

## June 2, 2012 – Weekly Review

### Weekly Review

Following one of the biggest one-day surges in history on Friday, the price of gold finished the week \$53 (3.4%) higher. Silver finished the week barely 15 cents (0.5%) higher, despite a robust \$1.40 rally from the lows early Friday. As a result of gold's outperformance this week, the gold/silver ratio widened out to near 57 to 1, just about the highest relative valuation gold has had to silver in more than a year and half. As such, there is a better reason, to my mind, to convert gold into silver than there has been in that time. (More on this later).

The obvious question is what the heck happened to goose the price, especially of gold, so violently on Friday? Yes, the monthly employment report was weak and the news from Europe was uniformly dismal, but readings from the world economy have been disturbing throughout the month of May. Up until Friday morning, it was precisely such weak data that was uniformly reported as being behind the slump in gold and silver for the month of May and ever since the price top on February 28. So how can the same data explain both weakness and strength in precious metals? The obvious answer is that it can't.

Additionally and as I have tried to report recently, we've been in a sort of "Twilight Zone" where the things that would normally cause people to rush to the precious metals (like banks runs and currency turmoil) have had no positive impact on prices. In fact, the price action led many to conclude that people were abandoning the precious metals instead, despite no concrete evidence of such abandonment (like ETF flows). Price action does dictate the news, but the suggestions that people around the world were dumping precious metals in response to the news were flat-out preposterous. But if a story sounds like it is in conformity with the current trend of prices, it tends to be accepted, no matter how little sense it makes.

So if it wasn't the disturbing news flow on Friday morning that accounted for the sharp gold and silver turnaround, it had to be something else. That something else was manipulation on the COMEX. You see, manipulation is not a handy and convenient fall-back excuse to be dragged out only when gold or silver prices decline. Either a manipulation exists or doesn't exist; regardless of whether prices are falling or rising. What determines a manipulation is artificial pricing through dominance and control by a few traders. Either that dominance or control exists or it doesn't exist. I contend the evidence of that dominance and control can be seen in Friday's gold price explosion. Prices exploded due to the same manipulative forces behind price declines.

Timing aside, the gold and silver markets were positioned to explode based upon the market structure according to the Commitment of Traders Report (COT), as I hope I have been conveying to you. We were (and are) configured very bullishly in gold and silver in COT terms, in that the commercials had a very small net short position in each and the speculators held a very small net long position. Anyone who studies the COT market structure would concur. But not all would agree with my premise that manipulation is at the heart of COT changes. Why there would be any disagreement is beyond me. To believe that normal free market forces lie behind the COT changes is unreasonable, in my opinion.

But where's the beef behind my claim that gold prices exploded Friday due to manipulation on the COMEX? It seems to me that the sharp gold rally was nothing more than the commercials ringing the cash register and harvesting profits. The long-running COMEX manipulation is a continuous process that involves a time when the collusive commercials sow the seeds and then harvest the crop on a never-ending cycle. The cycle includes rising and falling prices and goes to my statement that a rising price can involve manipulation. Let me get more specific.

As I mentioned in last week's review, there had been a build up in the gross short position of the technical funds in gold, as indicated in the long form disaggregated futures "only COT report. I gave the numbers for silver but not for gold, so let me do so now. This is the category of trader that the commercials lured onto the short side by the process of engineering lower successive prices. This "slicing of the salami" was the prime inducement for getting the tech funds to go short and the commercials pulled it off this time brilliantly. From the time of the first drop in gold below \$1600 (early May) to this week's COT, the short side of the managed money category increased by more than 30,000 contracts, from under 10,000 contracts (COT of May 1) to almost 41,000 contracts as of the Tuesday cut-off. I would calculate that the average price at which the tech funds sold short these 30,000 contracts to be around \$1575.

As I tried to explain, this type of pure tech fund short seller is always a bullish factor in the market because once they are done selling, you know they will buy back as prices rise (as opposed to the commercials who rarely, if ever, buy back shorts on higher prices). You don't know when or where these tech funds shorts will buy, but you know they will buy at some point. And they have a tendency to go through the door and buy all at once, if important moving average signals are flashed. Those signals were flashed on Friday and it was tech fund buying that was solely responsible for the explosion in gold prices. The only thing I don't know is if all 30,000 tech fund short contracts were bought back or is there some number remaining to be bought (the more remaining to be covered, the better). Of course, this tech fund short-covering is separate from the buying of long contracts by other tech funds. As always, this is what moves prices.

If the tech funds bought back these 30,000 gold short contracts at prices where the majority of volume was transacted on Friday, I would calculate that the tech funds lost (or will lose) up to \$150 million. Not bad for one day's pay for the commercials who made or improved their bottom lines by that same amount, even if it needs to be split 30 or 40 ways. And this is just a partial take for the commercials on a single trade that occurred within a month's period of time. It was a pretty big one, but just a single ringing of the commercials' collusive cash register. This is a cash machine that has been rung hundreds of times over the years, to the great shame of the regulators.

