November 15, 2014

Weekly Review

Gold and silver prices rose sharply for the second Friday in a row, after starting both days lower. Due to Friday's turnaround, gold rose $10 (0.8%) for the week, with silver ending 50 cents (3.2%) higher. As a result of silver's relative outperformance, the silver/gold price ratio tightened in to just under 73 to 1. With all the documented facts surrounding each, I am still amazed over how cheap silver is compared to gold and I can't begin to imagine how silver can remain so undervalued over time.

You can count on two fingers the number of week's silver has finished higher over the past 20 weeks. The past four months have been a particularly brutal time for gold and silver investors (not for those looking to buy, of course), as peak to trough, prices declined by $200 (15%) in gold and by a crushing $6 (28%) in silver.

What made this recent decline so devastating to investors is that it began from already-low levels, particularly in silver, which was close to the average production costs for primary silver miners before the decline took hold. I won't rant about it now, but the brutal price decline had nothing to do with anything in the real world of supply and demand for gold or silver and everything to do with paper trading on the COMEX. Not much new about that.

I'll get into it in more detail in a moment, but there were some unprecedented and potentially very exciting changes in this week's Commitments of Traders Report (COT) for COMEX silver that, quite frankly, threw me for a loop after thinking it over. Although I didn't expect the changes, they told a story that in hindsight was in complete conformity with the general premise of how I've always viewed silver. Of course, you will decide if what I see makes sense to you.

For the first time in a long while, turnover, or movement of metal into and out from the COMEX-approved silver warehouses subsided, as Â?onlyÂ? 2.1 million oz. were moved this week, well below the average weekly movement of 4.5 million oz this year. Total COMEX silver warehouse inventory declined by 1.8 million oz to 178.1 million oz. This is the lowest level of COMEX silver inventories since mid-August, but I want to remain consistent in focusing on movement and not total inventories. A colleague suggested that the low turnover this week (combined with the reduction in total inventories) might suggest there was not enough metal available for big movement, thus implying we were close to hitting the supply wall. I told him that I was crazy bullish enough on silver than to automatically accept that interpretation, but had to admit it was intriguing.

A 2 million oz deposit this week into the big silver ETF, SLV, in the face of a continued drain of metal in the big gold ETF, GLD, continues to suggest relatively stronger buying and holding of silver than gold, also completely at odds with the more rotten price performance of silver. Since trading volume in SLV hit the highest level of the year on Friday's sharp rally, I would expect further increases in metal deposits (unless the big buyers convert shares to metal to evade reporting requirements).

I was pleasantly surprised that the short position in SLV dropped by nearly 1.8 million shares, to just over 14.8 million shares (oz) as of Oct 31. I was sort of expecting an increase in the short position, not by the big silver insiders (JPM, et al) but by outside technical speculators, because silver price hit the lows for the month on the cut-off date, breaking $16 for the first time. Any time the short interest in SLV declines is a good time as far as I'm concerned and vice versa.
http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

The US Mint announced it would have a million Silver Eagles available for sale on Monday, as it scrapes up enough new production to provide some coins after running out (again). But with the end of the year drawing near, production of 2014 dated coins will not last much longer. The effect of the US Mint consistently running out of Silver Eagles at year end and at other times as well, is that the shockingly high number of Silver Eagles sold this year and for the past few years are substantially understated. So even though the Mint will produce and sell 40 million Silver Eagles this year (5% of world and more than 100% of US silver mine production), it would have sold a lot more if it produced enough to meet demand (as the law requires). So when you review the incredible sales of Silver Eagles over the past few years, know that they would and should have been even higher. No knock on gold, but there's rarely been a problem for the Mint to keep up with demand for Gold Eagles.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

Because of price volatility and heavy trading volume during the reporting week, I didn't have firm expectations for yesterday's COT report and, therefore, shouldn't have been as surprised as I was in silver. I did know, of course, that the market structure was extremely bullish in both gold and silver and yesterday's price pop appears to be a confirmation of the bullish setup.

In COMEX gold futures, the total commercial net short position (the headline number) declined by a further 5300 contracts, to 50,000 contracts even; yet another low-watermark going back to January. Over the past three reporting weeks (since Oct 21), the total commercial net short position in gold has fallen 55,000 contracts on the $100 decline in price. Of course, I would say that gold declined by $100 because the commercials lured the speculators to the sell side on purposeful rigged lower prices so that the commercials could buy what the speculators sold. Make no mistake Â? the lower the total commercial net short position, the better the prospects for higher prices.

By commercial category in gold, it was all raptor buying as the 8 largest gold shorts actually increased their net short position by 1300 contracts, meaning the raptors had to be buyers of 6600 gold contracts. Since I haven't done so in ages and because it is the key feature in this week's silver report, let me take a moment to describe the origin and methodology of the raptor analogy for those wanting to drill down to the analysis in greater detail.

