

July 17, 2019 – The Real Issue

I see there is now a rebuttal to my criticism of Alasdair Macleod's description of the silver whale in COMEX futures. It occurs to me that this will be a never-ending debate without purpose. Accordingly, I will not respond publicly, but will answer any specific or general questions from subscribers on the matter. Truth be told, the issue surrounding concentration, a subject I've been near-obsessed with for decades, is not widely understood.

Instead, let me move on to what I believe most of you are interested in, namely, what's going on and likely to go on pricewise, particularly in light of yesterdays and today's sharp moves up in silver. Is it destined to turn into yet another failed rally in which the commercial shorts on the COMEX come to smother and terminate the rally? Or is something else potentially in play?

Upfront, no one knows how things will turn out in the short term – to pretend otherwise is, basically, dishonest. But that doesn't mean the outcome is strictly up to chance; there is still great merit in trying to understand what defines whether we see yet another failed ending to the quite impressive gold price rally of late and an eventual failure of what must be called a budding silver rally. The whole purpose, in the end, of looking at a market closely is to try to understand what's really going on.

The gold rally over the past two months of more than \$150 to the highest levels in six years was largely (or exclusively) the result of managed money buying of close to 200,000 net COMEX futures contracts (20 million oz). The COMEX-induced gold price rally did set off, as it typically does, further buying in gold ETFs, including GLD, but not to an excessive extent.

As a result of the massive managed money buying on the COMEX, the gold market structure must be considered bearish and I can't say I'm surprised by the tremendous increase in commentary stating that gold prices are now most likely move lower as the commercials harvest the managed money traders on lower prices. I also can't say that I necessarily disagree with the expectation of a gold flush out to the downside, although I am much more ambivalent about whether gold will selloff as I'll explain in a moment. After all, I am a dyed-in-the-wool COT guy, so there's no way I could rule out a clean out to the downside.

Silver, of course, has been different over the past two months (excluding the price action this week). Where gold has risen sharply, silver has struggled to mount any rally of significance, causing the silver/gold price ratio to widen out to levels that represent a relative undervaluation close to levels not seen in thousands of years (not a misprint). It's not as if the managed money technical funds didn't buy COMEX silver futures, because they did buy close to 60,000 net contracts over the past two months, the equivalent of 300 million oz.

The only plausible reason for why silver didn't perform better with that quantity of managed money buying (including the unprecedented creation of a concentrated long position greater than the concentrated short position of the 4 largest traders), was because the commercials which sold to the managed money traders were much more aggressive in silver than they were in gold. Why the commercials were much more aggressive in selling to the managed money silver buyers than to the gold buyers is the key question, particularly in light of this week's silver rally. The answer, I believe, lies in the role of JPMorgan.

For more than ten years, I have been convinced and vocal that JPMorgan rules the roost in all matters silver and gold, ever since its acquisition of Bear Stearns. Early on, I discovered that JPMorgan had come up with the perfect solution to its vulnerability of being the big COMEX silver and gold short seller, as it appeared to be when silver ran to nearly \$50 in 2011. The solution, of course, was JPM's genius solution of acquiring massive amounts of physical silver and gold starting in May 2011. Over the past 8+ years, JPMorgan has accumulated more than 850 million ounces of physical silver and perhaps as much as 25 million ounces of gold. Say what you will, but JPMorgan wouldn't expend \$50 billion on anything without firm expectations of great profits. This is the real issue, as I see it.

About a year and a half ago, I started commenting about a JPMorgan double cross of other commercials in gold. At the time, gold was trading just below \$1300 and I noted that JPMorgan was going out of its way to buy back an impressive amount of gold shorts (close to 100,000 or thereabouts) as other commercials sold. Not much occurred price wise thereafter, but JPMorgan never built up its COMEX gold short position as heavily as it had before. JPM's gold short covering looked premature when gold slid to below \$1200 late last year, but doesn't look ill-advised currently.

I have returned to the JPMorgan double cross premise in gold and silver several times since the spring of 2018 and it now occurs to me that the premise may be more than a flash in the pan, but inevitable in essence. Let me restate that - I now believe that the big move up in silver must be accompanied with a JPMorgan double cross of the other commercials, perhaps in both silver and gold, but for sure in silver. When silver moves for real to the upside, there will be a large commercial short position in place on the COMEX, since the managed money traders will rush to cover short positions quickly in a silver rally.

The issue is whether JPMorgan will be a strong and continuing contributor to the overall commercial shorting effort, as it has always been in the past. If JPMorgan adds the same amount of new shorts as it has on all past silver rallies, it would appear to me that the silver rally in question will inevitably fail. But if JPMorgan is only a token short seller or gives up adding new silver shorts along the way, then we're talking about a rally of a very different nature. Certainly, none of this should be new to readers in general, what's new is my sense it can't be any other way.

