January 26, 2013 – Weekly Review

Weekly Review

After a promising start to another holiday-shortened trading week, gold and silver fell sharply at the end of the week to finish lower. Gold fell $27 (1.6%) for the week, giving back all of the prior week's gains, while silver fell 70 cents (2.2%), erasing half of the previous week's gains. As a result of silver's slight percentage underperformance, the silver/gold price ratio widened a bit to just over 53 to 1. Silver usually falls much further than gold on such price drops, but there's no way of telling if that is signaling something different this time or if silver will still Â?catch-upÂ? with gold to the downside. It generally has not been productive to base short term price predictions on short term price movements. On a longer term prospective, all the facts I look at still strongly suggest silver will outperform gold by a wide margin over time.

One of the facts that favor silver is the relative tightness in the physical supply of silver versus gold. My prime indicator of wholesale physical silver tightness, the movement of metal into and out from the COMEX-approved silver warehouses, registered perhaps the most frantic turnover yet this week, despite it being a 4 day bank work week. More than 4 million oz came in and were shipped out this week, as total inventories rose less than 200,000 oz, to almost 152.3 million oz. Try as I might, I can come up with no more plausible explanation for the frenzied metal turnover than it being due to almost hand to mouth conditions in the wholesale supply chain. And the more I think about it, I don't know if there could be a better indicator for a developing shortage.

Joining in on the frantic COMEX silver warehouse turnover, movement of metal into and out from the big silver ETF, SLV, has also been remarkable recently. Following the massive 18 million oz one-day deposit last week into the trust, the last week has seen an 8.5 million oz withdrawal afterwards. I'll have some special concluding commentary on the silver metal movement in the SLV, but the big metal turnover also suggests tight supply conditions in the wholesale physical silver market. The new short position report was released yesterday and indicated an increase of 850,000 shares (oz) in the short position of SLV to a total of 17.9 million shares. There was a bigger increase in GLD, the big gold ETF. http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99 It's still an open question if the big one-day deposit of metal in SLV was related to closing out the short position, as the short report was cut-off on Jan 15, a day before the big deposit was made. Later, I'll offer some different speculation about what the big deposit (and subsequent withdrawals) of metal may be all about.

There's not much to report on sales of Silver Eagles until the US Mint starts selling the coins on the 28th. However, published reports indicate that the Royal Canadian Mint has also allocated sales on Silver Maple Leaves due to heavy demand.

The latest Commitment of Traders Report (COT) appeared to both explain the strong price action of the reporting week and the subsequent price weakness after the Tuesday cut-off in gold and silver. In other words, there was an expected increase in the total commercial net short position in COMEX gold and silver on the strong price action thru Tuesday, as gold rose about $20 during the reporting week, testing the important 50 day moving average to the upside, while silver rose more than a dollar and did penetrate the 50 day moving average. This type of strong price action is invariably the result of technical fund buying and commercial selling. Weak price action is caused by the opposite.

In gold, the total commercial net short position rose by 10,800 contracts to 196,000 contracts, the largest level in a month. While all three commercial categories increased their short positions, the bulk was attributable to the raptors (the smaller commercials apart from the big 8). The gold raptors added almost 9000 contracts, increasing their net short position to 16,100 contracts. The big 4 and the 5 thru 8 added about a thousand short contracts each. My sense is that the increase in the total commercial gold short position was modest in that prices were deliberately kept from decisively penetrating the 50 day moving average thru the cut-off. It is also my sense that the entire increase in the commercial short position was reversed (and then some) on the price weakness over the past three days. In a nutshell, the gold COT structure is now back to bullish (from bullish to neutral) thru yesterday. It will take new monthly price lows on a closing basis to flush out more technical fund selling, but those lows are only $10 or so from where we closed on Friday. There may not be a tremendous number of technical fund contracts left to be sold, but the commercials will hunt for them if they engineer lower gold prices ahead. And there is no question in my mind that the commercials, led by JPMorgan, manipulate gold prices to aid in their bigger manipulation of silver prices. Gold is a much bigger market than silver, but JPMorgan's exposure to silver is much more important to them than their exposure in gold.

In silver, the total commercial net short position grew by a hefty 5,400 contracts (27 million oz), to 47,400 contracts. I believe the commercial short position grew disproportionately larger in silver than in gold because silver prices clearly penetrated the 50 day moving average, a buying signal that is hard for technical funds to ignore. By commercial category, it was a familiar pattern in that it was primarily a big 4 (read JPMorgan) and raptor affair. The big 4 added 2300 new shorts, while the raptors sold out 2500 long contracts, reducing the raptor net long position to 13,800 net contracts. The big 5 thru 8 added almost 600 short contracts. Like in gold, I believe the increase in the total commercial net short position in silver was largely reversed on the deliberate price weakness after the cut-off.

