

January 6, 2016 – Interesting Times

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Unless I'm hallucinating, there have been more unusual world developments over the first few days of the New Year than I ever recall. In addition, price action and trading activity in gold and silver have been unusual on their own. As such, it sort of scrambles the content of what I intended to write about today.

This morning, as I begin to write this article, gold has started out very strong, trading above its important 50 day moving average for the first time in two months. To this point, silver has lagged, unable to convincingly penetrate even its 20 day moving average and still some 40 cents under its 50 day moving average. I would imagine price action and trading conditions to change, if not later in the day, then certainly in the days and weeks ahead.

So far, however, I have seen nothing that contradicts the premise that COMEX futures market positioning fully explains price movement to date. It may seem like gold jumped on news that North Korea detonated a hydrogen bomb and the resultant financial anxiety, but the buyers of gold over the past few days were most probably the managed money technical funds.

While I'm tempted to say these buyers don't even know where North Korea is located, that would be gratuitously insulting and untrue. The truth is that no matter what occurs in the world, it has no bearing on what the technical funds do; the only thing that matters is moving average penetrations. Undoubtedly, we'll know more by the end of the day, so I'm going to save a trading update until later, after I deal with some other topics I wish to cover.

I'm not a big fan of those that purport to be experts on everything. The older I get, the more I realize how much I don't know, as opposed to what I think I know. That applies even to silver and gold, where I do try to stay as current and informed as possible. As a result, I tend to dismiss those providing a detailed road map for just about everything that will happen in the world, from finance to geopolitics. I do listen to what others say and write, but always with an emphasis on the facts and reasoning behind any conclusions reached. If the facts aren't substantiated or the reasoning sound, then I consider it just another uniformed opinion of which the world is always massively oversupplied.

Therefore, when I do run across a well-reasoned argument backed by facts and further supported by a credible track record, I tend to sit up and take notice, even in areas away from silver or gold. While I'm not involved in the stock market (away from silver related positions) and don't plan to get involved, big changes in the equity market can have an influence on gold and silver. Besides, who doesn't keep an eye on the stock market, whether involved directly or not?

Over the past year or longer, I have been impressed with the work of John Hussmann, who writes a weekly commentary on the stock market that fits my definition of well-reasoned and based upon accurate data. To be honest, some of his formulae are way over my head and I confess to not being that interested in immersing myself in the details.

If anything, his approach kind of reminds me of my approach to the COT report and changing market structure in silver and gold, namely, an approach both mechanical and including fundamentals; only not on gold or silver, but the stock market. Perhaps I am diminishing Mr. Hussmann and unnecessarily elevating myself with this comparison, but my point is what he writes resonates with me.

<http://www.hussmanfunds.com/weeklyMarketComment.html>

I'll summarize what Hussman has been saying, but don't rely on my interpretation; please read and decide for yourself. And in no way should you take this as investment advice on the stock market, as I try to avoid investment advice even in silver and gold. Certainly, I'm not buying or selling anything in the stock market; the only reason for me bringing this up is because we may be at a critical point in the stock market and if what I believe Hussman is suggesting occurs, it could have a big impact on precious metals, although he's never even mentioned gold and silver in any way to my knowledge. With the equity markets becoming volatile, I thought I should share this now or forever hold my peace.

Basically, Hussman is arguing that the stock market could fall sharply (on the order of 40% or 50%) based upon his indicators of valuation, investor behavior and past history. He's not pounding the table or giving firm declarations that this will occur and only speaks in measured and consistent tones. He points out that such declines have occurred regularly in the past when conditions are aligned as they are currently. He's certainly not calling for the end of the world and has stated his intent of buying aggressively should the decline occur. It's just a matter of his current risk profile. And in no way am I suggesting Hussman is alone in his opinion, as many whose opinions I respect feel the same way (Fred Hickey to name one).

My interest is confined to what impact a big decline in the equity market might have on silver or gold. I can't see such a development as being bearish for gold or silver. It's no coincidence that gold and silver prices have suffered over the past four or five years, just as equities have advanced, based upon investor preference (leaving aside the COMEX manipulation). A prolonged period of stock market weakness or a sharp sudden decline would likely result in increased investment demand in gold and silver as investment alternatives. Particularly considering how little physical silver is available for investment, any serious new investment flows in silver should have a profound impact on price.

On Saturday, I mentioned I had some new thoughts on how the silver manipulation might end, in terms of the old "full pants down" premise. As a refresher, this term came from my old friend and silver mentor, Izzy Friedman, to describe how the silver manipulation would likely be terminated. He held that the physical silver shortage would hit while the commercials were loaded up on the short side of COMEX futures, resulting in a short covering event of epic proportions. While I never ruled out the possibility of such an event, it always seemed more likely to me that silver prices would explode when the commercials were as least net short as possible and with the technical funds most short.

