September 13, 2014 – Weekly Review

Weekly Review

The two-month price decline in gold and silver accelerated this week, pushing prices to the lows of 2014 (and back to 2010 in the case of silver) on a closing basis. Gold ended $40 (3.2%) lower, with silver finishing the week down by 60 cents (3.1%). I don't know why there seems to be a magnet at the 66 to 1 level for the silver/gold price ratio over the past month. I'm almost certain short term volatility in the price ratio will return and where I usually plead ignorance about the direction short term for the price ratio, with gold and silver prices groping for a bottom, it seems reasonable that when prices turn higher, silver should lead the way up.

It's hard to be cheerful with silver prices at 4 year lows, particularly considering that the price has been manipulated lower, but at least the oppressive price behavior forces a critical examination of what has caused it and the likelihood for that to change. The cause for price change in silver (up and down) for the past four years and longer has been speculative positioning on the COMEX. So strong has the COMEX been at dictating silver prices that the only force that could possibly overcome it is the physical market itself.

The good news is that enough signals are emerging from the physical silver market to believe that change may be at hand. In addition, the market structure on the COMEX, the prime source of the manipulation, is now configured bullishly and highly supportive of higher prices. So while it's hard to be cheerful about past silver performance, it's real easy to be optimistic about where prices go from here. Let's review the signals coming from the physical silver market recently.

If my suspicions are correct, the most important signal emanating from the physical silver market is the turnover or movement of 1000 oz bars of silver into and out from the COMEX-approved warehouses. I have been reporting on this weekly for the past three and a half years since the rapid turnover first commenced. For some reason not entirely clear to me, the unprecedented physical warehouse movement has gone virtually unnoticed, or at least not discussed. I would think it would and should be a prime issue for wide debate.

This week, 9.1 million ounces of silver were moved into or taken out from the COMEX silver warehouses, about the highest weekly turnover yet, as total inventories rose 1.6 million oz to 181.8 million oz. Taken with the above average turnover over the past few weeks, if anything, the turnover seems to be intensifying. The 9.1 million oz turnover this week was more than 56% of all the silver mined in the world for a week (16 million oz). Considering that this spectacle of physical turnover is unprecedented in any other commodity, is it unreasonable to wonder why it exists only in silver and in the warehouses licensed by the COMEX?

Another thing I've noticed is that along with the turnover intensification, there seems to be more full truckload lots of 600,000 oz being moved in and out. One day this week there was a three truckload shipment to one of the warehouses. The trend towards more full truckloads in the turnover seems to add to the suggestion of intensification. If this isn't indicative of a tightening physical silver market, then I am a loss to give you a plausible alternative explanation.

An additional signal in the physical silver market that has been unusual and unexpected (at least by me) are the deposits into the big silver ETF, SLV. This week close to 6.5 million oz of silver were deposited into the trust and over the past four weeks nearly 14 million oz have been deposited. I don't recall a previous occasion of extended price weakness and significant metal inflows into the SLV, so the deposits were certainly unexpected by me. Clearly, there have been no net inflows into the big gold ETF, GLD, further highlighting the deposits into SLV. Between a different COMEX warehouse movement pattern and dissimilar ETF metal flows, the stagnant level of silver/gold price ratio becomes even more suspicious.

So why are such big physical silver deposits coming into SLV on pronounced price weakness? One of my pet theories for metal deposits into hard metal ETFs on price weakness has been to close out short positions. That does offer a partial explanation, as the short position in SLV has been steadily reduced over the past couple of months, including a 1.5 million oz reduction in the period ended August 29, to 14.3 million shares (oz).
http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

While depositing metal into the trust has resulted in a reduction of the short position of SLV, there has been more silver deposited than is accounted for by short position reduction. Aside from short position close outs, why has so much silver come into the SLV? The most plausible explanation is that metal has been deposited to satisfy net new buying, just as is proscribed by the prospectus. This is the way it's supposed to work Â? net new buying in SLV (or GLD) must be backed by additional metal being deposited. Please know that I'm not intentionally trying to seek out the most bullish interpretation – sometimes the most plausible explanation happens to be bullish, as appears to be the explanation in this case.

The real question is who is behind the net new buying of SLV shares? By process of elimination, we know it's not technical trend-following or price-momentum traders because these traders never buy on extended price declines. By default, the new net buyers of shares of SLV must be value-type traders, attracted by silver's low and undervalued price. As such, it would appear that these new buyers in SLV are unlikely to sell on yet-lower silver prices and may continue to buy. I may be missing something, but I don't see how this is bearish.

I also can't help but make a connection with the unusual pattern I uncovered of the buying of COMEX silver futures contracts on price weakness starting last year and continuing recently (although not in the latest COT report) in the managed money category. Like the net new buying in SLV on price weakness, the buyers in the gross long category of managed money are behaving in a different manner than previously. I'm not suggesting that the new SLV buyers and the buyers of silver futures in managed money are necessarily directly related, but rather that they share a common opinion that silver is undervalued and a great prospective investment. That's certainly an opinion they share in common with me and, I believe, with most of you as well.

Taking a break from the strong signals in the physical silver market in COMEX warehouse turnover and of apparent net new buying in SLV in reaction to low silver prices, the changes in this week's Commitments of Traders Report (COT) serve as the nexus for why prices are low to begin with. While I had expected more significant technical fund (managed money) net selling than was reported in COMEX gold, silver and copper, at least there was net selling, as well as counterparty commercial buying in all three markets.

