June 29, 2013 – Weekly Review/New Law of Supply/Demand

Weekly Review

Despite a spirited rally on Friday, particularly in silver, gold and silver prices ended the week lower again. For the week, gold finished $63 (4.9%) lower, while silver ended down 40 cents (2%). As a result of silver's relative outperformance, the silver/gold ratio tightened in by the same full two points it widened the week before and now sits at 63 to 1. This ratio still indicates silver is close to the cheapest it has been to gold in three years, but I can't help but sit up and take notice that silver has (relatively) more than held its own on a two-week price decline in gold of more than $150. As you know, silver usually accelerates gold to the downside. I hate to rely on short term price movement for market opinion because prices are so controlled and manipulated, but if silver is the better deal as I purport it to be, it needs to demonstrate that at some point.

Friday was the end of the quarter and first half and what a rotten quarter it was for gold and silver; in fact, among the worst on record. I'll spare you the horrid details, but if there was any validity to past price action dictating future prices, we'd be at zero in a few quarters. That's not something I envision and, in fact, still believe we are close to what should turn out to be a very strong rally caused by the mirror image of what accounted for the price carnage this year. I'll get into the details of that in a moment, but I must say that I have rarely seen the degree of universal negative sentiment and bearishness displayed towards gold and silver in my more than 40 years of professional involvement than I see today.

I suppose this super-negative sentiment is to be expected given the price extremes registered these past few months. Early in the year, I was not aware of many (or any) price projections calling for sub-$20 silver or gold less than $1200 and certainly none for legitimate supply/demand considerations. Now that we have seen these prices, there is no end to even more bearish projections. I'm resigned to the fact that the bearish expectations will persist until prices rise enough to encourage bullish expectations. That's just the way it works.

It seems that every day I wake up expecting the worst and almost every day my fears are realized when prices first appear on the TV screen. Then I am subjected to a non-stop barrage of why gold and silver are so bad and how they must continue to plummet in price for reasons only an idiot couldn't understand. I suppose I am an idiot, because I don't understand the reasons given, namely, prices must go lower because of inflation, the Fed, the stock market, that they never should have gone up in the first place, etc. I can't understand the reasons because none of them are the reasons I started pounding on the table for silver when it was in the low single digits. I can understand the continuous display of charts and graphs pointing down and how that seems to guarantee the permanent downward projection, but I also know that price direction always changes.

In my experience, price direction changes most violently and suddenly when we get to price extremes. The term used when any market gets over-extended to the upside is blow-off. I'm not sure of the exact term to the downside, but it sure looks like a blow-off in reverse to me that can change direction as violently as any up-side blow-off I ever witnessed. More on that in a moment.

Turnover or movement of metal in the COMEX-approved silver warehouses picked up a bit this week to maybe 1.5 million oz, as total inventories rose half a million oz to 164.5 million oz. The bigger surprise was the lack of liquidation in the big silver ETF, SLV, as a result of the high volume, dollar+ price smash on Wednesday. Up through last evening I was expecting a withdrawal, given the usual delay in reporting, but it never came. In fact, we added close to half a million oz in the days after that price smash. Now, with the higher volume rally yesterday, my expectations have shifted to deposits. Even the big gold ETF, GLD, has remained steady in metal holdings the past couple of days after consistently puking out metal on the persistent (and engineered) price decline in gold. With yesterday's high volume upward reversal in gold prices it will be interesting to see if metal gets deposited into GLD.

I've read a number of stories that have highlighted big withdrawals in the SLV, with predictions of big further withdrawals to come, but the stories have me scratching my head. As I reported last week, the withdrawals from SLV have been minor this year (less than 2% of holdings) and particularly minor compared to the withdrawals in GLD since year end (28%). I attributed the stark difference to silver investors holding for different reasons than gold investors. If that pattern changes, I promise to report on it.

