March 18, 2017 – Weekly Review

Weekly Review

Gold and silver prices rose, following a sharp two-week smack down, with gold ending $24 (2%) higher and silver up by 35 cents (also 2%). Naturally, the silver/gold price ratio remained unchanged at 70.7 to 1. Ostensibly, the midweek turnaround was due to interest rate cues from the Federal Reserve, but that connection is tenuous to my mind, apart from being a convenient cover story. The real price driver is more firmly rooted in COMEX positioning than ever before.

A quick word on the silver/gold price ratio. I've long ruled out the purchase or sale of actual metal as driving changes in the price ratio Â? there is no evidence of active physical trade between gold and silver, certainly not on a regular day to day basis. After all, actual metal ownership is long term in nature and very little changes hands daily; with only the smallest fraction of what is traded involving switching between either metal. Of course, there is plenty of paper derivatives trading in gold and silver, as I try to detail in these reports.

A new thought occurred to me. In following the COMEX positioning forces on gold and silver prices, it dawned on me that I have never uncovered any evidence of an active silver/gold price ratio trade on the COMEX or anywhere else. COMEX positioning has largely boiled down to a managed money/commercial contest and little else, with not the hint of any organized ratio trading. The bottom line is that no one appears to be trading gold versus silver in any meaningful way.

In other words, we all talk or read about how cheap or expensive silver may be relative to gold, but there is little interest in such activity in terms of actual metal or derivatives trading between the two metals. This can be seen in the complete failure of the COMEX's much ballyhooed attempt to launch a futures contract based upon the silver/gold price ratio several months ago. To my knowledge, not even one contract changed hands, making the introduction as much a flop as is possible and underscoring how little interest exists in actively trading the ratio.

My point on this is that the silver/gold price ratio is not where it is because of any active or substantial trading; it is determined by factors not remotely connected to the rational relative valuation of each metal. In such a circumstance, relative valuations can become distorted, since there is no legitimate relative valuation trade. In this case, I think this might account for why silver is so undervalued relative to gold, namely, because there is no active trade to keep values where they should be. I still believe silver is massively undervalued relative to gold and these new thoughts are in conformity with my long held beliefs. That doesn't mean I'm bearish on gold in any way, particularly after the new COT report, just a lot more bullish on silver.

The turnover or physical movement of metal brought into or removed from the COMEX-approved silver warehouses cooled off this week, as just over 2 million oz were moved. Total inventories rose by the same 1.7 million oz they fell in the previous week, putting COMEX silver stocks back at 188.3 million oz, equaling the 20 year record. My principle takeaway from this week's inflow of metal into the COMEX warehouses is that the metal was shipped in to accommodate deliveries on the March contract. Another 0.6 million oz were added to the JPMorgan silver warehouse, pushing the total there to a record of near 93 million oz. Should JPM follow its typical pattern over the past few years of physically moving the metal it took delivery of in COMEX futures into its own COMEX warehouse, more than 10 million oz might be deposited in the relative near term.

The COMEX March silver delivery process continues to play out both as expected and as extraordinary in the amounts of metal taken by JPMorgan. When I first mentioned that the remaining open interest in the March contract looked a Â?bit elevatedÂ? three weeks ago, I had no idea that JPMorgan would stop for itself and its client(s) as much silver as it has Â? this despite my standard open question of what would this bank do in every traditional silver delivery month.

But after the first days of delivery, based upon the usual formulae that the COMEX uses to assign deliveries, it was obvious that JPMorgan would be taking a boatload of silver contracts, mostly for itself, but also for a customer(s). JPMorgan has now taken 2299 contracts in its own name, already way above the 1500 supposed contract limit and the most I can ever recall being stopped. In addition, JPM has stopped an additional 568 contracts for customers. Based upon the remaining open interest in the March futures contract (over 500), I have to once again up my recent estimate of what JPM would stop in its own name from 2500 to 2700 contracts.

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

A closer examination of the above data reveals just how dominant JPMorgan has been in this March silver delivery. Of the 24 clearing firms listed in the above table, there are only two other net silver stoppers this month, Morgan Stanley to the tune of 53 contracts and Citicorp to the tune of 19 net contracts, both on behalf of customers Â? compared to the more than 2850 net contracts that JPM and its customers have stopped. Never have I seen such a mismatch. A number of thoughts cross my mind, including don't these other competitors of JPMorgan see what's going on? Are they not the least bit concerned that JPM is gobbling up every available physical ounce of silver and that a good number of them are short paper COMEX contracts up the ying yang?

