May 11, 2016 – Sticking to the Facts

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As expected, commentary about the market structure in COMEX gold and silver futures, as depicted in the Commitments of Traders (COT) Report, has exploded given the extreme current readings. This is as it should be considering the undeniable influence COMEX positioning has on price. Of course, while the data provided in the COT report are reliable and objective, the interpretations provided by commentators (including myself) are necessarily subjective when it comes to price predictions. That's why it's important to strive to stick to the facts.

What the facts indicate, essentially, is that the managed money technical funds have never been more long and that the commercials have never been more short. Therefore, the market structure is at an extreme. Based upon the makeup and nature of the traders involved and the historical record, I can only call the structure extremely bearish, likely to result in a selloff in which the technical funds sell on declining prices. But at the same time, I would allow for what Izzy Friedman referred to as the Full Pants Down premise (others call it a commercial signal failure), in which the commercial short position gets overrun and is bought back at much higher prices and devastating losses to the commercials.

The extreme market structure in COMEX gold and silver must be resolved in either manner seeing how the longs and shorts are open positions and must be eventually closed out; with only the eventual price levels and which side initiates the closeout to be determined. I think it is also fair and objective to note that should the commercials get overrun, it will be, by and large, the first time that has occurred.

According to the COT report and the companion Bank Participation Report, we know that the largest component of the commercial short position, roughly two-thirds, is held by US and foreign banks. Suggestions to the contrary, such as the extreme commercial short position is held by miners, for instance, are wrong, plain and simple. Additionally, the data indicate that the commercial short position is extremely concentrated or held by very few traders. In gold, 8 traders hold 84% of the entire commercial short position. In COMEX silver, the entire commercial short position is held by 8 traders. As a reminder, concentration is the hallmark of manipulation.

There is little doubt that the extreme speculative long position is held by traders in the managed money category, commonly referred to as technical funds. As is the case on the short side, where the commercial position is dominated by the banks; the managed money category dominates the long side of both COMEX gold and silver with a 75% share of each market. While there are many more managed money technical fund traders long than there are commercial traders short, because the technical funds operate on the same basis (buying as prices climb and selling as prices fall), the actual trading on the COMEX has become quite monolithic. In essence, there are only two types of traders in COMEX gold and silver Â? banks and technical funds.

Because there are, effectively, only two types of traders in COMEX gold and silver, one opposed to the other, and because they collectively deal in such massive quantities and dominant market share, this is what determines gold and silver prices. It's not that actual gold and silver production and investment has ceased to exist; it's more a case that the price effect from those real sources has ceased to exist, supplanted by COMEX paper futures positioning. I keep reading that the paper market is dying and being replaced by actual metal trading and that will come to pass eventually; but to this point, COMEX paper trading has never had a stronger influence on price. The reason for this is that prices are made at the margin.

Real metal is produced and consumed or invested in on a daily basis worldwide and is generally not given to spurts of production or consumption. Conversely, COMEX gold and silver trading is all about spurts of buying and selling. Since the beginning of the year, roughly 30 million real ounces of gold and 300 million real ounces of silver were produced and consumed (including investment) through the end of April worldwide. Because those real ounces were produced and consumed on daily basis, they didn't have a big impact on price. But in addition to those real ounces, 30 million paper ounces of gold and 300 million paper ounces of silver were bought by the technical funds and sold by the commercials on the COMEX in spurts. This Â?extraÂ? COMEX paper buying and selling is what caused gold to rise in price by as much as $240 and silver by $4.

This COMEX paper buying and selling is purely speculative when it comes to the buy side because there is no doubt that the technical funds are as purely speculative as can be. But it is also true that the commercial banks are speculating for the simple reason that it is not possible for them to be sitting on tens of millions of unencumbered gold ounces and hundreds of millions of silver ounces (JPMorgan excepted in silver) just waiting for prices to rise so that they can hedge.

Therefore, the most logical (at least to me) approach in analyzing COMEX paper positioning is trying to determine which side Â? commercial banks or technical funds – is winning or losing. Over the longer scope of time (decades), it is apparent that the commercials have handily beat the technical funds. There are many reasons for this, as I discussed on Saturday, including that the technical funds' trading accounts are held by the banks they compete against. That's not to say that the technical funds haven't or can't win at times, particularly in markets away from gold and silver.

A recent case is the sharp rise in the price of soybeans and grains due to a bullish report from the Agriculture Department regarding carryover. Before that and as a result of rising prices from the beginning of the year, the technical funds built up a very large long position in soybeans and in grain markets and benefitted greatly by the recent surge in price even though these funds pay little or no attention to soybean or grain supply/demand fundamentals. That's what technical analysis is all about. Many have asked over the years why the technical funds persist in trading COMEX gold and silver when it appears the game is stacked against them by the banks and one answer for that is because these funds diversify and take positions in many markets and persistent losses in gold and silver are balanced by gains in other markets.

But it's also true that the banks are not the primary counterparties to the technical funds in soybeans and grains and are not, in fact, big shorts in those markets, according to the Bank Participation Report, as they are in gold and silver. I think this makes all the difference in the world and explains why the technical funds have a poor performance record in COMEX gold and silver. The banks own the technical funds in COMEX gold and silver, as explained on Saturday.

