July 18, 2015 – Weekly Review

Weekly Review

There are not many weeks like this past week in precious metals. It wasn't just that gold finished lower by $33 (2.8%), silver lost 75 cents (4.8%) or that the silver/gold price ratio blew out two full points to 76.5 to 1, the most undervalued silver has been to gold in more than a year; it was much more than that.

This week, gold and silver prices fell every single trading day (very uncommon), each finished lower for the fourth week in a row, and each closed at new five year lows, as did the silver/gold price ratio. From the high price prints in 2011 ($1900 in gold, $49 in silver), gold is down around $800 (40%) and silver is down $34 (70%).

Of course, gold and silver prices first rose that by much and more in the years preceding the 2011 peaks, so it's probably fairer to say prices made a complete round trip rather than focus exclusively on just the trip down. But there is much to learn from the down leg and, increasingly, I have become more convinced than ever that what actually occurred virtually guarantees that silver, in particular, will achieve future price peaks impossible to conceive of today.

Even casting aside visions of sharply higher prices to come, there can be little doubt that buying and holding investment assets at the lowest price possible is the single most important aspect to investment success. When you buy low, you automatically reduce risk of loss and enhance investment return prospects. Buy a sound asset at too high of a price and a lot can go wrong. Buy a sound asset at a very low price and a lot can go right and not much wrong.

As rotten as price action has been, the ever declining prices are automatically making silver, in particular, an even lower risk and higher profit potential asset. And when you consider what caused the price decline (COMEX positioning) and the observable actual supply/demand fundamentals in play, the only reasonable conclusion is that the best investment asset in the world, silver, has gotten even better. I know it may not feel that way as prices seem to melt away, but lower prices assure eventually even higher returns.

There was quite a bit of outside news this week and I'd like to address one item that stuck out before getting into the usual weekly format. As part of its petition for currency reserve status, China announced that it had acquired 600 tons of gold over the past six years, increasing its official holdings to 1650 tons, or 53 million oz. The announcement was expected, but the amount of the increase (19 million oz) was thought way too low by most commentators.

Those commentators may well be correct, but that's not for me to opine; I had no expectation for the amount that China might increase its official gold holdings and certainly never offered a guesstimate. I did believe that gold was moving from the West to the East, but I'm strictly a hard numbers guy Â? if I can't verify via documentable evidence, I'm not inclined to accept numbers at face value. In particular, I'm reluctant to accept numbers coming only from China. That said, it occurs to me that the amount of gold that China announced it had acquired is strikingly in line with the amount of gold liquidated from the documentable holdings in Western ETFs and other investment holdings, especially the biggest gold ETF, GLD.

Since the beginning of 2013, when gold began a price decline from near $1700 to under $1200, close to 30 million oz were liquidated by investors is all the world's registered public investment holdings (from 100 million oz to under 70 million oz). About 19 million oz came from liquidation in the big gold ETF, GLD, approximately the same amount China said it had acquired. Yes, the time periods don't match up exactly, but where is it written that China didn't start to accumulate gold only after the big gold price decline commenced in earnest?

In any event, the matchup between what came out of GLD and what China announced it acquired is uncanny. And, more than ever, I am convinced that what drove gold (and silver) prices lower starting in early 2013 was position changes on the COMEX between commercials and traders in the managed money category. As a reminder, JPMorgan went from holding a short corner of 25% of the entire COMEX gold market in early 2013 to a long market corner of that same amount after gold prices fell to under $1200 that summer. The pattern of position changes were the largest factor in the general sweep of lower prices and the resultant lower prices caused investors to flee GLD and other gold investment vehicles and not vice versa.

Turnover or the movement of actual metal brought into and taken out from the COMEX-approved silver warehouses maintained the strong pace of the previous week, as 4.7 million oz were moved and total inventories fell again to 178.9 million oz, a drop of 1.3 million oz on the week. This physical inventory movement has become quite usual in silver, but remains unprecedented when compared to any other commodity and, by that comparison, must be considered frantic. The question is why such inventory movement in COMEX silver alone (and for more than 4 years)? I say it's a sign of tightness in supply and always seek alternative explanations.

Despite the overall decline in COMEX silver inventories this week, I would point out that nearly 1.2 million oz were brought into the JPMorgan COMEX warehouse in the eligible category. JPMorgan has taken 5.7 million oz of silver this month in the July delivery period, so I would expect another 4.5 million oz will soon be brought into its COMEX warehouse based upon the pattern of the past few months.

