March 7, 2015 – Weekly Review

Weekly Review

During a week in which prices fell every day, particularly on Friday, gold ended the week $46 (3.8%) lower, while silver finished 70 cents (4.2%) lower. As a result of the basically flat relative performance, the silver/gold price ratio finished unchanged at 73.5 to 1. Given that silver generally exceeds gold in percentage terms to the downside, particularly on sharp price declines, it was somewhat notable that wasn't the case this week. Short term action aside, silver remains exceptionally undervalued relative to gold.

I'd call the explanation most widely given for Friday's price smash, a reaction the monthly employment report, comical except there is nothing funny about price manipulation. I say that because there is no economic report that I can think of that should have less bearing on the price of gold and silver than this report. Yes, I know the employment report impacts many markets, including currencies, and that in turn can be said to effect gold and silver.

But that's absurd when you realize the main movers of the gold and silver prices, certainly on Friday, were the technical funds on the COMEX and they rely exclusively on mechanical price signals and not on published economic data for trading decisions. What the reaction to the employment report does do is provide a cover story and explanation for those who refuse to acknowledge that gold and silver prices are set by positioning on the COMEX. The good news is that the changes in positioning indicated in the new COT report and extrapolating for the prospective changes since the Tuesday cutoff are now flashing bullish signals.

The turnover or physical movement of metal into and out from the COMEX-approved silver warehouses picked up this week to just over 4 million oz, as total inventories rose 1.7 million oz to 178.6 million oz. This is the highest weekly turnover in 7 weeks, although it is still below the 5 million oz average weekly movement of the past year. I still remain in awe of this physical movement and if I had a Â?bucket list,Â? on it would be the explanation for why the physical COMEX silver turnover first appeared four years ago and why it has persisted to this day. Turnover in the COMEX-approved gold warehouses picked up this week, but there has been no inventory turnover like the COMEX silver turnover in gold or any other commodity.

I am going to skip over other normally covered weekly topics (since there isn't much to report) and jump to the changes in this week's Commitments of Traders Report (COT). Not only were there big changes in this week's report (as hoped for but not expected), there were big prospective changes since the cutoff, particularly on yesterday's high volume price plunge. It's no wonder that there is more coverage of the COT report than ever before, as it has gotten to the point that nothing comes close to explaining changes in the price of gold and silver than this report.

In a nutshell, gold prices rose $125 from the end of December to the end of January because 100,000 net COMEX contracts (10 million oz) were bought by technical funds and other speculators and prices have now fallen $140 from the end of January because 100,000 net COMEX contracts were sold by those same technical funds and other speculators. In silver, prices ran up $2.80 because of the buying of 28,000 net contracts (140 million oz) by technical funds and other speculators and have now fallen $2.50 on the net sale of close to the same amount of technical fund selling. See the connection?

Not only is the connection between net contracts bought and sold on the COMEX in precise lockstep with price changes in gold and silver, there is no other rigid connection that lines up with gold and silver price change; or at least none which I have uncovered. Because the connection between position changes on the COMEX is so rigidly connected to gold and silver price change, it has become like asking which came first, the chicken or the egg. Of course, the answer in gold and silver is that it is one and the same Â? COMEX position change is price change. One problem with that is that it is also the definition of price manipulation, since real world producers and consumers are not part of the equation.

In COMEX gold futures, the headline number of the total commercial net short position contracted by 12,300 contracts, to 123,400 contracts. This is the lowest (most bullish) reading since Jan 6, and considering the narrow price activity during the reporting week is a surprise; albeit it a hoped for and welcomed surprise. A bigger story is what position changes occurred since the cutoff, particularly yesterday. But let me finished up first on the report released yesterday.

By commercial category, it was mostly a raptor affair as the smaller commercials added almost 9,000 new long contracts to a gold net long position now measuring 29,700 contracts, the highest since Dec 2. The big 4 gold commercials shorts bought back 3200 short contracts with the big 5 thru 8 buying back the few contracts remaining to balance the commercial equation. As impressive as was the surprise reduction of the total commercial headline number, there was even a bigger and more welcome surprise in the composition of the counterparty selling in gold.

The technical funds in the managed money category sold just over 16,500 contracts, significantly more than the commercials bought on balance, reinforcing the notion that the game is primarily a technical fund/commercial tango. Of the 16,500 contracts sold by the technical funds, 9300 represented long liquidation and 7200 contracts of new shorts were added.

Sticking with my recent theme, we are now close to the recent historical low in managed money long contracts even without extrapolating for yesterday. Unless the managed money gold longs liquidate more contracts than the lowest number they held over the past two years or longer, there isn't much if any room for further managed money long liquidation. Any managed money selling must come from the selling of additional new shorts. I'm certain there was a bunch of that short selling yesterday and if that's true, there may not be much room for new technical fund short selling as well.

In COMEX silver futures, the reduction in the total commercial net short position of 2400 contracts, to 39,700 contrcats was welcomed because (as was the case in gold) this was the lowest (most bullish) reading since Jan 6. Even better was that by commercial category the eight largest traders, holding the most concentrated and manipulative short position of any commodity, did all the buying. The big 4 bought back 1500 short contracts, as did the big 5 thru 8. The raptors, who I sensed may be at close to maximum long position capacity since 8 or 10 of them bit the dust in November, actually sold 600 contracts from a long position now at 19,800 contracts.