I never reported the change in short positions earlier in the week for stocks, but they did grow about 2 million shares (oz) in SLV and were basically unchanged in GLD. At almost 18.5 million shares short in SLV, this is the highest short position in months and up several-fold from the lows. http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99 However, we are still down by half from the peak short position in SLV two years ago and for the time being I am not overly concerned about the short position in SLV. No, I haven't changed my mind about short selling being fraudulent in hard metal ETFs to shareholders so maybe I should explain a bit.

I was much more concerned in the past with excessive shorting in SLV because it occurred when there was an excessive and concentrated short position on the COMEX, the principal source of price manipulation. As you know, the total commercial net short positions in gold and silver on the COMEX are at record lows currently, so it doesn't appear the admittedly-large SLV short position is held by the usual silver crook of crooks, JPMorgan. It looks to me that the current SLV shorts are likely to be garden variety speculators playing the short side for technical and chart reasons. I also don't sense (but can't know for sure) that the current SLV short holders are doing so because they can't get the metal, like was the case at past times when JPM was the big SLV short. If my sense is close to being correct, then the large short position in SLV is likely to add bullish fuel to the fire when we turn up in price (as opposed to JPMorgan which never covered SLV shorts to the upside).

The month seems to have ended without an update in sales of Silver Eagles from the US Mint for the past couple of days, which is somewhat strange because retail reports from the field indicate strong buying demand. In fact, if there isn't a last minute revision, June will go down as the lowest sales month for Silver Eagles this year (same for Gold Eagles), although more than 3 million Silver Eagles were sold for the month. Certainly, more Silver Eagles were sold in the first six months of this year than in any similar period in the 27 year history of the program.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

But the simple truth is that neither the sale of Silver Eagles nor any other measurement of physical silver (or gold) supply or demand has had any affect on the price movement this year. I know that sounds counterintuitive, but I'll try to explain more why that is so in a moment.

The changes in this week's Commitments of Traders Report (COT) were largely as expected but perhaps not to the degree expected. That is, the total commercial net short positions in gold and silver were reduced to new record lows, but given the severe price declines during the reporting week, I had expected even larger reductions. My sense is that we're running out of road to the downside in terms of how much outside speculative selling JPMorgan can arrange. After all, there's only so much blood that can be squeezed from a stone.

In gold, the commercials reduced their total net short position by 8900 contracts to yet another new low of 35,200 contracts, a level not seen in more than ten years. By commercial category, it was exclusively a raptor affair, as the big 4 and big 5 thru 8 shorts stood pat and the raptors bought nearly all 8900 contracts in the form of new longs, pushing their net long position to almost 113,000 contracts.

While this is a new record raptor net long position by far, please remember that JPMorgan is included in this category by default. There's not enough conclusive data in this week's report to pinpoint what JPMorgan may have added to their long position this week, so I'll stick to last week's 65,000 net contract long estimate. More will be learned in the upcoming release of the July Bank Participation Report, but please note that report as well as the next COT report will be delayed to Monday, July 8, due to the Independence Day holiday.
http://www.cftc.gov/MarketReports/CommitmentsofTraders/ReleaseSchedule/index.htm

While JPMorgan's gold position change was a bit fuzzy this week, the technical funds (in the managed money section of the disaggregated report) accounted for all the net selling of the 8900 contracts that the commercials bought and these tech funds added just about 6000 new short contracts, to a new record of more than 77,000 contracts gross short. When we turn up in price, this gross short category will be featured aggressively on the buy side, so in the interim, the bigger this category gets the better.

In silver, the commercial net short position came down by 1900 contracts, to a new low total of 4100 contracts. Four months ago, this total commercial net short position was 51,900 contracts (Feb 5), so the commercials have bought nearly 48,000 net silver contracts on the COMEX, or the equivalent of almost 240 million oz, on a price decline of $13 (40%). By my calculations, I think JPMorgan may have accounted for as much as half (120 million oz) of the total commercial amount bought. IÂ?d like to see anyone (with a straight face) explain how that could have occurred without prices being manipulated lower.

