## May 4, 2016 - On Knife's Edge

## On Knife's Edge

I keep thinking that the near-universal attention to the COT market structure analysis in COMEX gold and silver has peaked out and I continue to be wrong. Not only is there more commentary than ever, the analyses are mostly quite good. Of course, there's a good reason for that Â? the data from the CFTC are among the most objective and best compiled market data available from the government. Of course, it doesn't hurt that past price performance has rarely been out of step with the data in the COT report.

Generally speaking, the underlying lesson of the Commitments of Traders Report is that a market selloff is likely when the managed money technical funds get excessively long and the traders called the commercials get correspondingly extremely short. By definition, such a market structure comes into being on a price rally and, as almost all the current commentary reflects, that's where we are right now. Therefore, should we experience a decline in price below the major moving averages (mainly the 50 day ma), accompanied by heavy managed money selling and commercial buying, no one should be surprised.

However, this market pattern has existed for so long (three decades by my reckoning) and has exerted such a pronounced influence on price that it is also a wonder it has lasted as long as it has. More than anything, it is the continuing commercial/managed money trading tango that is at the heart of the silver and gold price manipulation. In simple terms, this COMEX futures contract positioning has created an artificial price level, particularly in silver, because it has replaced completely real world supply/demand fundamentals as the main driver of price. As such, this can't last forever. Sooner or later, the real forces of physical supply and demand must overwhelm the artificial force of COMEX paper positioning; the only question being when.

It's no secret that I think we are facing the moment of truth in the very near future, either with or without one final managed money flush out to the downside. Augmenting my feelings is the fact that so many are focusing on the COT market structure premise. As I just indicated, if we do get a selloff, it should surprise no one, as the only possible reason for a price decline is the one market negative in place  $\hat{A}$ ? the COT market structure. I'm hopeful a selloff, should it occur, will finally focus attention where it should be, namely, on COMEX positioning.

To me, the incredible collective awareness of the COT market structure is like a thousand mile journey needing only a few short steps to complete. The hard part of the journey has been in understanding the intricacies of how gold and silver prices are set on the COMEX. Let's face it Â? as clear as the COT reports have become in time, they are as clear as mud at first. Now that so many have absorbed the details of the report, all that's missing is the last easy steps of the journey Â? standing back to reflect on what was learned. In other words, once you learn what drives the price of gold and silver, namely COMEX positioning, it becomes easy to realize how screwed up the price discovery process is. If you can understand what sets price, you can also understand that it is wrong.

At some point (and we may be at that point), commentators and observers will go from understanding the COT report to understanding that it is nothing more than an artificial pricing scheme in plain view. As artificial and manipulative as COMEX paper positioning is and as more recognize it for what it really represents, it can't possibly continue to exist for long; particularly since it is now at such extreme odds to what exists in the real world of silver. That's why I'm on the fence as to whether we get that final selloff or not.

As extremely negative as the COT market structure is presently, conditions on the physical side of silver (and gold) never looked more bullish, as I remarked on Saturday. I won't be shocked if we get one last selloff, but I won't be shocked if we don't and go up from here instead. Let me update you on the extremely negative paper market structure and the extremely bullish physical market set up over the past two days since Saturday's review.

On the negative side in gold, the total open interest for COMEX gold futures as of yesterday's COT cutoff has exploded to 565,774 contracts, up nearly 68,000 contracts over the reporting week. If there has ever been a larger weekly increase in total open interest in COMEX gold futures, then I am unaware of it.

I am hesitant to attribute the entire increase in total open interest to a commensurate net increase in the commercial short or speculative long position, but as I explained on Saturday, once an extreme market structure exists, big increases in total open interest means both the longs and shorts have added to net positions. Unless there was an explosion in (uneconomic) spread positioning, this Friday's COT report in gold should be a whopper. I can't see how the commercial net short position in COMEX gold futures won't be up by 30,000 contracts to as much as 50,000 or 60,000 contracts.

