July 13, 2022 – Disconnections

Many aspects of modern life seem quite different from times past, often perplexing, and to close observers and investors in gold, and especially silver, these are among the most confusing and trying times ever. Today, I thought I would take a look at some of the apparent disconnections between what appears to be the facts and common knowledge and the current prices of silver and gold.

Of course, the largest disconnect of all is between that of the price of each metal compared to what is generally accepted as being the â??normalâ?• factors that should determine prices. Just this morning, as I start to pen this piece, a much higher than expected consumer price index has resulted in sharply lower gold and silver prices, despite the fact that metals prices were quite low going into the inflation report. Thatâ??s not to suggest I know where prices will end up when I send this report out later, but this is emblematic of the disconnect of which I speak.

Certainly, the rate of inflation is but one factor long-thought to strongly-influence the price of gold and silver, but truth be told, itâ??s never been upper-most in my analysis. But, itâ??s not just the rate of inflation that seems disconnected with precious metals prices â?? itâ??s just about everything else as well, including the basic law of supply and demand. Here, itâ??s easier to speak of silver, because of its much larger industrial demand component compared to gold, whose demand is primarily investment-oriented.

For the past decade, total silver world production (mining plus recycling) has been virtually unchanged, while industrial and total fabrication demand has grown. That alone should have dictated higher prices, along with the sharply higher costs of producing silver compared to ten years ago. Ten years ago, silver prices were mostly over $30, today they are mostly below $20. (And while I would make the case that gold prices are not as high as they â??shouldâ?• be; ten years ago, gold prices were around the $1600 level and despite the recent steep drop in prices, are still higher today than ten years ago). But wait, you say, what about silver demand? Well, we use more silver today than ten years ago, or ever for that matter, in a wide-variety of applications centered on silver being the best conductor of electricity. In case you missed it, we live in a world more dependent on electricity than ever before and no one would dare suggest that electricity needs will diminish in the future.

Then it must be that investment demand for silver, the other important demand factor for silver, must have fallen off a cliff compared to ten years ago and over the course of the past decade. In fact, silver is the only commodity that has this unique dual-demand profile, being both a vital and indispensable world industrial commodity, as well as a primary investment asset. So, surely, silver investment demand must have fallen off a cliff compared to ten years ago and since. Not on your life, as silver investment demand has never been higher, with the proof of that being the immensely larger holdings in the worldâ??s silver ETFs and the highly unusual surge in direct retail silver ownership. Thereâ??s even been the highly-visible and completely unique formation of the grassroots organization on Reddit devoted to silver and responsible for many tens of millions of silver investment demand over the past year and a half that wouldnâ??t have otherwise existed.

So, there must be some special disconnect here, as you couldnâ??t possibly have the set of circumstances, I just described in silver accompanied by significantly lower prices, as that would go against every free market aspect of the law of supply and demand anyone has ever learned. And yes, there is such a special â??set of circumstancesâ?• existing in silver that fully explains the extreme disconnect between prices and what we all understand to be the free law of supply and demand and the explanation is an ongoing price manipulation on the COMEX, the worldâ??s largest precious metals derivatives exchange.

Getting more specific, the COMEX price manipulation is rooted in two highly unique and provable facts. One, COMEX silver has had the largest concentrated short position of any commodity, in terms of real-world production and consumption for four decades, and two, the most dominant and controlling traders on the COMEX, termed the commercials, have never collectively bought back short positions on higher prices. I know I have beaten this to death, which is not my intent today, but it wouldnâ??t have been proper for me to jump to some of the other disconnections I see, without first addressing the biggest disconnect of how the heck the price of silver (and gold) could be so darn cheap in the face of all the blatant and obvious bullish factors.

A disconnection Iâ??d like to discuss concerns the retail side of the silver market. No doubt the concerted effort of the big commercials on the COMEX to rig prices lower since the gold and silver price highs of March 8 (due to the wake-up call in LME nickel) has resulted in generally lower sales of retail forms of silver over this time. There is nothing particularly new or special about the very recent slowdown in silver retail sales, as there have been numerous similar slowdowns over the decades. The fact of the matter is that investors are generally buyers as prices rise and back off during periods of price weakness.

