

March 5, 2016 – Weekly Review

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Following two weeks of lower closing prices, gold and silver snapped back sharply this week, with gold ending up by \$32 (3%) and silver higher by 84 cents (5.7%). As a result of silver's relative outperformance (for a change), the silver/gold price ratio tightened in by more than 2 full points to 81.2 to 1. Silver is still incredibly undervalued relative to gold; just a bit less so this week.

To be sure, gold has appeared to beat the pants off of silver since the start of the year, with the noble metal up \$200 an oz or 19% in two months, with silver up \hat{A} ?only \hat{A} ? \$1.65/oz or 12%, with half the gains coming this week. Normally (whatever the heck that is), silver beats gold to the upside, so the white metal's underperformance on this year's rally has been a disappointment to those who feel silver is vastly undervalued to gold (like me). Gold has rocketed to one year price highs, while silver is still \$3 lower than the highs of a year ago. How come?

While the short answer is that the silver price has been manipulated more aggressively in COMEX futures trading than has gold; there has been a new factor, related to the COMEX manipulation that further explains silver's underperformance. Based upon unsettled macroeconomic conditions, the COMEX-generated price rise since yearend has resulted in massive buying in gold ETFs, with close to \$10 billion flowing into various gold funds. Until this week, there has been little to no net buying in silver ETFs, with such investment buying missing-in-action due to silver's price underperforming gold's. (However, signs emerged this week that the pattern might be about to change).

So heavy has been the buying in gold ETFs this year, that it was easy to misinterpret an announcement by BlackRock, that it had to suspend the issuance of new shares in its exchange traded commodity investment vehicle for gold, IAU. No doubt surging gold demand was behind BlackRock's suspension, but it appeared to be more of a regulatory filing mistake on the company's part in misjudging how close it was to the authorized shares limit of the security. Gold demand is strong, but BlackRock clearly screwed up and tried to place the blame elsewhere.

The important point in explaining silver's relative weakness to gold is that it has not come about by any actual selling of silver in order to switch into gold. I would have trouble envisioning a silver investor switching holdings to gold at current values if that investor were aware of all the facts. But even if my take is wrong, it wouldn't make any difference. That's because there is so little silver, in dollar or currency terms, in the world relative to gold that even if all the silver held by the world's investors were somehow sold and used to buy gold, the impact on the gold price would be temporary at best. That's because all the investment silver in the world is worth in the low tens of billions of dollars, while all the world's gold is worth \$7 trillion.

Silver's relative weakness to gold has had everything to do with price-setting on the COMEX and little else. Now there are more signs that the disconnect between the physical world of silver and the price that the COMEX imposes is wider than ever. On Wednesday, I wrote how things were more extreme than ever; but over the past two trading days, they've gotten even more so.

The turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses remained at a breakneck pace this week, as 10.7 million oz were moved and total silver inventories fell 3.8 million oz to 150.4 million oz, another fresh three year low. From the peak in levels over the past seven months or so, total COMEX silver warehouse inventories are now lower by nearly 35 million oz.

I understand how easy it is to focus on the decline in COMEX silver inventories — after all, what could be more bullish than falling inventories in the world of supply and demand? But I'll tell you what is even more bullish — white-hot inventory turnover. For five years, I have pounded on the table about the sudden appearance and continuation of the physical turnover in COMEX silver inventories. Such inventory movement was unprecedented and unique to silver. The only conclusion I have been able to reach is that the highly unusual turnover is an indication of a tight wholesale circumstance in silver. As you know, I have openly solicited alternative explanations along the way. Let me ask in a different way today.

Over the past eight weeks, nearly 70 million oz have been physically brought into or taken out from the COMEX silver warehouses, a weekly average of 8.7 million oz. Not only is this more than half of what the world mined over the past two months, it also represents a stunning acceleration of the pace of inventory turnover from what it was prior to eight weeks ago. Here I have been pounding on this issue for 5 years in the face of a virtual collective silence from other commentators and a real funny thing just occurred — the COMEX silver inventory turnover just doubled in intensity over the past two months.