Even at the lower number, a total commercial net short position of 270,000 contracts as of yesterday's close would mean that the commercials sold and the technical funds bought 255,000 net contracts on the gold rally since December 29. That's the equivalent of 25.5 million ounces of gold. In contrast, the big gold ETF, GLD, added 6 million ounces since year end and the total of 26.5 million ounces in the trust is about equal to just the increase in COMEX positioning over the past four months. Can there be anyone who doesn't see that COMEX paper positioning has been the prime driver of price?

The only potential negative factor in gold (and silver) is the high level of commercial shorts and managed money longs because of the threat that the commercials may succeed in rigging prices lower to induce technical fund selling (as has always occurred previously). On the other hand, should physical forces overwhelm the paper manipulation, all hell could break loose to the upside.

Unlike the massive weekly increase in total open interest in COMEX gold futures, the total open interest in silver actually fell by 8500 contracts over the reporting week. Even adjusting for the thousand or so contracts automatically liquidated as a result of deliveries against the March contract, the contrast with gold is stark, since price action and trading volumes were somewhat comparable. As a result, I'm not sure what to expect in this week's COT or Bank Participation Reports for silver, but I will be looking closely for clues of a JPMorgan double cross of the other big commercial shorts.

While I can't guess what this week's reports in silver might show, through last week, more than 60,000 net contracts were sold by the commercials and bought by the technical funds since yearend. That's the equivalent of 300 million ounces, not far from the total number of ounces (339 million) in the big silver ETF, SLV, the largest single visible inventory of silver in the world. As was the case in gold, changes in COMEX positioning dwarf real amounts of metal in the world, making it impossible not to identify the prime price driver in silver. And to boot, eight crooked traders are net short 450 million ounces of silver, the most extreme concentrated position in history for any market.

On the bullish physical side, the May delivery process in both gold and silver look extremely tight. As of last night, there are still 1770 gold contracts open (177,000 oz) with only 52 contracts delivered this month. May is not a traditional COMEX delivery month in gold and the number of open contracts is high and follows a very tight April delivery period. While not the biggest stopper (taker) this month, JPMorgan has taken 15 gold deliveries (JPM took 1200 in April).

Silver deliveries for May still look tight and JPMorgan is still the largest taker so far, having stopped 578 contracts out of a total 1370 silver deliveries issued this month. Based upon JPM taking an even higher percentage of deliveries over the past two days, it looks like JPMorgan, should it not back down, will take the maximum 1500 contracts allowed this month, since there are, effectively, more than 1700 May silver contracts still open. I would point out that JPMorgan is the biggest stopper of COMEX silver deliveries this month and darn near the sole silver stopper for more than a year.

http://www.cmegroup.com/delivery\_reports/MetalsIssuesAndStopsYTDReport.pdf

One interesting feature of this month's May silver deliveries is that behind JPMorgan, the Bank of Nova Scotia is the second largest stopper with 173 contracts accepted so far. Why I find this so interesting is that these two banks are the largest short sellers in COMEX silver futures and as such must be considered to be the main silver price suppressors. Yet the two main price suppressors are the two largest takers of physical silver deliveries. First you depress the price through paper short sales and then you take the most physical silver possible at the suppressed prices. Can it get more crooked than that?

There was a an absolutely massive physical deposit of metal into the big gold ETF, GLD, on Monday of 668,000 oz, the largest one day deposit ever, I believe. This followed the high volume gold price advance of last week and was just as should be expected. Likewise, there was a big deposit of 1.8 million oz of silver into the big silver ETF, SLV, which when combined with last week's deposit of 2.3 million oz, brought to 4 million oz silver deposits into SLV. I still think more is Â?owedÂ? to the SLV, but at the very least, these are large and fully expected deposits.

A number of subscribers asked me about SLV given my take that there was likely short selling of shares in lieu of immediate metal deposits. One subscriber, in particular, was concerned about the recurring commentary by many that SLV and GLD do not have the metal they claim to have. In light of my previous admission that my wife holds SLV, he asked me about my promise that if I changed my mind that I would make that clear. So let me be as clear as possible Â? I haven't changed my mind about SLV (or GLD) and I believe that claims that these trusts don't hold the metal they purport to hold are nonsense and horse crap, spread mostly by those trying to sell you metal in a form more profitable to them.

