July 15, 2023 – Weekly Review/Code Red

It was quite a strong week for gold and, particularly, silver prices as the yellow metal rose $30 (1.6%), while silver exploded higher by a stunning $1.77 (7.6%). As a result of silverâ??s extreme relative outperformance, the silver/gold price ratio tightened in by 5 full points to 78 to 1. In essence, silver went from being almost the most undervalued it had been relative to gold in the past year or so, to close to the most fully-valued over this same time. And all in three days.

One would think I would be ecstatic about the move higher in silver over the past three days, since it appeared to behave as Iâ??ve been expecting, namely, erupting higher out of nowhere (unless one wishes to argue that the mild inflation report on Wednesday that seemed to kick off the precious metals rally made any sense). While it is true that I was gratified to see silver surge in price and this could very well be the start of the move higher that would qualify as the â??big oneâ?•, my message today is quite different than any I could have imagined when I penned Wednesdayâ??s piece, â??The Process Explains the Priceâ?•.

In fact, my message today is not only to subscribers, but to the regulators, both the CFTC and the CME Group (owners of the COMEX). As a result of data released over the past week (mostly, the last 3 days), it seems clear to me that we may be facing a clear market emergency in COMEX silver futures. I am trying hard not to be alarmist, but what I see alarms the heck out of me â?? to the point that I believe we are at the most critical juncture in COMEX silver since the peak of prices back in early 1980, when all sorts of emergency measures were enacted to deal with the Hunt Brothers that are debated to this day, 43 years later.

I recognize that what I postulate today may turn out to be completely wrong and will prove to be personally embarrassing, but my reading of the data strongly suggests the likelihood of a disorderly market dead ahead in COMEX silver futures, in which I urge the regulators to take immediate emergency measures. The conditions I see should have already prompted the regulators (the CFTC, CME Group and others, like the S.E.C. and Treasury Dept) to have held or begin to hold emergency meetings, and my greatest fear is that might not be the case.

To be sure, I am not at all clear whether the â??disorderly marketâ?• conditions I see dead ahead will result in a sharp selloff (on the order of as much as $4 or $5) or an explosion in price (on the order of $10, $20 or more) or both (a selloff first, followed by a much sharper rally). While I plan to ride it out, my message today is not one of investment advice, but rather one of public service â?? with a promise to quickly admit that I was wrong in todayâ??s alarmist message, if I prove to be wrong.

Iâ??ll conclude this weekly review with a separate explanation of what I see as a â??Code Redâ?• market emergency in COMEX silver after running through the usual weekly format, because there is much that occurred this week that adds to the emergency that I believe exists.

The turnover or movement of physical metal either brought into or removed from the COMEX-approved silver warehouses continued strong this week as nearly 5.7 million oz were moved this week (thanks largely to yesterdayâ??s 3 million oz movement). Total COMEX silver warehouse holdings rose amuch-slighter 0.5 million oz this week to 278.9 million oz. Holdings in the JPMorgan COMEX silverwarehouse fell 0.6 million oz to 139.4 million oz.

Iâ??ve resigned myself to the fact that the frantic and unprecedented physical turnover in the COMEX silver warehouses will likely never be noticed (or mentioned) by the body of silver analysts and commentators, even though it has existed for more than 12 years and can only be driven by a persistent demand that canâ??t be denied. But the failure to recognize this incredibly important data point and the reason for its existence is, obviously, beyond my ability to communicate effectively.

Total COMEX gold warehouse holdings fell by 0.2 million oz to 22.3 million oz, with holdings in the key JPM warehouse accounting for the bulk of the reduction and with gold holdings there down to 8.38 million oz.

Thereâ??s nothing special or meaningfully new to report on ongoing deliveries on the July COMEX contracts (or at least that I see).

As far as physical metal flows in the worldâ??s gold and silver ETFs, the outflows or redemptions in the gold ETFs, mainly GLD, appear to have abated this week. However, in the big silver ETF, SLV, we witnessed very large and counterintuitive redemptions of more than 6 million oz. Considering the very strong price action in silver and increase in trading volume in SLV, by my reckoning, there â??shouldâ?• have been inflows of 6 million oz or more, not redemptions.

The most plausible conclusion for the unusual redemptions in SLV is that the metal was more urgently needed elsewhere â?? which is fully in keeping with extreme physical tightness and confirming my market emergency findings in COMEX silver.Â It also suggests a further increase in the short position on SLV.

Late Wednesday (after that dayâ??s article was published), the new short report on stocks indicated a fairly sharp increase in the short position on SLV, of 3.8 million shares to 22.6 million shares (20.7 million oz), as of June 30. This follows an even larger increase in the prior short report on SLV. All told, some 8.5 million shares have been shorted over the past two reporting periods and if there is a reason to explain this increase, apart from the necessity of the sellers to sell short because sufficient metal is not available for deposit â?? as required by the prospectus â?? I have no idea what that reason might be. More on this later.