I would calculate JPMorgan's concentrated short position to have increased 2000 contracts in the reporting week, to 31,000 contracts (155 million oz). After deducting the more than 42,000 spread contracts indicated in the disaggregated COT report from total open interest of 142,279 contracts, JPMorgan's net share of the short side of the entire COMEX silver market is 30.9%. This is an absurdly large share for any active futures market to be held by one entity. It is price fixing in its purest form. Worse, once again JPMorgan is emerging, effectively, as the only real short seller of additional contracts on rising silver prices. Let me keep this simple Â? silver prices wouldn't be at current low levels if JPMorgan didn't hold both an absurdly large share of the market and would climb sharply the moment that JPM stops selling additional short contracts. JPMorgan has been the dominator of the silver market for almost 5 years now (since acquiring Bear Stearns) and, if anything, seems more dominant than ever before. While some may suggest that can last indefinitely, I would look at it differently. The day that JPMorgan no longer controls the silver market will come suddenly and will amount to a shock to the system. I see signs that that day may not be far off.

Can silver and gold prices suffer further price losses? Yes. Will they? I don't know. But I do know why prices may fall further and that prices, especially for silver, are likely to climb sharply, with or without further short term price weakness. If we sell-off further, it will be for one reason only Â? because the collusive COMEX commercials, led by JPMorgan, succeeded in illegally rigging prices lower to induce technical fund selling. Any price fall will have nothing to do with real silver supply/demand developments, just COMEX price rigging. That this crooked COMEX game has become so obvious to growing numbers of observers suggests it will not last indefinitely, particularly considering that there are a number of ways for it to end. I'll explore one of them today.

I'd like to speculate concerning SLV and the big metal deposits and withdrawals witnessed in the trust recently. Let me preface this with the emphasis that it is speculation on my part, but it is based upon facts easily verified. In essence, such speculation amounts to trying to find the most plausible explanation(s) for a given set of facts. The goal is to then gauge if the explanation derived at will result in higher or lower price in the future. Every once in a while, the most plausible speculative explanation may strongly suggest a big price move ahead is probable. I suppose that's the whole purpose of speculating in the first place.

Of course, speculations can turn out to be correct or incorrect. I've had my share of both, but I like to think that there were more speculations closer to the mark than not. Let me give you an example of one I think I hit on the head (you didn't think I would remind you of a wide miss, did you?). This speculation didn't have an obvious short term price prediction indicator. Back in early September 2008, I openly speculated that JPMorgan was the big short, having taken over Bear Stearns at the request of the US Treasury Dept. http://www.investmentrarities.com/ted_butler_comentary/09-02-08.html Two months later, this speculation of mine was confirmed in CFTC correspondence to lawmakers and that hasn't changed since. And as stated in the article, it turned out to be profoundly important to the silver market that JPMorgan was the big short.

In trying to come up with the most plausible explanation for the recent big metal inflows and outflows of the SLV, I have suggested previously that they were related to the big short position and/or a single big buyer. Let me focus on the big buyer theory. It's plausible that a single big buyer is responsible for the big deposit and subsequent withdrawals from the SLV. It occurred to me that the big 18 million oz deposit came very close to 5% of the total shares outstanding the day the deposit was made (355 million shares). Five percent happens to be the ownership threshold set by the Securities & Exchange Commission (SEC) for publicly disclosing an ownership position in any publicly traded stock, such as SLV. One of the things I've always marveled at was the lack of any concentrated or large holdings in SLV. Unlike in GLD, where funds controlled by John Paulson held an SEC-mandated reporting position, the SLV had never listed any single owner of shares over 3% of total shares outstanding to my knowledge. The largest current holder of SLV holds only a little more than 2.2% of all shares http://www.nasdaq.com/symbol/slv/ownership-summary

A single entity buying and holding just under 5%, say 4.9% or less, would not have to publicly disclose that ownership until the 5% threshold was exceeded. Generally, public ownership disclosure is not something sought by a large buyer, at least until after the purchase is complete. Therefore, based upon the remarkable similarity of the 18 million oz deposit and the 5% threshold, it seems reasonable to me that a single large buyer was responsible for the purchase of SLV shares (which in turn necessitated the big deposit of metal). As I've previously written, the deposit was a shock in that there appeared to be no widespread buying interest based upon reported share volume and price movement. This is also supportive of the single big buyer thesis, as it is possible nowadays for large buyers and sellers of stick to use Â?dark poolsÂ? to amass or liquidate massive amounts of stock with little notice. (This came out of the government insider trading campaign under way as a means for large traders to hide trading activity). A big buyer of SLV (or any stock) would resort to a dark pool type transaction if he wished to shield it from those studying volume statistics (like me).

Therefore, the combination of using a dark pool to execute the transaction and staying under 5% ownership would seem to fit with what took place recently in SLV as far as the big deposit was concerned. But what about the subsequent 8.5 million oz in withdrawals of metal from the SLV? How does that fit into my speculation of a single big buyer of SLV? Actually, it fits in quite well once you factor in the mechanics of the trust. Let's speculate further that the big buyer wanted to purchase more than 5% of the SLV, but still desired for the ownership not to be made public. Is there a way that could be accomplished? I think there is and it may explain the subsequent withdrawals of metal from the trust.

