

January 4, 2014 – Weekly Review

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In what appeared to me to be a rather extraordinary week, the price of gold and silver rose for the second consecutive week (for the first time since October). Gold's gains were much more impressive at \$25 (2.1%), compared to only a 10 cent (0.5%) gain in silver. As a result of gold's relative outperformance, the silver/gold price ratio widened out a full point to 61.5 to 1, still stuck in the tight trading range of the past year or longer.

While I'm very bullish on both metals, I still believe silver will vastly outperform gold over time, given all the facts. I am also still amazed that even among those who have studied the matter closely; there is a hesitancy to recommend switching gold positions into silver. Just this week, in an interview with a respected gold commentator, he stated that while he believed silver would rise twice as much as gold, he would stick with gold. His reasoning is that silver is much more volatile than gold and would likely fall much faster after that rise. He listed how much silver had fallen from price tops in the last five years.

Not to sound like a smart aleck, it seems to me that the easy solution is not to buy silver at price tops, but only after it has fallen substantially like now. Later, as prices climb strongly and the silver/gold ratio declines to 20 or 30 to 1 (his targets), switch back into gold if you fear silver volatility. The time to fear volatility is when prices are high, not low.

Volatility was what made the week extraordinary – the sharp sell-off on the Monday and Tuesday before New Year's Day and the sharp rally on the first two days of the New Year. Generally, the days straddling the turn of the year are marked by listless trading volume and subdued price activity. Not this year, as both silver and gold came close to setting yearly price lows intraday on Tuesday before reversing. As is almost always the case, there was no news or apparent reason for the price plunge away from COMEX computer trading gone wild in a clear attempt to generate mindless technical fund selling. After the price bombing on Tuesday, the commercials absorbed and bought everything the technical funds sold. Oh Lord, how long will the COMEX commercial crooks (led by JPMorgan) toy with the price of gold and silver?

For only a four day work week, the turnover in the COMEX-approved silver warehouses was extraordinary. Scratch that ^ the gross in and out movement of more than 7 million oz was the highest in my memory for any week, as total COMEX silver inventories rose by 1.7 million oz to more than 174.9 million oz. While that is another new total inventory high going back 20 years, I am still focused on the incredibly high turnover because that is indicative of wholesale silver tightness.

With the highest trading volume on Tuesday since September in the big silver ETF, SLV, I was unsure of what to expect in the way of changes to silver holdings. Compounding the matter is the potential rebalancing by commodity index funds given silver's new low price and how much more metal can be purchased for the same amount of dollars as a year ago and for the year end of the past three years. Silver had ended close to \$30 for the last three years, meaning one can buy 50% more metal today for the same amount of money compared to the amount of ounces one could buy at the end of 2010, 2011 and 2012.

Yesterday, it was reported that 1.6 million ounces were liquidated from SLV, which considering my uncertainty was no big surprise. But more and more, considering the flow of new developments surrounding JPMorgan, I can't help but feel the recent declines in metal holdings in SLV (and maybe even GLD to a certain extent) may be the result of a big buyer (like JPM) converting shares to metal to conceal ownership. I've mentioned this from time to time in the past and it is something I would do ^ if I were in the fortunate position of needing to hide ownership of this much silver. I'd keep buying shares of SLV and convert shares into metal which doesn't need to be reported to anyone.

Once again, due to the holidays, the next Commitments of Traders Report (COT) won't be released until Monday. Complicating the delay is that the wild price action occurred on Tuesday, the report's cut-off date. In the past, wild price changes on the Tuesday cut-off are not fully reflected in the report. Accordingly, I may or may not have a comment late Monday on the new COT report.

Since there is no COT report to review today, I'd like to follow up to my year end review on Wednesday. I thought I would comment further on the stark difference between the market structure that existed a year ago and what exists today and what that might portend. Still vivid in many minds are not only the sharp, short takedowns in gold and silver last year, but also the brutally sharp takedowns in silver in 2011.

The common denominator in all the big price take downs was the existing market structure that encouraged and allowed the technical funds to sell and sell short massive quantities of COMEX gold and silver contracts in sudden bursts. You know the process ^? the commercials (led by JPMorgan) rig prices sharply lower on the COMEX thru HFT and spoofing (entering huge sell orders that scare others into selling with the original sell orders canceled immediately). The whole purpose behind the commercials' original phony spoofing sell orders is not to actually sell, but to cause the price to drop sharply to induce the tech funds to sell.

Once the tech funds start selling for real, the commercials place buy orders at very low prices and wait for the tech fund sell orders to come to the commercials' resting buy orders. The commercials sell very few actual contracts to get the price snowball rolling down the hill and the whole intent is to get the tech funds selling so that the commercial can buy. This is the essence of the scam.

What enabled this scam to occur on several occasions last year in gold and silver and in 2011 in silver was that the tech funds were in such a position so as to be susceptible to suddenly sell in massive amounts. This was due to a number of factors, including a prolonged bull market into the start of 2013 in gold and silver that caused the technical funds to be heavily net long and, therefore, ripe for selling large quantities of contracts whenever the commercials decided to rig prices sharply lower.

That's the key ^? does the market structure allow for the commercials to pull the rug out from prices and trick the technical funds into massive unified selling? Clearly, the market structure was so configured when we experienced all the big deliberate sell-offs of this year and 2011. Unfortunately, market structure is somewhat fuzzy or subjective and I can't give you a precise mathematical definition of when a big sell-off is likely or not. That's because there are too many variables to speak in definitive terms. But there are some things that can be pointed out without too much fear of contradiction.

