February 23, 2013 – Weekly Review/Captain Obvious

Weekly Review

The rotten price performance in precious metals continued this week, as gold and silver hit lows not seen since last summer. Gold lost $30 (1.9%), while silver finished $1.10 (3.7%) lower for the week. As a result of silver's deeper relative fall, the silver/gold ratio widened out a full point to 55 to 1. This is in the upper range of the year and a half trading range for the ratio and makes any switch from gold into silver more attractive. In addition to a more attractive price point for the switch, recent developments in actual metal ETF flows would seem to indicate that a budding movement into silver from gold may be underway.

The metal flows over the past week out from the big gold ETF, GLD and into the big silver ETF, SLV, were particularly instructive. Considering the extent of the price declines in gold and silver over the past two weeks, it would be normal to expect investor liquidation and a decline in metal holdings in both these ETFs. There were sizable liquidations in GLD, especially over the past three days, as more than 1.2 million oz of gold were withdrawn. I suspect this may have represented selling from funds associated with John Paulson, the biggest holder of GLD. It's not so much the amount of the metal that was liquidated, as 1.2 million oz represents a relatively small amount of gold in the GLD and is absolutely tiny relative to the 5+ billion oz of gold that exists; but in dollar terms, that's almost $2 billion liquidated from GLD.

In contrast to the metal and dollar outflows from GLD, the big silver ETF, SLV, experienced an inflow of nearly 3 million oz for the week. Of course, it would have been big news if holdings in the SLV had remained merely unchanged in light of the vicious beat down in the silver price; but to see silver metal holdings in the trust actually increase sharply is nothing short of stunning. At least it was stunning to me even though I fully expect silver to vastly outperform gold in the long term. The unusual contrast between gold and silver metal flows in the big ETFs this week suggest to me a move from gold to silver could be developing. As a reminder, silver is so much smaller a market than gold, particularly in dollar terms, that if even the smallest percentage of gold tries to convert into silver, the impact on the price of silver would be profound. For instance, if the $2 billion that flowed out of the GLD over the past three days were attempted to be put into physical silver, close to 70 million oz of silver would be taken off the market immediately. I would submit that the silver market could not accommodate such an immediate purchase. Therefore, it's probably only a matter of time before someone in the world attempts to do so.

The most important point I would make about the unusual metal inflows into SLV this week is that it reconfirms my claim that the price declines in silver these past two weeks were strictly a result of paper trading games and manipulation on the COMEX. I said that there was no evidence of physical metal selling in silver and that was before the big 2 million oz deposit in SLV on Thursday. It's hard to imagine how anyone paying the slightest attention to what is transpiring in the precious metals not to see the obvious signs of price manipulation.

I'm going to have to borrow a phrase from the younger generation and dedicate this article to Â?Captain ObviousÂ?. That's what my son calls me when I say something that is overly clear and obvious. Yeah, it's a bit disrespectful, but always fitting and quite funny. Looking over the developments of the past week, it would seem that Captain O should have a field day, starting with the observation that paper trading on the COMEX is why prices declined.

Metal flows into and out from the silver warehouses approved by the COMEX continued strong, in the 2 to 3 million oz range, as total silver inventories climbed by 600,000 oz to 160.8 million oz. This consistent and frantic metal movement is only present in silver and is a clear indicator of physical tightness and a developing shortage, in my opinion. Certainly, it should be obvious that the physical silver flows in the various COMEX warehouses has little to do with the paper trading on the exchange and provides additional proof that paper (electronic) trading is mostly separate and distinct from the real world of physical silver.

I keep waiting for the US Mint to catch up with and get ahead of demand for Silver Eagles, but I must wait a little longer as sales have remained strong through this week. As far as I can tell, the Mint has a production and/or blank supply capacity of around 120,000 to 125,000 Silver Eagles per day (7 day week) and is still selling and producing at maximum capacity. All told, silver retail and wholesale demand appears to be white hot, based upon all the available data and any suggestion that silver prices have declined due to cues from the physical world of silver are flat-out silly.

The changes in this week's Commitment of Traders Report (COT) were foretold by Captain Obvious himself. I've heard some proclaim the changes in this week's COT as epic. That's certainly true enough, but in addition to being epic, the changes were completely expected, right down to the nuances in the various sub-categories of the disaggregated COT. That's some combination, being both epic and expected.

