January 16, 2016 – Weekly Review

Weekly Review

While daily price volatility seemed higher than usual, gold finished $15 (1.4%) lower for the week, with silver down by 3 cents (0.2%). As a result of silver's slight relative outperformance, the silver/gold price ratio tightened in a point to 78.3 to 1, down from last week's multi-year undervaluation. I can't handicap the movement in the price ratio in the short term, but if silver isn't grossly undervalued to gold on a long term basis and in position to greatly reward those favoring silver over gold in time, then I couldn't be more wrong.

When new extremes in the price ratio are set, as has occurred recently, it is natural for there to be increased commentary about the relative merits of gold versus silver. Since gold has performed better than silver recently, it is also natural that most of the recent commentary tends to point out the merits of gold more than silver. That's just the way it is. Be that as it may, what is natural is not always correct.

Most overlooked in any discussion of the relative merits of gold or silver is how the price of each is determined in the first place. If there is one thing on which I am certain it is that gold and silver (and other commodities) prices are set by COMEX futures contract positioning. As I've pointed out in the past and will attempt to do today, almost all price movement can be explained in terms of futures positioning. Yet the one thing missing from recent commentary about past and prospective changes in the silver/gold price ratio is any mention of COMEX positioning.

In simple terms, gold has performed somewhat better than silver very recently because there has been more relative buying by managed money technical funds in COMEX gold than in silver. That can continue, intensify or reverse; but will still determine the direction of price both absolutely and relatively. What is certain is that there is absolutely nothing in the actual world of gold or silver behind changes in their price ratio Â? it is all a COMEX-orchestrated operation. There is no great switching of real metal in any sense of the word, just COMEX futures games. And in the near term, I can't see how that will change. I'll comment on the general volatility in world stock markets, with some mention on crude oil and copper in COT terms after the usual weekly review format.

The turnover or physical movement of metal brought into or taken out from the COMEX silver warehouses literally exploded this week, as 9.9 million ounces were moved and total inventories fell 2.3 million oz, to 159.1 million oz. I can recall only a few weeks over the past five years where more silver was physically moved than this week. I would also point out that this week's COMEX silver movement, when annualized, comes to more than 500 million oz or 60% of total annual world mine production.

I continue to be flabbergasted that the COMEX silver warehouse movement is completely overlooked in the analytical community despite this movement being so unprecedented and persistent and easy to verify. I've given up expecting an alternative explanation to my physical tightness premise and have also given up on expecting any mention of this stunning phenomenon.

Even more perplexing is that I know that the daily COMEX inventory data is closely followed by many. I just read a report commenting on the COMEX adding two new silver warehouses (bringing the total to eight), even though one of the warehouses held no silver (yet) and the other held 275,000 oz or less than 0.2% of the 159 million oz held in total. Perhaps in time the two new COMEX silver warehouses will prove to be newsworthy; but what about the 10 million oz physically moved this week? How can the unprecedented physical movement continue to be overlooked? I don't want to beat this to death, but isn't the point of analysis to consider the most relevant facts?

http://www.cmegroup.com/trading/energy/nymex-delivery-notices.html

Yesterday, there was another 124,000 oz of metal deposited into the big gold ETF, GLD, and another 1.4 million oz of silver removed from the big silver ETF, SLV; thus continuing the marked contrast of recent weeks. The deposits of gold make sense in that gold has been steady to higher in price and trading volume in GLD heavier than it had been; all pointing to net investor buying which would require additional metal deposits. Nothing unusual. It is the pattern in SLV that has been most unusual.

While gold has slightly outperformed silver on a relative price basis, it is closer to the truth to say that gold and silver price action for the past ten weeks has been largely flat Â? with gold on either side of $1080 and silver straddling $14. Given all that is happening in the world, it is not surprising investors would be buying, or at least not selling; so the additions to GLD seem reasonable. But metal should not be leaving the SLV and all things considered, the most reasonable explanation is a deliberate conversion of shares to metal for the purpose of concealing ownership. Obviously, small investors would have no need to deploy this process, so it indicates the likely presence of a large investor. What's new?

There is also nothing new about the pattern of sales for Silver and Gold Eagles from the US Mint. Statistics through yesterday indicate 75,000 oz of Gold Eagles sold and 4 million oz of Silver Eagles. I still think it will take until month's end to form firm conclusions about demand and the Mint's production capacities. But the standout feature continues to be overall weak retail demand in the face of documented strong sales from the Mint.

To be fair, the recent stock market weakness has increased retail demand from the particularly low levels into year end, but it would be a stretch to call retail demand strong at this moment. Nor would I argue against retail investment demand picking up measurably should financial market turbulence continue. But it still remains true to this point that over the past 5 years we have seen record sales of Silver Eagles against a backdrop of weak overall retail demand; resulting in the big buyer premise. To be specific Â? absent JPMorgan, the US Mint would have sold 50% fewer (100 million) Silver Eagles than it did. And that hasn't seemed to change in 2016 so far.

