

June 3, 2015 – Stepping Up to the Plate

Stepping Up to the Plate

I was originally going to title this piece "Doin' the Right Thing" after the old Spike Lee movie. I had used that title once before, back in early 2008 in an article complimenting Barclays Global Investors for deciding to publish the serial numbers and weights of the all the bars held in its then-sponsored silver ETF, SLV (now sponsored by BlackRock). I had written several public articles exhorting Barclays to publish the data and was gratified that it did so.

<http://news.silverseek.com/TedButler/1199736334.php>

While I lauded Barclays for providing greater transparency to the silver trust, it brought them on a par with what had already been a practice in place for the big gold ETF, GLD, sponsored by State Street. As such, while it was completely proper and laudable for Barclays to list all the silver bars it held for the SLV, it wasn't precedent setting. Therefore, I decided to use a different title today, to highlight an action that was both the right thing to do and precedent setting.

Following last Wednesday's article suggesting that silver mining companies write to the CFTC (which I did make public at the urging of subscribers), one mining company (befitting of its name) became the first to do so. The CEO of First Majestic Silver Corp, Keith Neumeyer, became the first miner to write to the CFTC concerning the massive historic one-week repositioning of speculative positions on the COMEX that far exceeded anything occurring in the real world of silver production or consumption.

<http://www.firstmajestic.com/s/RelatedArticles.asp>

While I hope additional mining companies take the matter up with the agency, Neumeyer not only did the right thing, he set a precedent that, to my knowledge, had not previously occurred in the 30 years that I have closely followed the silver market and, most likely, long before that. Much to my puzzlement over the decades in alleging a silver price manipulation on the COMEX, was the lack of questioning of the price discovery process on that exchange by those most damaged by it – the mining companies.

US Government data unquestionably prove speculators are setting the price of silver on the COMEX to the exclusion of actual silver producers and consumers and that is so far from the intent and spirit of US commodity law as to be inexplicable. There is no reason to expect silver industrial consumers and fabricators to complain about artificially depressed prices because they have benefitted from the existing price-setting regime. But, it's about time that silver producers questioned the single most important factor to their financial health — the price of their principle product. For being first to step up to the plate, here's a tip of the hat to Keith Neumeyer.

Rather than an end, Neumeyer's petition to the regulator is a start to a process that should have begun long ago. Will it play out as I hope it will? Who knows? But it certainly could. First and foremost, it will do no harm in bringing the question of manipulation to a potentially broader audience. After all, it's not as if speculators on the COMEX can control and dictate prices any more than they do already, so First Majestic's petition can't be considered as emboldening the speculators further.

The big potential payoff is that First Majestic's petition may set off a process that heretofore has not been allowed to exist, namely, an open and honest debate as to how prices are set on the COMEX. Specifically, how can the price discovery process on the COMEX be considered fair and within the spirit of commodity law if it, effectively, excludes actual producers and consists of only speculators? And how can there be a legitimate economic explanation for why COMEX silver has the largest concentrated short position of all regulated commodities, particularly with prices at or below the average primary cost of production?

If Mr. Neumeyer's petition results in an open and honest debate on these and related questions, the effect on the silver manipulation and prices could and should prove to be profound. And it's somewhat unbelievable, in this supposed day and age of transparency, that silver investors and mining companies even have to petition for an open and honest debate on these substantive issues. A fair and open debate is also more likely to attract outside investor interest to silver than any other single factor I can think of. To those who did take the time to write to various silver mining companies at my request, thank you. To those still considering it, please don't delay.

Finally, in the giving credit where credit is due department, I want to openly thank Ed Steer for consistently bugging me to write a sample letter for what a mining company might include in a letter to the CFTC. His prodding extended back for many months and I'm sorry I procrastinated.

(Since I did make last week's article, in which I petitioned readers to write to mining companies in which they had an interest public, I plan on making the above public as well, to thank those non-subscribers who wrote in.)

I had planned on writing something different today, a more reflective look back at the past 30 years and where we are today, but will do so at later date, considering the above and market developments since Saturday.

