January 3, 2018 – Back To the Contract Count

Rarely has it been clearer as to what really drives the prices of silver, gold and other markets than what has occurred over the past month or so. Even those who looked askance at suggestions that futures contract positioning changes dictated prices to actual underlying production and consumption forces canâ??t deny what has occurred very recently. Importantly, the futures positioning changes have occurred in full view, just as more were looking at these changes than ever before.

You donâ??t have to look further than to the changes in COMEX silver and gold futures to see what drives prices, but if you did, the same basic pattern emerged in a whole host of other important commodities, such as, but not limited to platinum, copper and crude oil. But letâ??s stick to gold and silver today, since they are the principle focus of this service.

After two months of basically sideways price action and very stable positioning changes on the COMEX, gold and silver prices broke to the downside for an almost uninterrupted 10 or 11 trading day decline in very late November, with the price declines in each ending on Dec 12. On the decline, gold fell about $60 (to $1240), while silver fell around $1.30 (to $15.70). While the price declines werenâ??t particularly noteworthy in size by typical historical measures, there was a standout feature in the extraordinary positioning changes that, essentially, drove the price declines.

Over the two-week price decline in gold into Dec 12, some 130,000 net contracts were sold by managed money traders, both in the form of long contract liquidation and new short sales. Thatâ??s the equivalent of 13 million ounces of gold and I can assure you that no larger amount of gold in any form was sold over that time. The vast majority of those COMEX gold contracts sold were bought by other futures traders, speculators termed commercials, both in the form of short covering and new longs.

In COMEX silver futures, roughly 80,000 net contracts were sold by the managed money traders into the Dec 12 price low; the equivalent of 400 million oz. Common sense would dictate that not only was this the largest amount of silver sold in any form over that time, such an extraordinarily large quantity of silver couldnâ??t possibly have been transacted in any other venue. After all, how the heck could anyone sell (or buy) half the worldâ??s annual production of any commodity in such a short period of time with such a minimal change in price away from doing it on the COMEX? As was the case in gold, the traders termed the commercials bought most of what the managed money traders sold in COMEX silver futures. See a pattern here?

From the price bottom on Dec 12, gold and silver prices have rebounded strongly, more than completely erasing the previous declines. Through yesterdayâ??s Tuesday cutoff for this weekâ??s Commitments of Traders (COT) report, gold had climbed nearly $80 to its highest level since September, while silver climbed around $1.50 from its low in Dec; in the process creating a very pronounced and rare â??Vâ?• price bottom formation. (Thatâ??s just to show you that I notice technical formations, even though I donâ??t profess to know or accept what they may signify).

What I (and you) do know is that the very same force that created the price decline, namely, managed money selling and commercial buying, also accounted for the price rise, only in reverse. We know that we can take it to the bank that there has been aggressive managed money buying driving gold and silver prices higher and that the commercials have sold into this buying. This pattern is as strong and reliable as the one that drives lake-effect snow. One doesnâ??t need to spend a lot of time trying to figure out why Erie, PA gets so much snow or what drives gold and silver prices. At this point, itâ??s all about measuring the amount of snow or positioning change that has occurred. Therefore, itâ??s back to the contract count.

At this point, the contract count is nothing more than trying to measure how many managed money contracts were bought on a net basis (new longs plus short covering) on the price rally and how many might be left for potential purchase. Fortunately, there exists one source upon which such calculations are based, the COT report. Without this data series, none of the market structure analysis that is literally exploding in popularity around us would be possible.

Unfortunately, there is still a high degree of subjectivity that must be applied to market structure analysis, not the least of which is that there are always variations in every price move, in terms of timing and quantities of contracts bought and sold. Itâ??s one thing to come to learn what really drives gold and silver prices and quite another to start spouting off price forecasts with implied precision. Knowing why a price move is occurring is different than knowing precisely how far it will carry before reversing. Letâ??s stay a bit humble even if we know why prices do what they do.

Cutting to the chase, how many net COMEX gold and silver contracts have the managed money traders bought through yesterdayâ??s close and that will be reported on Friday? Based upon price action and trading volume over the four day reporting week, all indications are for this weekâ??s COT report to be a lulu; likely featuring near record weekly changes. Iâ??m going to use specific contract numbers to help clarify the magnitude of the possible changes this week, but ask that you recognize that the bigger the changes, the more likely my (or anyoneâ??s) predictions may be off. The alternative, I suppose, is simply to wait and report on the changes, which wouldnâ??t be very helpful at this time.

In COMEX gold futures, I wouldnâ??t be particularly be surprised if the managed money traders bought and the commercials sold 60,000 net contracts or more in the just ended reporting week. Thatâ??s an extraordinarily large number of net contracts to be bought and sold in a four day reporting week, but the price action suggests the conditions were ideal for massive technical fund buying, in terms of volume, moving average penetration and the successive new salami price slices to the upside. Needless to say, should the actual numbers reported be lower, all to the better, with the converse true should the numbers be much higher.

Whether my estimates are close or not, since there were a fairly small number of managed money shorts going into this reporting week in gold, the large increase in total open interest thru yesterday of 45,000 contracts suggests most of the managed money buying was in establishing new long positions. With gold racing to new four month price highs, what technical fund wouldnâ??t want to be long gold?