By commercial category, as was the case in gold, the raptors did all the buying and now hold 46,700 contracts net long, an unquestioned record amount. Also like in gold, I can't pin down JPMorgan's net short position beyond being in the 12,000 contract range and will await the Bank Participation Report. Despite the record low total commercial net short position, the net short position of the 4 largest shorts is still extremely concentrated and almost ten times the 4100 total commercial net short position. The only difference is that JPMorgan isn't holding anywhere near what they were formerly short. While the tech funds (in the managed money category) bought a few more long contracts than they added to the short side, they did add more than 1100 new shorts.

Since I have been mentioning it recently, the changes in the total commercial net long position in COMEX copper did happen to come in exactly at my expectations. On pronounced price weakness during the reporting week, the commercial net long position surged to a new all-time record of nearly 40,000 contracts. Back in January, the commercials were net short 25,000 contracts when copper was trading near $3.80, the high for year. With a contract size of 12.5 tons, the commercials have flipped their position from net short to record net long to the tune of more than 800,000 tons of equivalent copper.

The last thing I'm intending is for anyone to speculate in copper, as I'm not doing so myself (please invest in silver instead), but it's hard for me to visualize how this record commercial net long position will get resolved with lower copper prices, although the popular consensus is calling for lower prices. I suppose I have a fascination with how markets operate, especially markets that are infected with manipulative behavior. In any event, it should be interesting to see how this gets resolved and I'll report on it from time to time, either way. Nothing to report on the US dollar index as the commercials haven't come back big on the short side yet following the massive short reduction (due to the expiration) before the recent rally.

Bottom line for the COT market structure for gold and silver remains the same Â? extremely bullish. Yes, I know that the structure has remained and gotten more bullish as prices have collapsed, but that's the nature of this analysis. There were many times as prices approached tops over the past ten years when bearish COT readings remained that way for months on end as prices climbed higher still. Invariably, big price declines eventually came and the commercials who had been extremely short, bought back those shorts on the price collapses. Those times were the mirror-image of the structure today and it still looks likely to me that it will end the same way, with a violent move in the opposite direction. Only this time the violence should be to the upside.

The New Law of Supply and Demand

The cornerstone of the free market system is the law of supply and demand. This is the premise that governs how the prices of resources are determined in any free market economy as opposed to prices being set by government edict or monopoly control. It is the mechanism by which resources are produced and consumed in the freest and most efficient manner. Here's a great definition of this law from the Free Dictionary Â? Â?the theory that prices are determined by the interaction of supply and demand: an increase in supply will lower prices if not accompanied by increased demand, and an increase in demand will raise prices unless accompanied by increased supply.Â? http://www.thefreedictionary.com/law+of+supply+and+demand

There are three components to the law Â? supply, demand and price. Price serves as the fulcrum between supply and demand, balancing the two. But the important point is that the interplay between supply and demand is what determines the price. That's elementary and spelled out in the above definition; a free market price means the price is determined by supply and demand. This is the definition we expect our children learn in school. Unfortunately, this definition is old-fashioned and no longer operative in gold and silver and other commodities. Instead a new definition of the law of supply and demand has supplanted the version still in the dictionary.

Simply put, the new law of supply and demand has the price determining supply and demand and not vice-versa as it should be. This may sound like a game of words at first blush, but it goes to the heart of the matter. When price determines how much is produced and consumed, instead of supply and demand being the determinant of price, that's just another way of describing price manipulation. All our laws against manipulation and the restraint of free trade are aimed at preventing an artificial price from coming into existence. That's because it is well-known that an artificial price will adversely impact production and consumption and cause overall harm to society. An artificial high price must lead to over-production and under-consumption and an eventual price crash, while an artificial low price must result in an eventual shortage and price explosion.