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

Turning to yesterdayâ??s Commitments of Traders (COT) report, I hadnâ??t expected much in the way of major positioning changes. given the rather choppy price action over the reporting week ended Tuesday and there were no big changes according to the headline number of the total commercial net short positions in gold and silver. However, there were some rather surprising changes under the hood in silver, which only add to the emergency conditions that developed in COMEX silver after the Tuesday cutoff.

Also as expected, was the explanation for the massive increase in total gold open interest of 35,000 contracts over the reporting week, which I attributed to an increase in phony spread creation. Yesterdayâ??s COT report confirmed that just over 30,000 phony gold spread contracts were created over the reporting week, or more than 85% of the total increase in open interest. This is in distinct contrast to what I see as the emergency market conditions I see in COMEX silver futures over the past three days.

Over the past three days, total open interest in silver has increased by 23,000 contracts (since the Tuesday cutoff). Unlike the case in gold this week, it appears that there was very little phony spread creation involved in the massive increase in silver total open interest. Iâ??d estimate that at least 20,000 contracts of the 23,000-contract increase in total silver open interest over the past three days is the real deal, namely, new longs and new shorts on the order of 100 million oz. I just pray the regulators are aware of the ramifications of this and are enacting plans to deal with this.

Letâ??s face it â?? the very last thing the silver market needs at a time of pronounced physical tightness and shortage is another 100 million oz of reckless and risky bets by a handful of large paper traders on the COMEX. Iâ??ll get to this in detail shortly.

In COMEX gold futures, the commercials increased their total short position by 3000 contracts to 18,700 contracts. With such a small overall change, the category changes shouldnâ??t have been large and they werenâ??t, so Iâ??ll run quickly through the details. The 4 big shorts bought back a bit over 200 contracts, reducing their short position to 163,311 contracts (16.3 million oz), while the next 5 thru 8 largest shorts added close to 1700 new shorts to a big 8 short position amounted to 224,191 contracts (22.4 million oz). The raptors (the smaller commercials apart from the big 8) liquidated 1500 longs, reducing their net long position to 36,500 contracts.

The managed money traders in gold were net sellers of a minor 705 contracts, consisting of the purchase of 1377 new longs and the new sale of 2082 short contracts. Therefore, there was not much change in the managed money net long position, now at 82,443 contracts (124,394 longs versus 41,951 shorts). Explaining how both the commercials and managed money traders could both be net sellers was the purchase of 3300 net contracts by the other large reporting traders. Not much exciting in the gold COT report this week.

In COMEX silver futures, the commercials increased their total net short position by 2100 contracts to 31,600 contracts, along the lines of the changes in gold and largely as expected. However, there were some very unexpected category changes under the hood. While the big 4 short position rose by less than 700 contracts to 34,761 contracts (174 million oz), it appears that the big managed money short which had been reducing its Â short position the past few weeks, turned around and added as many 3000 new shorts this past reporting week and at 6000 contracts short (or more) is back in the big 4 category. Therefore, the true commercial-only component of the big 4 short position was still at near record lows.

The 5 thru 8 largest shorts added 100 short contracts or so, and the big 8 short position rose to 52,804 contracts (264 million oz), but subtracting the 6000 contracts held by the big managed money short, the commercial-only component of the big 8 short position was close to 47,000 contracts, still historically low. If my calculations are correct, the silver raptors were holding a little over 15,000 long contracts as of Tuesday â?? very much in the category of not having much to sell on the price pop we saw after the Tuesday.

As was the case in gold, both the commercials and managed money traders in silver were net sellers this week, but in silver the managed money traders were much larger sellers, in selling 4298 net silver contracts, consisting of the sale and liquidation of 1327 longs and the new sale of 2971 short contracts. As a result, the managed money net long position in silver fell to 5498 contracts (31,522 longs versus 26,024 shorts), the lowest and most bullish since March.

Even more surprising than the increase of the big managed money traderâ??s short position, was another development that set me aback, namely, a sharp increase in the net long position of the other large reporting traders of 6600 contracts, including an increase of 6199 contracts of new longs.

Before I say what this means to me, let me first take the time to explain that my analysis and speculation is based upon the accuracy of the report itself. I have every reason to believe that the data in the COT report are accurate, mainly because the report itself is very easy to compile because there are less than 200 large reportingÂ silver traders required to report their positions daily and the CFTC has compiled this report for decades. But if there are reporting errors, my analysis and conclusions would likely be off.

