July 22, 2015 – Down and Out?

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When a market, any market, hits multi-year highs or lows, it is natural for there to be an outpouring of commentary, including by those who don't usually follow that market on a regular basis. This is particularly true for gold, a market that seems to have more rabid fans and critics than any other market (silver, by comparison, is more ignored by the majority of market observers).

Seeing how gold may be the asset generating the most emotion of all assets, it is not surprising that its recent fall to five year price lows has resulted in non-stop commentary, from it being no more valuable than a Â?Pet RockÂ? or the object of cultists. Throw in a dramatic fall, like occurred starting Sunday evening (ostensibly related to the disappointment that China didn't increase its official reserves more) and that only accelerates the flow of commentary. And as is always the case, price mileposts to the downside generate mostly bearish commentary.

Commentary must follow the price; that's a law rarely violated. It's actually more than that Â? it's a force of nature. When a market makes a new high, we demand to know why it went up; if a commentary is not in conformity with a market move, it is mostly overlooked. In the case of gold's new five year price lows, most commentary is bearish, as it must be. Unfortunately, commentary that conforms with the price move generally reiterates what is already known. Let's face it Â? none of the recent commentary (and I try to read it all) about gold contained anything new and mostly consisted of personal predictions of specific lower prices.

I can't and won't rule out anyone's specific price target, higher or lower, on any asset, but neither would I rely on them. I'm not interested in anyone's specific price prediction, but I am very interested in the reasons behind every price prediction. That's the difference between market commentary and analysis. Don't tell me gold is going under $1000 or over $5000 because, well, just because that's your prediction. We can all make predictions. Tell me the reasons behind your predictions.

Of course, I'm not talking about you, the reader; that's what I say to myself every time I read another commentary. Most, if not all of the time, cogent reasons are lacking, at least in terms of new cogent reasons and all that remains is a rehash of widely known clichÃ©s and uninformed predictions. For gold's decline, it has been attributed to the dollar, no inflation, competing investment assets, and its price trend over the past five years, etc. I can't help but feel there is little value added to any of the recent outburst of gold commentary.

With that preamble, let me contradict myself a bit and note that there was a marked increase, at least in Internet commentary (as opposed to main stream media), on the nature of gold's price decline; specifically, the sudden downdraft of $50 on Sunday evening. Most of that Internet commentary was focused just where it should have been directed Â? on the COMEX's role in the gold price smack down. The sell-off was clearly a COMEX electronic phenomenon as opposed to any type of sudden selling in the physical markets or due to any sudden change in actual supply and demand. Yes, there was a sudden change in paper or electronic supply and demand starting Sunday evening, but not in real gold supply and demand and therein lies the rub.

Certainly, the COMEX's influence on gold prices (along with silver and other CME metals) didn't begin and end on Sunday evening; futures positioning is virtually the sole price influence. That's what makes the vast majority of recent gold commentary unconstructive at best, because it leaves out the most important price influence. What's most incredible is that the most important price influence is also the easiest to verify because the CFTC publishes the data behind futures positioning weekly. I admit that the data in the COT report is mostly incomprehensible at first glance to most observers, but most observers aren't writing gold commentary, particularly in the main stream media. I would think those writing commentary have at least some responsibility to uncover what is most important.

That more Internet commentators are picking up on the COMEX's influence is a very good thing, even if main stream media is way behind the learning curve. It's good for a number of reasons; one, it reinforces the validity of the premise that changes in futures positioning move prices. Two, because the futures positioning changes are in clear violation of commodity law (because they are strictly speculative in nature), the increasing attention should hasten the day when the speculative price control ceases to be so dominant. Finally, there are such persistent patterns to the changes in futures positioning that is possible to better foretell future price trends using the COT analysis than by relying on popular MSM commentary.

So while the current popular commentary focuses on how down and out gold has become over the past five years; the COT data is remarkably bullish currently; in fact, more bullish than it has been in recent history. In all likelihood, the market structure in gold is much more bullish as a direct result of the price action of the last week thru today. And more than anything, how the current gold market structure (along with silver and the other CME metals) gets resolved will go a long way to judging the validity of the market structure premise.

While the vast majority of the recent commentary on gold focuses on what transpired over the past five years (because of the five year lows), five years is way too long of a time period to have relevance in COT analysis. A COT price cycle, from top to bottom or bottom to top, usually lasts a small number of months and sometimes weeks, not years. Over the past five years, there have been dozens of COT price cycles in gold and silver. I would define a COT price cycle as the time it takes the commercials and counterparty speculators to unwind an extreme in positioning.

Therefore, to truly analyze why gold is making five year price lows, don't try to explain current prices and future prospects by what occurred over the past five years; that's virtually impossible. Instead, focus on what has occurred since the last COT cycle top in price with the hope of gauging the next COT cycle bottom in price (which I think is here or so close you can smell it). This is fairly cut and dry in terms of dates and number of contracts. Of course, I can't tell you the future date and number of contracts of the next cycle extreme, because that would make me a prophet and not an analyst. But I can tell you the date and number of contracts of the last cycle top, along with every COT cycle top and bottom in history. Such is the nature of the data.

The last COT cycle top in COMEX gold and silver was May 19 (a bit over two months ago), the cutoff day for the COT report that week. On that date, the total commercial net short position in gold was 132,300 contracts and in silver 62,500 contracts; the highest in four months (the previous cycle top of Jan 27). At the May 19 COT cycle top, the price of gold was $1220 and silver $17.50, also the highest level in months. This is the definition of a COT cycle top Â? when the highest price and largest total commercial net short position are recorded. This is completely objective and measurable.