Please know that if you look, there is no Â?raptorÂ? category in any of the various versions of the COT reports; this is a term invented by me to describe a phenomenon that only applies to COMEX gold and silver and not, to my knowledge, to any other market. Because the concentrated short position of the 8 largest traders has always been a standout anomaly in COMEX gold and, particularly, in COMEX silver to an extreme not seen in most other markets, certain definitive patterns emerged from COT data. To me, the big 4 and 8 silver shorts, came to resemble the T rexes of the movie, Â?Jurassic ParkÂ? and the smaller commercials who joined in with and competed against the big 8 traders for their share of the technical fund food supply came to resemble the velociraptors, or the smaller but more vicious dinosaurs in the movie.

Colorful names aside, let me explain the methodology in my analysis. The long form (futures only) legacy COT report (simpler than the disaggregated report) contains all the data required. First, calculate the number of contracts held net short by the 8 largest traders by multiplying total open interest by the percentage listed for net short holdings (in this week's report 29.5%). Invariably, the 8 largest shorts are in the commercial category (since no one technical fund holds extremely large short positions).

You have to hand calculate this to convert from the percentage given to contract terms Â? that's just the way it is. Then, as is usually (but not always the case), since the concentrated short position of the 8 largest traders will be larger than the headline number (total commercial net short position), the difference is what the raptors hold (the smaller commercials apart from the big 8). If the concentrated short position of the big 8 traders is larger than the total commercial net short position (the headline number and as is the case now), then that means the raptors are net long the difference. I recognize that most readers' eyes are probably glazed over at this point, but if anyone wants to get into this in detail, please get back to me. I did want to back up and explain the methodology because this is very important this week in silver.

Finishing up with gold, the technical funds were the big sellers during the reporting week, having sold nearly 8200 contracts, including more than 5300 contracts of new shorts. At nearly 80,000 contracts gross short, the managed money category, for all intents, is close enough to previous record extremes to call the rocket fuel buying tank full. Perhaps some of this fuel was used up in yesterday's rally, but we'll have to wait for next week's report to uncover this. Bottom line, as of the Tuesday cut off, gold was locked and loaded to the upside in COT terms.

In COMEX silver futures, the commercials went the other way, as the total commercial net short position increased by 5200 contracts, to 17,600 contracts. While the lower the total commercial net short position the better, this is still a historically low (bullish) reading. More importantly, and I know this will sound confusing, despite the increase in the total commercial net short position, there was no new short selling by the commercials in the reporting week; the increase in the overall short position came as a result of the selling of long positions by the raptors. (And yes, I say this despite an increase in the commercial gross short position in the legacy COT report; which is explained by an increase in commercial spreading in the disaggregated report. Again, get back to me for greater detail).

What makes the silver COT report so unprecedented and noteworthy this week is that the raptors sold more than 8200 contracts of their net long position and almost 10,000 contracts over the past two reporting weeks. What makes this selling so unusual is that there has never been such heavy raptor selling before on lower prices. Previously, the raptors only sold on higher prices and this is what makes this (and last) week's report unprecedented.

To be fair, prior to yesterdays' COT report, a number of readers had asked me about the possibility that the raptors would blink and sell and take big realized losses on their very large net long position. While I didn't dismiss the possibility completely, since that never occurred before I was skeptical that it would occur. Furthermore, since up until two weeks ago, the raptors were the biggest commercial buyers on the silver price drop, it was reasonable for me to assume that the raptors were largely responsible for rigging the decline (since they were the biggest Â?beneficiariesÂ?). Yesterday's report blows that premise out of the water. Instead, the most plausible explanation is that the almost 10,000 contracts sold by the raptors over the past two weeks, the equivalent of 50 million oz, occurred because the price drop in silver was beyond the raptors' financial capacity to carry these heavily leveraged positions.

There is no law that shields margin calls from accruing to commercial traders, even though up until this recent drop in silver there was never a case of raptor liquidation of long positions in silver on lower prices. Previously, I wrote that commercial traders didn't have the same margin worries as did most speculators, but I was clearly wrong in this case. Let me finish up with the silver COT report before getting into why I am glad to have been wrong.

If the raptors sold 8200 long contracts and the total commercial net short position only expanded by 5200 contracts that means the eight largest short traders had to have bought back 3000 contracts; which they did. The big four shorts bought back 1200 of their short contracts and the big 5 thru 8 traders bought back 1800 short contracts, an unusually large number for them. You have to go back a full year to find a smaller concentrated short position held by the 8 largest trades and back to August of 2012 to find a smaller short position held by the 4 largest traders. Once again, when it comes to bullish price prospects, the smaller the concentrated short positions, the better.

Accordingly, I can peg JPMorgan's formerly manipulative short position in COMEX silver as now being no more than 8000 contracts and quite probably even lower. Never, since acquiring the massive short position of Bear Stearns in 2008, has JPMorgan's silver short position been lower. Considering how much physical metal I believe JPM has accumulated (SLV, Silver Eagles, etc.), JPMorgan has never been better positioned for a real upside move in silver.