More and more, I am becoming convinced Izzy and me may have not been as far apart as it might first appear; in that both of us were expecting some dramatic price action to punctuate the silver manipulation's end. I still feel more inclined to imagine the technical funds as being on the wrong side of the equation than the commercials, but a new possibility may have emerged as to who might have their pants pulled down and it may be closer to Izzy's opinion than mine or at least some combination of the two.

I make no bones about the key development in the silver market over the past nearly five years being the accumulation of 400 million oz of physical silver by JPMorgan. This is the largest hoard of privately owned silver in the history of the world and is so massive that it constitutes 30% to 40% of all the silver bullion in the world (1000 oz bars). Although I have been reporting on this accumulation for the better part of two years, I must tell you that even I find it a most amazing development. Most amazing of all, of course, is that JPMorgan was able to accumulate this massive stockpile on declining prices; by which the bank illegally manipulated prices lower via expanding and contracting COMEX silver short future positions.

The facts pointing to JPMorgan's physical silver accumulation are as plain as day and have been chronicled on these pages. My premise is becoming more accepted, but a surprising number of those accepting the premise are still convinced JPMorgan intends to use its massive physical silver stockpile to continue the price manipulation, rather than my conclusion that the bank intends to make the financial score of the ages. Time will tell which way it turns out.

But if JPMorgan has acquired the amount of physical silver that I claim, one thing it definitely changes is the full pants down premise. Izzy and I had the original debate many years ago, at least 15 years ago or longer. This was long before JPMorgan took over Bear Stearns and acquired its obscenely large COMEX silver and gold short positions in March 2008 and well before JPMorgan started to accumulate physical silver in May of 2011. JPM'S accumulation of physical silver changes everything in the world of silver, not the least of which is the full pants down premise.

Simply put, by having accumulated 400 million oz of silver, it is impossible for JPMorgan to get its pants pulled down in a silver short covering panic. That's because JPMorgan is no longer net short in silver and hasn't been for several years. Yes, of course, JPMorgan may be short on the COMEX and may or may not be the single biggest short futures holder currently; but by virtue of its much larger physical long position, the bank has been decidedly net long overall in silver. As such, any dramatic move higher in the price of silver will greatly benefit JPM, not pull its pants down.

The math is simple. If you own 400 million ounces of physical silver and are short the equivalent of 60 million ounces (12,000 COMEX contracts), you are net long to the tune of 340 million oz. That means you can't possibly lose if prices move higher and will make \$340 million for every dollar silver moves higher. You will lose \$60 million gross on your COMEX short position for each dollar of higher prices, but will make \$400 million gross or \$340 million net. Net is what matters.

To make matters even more interesting, should JPMorgan aggressively move to buy back its COMEX silver futures short position, that will both reduce its gross short position and increase its overall net long position, while turbocharging the price higher to its own benefit. I've referred to JPMorgan's accumulation of physical silver as the perfect crime, and this makes it even more perfect.

Neither the CFTC nor the CME will say boo if JPMorgan moves to buy back its COMEX silver short position to the upside. Aside from the regulators not saying anything to JPM in any circumstance as a matter of course, there is nothing for them to say about any entity buying back a previously shorted futures contract (or selling a previously purchased futures position). The CFTC regulates futures contracts, not physical holdings. The CFTC, most likely, isn't remotely aware that JPMorgan even holds physical silver (away from what I write), and is in no position, at this point, to say or do anything should JPMorgan move to buy back its remaining COMEX silver futures short position. Even though JPM would drive the price of silver even higher if it did cover its shorts. I couldn't make this up if I tried.

Regardless of what JPMorgan does or doesn't do, there is no way the bank could possibly get hurt in a silver price explosion. Personally, I would prefer to see JPMorgan get punished for what it has done to silver over the past 8 years; but I would prefer a lot of things, like no more terrorism and world peace, also not likely to occur. The fact is that JPMorgan is off the hook for getting hurt on a silver price rally as a result of its physical silver accumulation and that changes the full pants down premise. That is fact number one.

So now the premise comes down to who gets hurt on the short side – the commercials (ex-JPMorgan) or the technical funds? I still think the technical funds are the likely candidates to be caught off guard, but I can also now see some big commercials getting hurt if JPMorgan quits participating in the usual wash, rinse and repeat cycle of COMEX positioning. I don't even think JPMorgan needs to cover silver shorts to cause prices to explode – I'm still of the opinion that if JPM doesn't add to short positions on the next rally, that would be enough to set the price sharply higher.