Whereas the weekly average turnover of metal in the COMEX silver inventories was unprecedented and unique to silver at 4 million oz or so for the past five years, over the past two months that turnover has doubled. Since my only explanation for the turnover in the first place was physical tightness, I can't help but conclude that silver just got a heck of a lot tighter. I would be greatly appreciative of any alternative explanation anyone might offer for the sudden pickup in COMEX silver warehouse movement. At the very least, the accelerating turnover makes things more extreme than ever.

Sticking to the COMEX and expanding on the new development of the ongoing drama in the March delivery process, first mentioned a week ago and on Wednesday, the evidence of a tight physical situation also appears indisputable. After six delivery days, only 325 silver deliveries have been issued and around 2200 March contracts (11 million oz) remain open for delivery or futures liquidation. JPMorgan and its customer(s) have stopped or taken 273 of the 325 contracts issued so far, or 84% of the total issued. It would not be unreasonable, under COMEX delivery procedures, to assume that JPMorgan and its customer(s) hold a similar percentage of the remaining open contracts in March.

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

COMEX data also indicate that close to 1000 March silver futures contracts were closed out this week, either by outright sale, rollover to another futures month or possibly by some type of off-exchange delivery (an EFP, or exchange for physical transaction). Based upon the continuing data, it is obvious that JPMorgan or its customer(s) was largely responsible for the 1000 March contracts closed out this week. Let me speculate a bit here.

Going into last week's first notice day for delivery, it looked to me that JPMorgan and its customer(s) were each looking to stop or take 1500 contracts (7.5 million oz), which is the maximum amount of silver contracts any one trader can demand in a single month. Certainly, JPMorgan has taken this amount (or slightly less) on a number of occasions over the last year. I believe the only reason why JPMorgan and/or its customer(s) liquidated 1000 March contracts this week was to relieve a very tight silver delivery situation.

In other words, JPMorgan, which I allege owns more silver than any entity in the world, stood down from demanding all the silver it and its customer(s) had legally contracted to take because if it took all the silver it was entitled to, the sellers wouldn't have been able to deliver. That's how tight I believe physical silver supply lines have become. The funny thing is that this has happened before in silver, including last year every time JPMorgan took less than 1500 contracts in any deliver month.

And who could forget that this occurred in 1998 when Warren Buffett disclosed he was the big buyer in silver and offered sellers time to make delivery. You know, with the continuing examples of big buyers of silver accommodating the sellers in physical delivery demands, one might get the hint there isn't that much physical silver available to the market. And who knows \hat{A} ? the connection between unprecedented and accelerating physical turnover in the COMEX silver warehouses, the three year low in those inventories and what appears to be a potentially very tight March delivery process might be made by more in the near future. And it's not just those in the Internet community unaware (or not talking) about physical tightness in silver; I would venture that few in the mainstream world of metal have a hint about silver's physical tightness. That sets the stage for a shock to the system beyond compare.

On Wednesday, I also highlighted the unusually high trading volume in shares of the big silver ETF, SLV, the day before when more than 20 million shares were traded on an otherwise nothing price day. As a direct result of Tuesday's trading volume (perhaps along with trading volume on Thursday), some 11 million oz of silver were deposited into the trust over the past three days, the biggest deposit in quite some time. Yesterday's price surge in silver also resulted in heavy trading volume in SLV (18.7 million shares) and that suggests more metal to be deposited in the days ahead.

Yesterday's high trading volume in SLV looked to be of the plain vanilla type in which investors bought on higher prices. This is very similar to the buying seen in the gold ETFs this year, but heretofore lacking in silver. As such and should it continue, it should be expected to result in future big metal deposits in SLV, just as has occurred in the gold ETFs. If investment demand continues in SLV and other hard metal silver ETFs as has occurred in the gold ETFs this year, the impact on silver prices, by my calculations, would be many times the impact seen on gold prices. Nothing complicated about this – it's simply because there is much less silver available in dollar terms than there is in gold.

