March 9, 2013 – Weekly Review/Moment of Clarity

Weekly Review

It wasn't much of a price change in terms of magnitude, but for the first time in about a month the price of gold and silver finished higher. Gold gained back the $3 it lost in the previous week, while silver tacked on 40 cents. As a result of silver's slight outperformance, the silver/gold ratio tightened in a half a point to 54.5 to 1. The relative flows of metal for each in the leading Exchange Traded Funds (ETFs) continue to reflect a move away from gold and into silver and I can't help but believe that may be a signpost in my premise of longer term relative price performance favoring silver.

I'm not bearish on gold because of the metal withdrawals from the big ETFs because I think those withdrawals may be ending and most likely will end when gold prices turn up. However, my dollar equivalent comparisons for gold and silver only become more extreme as gold prices rise. I can easily envision a rally of hundreds of dollars for gold ($100 to $300), but I have trouble with projections of ten times that amount from a market capitalization perspective. Certainly, my personal ultimate targets for silver (well over $100) don't depend on $4000 gold. Of course, maybe gold will climb that high and I'll have to revise my price targets on silver sharply higher. I think I could live with that; in fact I hope I live that long.

It seems that every day more metal is taken from the big gold ETF, GLD, while silver holdings in the big silver ETF, SLV, remain steady or climb. From the beginning of the year, some 3.5 million oz, worth more than $5.6 billion, have been redeemed in GLD, while the metal holdings in SLV grew by 19 million oz (worth Â?onlyÂ? $600 million) over the same period when both fell proportionately in price. I have read some commentary suggesting that the gold withdrawn from GLD is more urgently needed someplace else and that is what accounts for the redemptions. That sounds like poppycock to me.

Investors are prone to liquidate any and everything on lower prices and I have little doubt that the metal outflows from GLD are the plain-vanilla investor liquidation they appear to be. I do think the gold liquidation in GLD came as a result of the deliberate lower price rigging stemming from the crooked COMEX, but that's markedly different than the suggestions that metal is being intentionally removed from GLD due to great demand elsewhere. As I said, I think those gold outflows have or may be ending, but that's different than putting a bullish spin on everything. The truly remarkable observation is that no metal has come out of SLV under similar price circumstances.

Movement of silver into and out from the COMEX-approved warehouses continued active, in the 2 to 3 million oz weekly range, as total inventories fell to 162.6 million ounces. Weeks like this one, in which the total amount falls or remains the same best highlight my point that turnover is what should be considered when determining tightness of wholesale supply. I remain convinced that the most plausible, and perhaps only, explanation for the continued turnover in and out of the COMEX silver warehouses is a hand to mouth tightness of supply. This condition would seem to be a precursor of outright shortage. I know there are many who vocally dispute the notion that silver is in or could go into a shortage; but I've never seen one of them address the unusual turnover in the COMEX silver warehouses these past two years. I think there is a good reason for that Â? none can offer a more plausible explanation for the turnover.

The changes in this week's Commitment of Traders Report (COT) came in close to expectations, but only after one looked Â?under the hood.Â? The expectations were for a decline in the headline number of the total commercial net short position in both gold and silver due to the price weakness during the reporting week ended Tuesday. After all, gold did fall in excess of $40 during the reporting week, while silver fell intra-reporting week by more than $1.30. At first glance, the declines in the total commercial net short positions seemed somewhat disappointing, as the net commercial short position fell by 3800 contracts in gold and 1700 contracts in silver.

In gold, the 3800 contract reduction put the total commercial net short position at 133,800 contracts, the second smallest since last May. While the weekly change was small, the commercial category breakdown was interesting. This week, it was mainly the raptors (the smaller commercials apart from the big 8), as they accounted for all the commercial buying. The gold raptors bought 6200 contracts, increasing their net long position to 10,900 contracts. The big 4 sold and added 3600 contracts to their net short position and the 5 thru 8 bought back 1200 short contracts.