A COT cycle bottom occurs when both the price and the level of the total commercial net short position are at their lowest. This is also objective and measurable once it has occurred. Therefore, the thrust of my COT analysis is to try to anticipate and gauge how much price will move from the cycle tops and bottoms based directly on the number of commercial contracts sold and bought (or their counterparties Â? mainly the managed money traders).

From the last COT cycle top on May 19, gold has fallen as much as $140 and silver by nearly $3. Thru last Friday's COT report, the commercials have purchased nearly 84,000 gold contracts and 47,000 silver contracts. Extrapolating thru yesterday's close of the reporting week, I'd guess another 20,000 gold and 5,000+ silver contracts were purchased by the commercials (and sold by managed money traders) and hopefully more.

As a matter of fact, gold declined by $140 since May 19 and silver declined by $3, precisely because managed money traders sold and commercials bought, most likely, more than 100,000 net gold contracts and over 50,000 net silver contracts, one of the largest position changes in history. Those are the equivalents of 10 million oz of gold and 250 million oz of silver. To my mind, the price declines had nothing to do with the dollar, China, Greece or any lack of inflation; and everything to do with the amount of futures contract positioning changes since the May 19 COT cycle top.

Having established that the May 19 top is beyond question, as measured by both price and the number of contracts repositioned, the analysis must now be centered on the pending cycle bottom. Both on a time and price basis, enough time has passed and prices have declined sufficiently for this to qualify as a COT cycle bottom. In terms of the most important variable in the COT cycle analysis, the number of contracts repositioned, we are at or close to all-time record large managed money short positions, a fact that satisfies every meaning of maximum number of contracts.

Does that mean that we can't move even lower with even more managed money selling/commercial buying? I suppose anything is possible, although we're already much deeper in this cycle, in terms of prices and contracts, than I would have imagined. As much as no one wants to hear it (and I don't want to say), lower prices and more contract positioning creates a more bullish setup.

I know that sounds repetitive and somewhat of a cop-out, but try to remember that May 19 was only two months ago, not five years ago. I invite you to reread the May 23 weekly review to see how concerned I was about the negative price implications of the COT market structure at the time. I say that only to dispel any notion that I always consider the market structure to be bullish. Back then, it stunk and I said so. Today it is spectacularly bullish and not to say so, in the strongest terms, would be flat out wrong.

It's not that gold or silver declined by so much over the past two months, as we have seen numerous larger price moves, both in dollar and percentage terms over the past five years. It's just that this last move lower took us to 5 year lows, so I suppose it's natural for folks to comment in that manner. But the reality is that what occurred over the past five years has little to do with what is occurring now, at least compared to what has happened in futures positioning over the past two months. And I believe this focus on the wrong time period and the wrong circumstances of what moves price presents an important opportunity for those that focus on the right circumstances.

I've spent more time on gold today than silver because I was taken with the outpouring of recent commentary on the five year price lows. However, as I hope you know, I'm an agnostic on gold and hold only silver. I don't know how to adequately analyze the supply/demand fundamentals in gold, while I feel I can do that better in silver. Those silver fundamentals compel me to be exclusively invested in silver.

But I don't have any reservation in speaking about gold in terms of COT market structure and on that basis alone, gold looks good to go higher from here. Like silver, it is very far advanced in establishing an important COT cycle bottom. Since there is no way to adequately predict in advance precise price bottoms and, especially, the maximum number of contracts to be positioned, the best anyone can do is hope to come close.

Instead of reminiscing over the past five years, an objective review of what transpired on the COMEX over the past two months should tell you all that matters in gold and silver. It has been the speculative selling of the equivalents of 10 million oz of gold and more than 250 million oz of silver (all arranged by the COMEX Â?commercialsÂ?) that has caused prices to drop. And it will be the unwinding of speculative short sales and new long positioning which will drive prices higher.

In fact, just as the maximum amount of attention and sentiment is set on lower prices, the focus should be on how high gold and silver prices will advance. That's the important consideration at this point. The answer to that question, of course, lies with how aggressive the commercials will be in selling when the speculators get buy signals (courtesy of the commercial price riggers themselves). But the fact that managed money shorts are larger than they have ever been also means these traders have never been put in a more compromising position. Funny, I haven't seen that mentioned in any of the main stream media commentary about the five year price lows.

Please allow me to violate (once again) a personal oath never to comment on short term price action as indicating something significant or portending some important occurrence. It's just that I've never witnessed such a sharp move down in gold as we've seen this week with silver relatively unaffected. Gold is down about $40 and silver is down about ten cents. I don't recall such a sharp improvement is the silver/gold price ratio on a move down in price and I am somewhat amazed that with new five year price lows the ratio has not expanded markedly.

I want to believe that all the visible signs of silver tightness both on a retail and wholesale basis might be behind the relative strength in silver, because that's the way things should function in a rational world. Then again, it's possible that the crooks might just be messing with my head and it's just a matter of time before another deliberate downward price adjustment.

But knowing that we're so close to completing this COT cycle bottom, it's gotten to the point of being unconcerned about still lower prices. Gold and silver prices are stupid cheap in COT terms and silver is so stupid cheap on every other possible term that the most reasonable course is to be fully invested. Just make sure you are not in danger of losing positions because you are on margin.

Ted Butler

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Silver – $14.75

Gold – $1092

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