It has to do with the mechanics of the SLV. Because SLV contains the mechanism that allows for shares to be converted into metal (and vice versa), it is quite possible for a buyer or holder of 4.9% or less of the total shares outstanding to reduce his percentage ownership of shares by converting already purchased shares into actual silver metal via the conversion mechanism. It is easy to convert, through Authorized Participants (AP's), baskets of shares into actual metal at any time. The buyer still holds the equivalent silver position whether in shares or actual metal, but for every share converted to metal, the percentage of share ownership declines as the actual metal component grows. I think this conversion of shares to metal is responsible for the 8.5 million oz withdrawal following the big purchase/deposit. Not only is there nothing wrong with this process, but this is exactly what I would do if I were fortunate enough to be in the position to buy that much silver.

For a big buyer, it's a no-brainer. It doesn't require additional capital as the SLV shares were paid for and the conversion to metal only requires some slight transaction costs to the AP's to effect the conversion. Then, instead of paying an ongoing management fee to BlackRock on shares of SLV owned, the same fees (or less) would be paid for storage and insurance for metal held in the buyer's name. It really is a piece of cake to convert shares of SLV into metal, if done in the basket size outlined in the prospectus (roughly 50,000 shares/ounces).

The best part for a big buyer is that by converting shares to metal, the process can be continued because he can stay below the 5% reporting threshold on shares owned even as his total position grows. For instance, if the 8.5 million oz withdrawal was by a single big buyer, that means he has room to buy 8.5 million more shares and still be below the 5% reporting limit. Theoretically, almost any amount of silver could be purchased with no reporting requirement, as long as share ownership remained below 5% of all shares outstanding. As I said, were I in position to buy a very large quantity of silver, this is the way I would do it. So, if my speculation is correct and a single big buyer has emerged in silver, via the SLV and the conversion of shares to metal process, what does this portend for the price of silver?

What makes this speculation so interesting is that silver has been a manipulated market for many years and the question is constantly asked as to why no big buyer has emerged. As such, the price has been artificially depressed and promises to explode the minute the manipulation is terminated. Given the signs that the wholesale physical silver market has been tight for some time, the entrance of a big physical buyer could and should be the straw that breaks the manipulators' back. It is important to point out that if there is a big buyer present in silver, there is no way of knowing what total amount he is looking to buy Â? 25, 50 or 100 million oz or more.

I've often postulated that in the end it is much easier for a buyer to write a check and take delivery of silver than for a short seller to round up and deliver a material in short supply. If it is true that a big buyer has entered into the silver equation, then we may soon witness firsthand that postulation in action. I'm not even surprised at the subdued price action witnessed so far if a big buyer has stepped into the fray. That's because breaking the silver manipulation is akin to an old fashioned bank run (before the US Government, effectively, guaranteed all bank deposits).

When the first worried depositors show up to withdraw their savings from a bank thought to be close to failing, the only hope of averting a full-blown run is for the bank to shovel out the money fast to as many depositors as required, thereby lessening the fears of other depositors that they may not get their funds. The idea is to calm the collective fear that the bank doesn't have enough for all depositors. Of course, if the bank runs out of money along the way, those depositors remaining lose everything (in the old days). The parallel in the silver manipulation is that JPMorgan and others must be quick to sell and deliver shares of SLV and metal to the buyers in the hope that the quick delivery will convince buyers that there exists plenty of silver to satisfy even the largest buyer at low prices. But if the buyers have done their homework and realize that there isn't unlimited silver available to purchase, the bluffing is destined to fail. Based upon all the facts as I know them to be, I think we might be real close to the bluff-busting moment of truth.

Even if we are close to that point, that doesn't mean the COMEX crooks won't be looking to rig prices lower first. These market criminals know the game and how important it is to cause as much technical fund selling as possible. It's all a numbers game and the numbers in COMEX paper contracts are even bigger than the big SLV buyer I am speculating about (at least so far). Just this week, more than 5000 net COMEX contracts were bought by speculators through the cut-off date of the COT and that many may have already been liquidated since. 5000 contracts is the equivalent of 25 million ounces, even more that the amount possibly bought in the SLV recently.

What this means is that silver may be set to explode if a big determined buyer has emerged, but still could experience another short term drop first on the usual COT market structure considerations. The move up will likely be spectacular, but may be preceded by one last engineered move down. Please be guided accordingly. That means don't lose positions and only add if you can weather a short term decline (that may or may not come). In essence, that means no margin. For the first time in quite a while, I feel call options should be considered, particularly if prices swoon in the short term, but only with funds you can throw out the window and wave good-bye to with no remorse.

Ted Butler

January 26, 2013

Silver – $31.20

Gold – $1658

Date Created
2013/01/26