January 11, 2020 – Weekly Review

Against a backdrop of military and geopolitical events in the Middle East, price volatility in precious metals was extreme this week, as gold traded in more than a $70 trading range and silver in a 90 cent range. However, when the dust settled in late trading at the end of the week, gold ended $7 (0.5%) higher, while silver finished the week unchanged. Still, it was the highest weekly close in gold for nearly 7 years.

As a result of goldâ??s slight relative outperformance, the silver/gold price ratio widened out by a fraction of a point to 86.3 to 1. Considering the amount of time the ratio has so persistently undervalued silver relative to gold, including periods above 90 to 1 earlier last year, I suppose itâ??s natural to believe the current undervaluation of silver is somehow normal. It will only be in the fullness of time that weâ??ll all see how nutty (and manipulative) silverâ??s undervaluation has been, but by that time it will have been too late to take advantage of just how cheap silver is today. The time to buy cheap assets is when the assets are cheap, not when we later discover how cheap they were.

At the risk of understatement, this was a pretty eventful week, both news wise, pricewise and for the revelations in yesterdayâ??s new Commitments of Traders (COT) report, which Iâ??ll dig into in a moment. I know Iâ??ve been remarking consistently about the amount of increased commentary associated with the COT report of late, but it seems that every day new commentators join in on the discussion. And the conclusions are all over the place, from extremely bearish to extremely bullish.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses cooled off to just under 2.7 million oz this week, ironically the first full five day work week of the past three. Total COMEX silver inventories rose by 1.7 million oz to 319.9 million oz, another all-time record high. Silver prices ended unchanged this week, but have been up over the past few weeks as inventories have climbed to new records, again suggesting no direct connection between rising inventories being bearish for price. No change this week in the holdings in the JPMorgan COMEX silver warehouse, which remained at 161.4 million oz.

Nothing special to report in COMEX deliveries, as weâ??re between big traditional delivery months for both gold and silver. One quick comment on the short positions in SLV and GLD, the big silver and gold ETFs. The short positions have been low enough so as not to warrant much discussion, as it is only when the short positions are high, particularly in SLV, does it present a potential problem. And while the new short report for SLV indicates a relatively low short position (10 million shares/ounces or 2.6% of total shares outstanding) as of Dec 31, that date coincides with a very high total commercial net short position in COMEX silver futures and a record high concentrated short position. (Almost ditto for GLD, but short selling has been more of a problem in SLV over the years)

https://www.wsj.com/market-data/quotes/etf/SLV

In the past, large commercial short positions in COMEX silver futures almost always coincided with large short positions in SLV, as the commercials, led by JPMorgan, would short the snot out of both on rallies, which preceded and brought about price declines. Additionally, Iâ??ve always considered JPMorgan to be the big short seller in SLV, just as it was the big short seller on the COMEX. But things can and do change and not only have I sensed JPMorgan no longer shorting aggressively on the

COMEX, the very low level of shorting in SLV, as of Dec 31, when commercial shorting on the COMEX was at or near a record (but not by JPM), shows things have changed a lot in SLV shorting. Â Bottom line â?? JPMorgan is no longer aggressively participating on the short side of silver and that portends some very good things for the price.

Turning to yesterdayâ??s COT report, it would have been natural to assume there would be large further increases in managed money buying and commercial selling, seeing how both gold and silver raced to new highs or closing highs every day over the four day reporting week ending on Jan 7. Certainly, that was the odds-on most popular expectation. But as I indicated on Wednesday, I wasnâ??t at all sure of that outcome and refused to handicap the expected results. It turned out that it had nothing to do with spread trading (as I had speculated), but the results were, nonetheless, quite shocking.

For the first time in memory, the commercials covered shorts on higher prices, booking and recording losses, also for the first time. The quantities of the short contracts bought back and closed out were not particularly large, but seeing as more new shorting was widely expected and the exact opposite occurred, the turnabout must be considered stunning. Whether this reporting week was an aberration or a signal for seminal change being at hand will only be known as time passes and Iâ??ll speculate as to which it may be after running through the report.

In COMEX gold futures, the commercials reduced their total net short position by 10,400 contracts to 356,100 contracts. Since this is the second largest commercial short position in history (last week was the record), it can hardly be called anything but still extremely bearish in conventional and historical terms, but as I hope I have conveyed recently, looking at the COT report in conventional terms might not be the right approach.Â Most of the decline in commercial shorting can be attributed to the 4 largest shorts, who reduced their concentrated short position by a bit over 11,000 contracts.

Based upon the new Bank Participation report, in conjunction with recent COT reports, Iâ??d peg JPMorganâ??s gold short position to be around 34,000 contracts, which is down a bit from last week, but up about 4000 contracts from the December Bank Participation report. The key here is that JPMorganâ??s overall share of the commercial short position is very much at a low ebb. In the past, when the commercial net short position and concentrated short position were at or near records, JPMorgan would typically be short as many as 100,000 contracts of gold. For JPM to be short only 34,000 contracts (3.4 million oz) with near-record total and concentrated short positions is next to nothing.