What made the gold COT much better than the headline number normally would indicate was the activity on the part of the counterparty technical funds. As I have tried to convey all along, the price of gold and silver is largely set on the COMEX as a result of the continuing market struggle between the big banks and other commercials versus the technical funds and other speculators. When prices decline by a significant amount, such as what has transpired over the past few months, the most usual cause is that the commercials succeeded in tricking the tech funds and other speculators into selling aggressively. The commercials are able to do this because they control (through HFT and other means) the short term pricing and the tech funds react to price changes, selling when the commercials rig prices lower.

The gold COT indicates that the technical funds fell, hook, line and sinker, for the commercials' price rigging during the reporting week. The tech funds can be found in the managed money category of the disaggregated COT report http://www.cftc.gov/dea/futures/other_lf.htm and this week's net selling (long liquidation and new short selling) by the tech funds amounted to over 9600 contracts, substantially more than the 3800 contract headline number of commercial net short reduction. Further, the tech funds in gold now hold their largest gross short position in history (I believe). The tech funds are, without a doubt, the weakest short sellers of all. That's because they have no chance or way to deliver metal and must, therefore, buy back at some point. When they get the appropriate price signal to the upside (at the commercials' discretion) the tech funds will bolt from the short side faster than any jack rabbit ever bolted from perceived danger. I can't tell you precisely when these tech fund shorts will bolt and rush to buy back, but I am reasonably sure they must bolt and probably will do so pretty soon. When the commercials decide it is time to harvest the tech fund shorts, the only question will be how high a price the commercials will demand from the tech funds to satisfy the buying back of tech fund short contracts.

In silver, the 1700 contract reduction in the total commercial net short position put that short position at 29,200 contracts, another new low level since last August. As was the case in gold, the tech funds' net selling (long liquidation and new short selling) was more than three times greater than the 1700 contract reduction in the commercial short position (please see link above). Also as in gold, the gross short position of the tech funds (managed money category) hit a new record high. Sticking to the jack rabbit analogy, the tech fund shorts in silver, when they do cover, will likely be rocket-propelled.

The standout in the silver COT (aside from tech fund selling) was the breakdown by commercial category. Last week, the big 4 (read JPMorgan) only managed to buy back 1200 of the 7100 commercial net contracts bought in the previous week's COT, taking a back seat to aggressive raptors buying. When the monthly Bank Participation Report was released early Friday (well before the COT) I thought JPMorgan had taken a back seat in the commercial short covering once again. That was not the case in the COT report. This week, it was all the big 4, as they bought back 3200 contracts, almost double the 1700 contracts bought by the commercials. In fact, the 5 thru 8 largest traders sold more than 1200 contracts, adding to their net short position, while the raptors sold a couple of hundred of their still-large 24,800 contract net long position.

I would now estimate JPMorgan's concentrated net short position in COMEX silver to be 24,000 contracts, down from last week's 27,500 contracts (I try to stick to 500 contract increments). Interestingly, during the full month covered in the new Bank Participation report and intervening weekly COT reports, the price of silver fell nearly $4 in the interim and the commercials were able to reduce their net short position by 22,700 contracts (113.5 million oz). That is an enormous amount of silver in real world terms of supply and demand and provides the clearest motive possible for tricking the tech funds (and manipulating the price). Aside from any actual profits taken (in the hundreds of millions of dollars), the big payoff to the commercials may come from the new market structure, made more favorable to the commercials by 22,700 net contracts. The change in COMEX holdings proves that the commercials had the means (HFT daily price control), motive (giant $) and opportunity (no regulator interference) in the continuing crime of silver price manipulation.

Of the 22,700 net contract reduction in the total commercial short position, JPMorgan accounted for 11,000 contracts and the raptors for 12,600 (the 5 thru 8 accounted for the difference by adding 900 short contracts). On the flip side, the largest component of the tech fund and speculative selling was new tech fund short selling of nearly 14,000 contracts. I always thought that JPMorgan and the raptors would battle it out (but in a very collusive manner) to buy as many silver contracts as possible in any downside rigging of price, so I can't say I'm surprised at the actual results. I'm a bit surprised at JPMorgan's showing this week, but I try to remind myself to look at the COT structure on a rolling basis and recognize that the once a week snapshot on Tuesdays is just that Â? a snapshot.

