

February 10, 2016 – Always the Same Problem

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It's hard to imagine a better macroeconomic background for an explosive move up in precious metals. World stock markets have stumbled badly out of the gate in the New Year, turning investors risk averse for the first time in years. In particular, concern over bank and financial companies have heightened, with some making comparisons with the financial crisis in 2008. A flight to safety by the largest investors has lowered the yields on sovereign debt to levels once unimaginable and crossing the zero interest rate floor to negative returns in Japan and Switzerland. Fairly suddenly, the return of capital seems to have risen in concern above the return on capital. To top it off, the most unsettled presidential election cycle in the US in decades has added to overall uncertainty. Could there be a better economic backdrop for gold and silver than this?

Further, considering the more specific actual circumstances in gold and silver, it's also hard not to imagine much higher prices. Here I would include the matchup between actual supply and demand which has continued to indicate a tightening physical market. Throw in prices close to the cost of production and even below that for many primary silver miners and that would be enough to be bullish on price. Finally, the shockingly small amount of physical silver in its most important form (1000 oz bars) suggests a near certain price accident to the upside at some point if only the tiniest slice of the billions of dollars seeking safety discovers the metal.

One of the most basic consequences of world wealth inequality is that of the concentrated nature of investment assets – more buying power in the hands of relatively fewer entities. One of the causes of negative interest rates on sovereign debt is that there are much fewer choices for placing hundreds of millions or billions of dollars quickly and safely than for a hundred thousand or a million dollars. The mega investors buying government paper at negative interest rates aren't dumb – they just have fewer alternatives than a saver seeking FDIC insurance.

If you attempt to contemplate the price reaction in silver, for instance, should the smallest fraction of the hundreds of billions (and trillions) of dollars of world investment buying power seek safety in the form of the 1000 oz bars known to exist (less than \$15 billion worth) and don't get chills, then one of us is missing something. I can't do that exercise and come up with a price that would sound reasonable to someone not familiar with the particulars.

So here we have a near perfect broad economic backdrop for higher gold and silver prices accompanied with the best specific fundamental supply/demand circumstances in years. To top it off, price action, particularly in gold, since the first of the year has been better than just about any asset class and has attracted the requisite attention. In many ways, the precious metals never looked better. I could easily imagine prices tearing upward from here. Then again, they might not. What's the problem?

The problem is the same rotten problem precious metals investors have faced repeatedly over the years — the damn crooked COMEX, the world's main precious metals exchange. This is the one and only potential problem that confronts the market. If gold and silver prices move lower, instead of higher, you won't have to look far to understand why. Upfront, I must admit that I don't know how it will turn out in the short term, but regardless of how prices move, I believe the explanation will come from changes in COMEX positioning.

It is entirely possible that the one potential negative factor that has inflicted gold and silver prices might get overrun by the many more positive factors and nothing would please me more. Further, even if we get a COMEX-induced price swoon, given the level of current prices, especially in silver, any price declines can't be that extreme for a commodity already down close to 70% from its highs. Finally, as I'll describe, my concern about the one recurring problem is based largely on what I perceive will be indicated in Friday's Commitments of Traders (COT) Report. There could easily be surprises in that report which would cause me to temper my short term concern.

But if you live by the COT sword as being the prime price driver in gold and silver, you can't turn your back on it when you might not like what it says or may say. So let me present this as objectively as possible. The five trading days to be covered in the new COT report which ended yesterday, happened to be one of the largest volume price advances in gold ever. Not only did gold rise as much as \$70 over the course of the reporting week, it penetrated its 200 day moving average on the first day of the reporting week for the first time in months and ran up from there in classic salami slicing manner. While silver has quite notably lagged gold in vim and vigor, it too penetrated its 200 day moving average in a reporting week that featured a full dollar rise.

This is the kind of price action that mandates technical fund buying and such buying can only be satisfied by commercial selling. In fact, one would be hard-pressed to avoid the conclusion that technical fund buying largely caused gold and silver prices to rise. The only question is how much technical fund buying and commercial selling occurred. On Saturday, I ventured as many as 40,000 net gold and 10,000 net silver COMEX contracts were bought by the technical funds and sold by the commercials as of last Friday. I have to up my estimates as a result of the trading through yesterday

I'm hesitant to predict much more than 50,000 gold contracts and as many as 15,000 silver contracts were bought by the managed money technical funds and sold by the commercials, simply because these are among the largest one-week changes of all and the bigger the numbers, the bigger the chance of a prediction miss. But I won't be surprised if the gold numbers are larger. Regardless of the actual amounts, if we come in close to my expectations, the market structure will be no less than neutral to bearish in gold and bearish in silver. You'll remember that up until very recently, strongly bullish market structures were in place.