I havenâ??t mentioned it in a while, but for quite some time, Iâ??ve maintained that JPMorgan holds at least 25 million oz of physical gold (in addition to the 900 million ounces of physical silver I claim it holds). Iâ??ve consistently pegged JPMâ??s average cost of its gold at around $1200 per ounce ($18 per ounce for silver). If Iâ??m correct, that means that at current prices ($1560 for gold and $18.10 for silver), JPMorgan is ahead by $9 billion on its gold holdings and is even on its silver holdings. Not only are very few aware of this, when gold and silver prices truly soar at some point, it is most likely the same very few will ever become aware of how much money JPMorgan has and will make.

On the sell side of gold, the managed money traders did sell nearly 3000 net contracts (the non-reporting traders were the biggest sellers), but the composition was unusual in that the managed money traders did add 2726 new longs, but also added 5701 new shorts. Therefore, those expecting managed money buying werenâ??t incorrect, itâ??s just that few, if any expected even greater managed money new shorting. The resultant managed money net long position of 229,757 contracts (261,083 longs versus 31,326 shorts) must still be considered extremely bearish in conventional terms, but not at all bearish if these traders donâ??t sell aggressively on lower prices.

In COMEX silver futures, the commercials reduced their total net short position by 5500 contracts to 91,200 contracts. Since this is still the second largest short position in years, it can hardly be called anything but extremely bearish in conventional terms (same as in gold). But it very much remains to be seen if the current lopsided market structures in silver and gold will get resolved in the conventional terms of the past or something else. The extreme structures will, most assuredly, get resolved â?? itâ??s just that no one can know for sure the manner of resolution at this point.

As was the case in gold, JPMorgan reduced its silver short position from last week, to around 15,000 contracts and that is up from its short position in the December Bank Participation report. Like gold, JPMâ??s silver paper short position, the equivalent of 75 million ounces, is a fraction of the 900 million ounces I allege it holds physically, leaving it net long 825 million oz, standing to make $825 million for every dollar silver advances in price. A $50 increase in price would bestow more than $40 billion in profits to JPM â?? just the kind of stakes meaningful to an institution as large as JPMorgan.

The managed money traders in silver were sellers (just like their gold counterparts) of 1854 net contracts and in the same manner, in adding 2099 new longs while also adding 3953 new shorts. As was the case in gold, the non-reporting traders were the biggest sellers of just over 3000 net contracts. The resultant managed money net long position of 57,014 contracts (87,915 longs versus 30,901 shorts) is still bearish in conventional terms and definitely not bearish if these traders donâ??t sell on lower prices.

For those keeping tabs, the concentrated long position of the 4 largest traders in silver was reduced by around 600 contracts this reporting week to 50,145 contracts, while the corresponding concentrated long position in gold rose by more than 3100 contracts to 139,883 contracts â?? the highest in history.

Looking at the COT report through the prism of what I discussed on Wednesday in â??What Matters Mostâ?•, it seems to confirm the basics of my adults (CFOâ??s and senior management) versus children (the young traders) premise. But I want to be very careful here in that any one report can neither confirm nor disprove my premise. It will take further data and price revelations to either prove or disprove my speculation as to what may be going on behind the scenes. The only way to do that, in my opinion, is to stick to the facts as they become known.

The COT report yesterday covered the four trading days since the Dec 31 closing of the calendar year and quarter end. These four trading days (January 2, 3, 6 and 7) were the very first opportunity in which senior management at the 7 or so big shorts in COMEX gold and silver could react to the year ending record mark-to-market losses of $3.8 billion. And, youâ??ll remember, the yearend losses nearly doubled from Dec 23 onward, offering scant advance notice of such a large record loss at yearend.

While the commercial short covering wasnâ??t particularly large in terms of contracts, it was practically unprecedented in terms of how the commercials usually operate, namely, always adding new shorts on advancing prices. Something made some commercial shorts do what they had never done before and buy back and cover shorts on higher prices. The most plausible explanation would appear to be that an overriding order was issued from some adults from above to the traders down below.

Iâ??m not being arrogant or adamant about what may have occurred and will be quick to admit otherwise and change my mind if the data ahead point to some other explanation, but the short covering and booking of realized losses (around $100 million) has all the appearances of an order from above to close out positions. This is strictly in the â??if it walks, looks and quacks like a duck, then it is likely a duckâ?• line of thinking â?? plus, most importantly, itâ??s something that should have occurred, according to how things work and should work in the real world.

The sudden and unprecedented year and quarter end losses should have aroused senior management to do something (as I wrote on Wednesday), so it shouldnâ??t be a shock to see evidence of exactly that transpiring. Nipping this thing in the bud and reacting quickly to a situation that could threaten the ongoing viability of the organization is what senior managers get paid for and to do otherwise would threaten their own jobs, to say nothing of the organization itself.

Not to react to a developing problem of this nature would automatically come to engulf any senior managers which didnâ??t respond quickly and appropriately. Forget the traders responsible for massive and uneconomic short positions â?? they are likely already dead meat â?? the question is how many senior managers will get dragged into the quicksand by not acting quickly and appropriately enough. And weâ??ve already seen signs of what is fast and appropriate enough in the short covering over the first four trading days of the New Year.