The sharp increase in the other large reporting tradersâ?? category over the week ended Tuesday, suggests to me that a single large trader bought around 5000 silver contracts, pushing the net long position of this category close to its highest level in years. This also suggests to me that a big question on my and many of your minds just about forever â?? why someone big hasnâ??t jumped on silver? â?? may have just been answered. Â It appears to me that someone big may have just bought the equivalent of 25 million oz of silver in the most efficient manner possible.

I donâ??t think a purchase of this amount could have been made in any other venue, away from the COMEX futures market without impacting the price â?? not in the cash market, not in SLV or other silver ETFs, not anywhere but in COMEX futures. Remember, this purchase was made over the reporting week ended Tuesday, before prices jumped by close to $2, meaning if my analysis is correct, the position, if not sold, was ahead by $50 million as of yesterdayâ??s close.

Of course, thereâ??s no way I can anticipate what this large long might do next, but you can be sure I will be trying to follow his (or her) actions. Likewise, I was taken aback by the apparent increase in the big managed money shortâ??s position, because it appeared to be so ill-timed, following what had seemed to be well-timed trading until the past few days. Regardless, let me address the serious concerns I have about the current state of the COMEX silver market.

Code Red

Trading in silver, both on the COMEX and in shares of SLV and other silver ETFs, since the close of business on Tuesday, July 11, has created what appears to me to be a â??Code Redâ?• situation, in that prices must soon move sharply higher or lower (or both). Iâ??m not trying to be cagey and describe it in a manner where no matter what happens, Iâ??ll appear to be correct. Iâ??m motivated by something else entirely, namely, Iâ??m almost stupefied by the changes in the official data over the past three trading days and how these changes portend a market that could lose its bearings.

First, there are the changes related to the pronounced ongoing physical silver shortage, starting with the new short report on securities released late Wednesday and which indicated that the short position on SLV rose by 3.8 million shares to 22.6 million shares (20.7 million oz), as of June 30.

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

Over the past two reporting periods (4 weeks in all), the short position on SLV has increased by 8.5 million shares (7.8 million oz), at the same time that the much larger total commercial net short position on the COMEX had contracted notably (by roughly 45 million oz) over the same approximate time period. Over the years, generally, the short position on SLV and the commercial short position on the COMEX rose and fell in unison (although not always). The most plausible explanation for the divergence in the two short positions this time around would appear to be that shares of SLV were shorted because the physical metal was not available for deposit, as required by the prospectus, leaving the short sellers no choice but to sell short. The only other reasonable explanation was a conversion of shares of SLV for actual metal which suggests the converter was seeking to buy more and avoid reporting requirements. Both explanations are bullish.

This was compounded and confirmed by the redemption of more than 6 million oz from the SLV this week, instead of a large deposit â?? also highly-indicative of pronounced physical silver tightness. The sharpest short-term price rally in some time on increased trading volume strongly suggested there would be big net new investment buying, which should have resulted in metal deposits, not redemptions. Again, the most plausible explanation is that physical metal was withdrawn from the SLV to satisfy more urgent needs elsewhere.

But, by far, the most urgent factor pointing to a code red was the almost-unbelievable increase in total open interest in COMEX silver futures since Tuesday. Over just three days, the total open interest in COMEX silver futures rose by a massive 23,000 contracts, with at least 20,000 Â contracts being of the true and non-spread related increase in net new buying and net new selling

The way the futures derivatives market works is that a large increase in total open interest means an equally large increase in new long contracts as well as an equivalent increase in the number of new short positions (one new long plus one new short equals an increase of one contract of new open interest). Often times, a large increase in total open interest involves the creation of new spread positions, which are market neutral transactions (as phony as a three-dollar bill) and is not at all representative of actual price-moving trade positioning.

Therefore, the sharp increase in total silver open interest over the past few days doesnâ??t look related to phony spread activity â?? it looks very much like the real deal, namely, massive new bets on price direction. This is at the heart of my code red premise. The very last thing the silver market needs right now, in its current state of confirmed physical shortage, is another 100 million ounces added to a derivativesâ?? bet already too large at hundreds of millions of ounces on the COMEX and more than a billion oz in OTC derivatives. Itâ??s like throwing a hundred million barrels of gasoline on a fire already raging.

While we have to wait until next Fridayâ??s COT report to know for sure what the actual positioning changes might be, thatâ??s an eternity from now in terms of a possible market emergency and is why Iâ??m sounding the alarm now. Iâ??m hopeful that the CFTC and CME Group (owners of the COMEX) are on top of this, but fear they are not. Simply stated, this is the greatest market emergency in COMEX silver since the Hunt Brothers emergency in 1980. As far as possible regulatory actions, I would imagine some type of trading restrictions of the kind initiated back then. If this was analogous to a real war setting, the nuclear weapons would already have started to have been deployed.

