

June 1, 2019 -Weekly Review

A sharp Friday rally powered gold to a weekly gain of \$22 (1.7%) and its highest weekly finish in more than two months, while silver could only muster a move back to unchanged or so for the week from the six month lows it established on Tuesday. As a result of gold's strong outperformance, the silver/gold price ratio widened by nearly two full points to 90 to 1, the cheapest silver has been relative to gold in 25 years. Why is silver so weak relative to gold?

The answer doesn't have anything to do with real world investors switching silver positions to gold or anything close to that, even though that's an opinion that seems reasonable on the surface. And it's certainly not as if gold shouldn't be moving higher, as just about everything supports higher gold prices (as I hope I have conveyed). The answer to why silver has been so punk relative to gold lies in the same reason why a whole host of really important world commodities, from crude oil to copper to corn and soybeans have had major prices moves of late.

That reason, of course, is the extreme buying and selling by the two major counterparties in futures trading – the managed money technical funds and the commercials which take opposite sides of each other. When prices move sufficiently (usually by commercial instigation), and the managed money traders get to buying or selling big, stand back – because that's what moves prices. It's important to recognize that managed money buying and selling is what moves prices and such buying and selling is not just coincidental to the price moves. It is causal, not coincidental. And even though it is managed money buying and selling that drives prices, the commercials on the other side are who actually then set the price. Once you see this, everything makes sense.

As I indicated on Wednesday, the managed money/commercial positioning in corn has been almost solely responsible for the recent dramatic price moves. In little more than 11 trading days, the price of corn moved from near historic lows (\$3.50 per bushel) to multi-year highs (\$4.20 as of Tuesday), a move of 20%. The reason corn prices were so cheap a few weeks ago was due to record managed money shorting of 530,000 corn contracts (equal to 2.6 billion bushels) and the reason prices soared was because more than 250,000 of those short contracts (equal to 1.25 billion bushels) were bought back in less than 3 weeks. The short covering is equal to 10% of the annual US corn crop. Not a single bushel that was sold short or subsequently bought back by the managed money traders was a legitimate hedge – just pure speculation.

Let's look at copper and crude oil. At the beginning of the year, I commented that copper prices, then in the \$2.65 price range looked ripe for a substantial rally due to the existence of a near-record managed money net and gross short position. Copper did experience a substantial rally of more than 30 cents per lbs. into the spring as the managed money traders bought more than 60,000 net COMEX contracts, the equivalent of 750,000 tons of copper (and even more on the LME).

Over the past month, the managed money traders have turned sellers again in copper and their net and gross short position is back to near records (and likely establishing new short records since the Tuesday cutoff), as copper prices are now less than \$2.64 again. While it's always tricky to call precise price bottoms, at some point, once the managed money traders exhaust themselves on the sell side, a substantial rally should once again occur. But here's the kicker – reliable published reports indicate that the actual supply/demand situation in copper is quite bullish; in fact, pointing to a

deficit supply picture in copper where demand exceeds current supply.

That's the most bullish actual fundamental that can exist in any commodity where demand exceeds supply. Yet copper prices have declined by nearly 10% over the past month. The only possible explanation for the extreme weakness in copper prices can't be anything related to actual supply and demand it has to be something else. That something else, quite frankly, is record managed money selling on the COMEX and LME.

Then there is the dramatic fall in crude oil prices, the most important world commodity by far. Over the past seven trading days, the price of crude oil (WTIC) has fallen by \$10 a barrel and three of those days have featured higher or unchanged prices; meaning the most important commodity in the world has fallen by more than 15% in just four trading days. Let me assure you that the world has not experienced a sudden surge in oil production or a drastic decline in oil demand over the past 7 trading days that would be impossible. The sudden drop in crude oil prices has nothing to do with what is being produced or consumed in the real world.

Instead, the oil price drop has everything to do with the key moving averages being penetrated to the downside for the first time in many months, causing the brain dead managed money traders to rush to the sell side with many tens of thousands of futures contracts to sell. Since a big part of the decline took place in the three days since the Tuesday cutoff for the COT report, let me defer an actual count of how many contracts the technical funds sold until next week's COT report.

But my point is clear the price of just about every commodity is being set by speculative derivatives positioning, in direct violation of US commodity law. Since none of us is in position to litigate that violation, the best we can do is understand and try to position ourselves as best we can. That means, at least to me, adopting a bullish position in those markets which interest us most when the nitwit technical funds get overloaded on the sell side, as is the case in crude oil, copper, platinum, gold and, most particularly, silver.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses slowed to a trickle this four day work as less than 1.5 million oz were moved (and nearly 1.3 million oz of that was moved yesterday). With such small weekly movement, there couldn't have been a substantial change in total inventories and there wasn't – a drop of 0.2 million oz to 305.9 million oz. No change again in the JPMorgan COMEX warehouse, still stuck at 150.6 million oz.