As far as this \$150 million changing hands, what it took was first a manipulation of prices lower by the commercials to induce the tech funds to go short the 30,000 contracts (which the commercials bought) and then for the commercials to decide when and where to then stand aside and let prices rip higher (for no other real reason), forcing the tech funds to buy back at a loss (which the commercials sold). I'll discuss in a moment the future prospects for prices after Friday, so don't interpret the move as being done. My point here is that the gold rally on Friday was due to what I just described as having occurred on the COMEX and that's just as much a manipulation as was the prior price depression.

Conditions in the wholesale physical silver market still appear tight, based upon my leading signpost, turnover in the COMEX warehouses. In a holiday shortened week, gross turnover was close to 2 million oz again and total inventories climbed over a million ounces to 143.2 million oz, just about the high point recently. There was some in and out movement in the big silver ETF, SLV, as well as a million oz+ withdrawal in another big silver ETF, SIVR. I still think the turnover equates to tightness in wholesale supplies.

Sales of Silver Eagles for the month of May did hit the highest levels since January's super-strong level and continued to outpace sales of Gold Eagles. While sales of Silver Eagles are not blistering, they are strong enough to suggest that recent stories of net selling by investors were, in fact, incorrect. Again, we went down in price (and up on Friday) due to prices being set on the COMEX.

The changes in this week's COT were as expected in gold, which indicated a reduction in the total net short position of the commercials by 4900 contracts to 130,700 contracts. This is another multi-year bullish extreme and fully explained in advance the price run up on Friday. The big 4 accounted for most of the buying (4000 contracts), which reduced their net short position to 95,338 contracts, a new low for a few years. Certainly, the big 4 were positioned very well for the price rally on Friday.

Rather than dwell on the details of this report, we have to think of how much deterioration took place on the big rally on Friday, which was accompanied by high volume. At the top (\$1785) on Feb 28, the total commercial gold net short position was 245,400 contracts. By Tuesday, that short position had declined by almost 115,000 contracts. I'd guess some 30,000 net open contracts changed hands, on yesterday's heavy volume, but only future COTs will tell us precisely and with a delay. Still, it appears there is ample room to run to the upside in gold, if we are to run. We may have used up the fuel from one booster rocket in gold on Friday, but world conditions and the still low relative level of total net commercial shorts would point to the potential of a much bigger move to come in gold. As always, however, this remains a manipulated market and nothing can be taken for granted.

In silver, the changes in this week's COT were more complex. The total commercial net short position did decline by 900 contracts, to 14,300 contracts, which is still at an historical bottom of the barrel level and very bullish. The tech funds' net long and gross short positions were slightly better and as good as they have ever been. But there was an anomaly in this week's report that stands out, namely, it appears JPMorgan increased its short position on what were lower prices during the reporting week. Remember, I had framed the major market question to be decided in silver as whether JPMorgan would increase its net short and manipulative position on rising prices. I hadn't considered JPM as increasing its short position on lower prices. Yet, that's what occurred, according to the new COT.

Although the total commercial net short position was reduced by 900 contracts, the big 4 (read JPM) increased its net short position by almost 2400 contracts (12 million oz). The raptors were buyers on lower prices, as usual, picking up 2800 contracts and increasing their net long position to 23,200 contracts, the highest number for them in years. The 5 thru 8 largest commercial shorts also bought back a few hundred contracts, as expected. In studying the details, I am left with the conclusion that JPMorgan was the only net commercial seller in the reporting week. I did not expect this and am left to ponder its meaning.

I would now calculate JPMorgan's concentrated net short position in silver to be around 14,000 contracts (70 million oz). That's up from a recent low of 11,000 contracts, but still down from 24,000 contracts at the end of February. I don't know if this means that they will sell more on the next rally or whether they bought back some on Friday's turnaround. This coming Tuesday will be the cut-off for the Bank Participation Report for June (as well as the COT) and we'll get a firmer picture on what JPM holds next Friday.

I try to be objective about JPMorgan's motives in gold and silver, but it is hard to come up with legitimate explanations for many of their actions. I know the vast majority of JPMorgan's 250,000+ employees are honest and conscientious human beings, as was my late father who worked at a predecessor bank (Chemical) before it was ultimately acquired by JPM in the 1990's. I'm sure it pained my Dad to know I thought they were manipulating the price of silver, so I didn't dwell on it when I was with him. But try as I might to come up with legitimate explanations for JPMorgan's actions in silver and gold, I usually come up empty-handed.

This time is no exception. I don't care if they claim "they were just hedging or making a market," JPM's selling of silver in the reporting week was pure manipulation because according to the COT they appear to have been the only commercial seller. Manipulation doesn't get clearer except when there is only one buyer or one seller. That's because without that one buyer or seller, the price would have had to have been away from actual prices recorded. As clear as a case of manipulation as was JPMorgan's selling in silver during the reporting week, it is not something the CFTC will pick up on, as they are just not capable of doing so. Here we have a federal agency in the midst of an active investigation into an alleged silver manipulation that observes (as it is investigating) multiple acts of overt price manipulation (the two 30%+ takedowns within days in 2011 and the latest takedown starting Feb 29 this year) and it does and says nothing, even though such takedowns can't be explained in free market terms. The CFTC is not capable of dealing with JPM's concentrated selling in the latest reporting week. That would be like asking them to certify the safety of a nuclear power plant.