I know there are many who still deny the legitimacy of the metal holdings in SLV and GLD, despite the detailed disclosure of holdings and the remarkable logic of metal flows in these ETFs for more than a decade. I'm not promoting or personally guaranteeing these investment vehicles, but as an analyst, the hard metal ETFs (I do have severe reservations about leveraged ETFs for the common man), look Kosher to me (aside from the short selling of these shares). Don't buy the silver ETFs if you so choose (hard metal in hand is still best), but remember that net investment buying in them may be the most bullish circumstance for the future price of silver.

Let me go back to last Tuesday's high volume in SLV, which resulted for much of the 11 million oz deposit of metal. Unlike yesterday's trading, Tuesday's trading looked to me to be the work of a single buyer (guess who?). That's because prices were mostly lower on Tuesday and the volume in SLV was so large — on its face unusual. But I also sense something else. Whenever anyone buys a security, there is the expectation of higher prices to come. This is true for any stock or investment security.

But SLV (and GLD and other hard metal ETFs) is unique among all other securities in that it is possible that a buyer might be motivated by something else, namely, the acquisition of physical metal. That's what makes SLV special (and lies behind the Death Star premise). Let me cut to the chase — I believe last Tuesday's unusually high trading volume and subsequent deposits of metal were the work of a single buyer whose principle intent was to secure physical silver in the most price efficient manner available at the time and not just because silver prices were likely to climb. The primary intent was to secure physical metal. If I'm correct (as I believe I am) that just adds fuel to the coming physical silver price bonfire.

Sales of Silver and Gold Eagles from the US Mint are still pedal to the metal and I still contend that JPMorgan is the biggest buyer of each; gold since the middle of last year and silver for the past five years. Some still contend strong overall retail demand accounts for the record sales of Silver Eagles, but I find that to be hogwash based upon all the evidence I review. In the first two months of this year, the Mint sold more Silver Eagles (11 million) than it sold in most of the full years of the 30 years the coins have been produced. If it was due to broad overall retail demand, it would be obvious and apparent to all. As it is, most are just assuming it must be strong retail demand because the Mint sales are strong — strictly circular logic. Silver Eagle sales have been so strong these past five years because JPMorgan has been buying the snot out of them.

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

The changes in this week's Commitments of Traders (COT) report were either expected or not way off my expectations. However, there was a very big and very pleasant surprise in the Bank Participation Report; a potential game changer. Let me run through yesterday's COT report first.

In COMEX gold futures, the commercials increased their total net short position by 8300 contracts to 171,400 contracts, the largest (most bearish) position in a year. (I had expected mostly unchanged given the lack of overall price change for the reporting week and in my defense, this was the smallest change in several weeks). By commercial category, it was an all for one, one for all commercial affair, as the four biggest shorts added 4500 new shorts, the big 5 thru 8 added 1900 new shorts and the raptors chipped in with 2000 new shorts.

Somewhat unusual was that the managed money traders were also net sellers of 4727 contracts, including the sale of 7550 long contracts and the buyback of 2823 short contracts. The explanation lies in trading by other categories and tends to highlight the overall small change in overall positioning.

Of course, the reported gold positioning changes likely pale in comparison to what took place since the Tuesday cutoff. Based upon the latest changes in total open interest and volume (including preliminary estimates for yesterday's trading), the changes in positioning over the past three trading days are likely a few times greater than this week's report indicates. Total gold open interest is roughly 50,000 contracts higher than on the cutoff date and that supports the idea that those long got longer and those short got shorter. As of yesterday's close, it is likely that the total commercial net short position soared.