In the weekly review, I commented on gold and how after the first two delivery days of the normally active COMEX June gold contract there were actually more deliveries on the normally inactive (non-traditional) COMEX June silver contract. I didn't expect that would continue for long, as there were still 5500 June gold contracts still open and few silver contracts remaining.

In addition, since Saturday, there have been several articles published highlighting the large number of June gold contracts still open and, while not stating explicitly that there would be a delivery default, described how such a default was possible; particularly since the amount of registered gold in the COMEX warehouse inventories was so low (around 370,000 oz) compared to the 550,000 equivalent ounces still open in the June contract.

A failure to deliver physical metal, in COMEX gold or silver or in any other commodity or on any other exchange, to a holder of a long position qualified to take delivery would not only be a delivery default, it would also most likely result in the closing of trading in that commodity and perhaps the closing of the exchange involved. It is the most serious issue possible from a contract and an exchange perspective and should not be referred to as just another thing. And there is no such thing as a minor or major default any delivery default would be catastrophic for the exchange involved.

While I did note that conditions in the June COMEX gold delivery did look tighter than usual, due to tightening spread premiums and the level of remaining open interest, I generally avoid focusing on the registered vs eligible categories of COMEX warehouse inventories, preferring to stick to the combined total warehouse inventories. The reason I do so is because the difference between registered and eligible gold and silver in the COMEX warehouses is strictly a matter of paper work. That appeared to be the case in delivery and warehouse developments this week.

On Monday, the third delivery day for the June gold futures contract JPMorgan delivered (issued) 2468 gold contracts from its house, or proprietary trading account and as of yesterday, the total open interest remaining in the June contract totaled around 2000 contracts. In addition, JPMorgan had transferred 177,000 ounces (1770 equivalent contracts) of gold from the eligible to the registered category, obviously for delivery purposes. This would seem to confirm the ease at which the two different categories of inventories can be switched. This is not to say that physical gold conditions on the COMEX are no longer tight and could not get tighter, but the remaining number of open contracts is not unusual at this time thanks to JPM's big issuance.

Lost in the discussion of tightness in the June COMEX delivery process or possible default is the emergence of JPMorgan as nearly the sole issuer of deliveries over the first four days of the delivery month. As of today, JPMorgan, in its own trading account (not for customers), has delivered 2468 gold contracts out of the total 2588 issued so far, or more than 95% of the total. Previously, in the December and April gold delivery months, JPMorgan had taken (stopped) nearly 3250 gold contracts in its house or proprietary trading account. Remember, the house or proprietary designation means that this is metal taken or issued for the bank's own account and does not involve customers. Thus, it appears that JPMorgan is issuing what it previously stopped in COMEX gold and doing so in a clearly dominant manner.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

I don't know if Paul Volcker, the former Federal Reserve chairman after which the Volcker Rule was named, would approve of what I just wrote as the aim of the rule is to exclude banks from doing what JPMorgan is doing – trading on a speculative basis for their own account. And not only trading on a speculative basis, but playing a dominant role in the markets. Plus, what happened to all the announcements or inference that JPMorgan and other large banks were quitting commodities trading? More than ever, these banks, particularly JPMorgan, seem to be playing a larger role than ever before, especially in COMEX gold and silver. Along with the issues raised in First Majestic's letter to the CFTC, I'd like to hear the agency comment on this.

There has been a continued drain in metal holdings in the big gold ETF, GLD, but that doesn't look particularly counterintuitive given the recent selloff in gold prices. Definitely counterintuitive was yesterday's increase of 1.1 million oz in the big silver ETF, SLV. I've just about given up trying to reconcile deposits and withdrawals in holdings of SLV, as they haven't been in accord with what normally occurs on price advances and decline. And I'm still trying to comprehend the recent massive reduction in the short positions in SLV and GLD, although those reductions must generally be considered good news. Perhaps yesterday's deposit was intended to reduce the short position in SLV, but that is not highly reasoned speculation on my part.