Based upon the release of the companion Bank Participation Report for March, I would estimate JPMorgan's concentrated short position to be no more than 17,000 contracts and maybe closer to 15,000 contracts. While still higher than the historical nadir of JPMorgan's silver short position of 7000 contracts last November-December, just as was the case back then, it means JPMorgan is likely no longer the biggest short in COMEX silver. And I would lose the bet if it turns out JPMorgan is not short a lot less after yesterday's trading.

But if the 2400 contract reduction in the silver commercial headline number was a welcomed surprise, then the counterparty selling in the managed money category was almost like hitting the lottery. The technical funds sold an incredible 8500 net contracts, including the liquidation of more than 3600 long contracts and the selling of more than 4800 new short contracts. The long liquidation brings the number of managed money long contracts down to 40,500, or very close to lowest level of longs since last July and a level I have opined that was unlikely to be decisively penetrated. YouÂ?ll remember that even on the move in the price of silver from $21 in the summer to under $15 in November, managed money longs never dipped much below 40,000 contracts. Although we may be below that level after yesterday's trading, I think it more likely that new managed money shorts were added after the cutoff.

At close to 20,000 contracts held short in the current report, I've been thinking 25,000 or so might represent the extreme in the number of managed money short contracts total potential, or in other words, 5000 from here. This assumes, of course, that the 20,000 or more short contracts that the technical funds unexpectedly and profitably bought back in November at close to current prices will not be re-shorted. Should anywhere near that amount of new technical fund short contracts come into the market from here, more price weakness must be expected in silver. Since I don't expect that, I am of the opinion we are at, or very close to the lows in silver (and most likely gold).

This is the essence of the COT analysis as I see it in gold and silver. Into the end of December, the price of gold and silver looked to move higher based upon the low number of technical fund longs and commercial shorts. The only question was what the ensuing rally would look like and that depended exclusively on how aggressive the commercials were in selling into that rally. The answer turned out to be aggressive enough to cap the gold rally at $125 and silver at $2.80.

From that point in late January, all the price gains were wiped out and then some in gold and mostly wiped out in silver, as the commercials now appear to have bought back all the contracts they sold in gold and silver when extrapolating thru yesterday's trading. That means we have made a round trip, both pricewise and in terms of market structure and are back to where we were in late December. Can we go lower in the short term as more technical funds are lured onto the short side? Of course we can. Is it possible we're at or very close to the maximum number of technical fund contracts to be sold and with it the low in price? You betcha; and, in fact, this is the way I've bet as of the close yesterday. What that means is no more defensiveness and if we do go lower for a bit longer I will add more speculative call options as I can't add any more to core silver positions.

It's important to recognize that my version of COT analysis is highly contrarian to price direction. Rotten price action, especially that which results in maximum technical fund long liquidation and short selling translates into the best time to buy. That was the case going into the end of last year. Upward price action (the kind that causes you to feel good about investment holdings), if accompanied by heavy technical fund buying of new long positions and the covering of short positions, is usually a time for caution about a price reversal. That was the case in late January. According to my brand of COT analysis, one should be more aggressive as a buyer when prices look rotten and the technical funds have sold close to what one perceives to be their maximum selling capacity. That time appears to be now.

It's also important to recognize under my brand of COT analysis that once conditions in the market structure flash a buy signal (like now) that buy signal remains in place and only gets stronger on further price weakness accompanied by additional technical fund selling. This is not about buying with a tight sell stop in case it goes lower. Therefore, it is imperative to hold positions that can weather a drawn out period of rotten prices. Generally, that means no margin and holding fully paid for positions. If one chooses to speculate, please do so with call options on money you can afford to throw out the window.

While the changes in the just-released COT report were a welcomed surprise, the trading action yesterday and since the cutoff looks more significant, on the order of 30,000 to 40,000 contracts net improvement in gold and 5,000 to 10,000 in silver for the headline number. And I sense the biggest commercial shorts were among the strongest buyers. This is also the point at which one can look real stupid on a short term basis if the technical funds have further selling to do, but that's always a contrarian hazard.

Even if there's a bit more technical fund selling ahead (and lower prices), the most important recurring question will soon be what the commercials, especially JPMorgan, intend to do on the next silver rally, whenever it commences. There's no question that the aggressiveness of the commercials in selling into the increasingly anemic silver rallies over the past two years are precisely why those rallies have been so anemic. Because every emerging silver (and gold) rally has been increasingly snuffed out by aggressive commercial selling on the COMEX, it is only natural that more observers believe this will continue to be the case, almost forever. I understand that reaction but it raises the risk of potential shortsightedness in extending recent experience into permanence. It overlooks the realities of the physical market in that a remarkably small amount of dollars being funneled into physical silver would end the COMEX scam as we know it. It also overlooks that JPMorgan may be holding the largest physical silver position in history and the motivation, also for the first time, of it wanting the price to move sharply higher.

Ted Butler

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Silver – $15.90

Gold – $1168

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