I'm not in position to personally guarantee the many billions of dollars of metal held in the trusts (I never held GLD), and I'm not suggesting there aren't better ways of holding silver; but everything I study points to the metal being there in SLV and GLD. The craziest thing is that many of the alternative storage arrangements advanced by critics of SLV and GLD, quite frankly, stink. As a simple rule of thumb, never, ever store metal with the same dealer you purchased it from. In the case of silver and 1000 oz bars, you should have the serial numbers, weights and hallmarks of all metal you own via a direct contract with the storage provider and not comingled in the dealer's name. This way, even if the dealer gets into financial difficulty, your metal won't be at risk.

It's also important to put this short selling in SLV in perspective. Should the SLV short position climb by more than 5 million oz in next week's (May 10) short report, I will complain to the SEC; but this short selling is not what is driving the silver manipulation. I just wrote how the commercial crooks on the COMEX sold more than 300 million oz over the past 4 months and without that selling the price of silver would have doubled or tripled or more in price. Please don't confuse that with the 5 million oz (or more) that may have been sold short in SLV shares. I'll continue to make short selling in SLV a signature theme, but remember increases in the short position are primarily an indicator of physical tightness and secondarily a manipulative fraud.

Also, a subscriber questioned the institutional ownership of SLV, versus the percentage held by retail investors. As it turns out, there is an extraordinarily small percentage of SLV ownership held by institutional investors on an absolute basis and relative to GLD, where institutions hold almost double the percentage held in SLV.

http://www.nasdaq.com/symbol/slv/institutional-holdings

I think this is bullish for silver because at the very least, there can't be much institutional selling in SLV and if institutions ever awake to the investment merits of silver, they can only buy. I suppose that will only occur on higher prices, but we will get those higher prices eventually. The institutions buying COMEX silver futures are specifically limited to futures contracts; whereas just about every institutional investor around has the ability to buy common stocks, which is the structure of the SLV. These investors can all buy SLV; it's just that they haven't up until now. When they do move to buy shares of SLV, it will drive demand for physical silver because that's how the trust is set up. I still view SLV as my friend Carl Loeb dubbed it many years ago as the Â?Death StarÂ? destined to potentially gobble up all the available silver in the world.

Finally, a couple of stories in both the Wall Street Journal and on the front page of the NY Times caught my attention. It seems that investors in China, as a result of monetary stimulus and a lack of interest in the stock and property markets there, have taken to aggressive speculation in a wide variety of futures markets. This would seem to confirm widespread opinion that Chinese investors are inclined to gamble and speculate more than others. Commodities mentioned spanned the spectrum from steel rebar (used in concrete) and iron ore to eggs. The dollar amounts involved in futures speculation were said to be in the many billions of dollars and trading activity was so large as to be influencing prices like never before.

Of all the commodities mentioned in the articles I read (and there were quite a few), there was no mention of silver or gold, although much is written about gold trading in China on various exchanges. Like institutional investors in the West (excepting JPMorgan), it seems to me that few have woken to the merits of silver, perhaps the premier speculative commodity of all time. When investors everywhere do awaken to the merits of silver, the impact on price will be profound, given how little silver is available for investment. Of all the commodities currently the object of Chinese speculation, only silver can be dealt in both ways Â? as paper and physical. I don't believe China has the infrastructure to distribute physical silver to its citizens currently, but should the demand develop, which appears inevitable, it shouldn't take long.

While I'm anticipating China will impact silver in a big way, I don't think that's been the case yet. Gold and silver prices are still driven by COMEX positioning, but it would appear that the handwriting on the wall may be in Chinese characters. If we do get that final COMEX-generated selloff, I'm hopeful that all those pointing to the COT market structure will take that final easy and logical step and recognize the decline as the pure manipulation it always has been. Alternatively, if the commercials fail to rig prices lower and this whole thing blows up in their faces due to physical market considerations, there will also be little doubt as to what occurred.

Ted Butler

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Silver – \$17.36 (50 day moving average – \$15.86)

Gold - \$1279 (50 day moving average - \$1246)

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