After recording the slowest month in almost a year for sales of Silver Eagles, sales this month are off to a very brisk start, amounting to 775,000 coins for the first two calendar days of June. Adjusting for the 375,000 coins sold on the last calendar day for May, which brought sales for the month to just over 2 million coins, the Mint has sold more than 1.1 million Silver Eagles over the last three calendar days. This is a rate which can't continue for long before the Mint is back to rationing sales of Silver Eagles and a rate which I don't believe will continue. For the first two calendar days of June, the Mint sold 2500 ounces of Gold Eagles. I'm not about to extrapolate just two days' worth of sales for any longer period of time, but I also can't help but point out that for these first two days of June, the Mint has sold more than 300 times as many Silver Eagles than it has sold in Gold Eagles in terms of ounces of each.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

My point is not that this ratio of sales can continue because it is obvious that it can't; my point is that what could possibly explain the extreme start/stop nature of sales of Silver Eagles away from my big buyer premise? I can accept a disagreement that it may not be JPMorgan as the big buyer, because hard and fast proof is impossible to uncover. But one must rule out that broad numbers of public retail buyers are as erratic as a group to be buying aggressively on certain days and not buying at all on other days, all while silver prices are stagnant.

As encouraged as I am by First Majestic's letter to the CFTC and precisely as that letter states the case, silver and gold prices are still clearly being set by the speculators on the COMEX. If anything, today's and recent price action underscore that premise. Nothing, and I do mean nothing, matters more to gold and silver prices than the market structure on the COMEX, as confirmed by the Commitments of Traders Report (COT). Not what China, India, Russia or Greece might do, not what the dollar or other currencies might do, not interest rates or the stock market, not the Federal Reserve, the Wizard of Oz or the man in the moon (which may be all the same).

Someday, some of these things, along with changes in actual supply and demand may dictate gold and silver prices; but that day is not this day. For this day, the speculators, both managed money traders and speculating banks and other commercials alike are in full price control on the COMEX. I wish it wasn't so and I am doing whatever I can to expose and terminate the stranglehold that the COMEX has on the price discovery process and I am supremely confident that it can't stay this way indefinitely; but I am also realistic that in the very short term, COT market structure holds sway to the exclusion of everything else. And I hope I have been clear in conveying this, namely, that the COT structure in silver turned bearish, while the structure in gold had become neutral.

While I fully admit that, given all the bullish factors in silver away from the COT market structure, including an apparent awareness in some sectors of the mining community that something is wrong, that while those factors might kick in to drive prices higher, the high probability bet is that speculative selling on the part of the managed money traders (both long liquidation and new short selling) arranged and rigged by other speculators we call commercials will drive prices lower.

Today, since we penetrated for the first time to the downside the key 50 day moving average in silver, I suppose the official price takedown cycle is now in effect. Gold, you'll remember, had penetrated its 50 day moving average a week or so ago, so the market structure there is more advanced than it is in silver. Therefore, in silver, it's more a question of how many contracts the commercials can induce the managed money traders to sell than it is how low prices must fall. It's more about contracts sold than prices, although successive lower prices (salami slicing) are necessary to effect the full contract count outcome. In other words, it's not necessary that we drop dramatically in price, just enough and in the manner necessary to accomplish whatever complete managed money selling results this go around.

Of course, please dismiss any suggestion that I (or anyone else) know for sure the direction of prices in the short term. This is about probabilities based upon the same thing that those probabilities have always been based on \hat{A} ? past and prospective COT patterns. And even though those probabilities suggest lower silver prices ahead, any such decline should prove minor compared to the eventual much higher prices that the actual fundamentals and facts point to. While I hope my COT analysis is beneficial, please understand it is not my intent to handicap silver prices in the short term, although many others do seem so engaged.

Instead, my intent is to use my analysis of the COT market structure to show just how screwed up is the price discovery process on the COMEX and, after 30 years, it is encouraging to see that at least one silver miner may feel the same. In the unfortunate circumstance that the probabilities once again prove correct and we do witness further declines in the price of silver, perhaps that might aid in convincing other silver producers to step up to the plate and write to the CFTC. Trying to come up with rational explanations for why silver and gold prices behave as they do while leaving out the COT market structure on the COMEX is guaranteed to reduce one to the babbling idiot level.

Ted Butler

June 3, 2015

Silver – \$16.50

Gold – \$1185

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