This is especially true since either this March silver delivery is the tightest ever or, at the very least, is putting on the greatest impersonation of tightness I have ever seen. About the only comparison that comes to mind is more than 32 years ago when I knew a client of mine was set and in position to take delivery of more than a thousand contracts of frozen orange juice, although I clearly didn't know the full ramifications of the other side not having the actual goods. I am not a participant, in any way, in the current March silver delivery tightness, just an observer, but are the other big silver clearing shorts oblivious to what's going on? I wouldn't expect the average person to fully appreciate the unfolding COMEX silver delivery tightness, but I would imagine close competitors of JPM (assuming it has competitors) would be all over this data. Yet I see no signs of such awareness.

The other thing that bugs me is why JPMorgan is being so blatant and transparent in its acquisition of silver via COMEX deliveries? After all, COMEX deliveries are the most transparent of all methods of acquiring silver, particularly when stopped in a clearing member's own name. I started pointing the finger at JPMorgan for accumulating physical silver before it started to stop COMEX deliveries so aggressively; so, in essence, JPM has now unquestionably confirmed my original findings. Making me look good has to be the last thing JPMorgan intends, but that would appear to be an unbiased conclusion. Hey, did I ever tell you I have more questions than answers?

Another question is why JPMorgan has stopped buying Silver Eagles, but there can be no question that it has stopped after absolutely devouring the coins for six years. Best explanation I can come up with is that the bank is trying to put some distance between its buying of coins and the time silver lifts off in price. How JPM cajoled the US Mint into, essentially, allowing the bank to buy as many as 150 million oz of silver is best left secret, at least according to both the Mint and JPM, I would imagine.

The changes in the Commitments of Trades (COT) Report were in the expected direction of managed money selling and commercial buying, if a bit more extreme than I expected. After all, the reporting week covered a good old-fashioned and traditional deliberate smack down in price, engineered by the commercials to induce managed money technical fund selling. With gold and silver slicing through moving averages throughout the last two reporting weeks, it was impossible not for there to be substantial managed money selling and commercial buying.

In COMEX gold futures, the commercials reduced their total net short position by a hefty 29,400 contracts to 123,300 contracts. The two week reduction of the commercial short position completely eliminates the only notable commercial selling for months, essentially setting the gold market structure back to the spectacularly bullish setup that existed around yearend. Everything about the gold COT report was bullish. The important point is that we are now $100 above where gold was back then and the market structure is every bit as bullish as it was then.

By commercial category, all three groups got the memo pre-arranging collusive buying. The big 4 bought back 13,600 short contracts and now hold their lowest (98,019 contracts) level of concentrated shorts since yearend 2015 Â? early 2016. Likewise, the big 5 thru 8 bought back 3600 short contracts, also reducing the net short position of the big 8 to the levels of 2015-2016. Always is it most bullish when the biggest commercial shorts hold the least number of shorts and that time is now. The raptors (the smaller commercials) added 12,200 new longs to a net long position now totaling 22,500 contracts.

On the sell side of gold, the managed money traders sold substantially more than the commercials bought on balance, in selling nearly 44,000 net contracts, including the sale of 29,098 long contracts and the new short sale of 14,775 contracts. The net long position of the managed money traders is now close to 46,000 contracts, nearly as low as it was at year end, meaning that all the net longs added by managed money traders on this year's budding gold rally have been sold as of Tuesday. Yet the price is $100 higher.

In every possible traditional analysis of COT market structure, whenever the commercials, particularly the largest ones, are as least short as possible or likely to be and the managed money traders are as least long as possible or as they are likely to be, bullish alarms and sirens should be blaring. That's my current reading of the gold market.

In COMEX silver futures, the commercials reduced their total net short position by 7900 contracts, to 98,000 contracts (this was midway between my guess of a 5000 to 10,000 contract reduction. Where I was off was in similar managed money selling amounts). By commercial category, it was the same Three Musketeers routine that it was in gold. The big 4 bought back 2300 shorts, the big 5 thru 8 bought back 1600 shorts and the raptors bought back 4000 shorts, reducing their net short position to 400 contracts.

I would estimate JPMorgan's short position on Tuesday to be down to 27,000 contracts, down 2000 for the week. Without getting too technical, because JPMorgan has been stopping so many deliveries in the March contract, this stopping of deliveries has the mathematical effect of increasing the size of JPM's existing short position (because their March longs get automatically liquidated on delivery). In essence, JPM's paper silver short position was much closer to 25,000 on Tuesday, within the 5000 to 10,000 contract increase I had Â?allowedÂ? before worrying. Of course, if JPM added to silver shorts on the post-cutoff day rally, then that would change things.

It was the sell side of silver that was larger than I expected, as managed money traders sold nearly 16,000 net contracts, double what the commercials bought, including the sale of 13,905 long contracts and the new short sale of 1980 contracts. While I was surprised initially at the number of managed money long contracts sold, I'm happy to report that not only was the selling beneficial for the overall market structure, it also kept my crazy premise alive. You know, the one about some managed money silver traders rebelling about being the stooges for the commercials.

