February 6, 2016 – Weekly Review

Weekly Review

Gold and silver prices surged this week, with gold ending $55 (4.9%) higher and with silver finishing up by 75 cents (5.3%). As a result of silver's slight relative outperformance, the silver/gold price ratio tightened in a bit to 78.2 to 1, very close to where the ratio has ended the past few weeks. And still representing a pronounced undervaluation of silver relative to gold.

But the truth is that the price of gold has acted so much stronger relative to silver that each week I am surprised when tallying up the numbers that the price ratio hadn't widened out dramatically. It's as if there has been some special weight or handicap holding silver back. (Which I suppose is another way of describing price manipulation).

In contemplating why silver feels like it has greatly lagged gold on a relative basis, even though very recent percentage price performance has been flat, it seems to me to be related to silver's starkly low price. In other words, silver's price is so low (on any basis) that even its weak, tag-along-to-gold price rise has been sufficient to keep the silver/gold price ratio somewhat in line. I believe that's a testament to an investment asset deeply undervalued.

It's not as if there is anything wrong with gold leading the price way, particularly since gold was in an extremely bullish COMEX market structure since mid to late November. I didn't utter a bearish word on gold since then, if my memory hasn't failed me. At the very least, the gold (and silver) price rally over the past several weeks, once again, confirms the validity of the COT market structure approach.

I'll get into greater detail in a moment, but since yearend and extrapolating through yesterday, close to 100,000 net contracts of COMEX gold futures were bought by technical funds and sold by the commercials as the gold price rose by $115. That's the equivalent of 10 million oz of gold. I fully acknowledge that these 10 million gold oz were in the form of paper derivatives contracts and not actual metal, but one would be hard pressed not to see the connection between the concerted and excessive buying and selling on the COMEX as not impacting the price. Heck, over the past five weeks, the world barely mined 10 million oz of gold; so how could a few players on either side of a derivatives market dealing in larger size not affect price? There was a helluva lot more real producers and consumers behind the actual gold that came out of the ground over this time, so why should a few COMEX speculators determine the price for everyone?

There really wasn't much question that we would rally in gold and silver given the previous market structure established beginning in November; the question was more the nature of the rally and were there any other market factors in place that could overcome the continuous wash, rinse and repeat cycle of COMEX positioning. It was much more certain that we would rally than what would occur after the rally. Upfront, we are at the uncertain point now and the other market factors could take on an oversized role. These other market forces are more physical in substance and of the type I usually highlight.

First is the weekly physical turnover or movement of metal brought into or taken out from the COMEX-approved silver warehouses. Early in the week, it looked like the torrid pace of the past few weeks was cooling, but by weeks end, more than 7.2 million oz were physically moved as total COMEX silver inventories fell 2.5 million oz to 155.8 million oz. This kept the average weekly movement for the past 4 weeks at 8 million oz per week – 50% of all the silver mined in the world over this time.

I'm starting to think that the COMEX physical silver warehouse movement is so incredibly large and unusual that many just can't get their minds around it and that explains the lack of commentary. But it certainly exists and if my conclusion that it represents a strong physical demand for metal is correct, this is just the type of other market force that could take the price baton from COMEX futures contract positioning.

Switching to other market factors in gold, the ongoing February COMEX delivery still looks tight. After the first full week of deliveries, 832 total contracts have been issued and roughly 2200 contracts remain open to be delivered against or closed out by futures contract liquidation. These are not truly extreme numbers, but they do suggest a reluctance (or inability) to deliver. Spread differentials also seem tight and suggestive of physical tightness, but it must be remembered that with interest rates near zero, spread differentials should be tight in general.

I can't help noting that JPMorgan has not participated in the February COMEX gold delivery for its own account, after being almost the exclusive stopper in the December delivery month and taking more than 2000 gold deliveries. I get the feeling that JPM is not pressing for more gold deliveries so as not to put too much upward pressure on the price. Certainly, JPMorgan is not letting up in its acquisition of Gold and Silver Eagles from the US Mint, but then again, buying from the Mint puts no short term upward pressure on price, as would forcefully stopping gold or silver deliveries on the COMEX.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

While February is not a traditional COMEX delivery month for silver and there have been no deliveries recorded so far this month, there has been a somewhat unusual build in the open interest of the February contract. The numbers are not large (140 contracts), but it would seem reasonable to conclude that anyone buying contracts for delivery this month is interested in receiving physical silver. I admit to being super-sensitive to additional indications pointing to physical tightness, particularly when such indications already exist in the form of the unusual physical turnover of metal in the COMEX silver warehouses.

Much is written about a possible delivery crunch in COMEX gold (and silver), mostly revolving around the paucity of gold in registered form and the number of ounces represented by total open interest. But it's hard for me to imagine the CME Group or the leading COMEX commercials failing to see a developing delivery default based upon the known data. Where I can imagine real delivery pressure occurring is from new buying in the current delivery month as a result of physical tightness away from the COMEX.

