June 29, 2022 – A Test of One’s Patience (and Sanity)

These are difficult times for a silver investor, perhaps the most trying of all. What makes the current scene so difficult is the uniformity of the reaction of the price of silver to developments that can only be termed counterintuitive. It almost hasnâ??t mattered what the developments have been, the price reaction has been the same.

Highest inflation rates in 40 years? Silver goes down in price. Energy shortages and soaring prices? The price of silver yawns. War, political divisiveness, increasing interest rates, financial market upheaval, cryptocurrency crashes, plunging consumer confidence, etc. – the list is quite long. Nothing seems to affect positively the price of silver. What about actual supply/demand, in the form of years of flat to declining world silver production, steady industrial consumption and surging investment demand? Ditto â?? none of these things appear to influence the price of silver.

Truth be told, nothing seems to impact the price of silver positively as the developments normally thought to be constructive havenâ??t seemed to matter a whit. Therefore, itâ??s easy to fall into the mindset that the prospects for even a modest-sized rally in silver prices â?? forget the true explosion some (like me) speak of â?? are thought to be the stuff of misplaced dreams. However, easy isnâ??t always correct and more often than not, the easy conclusions are more often incorrect.

Since the list is long for the reasons that should have propelled the price of silver higher, but didnâ??t â?? why not ditch those reasons (at least until they do begin to matter) â?? and focus instead on what can be demonstrated as having influenced the price of silver? Certainly, Iâ??m not suggesting that inflation, war, energy shortages, etc., have caused the price of silver to decline â?? Iâ??m simply noting the obvious, namely, that they havenâ??t mattered much, if at all.

As a â??commodity guyâ?•, I firmly believe that everything related to supply and demand affects, or should affect, the price of silver. And in the long run, I also firmly believe that everything related to actual supply and demand will come to influence the price of silver. But that is not the case currently, so for the sake of the patience and sanity of silver investors, it is imperative to focus on what is affecting silver prices and not what â??shouldâ?• be affecting them. Here, the record is clear â?? what has determined silver prices more than any other factor has been the positioning of futures contracts on the COMEX.

The remarkable thing is that while investors and observers scratch their heads concerning the lack of connection between those factors which should affect the price of silver, but donâ??t, the track record of the positioning of futures contracts on the COMEX or changes in the market structure has been flawless, or nearly so, for 40 years. By â??flawlessâ?• I mean that changes in the COMEX market structure fully explain silver price movements, whereas the factors that should impact prices offer little practical explanation for price movement.

Therefore, the choice is clear (at least to me) â?? we can either spend time wondering to the point of confusion why inflation, or war, or energy shortages or everything under the sun that should but doesnâ??t influence the price of silver or we can focus on what is actually determining silver prices, namely, COMEX positioning. Iâ??ll spare you a detailed review of the past 40 years and concentrate on the past few months. However, the principle is the same â?? the COMEX traders classified as â??commercialsâ?• (mostly banks and not mining companies) have the upper hand in dealing with their main counterparties, the traders classified as the managed money traders.

The most active of the managed money traders are considered to be the technical fund entities which, mostly, buy and sell based upon moving average signals â?? buying as prices move above the key moving averages and selling (and selling short) as prices move below the moving averages. These technical fund traders, also known as quantitative traders, or â??quantsâ?•, while relatively few in number (30 to 50), happen to control hundreds of billions of investor dollars collectively, and the positions they collectively buy or sell are large enough that the entities on the other side of their transactions, the commercials, while also relatively few in number, must also deal in very large numbers of contracts.

Of course, Iâ??m not describing a circumstance unique to COMEX silver (and gold), as the managed money technical funds and their counterparties, the commercials, are a significant price force in just about every market, from stocks and bonds and currencies to all manner of commodities. But the key point is that only in COMEX silver futures is the pricing power of the competition between the managed money traders and the commercials so uniquely powerful and controlling. This can be seen in the fact that in order to accommodate the collective buying of the managed money traders over the decades, that the concentrated short position of the commercials on the COMEX has always been much larger in silver than in any other commodity in real world terms.

In other words, so unusually large is the share of the market represented by the counterparty competition between the commercials and managed money traders in COMEX silver that it overwhelms all the â??normalâ?• factors that should influence silver prices â?? like inflation, war, shortages and all true supply and demand factors. This goes a long way to explaining the question of why arenâ??t silver prices reflecting all the things we see that should be driving prices higher.

From the middle of April, silver prices fell from $26 to under $21, by the middle of May, less than 20 trading days later, as the managed money traders sold and sold short more than 40,000 net COMEX silver contracts or 200 million oz (which the commercials bought). This is such a large quantity of silver sold that it completely overshadowed and overwhelmed any and all other factors like inflation, war, energy shortages, etc. Since mid-May, there have been relatively minor changes in managed money and commercial positioning and, as a result, silver prices have remained flat and depressed at the lows of mid-May.

But it is not only that significant COMEX positioning changes fully-explain past silver price movements; so dominant and controlling are these positioning changes that they, in turn, help predict future price movements. Â Since it appears that the commercials have the upper hand when dealing with the managed money traders, based upon a verifiable history and track-record that goes back four decades, predicting future silver prices is mostly a case of determining whatâ??s best for the commercials. This is particularly true whenever the managed money traders build up significant COMEX silver short positions and relatively small long positions, as is currently the case.

