March 6, 2019 – Tail Wags Dog

If there is one thing instructive about the Commitments of Traders (COT) report issued yesterday, it is that it demonstrates clearly how prices get set in a variety of world commodities. Yesterdayâ??s COT report is the last of the delayed reports caused by the government shutdown, as this Fridayâ??s reports (including the Bank Participation Report) will include positioning as of the close of business yesterday. Iâ??ll get into what Fridayâ??s new report might indicate later, but there is a wealth of knowledge to be gleaned from yesterdayâ??s report covering positions held as of Feb 26.

With more commentary on the COT reports than ever (and for very good reason), itâ??s easy to get lost in the swirl of numbers inevitably accompanying the commentary, including mine. But numbers and data are only useful to the extent we can learn from them and itâ??s important not to get so caught up in the data that we miss the true message. The most important message is that the COT reports show that such enormous quantities of futures contracts are being positioned, when converted to and expressed in real world terms, that the paper positioning is setting prices, instead of changes in actual commodity production and consumption. This is completely at odds with commodity law and undercuts the law of supply and demand which is an integral component of the free market system.

Iâ??ve used the example in the past that this is like having the tail wag the dog, but recent COT data show that the tail (futures market positioning) is so grotesquely large that actual supply/demand fundamentals have almost no bearing on price. Even more perversely, the outsized paper futures contract positioning is largely a personal matchup between only two distinct trading entities â?? the managed money traders and their counterparties, loosely termed the commercials. Nothing compares to COMEX silver futures in terms of grotesquely large paper positioning determining prices and Iâ??ll cover the positioning changes in silver and gold in a moment, but let me highlight the changes in the latest COT report for two other CME Group commodity futures, copper and platinum.

Both COMEX copper and NYMEX platinum futures, as I have recently remarked, had built up a record or near record large managed money short position. The net effect of these record short positions being put on, was that both copper and platinum prices had fallen to extreme lows, copper to the low $2.60â??s per pound and platinum to near $780 per oz. This is because many managed money traders are technically oriented and sell short as prices fall, regardless of value or cost of production considerations. Therefore, whenever a large managed money short position has been established, the odds of a strong rally developing are high, since these traders have no option of delivering metal and must buy back short positions at some point (and go long). The timing of such short covering rallies is always questionable, but not the inevitability of the rallies.

The price of copper rose as high as $2.97 during the reporting week ended Feb 26, as the managed money traders bought 23,187 net contracts, covering shorts and adding new longs. Since there are 12.5 tons (25,000 lbs.) of copper represented in each COMEX copper contract, the managed money traders bought the equivalent of 290,000 tons of copper over five trading days. The world produces about 50,000 tons of copper each day, so the managed money traders bought nearly six full days of world copper production in one week. There were no reported changes in actual world mine copper production or consumption to account for the sharp jump in price. The truth is that the counterparty commercial sellers to the managed money buyers could have demanded even higher prices before selling.

In NYMEX platinum futures, the managed money traders bought 16,779 net contracts (almost all short covering) during the reporting week, as price rose as high as $860 an oz. This is an astounding 21% of total open interest. Even more astounding is that the 16,779 contracts bought is the equivalent of 839,000 oz of platinum (50 oz per contract), or 14% of the 6 million oz of the total world platinum produced annually. That breaks down to around 16,500 oz in daily world platinum production. In other words, the managed money traders bought the equivalent of 50 days world platinum production in one reporting week. Can there be any question about why platinum prices rose as much as they did during the reporting week (or fall as much previously as the managed money traders were putting on short positions)?

Itâ??s one thing to try and use the managed money/commercial positioning to time purchases and sales and I hope my commentary might be of some aid; but the broader and more important issue is that this positioning should not be allowed to set prices, as it clearly does. Iâ??m not trying to be a scold or Miss Polly Proper, but allowing excessively large paper positioning by speculators to set prices completely screws up the intended functioning of the law of supply and demand by sending false price signals to the worldâ??s actual producers and consumers.

Turning to COMEX silver and gold futures, yesterdayâ??s COT report seemed completely in line with price action during the reporting week ended Feb 26. I indicated I was somewhat surprised that in the previous reporting week, there wasnâ??t more managed money buying as was reported, but I rationalized that silverâ??s big up day (Feb 20) occurred during the reporting week covered in yesterdayâ??s report; whereas goldâ??s big up action occurred during the previous week and was reflected in that weekâ??s massive increase in managed money buying (nearly 40,000 contracts). This week, things kind of balanced out, as silver did see big managed money buying, while gold featured slight managed money net selling.

In COMEX gold futures, the commercials reduced their total net short position by 6600 contracts to 159,800 contracts. Of particular note was that the concentrated short position held by the largest commercial shorts declined quite sharply, by more than 15,000 contracts to 194,500 contracts for the 8 biggest shorts. As you may recall, this concentrated short position had grown very sharply into the gold price highs, hitting nearly 210,000 contracts in the previous reporting week, the equivalent of 21 million gold oz.