For instance, if the physical market in silver became so tight that industrial users were subjected to delivery delays and as a result sought to build physical inventory, then I could easily imagine some of those users turning to the COMEX for immediate delivery. In other words, any delivery crunch on the COMEX is likely to occur after a broader physical tightness has taken hold and users rush to the COMEX in a last ditch effort to secure physical inventories. I see this happening in silver more readily than I do in gold, given that there are few industrial consumers of gold, but I suppose the principle would be the same Â? a rush for physical delivery via futures contracts after physical tightness occurs in a broader sense.

Back to gold, there is little doubt that physical investment demand has emerged on the rally that began at the start of the New Year. This can be seen in the sharp increase in the holdings of the big gold ETF, GLD, but is certainly not limited to this one ETF, as most of the world's physical gold investment vehicles have increased in the size of gold holdings. This needs to be put into perspective, given the near shocking decline in the gold holdings in investment vehicles from the beginning of 2013 until very recently.

All told, gold holdings in investment vehicles declined by more than 40% in three years (from 100 million oz to 60 million oz), courtesy of the historic decline in price. We have bounced by 5% or more (by 3 million oz) in gold holdings since year end and that has had some effect on the price, although not as much as the 10 million paper oz on the COMEX, in my opinion. But that is not to say that continued investment buying in gold can't or won't impact prices from here, particularly considering how much metal was sold by the world's gold investment vehicles since 2013.

The simple beauty (or curse) of hard metal ETFs is that when there is net investment buying of GLD, for example, physical metal must be secured and deposited in the trust. If there is net investment selling, metal must be withdrawn from the trust, as occurred for much of the past three years. Now that gold prices have moved higher since year end, it is no surprise that the holdings of GLD have grown, as this is the way it is supposed to work.

The twist here is that if there is existing physical tightness in the gold market, as several indicators suggest, should net investment buying in the various hard metal ETFs continue, increased physical pressure would be exerted as a result of the ETFs' requirement to back newly created shares with metal. It doesn't make a difference what motivates investors to buy GLD – they could be buying strictly on a chart breakout Â? net new buying automatically increases physical demand. This is simply a mechanical process.

Of particular interest is how this same mechanical process plays out in silver. Because the silver rally has been much weaker than in gold, investment buying in SLV has been much more subdued than in GLD. In fact, while gold deposits in GLD since year end have amounted to more than 1.8 million oz, worth more than $2 billion; close to 9 million oz have come out of the SLV. I'm convinced most of the reduction is a result of JPMorgan converting shares of SLV into metal to avoid reporting requirements, but that's separate from there being nowhere near the overall buying in SLV than has occurred in GLD.

Collective investor behavior is to buy as asset prices rise and because gold has risen more strongly than silver, it is no surprise that much more net investment buying has occurred in GLD than in SLV. But at some point and for a wide variety of reasons, strong investment buying will occur in SLV. That's when the rubber will meet the road. Back in the fall of 2010, as silver prices began to rise to an eventual peak some seven months later, I would credit the largest factor in that rise to the investment buying that resulted in 60 million oz being deposited into SLV. That was the deciding influence in why silver ran to nearly $50. I am convinced that investment buying in SLV and other silver investment vehicles will occur again at some point to that same extent. Only this time, given the other indications of tightness in the physical silver market, net new investment buying will have an even stronger impact on price. I would tell you exactly when this investment buying will blow the roof off the silver market if I could, but I simply don't know when.

Despite pronounced investment buying in GLD and other gold investment vehicles, reports from the retail front continue to indicate weak retail sales for gold and silver coins and small bars (although some pick up was noted later in this past week). Since the US Mint is pumping out Silver and Gold Eagles at its maximum production capacity, my conclusion is that it is still JPMorgan acquiring everything that the public is not buying Â? which is plenty.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

The changes in this week's Commitments of Traders (COT) Report were exactly as expected in silver, but wide of the mark in gold. As a reminder, I based my expectations for some slight deterioration on the relatively low volume and subdued price movement during the reporting week that ended on Tuesday, Feb 2. Of course, the dramatic price action and high volume since the cutoff have involved substantial technical fund buying and commercial selling.

In COMEX gold futures, the total commercial net short position increased by 17,500 contracts, to 77,400 contracts, the largest level since November 3. There was a bit of a twist in the various commercial categories from what had transpired recently in that the raptors (the smaller commercials away from the big 8), only accounted for 2600 contracts of long liquidation, much less than recently. The big 4 only added 1600 new shorts so, mathematically, the big 5 thru 8 added 13,300 new shorts. I am encouraged at the small increase in new shorting by the big 4, but the big question is how much they sold since the cutoff.

