

May 21, 2016 – Weekly Review

Weekly Review

After establishing yearly price highs three weeks ago, gold and silver fell for the third week in a row, with gold down by \$20 (1.6%) and silver down by 58 cents (3.4%). As a result of silver's underperformance, the silver/gold price ratio widened out (also for the third consecutive week) by nearly 1.5 points to just under 76 to 1. By coincidence, this is not far from where the price ratio began the year. Given all that has transpired in gold and silver this year, I find it somewhat odd their relative values are basically unchanged at this point.

Interestingly, this is the first three week price decline in gold and silver this year, an occurrence that happened with much greater frequency in 2015. Last year, there were four different periods where silver fell for three or more weeks consecutively and five different occasions in gold. Of course, observing past price patterns is easy enough; assigning an explanation for why price patterns occur is much more difficult.

I admit to being predisposed to price explanations rooted in the market structure premise, as reflected in the Commitments of Traders (COT) Report. Therefore, it's hard for me not to attribute the \$40 gold and \$1.30 silver price declines over the past three weeks to COMEX futures contract positioning. After all, it was three weeks ago that we first witnessed historic extremes in managed money long and commercial short positions. Aside from dollar strength over the past three weeks, I'm hard-pressed to come up with rational explanations for why precious metals prices have set back. And since the technical funds in COMEX gold and silver seem more motivated by price change rather than currency changes, the strength in the dollar seems more a cover story for HFT rigging on the COMEX.

Certainly, the news specific to gold and silver hasn't been negative these past few weeks and if anything has been on the positive side. I'll get into the changes in this week's COT report later, including trying to explain a second week of missed personal predictions; but let me first review what are mostly bullish developments in the world of actual metal. I'm sure I've stressed that the only negative potential in gold and silver is the COMEX market structure and that hasn't changed.

It was another monster week, the largest in two and a half months, in the turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses, as nearly 7.7 million oz were moved. Total COMEX silver inventories increased by 1.5 million oz, to 154.6 million oz. A standout feature was that nearly 3 million additional ounces came into the JPMorgan warehouse, which combined with last week's 1.2 million oz comes close to satisfying the 5 million oz I suspected was due to come in as a result of March's delivery stopping by the bank. I had nearly given up my expectations, given the longer delay than normal this time around.

As far as the delivery process this month in the COMEX May silver contract, JPM is now up to 1076 contracts out of the total 2128 total issued to date (Scotia Bank is second with 363 stopped). With only 600 contracts remaining open in May, JPM could still manage to demand the full 1500 contracts allowed for any one speculator, but it looks nip and tuck given the extreme reluctance (inability?) of the shorts to deliver. So far, the May silver delivery process can be said to be "sticky" thanks largely to JPM. I wouldn't be surprised if JPM backs down and lets a few shorts off the hook, but the bottom line is that it all reeks of physical silver tightness.

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

Turning to gold, tightness in the May gold COMEX contract was relieved earlier in the week when HSBC deliver more than a thousand gold contracts (100,000 oz). Now all eyes will turn to the traditional June delivery contract as first notice of delivery day approaches in less than two weeks.

But the biggest standout feature in gold are the continued large deposits in the big gold ETF, GLD, over the past three weeks. Some 2 million physical gold oz have been deposited into GLD over this time, including 400,000 oz over the past two days, despite pronounced gold price weakness. The first 1.6 million oz came in somewhat counterintuitively, given flat gold price action and subdued trading volume up until the past few days. But the deposits over the past two days on price weakness went beyond counterintuitive to downright puzzling (at least to me).

I don't think the big deposits in GLD can be explained by an attempt to close out the short position, as the deposits this month are double the total GLD short position. I don't sense broad investment buying interest given the flat (to down) price action and generally subdued trading volume, so the most logical conclusion is accumulation by a single buying force. My first reaction is that this is bullish, particularly considering the dollar quantities involved (\$2.5 billion in three weeks) and perhaps I should stop there.

But in trying to be objective about it, I'm also struck with the thought that 2 million physical oz of gold were deposited in GLD over the past three weeks with, apparently, little difficulty. I mean, here I am describing what I see as tightness in COMEX gold deliveries and the equivalent of 20,000 COMEX gold contracts were deposited into GLD in three weeks. The biggest month for gold deliveries this year on the COMEX (April) was for less than 4000 contracts and most months are around the 2000 contract level, so the 20,000 equivalent contracts being deposited into GLD over the past three weeks is genuinely enormous. The only possible comparison where 2 million oz of gold wouldn't appear enormous would be comparisons with the total amount of gold known to exist in the world — measured in the billions of ounces.