The only negative feature to the silver COT report was that the technical funds (in the managed money category) bought back more than 3800 short contracts – thus reducing the amount of rocket buying fuel. Combined with last week, the technical funds have bought back a hefty 6000 short contracts that I would have thought (and preferred) would be bought back at much higher prices. There's no question that the technical funds cashed in on some very hefty profits, perhaps to the tune of $50 to $75 million and this was contrary to my expectations. However, with just over 40,000 short contracts still open, the technical funds have only covered around 15% of the new short contracts they sold since July.

As much as I am surprised (and disappointed) that the technical funds booked such large profits at such low prices, the real message in this report to me were the extraordinary changes among the commercial traders. On the plunge to four year silver price lows over the past two reporting weeks, the raptors sold 9700 long contracts and the big 8 bought back more than 6300 short contracts (with the big 4's share of that being 4000 contracts). Never have the commercials, usually thick as thieves, gone in such different directions. Heretofore, it was always the commercials behaving as the three musketeers Â? you know, one for all, all for one. Not this time.

From the data, here's what I think occurred. The big commercial shorts (JPM) knew that some raptors were stretched thin on margin on a massive long position in silver that totaled 42,400 contracts two weeks ago. When the price of silver suddenly plunged an additional two dollars, the margin calls were overwhelming for a number of the raptors and they were forced to liquidate almost 10,000 of their long contracts. A two dollar adverse move on 10,000 contracts means coming up with $100 million on, quite literally, a moment's notice. If you don't have the $100 million to deposit immediately, you are sold out immediately.

Since the biggest beneficiaries of the price plunge (apart from the technical funds, which, no matter what, are not running the show like the commercials) were the biggest shorts (including JPMorgan) which bought back 6300 shorts at immense profits; it stands to reason that these big shorts orchestrated the whole damn thing. Otherwise, I suppose you would have to believe that the commercials are such clean good guys that someone from above rewarded them. Looking at the almost daily settlements for price manipulation by the big banks, it's not possible they are innocent good guys in any way.

The most important takeaway is that the data over the past two weeks set the stage for either a silver price explosion or what will be the clearest evidence in advance for a coming manipulative cap on the next rally. The great thing about the raptors selling almost 10,000 contracts of existing long positions is that reduces the potential for further long liquidation by the same 10,000 contracts. I had always calculated that the raptors would sell all, or nearly all of their long positions on higher prices, but now that they've sold those contracts on lower prices, that's bullish on its face. It's kind of funny, I had always thought that JPMorgan might buy contracts from the raptors on sharply higher prices, but never imagined it could occur on lower prices Â? but that's what the data indicate.

But more than ever, the current setup brings an old theme of mine directly into the crosshairs. To the point of redundancy, I've written over the years that the speed and extent of any silver rally would be determined by whether JPMorgan and the other 7 big concentrated shorts added to short positions for the purpose of capping the price of silver. The events of the past two weeks bring that premise into sharper focus than ever before. With an assured reduction of potential raptor long liquidation, if JPMorgan and the other big concentrated shorts don't add significant new short positions on the next silver rally (possibly begun yesterday) silver will fly like a rocket to the moon.

In the event these big crooked commercial shorts do add big numbers of new silver shorts, this must be accepted as prima facie evidence of manipulation presented in advance. One thing for sure, with the cost of primary silver production several dollars above the current price, it is not economically conceivable that any new short selling by the big 8 could possibly be for legitimate hedging purposes below $20. After all, no producer looks to lock in a loss when hedging and that means any commercial shorting below $20 can't be legitimate selling. Maybe there is some grey area ahead, but it looks to me like a case of black and white Â? either we explode if the big commercials don't add new shorts or the price gets capped illegally if the big commercial shorts do add new shorts.

In closing, something caught my eye this week that drove home the broader implications of the ongoing silver manipulation. The reason manipulation is the number one market crime is because it distorts supply and demand and the economy far beyond the interests of investors and other interested parties. Manipulation hurts innocent bystanders as well and that's what makes it evil and pernicious.

In reviewing the third quarter earnings release of First Majestic Silver, in addition to learning the company subsequently sold the 900,000 some odd oz of silver it had originally withheld from the market; in order to cut costs due to low silver prices, the company laid off 1100 employees since the beginning of 2013, or more than 22% of its workforce. Gainful employment is a necessity of modern life and to lose one's livelihood through no fault of one's own is sad beyond description. The crooked ongoing COMEX silver manipulation is directly responsible, in my eyes, for 1100 human beings at just one miner being denied the opportunity of supporting their families and God knows how many more at other mining companies. These COMEX silver crooks should be burnt at the stake.
http://www.firstmajestic.com/s/NewsReleases.asp?ReportID=683054&_Type=News-Releases&_Title=First-Majestic-Reports-Third-Quarter-Financial-Results

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Silver – $16.30

Gold – $1188

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