

## July 9, 2011 – Weekly Review

### Weekly Review

After a number of down weeks, the price of gold and silver rebounded strongly this past week. In dollar terms, gold recorded its largest weekly price gain in my memory by climbing \$58 (almost 4%) to its third highest weekly close in history. While still some distance from its highest close, silver greatly outperformed gold this week by climbing \$2.90 (over 8.5%). As a result of silver's outperformance, the gold/silver price ratio tightened in to almost 42 to 1. That silver is still a good distance from achieving new price highs while gold is knocking at the door seems to imply (at least to me) that silver has relatively much further to climb as it "catches up" and overcomes the brutal deliberate takedown of early May.

One immediate observation to the notable price performance this week in gold and silver was that there appeared little obvious news to account for it. The dollar gained for the week and financial markets generally finished the week steady, despite the troubling unemployment report on Friday. So if it wasn't dollar weakness or financial turmoil that accounted for the price strength in gold and silver, then what was it? The most plausible explanation to me is that the price move was as a result of the extremely favorable market structure on the COMEX, as depicted in the Commitment of Traders Report (COT). I'll cover the new COT report momentarily, but the "spectacularly bullish" changes reported in last week's review would seem to be at the heart of why gold and silver prices zoomed up this week.

In the physical world of silver, the pattern of tightness appeared intact. The movement (mostly out) of metal from the big silver ETF, SLV, seems to have abated this week, but the turnover of metal into and out from the COMEX licensed warehouses continued active. Total silver stocks at the COMEX held steady, at close to 100 million ounces, and I am still of the opinion that it is a case of sellers needing to constantly bring in metal in order to project the illusion that supplies are sufficient, if not abundant. It doesn't appear to be a case of abundance to me. The number of contracts delivered against the traditionally big July COMEX contract, as well as the number of remaining contracts open is still unusually low and in stark contrast to the active turnover of physical COMEX inventories. This is still very much a different pattern than what has been seen over the years, namely, big deliveries against futures contracts and little turnover of physical COMEX inventories. The US Mint is still selling a disproportionately large number of Silver Eagles compared to Gold Eagles through the first week of July. This is as close to an apples versus apples comparison of retail investment demand for silver compared to gold as it gets and is a big reason why I feel that silver will outperform gold in the future.

In addition to this week's COT Report, the CFTC also released the monthly Bank Participation Report. In the past reporting month, there was little change in the silver short position of the big US banks, although there was some reduction in the gold short position. This conforms to the weekly changes in the COT reports. This week's COT report did show a notable increase in the total commercial net short position in silver of 4300 contracts, but a further reduction in gold of 6700 contracts.

Normally, I would be concerned by a 4300 contract net increase in the silver total commercial short position, as that is a large weekly change. But I am not overly concerned with this particular increase due to other circumstances. For one thing, this increase follows a much bigger decrease the week before, when the commercial short position was reduced by 6400 contracts. Despite this week's increase, the total commercial net short position, at 33,500 contracts, is still among the lowest in years. Just to put it into perspective, when we first crossed the \$35 price mark in March, the total net commercial short position in COMEX silver was more than 20,000 contracts (100 million oz) greater than it is in the current COT report. Simply put, this means that there are 20,000 contracts less to be potentially sold by the commercials now than there was then. This greatly reduces price risk to the downside.

Importantly, the 4300 contract increase in the commercial net short silver position did not occur as a result of an actual increase in commercial short selling, but rather as a result of commercial selling of long contracts held. (I know this can seem confusing to many, so let me expand a bit. As always, if you have questions please get back to me, as it is my responsibility to explain myself). As of the current COT report, there are 40 commercial trading entities in COMEX silver, each holding 150 contracts or more. I break these commercial traders into three categories; the big 4, the next 5 thru 8 largest traders and the remainder (32 this week). I call the big 4 and the 5 thru 8 the T. rexes and the remainder the raptors.