There was, however, some big changes in silver warehouse categories this week that bear mentioning. Some 4.6 million oz (3 million oz yesterday) were switched from registered to eligible and while this does not involve a physical movement of metal, it does point to JPMorgan. As previously mentioned, I'm of the opinion that the JPMorgan COMEX warehouse may have reached maximum capacity at 150 million oz and any additional silver the bank has come to own for itself or clients (via futures delivery) needs to be stored in other COMEX warehouses.

Eligible silver is cheaper to carry in term of storage and insurance charges than registered and the fact that so much was switched right at the end of the month, suggests to me getting to the cheaper storage charges was the prime motivation for the transfer. JPMorgan and its clients have been the big stoppers on futures deliveries and the amounts just transferred this week further suggests to me that JPM et al likely own more than the 50 million oz I previously opined about making it a bare bones

minimum of 200 million oz that JPM controls of the 305 million oz total of COMEX silver inventories – perhaps closer to 225 or even 250 million oz.

After two days of delivery in the COMEX June gold futures month, the standout feature is not many deliveries – only 90 total deliveries have been issued so far, an unusually low number. And with only 2000 contracts remaining open in the June contract (traditionally an active delivery month), there wouldn't appear to be many more deliveries to go, although that could certainly change. I would note that JPMorgan has been a stopper of 24 gold contracts (19 for clients and 5 for itself), supporting the idea that it is not looking to sell physical gold. Hard to say what the low number of gold deliveries portends, but all things considered, it doesn't look bearish.

Turning to yesterday's Commitments of Traders (COT) report, my guesses were largely on the mark, even though I characterized my gold prediction as a WAG, given the uneven price performance over the holiday-shortened reporting week. I guessed managed money buying/commercial selling in gold of 15,000 contracts and we got a bit over 10,000 contracts of managed money buying, but only 2000 contracts of commercial selling. Less in this case is better. I predicted the opposite in silver, namely, 5000 contracts of managed money selling and commercial buying, hopefully more, and we got more than 8500 contracts of managed money selling and nearly 6300 contracts of commercial buying. Thus, the gold market structure deteriorated less than expected and silver's structure improved more than expected – not exactly heartbreakers.

In COMEX gold futures, the commercials increased their total net short position by 2000 contracts to 110,000 contracts. Even girding for the expected more significant increase in net commercial selling yesterday, the market structure in gold is hardly bearish. It does remain to be seen whether yesterday's surge up through the remaining key moving averages (the 50 and 100 day ma's) will prove to be the same brief stab to the upside like occurred in the prior reporting week only to result in an about face to the downside or whether gold has commenced on its long-expected upward journey. Time will tell.

Since there is not much to report on as far as commercial selling (other than there was much less than expected), let me jump to the managed money and other traders. The managed money traders purchased 10,337 net gold contracts, comprised of the purchase of 4328 new longs and the buyback and covering of 6009 short contracts. The resultant net long position of the managed money traders of 26,274 contracts (119,314 longs and 93,040 shorts) on Tuesday was still historically low and bullish. That net long position is likely much larger in trading since the cutoff, but even an increase of 30,000 to 40,000 contracts would be no worse than neutral.

One oddity in gold was the sale of 13,493 long contracts by the large non-managed money traders, as those long contracts obviously missed the big gain in gold through yesterday.

In COMEX silver futures, the commercials not only reduced their net short position by 6300 contracts, they eliminated it completely and ended up net long by 1100 contracts. While almost as rare as henâ??s teeth throughout history, a commercial net long position appeared for a number of weeks back around last September, when silver traded down to the \$14 level. Such a commercial net long position was then and must now be considered bullish, although the resultant rally from last fall must also be considered quite weak as it only amounted to \$2 or so before the managed money traders bought and the commercials (including JPMorgan) sold quite aggressively into the Feb price highs. So here we are again, back where we were last fall.

Back in the Sept to Nov timeframe, when the commercials had first achieved a net long position in silver for, essentially, the very first time, my notes indicate I had pegged JPMorgan as also getting net long for the first time since it acquired Bear Stearns in 2008, to the tune of as much as 3000 contracts. Itâ??s not that the numbers are so much greater in the just released COT report, but I would calculate that JPMâ??s net long position in COMEX silver is now up to 6000 and possibly 7000 contracts, as of Tuesday. Whether it has sold or will sell before next Tuesday should be apparent in next weekâ??s Bank Participation Report.

While JPMorgan holding its largest silver futures net long position is not insignificant by any stretch, what is much more significant is that it holds at least 50 million more physical ounces than it did last fall. Yes, I have stated on several (many) past occasions that JPMorgan had held what was then its largest net long position in silver, invariably consisting of a then large physical position and a then small COMEX net short position. On each and every past such occasion, I indicated that was the best overall position JPMorgan had been in, suggesting the time was ripe for the big upside silver move. No such big move ever occurred, despite what I portrayed being correct, namely, that at those particular times, JPM was positioned the best it had ever been. JPMorgan is now there again, owning more physical silver (and gold) and its biggest COMEX paper long position ever. Time will tell if I get to make this statement yet again in the future or if this is it.

