

June 11, 2010 – Current Market Observations

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I prefer to avoid assigning importance to short term price gyrations in silver (or other markets), as it can lead to a "chasing your tail" mindset. If you allow your investment decisions to be determined by short term price movements, you often end up feeling good and buying when prices take a jump and feeling depressed and selling when prices slump. Let's face it, we're all human and are subject to emotional influences. But buying price breakouts and selling breakdowns is a tough way for most to make consistent profits (although some traders do have a natural talent for this).

Upfront, I freely admit to not being a technical analyst. This in spite of watching most technical patterns in silver closely and placing heavy emphasis on the market structure, as depicted in the COT and Bank Participation Reports. (I consider COT analysis as more fundamental in nature.) My resistance to relying on charting and other technical approaches to silver is that it often clashes with long term value investing, which I'm convinced is the best way to invest in silver. After all, if you buy on a technical price signal, you should sell when you get a technical sell signal. I'm not comfortable with that, and would much rather buy low and sell high. I am especially leery of relying on price signals in silver to buy or sell because I know the market is manipulated in price. While I pay too much attention to daily trading details, like prices and deliveries and warehouse statistics, etc., than I should, I am very reluctant to pass these daily thoughts onto subscribers, as I don't think it will help you in any way. That said I would like to share some thoughts about the current short term silver price movements.

Just this morning, silver jumped more than 20 cents on the COMEX open to a multi-week high and above all the moving averages. This generated technical buying, although the volume was light. But no sooner was this buy signal flashed, that the market sold off sharply from the high (almost 50 cents), causing the early buyers to sell what they bought. This all occurred within the span of an hour or so. I can assure you that this was all COMEX paper manipulative games, as it is impossible for the real supply fundamentals of any commodity to change that quickly. How the rest of the day may play out is anyone's guess, but I still feel the set-up in silver is conducive to a sharp jolt to the upside, technical signals notwithstanding.

Today's COT report should show a notable reduction in the total net commercial short position for the reporting week, reflecting the sharp engineered sell-off last Thursday and Friday. I am also hopeful for a reduction in the concentrated short position of the four largest traders, as I indicated earlier this week that I thought it was JPMorgan buying on Monday's rally. As a reminder, a reduction in the commercial net short position is a reduction of potential risk to the downside.

As I hope I've been conveying, I think the COT set-up in silver is good, with fairly low odds of a prolonged price slump and much higher odds of a sharp move to the upside. The commercials, being the collusive group that they are, can always create sell-offs. The only way we can protect ourselves from these price rigs is to avoid margin and focus on holding and buying through the price dips. I would expect any sell-offs at this point to be temporary, with sharp snap backs in price following any potential sell-off. Increasingly, that does appear to be a developing price pattern, and is something very different from years past, when it took weeks and months to recover from the deliberate silver sell-offs.

One of the factors that I am encouraged by is that we appear to be at a moment of resolution in terms of the COT structure, as well as at important points of resolution in the physical and regulatory areas. While we can't rule out intentionally induced sell-offs, there doesn't appear to be a great number of long contracts that the commercials can shake out to the downside. And even if they do succeed in liquidating additional tech fund long contracts, it will only improve the prospects of an explosive upside move afterwards. Also, I notice a distinct "jerkiness" to recent price moves, where prices suddenly move sharply with little warning or apparent cause. This is very much in accordance with my recent analysis about JPMorgan looking to rid itself of its short position.

I know there is a sense that silver price performance has been lethargic recently, particularly relative to gold, which just hit historic highs. But there is a flip side to this. It is interesting that the key silver price moving averages (like the 50 day and 200 day) are at or near all-time highs (for 30 years, anyway), with the COT structure nowhere near all-time negative extremes. This is encouraging. In addition, it still looks to me like the biggest short, JPMorgan, is interested in reducing its giant position, not increasing it as has always been the case previously and as is currently the case with gold. I can't emphasize how important this change in pattern could be to future silver pricing.

My sense is we have been moving, inexorably, to a resolution of the silver price manipulation. This includes on physical and regulatory levels, and now on a COT basis. In short, I don't think there is much true liquidity in silver trading currently. An incredibly small number of COMEX contracts changing hands are having a disproportionate impact on price. I don't think this is necessarily bad for silver investors. In fact, I think it could be quite beneficial, as it suggests that the old paper games are not working as well for the commercial manipulators. We don't need trading liquidity to achieve true free market prices for silver. The shrinking COMEX trading liquidity threatens the manipulative paper games, not the long-term value of physical silver. Please don't obsess with near term pricing. (That's in the do as I say, not as I do category). In the long run, current near term price volatility doesn't matter a whit. Ignore it, or put it to your advantage by buying the dips.

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