commercial short position and then some, as they bought 3000 contracts, increasing their net long position to 17,000 contracts. You may recall that the raptors had been the exclusive commercial seller in the previous reporting week. This underscores the collusive nature of these smaller commercials; underscores, obviously, to almost everyone away from the CFTC. The big 4 added 300 contracts to their short position, with the 5 thru 8 big traders adding the balance of 500.

In gold, during a reporting week that recorded price declines of as much as \$100, the total commercial short position declined by 15,300 contracts to 186,200 contracts, a six week low. Undoubtedly, the number is lower since the cut-off. After a few weeks of little change in their position, the gold raptors were the big traders this week, accounting for almost all the total commercial short position reduction. The gold raptors bought back a bit over 15,000 of their net short position, reducing it to 6,600 contracts held short. After the cut-off, I'd bet dollars to donuts (perhaps not saying much given the current price of donuts) that the gold raptors are net long, perhaps significantly so.

In general, the silver COT structure has been spectacularly bullish for almost three months now, ever since the deliberate takedown of September. Trying to put this into proper perspective, that September takedown created an almost 30,000 contract reduction in the total commercial net short position in a few weeks. That's the equivalent of 150 million ounces of silver and is similar in size to the reduction in the commercial short position in May. Since then, the silver COT structure has remained fairly static compared to what transpired from late August to late September, as silver has chopped around with a downward bias. Try to keep these quantities of silver in mind when we talk about the very few millions of ounces changing hands normally in SLV, COMEX warehouse inventories and Silver Eagle sales. My point is that the changes in the total commercial short position on the COMEX dwarf what occurred in other silver venues during the big takedowns. I realize I may be somewhat preaching to the choir, but it should be clear that what occurs on the COMEX during the big price smashes is responsible for the price action. That's why I make a big deal of it.

Another big deal I try to make is that of the role of JPMorgan in the ongoing manipulation with their big concentrated silver short position. One of my strongest held premises is that JPMorgan is attempting to close out its manipulative silver short position and rid itself of what could be a major legal headache. While I do hope that they still face serious legal repercussions for their role in the silver manipulation, the data seem to confirm JPMorgan is trying to beat it out of Dodge City by reducing their short position. I still think that position is down to the vicinity of 13,000 contracts. Importantly, given the big net long position of the raptors, JPM is in position to buy back a significant chunk of their remaining short position on a rally in silver prices. We'll see if that occurs.

The unvarnished determinant to the future price of silver and the continued existence or not of the silver manipulation itself is whether JPMorgan increases its short position on the next silver rally. That and whether the short position in SLV increases on the next silver rally. Rarely does it come down to such a fine line of demarcation, but it's hard for me to see it otherwise. Don't misunderstand me — I don't know what these silver crooks are going to do, but if JPMorgan does not add to their short position and the short position of SLV does not increase on the next rally, the manipulation should be over.

No one can say for sure what the bottom be or whether we've already seen it (which I lean towards), but the prospects for significant further long silver liquidation on the COMEX seem limited given the extremely low level of current speculative long positions. For instance, the net long position in the non-reporting category of traders (the little guys) is now the lowest I have witnessed in 30 years of studying the COTs. Likewise, other categories and sub-categories of the COT indicate similar low levels of speculative long participation, particularly in the managed money category (the tech funds). We are well into the taking of blood from a stone level of long liquidation. While it may be possible for the commercials to lure more unsuspecting speculators onto the short side, which would result in more commercial buying, such activity would ultimately prove very bullish as speculative silver shorts would likely be quickly blown away on a silver rally.

I think the gold COT structure is back to a bullish set up, especially if the improvements after the cut-off are what I think them to be. As such, gold may also be at a price bottom, especially considering the bullish signals (or lack of bearish signals) coming from the gold physical market (ETF holdings, etc.). But to be fair, while gold is near bullish COT readings over the past year or so, on a much longer historical basis there may still be room for further liquidation. My personal sense is that we probably shouldn't see big further speculative long liquidation in gold and may, in fact, be good to go to the upside. But if the COT structure in gold is bullish (as I think), then silver's structure is screamingly, super-duper bullish.

That doesn't mean, of course, that we can't go lower in price on a very short term basis. After all, silver is the most manipulated market in the world. And the crooks at the CME Group have armed the commercial manipulators with powerful anti-free market tools, such as High Frequency Trading. But the greater weight of the evidence suggests that we are at an important silver price bottom regardless of continued dirty market tricks from the commercials. In fact, we appear to be at an almost mirror-image opposite of where we were at the top in April, including price action, sentiment, technical readings, etc. I firmly believe that we had reached the breaking point back in April in terms of physical shortage and the commercials getting overrun on the short side. The crooks managed to save themselves at the very last minute with the blatant and desperate Sunday evening massacre of May 1 that led to these 8 months of downward price manipulation. Unfortunately, there are times when the criminals get what they want, especially when the regulators are negligent and timid. Hopefully, we are at the end of the criminals' holiday since there appears to be little left for them to steal.

Ted Butler

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Silver – \$29.75

Gold – \$1600

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