That there was such pronounced short covering by these big traders suggests to me that they are anxious to buy back as many short contracts as possible as quickly as possible. Undoubtedly, there should be massive managed money selling and commercial buying for the reporting week ended yesterday, so weâ??ll be able to measure how aggressive the big shorts were in buying back contracts on Friday.

On the sell side of gold thru Feb 26, the managed money traders sold 3818 net contracts, but the actual mix was somewhat unusual in that there was managed money long liquidation of 12,194 contracts, but managed money short covering of 8,376 contracts. Given the sharp break in gold prices (nearly $45) and the five straight days of new price lows (salami slices), it is near certain that there will be substantial managed money long liquidation and new short selling in Fridayâ??s report. Any other outcome would be tantamount to a â??man bites dogâ?• headline.

In COMEX silver futures, the commercials increased their net short position by 4300 contracts to 78,200 contracts, tying the level of Feb 5 as the largest and most bearish level since Nov 2017. Unlike the situation in gold, the concentrated short position of the 8 largest traders rose substantially above the level of Feb 5 to 104,049 contracts, the equivalent of more than 520 million oz. In terms of total world mine production, the short position of the 8 largest traders is over 60% of production and in days of world mine production it comes to 226 days. No commodity comes close to such a level and not one of these 8 big shorts is engaged in legitimate hedging, not even JPMorgan which I estimate holds at least 28,000 contracts net short, the equivalent of 140 million oz and 61 days of world production by itself.

On the buy side of silver, the managed money traders bought much more than the commercials sold, as these traders bought 8962 net contracts, comprised of new longs of 2610 contracts and the buying and covering of 6352 short contracts. Traders other than the commercials joined in on selling to the managed money traders this reporting week. From the price bottom of Nov 13 to the price high in the reporting week ended Feb 26, a gain of $2.20, the managed money traders bought 88,595 net silver contracts, the equivalent of 443 million oz (more than 50% of world production). By my calculations, 8 big commercial shorts sold that entire amount. As to why the 8 big shorts were so aggressive on the sell side, the most plausible explanation I can come up with is that they were looking to contain the silver price rally so as not to set off widespread investment buying that might very easily spill over into physical buying demand, impossible to contain with additional paper short sales.

Regardless of the motivation, there can be no question as to what drives and sets commodity prices, particularly in silver. The only question is how can this be allowed, either by the regulators or the Department of Justice? By simply converting published contract amounts into equivalent commodity quantities, it becomes obvious that paper trading quantities completely swamp real world actual amounts and, thus, hold the dominant role in setting prices. Not only is this the tail wagging the dog, but when one looks closer and sees that only two groups, small in number but extremely large in numbers of contracts positioned are doing the wagging, the picture becomes even more illegitimate. Throw in the equally verifiable fact that 8 traders control the short side in silver and the manipulative picture is complete.

As simple as it is to convert the number of contracts into equivalent actual world amounts by multiplying the number of contracts by contract size (5000 oz in COMEX silver and 100 oz in COMEX gold), it is something not done regularly. As a reminder, this was the simple exercise I happened to do (almost by accident) more than 34 years ago that alerted me to what was wrong with silver in a delayed response to Izzyâ??s challenge for why silver prices were so cheap. It is simply astounding to note nothing much has changed over three decades, namely, that a 200,000 contract total open interest in COMEX silver doesnâ??t look at all out of line with the total open interest of many other commodities. But when you do the simple math of converting those contracts into equivalent amounts of silver (by multiplying by 5000 oz), the result of one billion oz is shockingly out of line with all other commodities in terms of total world production and consumption.

This likely explains why the CFTC refuses to acknowledge this simple calculation. After all, futures trading was created to allow actual commodity producers and users to hedge risk and since few, if any actual producers or users actually trade in COMEX silver futures, I suppose it matters little that pure speculators control more silver than all the real producers and consumers in the world (yes, Iâ??m being sarcastic). Just like dogs are supposed to wag tails, real world producers and consumers are supposed to set prices to the derivatives traders and products which are supposed to be derived from and dependent on the real world. Thatâ??s why they are called derivatives contracts. Too bad thatâ??s completely upside down.

Having made back completely, the entire $1.8 billion they were losing on an open basis just two weeks ago, the 8 big shorts in COMEX silver and gold are busy buying back as many shorts as possible on the big price declines this past week. Accordingly, there should be truly massive amounts of managed money selling and commercial buying in Fridayâ??s COT report, close to historical large weekly changes; as a rough guide more than 50,000 contracts in gold and 20,000 contracts in silver. More difficult is gauging when the all-clear signal will sound, as that depends on a multitude of factors, including DOJ actions and what JPMorgan, intends.

Ted Butler

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Silver – $15.09Â Â Â Â Â Â (200 day ma – $15.25, 50 day ma – $15.61)

Gold – $1287Â Â Â Â Â Â Â Â (200 day ma – $1251, 50 day ma – $1302)

Date Created
2019/03/06