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

The changes in this week's Commitments of Traders (COT) Report came in darn close to my revised guesses on Wednesday, even if I do say so myself (maybe that's the Trump influence). Under the cover of categorizing it as a low conviction guess, due to unusual intra-reporting week price gyrations, I was under and over in the two headline numbers in gold and close enough on silver. I had toned down prior expectations of a 30,000 to 40,000 contract deterioration in gold to 20,000 contracts and stood pat on an unchanged number in silver.

In COMEX gold futures, the commercials increased their total net short position by 24,300 contracts to 43,600 contracts. This is the largest commercial net short position in gold since November 10, as expected. Gold prices penetrated the important 50 day moving average to the upside for the first time in months during the reporting week as the commercials sold into managed money technical fund buying.

By commercial category, it was strictly a raptor affair, as the smaller commercials sold off 28,600 long contracts, awhile the 4 largest shorts actually bought back 500 short contracts which was both notable and encouraging. The big 5 thru 8 bought back 3800 shorts, but that involved a number of managed money shorts. On the buy side in gold, the technical funds in the managed money category bought just over 16,000 contracts, including 12, 843 contracts of short covering, and 3176 contracts of new longs.

While it is true that we are now somewhat off from the record gold net and gross short position in the managed money category, as a result of the upward penetration of the 50 day moving average; it is truer to say that we are only off by a relatively small amount. In managed money terms, from the top in gold in the Oct 27 COT report to the recent bottom on Dec 1, these traders have now bought 30,000 contracts of the 150,000 net contracts they sold. I suppose that raises the possibility of a sell-off, but with a potential 120,000 contracts of buying potential still ahead, the gold market structure is still skewed to the upside. Since Tuesday's cutoff, I don't think there has been much change in the gold or silver market structure through yesterday's close.

Most notable to me is in how few gold contracts have been purchased by the technical funds thus far. Gold first penetrated its 50 day moving average on January 6, so it has been 8 trading days that we have closed above that average. Had you told me two weeks ago that gold would penetrate and close above its 50 day moving average for 8 days, I would have assumed that the technical funds would have bought a heck of a lot more contracts than is indicated in the COT data and extrapolation from the cutoff date.

I have to interpret this as bullish since much more potential buying still exists than I would have imagined at this stage. As to why the technical funds bought as relatively few gold contracts as they have, I can't help but attribute it to the commercials' skill and cunning in trying to keep the potential buying power of the managed money traders intact, only to be fully unleashed when the commercials decide.

In COMEX silver futures, the commercials increased their total net short position by 1800 contracts, to 30,600 contracts. Not only have silver prices changed little over the past 10 weeks, there has been remarkably little change in the COMEX market structure. (The same is true in gold, with the exception of this week). My point should be anticipated, namely, that if changes in COMEX positioning dictate price change, then no positioning change should dictate little price change Â? as has occurred.

By commercial category in silver, as was the case in gold, it was all raptors, as the smaller commercials sold out 3500 long contracts; meaning the big 4 and big 5 thru 8 bought back shorts. The big 4 bought back 1200 shorts and the big 5 thru 8 bought back 500 short contracts. I'd peg JPMorgan's short position down 1000 contracts to around 16,000. A reader asked if it was troublesome that JPM's short position is up a few thousand contracts from where it was recently and the answer is it is troublesome that JPMorgan even exists. But everything is relative and it's still better than JPMorgan being short 25,000 contracts, as they were in late Oct-early Nov.

The managed money traders bought less than 700 net contracts (much closer to my unchanged call), including new longs of 1333 and new shorts of 675 contracts. That puts us back above my core non-technical fund long position of 50,000 contracts and leaves the rocket fuel tank of potential short covering close to full at nearly 42,000 contracts of technical fund shorts.

The simple reason gold has slightly outperformed silver in recent weeks is because more managed money buying occurred in gold than in silver. As I indicated above, that can continue for a while, but sooner or later, managed money buying will kick in for silver as moving averages are penetrated. As it stands, silver has yet to close above its 50 day moving average for even one day, compared to gold closing above its 50 day moving average for 8 trading days. That's not a permanent configuration.

As if they were reading my mind, a number of subscribers asked me to comment, in COT terms, about the big price declines in crude oil and copper. There are not many unaware of the situation in crude oil and the financial havoc and turmoil the 70% decline over the past year or so has created. Previously, I held that the most important feature in crude oil was the daily oversupply that resulted from OPEC (read Saudi Arabia) refusing to cut production in late 2014.