In COMEX gold futures, there was a reduction in the total commercial net short position of 5600 contracts, to 98,000 contracts, another three month low. We're now down 68,000 contracts (6.8 million oz) from the high point of commercial shorts on July 8. By commercial category, the big 4 shorts bought back 2500 short contracts and the raptors bought 3000 contracts. Interestingly, both the big 4 and big 8 short traders in COMEX gold now hold their smallest (most bullish) net short positions of 2014. For such a relatively small total net commercial change for the week, JPMorgan accounted for a fairly large share in adding 2000 contracts to a long position now at 25,000 contracts.

On the speculative selling side of COMEX gold, the technical funds added nearly 5300 new shorts, much less than I expected on the stair step decline during the reporting week. And there was some unusual buying of nearly 2600 contracts on long side of the managed money category, suggesting some non-technical fund undervaluation buying as has occurred in silver. With a gross short position of 58,500 contracts, we are still shy by 15,000 contracts from the technical fund short peak of 73,500 contracts of early June. Undoubtedly, we are much closer to that peak as a result of trading since the Tuesday cut-off.

In COMEX silver futures, there was a reduction of 2300 contracts in the total commercial net short position, to 30,000 contracts. Somewhat unusually, the big 4 accounted for all of the change and then some in buying back more than 2800 short contracts. The raptors bought 200 contracts, increasing their net long position to 31,000 contracts and the big 5 thru 8 were net sellers of 700 new shorts. There's no question that the standout feature on the commercial side was the aggressive buying by JPMorgan which I calculate came to nearly 3000 contracts and reduced the bank's net short position to 14,000 contracts.

Not only is this near the lowest concentrated short position in COMEX silver for JPMorgan this year (only slightly above the year's low of 13,000 contracts of June 17), the reduction adds to a feeling that has occurred to me recently. I get the feeling that JPMorgan wants to wash its hands of this silver manipulation and is trying to ease towards the exits.

Of course, I can't know this for sure, but in addition to reducing its net short position in silver once again, JPMorgan seems to have recently withdrawn from COMEX gold and silver deliveries, particularly in its house or proprietary trading account. Before this recent absence, JPMorgan was the leader in making and taking deliveries of COMEX gold and silver. The reduced size of the concentrated short position in silver and its virtual disappearance on the gold and silver delivery front seem to suggest the bank may have had enough of the manipulation scam. Time will tell, but if I were in charge at JPM, I'd rid myself of this involvement, if at all possible.

On the sell side of COMEX silver futures, the technical funds added nearly 1500 new short contracts, where I had been expecting much more. Still, at more than 37,000 contracts gross short in the managed money category, there have been only two other weeks when the short position was larger and it is possible the technical funds sold short the additional 6000 contracts needed to hit the record since the cut-off.

There were more than 1800 long contracts liquidated in the gross long position in managed money. I'm inclined to believe that this was long liquidation from very stale tech fund longs, rather than selling from the new longs buying on the way down I've talked about. To be fair, I can't substantiate that except when resorting to the most plausible explanation template. By the way, in this or in any other instance, if you ever disagree with what I allege to be the most plausible explanation for anything, please give me your version.

Here's my version of what I thought when I first reviewed the latest COT report Â? had I known the technical funds didn't add the number of new shorts I had anticipated, I probably would have held off for a short while longer before topping off and buying calls. For me, it's not just the price, but the price relative to market structure, or how close we are to maximum technical fund extremes. I had extrapolated that the technical funds sold short enough to be at a record and didn't want to wait for the release of the new report. As it turns out, I feel the same way after the market action since the cut-off on Tuesday, so I would be buying a few days later anyway.

Silver (and gold) looks much closer to a bottom in terms of price and market structure than last week. If and when new price lows are established, both the price and, undoubtedly, the market structure will only reinforce the premise of a bottom. That might sound elementary to a value investor or one who studies market structure as I do, but new price lows are treated by many as a cause for great concern and certainly not as a reason to buy. Let me give you an example of what I'm talking about.

Recently I read a fairly lucid account of why gold was undervalued and worthy of purchase; with the author giving a long list of valid-sounding factors supporting his case, ranging from supply/demand to numerous technical reasons. The price of gold was around $1300 at the time. But after his most convincing overall proposition, he concluded by stating that if the price fell below $1240 to abandon all positions immediately. I understand the principle of attempting to limit investment risk, but I have trouble abandoning an undervalued investment just because it became more undervalued. That's particularly true if the reason why the undervaluation exists is known and is expected to reverse course. This is precisely the case in silver presently.

Silver is undervalued on every objective metric possible, ranging from its primary cost of production, to its relative price valuation compared to every other commodity or asset, to how little is available for investment, to how far it is below its recent price peak. It can be demonstrated how silver has the most concentrated short position relative to actual production or consumption. Now, in addition to the uneconomic concentrated short position of the 8 largest commercials shorts, a separate short position is held collectively by technical funds who must and will buy back on the next price rally.

It has been the short selling by the technical funds on the way down, followed by technical fund buying on the way up that has explained every silver price move over the last year and much longer. I can't see how that pattern won't hold in the near future. Since the technical funds are close to done in adding new shorts, more attention should be placed on what happens when they turn. In addition, we are getting strange signals from the physical silver market in the form of unprecedented warehouse movement and deposits in the big silver ETF, SLV.

The only real risk in buying silver now is if one buys on margin and must sell if prices fall sufficiently from here. That's a risk safely eliminated by not buying on margin. Knowing that silver has been and is manipulated in price means always knowing it can move lower if the commercials decide it to be so. By only buying on a cash basis or speculating with fully-paid for options, the remaining risk is reduced to the time waiting for prices to turn and the embarrassment (in my case) of missing the bottom in time and price. This continues to look like an especially opportune time to buy silver and that will only strengthen on lower prices.

Ted Butler

September 13, 2014

Silver – $18.60

Gold – $1228

Date Created
2014/09/13