On the sell side of silver, the managed money traders sold 8576 net contracts, consisting of the sale and liquidation of 2644 long contracts and the new sale of 5932 short contracts. The resultant net short position of the managed money traders of 38,007 contracts (49,913 long contracts versus 87,920 short contracts) is now among the largest and most bullish in history. The gross short position was larger for several weeks back last September, but itâ??s important to remember the slide in price back then to \$14 started at a higher price (\$17+) and lasted for a slightly longer time, picking up more momentum as it moved lower.

Last week, I mentioned that the number of traders in the managed money category on the short side was less than what the number of traders were back in Sept when the total short position was larger; resulting in a higher number of contracts held short on average per trader now, as opposed to back then. In this weekâ??s COT report, while the gross short position of the managed money traders rose by a substantial 5932 contracts, the number of traders in that category fell by one to 46 traders. This has resulted in each short managed money trader now holding the largest number of contracts per trader ever on average â?? 1911 each (87,920 short contracts divided by 46 traders). A number of observations on this.

One, while the managed money short traders may each hold 1911 contracts on average, in reality, the actual distribution must be different, likely on the lines of the Pareto Principle, where 80% of the

position is held by 20% of the participants. This is reflected in the concentration data, which increased this week despite it being impossible for commercials to have increased concentrated short positions. That there are a number of very large managed money shorts is inherently dangerous to the overall market as these traders stand as much chance of being able to deliver tens of millions of actual ounces of silver as any of us solving the trade war. They must cover at some point.

But putting the actual short concentration issue aside, even if the 87,920 short contracts (nearly 440 million oz) were held equally by the 46 traders in the managed money category, the 1911 contracts comes to more than 9.5 million silver oz held short by each trader. Apart from the 20 or so largest silver mines in the world, very few other mines produce more than 9.5 million ounces of silver annually. To my knowledge and according to public reporting requirements, no silver miner is currently short silver on the COMEX. Certainly, none of the managed money traders currently short, on average more than 9.5 million oz each, is clandestinely representing mining companies with their short positions.

The 46 managed money traders holding 440 million oz of COMEX silver short are purely speculating and the fact that they have been allowed to short more than half of total world annual mine production is an outrage and disgrace and fully reflects a federal regulator, the CFTC, and a self-regulator, the CME Group, which should be beaten with a stick for allowing such a travesty. This is even worse than the 530,000 corn contracts held short a few weeks back by managed money speculators. Have the regulators no common sense? How could it be possible for such large speculative short positions not to depress prices? Ditto for all the other commodities. Rant over.

Yesterday's surge in gold prices undoubtedly involved heavy managed money buying and commercial selling, although the jury is out on whether we next see a failed breakout like we saw a week or two ago or whether we are off to the races. In the real world, I see nothing but stronger buying than selling in gold. More central bank buying emerges daily and the only central bank seller seems to be Venezuela, which can't have much gold left to sell. Private and institutional holders of gold wouldn't seem to have a reason to sell and many reasons to buy, judging from world financial developments. The only potential fly in the ointment would seem to be COMEX shenanigans, but that game is getting long of tooth.

Silver is different in that I don't know what to make of yesterday's action. Volume was high and prices were up, suggestive of managed money technical fund buying and commercial selling. At the same time, however, no key moving averages came close to being penetrated to the upside (save for the 20 day moving average intraday, but not even on a closing basis). We've seen times in the past when silver prices are well below the key moving averages (like now) and rally but don't penetrate the moving averages, and some technical funds actually add to short positions.

You would think the technical funds would be beyond nervous about being so heavily short silver at such depressed prices (particularly since they've always lost in the past), but how nervous could they be since they wouldn't have gone short so heavily if they knew they were going to lose. What the technical funds did yesterday in silver is something I'm asking myself and am in no position to answer. I'm going to assume there was some buying back of shorts, but not excessively - certainly not enough to radically alter what is a phenomenally bullish market structure.

What comes next for silver is what already came in corn - a spark to turn the tide and begin managed money mindless buying from mindless selling. In corn, the spark might have been planting delays, but if it wasn't that, it would have been something else. What the spark will be in silver is for

fortune tellers to pronounce, I just know there will be a spark, even if it is invented after the technical funds turn to the buy side. The record average per managed money trader short position will largely be bought back at some point that has always occurred and is, essentially, guaranteed. How much of a rally it will generate is the great unknown, as that is up to you know who who happens to be better positioned for the big one than it ever has been. You should be as well.

(On a housekeeping note, I'm switching to the COMEX August gold contract from the June contract for pricing purposes, which adds \$5 to the price).

Ted Butler

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Silver – \$14.56 (200 day ma – \$14.91, 50 day ma – \$14.89)

Gold – \$1311 (200 day ma – \$1261, 50 day ma – \$1290)

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