I've read reports where the commercials are said to have massive losses in gold and silver as a result of this year's big run up in price, but that doesn't jibe with my calculations. The commercial net short position was near historic low points at year end and the raptors (the smaller commercials) were, in fact, massively long. Therefore, the price run up made the commercials close to $750 million in realized profits and it was the technical funds, which were heavily net short at year end, which suffered losses of that amount.

As I have been reporting, the average price on the 300,000 gold contracts that the commercials are now short and the technical funds, largely, are now long is around $1250. Admittedly, because the commercials have assembled such a large short position, it is impossible for them not to be experiencing large open and unrealized losses. But that's more of a function of the size of the short position than it is of the dollar amount per contract they are behind. In any event, it is easy enough to calculate Â? at $1275 gold, the commercials are $750 million in the hole on gold, or about what they made on realized profits earlier in the year. (Similar, but smaller numbers apply in silver).

A couple of points. First, there is a big difference between realized and unrealized profits and losses. Realized profits and losses are booked once and for all time. Open or unrealized profits and losses matter for daily margin purposes and mark-to-market calculations, but by definition are subject to change and not written in stone. In positioning against the technical funds, moreover, the commercials expect to incur unrealized losses in assembling any position of size. That's because the technical funds only add to positions as open profits accrue. This has nothing to do with which is the better approach and everything to do with how things are done in commercial/technical fund positioning.

The most remarkable observation I can make in the case of the current positioning in COMEX gold and silver is how little (in dollars per contract) the commercials hold in open losses compared to the size of their open losses in times' past. I believe this is a testament to commercials' skill and treachery. But there's more.

Not only do I believe that the commercials have been masterful in assembling a massive gold and silver short position at an extremely high average price, the sons of guns (I had a different word in mind) have also been profiting on a shorter term basis as well. In reviewing the latest COT report on Saturday, as well as the subsequent action since the previous Tuesday cutoff, I remarked how skillful and treacherous the commercials were in selling to the technical funds on price spikes orchestrated by the commercials.

After topping off shorts on Friday, the commercials arranged for prices to fall sharply first thing Monday morning. Since the technical funds only sell on price declines and because there was fairly heavy trading volume on Monday, it's a pretty safe bet the technical funds were selling that day. And if the technical funds were selling, that means the commercials were buying (what they sold short on Friday). By my back of the envelop calculations, I would guess the technical funds sold and the commercials bought between 10,000 and 20,000 net gold contracts by Tuesday's close (plus a proportionate number of silver contracts).

Bottom line, the commercials took out a $2500 per contract profit on the gold contracts they sold short on Friday and bought back Monday/Tuesday. Collectively, the commercials made and the technical funds lost between $25 million to $50 million on the quick trade of 10,000 to 20,000 gold contracts. This is the Â?scam within a scamÂ? I've written about previously. Sure, this profit had to be split between, mostly, the 8 big gold shorts (plus the raptors which participated), but what's wrong with a $5 million plus quick profit per man between a few crooks? At the very least, these quick and not so minor quick trades goes towards improving (increasing) the commercials' average shorting price. And yes, I think the rebound in prices into today was re-shorted by the commercials.

Despite the control that I believe the commercials hold over the technical funds, I fully stipulate that should gold and silver prices rip higher from here and the commercials are forced to cover at much higher prices, the losses to them would be massive and unprecedented. Every dollar higher in gold would equate to $30 million in losses to the commercials. A $100 move higher would cost the commercials $3 billion. Every full dollar move up in silver would cost the 8 largest and most crooked commercial shorts $450 million. Please reverse those amounts should prices fall instead.

Seeing how the short side of COMEX gold and silver is dominated by the big commercial (bank) shorts, I concede if they get overrun, all hell is likely to break loose. To my mind, that argues against such an event occurring, but it isn't up to me Â? I'm just an observer and analyst. If it were up to me, the commercials would have been overrun long ago. Therefore, the probabilities still suggest a downside price resolution. But I still think that if we get that downside resolution, it will be the last selloff before the big move up, particularly in silver.

In other matters, the new short interest report for securities for positions held as of April 29, indicated an increase in the short position of the big silver ETF, SLV, of Â?onlyÂ? 1.3 million shares to 15.3 million shares (ounces). I had expected a much larger increase and was prepared to complain to the SEC on any increase over 5 million shares. The good news (I suppose) is that I'm off the hook, temporarily, from having to complain, but the bad news is being so far off in my guess. Perhaps the DTCC can't be trusted, but it's more likely that my calculations were just plain off. Still, we did see an increase and this is the highest short position in SLV of late. The short interest in GLD, the big gold ETF, fell slightly.

http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

As far as what to expect in this week's COT report to be reported this Friday, it's a lot trickier than last week, given what I perceive to have been the increase in commercial shorting/technical fund buying thru last Friday and the reverse of that on Monday. I probably should call it unchanged or say that I don't know, but based upon the changes in total open interest through yesterday's cutoff and the fact that the 50 day moving averages in gold and silver have not been penetrated to the downside, let me call for an increase of 10,000 contracts or so in the total commercial net short position in gold and an increase of 5000 contracts in silver.

Ted Butler

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Silver – $17.38   (50 day moving average – $16.08)

Gold – $1278   (50 day moving average – $1250)

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