September 15, 2012 – Weekly Review

Weekly Review

For the fourth week in a row, the price of gold and silver closed higher; gold by $38 (2.2%) and silver by one dollar (3%). In a slight change this week, the big day up accounting for all of the week's gains was Thursday, following the Fed's announcement of more monetary stimulus. Both gold and silver reached six month highs and the gold/silver ratio tightened in slightly to close to 51 to 1, reflecting silver's slight outperformance this week.

Over the past four weeks, we have witnessed an impressive rally in gold of $156 (9.6%) and in silver of $6.65 (23.7%). The main cause for the rally in each appears to be speculative buying of COMEX paper futures contracts which was met with customary commercial (mostly bank) selling. In gold, net speculative buying/commercial selling over the past 4 weeks amounted to 93,000 COMEX contracts or the equivalent of 9.3 million paper gold oz. In silver, the specs bought and the commercials sold nearly 24,000 contracts or the equivalent of 120 million oz. This is through the Tuesday cut-off of the COT report (which I'll cover in a moment).

Since these amounts of COMEX paper metal contracts were much larger than the verifiable amounts of gold and silver produced or consumed or bought and sold in ETFs or anything else, over the past four weeks, it is reasonable to conclude that COMEX trading activity and positioning was the prime cause behind the rise in price. My intent here is simply to identify what appears to be the prime cause behind the recent price rise in gold and silver; nothing more, nothing less. After all, this is a subscription advisory service purporting to analyze silver and gold, so it would seem appropriate to attempt to answer what was behind an impressive price rally. Therefore, the most direct explanation as to why did gold and silver just go up would seem to be positioning on the COMEX.

I'm taking time to go over something that appears very simple because you rarely hear or read that simple COMEX explanation for why gold and silver prices moved up or down, even though all the verifiable data point to the COMEX. I'll get into more detailed analysis on the COT and some speculation, but I just wanted to point out how amazing it is to me that there is so little public recognition that the COMEX pricing mechanism is usually the prime component in setting gold and silver prices and not the usual reasons offered.

Turnover in metal coming into and moving out from the COMEX-approved silver warehouses cooled slightly this week, but only compared to recent heavy activity. Total COMEX silver inventories increased less than 300,000 oz to just under 141.7 million oz. The most plausible explanation for the frantic turnover among COMEX silver warehouses is still tightness in supply. But another strong indicator of tightness in the wholesale physical silver market has emerged recently in the form of the lack of deposits coming into the big silver ETF, SLV. I'm still scratching my head about the lack of a big increase in the latest SLV short sale report, but in addition the strong one month silver price rise on heavy SLV trading volume Â?shouldÂ? have resulted in many millions of silver oz being deposited into the Trust. I can't help but wonder why those silver deposits haven't occurred.

I'm aware of Internet rumors and reports of heavy physical silver demand and long delays in silver shipments, but I hate to rely on such rumors, not the least reason being that it strikes me as unprofessional to report on such rumors. However, sometimes where there is smoke, there is fire. The lack of deposits into the SLV is another matter, at least to my mind. Recently, I discussed the mechanical nature of silver metal acquisition in the SLV being based upon net new buying, which most usually occurs on price rallies. Clearly, we have had a price rally and volume pattern over the past month where net new buying should have occurred in SLV, along with an almost automatic increase in silver deposits into the Trust. So what it comes down to is this Â? either there was no net new buying in SLV (despite the volume and price) or there was net new buying and the silver wasn't deposited for some reason. If it was the latter circumstance, the most plausible explanation would seem to me to be because the physical silver wasn't available for deposit. If true, this puts a capital Â?TÂ? on silver tightness.

In the somewhat distant past, I explained a theory of mine regarding the silver manipulation, comparing the distribution of physical silver to the Â?triageÂ? operating principal in a hospital emergency room, where the patients in most urgent need of care are given top priority. The big paper short sellers in COMEX silver are also the prime wholesalers and distributors of physical metal. Since silver is both demanded as an industrial material and as an investment asset, there is a different profile between silver industrial users and silver investors. In our just-in-time world of manufacturing and inventory control a silver industrial user must have the metal delivered when it is needed and not much later. The element of timely delivery is less critical to a silver investor (although no one wants to be lied to that silver has been deposited when it hasn't). The big COMEX silver short sellers know this better than anyone and given the choice between delaying delivery to a silver user versus an investor, the shorts will deliver to the industrial user first ever time. (An exception may be with a vocal silver investor, like Sprott).

