December 6, 2014 – Weekly Review

Weekly Review

In a week I'm still trying to wrap my head around and despite price weakness for the second Friday in a row, gold finished $27 (2.3%) higher, while silver ended 85 cents (5.5%) higher. This week's gains came close to reversing the prior week's sharp losses, but only after steep further losses to start the week in which silver traded as low as $14.10 before closing that day in the mid-$16's. As a result of silver's relative outperformance this week, the silver/gold price ratio tightened in by two full points to finish at just under 73.5 to 1. By any recent historical measure, silver is still deeply undervalued relative to gold and which still runs counter to the continuing flow of data related to the world's two main precious metals.

What I am still struggling with is trying to sort out what and who were behind the extreme price weakness of the prior Friday which accelerated into the start of COMEX (Globex) trading Sunday evening, only to see the cumulative price decline completely erased by Monday's close. I know it was, most assuredly, a COMEX orchestrated price affair, particularly in silver, and after reviewing the new Commitments of Traders Report (COT) some, but not all of my questions were answered. Let me run through the usual weekly format first.

Following a recent pattern of uneven, but still heavy overall movement of metal coming into and moving out from the COMEX-approved silver warehouses, this week's physical turnover of silver surged to 7.3 million oz, the highest weekly turnover since September. Total COMEX silver inventories rose by 700,000 oz to 177.7 million oz. Stated differently, this week's physical silver turnover in the COMEX warehouses was ten times greater than the net increase in total inventories.

Remarkably, this has been the pattern for the full year (and longer) in that there has been a frantic and consistent turnover or churn in COMEX silver inventories while the total level of inventories remains mostly flat. It's a pattern that has never occurred previously in other COMEX metals and is strongly suggestive of overall supply/demand tightness; but the most peculiar aspect of the turnover is that it is hardly mentioned, even though the data are published daily and easily retrieved. Very recently, there has been a pickup in COMEX gold warehouse movements but more in the way of steady withdrawals than in the frantic turnover seen in the COMEX silver warehouses.

I know it is the total level of inventories that most focus on, but total visible inventories can be misleading at times. For instance, we know from accepted data sources that there is more gold and silver (since 2006) in the world each year whether visible inventories increase or decrease and it would be a mistake to assume otherwise just because visible inventories decline. Such declines in visible gold or silver inventories may very well indicate a movement in ownership from weak to strong hands, but not that there is less overall metal in the world.

There was an additional withdrawal of 2.2 million ounces from the big silver ETF, SLV, after the 2.7 million oz reduction I reported on Wednesday, bringing to 5 million oz the total reduction in SLV holdings this week. Silver prices were higher this week and SLV wasn't even open for trading on Monday until after the sharp Sunday evening losses on the COMEX were reversed, so the reduction in metal holdings in SLV were counterintuitive. This reinforces my conviction that the reduction in SLV metal holdings came as result of a large buyer converting shares into metal to avoid SEC reporting requirements. As with the COMEX silver warehouse turnover, I seek alternative explanations for the counterintuitive SLV holdings.

Sales of Silver Eagles actually cooled off a bit by my under the microscope review, as total sales for the year inched closer to last year's all-time record. For the seven production days for December (including the last two days of November last weekend), the US Mint sold 821,500 Silver Eagles or a daily run rate of 117,000 coins. This is lower than the daily production and sales rate up until this week and could mean that the Mint is winding down sales for this year or had a production glitch. It could also mean that the big buyer might have stepped away, as continued reports from the retail dealer front indicate no retail buying surge. I'm still convinced that a big buyer has purchased massive amounts of Silver Eagles over the past few years, to the tune of 60 million coins or more.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

I didn't know what to expect in this week's COT report, but knew it covered some of the most volatile and high volume days in memory, including Monday in which gold traded in an $80 trading range and silver travelled more than $2.50 from low to high. Adding to my uncertainty was that there were distinct high volume periods in the reporting week ended Tuesday; the high volume selloffs on Friday and into Monday morning and the high volume rally during the day on Monday. I knew the price volatility and heavy trading were strictly due to positioning on the COMEX (as opposed to the news from OPEC and the Swiss gold vote), but didn't know how to predict in advance the likely changes.