On the buy side of the 100 million silver oz purchased over the past three days, the leading candidates would appear to be the managed money technical fund traders, as just last week I estimated they could buy 25,000 contracts (125 million oz or more) on higher prices. Certainly, we did get the type of buy signals associated with managed money buying â?? upside penetrations of key moving averages.

We also know for sure that the silver futures buyers were the initiators of the transactions on the COMEX, because when the price of any asset moves higher, it is always due to buyers initiating the transaction and with the sellers accommodating the buyers. Therefore, the question is not who were the buyers or what their motivation might have been, because thatâ??s obvious â?? the buyers bought in the expectation of even higher prices (in order to make a profit). The real question is who were the sellers and what was their motivation. One might quickly counter that the sellersâ?? motivation was the same as the buyers, namely, to make a profit on the expectations of lower prices â?? but it isnâ??t as simple (and pure) as that.

The amount of buying over the past three days in COMEX silver was so large that prices should have carried much further than they did â?? and not just by $2. Iâ??d estimate that if the sellers were purely motivated by a profit incentive, they would have demanded and extracted from the buyers much higher prices, say to well-over $30 or $35. Instead, the sellers accommodated the buyers by selling to them at way lower prices than the buyers would have paid. In other words, the sellers –Â all new short sellers at that â?? had a different motivation in mind. Without question the short sellersâ?? motive was to keep silver prices from surging higher, so as to cool and cutoff even further buying.

This is as sure as the nose on your face and is the same manipulative motivation deployed by the COMEX commercials over the past 4 decades. And while I had high expectations that 4 and 8 big former commercial shorts were done capping and controlling silver prices by aggressive and practically unlimited new and highly-illegitimate short selling, itâ??s hard for me to come up other than these big former shorts being the big short sellers over the past three days.

While itâ??s true that the 4 big COMEX silver shorts didnâ??t add to their short positions on the $6 rally in March, it looks extremely likely they added aggressively on the $2 rally over the past three days. Why? What else could it be over than a blatant attempt to cap and control silver prices before they got out of hand and began to reflect tight physical market conditions? This in-your-face and uneconomic short selling is what has created extreme market emergency conditions in COMEX silver.

The newly-created 100 million oz of new longs and shorts are very much open positions that must be resolved or closed out in time â?? along with any new positions still yet to be created. The mostobvious thing is that it makes compelling sense to be a silver buyer â?? whether that buyer was the big reporting trader which bought just before prices jumped or whether it was technical fund buying overthe past three days on the technical signals created by higher prices. Flip that around and ask howmuch sense it makes to be an aggressive short seller at $25 silver (or less) and see what you come upwith – away from another attempt to cap and eventually rig prices lower?

While I am hopeful that the regulators are fully abreast of the current extreme conditions that exist in COMEX silver futures, my fear is that they are not. There is a lot more blame and fault that can be assigned to the short sellers than the buyers, but thatâ??s no guarantee or indication the regulators will see it that way. Regardless, the emergency looks to be fully in place, even if it is obvious to only a few, so we already have in place the conditions for extreme price violence.

The problem is that thereâ??s no way I can tell if that price violence is to the downside first, followed by even greater price violence to the upside or if we explode straightaway â?? even more strongly than I have been suggesting previously. Yes, I know that the commercials have never been overrun to the upside, as my late friend and silver mentor, Izzy Friedman, always insisted they would, but then again, current conditions are more extreme than Izzy ever imagined, starting with all the signs of the intensifying physical shortage. Let me fully-acknowledge that Izzyâ??s full pants down premise looks more plausible to me than ever.

Knowing full-well and agreeing with the motivations of the silver buyers, be those motivations fundamental or technical in nature and believing I understand the motivations of the short sellers to be purely illegitimate and manipulative, itâ??s impossible for me to see how silver prices wonâ??t explode in the end â?? even if they do flop first. I also canâ??t help envisioning the profile of a big bank short as 30-year-old kids running the books and shorting aggressively and where if they guess wrong and prices explode, they lose their jobs but not their money, as the losses will accrue to the banks, not the kid traders. I also have trouble thinking that JPMorgan is a big silver short in light of its yet to expire deferred criminal prosecution agreement.

Yes, I am convinced a real and present danger and emergency exists in COMEX silver, mainly as a result of the new 100 million oz long and short position created over the past three days which canâ??t help but result in extreme price volatility dead ahead. But in the end the result will be sharply higher prices â?? regardless whether we see lower prices first (or not).

Ted Butler

July 15, 2023

Silver – $25.15Â Â Â Â Â (200-day ma – $22.72, 50-day ma – $23.88, 100-day ma â?? $23.59)

Gold – $1960Â Â Â Â Â Â Â Â (200-day ma – $1872, 50-day ma – $1970, 100-day ma – $1959)

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