November 23, 2013 – Weekly Review

Weekly Review

Both gold and silver prices fell sharply again for the week, continuing a four week pattern. Gold fell $46 (3.6%) and silver dropped by 90 cents (4.3%) for the week. As a result of silver's underperformance, the silver/gold price ratio widened a bit to just over 62.6 to 1. My main take away from, effectively, the joined at the hip recent price action in gold and silver is that the last thing the relative and absolute price performance represents is true value or real supply/demand considerations.

There can be no doubt that gold and silver investor sentiment is plumbing new depths as a result of declining prices over the past year, month and week. This year's price decline has shattered investor confidence to an extent I don't think I can previously recall. It has been more than two years since gold and silver's price highs, making this the longest and deepest sell-off in decades. It is impossible for any asset to decline as much and for as long as silver and gold have for that not to result in collective investor sentiment being in the dumps, regardless of the reason for the price decline. When price talks, everybody walks.

A pronounced and extended price move, either up or down, in and of itself is what determines collective investor sentiment, so it is no mystery why that sentiment is so low right now in silver and gold. Most often, extreme investor sentiment marks important market tops and bottoms and my sense is that is the case in gold and silver presently. But, that's beside the point. Sometimes, the reason for the extended price movement is even more important than collective investor sentiment. Please let me run through the usual weekly format before returning to this theme.

Movement of metal in the COMEX-approved silver warehouses was headed for the slowest week in quite a while until yesterday's big addition of 2.5 million oz pushed total turnover over the 3 million oz mark again. For the week, total COMEX inventories rose almost 2 million oz to 170.5 million oz, another multi-decade high. The total level of COMEX inventories is secondary; I still contend it is the rapid inventory movement in silver that is the tell. If someone tried to explain silver's price weakness to growing COMEX inventories, he would be at a loss to explain gold's price weakness to the big drop in COMEX inventories earlier in the year.

I attribute the rapid turnover in the COMEX silver warehouses to an underlying tightness in the wholesale supply of physical silver since April 2011. Obviously, there has been no shortage yet; but the turnover indicates a slow-boil beneath the surface. Despite rotten price action, the world is not swimming in physical silver; it is swimming in paper short sales. Therefore, it wouldn't take much of an increased demand to crank the heat up to full-boil. Since it is hard to imagine investor sentiment getting much worse, it is easier to imagine it getting better. On the next up cycle in price, investor demand for silver will set-off the shortage, in my opinion.

I was somewhat surprised that less than 1.5 million oz came out of the big silver ETF, SLV.
I was expecting more to come out as a result of the price decline this week, particularly after Wednesday's high volume sell-off. The big gold ETF, GLD, has continued to shed metal. For the year, GLD has lost 16 million oz, or almost 37% of holdings at year end due to investor disappointment and liquidation due to the price decline. SLV holdings are still up 3% or so for the year, despite even worse price performance than for gold. I don't want to read too much into it, but I continue to sense a greater investor willingness to hold silver compared to gold. If correct, that suggests better relative performance when prices turn higher.

Before getting into the changes in this week's Commitments of Traders Report (COT), let me comment on notes I received from a couple (2) of subscribers this week. In essence, they both asked that I lay off my emphasis on this report and get into the Â?realÂ? reasons for the price decline. I understand that the price decline has undermined investor confidence. I further understand that the COT report is undecipherable to the vast majority of observers and many subscribers expect my analysis. Please don't take this as egotism in any way, shape or form, because that is the last thing I am feeling, but sometimes I feel as if I am the only one who can dig deep into the COTs (who openly writes about it).

The simple message is that trading on the COMEX is the only reason for short term price movement in gold and silver and, thankfully, that is recorded in the COT report. If I thought for a second that price movement came from anything else (the Fed, QE, interest rates, the dollar, etc), I would say so; but it doesn't. Yes, real supply and demand must influence price movement in the long term; but in the short term the only supply and demand that matters is in paper and electronic trading on the COMEX. The remarkable thing is that is proven in just about every new COT report.

There were substantial reductions in the headline number of the total commercial net short positions in COMEX gold and silver in the reporting week ended Tuesday. Privately, I expected a pretty big improvement in silver because even though prices weren't sharply lower during the reporting week, we did witness three days of new multi-month lower price lows.

Successive lower price lows are always the same for technical fund selling as is waving a red flag at an agitated bull in a field; you generally know what's going to happen. Since we did not witness those new lower price lows in gold during the reporting week, I had not expected increased technical fund selling and commercial buying. That we did get that technical fund selling in gold as well, suggests to me that there was some delay in full reporting in the prior week's COT report (since the prior report featured a big price decline on the Tuesday, Nov 12 cut-off).