I started using this description years ago, patterned after the movie, "Jurassic Park." I did this because the dinosaurs in the movie seemed to be broadly categorized as either plant eaters or meat eaters (which preyed on the plant eaters). It seemed a perfect analogy to the COMEX where the commercials preyed on everyone else (mainly the technical funds and other speculators). The big 4 and the big 5 thru 8 were at the top of the meat-eating food chain, like Tyrannosaurus Rex. The smaller meat-eaters were the velociraptors, much faster and given to hunting the plant eaters in packs. JPMorgan and the other big commercials were the T. rexes while the smaller commercials were the raptors. The technical funds and other speculators were the plant eaters and the food supply for all the commercial dinosaurs. (Interestingly, I started using this dinosaur analogy years before JPMorgan actually became the lead T. Rex when they acquired Bear Stearns in 2008. It still seems like an apt description to this day).

The basic premise of the analogy was that I could identify what each group was doing by virtue of the incredibly detailed information provided weekly in the COT reports. I could also predict (but certainly not with timing precision) when the food supply (the position of the technical funds) was abundant or sparse and how that related to major tops and bottoms in silver (and gold). When the technical funds had a full long position on, it was just a matter of time before the meat eaters would attack them by engineering lower prices, forcing the technical funds to sell. When the technical funds had a small long position there was little likelihood of a major takedown in price (this past price smash in May being a notable exception). Currently, the technical funds have a small long position. That's why I have been characterizing the price risk in silver as small the past two months.

Lastly, this analogy held that the biggest commercials couldn't move in and out of the market as easily and quickly as the smaller and faster raptors. Due to their great size, the biggest commercials were always easy to track. And this also went to the heart of the silver manipulation in that size and power was what mattered in the dinosaur world and in concentrated positions, the necessary key ingredient in manipulation. Just like T. Rex dominated the dinosaur world, so does JPMorgan dominate the world of silver. And just like T. Rex became extinct, so will JPMorgan become extinct in matters related to silver.

The point of all this is to highlight that this week it was all raptor selling of previously held long positions that accounted for the increase in the total commercial net short position in silver. The big 4 (JPMorgan) didn't sell any additional silver contracts short. While the raptors are willing and collusive participants in the silver manipulation, through HFT and other means, they can't be accused of concentration, like JPMorgan. So the key question going forward is what JPMorgan does. Will they increase their silver short position on higher prices and try to prolong the silver manipulation? Or will they quit manipulating silver, allowing the price to find free market levels?

While I am still encouraged that JPM is holding its lowest COMEX net short silver position since it acquired Bear Stearns three years ago, there is no guarantee that they won't increase it in the future. JPMorgan had increased its silver short position by a large 6000 contracts back in March, but they took heavy losses buying back in April, driving prices to a record. My sense is that JPM won't significantly increase their COMEX short silver position again and this will allow silver prices to climb to new highs, due to a confluence of reasons, including regulatory developments. But that's speculation on my part. What's not speculation is that JPMorgan has been manipulating the price of silver and the manipulation will end if they refrain from selling more silver short.

Bottom line is that the silver COT structure is still quite constructive despite the increase in the total commercial net short position this week. That the raptors took profits on 4100 contracts is not of particular concern at this time. At Friday's close, the price of silver closed right at the 50 day moving average, an average it has not penetrated to the upside for more than two months. When, not if, this average is penetrated decisively we will soon learn of JPMorgan's intentions and the condition of the ongoing silver manipulation. The overall risk/reward ratio in silver looks particularly attractive at this point. We could see a sell-off, if the raptors look to trick the tech funds into selling so that the raptors can buy back the 4100 contracts they just sold, but that should be temporary in nature and not particularly devastating to price. But when the 50 day moving average is penetrated decisively, if the T. rexes don't sell additional contracts short, we could really fly in price. In practical terms, it seems safest to play it like we will move up substantially. Like has been the case for much of the past year (May excepted), worrying about a couple of dollars worth of decline could cause one to miss much bigger upside than a couple of dollars.