But itâ??s also true that very little, if any net selling takes place during periods of slower silver retail sales and that has proven true recently as well. The fact of the matter is that on the numerous periods of slowdowns for investors buying retail silver products I have observed over the decades, itâ??s never been a case where the retail supply lines of silver build up to any notable levels. In the distant past, I recall using the analogy of the retail silver supply lines being very wide, but not at all deep â?? much like (I believe) the Platt River, said to be very wide but not particularly deep.

What this means is that even during periods of slower investment demand, the retail silver supply lines donâ??t build up and the minute investment demand turns higher, retail product availability dries up, premiums shoot higher and wait times for delivery get extended. Iâ??ve seen this movie too many times to imagine a different outcome.

However, Iâ??d like to make a different point about a disconnect in retail sales and supply lines in silver, namely, just how persistently high premiums have remained over the recent slow period. I do hear commentary about retail premiums of silver falling a bit of late, but the real story is how high silver premiums have remained. And I often think of my dear departed friend and silver mentor, Izzy Friedman, whenever I take a glance at current prices on his favorite retail form of silver â?? American Silver Eagles. Izzy always maintained that someday, the US Mint would intentionally curtail production of Silver Eagles so as not the exacerbate the inevitable silver shortage and that premiums would soar to unimaginable high levels. To be truthful, I always looked askance at Izzyâ??s predictions for Silver Eagles, but Iâ??ll be darned if he hasnâ??t already turned out to be far more accurate than I ever would have expected.

The disconnect I believe many have missed in the persistently high premiums on retail forms of silver is how different the current high premiums are from what existed in the past. So many hundreds of millions of ounces of silver were used in the common coinage in the US and other countries that up until relatively recently, the amount of silver available to the wholesale market due to the melting of common silver coinage was always an important source of supply.

Ever since silver was removed from common coinage in US coins in the mid-1960â??s and as silver prices began to rise above $1.29, even though the recoverable silver in such coins always sold at a discount to the then-current wholesale price of silver, the price received was much more than the original face value of the coins. The net effect of this was that the melting of older coinage became a dependable source of total silver supply, even though this was theoretically a finite source of supply that would run out one day.

For all intents and purposes, the discounts on these older â??junkâ?• coins (I still despise that term) are now a thing of the past and the current premiums on such coins make it impossible for anyone to melt these coins on economic grounds. Likewise, the premiums on all smaller retail forms of silver â?? even up to 100 oz bars, make it economically impossible for any one to melt these forms into the wholesale form of 1000 oz bars. That would be like giving someone a $20 dollar bill for only $10 in return.

The disconnect here is that while many are commenting on some recent shrinking on the premiums on retail forms of silver, even the lower premiums mean no forms of retail forms of silver are being melted for conversion into 1000 oz bar form. Current pricing dictates that 1000 oz bars are still being converted to retail forms and not vice versa. This is a relatively recent development in the history of silver and to my mind is quite significant.

Another disconnect is the continued discussion in some quarters about the significance about the reduction in the registered category of silver compared to the eligible category in the COMEX silver warehouses (particularly yesterdayâ??s 5 million oz transfer). Please donâ??t take me wrong, the decline in the registered silver stocks is bullish, just not for the reasons typically given. My take is that it signifies a switch to the form of silver (eligible) slightly less costly to hold compared to the registered category and signifying longer term ownership.

But regardless of the reason to find the reduction in the registered as bullish, the real disconnect is that despite the reduction in the registered category (versus the eligible), the most glaring feature is that the price of silver has declined sharply. Obviously, whatever the reason for the decline in the registered category, it hasnâ??t resulted in higher silver prices. Why not? Clearly, some other force is driving the price of silver (I say the paper manipulation on the COMEX) and not to focus on this other force is a disconnect in and of itself.