Yes, the remaining long position held by managed money silver longs fell to 80,582 contracts, lower than the 90,000 contracts I was bandying about on Wednesday. But besides managed money selling always improving the market structure, the 80,000 contracts the managed money traders are still long is not exactly chopped liver. It represents 400 million oz of silver and if I am correct about this being the new Â?floorÂ? for non-technical fund core long positions, it would confirm my premise handily. After all, the recent low for managed money longs was 57,000 contracts at yearend, meaning some 23,000 contracts of additional managed money longs since then and after a very blatant price takedown.

One thing I haven't mentioned but have thought about often is that roughly 25,000 contracts of expected managed money short selling never materialized last fall when it should have, as some, but not all managed money traders refused to short as they had in the past. Now that nearly that same amount has been added to the long side, but not sold where previously they would be sold, I can't help but conclude the same traders who refused to sell short are now refusing to pitch long positions as well. The similarity in the amounts is uncanny.

Much more than that, there is a wider basis to my premise of renegade managed money behavior. One of the standout features of the current COT silver report is the continued buildup in strongly held long positions by other traders (large reporting non-managed money traders and smaller non-reporting traders). The reason the managed money traders sold twice as much as the commercials bought this week is because these other traders bought more than 8000 net silver contracts this week. (A similar situation occurred in gold). Not only is this an enormous number of contracts for these other traders, it is astounding that it occurred on the severe price beating during the reporting week, when silver fell more than 60 cents to new recent lows.

Previously, I estimated that the managed money traders might hold a non-technical fund core long position in silver of as many as 90,000 contracts and these other traders 20,000 contracts more for a total 110,000 combined long contracts. After reviewing the new data, I would estimate the core managed money long position to be 80,000 contracts, but have to increase the core holdings of the other traders to at least 30,000 contracts and possibly more. The bottom line is that there still appears to be a core long holding in COMEX silver of 110,000 contracts or 550 million oz.

As a reminder, I started noticing the buildup in core non-technical fund managed money silver long positions in late 2013 to early 2014, when the core long position was in the 20,000 contract range. Now we are four times that amount and have seen a similar but much smaller buildup in the core long silver holdings of the other large traders. While the managed money traders represent, by far, the largest portion of the core COMEX paper long position, it would be a mistake to ignore the separate 30,000 core long position of the other large reporting traders and the non-reporting traders. It's all part of the same crazy premise.

The problem, if one can call it that, is not with the 110,000 contract mostly passive long paper core position in COMEX silver futures. After all, holding a cheap asset for as long as it stays cheap is no big problem if you have the funds to hold Â? which seems very much the case currently and into the foreseeable future. If any potential problem exists it would seem to be on the part of whoever is on the other side of the equation and, in this case, that would be the 8 biggest COMEX shorts, which hold nearly all of the short position and in a most concentrated form.

However, we must remove JPMorgan from the equation because of its large and growing physical ownership of silver. JPM can continue to cap silver with additional paper short sales, but should it choose not to add shorts, it can't possibly get hurt by the explosion in silver prices that would follow its refusal to add short positions. The problem is with the 7 other large shorts which hold 70,000 contracts net short. These are the very same traders which seem to be oblivious to what's occurring in the March deliveries. Is it possible that these other large shorts are not aware of the danger of being massively short silver at this time? On the other hand, has there ever been a massive financial miscalculation or institutional accident that didn't involve unawareness?

Clearly, the difference in market structures in gold and silver is striking, with gold being as bullish as can be imagined on every traditional basis and with silver still bearish by traditional measures. Yet, what's going on under the hood is potentially much more bullish in silver, should the 7 big shorts ever wake up to the financial nightmare they are likely to face. The one key point I would make is that the aggressive buying that will power silver to unimagined heights is not necessarily new buying on the COMEX. After all, core long positions are already extremely high. What will power silver higher on a real move basis is short covering by the 7 big shorts and no new shorting by JPMorgan. I can't tell you precisely when that will occur, just that it seems unavoidable in time.

Finally, since I did mention it recently, the latest COT report also revealed shockingly aggressive selling by the managed money traders in crude oil, as more than 100,000 net contracts of crude oil were sold by these traders on the 10% decline in price during the reporting week. That's the equivalent of more than 100 million barrels of oil sold in 5 trading days and if anyone can offer a more succinct reason for why crude oil prices collapsed, please send it my way. I'm not predicting the future direction of oil prices, just explaining the fall during the reporting week.

Ted Butler

March 18, 2017

Silver – $17.40   (200 day ma – $18.05, 50 day ma – $17.45)

Gold – $1229   (200 day ma – $1263, 50 day ma – $1218)

Date Created
2017/03/18