This sets the stage for high price drama. It would appear that the commercial shorts would be in position to be overrun for the first time in history, particularly if physical gold demand from the ETFs continues. But it has been a losing bet to count on a commercial overrun at past COT market structure extremes. And on closer examination, the commercials are not yet in apparent financial difficulty. The biggest losers in the \$200 gold run up the past two months have been the technical fund shorts who have suffered at least a half billion dollar loss in buying back gold short contracts they held going into year end.

My back of the envelop estimate of the average price at which the technical funds have gone long (including the last few days) is somewhere around \$1235 or higher on what could be as many as 100,000 added long gold contracts. This means that the technical funds may be ahead and the commercials behind by around \$250 million on an open and unrealized basis at yesterday's closing price. Yes, the commercials could and would get hurt on sharply higher gold prices from here and I wouldn't cry much if they did, but I'm not sure it's wise to celebrate that at this point. The current market structure may be the only negative in gold at this point, but it could be a mistake to underestimate it.

In COMEX silver futures, the commercials reduced their total net short position by 8400 contracts, to 65,200 contracts. (I had estimated at least a 5000 contract reduction and possibly more). By commercial category, the big 4 bought back 2000 short contracts and the raptors added 6600 new longs, meaning the big 5 thru 8 bought back 200 short contracts.

On the sell side in silver, the managed money technical funds sold 4566 long contracts and bought back 100 short contracts of a short position now near the lowest recent historical levels (meaning not much rocket buying fuel left). The market structure in silver, like gold, is bearish and may have gotten more bearish based upon yesterday's trading. But there may be some extraordinary extenuating circumstances.

The big surprise and potential game changer in yesterday's Bank Participation Report was that JPMorgan did not increase its silver short position from month ago levels as I have been suggesting recently. Because two recent COT reports had indicated that the concentrated net short position of the four largest shorts in COMEX silver had increased by 8000 contracts, I assumed those additional contracts were sold by JPMorgan, since that was always the case up until now. In my defense, I was clear that I was awaiting the Bank Participation Report to confirm whether JPMorgan did, in fact, add to its short position. The report has been published and JPMorgan did not add shorts. I'd calculate that JPMorgan holds little more than 18,000 silver contracts net short as of last Tuesday. To me, this is big stuff, maybe the biggest stuff possible.

First, by way of explaining the methodology of what I am reporting; from the previous Bank Participation Report of Feb 2 to the report thru March 1 (last Tuesday), the net short position held by US banks increased by a scant 700 contracts (I consider that unchanged). This is the category in which JPMorgan is classified and the bank usually accounts for most of that category. Over that same time frame (Feb 2 to March 1), the total commercial net short position increased by 20,000 net contracts in the COT report and the amount held short by the big 4 increased by 6500 contracts (hence my assumption that JPM was the big short seller). But the lack of a big increase in shorting by US banks, coupled with a big (10,000 contract) increase in short selling by non-US banks, sealed the deal that JPMorgan wasn't the big short seller. (As always, if anyone has any questions, please let me hear from you).

For many years, I have held out as the key determinant to silver prices as to whether JPMorgan added to its short position on the next silver rally. And on scores of silver rallies since JPMorgan took over Bear Stearns' big short positions in early 2008, JPM always added aggressively to its COMEX silver short position. And just as often, JPMorgan always succeeded in turning silver prices lower and in exiting its additional silver shorts at a profit. No exceptions, no double talk, no nothing Â? this is what JPMorgan always did.

Starting in early 2011, it dawned on JPMorgan that the price of silver was destined to reach for the stars and that's when it initiated its plan to accumulate as much physical silver as it could; all the while continuing to manipulate prices lower in its role of silver short seller of last resort. I reasoned that one day, because of growing physical tightness, JPMorgan would end its practice of shorting additional quantities of COMEX silver futures contracts when it saw the point had come when that would no longer be productive. Not being able to read JPMorgan's intent in advance, I would instead rely on the bank's actions which I defined as ceasing to a

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