

## January 25, 2014 – Weekly Review

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A sharp late-week rally in gold pushed that metal higher for its fifth weekly gain, a feat last seen in the summer of 2011 on the way to all time price highs. Gold rose \$15 (1.2%) for the week, vastly outperforming silver which fell a sharp 40 cents (2%). As a result of silver's dismal showing, the silver/gold ratio widened out a full two points to just under 64 to 1.

While still within the broad trading range of the last year or so, it is notable that very recently silver has been underperforming gold as gold prices rose and outperformed as gold prices fell; contrary to past experience. While all the facts support silver outperformance over time, in the short term anything goes. It's not just the short term action in the price ratio  $\hat{A}$ ? more at point is the relative extreme undervaluation of silver to gold for most of the past few decades. There is a lot less available above ground silver than gold, particularly when expressed in dollar terms (tens of \$billions vs. \$trillions) that it makes little sense for silver to be priced relative to gold the same as it was 50 years ago when there was much more silver bullion in the world than gold. What gives?

You have to throw away any attempt at a free market explanation to that question. There is only one answer for why silver is as undervalued to gold as it was back then and why it stunk up the joint last week and that answer is the price is wrong. Silver's price is wrong because it is set on the COMEX. For sure, gold's price is wrong for the same reason; it's just that the data show the  $\hat{A}$ ?wrongness $\hat{A}$ ? is more extreme in COMEX silver. Let me offer some statistics I don't think I've used before.

Using rounded numbers, total COMEX silver futures open interest is 140,000 contracts or the equivalent of 700 million oz. That's about 88% of total world silver mine production of 800 million oz. In COMEX gold futures, the total open interest is 410,000 contracts or the equivalent of 41 million oz. That's about 43% of world gold mine production of 95 million oz. Thus, in terms of world production, silver's open interest (long and short position) is double that of gold's. Why?

In terms of world bullion inventories, the 700 million oz of total COMEX silver open interest is almost 50% of the 1.3 billion oz of world silver bullion inventories. The 41 million oz of gold represented on the COMEX is less than 1.4% of the 3 billion oz in gold bullion inventories (out of the 5.5 billion oz of total above ground gold holdings). 50% vs. 1.4% means that COMEX silver open interest is 35 times greater than COMEX gold open interest in terms of world inventories. Why?

One last one – the concentrated net short position of the eight largest shorts in COMEX silver futures is 60,000 contracts, or 300 million oz. In COMEX gold futures, the 8 largest shorts hold 136,000 contracts or 13.6 million oz. That means on an ounce basis, the silver concentrated short position is 22 times the size of the COMEX gold concentrated short position. Why all these numbers are out of line is that the world produces only 8.5 times more silver than gold in ounce terms and there is no legitimate reason for the ratio of total open interest or the concentrated short position on the COMEX to be so out of line.

In terms of relative world inventories of each, there is no legitimate free market reason for silver to have a total open interest or concentrated short position larger than in gold. And remember, there are very little, if any, COMEX futures positions held by the world's silver and gold miners, mostly just big banks and other speculators. In essence, the grotesquely large positioning in COMEX silver futures relative to gold fully explains why silver prices are distorted relative to gold, both over the past week and the past few decades. Throw in crooked HFT algo trading, which is always more extreme in silver than in gold (or any other commodity) and the answer for silver's underperformance should be clear. The real question is how long can this persist? In the short term, the answer is unknowable, but thanks to the law of supply and demand, such price manipulations must end. When it ends in silver, all will see it in the price action.

None of this should be taken as being bearish for gold prices. The market structure has been bullish for many months and with JPMorgan holding a long market corner in COMEX gold futures, the rise in price shouldn't be surprising. World financial stresses are rising and that could inject a new factor into the price process, but up until now, the price moves in gold and silver seems to be COMEX related. I'll come back to this theme later.

For a change, the turnover of metal moving into and out from the COMEX-approved silver warehouses slowed sharply. Were it not for a large deposit yesterday, movement wouldn't have totaled 2 million oz vs. last week's 9 million oz turnover. Total COMEX silver inventories climbed by 1.4 million oz to 178.5 million oz, another new 20-year high. However, the biggest stir in COMEX inventories this week was in gold, where 321,500 oz or ten tons were removed from the JPMorgan warehouse. At more than 4% of total COMEX gold inventories, it was one of the largest withdrawals in memory.