That doesn't mean we can't go higher in price in the short term or that we won't go much higher in the long term, particularly in silver; just that this is a markedly different market structure than existed as recently as six weeks ago. If my extrapolations are accurate, this means that on the \$140 gold rally from the end of December through yesterday, close to 120,000 COMEX contracts (12 million oz) were sold by the commercials. In silver, on the \$1.50 rally over that time, around 30,000 net contracts (150 million oz) were sold by the commercials.

While there is always room for more commercial contracts to be sold on higher prices that doesn't diminish the number of contracts already sold, particularly recently. I can't know for sure how this is going to play out (I wish I could), but this is strikingly similar to what occurred on the gold and silver rally of early October that quickly petered out.

There are, of course, differences this time around, not the least of which is the darkening macroeconomic backdrop. Also different is the pronounced buying of physical metal in the big gold ETF, GLD, and continued signs of physical tightness in both silver and gold. Coinciding with the expected technical fund buying and commercial selling on the COMEX over the reporting week, the last five trading days have seen the highest trading volume in GLD in years. In stark contrast, the trading volume in SLV, as well as price performance, has been much more subdued and I am not overly surprised that metal has not been deposited into the silver trust. (I'm still surprised so much metal has departed the trust and chalk that up to JPM converting shares to metal).

A big specific factor I will be looking for in Friday's report is what JPMorgan is up to. I've long contended that silver's price fortunes ride on whether JPM adds to short positions on the next rally. Well, the next rally is here and this week's COT report should help reveal how JPMorgan has behaved. Certainly, I haven't seen anything to dissuade me from my belief that JPMorgan is micro-managing the gold and silver markets.

On Monday, JPM switched around 64,000 ounces of COMEX eligible gold to the registered category and delivered 650 gold contracts against the open February short contracts it held today, all in its house or proprietary trading account. You'll remember how JPMorgan was nearly the sole stopper of gold in the big December COMEX delivery period (taking 200,000 oz) in its house account. Despite JPM's apparent emergence as a gold delivery issuer, gold still feels "tight." I have the distinct impression that only JPMorgan could have prevented gold's physical tightness from getting out of control and that it may have been drawn into delivering gold to "save" the day.

A broader issue is what the heck the US's most important bank is doing in being the dominant speculative force in gold and silver? I don't wish to engage in politics, but in the unlikely event that Democratic presidential candidate Bernie Sanders prevails, the issue that a crooked bank like JPMorgan literally controls the gold and silver market being raised does not cause unease to me. Other things perhaps, but not that specific issue.

Yesterday's release of the new short report on securities was pretty much a non-event, as the short position in SLV, the big silver ETF, fell by 1.2 million shares to 10.2 million shares (ounces). The short position in GLD, the big gold ETF, was largely unchanged at just under 9.2 million shares (0.9 million oz). Of course, this report covered short positions as of Jan 30, just before prices rallied sharply. I'd love to know what transpired since then. Also, in the honesty is the best policy department, an early morning note from a subscriber reminded me the short report was just issued; otherwise I would have missed it.

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

So where do we go from here in the short term? I'd be lying if I told you I knew for sure. Imaging gold and silver prices moving higher and sharply so, is not difficult. But neither is a gut-retching selloff ala the typical COMEX positioning scam. If we were to get that slam, let me announce in advance (as I do continuously) that will be the last selloff. We did rally pretty hard, at least in gold, as a result of the bullish market structure in place at year end; but we came nowhere close to the potential epic liftoff that would have occurred had the COMEX commercials stood aside when the technical funds came into the market on the buy side.

So I guess it comes down to whether COMEX futures market positioning is cast aside as the main price driver and we move up for non-COMEX related matters. If ever there was a time for the COT market structure to be proven wrong, the present time would seem to be it. But it is also worth considering that the rally so far has found the technical funds on the wrong side and the commercials on the right side.

That's because the technical funds were very short going into the rally and the commercials not as heavily short as customarily. The raptors (the smaller commercials aside from the big 8) were heavily long going into the rally and now have sold off long positions at very decent profits. At this point, the commercials have fared the best, but there's no guarantee that won't change. That said, the prospects for higher prices have been best before the technical funds have bought aggressively, not after.

Ted Butler

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Silver – \$15.25 (50 day moving average – \$14.18)

Gold – \$1192 (50 day moving average – \$1092)

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