And while it hasn't reached shocking levels (yet), a pattern has developed in the ongoing COMEX July delivery period different from what has been seen in the past Â? persistent new buying of July contracts for delivery purposes as the month has progressed. Based upon spread differentials and delivery patterns, it appears the buyers are the initiators of new contracts (as opposed to the sellers), and this suggests the new contracts represent an immediate demand for physical silver (as opposed to sellers looking to dump metal owned). Why this is important is because it suggests an urgency for immediate delivery of actual silver and looks to be yet another sign of physical tightness. As I indicated, the numbers involved aren't particularly notable, but the pattern sure is. Someday, there is going to be a rush for physical silver delivery on the COMEX and the sooner one sees it begin to develop, the better.

I can't tell if JPMorgan is adding to its holdings in the July contract, although it still is the largest stopper of silver deliveries this month (taking 1141 of the 3304 total deliveries tendered so far in its house account). If I had to guess, it looks like a lesser known COMEX clearing member, Mizuho (on behalf of a customer), may be behind the new buying in the July contract, but that's less important than what the buying may portend. It's just not possible that JPMorgan will remain the sole buyer of physical silver indefinitely Â? sooner or later others will join the fray.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

Others joining in following JPMorgan's lead also seems to be apparent in sales of bullion coins from the US Mint. With sales of Silver Eagles now being rationed once again due to the Mint's inability to meet demand (as required by law), it appears buyers are turning to Gold Eagles as a substitute. Sales of Gold Eagles have soared to the highest monthly level in more than two years (over 100,000 oz) with plenty of time left in July. Silver Eagles, of course, are not available currently from the Mint.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

I know some might dispute my assertion that Gold Eagle sales have surged because Silver Eagles are no longer available, but supporting my premise is the fact that overall investment demand in gold has not picked up as measured by gold mining stock performance and, especially, by the metal flows in gold ETFs. Yesterday, a very sizable 373,000 ounces were redeemed from the GLD, most plausibly because of investor liquidation in the face of lower gold prices. If the very strong recent demand for Gold Eagles was, in fact, indicative of strong overall gold demand, there wouldn't be such big withdrawals from GLD and such price weakness in the shares of mining companies.

One thing that I think can't be disputed is that the sudden shortage of Silver Eagles from the US Mint has caused a rush to competing retail forms of silver investment demand. Dealers are still reporting very robust sales of silver with the most common complaint being a lack of metal to offer to their customers. This can be seen in premiums that have, quite literally, exploded. How long this circumstance lasts is anyone's guess, but the turnaround in retail demand since the Mint's announcement that Silver Eagles were sold out is nothing short of stunning.

Since it appears clear that the start of the silver retail buying surge started almost the moment of the Mint's announcement, I can't help but mention something I find highly ironic, but telling. It's important to recognize that the recent burst in silver retail investment demand began after, not before the Mint's announcement, because if retail demand was the cause of the Mint running out of Silver Eagles, premiums would have already been high and dealers would be reporting strong sales into the Mint's announcement. But that wasn't the case at all.

Please remember, no retail dealer would ever openly advertise that sales were weak, for the simple reason that customers might get spooked about advancing money, in the form of buy orders, fearing the dealer's ability to deliver. And, as it turned out, more dealers have gone out of business over the past few years from Tulving to the latest, Bulllion Direct. This is further proof that retail silver investment demand has not been strong over the past few years, as I have consistently maintained.

The great irony is that JPMorgan, singlehandedly, kicked off the retail silver investment surge. The bank backed off from buying Silver Eagles in April and May, because it knew it would soon rig silver prices lower on the COMEX and why buy high if you know you will soon bring prices lower? So JPM refrained from buying Silver Eagles until it lowered the boom on prices and then bought all the Mint could supply at the lower prices. The only question is whether JPM knew its cleaning out of the Mint's supply of Silver Eagles would set off the retail investment buying surge? My guess Â? this bank is so powerful and arrogant that it is unconcerned with such matters.

The changes in this week's Commitments of Traders (COT) Report were relatively inconsequential after many weeks of dramatic positioning changes. The bigger story is what happened with positioning after the Tuesday cutoff and my sense is that if the final COT tally were as of yesterday's close of trading, we would be at the most bullish setup in silver and gold ever (again). First, let me run through this week's report.

In COMEX gold futures, the commercials reduced their total net short position by a further 4100 contracts to 48,500 contracts. This is the lowest (most bullish) level since late 2013. I'm going to skip over, once again, the breakdown in the specific commercial categories because there are likely some managed money shorts now in the big 4 and 8 categories.

Managed Money Traders did sell more than 3200 of the 4100 commercial contracts bought, including the liquidation of 3069 long contracts and the new short selling of 153 contracts. Although the short increase was slight, it was another new managed money short record and a confirmation that the rocket buying fuel tanks were fuller on Tuesday than ever before. As of today, it's easy for me to imagine that at least another 10,000 to 15,000 new short contracts were added by managed money traders. Whether that is confirmed in next Friday's COT report is dependent on what happens on Monday and Tuesday.