In gold, the commercials reduced their total net short position by a whopping 28,600 contracts, to 132,100 contracts. This is the lowest commercial net short position since last May and the weekly decline was almost exactly the double predicted from the previous week's reduction. Almost undoubtedly, with the expected improvement since the Tuesday cut-off, we are now sitting with the lowest total net commercial short position in gold in years.

By commercial category, it was mostly a big 4 and raptor affair, although the 5 thru 8 did buy back about a thousand short contracts. The big 4 bought back almost 10,000 short contracts and the raptors (the smaller commercials apart from the big 8) bought almost 17,500 gold contracts, creating a raptor net long position of 12,400 contracts. You also have to go back to last May to find a larger raptor net long position and I would guess that since the cut-off, the raptors' net long position is now larger than any time since late 2011. Importantly, the largest selling categories in gold were new short selling by the technical funds and by the non-reporting traders. The short position held by the technical funds may now be so extreme as to serve as a powerful thrust to the upside when the turn up in gold occurs. You might remember that big increases in short selling by the technical funds at the price bottoms in December 2011 and the summer of last year (especially in silver) did serve as a price catapult in the ensuing rallies. There's no reason not to expect that again. Seeing tech funds plow onto the short side of gold (and silver) is about the best set up for higher prices possible. Just ask the Captain.

In silver, the commercial total net short position declined by an epic 8,800 contracts, the largest one-week reduction since the first week of March 2012. This was a bit less than the 10,000 contract reduction that I hinted at, but is still a massive amount, the equivalent of almost 45 million oz of silver. I had expected the report to indicate that the technical funds plowed onto the short side and I was not disappointed, although I was a bit taken back (pleasantly so) by the large increase in the gross short position of the non-reporting traders. I can honestly say that every one of the sub-categories in the disaggregated report for silver (and gold) came in bullishly.

By commercial category, the big 4 (read JPMorgan) and the raptors did the heavy lifting. The big 4 bought back more than 4700 contracts and the raptors bought back nearly 4000 contracts, increasing the raptor net long position to 19,300 contracts. This is the largest silver raptor net long position since last July, before silver prices rallied strongly. One thing Captain Obvious would say about the silver raptors is that they don't sell until they have a profit and there is no reason to suggest that they will behave any differently on this go around.

I would estimate that JPMorgan's net short position is down to 28,500 contracts, down 5000 contracts from last week and down 6500 contracts for the two weeks ended Tuesday. Even with the reported reduction in JPM's short position, the 28,500 contract short position is still 29.3% of the entire net short side on the COMEX (net of spreads). Undoubtedly, there was further significant commercial buying since the cut-off on the severe price weakness and it would not surprise me if JPMorgan was now close to the 25,000 contract level for their concentrated silver short position. That would mark a 10,000 contract net reduction in the most important short position of all over the past two and a half weeks. That's the equivalent of 50 million oz of silver and fully explains why silver declined by more than $4 over the past few weeks. Fifty million ounces is an enormous amount of silver and the silver crooks at JPMorgan would sell their mothers to reduce their short exposure by that much. But as long as the federal regulators at the CFTC and the self regulatory organization at the CME have given JPMorgan the green light to manipulate the price of silver (and gold) no mother-selling by JPMorgan was required.

A friend reminded me yesterday that the epic reductions in the total commercial short positions and JPMorgan's short silver position in particular, proved categorically that this had nothing to do with legitimate hedging and everything to do with price-rigging. Real hedgers don't move positions around like this. The fact that the commercials have been uniform in their behavior, namely, creating price plunges so that they can trick the technical funds into selling while the commercials buy, also proves collusion. Throw in the fact that there has been no net reduction in silver investor physical holdings for many months and all price influence can be directly traced to COMEX paper positioning. This not how the price discovery process of regulated futures markets is supposed to work.

By this time, it should be clear that the CFTC has no intent of addressing the silver (and gold) manipulation in an honest manner. Since preventing market manipulation is the prime mission of the agency, the Commission's refusal to do anything about the silver manipulation effectively renders the CFTC a federal agency that is without a mission. As such, the agency does not appear worthy of existence or taxpayer support. It's too bad the agency Â?onlyÂ? gets $200 to $300 million annually, as eliminating it completely would hardly provide relief to overall budget problems. I'm starting to think that the whole Dodd-Frank reform effort was a diversion intended to distract attention from core issues. Please allow me to explain.