I know there has been an active discussion on the Internet for quite some time concerning the status of COMEX gold inventories. The discussion has mostly centered on the 3 to 4 million oz withdrawals from the COMEX gold warehouses early last year and the dramatic recent decline in registered gold inventory vs. the category labeled eligible. The difference between which category of inventory can be delivered against futures contracts can be a confusing discussion and I've chosen to avoid it. To be frank, I never thought the category distinction was important.

But there can be little question that the direction of the general discussion has been that the low level of COMEX gold registered inventories could lead to a contract delivery default, due to a mismatch between the amount of gold actually available for delivery in the approved warehouses and the number of futures contracts that could demand delivery. Further, the upcoming February COMEX gold futures contract (where delivery starts in a week) is cited as possibly being the flash point for a default.

I've learned to never say never about almost anything and I can't certify that there will never be a COMEX delivery default. I've actually discussed the issue for many years in regards to COMEX silver (not gold). That said, what I can point out is the serious nature of any COMEX delivery default. In fact, no issue could be more important to the COMEX (CME Group) itself or to the markets overall than a delivery default in gold or silver. To my mind, a delivery default on the COMEX would spell the end to COMEX trading in the commodity in question or to the entire exchange. Let me explain why.

What gives COMEX gold and silver futures trading the legitimacy that has made the exchange the price discovery leader in the world is that physical delivery can be made by sellers and demanded by buyers. Without the physical delivery mechanism in COMEX gold and silver contracts, not only would the exchange not be the world leader, there would be no reason for anyone to trade on the COMEX in the first place. Yes, I'm fully aware that a remarkably small percentage of futures contracts result in physical delivery and that the COMEX has facilitated a 30 year manipulation in silver. This is a separate issue.

Perversely, what allows the manipulation to exist on the COMEX is the sanctity of the delivery process. It is the delivery process itself, whether utilized or not, that makes the COMEX legitimate. It is the possibility of converting a futures contract into actual metal should one demand to do so that legitimizes the exchange. The alternative of no delivery mechanism being present on a physical commodity futures contract (a cash settlement), removes any link or connection between paper trading and the actual commodity in question. Who in their right mind would trade on any futures exchange that didn't allow for physical delivery should any seller or buyer choose to do so? Without the possibility of actual delivery there would be no connection between traded contracts and the actual commodity. Should COMEX gold and silver futures contracts remove the physical delivery requirement and announce cash settlement only, trading would quickly migrate elsewhere, to other exchanges and instruments (ETFs). The COMEX would quickly cease to exist.

A delivery default would do the same thing, namely, kill the COMEX. Please don't misunderstand me — that would be fine for me and every other precious metals investor because without the COMEX, there would be no manipulation and prices would fly. But it is hard for me to see the exchange not move heaven and hell to avoid such a delivery default because such a default would equate to the COMEX's demise. Plus, there are some other special factors arguing against a COMEX gold delivery default at this time.

As I have been reporting for months, JPMorgan holds a long position in COMEX gold futures so large as to constitute a market corner. This was born out in the very large gold deliveries taken by JPMorgan in its proprietary (house) trading account in December, when the bank took more than 96% of the more than 6000 gold contracts delivered. Yesterday's withdrawal was about half of the more than 600,000 oz JPMorgan acquired last month. Unfortunately, the trail for that gold stops when it leaves the warehouse, even though that's where the speculation usually begins.

I suppose, given JPMorgan's singularly large position in COMEX gold futures that it would be in position to demand an equally large amount of deliveries in the February contract to the point of squeezing the market and possibly threatening a delivery default. Certainly that should light a fire under gold prices and benefit the bank. But JPMorgan is perhaps the COMEX's most important member and is up to its neck in allegations of gold and silver manipulation which a delivery default would highlight like no other event. I suppose anything is possible, but I have a hard time imagining JPMorgan abandoning its dominance in gold and silver by deliberately engineering a delivery default and the COMEX's demise. JPM has the power to do so, but why would they exercise that power? As far as the February COMEX gold contract, we should find out soon enough.

The irony of ironies is that it is JPMorgan at the center of everything, from price control in gold and silver to whether there could be a delivery default. It is unfortunate that there will be no regulatory intercession in these matters, but it is fortunate that the story of JPMorgan's market control continues to advance. At some point enough world observers will be aware of the facts that it will not require regulatory action.

The changes in this week's Commitments of Traders Report (COT) were minor and inconsequential. Of much more importance is what happened to traders' positions on Thursday and Friday, well after the Tuesday cut-off. But let me run through the latest numbers quickly.