In COMEX gold, the total commercial net short position was reduced by 14,300 contracts, to 51,500 contracts, the lowest level since the beginning of August. More than 11,500 contracts were sold by the technical funds, including more than 8,000 contracts of new short selling. On the commercial buy side, the four biggest shorts bought back 9,000 contracts and the raptors purchased 5,000 new long contracts.

I would peg JPMorgan's long market corner in COMEX gold futures to have grown a few thousand contracts to 75,000 contracts, or 22.7% of the entire long side of the COMEX gold futures market (minus spreads). Of the 151,919 gold contracts held by 45 different commercial traders on the long side of COMEX gold futures, JPMorgan holds more than 49% of those contracts. If I were to make an example of what type of market share or monopoly this represents, it would be like General Motors controlling a 95% share of the automobile market. That's because futures markets are designed to have no more than a 5% or less share held by any one trading entity.

I have been somewhat surprised that JPMorgan hasn't increased its long gold market corner much more on the dramatic gold price decline recently. Considering how much technical fund selling has occurred these past four weeks, JPMorgan could have bought a lot more gold contracts than it did. Why didn't it do so? Strictly speculation on my part, but I think JPM's glaringly large gold market corner has become obvious enough to have prevented the bank from cranking up the position more, even though it could have done so. It's too soon to know this for sure, but it is something that encourages me.

In a speech yesterday, JPMorgan's top lawyer, Stephen Cutler, lashed out at the regulators for extracting too much in the way of fines from the bank. He asked, Â?At what point does this stop?Â? I'm not trying to be a wise guy, but maybe it will stop when JPM stops violating the law in just about every line of its business. http://blogs.wsj.com/moneybeat/2013/11/22/j-p-morgans-top-lawyer-at-what-point-does-this-stop/

In COMEX silver, there was a very substantial reduction in the total commercial net short position of 5,200 contracts to 17,500 contracts. As was the case in gold, most of the selling came from technical funds, which accounted for 4,500 of the contracts sold, including 4,000 new short sales. By commercial categories, the big 4 (JPM) bought back almost 2800 contracts and the raptors added a hefty 4000 new long contracts. The big 5 thru 8 shorts added 1600 new shorts and it would appear that a technical fund or two may now be in that category given the growth in technical fund short sales.

I would peg JPMorgan's silver short position to be back at the lowest level the bank has been able to achieve over the past five and a half years, or 12,000 contracts. Considering the sharp price drop and high volume in gold and silver on Wednesday (right after the cut-off), JPMorgan's silver short position could be 10,000 contracts or less. In other words, JPMorgan has never been better positioned for a major silver price advance than it is now, particularly considering its long market corner in gold.

Investor sentiment may stink in gold and silver with almost a universal expectation for lower prices ahead, but the COT structure is signaling the opposite. The beauty of the COT report is that it offers the only plausible explanation for the price decline over the past four weeks and in doing so offers the most reasonable explanation for what lies ahead.

Since the COT report of Oct 29, gold prices have declined by approximately $120 and silver prices by almost $3. Coming after the worst gold and silver price year in decades, prices had rallied in the summer by a hefty $200+ in gold and $5+ in silver, in the process encouraging many to believe that the worst was past. But the last four weeks have shattered any investor lift in collective sentiment. The last price leg down always does this. So let's look at the four week price decline in detail.

On the $120 gold price decline since Oct 29, the commercials bought and the speculators (mostly technical funds) sold 55,000 net contracts of COMEX gold, or the equivalent of 5.5 million gold oz. ($7+ billion face value). Of the 55,000 contracts sold by speculators, new technical fund short selling accounted for more than 41,500 contracts, or more than 75% of all gold contracts sold. In silver, 8,600 net contracts were sold by speculators and bought by commercials since Oct 29, with an astounding 11,600 contracts sold short by technical funds, accounting for much more than 100% of the total speculative contracts sold. (Extrapolating since the Tuesday cut-off, it's certain the numbers are more extreme)

You don't have to look far to see why gold and silver prices fell over the past four weeks Â? new technical fund short selling on the COMEX. That's a fact, Jack. And you don't even have to accept my version that JPMorgan and other collusive commercials lured the technical funds into those short sales by lowering the price at key points, through HFT and spoofing. Let's leave that aside and just look at the data in the COT reports and other indisputable facts. What can be said about the technical fund short sales?