However, as clear as the set up and the new full pants down premise now appear, there is no sign that JPMorgan is finished accumulating physical silver. The continuing price manipulation damages all silver investors and silver producers, but greatly benefits JPM in its quest to acquire even more massive amounts of physical silver. Let's face it – JPMorgan is never going to run out of money with which to buy silver – it will sooner run out of physical silver to buy at artificially depressed prices. That circumstance should be front and center to all silver investors.

Now what about the current price action in which, among other things, gold seems to be leaving silver (and other metals) in the dust? The outstanding feature is that gold is the only COMEX/NYMEX metal (silver, platinum, palladium and copper being the others) to have penetrated its 50 day moving average decisively to the upside. This penetration in gold has brought in heavy managed money technical fund buying, as has always occurred.

The only real question is why the commercials orchestrated the move in this manner. I don't have an answer because I can't read their minds. I do know that gold, as well as all the other metals were configured as extremely bullish in COT market structure terms; so gold's price pop can hardly be called surprising. If anything, the gold move up has been somewhat unusual in that it has taken so long to unfold.

Undoubtedly, we'll hear all manner of reasons for why gold moved higher and if my hunch is correct, there will be stories suggesting the other metals didn't participate because they are more industrial or some such nonsense. The fact is that technical funds buy only when prices penetrate moving averages and the commercials control when those moving averages are penetrated. I'm not saying what will evolve over the long term, I'm just explaining what has happened through today.

In fact, based upon the market structure extremes in place, I'm somewhat disappointed with gold's performance today. Rather than question why gold is so much stronger than other COMEX/NYMEX metals today, I'm more concerned about how much technical fund buying potential has been expended on the rally. It's hard to be concerned about the buying potential in the other metals being used up in the face of the moving averages in these other metals not being penetrated. The simple fact is that the commercials could have induced the technical funds to buy at much higher prices than have been seen so far.

Since the end of October through last week's COT report, roughly 150,000 net contracts of COMEX gold were sold by the technical funds and purchased by the commercials, as prices fell more than \$100. In silver, more than 40,000 net contracts were positioned on a more than \$2 price drop. Based upon trading through yesterday's COT cutoff, I'd estimate 15,000 to 20,000 net gold contracts were bought by the technical funds and sold by the commercials and relatively very few silver contracts.

I'd venture a similar amount of contracts were bought by the technical funds and sold by the commercials in gold today; all told, some 40,000 contracts of the 150,000 gold contracts orchestrated since the end of October. In silver and other metals, not that many contracts have been bought by the technical funds because the price action in these metals has been so punk. That both explains the price action and describes the current market structures. In summary, we've used up quite a bit of gold buying potential; in other metals, not so much.

What does that portend from here? The simple answer is whatever the commercials decide. There would still appear to be more than 100,000 net gold contracts worth of buying potential remaining, so gold prices could easily power higher from here. At the same time, I can't overlook the potential for some serious selling by the technical funds should the commercials decide to rig gold prices lower. I don't like talking out of both sides of my mouth, but there has been a significant number of gold contracts bought by the technical funds these past few days, as well as there being an even larger amount of potential buying remaining. In a manipulated market, one has to try to read the minds of the manipulators (even though that is impossible). I suppose being prepared for anything is the order of the day.

As to what the commercials intend in allowing gold to move higher and keeping the silver and the other metals in check, I contend you'll drive yourself mad before you arrive at the answer. The silver/gold price ratio is at the upper extremes of the levels seen over the past year and there is no question that indicates silver is grossly undervalued relative to gold. Can silver get more undervalued? Of course it can, but that only underscores the undervaluation. And that makes silver even more of a relative bargain. It's important to remember that the silver/gold price ratio is a measure of relative valuation and its short term movement will not determine where it will be long term. What will determine the ultimate level of the silver/gold price ratio will be the actual fundamentals and the status of the manipulation.

If anything, the past few days would seem to have resulted in some deterioration in the gold market structure both absolutely and relative to silver and the other COMEX/NYMEX metals. It's hard to be certain of what the commercials are up to (other than no good), but nothing I see persuades me that this is not related to the premise that COMEX futures positioning determines price. Why the commercials induced the technical funds to buy gold and not the other metals may or may not become known in the near future. It could be because the commercials intend to smack gold down at some point and pressure the other metals even more. Or it could be that gold continues to climb and the move up in silver and other metals has been merely delayed.

Certainly, I'm aware of no sudden new developments that would impact gold and not silver (or the other metals), away from COMEX positioning. To be sure, gold was setup for a rally, as I have intoned for nearly two months; but that also goes for silver and the other metals. I can't know why gold was allowed to sprint out of the box and not silver, but there's nothing inherently damaging to silver's case as a result of its hesitation.

Ted Butler

January 6, 2016

Silver – \$14.00 (50 day moving average – \$14.40)

Gold – \$1094 (50 day moving average – \$1085)

Date Created
2016/01/06