The main reason that it is particularly bullish when the managed money traders are holding large short positions in COMEX silver futures, like now, is because their only recourse after establishing large short positions is to buy those short positions back at some point. The managed money traders certainly canâ??t make physical delivery against their silver short positions, the only other way to close out short positions. Of course, itâ??s always possible for the managed money traders to continue to add new short positions on lower silver prices, but at some point, there is a limit to how many new shorts the managed money traders can add and once that limit is hit, thatâ??s it â?? the price bottom is at hand.

By definition, as the very last new managed money short sales are established in COMEX silver futures, prices are low and investor sentiment is usually even lower. Long time readers undoubtedly know this well, namely, when silver prices have risen and the managed money traders have already bought heavily, investor sentiments is upbeat (itâ??s summer-time, when the catfish are jumping and the living is easy). Unfortunately, that has also proven to be a time for caution.

But as and when the managed money traders have built up significant short positions, it means silver prices have already come down hard and it feels like silver prices will never go up again. Yet history has always recorded major silver price lows as having occurred when managed money short positions have peaked out. For sure, itâ??s always much easier to identify silver price bottoms after prices have turned up and managed money short positions start to get bought back, than by anticipating when the price turn and managed money short covering will commence, but that goes without saying. The trick is to come reasonably close and it feels (and has felt), that that time is at hand. I base that on a number of things.

Not only do I expect an increase in managed money silver shorting in Fridayâ??s COT report, given the greater than one dollar decline in price over the reporting week ended yesterday, the necessary decline in prices to affect the increase in managed money shorting was also made possible by counterparty commercial buying. Most likely, the bulk of the commercial buying was by the raptors, the smaller commercials apart from the biggest commercial shorts, whose net long position should now be back to 40,000 contracts â?? almost a mirror-image of the expected managed money short position.

While no doubt, as a result of the short-term positioning of late, the raptors have taken not-insignificant profits as a result of recent closed-out long positions, my take is that the raptors have effectively reduced the cost basis of their quite large silver long position to between $22.50 to $22.75, implying a total open loss of close to $400 million, about their largest such loss in history. I have yet to detect any silver raptor capitulation or selling on lower prices, but I am mindful and alert to such a case. Therefore, I still think the raptors as a whole may be looking for greater than usual profits when the dust settles on this trade and we get to trade well-above the moving averages, as must occur at some point.

The real key to how high silver (and gold) prices may rise, of course, depends on the biggest commercial silver shorts and whether they add aggressively to new short positions whenever prices do penetrate the moving averages to the upside.

In other matters, the new short report on securities, for positions held as of the close of business June 15, was released and indicated a slight reduction in the short position of SLV, the big silver ETF, of less than a million shares, to just under 30 million shares (ounces). Considering the historically low commercial net short position in COMEX silver futures, the slight reduction in the short position on SLV, while welcome, is still, in my opinion, way too large, even though it is lower by 25% or so from recent high points. Further, Iâ??m still of the opinion that the short position in SLV is as high as it is, not because the short side is so attractive, but because there is such tightness in wholesale physical silver, that it necessitates the shorting of shares in lieu of making actual metal deposits, which, of course, is inherently bullish.

https://www.wsj.com/market-data/quotes/etf/SLV

I havenâ??t mentioned it in a while, but I am still quite bullish on copper, which has declined precipitously of late, by nearly 20% over the past two weeks. From everything I see, the sharp decline has to do with managed money positioning (shorting) on the COMEX and the larger LME. In the keeping it simple department, the current market structure in COMEX copper futures reflects a managed money position now more bullish than any time since copper was priced between $2 and $2.50 back in early 2020. As such, I would expect at some point a sharp copper rally. While the managed money technical funds are a very large component of copper trading, their commercial counterparties are not the banks, but other dealers in the metal.

The glaring fact is that COMEX positioning in silver (and gold) has gotten to the point where such positioning completely offsets and renders as non-existent all the factors that should be influencing prices, like actual supply and demand considerations, is also the definition of price manipulation. Not to point out that COMEX positioning is an ongoing price manipulation in silver would be a disservice on my part. On the other hand, I still sense we are quite close to the COMEX silver manipulationâ??s end, for a variety of reasons Iâ??ve mentioned in the past.

Tomorrow is first notice day of delivery for the big July COMEX silver contract. Based upon the sharp drop in open interest in the July contract, as well as yesterdayâ??s widening of spread differentials to the July contract, it wouldnâ??t appear at this point that this will be a large delivery month. My biggest hope, as usual, is for JPMorgan not to be a big silver issuer, particularly, for its house account.

The price weakness since Friday has further reduced the total loss for the 8 largest COMEX gold and silver shorts by $300 million to $7 billion. This is the lowest big 8 short position loss since March 2020. With tomorrow being the end of 2^{nd} quarter and first half, Iâ??ll provide the quarterly results on Saturday.

Ted Butler

June 29, 2022

Silver – $20.70Â Â Â (200 day ma – $23.36, 50 day ma – $22.24, 100 day ma – $23.50)

Gold – $1820Â Â Â Â Â Â (200 day ma – $1844, 50 day ma – $1861, 100 day ma – $1892)

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