For one thing, no one would argue that technical funds are anything other than pure speculators, trading the markets for profit and assuming the associated risks. While there is no one single technical fund that I can identify (like I can identify JPMorgan), there is also no question that the collective actions of the technical funds do influence the price as they were almost the exclusive sellers on this four week decline. Since the technical funds are speculators (not hedgers or market makers) and their collective selling is what caused gold and silver prices to decline over the past four weeks, then these speculators clearly manipulated prices lower (whether they were tricked by the commercials or not).

What I just described is against commodity law and the CFTC and CME know or should know this. It is unlawful for speculators to set prices and the prime purpose of commodity law is to prevent this from occurring. Commissioner Chilton has long complained about the Â?massive passivesÂ? on the long side of many commodities, but speculative short selling that can be proven to have caused extreme price movement is infinitely worse.

Another fact is that technical funds rarely make or take delivery on metals futures contracts. There is no reason for technical funds to mess with delivery because they are merely speculating on price change. These funds buy when they think prices are going higher and sell when they think prices are going lower and they change their mind as often as price changes, which is never ending. That also makes the technical funds the weakest of all holders in that they can and do change their positions in a heartbeat, or more precisely, when the price changes.

In up markets it feels good when the technical funds buy because that pushes prices higher. But it is also what creates the risk and occurrence of big price declines when the technical funds eventual sell on lower prices. It is the opposite in down markets because technical fund short selling feels very bad to investors and producers because it lowers the price, like now. But it is also true that once the technical funds are finished with adding new short sales and depressing the price, it is only a matter of time before they buy those short contracts back on rising prices. After all, since they have no interest or capability to make delivery, technical funds must buy back short sales at some point.

When and what is that some point? Since this is the purest definition of a market bottom in gold and silver possible, it must be the question most pertinent. No one can know for sure in advance, but there are still some hard facts we can draw on in trying to determine when the technical funds will stop adding to short positions and begin to buy those short positions back. We know that there are a finite number of contracts that technical funds can go short in gold and silver, mainly because there are a finite number of technical funds.

Knowing that the number of new technical fund short contracts is not infinite, the most reasonable way of estimating the maximum number of contracts to be shorted is by how much the technical funds have shorted in the past. As it turns out and particularly if the selling on Wednesday represented additional technical fund short selling, we are close to or at the maximum number of gold and silver short contracts that the technical funds have ever held. While it is always possible for the technical funds to sell slightly more additional gold and silver contracts short, there is nothing to suggest that there should be substantially more contracts sold short. I didn't predict this four week price decline but I have always explained over the past six months that any down moves must be accompanied with big short selling from the technical funds. That has now occurred.

The important point is that technical fund short selling, in addition to causing prices to decline, is guaranteed to lift prices when, not if, those short contracts are bought back. It was technical fund short covering that caused gold prices to rise by more than $200 and silver prices to rise by $5+ this summer and it will be technical fund short covering behind the next gold and silver rally. The additional twist in silver is whether JPMorgan artificially caps the next silver rally by adding manipulative shorts as it did this summer (and on every previous silver rally).

I wish there were no such thing as technical funds and manipulative commercial banks. But since they do exist, the next best thing for a bull is having the technical funds as heavily short as they are currently. There is no doubt that the recent technical fund selling has caused prices to decline and that decline has destroyed collective investor sentiment. But the technical fund short sales are open transactions that must be closed out at some point.

The buyers (the commercials) know this better than anyone and that is why they buy all that the technical funds care to sell short. You can be sure that the sentiment of the commercials is not like the sentiment of gold and silver investors because the commercials know what happens next. While no one can pinpoint a precise bottom in advance, it is hard to imagine more signs of a bottom than exist at this time. As always, if the commercials will it so, the next rally will be incredibly steep.

One closing comment on COMEX copper, which I mentioned on Wednesday as undergoing the same sharp increase in technical fund selling and short selling as has occurred in COMEX gold and silver. The latest COT report for copper confirmed a sharp rise in technical fund short selling to a near record and prices did bounce impressively late last week. I'm not intending this as trading advice, but I am watching it evolve as I believe the exact same forces are at work in COMEX copper as are in play in gold and silver and the sharp rally in copper prices that I expect may influence the timing of the coming gold and silver rally.

However, what looks so clear to me in COMEX gold, silver and copper is not at all in play in crude oil, where I expected a price decline due to a record commercial net short position in the summer. There has been no real reduction in that commercial net short position (or technical fund long position), despite a significant price decline in crude oil. This causes me to quit while ahead and admit that what's moving crude oil prices is not what I thought. Believe it or not, I'll say the same thing in gold and silver if the data say so. So far, that's not close to being the case.

Ted Butler

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Silver – $19.85

Gold – $1244

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