My point is that while I am puzzled by the large quantities of GLD being apparently bought by a large entity, I am even more puzzled by the apparent ease there appears to be in physically depositing such large quantities of gold. By comparison, had a large entity purchased \$2.5 billion worth of SLV over the past 3 weeks, instead of GLD, there is no way that 150 million oz of physical silver would have been deposited into SLV amid flat price conditions.

I know some will argue that everything about GLD and SLV is phony, but (aside from the short position) I find that is bunk. The GLD is in its 12th year and SLV in its 10th, and the sponsors (State Street and BlackRock) have everything to lose and nothing to gain for running a rigged game. I'm not telling anyone to buy either, but there is zero credible evidence to suggest that the two largest public holdings of gold and silver in the world are scams. God willing, I will be saying that 10 to 12 years from now, because I will still be here to say it (not because they turned out to be scams).

Another week, another near sellout for Silver Eagles from the US Mint, with total sales falling slightly short of the one million ounce allocated amount to be sold (thanks exclusively to JPM's desire to avoid a complete sellout — who in the world doesn't JPM game?). Sales of Gold Eagles are strong, but off last month's blistering pace. It has become routine, but only sales of Silver Eagles stay right at the Mint's ability to produce (and in the face of a pronounced lack of retail demand).

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

On to the changes in this week's COT report. I'd just as soon forget that I missed on both gold and silver, but I will try to explain why and what it might portend. I had expected the commercials to have increased their total net short position in silver by a minor one to two thousand contracts and instead it decreased by nearly 2000 contracts. In gold, I had expected an increase of 15,000 contracts in the headline number and it came in at only a bit over 5000 contracts. Somewhat embarrassingly, I was actually off more when looking at the counterparty managed money changes.

In COMEX gold futures, the total commercial net short position rose by 5200 contracts to 290,200 contracts. This was not the 300,000 contract total I expected, but it is still the largest (most bearish) commercial short position after the high water mark set two weeks ago. Just to put it into proper perspective, I'm moaning about being off by 10,000 contracts, when at yearend, the total commercial short position was 15,000 contracts, 275,000 contracts less than now.

Given the small weekly change, there couldn't be much of a change by commercial category. The 4 biggest shorts reduced their net short position by a little over 100 contracts and the raptors (the smaller commercials apart from the big 8) added 1200 short contracts, leaving the big 5 thru 8 shorts to add nearly 4200 new shorts. At 91,000 net contracts short, this is the largest the big 5 thru 8 traders have ever been short (the same story in silver).

The real surprise was in how few contracts the managed money technical funds bought \hat{A} ? just 1250 net contracts, including only 277 new longs. I was sure the high volume gold price surge to \$1290 on Monday involved thousands of new long contracts by the managed money technical funds. As to the accompanying big increase in total open interest which I also noted in my predictive calculations, it was mostly due to an increase in spread transactions (which I considered privately, but never mentioned).

In COMEX silver futures, the commercials reduced their total net short position by 1800 contracts to 89,900 contracts, still bumping up against the largest (most bearish) levels in history. By commercial category, the raptors were the only buyers as they added 2900 contracts to a net long position now totaling 4000 contracts. The big 4 added 200 shorts and as was the case in gold, the big 5 thru 8 were the big sellers, adding 900 new shorts. I'd peg JPM as still around 25,000 contracts net short.

As I just mentioned in gold, the big 5 thru 8 in silver now hold their largest net short position (30,900 contracts) with the added kicker that the concentrated short position of the 8 largest traders in COMEX silver is now at a record 93,949 contracts, the equivalent of just under 470 million oz. Eight traders (mostly banks) are short close to the total amount of silver in the two largest stockpiles in the world, SLV and the COMEX inventories (490 million oz). A larger and more concentrated short position and, therefore, more manipulative position has never before been witnessed in any commodity. I'd shout "Holy Cow, Batman," except I might wake up the slumbering and crooked regulators at the CFTC and CME Group. (However, I will send them this "as always").

As was the case in gold, the big surprise in the silver COT report was in the managed money category. Unlike the small amount of buying in gold, the managed money traders in silver sold a net 4742 contracts, almost evenly divided between long liquidation (2363) and short additions (2379). Looking back over the price action during the reporting week, along with the smaller increase in total open interest, I wasn't expecting big changes in silver, so I'm not shocked by the changes this week.