There is undeniable proof that the recent price action on the COMEX in gold and silver is the new and manipulative version of the law and supply and demand. There was no big increase in production or weakening of demand for gold or silver leading to sharply lower prices; instead the price decline, due to speculative selling of futures contracts, is determining what will be produced and consumed in the future. Speculative selling on the COMEX has resulted in prices low enough to threaten mine production and encourage increased demand (especially investment demand).

Think of how crazy that is Â? speculators on the COMEX are dictating what amounts real producers and consumers will make or use. Far from being a matter of semantics, this goes to the spirit of the law of supply and demand. It's just that we've come to accept it. Worse, since our regulated futures markets were created for the purpose of allowing legitimate hedging and there is little to no actual hedging occurring (who hedges production below the cost of production?), this is a double-whammy for legitimate producers; not only do they have no input in the price determination process as they should, but they are also are damaged by it. Futures markets are supposed to Â?discoverÂ? prices following the worldwide interplay between real producers and consumers, not dictate prices to those same real world market participants.

Let me give you two real world examples of the impact of the price being set on the COMEX. If the prices of gold and silver stay at the level where they closed yesterday, the largest gold miner in the world, Barrick Gold, won't be producing at a profit and Pan American Silver, an important primary silver producer, will start reporting losses. Let me be careful to point out that I am not predicting future earnings or losses (as I don't do that). What I am doing is taking each company's first quarter earnings report and adjusting revenue by the price of metals today versus the prices actually received in the first quarter. Barrick reported profits of close to $850 million in the first quarter on production of 1.8 million oz of gold sold at $1630. Pan American reported net profits of $20 million on production of 6.3 million oz of silver sold at $30.11 and 32,000 oz of gold sold at $1630. If you do the math, Barrick's first quarter profit will all but disappear at with gold near $1200 and Pan American will be deeply in the red should silver and gold prices remain as low as they have been. The great irony here is that these two mining companies have been vocal in the past about there not being a price manipulation in gold and silver.

Please don't misinterpret what I am saying. I am not saying gold and silver prices will remain here or go lower; I have been stating the opposite (and have been wrong to date). What I am saying is that it is crazy (and illegal) for speculators on the COMEX to be establishing prices that will cause great harm to legitimate producers. The COMEX has bastardized and turned upside down the law of supply and demand and all the owner of the COMEX, the CME Group, does about it is announce trading volume records. All the CFTC does is waste valuable and limited resources on pointless lawsuits with a political agenda (against Jon Corzine).

The reason I bring up this new and distorted version of the law of supply and demand is that it confirms and verifies everything I have alleged about silver being manipulated for the past 30 years. Again, with a straight face, I'd like to see someone explain how the mining industry is in trouble due to any overproduction on its part of gold and silver. I'd like to see someone deny how the price of the resource is not the most important factor for any producer and how the crooks at the COMEX are not setting the price.

I have no expectation that anything will change, but that doesn't mean we shouldn't at least understand what's really going on with gold and silver prices. I can't see how it would be better to remain unaware of what's responsible for the low prices and why the miners are suffering. Who wants to live in the dark? Actually, as upside down as the price setting process has become, because of it the prospects for sharply higher prices now looms large.

Yes, it has been excessive speculative selling on the COMEX that is responsible for the lower prices, with all its effects (ETF liquidation and miner suffering), but it is also obvious that those selling have been tricked into selling by the crooks at JPMorgan and others, so that the crooks could buy. And buy they did as I and many others have detailed each week when the COT reports are published. And this has led to the extraordinary bullish set up in place.

It seems foolish to keep talking about a pending price explosion as prices sink further, but I have no choice based upon the facts. I can't guarantee what will happen, but I can point out the possibilities. The big speculative selling on the COMEX and elsewhere has been a self-reinforcing process to the downside, namely, low prices beget lower prices in a vicious cycle. The selling that has been short selling, in particular, represents open transactions; meaning the sales mus

Date Created
2013/06/29