What about the rally this week - is this the start of the big one? Could be, but not enough data are available at this point, specifically, how JPMorgan is behaving on the short side. But the thing is that silver is still so damn cheap in price that the rally must be treated as if it's the big one. The alternative, at least for me, of selling to take advantage of what may be yet another failed rally, is simply unacceptable. That's because the risk of lightening up just as silver prices truly explode is not worth it to me. If I have to suffer through yet another manipulated rigging to the downside, so be it.

What now appears inevitable to me is that JPMorgan must double cross the other commercials at some point – there's no other way. JPMorgan didn't accumulate 850 million oz of silver and 25 million oz of gold over the past 8 years for no good reason and the only plausible reason was to make a financial score. The only way JPM can score is on higher prices; therefore, those higher prices are assured, even if the specific short term timing isn't. But assured profits to JPMorgan also mean devastating losses to the other big commercial silver shorts when silver does run for real.

I wonder what my old silver friend and mentor, Izzy Friedman, would make of this modified version of his full pants down premise, namely, the overrun of the COMEX commercial shorts – only this time with JPMorgan not only having escaped the consequences of being short on a price explosion but scoring mightily because of it. My sense is that it would take him no time at all to fully embrace the revised premise. (I just wish I had the opportunity of knowing for sure).

Although I am pinning the outcome of this week's rally on JPMorgan, let me not overlook another very important factor in silver that was not only close to Izzy's heart, but also mine and many of yours – the prospect of a genuine physical shortage in silver. Let me acknowledge upfront that with JPMorgan holding 850 million oz of physical silver, should it desire to forestall or prevent a physical shortage in silver, it is fully capable of doing so. Then again, any efforts to do so would deprive JPMorgan of the mega-profits it is lined up to collect.

What prompts this line of physical shortage in silver is the extraordinarily large trading volume in SLV the past three days, including today. Yesterday saw the highest upside trading volume in SLV in years, nearly 40 million shares. Plus there was unusually large volume of 17 million shares on Monday and close to 25 million shares so far today. This raises the issue of how much physical silver is now owed – to not only SLV, but other silver ETFs as well.

Of course, we are all indebted to Carl Loeb for his coining of the phrase "Death Star" to describe a feature of the SLV little understood by many, even after so many years. An underappreciated feature of SLV (and all other "hard-metal" ETFs, including GLD on the gold side) is that net new buying of shares results in new share creation that must be immediately backed by the appropriate deposit of physical metal. Theoretically, net new buying of shares of SLV could easily "eat" all the physical silver in existence, much like a Death Star could consume other stars in the universe. The principle works the same in gold, but with \$8 trillion worth of gold in the world and only a little over \$30 billion worth of silver, it is much more likely to matter in silver than gold.

I don't think for a moment that many, if any of the new share buyers of these ETFs knows or gives a whit about how the physical metal deposit requirement works – all these new buyers are buying shares to get an exposure to silver or gold. When the price of anything breaks out, there is almost certain to be chart buying. After all, who doesn't have an app on their smartphone for which to buy or sell shares in an instant, at greatly reduced commissions to boot? But it matters little if the new share buyers know whether their purchase of SLV or GLD shares mandate the deposit of physical metal – an appropriate amount of physical must be deposited. The only way around this is if the sellers (mostly Authorized Participants) enter into short sales. By the way, I have uncovered a new source for short sale data for ETFs, but will forego that discussion now because Monday was the cutoff date for the next short report and as such, yesterday's big volume will be in the report following the one due July 24.

Based upon the trading volume over the past three days, I would estimate that at least 10 million new ounces of silver are owed to the SLV and perhaps much more. How quickly that metal is deposited will reflect how tight the wholesale physical market is in silver. And this time around, it's not just SLV involved. Over the past 4 weeks, more than 10 million oz have been deposited into SIVR, another silver ETF, including nearly 1.8 million ounces yesterday. SIVR is now the second largest silver ETF, with over 94 million oz on deposit. Crikey Mate â?? there are now more than one silver Death Stars?

As far as what to expect in Friday's COT report, the price, volume and open interest surge on yesterday's silver rally suggests significant net managed money buying and commercial selling in silver, perhaps on the order of 10,000 contracts. Accordingly, I also would be surprised if there wasn't a notable increase in the concentrated long position of the 4 largest traders in silver (as well as in the concentrated short position). The one thing I don't know is what JPMorgan may have done and more precisely, intends to do from here. But therein lies the real issue. And wouldn't it turn out to be ironic if silver, after lagging so badly behind gold, turns into pulling it higher?

Ted Butler

July 17, 2019

Silver – \$15.98 (200 day ma – \$15.01, 50 day ma – \$14.91)

Gold – \$1425 (200 day ma – \$1288, 50 day ma – \$1344)

Date Created

2019/07/17