On the buy side of gold, the managed money traders accounted for 12,233 contracts bought, including 4821 new longs and the buyback of 7412 short contracts. At just over 100,000 managed money contracts long on the cutoff date, this amount is only up by 20,000 contracts or so from the core level of non-technical funds long and subject to long liquidation on lower prices. Likewise, the 71,530 short contracts remaining in the managed money category still represented a decent quantity of rocket fuel buying. Of course, these numbers have changed dramatically since the cutoff (and not for the better).

The last three trading days have featured a very decisive and high volume penetration of gold's 200 day moving average (now at $1131). Silver approached its 200 day moving average (now at $15.12), but has not yet penetrated it.

In COMEX silver futures, the total commercial net short position increased by a slight 400 contracts, to 45,500 total contracts. By commercial category, the big 4 (read JPMorgan) increased their net short position by 800 contracts, while the raptors sold off 100 contracts of net longs and the big 5 thru 8 added 500 new short contracts.

Yesterday's release of the monthly Bank Participation Report convinced me that JPMorgan was holding 18,000 contracts of silver net short as of Tuesday. This is about 4000 contracts more than I calculated the bank was holding a month ago, but I'm now more convinced JPM never held less than 16,000 contracts short, so at this point, JPM looks to have added 2000 new shorts over the past month or so. This isn't enough to declare that JPMorgan is back to its evil manipulative ways in single-handedly adding shorts to cap the price, but if I knew what this crooked bank did for sure over the past three trading days, I'm confident I would be able to declare one way or the other.

The managed money traders did little in silver and actually ended up as net sellers in adding 335 new longs and selling 714 new shorts. But Tuesday's gone and what matters is how many contracts the managed money traders bought over the last three trading days and how many contracts the commercials sold. Using my typical trading volume and price movement metrics, I'd guess that some 40,000 COMEX gold and 10,000 silver contracts were bought by the managed money traders and sold by the commercials on a net basis over the past three trading days. Less would be better, more, not so much.

So what does this mean for the future price of gold and silver? The simple answer is I don't know. I don't shy away from pounding on the bullish price table when the COT market structure gets as extremely bullish as it got into yearend for gold and silver. Likewise, while I hate having to do so, I don't believe I am shy when sounding a bearish alarm on an extremely negative COT market structure, as was the case most recently at the end of October. But even if my extrapolation of what occurred over the past three trading days is close to the mark, I am hesitant to pound either table on COT changes alone. I'd like to explain why.

First and foremost, given general financial conditions, I find gold and, particularly, silver to be cheap and more than capable of catching a genuine bid. I don't sense a mad rush about to develop to buy stocks or bonds or other traditional investments and find it easier to imagine a rush to metals. Some things stand out to me, like yesterday's $11 billion loss of market capitalization in shares of Linkedin as a result of a projection of 10% less revenue. There are 813 million oz of total visible world inventories of silver in 1000 oz bar form, worth only slightly more than what Linkedin shares lost yesterday. Something pounding in the back my mind tells me if a single stock can lose in the blink of an eye what all the world's visible supply of industry grade silver is worth; then silver is not close to being valued as it should be.

The COMEX commercial crooks may very well succeed in rigging an engineered selloff in the near future, just as they have done on countless occasions in the past, but this crooked game is getting more obvious and subject to real change. At its heart, the game involves paper derivatives controlling the price of actual commodities. This is what the hardcore manipulation deniers can't confront. It's not about the price of gold and silver being kept low, as each has risen mightily at times. It's about paper trading by a handful of technical funds and commercials controlling both the price ups and downs. Who appointed the COMEX crooks as price czars?

It is also important to keep in mind that COT market position levels are dynamic and subjective. There have been times in the fairly recent past where a 150,000 contract total net commercial short position in gold would be considered extremely bullish and 250,000 contracts considered bearish. You can't rely on one indicator.

Lastly, $15 is a stupid cheap price for silver on any objective basis, including its own cost of production, how miserly it values all the silver in a world drowning in financial buying power and compared to any other commodity, particularly gold. I was extremely hesitant to part with silver at $16 at the end of October and felt extremely fortunate to have gotten back in, stronger than ever. Given all that has transpired until now, I'm not inclined to do that again at even lower prices and increased evidence of physical tightness that could turn into pronounced shortage on any legitimate uptick in price.

Several billions of dollars have flowed into gold ETFs over the past five weeks due to gold's price rally. Should even $1 billion flow into silver ETFs, as could easily occur, the price impact would likely shock many. It might be reasonable, therefore, to expect a concerted effort to contain the price of silver. But at some point, it appears even more reasonable that such efforts will eventually fail.

Ted Butler

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Silver – $15 (50 day moving average – $14.13)

Gold – $1173 (50 day moving average – $1087)

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