There is no doubt that the COT market structure both in gold and silver is strongly bullish, especially considering the high level of technical fund short positions in each. Long time observers know that this tilts the odds to a price rally of some significance at some point. But those observers also know the actual timing of that rally is unknowable, as well as knowing that the possibility of further, if slight, new lows is always possible in a marked as crooked and rigged as silver (and gold).

The real question in silver is what that bad boy, JPMorgan, is gonna do when the physical market comes calling. Or more precisely, what can the baddest silver boy do? Down an impressive 11,000 contracts in a month and 14,000 contracts from the recent peak of 38,000 contracts in its short position, the 24,000 contracts JPM is still net short is way too large for this stage of the silver and gold deliberate sell-off. By this time, JPMorgan should have covered many more short silver contracts. I believe the crooks at JPMorgan intend to continue to press silver prices lower, but I am unsure how much more tech fund selling the bank can orchestrate. With the tech funds holding a record large gross level of short positions currently that argues for not much selling being left in that category. JPMorgan can only buy back shorts as and if other entities sell. In a nutshell, that's the story in silver Â? what's JPMorgan going to do?

A Moment of Clarity

Every once in a while, someone utters a statement that suddenly galvanizes the issue at hand. In the fable Â?The Emperor's New Clothes,Â? Hans Christian Andersen tells of two weavers who convince the emperor that their special clothing for him is invisible only to those unworthy. When the emperor parades in front of his subjects wearing the special clothing, a child cries out the obvious, Â?he isn't wearing any clothes at all.Â? That's the first thing that came to my mind when I read of the US Attorney General's words before a Senate hearing this week.

Asked why the government hadn't pursued criminal charges in a case where a large bank admitted to money laundering for drug interests, Attorney General Eric Holder said: Â?I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if you do prosecute, if you do bring a criminal charge, it will have a negative impact on the national economy, perhaps even the world economy.Â? A senator admitted to being stunned by the frankness of the response. While Mr. Holder's no-nonsense answer got the widespread attention it deserved, it should have resonated most loudly with silver investors, or at least with readers of this service.

In a blinding moment of clarity, the answer to the whole Â?why isn't the CFTC doing anything about the silver manipulation and JPMorgan's stranglehold on the priceÂ? question flashed for all to see. Mr. Holder's words couldn't be any clearer and fit perfectly with the now-consensus view held by those who know that JPMorgan is manipulating the price of silver. The reason the CFTC is allowing JPMorgan to continue with their illegal behavior in silver is because the bank is too damn big and powerful to rein in for fear of the unintended consequences. Not only is this the most plausible explanation for the hands off treatment for JPM, countless specific facts unique to silver also reinforce this view.

There is no reason for a US federal agency that spends four and a half years investigating a simple question about market concentration not to find the answer, other than intent not to find it. Clearly, the CFTC won't conclude the silver investigation because of the fear that charging JPMorgan with criminal charges for manipulating the price of silver could have extremely negative consequences for the bank that could radiate throughout the financial system. Throw in that certain guarantees and assurances were most likely given to JPMorgan by the US Government at the time of their assumption of Bear Stearns' concentrated short position and the most plausible explanation becomes more obvious. I never represented that this manipulation business was anything but a very serious circumstance being played out at the very top of the financial and regulatory food chain. It's hard to imagine the Attorney General's words being more applicable than to the silver price manipulation by JPMorgan.

I had this discussion with a friend the other day when the story first broke and he raised the obvious point that this would seem to extend the life of the silver manipulation indefinitely. After all, if the regulators were reluctant or afraid to force JPMorgan to cease manipulating silver, then that gives the green light for JPM to do so forever. I can understand that sentiment. Understand, yes. Accept? No. While I think that the growing general awareness that some banks are too big to fail or even be sued and, specifically, that JPMorgan is manipulating the price of silver would argue for a quicker end to the manipulation than otherwise, but that's different than the main point I would make.

Many conclude that the termination of the silver manipulation will arrive only in some long from now timeframe, given the power of JPMorgan and the regulators' temerity in confronting the biggest of the too big to sue banks. Often, this sentiment is aligned with thoughts that so as the government's ability to create money and debt appears unlimited; so can JPMorgan sell unlimited amounts of paper silver contracts short to control the price. This is an easy analogy to make and brings me to my main point, namely, there is a world of difference between the creation of new money and the creation of new short silver contracts. The key is in knowing why they are different.