In COMEX gold futures, there was a minor 800 contract increase in the total commercial net short position, to 46,100 contracts. There was a 5,000 contract decrease in the big 8's total net short position (mostly the big 5 thru 8) and a 6,000 contract decrease in the gold raptors net long position. Despite the raptor decrease, JPMorgan's long market corner increased to 61,000 contracts, or almost 18% of the total net open interest (minus spreads).

It was encouraging that the technical funds only decreased their gross gold short position by 1500 contracts (in the managed money category of the disaggregated report). But this, of course, was as of Tuesday, before the high volume decisive penetration of the 50 day moving average late in the week. Therefore, the key variable at this point is how many of the existing 74,500 tech fund short positions were bought back on Thursday's and Friday's gold price jump (and how many more will be bought back if prices continue to advance on Monday and Tuesday). I was hoping we would get a bigger price punch than seen so far from tech fund short covering, but I may be looking at it too closely.

In COMEX silver, the total commercial net short position decreased by 800 contracts, to 24,000 contracts. The raptors accounted for basically all the change in increasing their net long position to 36,100 contracts, the highest level in 4 weeks. JPMorgan looks to have stood pat at 16,000 contracts held short. The technical funds actually added more than 1600 contracts to their gross short position.

As was the case in gold, the key question was how many contracts were bought by the technical funds (new longs and covered shorts) on the (initial) price rallies on Thursday and Friday. Of course, the early silver rallies faded badly on both days which suggest there may not have been much net buying by the technical funds in silver as there appears to be in gold. But it is also hard to deny that the price action in silver was putrid which may indicate a determination by JPMorgan to keep silver from advancing no matter what.

Unfortunately, there is no escaping that silver is manipulated in price by JPMorgan and will be until it isn't any longer. This is a cross silver investors must bear in the short term, much as they have over the years. I would remind you that despite the continuous manipulation by JPMorgan over the past six years, silver prices still managed to climb to almost historic price levels. The conditions that caused silver prices to rise previously (being on the cusp of a physical shortage) are still in place, only sleeping temporarily.

While JPMorgan is in complete control of gold and silver prices, considering the bank's mega-long position in COMEX gold futures and physical gold, as well as a mega-long position in physical silver, the crooked bank could decide to let prices run at any time. And even if it is not JPMorgan deciding to let prices run, world financial circumstances could overwhelm attempts to by JPMorgan to contain prices. The run up in gold prices on Thursday and Friday looked to me like a COMEX-dictated affair, despite world currency and financial rumblings. But if world events do spin out of control, there is not much better comfort for panicky investors than gold or silver.

I admit to being disturbed by the intentional COMEX bashing of silver prices on Thursday and Friday relative to gold, even though I've always known that silver is much more manipulated. If gold's up move is not just another attempt to force technical fund buying before a renewed sell-off, a higher permanent price for gold is not bad for silver. In fact, a higher price for gold may be the best thing of all (although it will hurt emotionally if silver doesn't lead or tag along in the short run).

Silver has many unique bullish factors attached to it on a stand alone basis; like how little exists when compared to 60 years ago, or how little is left over for investment annually after industrial and fabrication demand and how little for both that represents in dollars in today's world of almost unlimited dollars. These are absolute measurements that compel a long term exposure. But there is also a compelling reason to hold silver on a relative dollar comparison with gold. If just 0.3% (a third of one percent) of the total current value of all the gold in the world (\$7 trillion) tried to convert to silver that would be more than all the silver bullion that existed. Higher gold prices would only amplify the comparison.

I just don't think that fact is widely known or appreciated. That was in the back of my mind when I listened to Eric Schmidt, chairman of Google, at the Davos, Switzerland conference this week. Asked to name the most influential individual on the world scene over the past 25 years, Mr. Schmidt named the three scientists most responsible for the Internet because that enabled a revolutionary transition in world communication and knowledge sharing.

I've long felt that it is only a matter of time before the true facts surrounding the absolute and relative scarcity of silver become known to enough people in our modern world. Throw in a world awash in investment buying power accompanied by an aggressive search to find good investments and coupled with the existence of vehicles that can instantly convert cash to metal (ETFs) and silver will surely be lit upon at some point. JPMorgan may continue to press silver prices lower in order to add to its large physical holdings, but that will only increase price sensitivity to the upside as others come to learn of the real silver story.

Ted Butler

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Silver – \$19.90

Gold – \$1269

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