Finally, in todayâ??s discussion of disconnects, I am drawn to the increasing popularity of the Commitments of Traders (COT) report by precious metals commentators. In case you hadnâ??t noticed, more observers are now following the COT reports than ever before, to the point that itâ??s now easier to count those commentators not featuring analysis of the COT market structure than those that do. It may have a more than a few years ago, but I distinctly recall how a very well-known precious metals commentator (who shall remain nameless) openly remarked how only those who should be committed, considered the Commitments of Traders report. My, how things have changed.

But hereâ??s the real disconnect. Despite the sudden explosion in interest and commentary in the COT reports by a wide variety of commentators, you can count on one hand (with fingers left over) the number of commentators making the real connection as to why the COT reports are so important in silver and gold. Having been raised a Roman Catholic and educated in parochial schools when I was much younger, Iâ??m fairly-well acquainted with the teachings and tenets of the religion and would do nothing to denigrate those beliefs, so please donâ??t misinterpret what Iâ??m about to say.

It seems to me that the vast majority of both the old and new observers of the COT reports have adopted a form of the belief of the â??Immaculate Conceptionâ?• when it comes to the reports. While there is near-universal agreement from what I have read that the current market structures in COMEX gold and silver (and other markets), is no doubt very bullish in the commercial short position being very low and the managed money short position being very large, I see virtually no discussion on how the current bullish market structures came to be.

Matters of religion aside, there was no Immaculate Conception on the COMEX. The current extremely bullish market structures in COMEX silver, gold, platinum and copper didnâ??t come about by divine intervention. Far from any guiding hand from above, the current bullish market structures on the COMEX were very much the work of greedy and manipulative men, overseen by, at best, incompetent regulators. The supreme disconnect is that those now commenting on how bullish the market structures have gotten, without any reference whatsoever to the actual process of how this came about are either clueless or gutless.

In other developments, yesterdayâ??s release of the new short report on securities indicated an increase of just over 2.25 million shares, to 32.24 million shares in the short position on SLV, the big silver ETF, as of June 30. While the increase wasnâ??t particularly large, it is still on the troublesome side that close to 30 million oz of silver are held short in the face of the sharply-reduced commercial short position on the COMEX. Ironically, I still view the still too-high short position as bullish overall, as Iâ??m convinced the most compelling reason for the short position is due to tightness in the wholesale physical silver market.

https://www.wsj.com/market-data/quotes/etf/SLV

As far as what to expect in Fridayâ??s new COT report, itâ??s hard to see how there wouldnâ??t be continued improvements (commercial buying and managed money selling), particularly in gold, but also in silver. No divine intervention employed, just the fact that gold prices were weaker than silver over the reporting week ended yesterday, with gold on a closing basis down more than $40, while silver was down closer to 20 cents.

As it turned out and as the day wore on, the early and counterintuitive plunge to new price lows in gold and weakness in silver prices were somewhat reversed as the day wore on. I am of the opinion that the price weakness over the past four months in gold and silver is attributable to the deliberate rigging of prices in order to reduce the short positions of the biggest COMEX commercial traders and that has proven to be remarkably successful. Since the extent of the commercialsâ?? success has been much greater than what I had expected, I am, accordingly, more bullish than ever I can recall.

Even if the collusive COMEX commercials succeed in rigging prices lower still in the very short-term, the path of least resistance and, certainly, the magnitude of the prospective move higher dwarfs any move lower. The most important factor is still that whenever the move higher begins in earnest, the behavior of the largest former commercial shorts as to whether they add aggressively to new short positions to cap and contain prices or whether they will stand aside and allow prices to fully-reflect true free market levels and end the disconnect that has plagued silver for decades.

As of the prices prevailing as I prepare to send this article, the slightly lower prices since Fridayâ??s close have reduced the 8 big (commercial) shortsâ?? total losses by less than $100 million to $5.2 billion.

Ted Butler

July 13, 2022

Silver – $19.20Â Â Â Â Â (200 day ma – $23.21, 50 day ma – $21.36, 100 day ma – $23.17)

Gold – $1735Â Â Â Â Â Â Â Â (200 day ma – $1843, 50 day ma – $1831, 100 day ma – $1885)

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