In COMEX silver futures, there was a slight increase of 1300 contracts in the total commercial short position to 15,600 contracts, still a very low and very bullish reading. I'll continue to skip over the big commercial category breakdown due to managed money infiltration into the ranks of the 8 big shorts.

At first I was disappointed at seeing 5108 contracts of managed money short covering, as that mathematically subtracts from the record short position of the prior week and reduces the amount of rocket buying fuel to the upside. That 1558 long contracts were sold by other managed money traders is constructive in that the 42,753 contracts remaining long are close to a non-technical fund core long position dating back a full year.

Despite my initial disappointment at the amount of managed money short covering, when I reviewed the trading details of the reporting week, my feelings changed. Admittedly, it would bother me if 5000 managed money shorts covered at price lows and took big profits, particularly if commercial traders were selling at a big loss (as occurred last fall). But it doesn't look like that is what occurred. Instead, it looks like managed money shorts bought back with no profits and likely a loss on the fairly sharp but now forgotten price rally of more than a dollar during the reporting week, especially when the 20 day moving average was temporarily penetrated to the upside in silver. (By the way, there was no similar upside penetration in gold, which accounts for its improvement in market structure).

Of course, I recognize that the managed money short positions are in an open profit of at least a dollar, so where do I get off suggesting they bought back 5000 short contracts at a breakeven or a loss? It has to do how these traders and their commercial counterparties conduct business. Since additional managed money (technical fund) short positions occur at lower and lower prices, the most recently added are most vulnerable to actual closed out loss on any price upturn. Likewise, the lower the price at which the commercial counterparties buy, the easier it is to sell those added contracts at a profit on the slightest upturn. Think of this as an accounting issue in which last in are first out.

If this is what occurred, as I believe, then this is very much unlike what occurred last fall when managed money short traders took very large profits and in which certain commercial raptor longs were decimated. This time, managed money traders appear to have cut losses quickly on recently added shorts and commercials sold with quick profits. I also think that all the managed money shorts that were covered (at a loss or breakeven) have been subsequently put back on and then some.

Therefore, as is the case in gold, I believe the managed money silver shorts are back to holding a new record number of contracts as of yesterday's close. And that being the case (or at least close enough), there still looks to be a minimum of 60,000 contracts' worth of managed money buying (short covering plus new longs) baked into the silver cake on a decisive upside penetration of the moving averages and now at least 100,000 contracts of pure managed money buying baked into the gold cake.

However, I would like to correct something that I misspoke of in Wednesday's article. I was looking at the chart of SLV and not of COMEX silver when I said a decisive penetration of the $16 market would trip off the surge of managed money buying in the magnitude I outlined. Because there is close to a 5% discount built into the price of SLV (as a result of the cumulative payment of the 0.5% annual management fee since the introduction of the trust), $16 is the correct number for SLV, but COMEX silver would need to decisively clear $16.50 to get all the managed money traders to buy the 60,000 net contracts I spoke of. The number for upside penetration in gold is still just above $1200. Sorry for any confusion.

I'm still scratching my head about what occurred recently in the grain markets. The new COT report on corn indicates a further 30,000 contracts of managed money short positions, bringing to almost 280,000 contracts the amount of pure short covering on the part of these traders. That's the equivalent of 1.4 billion bushels or ten percent of US annual corn production (and the US is the world's largest corn producer by far). No wonder corn prices fell so much as the managed money technical funds shorts added that amount on the way down and bought that same amount all at once causing prices to surge. Two points come to mind.

One, it is disgusting that the CFTC and the CME have allowed our markets to become so manipulated and controlled by speculators in direct violation of US commodity law. On any practical level, the regulators have dropped the ball and should be drawn and quartered for being so blinded by special interests.

But the second point is that silver (and gold) investors should also be ecstatic at the grotesquely large amount of managed money shorts now in place because just as was the case in corn, when these shorts go to buy back those shorts (as they must), they do so in unison and with a urgency not common in most trading. To get the managed money shorts in place, it takes a commensurate price pounding like we've just witnessed; there is no other way. To get the these same shorts bought back requires a jolt to the upside, like just occurred in corn and will occur in gold and silver and other CME metals.

At that point comes the critical question of how aggressive the commercials will be in selling into the certain coming managed money buying, but we'll get the answer to that in time. The great thing is that all the important details should be revealed in future COT reports. Despite the recent price pounding, I feel fortunate to have been an observer of what soon should be an unfolding of market history, in addition to a very profitable outcome.

Ted Butler

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Silver – $14.85

Gold – $1133

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