But the problem for the senior officers of the organizations involved is that there is a very long way to go in terms of the full resolution of the situation at hand. To buy back and close out short positions amounting to $100 million of what are still $5 billion in open losses leaves an awful lot left to resolve â?? 2% down and 98% to go. And this is far from linear in terms of potential price pressure â?? the first 2% of short covering would be accomplished with much less upward price pressure than the last 2% and any percentage up to that. Yet we are at near 7 year price highs on gold and the prospects for much higher prices should a concerted short covering have commenced tends to boggle the mind.

As mind-boggling as a pronounced commercial short covering may seem, it is rooted in the facts and data at hand. I donâ??t know if there are hurried high-level emergency meetings taking place, but there sure as heck should be. If there are not emergency meetings taking place, then that would be in stark contrast to what the data indicate. Of course, my suppositions and deductions are not based upon any personal connections or inside sources â?? just publicly available data. I donâ??t have any reason to distrust the data, so it is up to you to decide if I am interpreting the data correctly.

One specific area where the vast majority of COT commentary is at odds with my own findings is the matter of whether the big shorts in gold and silver are somehow covered and hedged or if they are â??nakedâ?• shorts with no real backing, physical metal or paper holdings elsewhere â?? say OTC (over the counter). I think a large part of the disagreement comes from the wording in the COT report itself, which refers to the big short sellers as commercials and producers, merchants, processors, users and swap dealers. Those words do conjure up visions of true hedgers and not of speculators, but words can be misleading.

Iâ??ve tried to point out in the past how very few, if any gold and silver miners are engaged in short selling on the COMEX and have offered as proof the strict requirement from the Financial Accounting Standards Board (FASB) that all such hedging be fully disclosed in quarterly and annual financial statements. To my knowledge, no one has ever followed up and pointed out any specific hedging by mining companies on the COMEX or elsewhere.

But itâ??s more than that. For some reason (I say crazy reason) many assume the banks unarguably involved (via the Bank Participation report), wouldnâ??t dream of speculating on the short side of futures, despite a long and rich history of such bank speculation throughout history. The argument is always advanced that the banks are hedged in some way â?? either by owning the physical metal they are selling short on the COMEX or by somehow being magically hedged by other derivatives. Letâ??s look at each â??excuseâ?•.

For one thing, if the banks involved do own such amounts of physical metal (away from JPMorgan) then it was completely unhedged 6 months ago, before the commercial short position grew by nearly 300,000 contracts (30 million oz) in gold and by 100,000 contracts (500 million oz) in silver. To assume they all waited to hedge after gold rallied about $100 and silver by a couple of dollars is preposterous and absurd. They didnâ??t have 30 million oz of physical gold or 500 million oz of physical silver either before or after they sold those quantities of paper contracts short.

As far as the big shorts being hedged by other derivatives in the OTC market or elsewhere is equally absurd. Everyone points to the quarterly OCC derivatives report from the US Treasury as proving whatever they want it to prove, but the fact is the report is incredibly vague in that it doesnâ??t indicate whether the banks are long or short or neutral â?? so anyone can say what it means or doesnâ??t mean. But the simple fact is that if a bank or banks were long in OTC dealings against short COMEX positions that would mean someone else has to be holding massive OTC short positions and there is no reasonable party (other than banks) to identify. And itâ??s not mining companies for the very same reason that would have to be disclosed according to FASB.

In essence, those clinging to the canard that the big shorts on the COMEX are somehow hedged are deluding themselves and failing to see the very big problem that these big shorts are in and which might be explained by this weekâ??s COT report. Either that, or Iâ??m all wet and wasting your time with my ridiculous and far-fetched analysis. The good news is that we should learn which it is, likely in the near future.

If â?? and thatâ??s a big â??ifâ?• â?? the senior managers are wresting control from the kids on the trading desks, they have just begun to do so and there are miles to go before they sleep. I suppose that doesnâ??t mean it will be a straight price line up, given the stakes involved, but on the other hand, it could be just that when one considers just how many short contracts have yet to be bought back and covered. As I indicated earlier, this is not a time to be arrogant or adamant in oneâ??s convictions, but neither is it a time not to clearly see what is occurring.

As far as the financial standing of the 7 big shorts in gold and silver, the apparent booking of realized losses complicates my running tally somewhat, so bear with me on this. In addition to booking a $100 million realized loss this week, there was a further $100 million increase in open losses given the $7 increase in gold prices in late trading. That would put Fridayâ??s open loss at $5 billion, up from last weekâ??s $4.9 billion open loss.

Accordingly, there is no apparent reason for the adults in the upstairs offices not to continue to pressure the kids on the trading desks to make this problem go away. The only real way to make the problem go away is to close out the short positions. The wonder is not that this may be occurring, but that it has taken so long to occur.

Ted Butler

January 11, 2020

Silver – $18.10Â Â Â Â Â Â (200 day ma – $16.48, 50 day ma – $17.35)

Gold – $1562Â Â Â Â Â Â Â Â Â Â (200 day ma – $1430, 50 day ma – $1491)

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