In COMEX gold futures, the headline total commercial net short position expanded by a hefty 20,900 contracts to 89,400 contracts. Over the last three reporting weeks, the total commercial net short position has grown by nearly 40,000 contracts. The last time the total commercial short position increased by this much (into late October) the price of gold promptly fell by nearly $100. At the very least, the large increase in the total commercial short position detracts from the formerly strongly bullish gold setup I've been writing about. Yet there are aspects to this report that don't appear extremely bearish.

For one thing, and as has occurred in silver recently, even though the total commercial short position increased significantly in gold, there was no real increase in commercial shorting; just a big liquidation in the net long positions held by the smaller commercial traders I call the raptors. In fact, the 8 largest commercial shorts not only bought back nearly 12,000 short contracts during the reporting week, the concentrated net short position of the eight largest shorts is now lower than any time in at least 4 years (as far back as my available personal notes go back). When the biggest commercial gold shorts end up with the smallest short position in years as a result of unprecedented price volatility, that can't possibly be considered bearish.

Mathematically, the only way the 8 largest commercials could buy back nearly 12,000 short contracts with the total commercial net short position having increased by 21,000 contracts would be if the raptors who were long sold out 33,000 long positions, which is exactly what was indicated in the report. Most of the time, the commercials buy and sell in unison, aligned against the technical funds and other speculators. That is the usual pattern and when that pattern is broken as decisively as indicated this week, my sensors go up.

On the buy side in gold (away from the big 8 commercial shorts), it was largely the technical funds (in the managed money category) which bought more than 14,000 net contracts, including more than 10,000 contracts of short contracts bought back this week. Over the past few weeks, the technical funds have bought back around 30,000 short contracts and while gold did rally over that time, that's less rocket buying fuel in existence. Let me discuss the silver COT before commenting further on gold.

In COMEX silver futures, the total commercial net short position increased by a notable 4,500 contracts, to 26,600 contracts, the highest level since September. As has been the case for the past few weeks, the smaller commercial raptors sold out another 3100 long contracts, reducing yet again their net long position to 23,700 contracts. Unlike in gold this week, there was some increased short selling by the big 4 and 8 commercial shorts, but at 600 and 900 short contracts added respectively, warning alarms are not yet blaring. Based upon both the COT report and the companion Bank Participation Report, JPMorgan appears to be short around 7500 silver contracts and long no more than 12,000 gold contracts, still very low numbers for the bank.

The big Â?disappointmentÂ? was that the technical funds bought back 7200 additional short contracts, leaving the silver rocket buying fuel tanks severely depleted. Since the record level of technical fund short positions of October 28, these funds have bought back 22,000 short contracts of the 36,000 contracts they shorted into the peak level, leaving less than 15,000 short contracts yet to be covered. Moreover, the technical funds have booked, by my estimate, some $400 in realized profits, not counting open profits on remaining short positions of around $200 million at current prices.

Let me stop here for a moment to remind you that recently I stated that I would dress up as the Easter Bunny and fly the Space Shuttle if the technical funds did manage to close out their big silver short positions at a profit. Please picture me as the Easter Bunny, although no one was ever going to let me near the shuttle in the first place. I hope you know I based my conviction on the historical precedent of the technical funds never having even come close to holding and booking such large profits on the short (or long) side of silver. It would be an understatement to call what just occurred as merely unprecedented Â? it seems way beyond that.

The main reason I was convinced the technical funds would never book the large open profits on the short side of silver that they did, in fact, book was because the commercial counterparties on the other side of the transaction, mostly the smaller commercials I call the raptors, were always in control and able to engineer the market to force the technical funds to buy and sell at the wrong times. It wasn't just that the raptors always prevailed; because the technical funds relied on price change to buy and sell and the raptors (along with the big 8) controlled prices (thru HFT), it appeared the commercials would always win (until a physical shortage arrived). A long track record and a seemingly unbeatable (but illegal) methodology told me the tech funds had to lose.