Oil is a funny commodity, in that the big problem with an oversupply is that the excess crude must be stored and storage capacity was finite or slow to come on line. There is no doubt that the cumulative daily oversupply over the past year and longer is the main pressure on the price of crude oil and unless production fell below daily consumption rates, it was hard to see how prices could turn around in earnest. That's still the case a year later and storage capacity is even more of a concern.

However, I also pointed out that the insidious market disease first concocted in COMEX silver, namely, price-rigging caused by commercial/technical fund futures contract positioning, had spread to other markets, like gold, copper and crude oil, the world's largest (by far) commodity market. In medical terms, this futures market positioning is every bit as contagious and lethal to the price discovery process, as is Ebola to human life.

In a market as large as crude oil, I am not suggesting that futures market positioning in general or managed money technical fund shorting specifically, is responsible for the 70 % decline in the price of oil. But you can bet your bottom dollar that when it comes to very sharp declines (or rallies) in short periods of time, the technical funds exert enormous influence far beyond what the actual fundamentals would dictate. Let's look at the facts.

Over the five days of the COT reporting week in NYMEX crude oil, the price fell from over $36 to as low as $30. The disaggregated COT report indicates that nearly 31,000 new shorts were established in the managed money category. Not only was this the single largest category of selling in NYMEX crude oil futures, it increased the number of managed money technical fund short contracts to a new record of more than 213,000 contracts (only the producer category held more shorts). 213,000 NYMEX futures contracts are the equivalent of 213 million barrels of crude oil and are held by trading entities with less capability of actually delivering even a single physical barrel of oil than you or I.

The 31,000 crude oil contracts sold short by the managed money technical funds are equal to 31 million barrels. Over the 5 trading days of the reporting week, perhaps 5 million actual (Â?wetÂ?) barrels of oil were added to the world's inventories. There is no question that the price of crude oil dropped by $6 during the reporting week, so the question to you and the world is what had the bigger effect on price Â? the 5 million actual barrels whose purchase and sale were negotiated and transacted by those customarily involved in the physical oil trade, or the 31 million barrel equivalent sold by technical funds in frantic computerized flash trading, basically with at-the-market sell orders?

Even leaving out that the technical funds may have been set up and lured into selling by other futures markets participants, the answer must be that during the current reporting week, according to the data published by the CFTC, the 31 million paper barrels of oil sold by managed money traders is why the price of oil dropped so much. There can be no other answer.

It suggests to me that the world has lost its collective mind. Most stock market pundits are attributing recent declines in equities and increases in financial anxiety to disarray in the oil market. Yet the clearest market data available prove that the single strongest factor in the last $6 of decline can be traced to technical fund short selling on the NYMEX. Am I the only one that sees this? What the heck do the regulators do all day that they don't see this? Worse, why are they not doing anything about it?

In the small chance that they (the CFTC and the CME) may wake up before the few commercials and technical funds that engage in this price rigging literally destroy the financial world, let me offer the only possible solution Â? restrict these bums. That could and should be done in an instant. No small number of traders ever have the right to ruin the markets, yet that is unfolding as clear as day.

As to what it means for oil, until production is no longer in surplus to demand, prices will be pressured. But, as and when the technical funds buy back their massive short positions, sharp rallies will unfold. My main point is still why have we allowed the price discovery process to be hijacked by a handful of paper speculators?

I had also expected a large increase in technical fund shorting in COMEX copper futures and was somewhat surprised that the increase was less than I expected because copper prices moved lower by 13 cents or so during the reporting week in a salami slicing fashion to new lows. The increase in technical fund shorting wasn't minor, at more than 5200 contracts or 65,000 tons, considering total COMEX copper inventories are 67,000 tons. And the total short position of the managed money traders is now over 60,000 contracts or more than 750,000 tons, more than double combined COMEX and LME inventories.

In COMEX copper dealings, the managed money shorts are, by far, the largest single category on either the short or long side, which is about as nutty and manipulative as it gets. Come to think of it, the managed money short positions in COMEX gold and silver are also larger than any other short category. How can it be accepted that the largest and, therefore, most important to price category on the short side be held by traders not capable of making physical delivery if required and who have nothing to do with legitimate hedging in any sense?

As I was pondering these facts, I ran across a big story in the Wall Street Journal yesterday, titled, Â?Copper Outlook Confounds AnalystsÂ?. Since the article may be limited to WSJ subscribers, let me both link it and describe was it said.

http://www.wsj.com/articles/copper-outlook-confounds-analysts-1452871585

As the title suggests, the gist of the story was that the majority of professional copper analysts were confused by the low price of the metal in light of the actual supply/demand fundamentals as they knew them to be. Here's the money quote – Â?