I can't speak to all the issues involved in Dodd-Frank, particularly to those in areas away from commodity trading. But as concerns commodities, the only real issues under Dodd-Frank were position limits and the Volker Rule, both of which the Commission has allowed to drift off into the sunset. Yeah, JPMorgan and the CME have tied up position limits in court and their lobbyists have chipped away and delayed the Volker Rule; but let's face it Â? sponsorship of these issues has quietly disappeared from former staunch advocates like Chairman Gensler and Commissioner Chilton. When's the last time Gensler uttered the words concentration or position limits? Or the last time Chilton spoke out about his prior public thoughts that there was something rotten in silver?

It wasn't that long ago that market concentration and position limits were all Gensler talked about, while Chilton prattled on about the agency being some type of tough cop on the beat. Those days are gone. Some tough cop indeed Â? these guys can't even address straight up questions about a concentration on the short side of silver and instead hide behind a phony dragged-out investigation. A reader sent me a copy of an email he sent to the CFTC asking if the five year statute of limitations that applies in securities cases does not or should not apply to the silver investigation as well. Another reader suggested a writ of Mandamus to force the agency to conclude the investigation. I understand that JPMorgan's lawyers and lobbyists are the best that money can buy, but to see regulators neutered without a fight or even an explanation is shameful. So shameful, that I look at the recent charges leveled against the CME by the CFTC for unlawful disclosure of client identity http://www.cftc.gov/PressRoom/PressReleases/pr6519-13 with feelings that it may be an intentional distraction from the real issue. Why is the CFTC wasting time and precious limited resources on such a relatively trivial matter? The CME is enabling a market manipulation to exist in silver and the CFTC chooses to sue the CME for reasons unrelated to the agency's basic mission. I'd laugh if it wasn't such a serious matter.

While it's hard for me not to dwell on the colossal failure of the CFTC for not addressing the silver manipulation, it would be wrong not to highlight the sharply improved market structure that has resulted from the deliberate price smash over the past number of weeks. Just as long as everyone recognizes that how we got to the improved market structure was shameful and illegal, the current structure is phenomenal in gold and maybe not far from that in silver. It would seem that the anticipated further improvement since the cut-off was the result of continued new additional short selling by technical funds and other speculators and I'd like to explain again why these are the weakest short sellers of all and of the type that metal bulls should pray for.

Just as technical funds never demand delivery on long futures contract positions, no technical fund is even capable of making delivery on any short futures contract. I don't believe making or taking delivery is allowed in most technical fund charters and business plans. Even if it were legal for a tech fund to make delivery on a short futures contract, in the case of silver, it would not matter much since there is so little available silver around for delivery. When the commercials hold a large short position, there is the possibility of actual delivery. When the technical funds hold big short positions, there is virtually no chance of actual delivery by them. The tech fund shorts have one option and one option only Â? to buy back at some point. The only question is at what price will the short contracts be bought back? And because any short position holds the theoretical risk of unlimited loss, when the tech funds and speculative short positions are covered, they are covered aggressively, most often on Â?marketÂ? orders or on a best price available basis. Of all the various buy orders possible, speculative short covering can be considered the most aggressive of all. I can't tell you when the tech fund and speculative short covering will commence, but I can tell you it will be forceful enough that if the commercials decide to let the price of gold and silver rip to the upside, a price explosion can easily result.

The emergence of technical fund and speculative short selling has created the finishing touches to a market structure set up that is good to go in gold and maybe in silver as well. The essential difference is the role of JPMorgan in silver. Two questions arise. Are there more technical fund shorts that the commercial can lure into COMEX gold and silver and what will JPMorgan do on the next silver rally? Since the technical funds may be at a record extreme gross short position in gold presently, it's hard for me to see significant further increases ahead. Silver may have some room for additional technical fund shorts, but after the trading action on Wednesday and Thursday, that room might be limited. As to what the big silver crook, JPMorgan, will do on the next silver rally, I can only wait and report. And agitate.

The bottom line is that an important price low is being put in, if it has not been seen already.
I would take a clue from the raptors in both gold and silver, in that they will not likely sell until there is sufficient profit in their newly acquired long positions. In my opinion, it is too late to sell and not too early to buy. With the extreme degree of commercial control over pricing, new lows can never be ruled out, but it also appears to be only a matter of time before purchases at current levels will show a profit. For long term silver investors, there is no reason not to be all in or to get all in on lower prices from here. And while I expect gold to rally sharply at some point due to the bullish market structure, this is still a great time to switch from gold into silver as silver could really catch fire when the price turn comes. Don't wait until Captain Obvious shows up.

Ted Butler

February 23, 2013

Silver – $28.70

Gold – $1580

Date Created
2013/02/23