It's possible that Friday's turnaround might be the start of a major leg up in the metals. It certainly should be the start of a major up leg, given the state of world economic and financial conditions and the super-constructive structure of the market, according to the COTs. But manipulation is an integral component of this market at all times, making short term predictions impossible. It does still appear clear to me that any potential silver price declines from here should be much less than the potential price increases to come to the upside. That's the reason for buying and holding silver.

A few words on the gold/silver ratio and what I expect to be long term outperformance by silver over gold. As I indicated earlier, the current weakness in silver relative to gold presents an attractive switching point, as would further strength in gold over silver. It has to do with numbers and common sense. As I hope I have made clear, I am bullish on gold and the higher it goes the better a buy silver becomes. Gold rallied almost \$66 on Friday. Based upon the 3 billion ounces that exists in the form of gold bullion equivalent (not the 5 billion oz of total gold oz, which includes jewelry and ornaments), the value of the world's gold bullion increased by \$200 billion on Friday. That means that just the one day change in the value of gold bullion exceeded by 7 times the total value of the world's one billion oz of silver bullion. Just the one day change. Since gold and silver are remarkably more similar than they are dissimilar, this suggests a mispricing of relative valuations of epic proportions.

I know I constantly promote the switching of gold to silver. I've done so since at least 2000 and in the intervening years, when the ratio was much larger than it is currently and also when it was lower than it is now. This is very much intended as a long term position and one not undertaken with the use of margin or leverage. While I think I have had some influence in convincing people to buy silver over the years, I know I have not had a big influence in getting them to switch from gold into silver. I know that because not even the slightest percentage of gold investors has made the switch, according to simple math. Let me see if I can prove that.

The first thing is to define "slightest percentage." I would define a slight percentage to be 1% of something. I would further define slightest percentage to be one-tenth of 1% (or 0.1%). That's the opposite and the reciprocal of 99.9% which is close to the greatest percentage possible of something.

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The total dollar value of all the world's 3 billion oz of gold bullion is near \$5 trillion (3 billion oz x \$1626). One-tenth of 1% of \$5 trillion is \$5 billion. That means that \$5 billion, which is close to the slightest percentage possible for all the world's gold bullion, is an enormous sum when it comes to silver where it would buy 170 million ounces at \$29. There is no way that anyone could buy 170 million ounces of silver without profoundly influencing the price higher, as that would be equal to 17% of all the world's silver bullion. One-tenth of one percent of all the world's gold bullion is equal to 17% of all the world's silver bullion. Another way of looking at it is to focus on gold ounces compared to silver ounces. With 3 billion gold bullion ounces in the world, one-tenth of one percent equals 3 million gold ounces. At the current gold/silver ratio of just under 57 to 1, that's also equal to 170 million silver ounces (57 x 3 million oz).

My point is that even if the slightest percentage (0.1%) of the world's gold bullion attempted to be switched into silver, it would have negligible impact on gold prices, but a profound impact on silver prices. Because we haven't seen that profound impact on silver prices yet, we know that even the slightest percentage of gold investors have yet to attempt the switch. Therefore, I know I haven't been successful yet in promoting that switch.

The operative word here is "yet." Because the switch hasn't been made yet, doesn't mean that it won't be made. In my experience, gold investors are among the most savvy of all investors. They have learned to be skeptical of the naysayers of gold and gold investors know how to look ahead and think for themselves. That's why so many sharp hedge fund managers hold significant gold exposure. Because gold investors think independently, I believe it is just a matter of time before they come to understand how silver stacks up compared to gold. Let's face it, silver has been under everyone's radar due to a variety of reasons, not the least of which is that it has been manipulated more than any other commodity and made to look bad by the collusive COMEX commercials. But it is precisely the depressed silver price, relative to gold, that will compel more to consider the switch from gold to silver or to purchase silver without selling gold.

Can the gold/silver ratio climb higher? Of course it can, but if it does, that only makes silver more attractive. The funny thing is that the main reason to invest in gold in the first place is to preserve and insure future purchasing power; to be able to convert current savings for the future purchase of goods and services no matter what currency conditions may be at the time. The beauty of converting gold to silver now is that the switch enhances the future purchasing power of gold by substituting a similar but greatly undervalued asset. As and when silver breaks its price manipulation (which it will) and becomes more appropriately and even over valued compared to gold, it may become advisable to switch back to gold. But as long as one-tenth of one percent of the world's gold bullion buys 17% of the world's silver bullion, silver is the better buy.

Ted Butler

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Silver – \$28.65

Gold – \$1626

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