Commodity futures and options trading is a zero sum game; meaning that whatever profit is made by someone must also be lost by someone else. In other markets, like stocks, bonds and real estate, all holders profit when prices rise and all holders lose when prices fall. This is the opposite of zero sum; everybody either wins or loses depending on whether prices rise or fall. There are some short sellers in stocks, but less so in bonds and real estate. In any case, it's much different in derivatives contracts, such as futures and options contracts.

In derivatives, there must be a short for every long (and vice versa), as a contract can only exist if there is both a buyer and seller. One side (long or short) will win and one side will lose. This is the basis for studying the market structure, namely, trying to determine which side, the long or short side, is likely to win or lose. This is the objective in studying the COT report.

More specifically, in COMEX gold and silver trading, we can identify the principle adversaries as the technical funds and the commercials. Generally, either the technical funds or the commercials will win in the end. It is important to define "in the end". I define it as when most contracts are closed out. Open gains and losses are calculated every day for margin and other purposes, but only when most contracts are closed out and liquidated can the true gains and losses be calculated and measured. In other words, it is possible for a contract to be held open at great loss or profit for extended periods of time, only to turn into a realized profit or loss when the contract is closed out. This typically occurs when there is a sudden jump or fall in price opposite to what prevailing price trends have been.

Currently, the technical funds are more short gold and silver than they have been historically and the commercials are more long than they have been historically. The technical funds are more short (and less long) because gold and silver prices have been trending lower and technical funds react to declining prices by selling more as prices decline. This means the technical funds are holding most of their short contracts with open profits and those commercials which are long are holding with open losses.

At some point, most of these open contracts will be closed out and it is entirely possible that what are now open profits for the technical funds can end up being closed out with realized losses. In fact, I believe that this will turn out to be the case and I'd like to speculate how this may come about. The important point is that this is indeed speculation and different from the main thrust of this service which is to take a long term approach in holding silver. Further, I have made this speculation in the past and it did not come to fruition (at least yet). But to not present all the possibilities could be considered a disservice on my part.

We have witnessed in 2013 the circumstance where gold fell by \$200 in two days and silver by \$5 (in April). We have also witnessed in 2011, two occasions where silver fell \$15 in a matter of days. My first observation is that any market that falls by such amounts can also rise by that much or more within days as well. Whatever caused the price plunges could also cause similar price surges. Since what caused the plunges was the market structure at the time which allowed for massive and compressed selling by technical funds; a price surge would be caused by massive and compressed buying by technical funds.

The relevant question is if the current market structure allows for the possibility of massive and compressed buying by the technical funds in COMEX gold and silver. The simple answer is yes, the current market structure allows for such a possibility. Because gold and silver have been in a pronounced down trend for almost a year, the technical funds are massively short and could be provoked into buying back their short positions and going long in a dramatic manner.

What would cause the technical funds to rush to buy massive amounts of COMEX gold and silver contracts? One thing is prices rising high enough. It's not that complicated – technical funds sell as prices decline and buy as prices rise. So all it would take for technical funds to abandon the short side of gold and silver and rush to the long side would be prices rising high enough. What price is high enough? Generally, the technical funds are motivated most when prices penetrate the key moving averages.

On Friday's close, gold closed within \$25 of its key 50 day moving average (\$1260) and silver closed within 35 cents of its 50 day moving average (\$20.49). Not that far above that looms gold's 200 day moving average (\$1346) and silver's 200 day moving average (\$22). As and when the price penetrates these moving averages it can be expected that the technical funds will be in full buy mode. As I've written previously, it's mathematically impossible for these moving averages not to be penetrated at some point, either due to the price climbing or the moving averages declining, or some combination of the two.

We did have an upside penetration of the 50 day moving averages in gold and silver during the summer and that is what accounted for gold's \$200 and silver's \$5 rallies. However, we have not experienced a penetration of the 200 day moving averages in each for more than a year; but those penetrations are also closer than they have been for almost a year. Please don't misinterpret what I am saying. I think trading or investing on such mechanical signals is nuts and I am not endorsing this approach. On the other hand, I can't turn my back on what might influence price on a self-fulfilling basis if enough trading entities follow it.

It is certainly possible that the commercials (JPMorgan) are not ready for prices to move higher now triggering technical fund buying and we may back and fill and generally stall in price for a while. But it's just as possible that the commercials are ready to let prices rip higher and induce a massive technical fund buying surge in the very near future.

More than the actual timing of the coming price penetration of the moving averages in gold and silver, there is another possibility that looms large – how easily (or not) will the commercials let the technical funds buy back their short positions and establish long positions? This is the question I ponder more than any other. Simply stated – unless the commercials sell fairly aggressively as the moving averages are penetrated to the upside, there is a real possibility of disorderly pricing to the upside. I'm back to the thought that a market that can fall \$200 (gold) or \$5 or \$15 (silver) in days can also rise by such amounts. It comes down to how easily the commercials will let the tech funds off the short hook. Time will tell, but let me remind you that the commercials (and particularly JPMorgan) will rip out the financial lungs of anyone on the wrong side of a trade if it suits them.

It does seem to me that the current set up is not one that can be easily replicated should the technical funds escape with minimal damage to the upside. It has taken a year for the commercials to achieve getting the technical funds in their current position. If the technical funds are let off with minimal damage to the upside, I don't know if the commercials can put them back onto the short side to current extreme levels. That argues for the commercials ripping off the tech fund's faces in the here and now.

Please take this in the manner it is offered, namely, to alert you to the possibility of a dramatic upside surprise for the reasons I have outlined. Again, not to have done so might be considered a disservice. It's always imperative to consider all the possibilities.

Ted Butler

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Silver – \$20.15

Gold – \$1238

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