In silver, itâ??s a bit different. While silver prices have kept pace with goldâ??s advance, by and large, silver has appeared to struggle more, only decisively closing above its two key moving averages on yesterdayâ??s close (whereas gold has done so for six trading days). While trading volumes have been heavy, the total open interest in COMEX silver has fallen by about 8,000 contracts, as opposed to the hefty increase in gold total open interest. The difference, to my mind, is that there was a very large managed money short position in place in COMEX silver, while that wasnâ??t the case at all in gold. In addition, there was a relatively small managed money long position in silver, and most of it appeared to be of the non-technical fund core long variety.

Therefore, I believe there was both significant managed money silver buying on both counts, namely, new longs and significant short covering. The net result of this would show up as not much change in total open interest, as managed money short covering and new buying would tend to net each other out in terms of changes in total open interest. Despite the relatively small decline in total open interest over the reporting week, it wouldnâ??t surprise me if there was a 30,000 contract net change in managed money buying this week, along with a corresponding change in commercial selling. As was the case in gold, the smaller the changes the better.

Should the net positioning changes reported on Friday approximate my very loose estimates that would put the market structure in gold solidly in the neutral category from the previous extremely bullish structure on Dec 12. If my estimates hold true in silver, it would leave silver still in a bullish market structure, although nowhere near as bullish as on Dec 12.

There can be no question as to what drove gold and silver prices lower into Dec 12 and what has driven prices higher since then, but there are nothing but questions as to what happens next. Moreover, the influence of managed money/commercial futures positioning was so pronounced on the move down and then up as to raise the question of why such intense and deliberate positioning changes in such a short time. This increases the possibility of something truly profound occurring ahead. Maybe what has occurred over little more than a month just indicates a series of even more pronounced positioning changes to come in which the commercials continue to whip the hapless technical funds in and out of the market with the net effect of taking many hundreds of millions of dollars out of the managedÂ money tradersâ?? pockets. Or maybe there is something else afoot (like a really big move to the upside, particularly in silver).

The wildcard, at least in silver, but possibly in gold as well, is the role of JPMorgan, or so it seems to me. A key feature of this Fridayâ??s COT report, of course, will be the amount of new short selling by the 4 biggest shorts in silver, of which JPM is the Godfather. The release of the monthly Bank Participation report on Friday should also help ascertain just what the silver (and gold) marketâ??s biggest crook is up to. Itâ??s reasonable to expect an increase in JPMâ??s shorting, otherwise I would have imagined silver prices would have performed much better. Itâ??s just as reasonable to expect that the majority of commercial selling in silver was from raptor (smaller commercial) long liquidation (at great profit).

What makes JPMorgan the wildcard, of course, is its massive physical accumulation of silver over the past nearly seven years, now amounting to at least 675 million oz. Even if it adds to its manipulative COMEX paper short position, the bank stands to profit more than anyone in the event of a price melt-up. While I could never rule out that the current rally will get capped and eventually fail should JPMorgan really put its shoulder to the overall commercial selling; neither can I rule out a commercial double cross by JPM and a run to the upside. I suppose it all depends on whether JPMorgan believes it can eventually turn silver prices lower to again buy back profitably any new shorts it adds, as well using the time for picking up more physical silver on the cheap.

I know that many have become convinced that things will never change and JPMorgan will always add to its paper COMEX short position on any price rally, while continuing to amass physical silver. Increasingly, I find myself subjected to lectures about how things will never change, even though I am being instructed about something I introduced in the first place. But always is a very long time and it appears to me that one of these days (and maybe now), JPMorgan is likely to choose to ring the mother of all cash registers and step aside from suppressing the price of silver. I would define â??one of these daysâ?• as coming soon, either on this move or the one immediately following, should this one fail.

In other words, Iâ??m not so sure that any new shorting by JPMorgan in Fridayâ??s reports automatically dooms the current rally. Of course, should these crooks lay heavy wood onto the short side, at some point, Iâ??ll face the obvious conclusion.

Even a 30,000 net contract deterioration in Fridayâ??s silver COT report would leave open the possibility of as many as another 50,000 contracts (or more) of managed money buying on higher prices, should the commercials seek to induce that much technical fund buying. Like it or not, silver and gold price analysis has become little more than a game of trying to read the crooksâ?? minds. Thatâ??s certainly not the way it should be, considering there is a federal agency in place, the CFTC, as well as a self-regulator (the CME), who are charged with preventing such a distorted price discovery mechanism. But a lot of things that shouldnâ??t be do exist and I suppose itâ??s better to be aware of things that shouldnâ??t exist but do, as opposed to living in the fairy tale of everything being peaches and cream.

For my part, I am aware of the very recent deterioration in silver and gold market structure and while I am not particularly happy about it, Iâ??m still playing it the same â?? all-in and then some.

Ted Butler

January 3, 2018

Silver – $17.15Â Â Â Â Â Â Â Â Â Â (200 day ma – $16.98, 50 day ma – $16.67)

Gold – $1314Â Â Â Â Â Â Â Â Â Â Â Â (200 day ma – $1272, 50 day ma – $1277)

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