At least I have no regrets in the way I have portrayed the technical fund/raptor matchup all along. Of all the traders most responsible for the COMEX positioning that sets the price of silver (and gold), I know I have been accurate in describing these two groups of traders as being the two that matter most. In nearly every COT report it's always the same thing Â? the raptors and the technical funds are the two largest competing categories. What I got wrong is which one would prevail on this go-around. This was strictly an intellectual prediction based upon history and in which it made no financial difference to me which one prevailed. But the manner in which the technical funds beat the raptors was so extreme as to potentially be a game changer.

Being that futures trading is a zero sum game, the $400 million that the technical funds booked in profits on COMEX silver shorts (so far) was largely lost by the raptors. Technical funds closed out 22,000 short contracts at a profit and some, but not all, raptors sold nearly 19,000 long contracts at a loss of close to $400 million. While the large gain will undoubtedly increase the technical funds' financial war chest, the loss to the 10 or so raptors which sold contracts is devastating. Because the loss was not only large but concentrated among so few raptors, it is reasonable to assume the losses have knocked those traders out of the silver game for good. No speculator can lose an amount equal to years' worth of cumulative gains in any one trade and remain solvent or continue as if nothing extreme has occurred.

Therefore, the relatively few raptors who got caught and sold the 19,000 long contracts in the downdraft from over $17 as recently as Oct 28 to $14 and $15 can no longer be, effectively, in business. It is highly unlikely that these traders will trade silver futures anytime soon. And it's possible that the large selling by the raptors in gold this week may be related to the massive losses of the silver raptors. After all, how hard is it to imagine that the raptors who got caught flat footed in silver were also long gold futures? While the losses to the raptors in silver overshadowed what might have been lost on gold longs, what real difference does it make? A trader put out of business by silver losses isn't going to trade gold as if nothing mattered.

Maybe two wrongs do make a right. I was wrong twice in assuming that the technical funds would lose and the raptors would win on this silver go-around, but I'm not sure that matters much. What matters more is that a certain significant, but unquantifiable, level of liquidity and market making may have just been removed from silver (and gold) with the financial demise of what were formerly important players. Not only does this suggest increased price volatility going forward, it also sharpens what was already the prime price determinant ahead Â? whether JPMorgan and the other big silver (and gold) shorts will add aggressively to short positions on the next rally to cap and control the price. The forced liquidation of 19,000 raptor long contracts increases, by at least that amount, to what the big silver shorts must sell short on the next rally.

Since silver is so far below the cost of primary mine production, any aggressive increase in concentrated short selling will, by definition, be manipulative because it couldn't possibly be related to legitimate hedging. Last I looked, manipulative commodity positions by the big banks are already in the forefront and a massive increase in concentrated short selling in silver and gold will stand out like a sore thumb.

In the meantime, price volatility looks set to increase and that's not necessarily a bad thing. We're still at stupid cheap price levels in silver and it's hard for me to see how eventual higher prices can be attained without volatility, particularly considering the apparent loss of raptor liquidity. And while I won't dwell on it today, in addition to the game changing potential of the loss of a number of raptors, the biggest transformation must be the large physical silver position that I believe has been amassed by JPMorgan. The silver market looks to have been transformed radically and at current prices, change isn't such a bad thing Â? especially for the long term.

For those who may have an interest, the CFTC will be conducting an open meeting on position limits on Tuesday, December 9, staring at 10 am EST. You can access the meeting live or later by recording. http://www.cftc.gov/PressRoom/Events/opaevent_aac120914

Please remember that it is unlikely that the word silver will be mentioned in terms of position limits as the agenda is based upon agricultural commodities. This is a little strange as we've had speculative position limits in place for as long as 80 years on most agricultural commodities and Dodd-Frank mandated that the 28 physical commodities without position limits be brought into the fold. I never represented that position limits in silver were the prime concern of the regulators, even though limits were needed in silver more than in any other market. My operating premise was always that if the Commission ever got around to following the law, position limits on silver would have to be included. Let's see what the meeting holds and we'll take it from there.

Ted Butler

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Silver – $16.30

Gold – $1193

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