In gold, the reduction in the total commercial net short position was across all three commercial categories. More pertinent is what happened after the Tuesday cut-off. Undoubtedly, there has been deterioration in the gold COT structure since the report, with more to come on higher prices. My sense is that the assumed increase in the gold commercial short position since the cut-off is not excessive enough to cause a sharp decline in price yet. After all, we have only closed above the 50 day moving average in gold for three days. I will make the observation that gold has never been this high in price with such a favorable COT structure as depicted in the latest COT report. I'm more impressed with the silver COT set up, but there is room for gold on the upside based upon its structure.

I know I harp on the COT structure continuously, but that's because I feel it is a key factor in determining silver and gold prices. I've done the same thing recently with the short position in SLV and HFT and before that with regulatory developments. I know there are many other stories concerning gold and silver developing every day. I read everything I can on silver and if I do miss something, it is not long before a reader sends it along. Please keep sending them as they are greatly appreciated. But the fact is that I rarely comment on most of the new developments. Quite simply, if I don't comment on a new silver development or report, it's because I don't think it is that important to the price. Of course, I may turn out to be wrong and something I have chosen to ignore may prove to be more important than I surmised initially. But I honestly don't recall ignoring anything important to silver for long.

I see this service as prioritizing what's important in silver in order to help you learn and handle the incredible opportunity in front of us all. I don't want you (or me) to become bogged down or overwhelmed with the daily statistical minutia or to become unbalanced or emotional with every new story or chart development. I don't want to look so closely at silver as to not see the big picture. I'm not going to make it a habit of commenting on stories that I don't feel are significant, but some recent examples include stories of new gold and silver exchanges starting in China or detailed analysis of statistics from the BIS. It generally takes a long time before a new exchange exerts an influence on price and the statistics from the Bank for International Settlements are notoriously simplistic and double and triple counted. I just don't see the value added from disseminating any and everything related to silver. I want to attempt to focus on what's really important to the price.

To that end, I feel there was an important regulatory development this week. The CFTC passed, by unanimous vote, final rule makings on five important rules, including an anti-manipulation and ant-fraud measure.

[http://www.cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank070711.html](http://www.cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank070711.html)

I know that the pace of regulatory reform has been agonizingly slow for many, including me. I know that the CFTC had sufficient authority with existing statutes to move against the silver manipulators and to enact legitimate position limits in silver. I know that the Commission has apparently ignored and refused to comment on the blatant silver price manipulation that occurred during the first week of May. I know that The Commission has turned a deaf ear to many thousands of public complaints about silver over the years. I know that a broad and unhealthy distrust in public opinion has developed because of the Commission's inaction.

But I also know that the Dodd-Frank Act is the most comprehensive regulatory undertaking in 80 years. I know that it is important to every American citizen and world market participant. I know that its implementation is incredibly complex and there are powerful forces actively hostile to its enactment. I know that relative to its complexity and the hostility against it, the fact that it has advanced to its current state is nothing short of a miracle.

I admit that my focus on Dodd-Frank is specific to silver. I say that as a silver investor and analyst. I am appalled at the delay in the enactment of silver position limits and the lack of CFTC movement against the silver manipulators. But as an observer on a broader basis, I am deeply impressed with what has been accomplished to date. The process has been transparent and Chairman Gensler has worked hard and efficiently to be as inclusive as possible. Soon, I may have to eat those words, but the enactment of the five final rule makings this week is a very constructive development.

Shortly (over the next few weeks and months), the Commission will propose the final rules for position limits in silver and other commodities. Then we will all learn how much weight the agency placed on the thousands of public comments it solicited for consideration of this issue. In my opinion, how the Commission addresses the public input will be the *“tell”* in what the Commission really feels about the issue of silver. I'm not going to handicap what they might do or say, other than we should finally know once and for all time. The point of resolution that I have written about for the past two years is rapidly approaching and win, lose or draw, it's high time this matter was resolved.

In summary, we may be at an unusual and defining moment in silver. There could be some further time and price delay, but that should prove temporary at worst. The silver fundamentals and market structure point to significantly higher prices, perhaps quite soon. The regulatory resolution, whatever it may be, is dead ahead. All in all, it's pretty exciting.

Ted Butler

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Silver – \$36.75

Gold – \$1544

**Date Created**

2011/07/09