As to why there wasn't much larger buying in gold and some buying in silver by the managed money traders, the most plausible explanation that comes to mind is that the technical funds may have reached their limits of buying capacity. After all, that is the reason so much attention is paid to record market structure extremes. A record extreme implies we are close to the maximum amount that the managed money traders can buy or sell.

New positioning records can always be set, of course, but built into my brand of COT analysis is that barring evidence to the contrary, record positioning suggests only incremental amounts are likely to be added, as opposed to say a doubling of previous record extremes. Evidence to the contrary would include signs that the assets under management that the technical funds control had increased dramatically. Given the overall performance of the technical funds over the past few years, I'm not aware of a true surge in assets under management which would allow for a quantum increase in positioning power.

I guess what I'm saying is that everyone has trading capacity limits of some sort and that would include the technical funds. So the most plausible conclusion for why the managed money technical funds didn't expand their extreme long positions might be that they came close to whatever limit they were subject to. I don't and can't know that for a fact because that can only be seen in hindsight — after whatever extreme they hit can be identified by subsequent lower prices and reduced long positions. The whole idea behind being bullish when the technical funds hold an extreme short position and being bearish when they hold an extreme long position is that at some point they will max out their extreme positions and then begin to reverse the process. I'd be lying if I said this week's COT report and price action didn't suggest that the process was beginning to be reversed.

What about the commercials, in terms of maximum positioning capacity? That has always been less clear to me and for that reason, I look more at how they are doing collectively in open profits and losses. Three weeks ago (in the weekly review of April 30), gold closed at \$1292 and silver at \$17.82, and I calculated the open loss to the commercials (and corresponding collective open profit of the technical funds) at close to \$1.2 billion in gold and a few hundred million additional dollars in silver — call it \$1.5 billion. This was based upon a net commercial short position of 240,000 gold contracts and 90,000 silver contracts, with average sale prices of \$1240 in gold and around \$16.50 in silver. I believe I remarked that this was the largest amount of open losses the commercials had ever experienced and described in articles that followed how we were on knife's edge, etc.

Subsequently, the commercials sold an additional 50,000 gold contracts short, but did so in a manner that increased their average sale price to \$1252 or so. Based upon closing gold and silver prices this week (including technical fund selling and commercial buying late in the week), the commercials are now even, having gained back the \$1.5 billion in open losses they were out three weeks ago. (The commercials are still ahead the \$750 million profit they booked and closed out earlier in the year on the gold rally). Open profits and losses are just that — open and subject to change — and as the man sang, you don't count your money when you're sitting at the table.

Still, from where things stood three weeks ago, conditions surrounding the only negative factor that exists — the COMEX market structure — have clearly swung in the commercials' favor. At Friday's close, their massive short position (albeit somewhat reduced since the cutoff) was no worse than even and right at the 50 day moving averages. I don't care about the moving averages and I would imagine they don't mean much to the commercials either — except as to what these averages might motivate the technical funds to do.

If the technical funds act as they have in the past (perhaps a big "if" considering subscriber Philip's suggestion that they might be of the core non-technical fund variety) and the moving averages are penetrated decisively to the downside, we may be in for a spate of technical fund selling. And if (another big "if") the commercials intend to induce technical fund selling of significant proportions, then we may be facing a series of new price lows that Izzy termed as salami slicing, but not necessarily thin slices.

On the other hand (why are there always different hands?), the commercials may not be in control and forces in the physical world, including a big fat black swan may make this discussion irrelevant. And at the very least, the COT market structure premise is never about timing, just price and positioning and even if the commercials are in complete control, they might toy with the technical funds like a cat with a mouse or lizard, rigging the market up and down to lure the technical funds into losing short term trades (the scam within the scam).

It must be said that it is absolutely illegal and crazy for the price of gold and silver to be determined as I typically describe; but then again, up until now it would have been crazy to ignore that COMEX positioning is the main price driver. Can or will the commercials get overrun or will they orchestrate the technical funds into selling on lower prices yet again? No one can answer that question definitively, but the probabilities still suggest that the commercials are in control. I wish it weren't so and will celebrate their demise, but it will take a force outside the COMEX to pull that off.

My hope is that in the event we do experience yet another commercial rig job of the technical funds to the downside that all the new followers of the market structure premise recognize what happened and put an end to it by speaking in a unified manner. That will go a long way to making sure any prospective selloff is the last such engineered selloff.

Ted Butler

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Silver – \$16.55 (50 day moving average – \$16.35)

Gold – \$1253 (50 day moving average – \$1252)

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