I agree and stipulate that JPMorgan has always sold as many new short contracts as it found necessary to cap and contain the price of silver. We've seen stark proof of this on two recent prior occasions, on the two-month $10 silver rally from the end of 2011 and in the $8 silver rally from last summer into early winter. On both occasions, JPMorgan, as the sole new short seller, single-handedly stopped each silver rally from progressing further. And truth be told, I can't rule out JPMorgan not being the sole new silver short seller on the next price rally. That's precisely the most important consideration for the future price of silver. So, what I'm saying is that yes, the dirty rotten crooks at JPMorgan have single-handedly stopped silver in its tracks in the past and may do so again. But I am also saying JPMorgan can't do it forever and maybe not even once again, because of something else.

The something else concerns the specific nature of the instrument through which JPMorgan is controlling and manipulating the price of silver. By selling short heretofore unlimited quantities of COMEX silver contracts to control the price is, at the same time, also obligating the bank to the actual delivery of physical metal, under very easy to imagine circumstances. The Federal Reserve can buy $45 billion a month in securities or $450 billion worth, the consequences of which are impossible to determine with accuracy. On the other hand, the short sale of a regulated commodity futures contract that calls for physical delivery at the option of the buyer has an easy to determine outcome if that commodity moves into a physical shortage. COMEX silver is such a physical delivery futures contract.

What this means is if silver does move into a pronounced physical shortage, something I see increasing signs of, then it will only be a matter of time before cash physical silver buyers begin to demand actual physical delivery on COMEX futures contracts. That's because the COMEX has ascended to the pinnacle of the silver pricing world. Along with that silver pricing ascendency has evolved unintended consequences (why are there always unintended consequences for things that shouldn't have occurred in the first place?). For COMEX silver contracts, one unintended consequence is that most silver market participants, including industrial users and large investors, know that in a pinch, they can get physical delivery by accepting and paying in full for actual metal on a futures contract.

Yes, I know that only a very small percentage (1% to 3% or less) of all futures contracts on physical commodities ever end in actual delivery. Left unsaid is that's because only in a very small percentage of the time is a physical commodity ever in an actual shortage. In an actual physical commodity shortage it must be expected that, depending on price, there will be a great demand for delivery for the item in a shortage and an equally great reluctance by futures contract sellers to make delivery; otherwise there would be no shortage to begin with. This is the problem in silver, namely, that the biggest short seller, JPMorgan, has driven the price so low that, if a physical silver shortage develops, you can be sure many more buyers of silver futures contracts will demand physical delivery and expose JPM's inability to deliver. Of course, we'll only learn this after the fact when JPMorgan proves incapable of delivering physical silver. That's when the federal regulators and the crooked regulators at the CME will pronounce that a special problem has emerged that necessitates contract default. The truth is that the problem already exists today in JPMorgan's crooked concentrated short position and the only thing that must emerge is recognition of a physical shortage. In a play on the expression Â?it's all over but the shouting,Â? in silver, it's all over but the shortage.

That we have come to the point in this country where the leading federal law enforcement official acknowledges that the Department of Justice is reluctant to file criminal charges for fear of the fallout explains why the CFTC has not cracked down on JPMorgan in silver. But that explanation has nothing to do with what will occur when the silver shortage hits with full force. Nothing that the Attorney General, the CFTC, JPMorgan or any other entity in the world says or does will deter the worldwide buying force that will rush into silver when the shortage is exposed.

One final note Â? there has been increasing talk of a silver and gold shortage leading to a COMEX contract default of some type. I don't know where this talk of a gold shortage comes from. Gold is not industrially consumed and that makes it virtually impossible for it to develop into an actual physical shortage. I understand that silver and gold are manipulated in price by virtue of COMEX game playing, but I think it's important to distinguish between the two based upon the facts. Yes, gold can go higher, even higher than I anticipate, but a physical shortage is a completely different animal. It is the prospect of a silver shortage that lies behind my switch from gold to silver mantra.

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Silver – $28.95

Gold – $1580

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