The big silver manipulators know that if the users are delayed too much, they may panic and order extra, setting off a shortage and price conflagration to the upside. That must be avoided at all costs by a silver short seller. Investors are much less likely to panic by delivery delays and in most cases, not even be concerned or aware of such delays. My point is that if the lack of deposits into the SLV indicates a conscious choice by the silver shorts to deliver to the users at the expense of timely deposits into the Trust, it still indicates a silver supply/demand situation that can only be described as extremely tight. Leaving aside all the other ramifications of this circumstance, if I am anywhere near close on my triage explanation, conditions in physical silver may be tighter than believed. If there is anything that can rout the shorts in silver it would have to be a shortage of material becoming known.

The changes in this week's Commitment of Traders Report (COT) basically conformed to the price pattern of the past four weeks as described above. Since we went up in price in gold and silver because of COMEX positioning, that positioning must be reflected in the COT headline number. For the reporting week ended Tuesday, gold was up by $40 and silver by more than $1. Accordingly, the total commercial net short position in gold increased by 17,700 contracts to 237,100 contracts, while the total commercial net short position in silver rose by 2400 contracts to 47,300 contracts. In gold, this was the highest commercial net short position since the day of the top on Feb 29; in silver, you have to go back to Sep 2011 or just before silver plunged 35% in three days.

All three gold commercial categories added to their short positions, with the big 4 accounting for the largest share with 12,000 new short contracts. The gold raptors (the smaller commercials apart from the big 8) added almost 4000 contracts, lifting their net short position to 55,200 contracts, another new raptor record. The 5 thru 8 biggest gold shorts accounted for the balance. Over the past 4 COT reports, the big 4 went from a record low number of net short contracts by adding more than 45,000 short contracts. Over that same time frame, the gold raptors added almost 40,000 contracts. Forty thousand contracts (4 million ounces) here and forty thousand more contracts there and pretty soon you're talking big quantities on the short side.

In silver, of the 2400 contracts added to the commercial net short position around 1400 were sold short by the big 4 (read JPMorgan), with the 5 thru 8 adding 700 contracts short. The silver raptors sold 300 contracts from net longs and reduced that net long position to 5100 contracts. Over the past couple of weeks, the raptors haven't done much selling and have indicated they are in no hurry to get short silver.

I would peg JPMorgan's silver short position to be around 27,000 contracts as of the Tuesday cut-off, or the equivalent of 135 million oz. From the 14,000 contracts they held short at the beginning of July, JPMorgan has roughly doubled their manipulative silver short position. If my calculations are correct, this is a short concentrated short position without precedent, except by previous JPM benchmarks in silver. After removing spreads (in the disaggregated COT report), JPMorgan's share of the true net total COMEX silver open interest is now 28.8%. In any normal and non-manipulated major futures market, regulatory alarms should go off if any one participant held more than a 5% or 10% share of the market (remember the proven copper manipulation in which the Sumitomo trader was called Mr. 5%?). Even if my calculations for JPMorgan are off a bit (I don't think they are), the fact that the 4 largest shorts hold more than a 46% share of entire net COMEX silver futures market indicates a dominance and control rarely, if ever seen in any other market before. It's actually worse if some other big entities in the big 4 are working collusively with JPMorgan, rather than JPM doing all the heavy silver shorting as I contend. That the regulators (the CFTC and the CME Group) and JPMorgan have been silent in the face of such specific allegations of concentration and manipulation is astounding, particularly as more come to learn the true facts.

Since the big Thursday price advance took place after cut-off, it would appear that the COT structure has grown even more extreme. As such, there is real danger and opportunity present in gold and silver at this juncture. In the recent past, some of the biggest price smashes on record have occurred when the gold and silver COT readings have been as extreme as they are now. As I indicated above, one year ago we witnessed perhaps the largest and most deliberate takedown in commodity market history, when the price fell $15 or 35% in three days. That sell-off was due to a commercial rig job with COT readings largely the same as now. It occurs to me that neither the Commission, nor the CME, or even Commissioner Bart Chilton has even so much as mentioned any reference to the largest and most deliberate commodity sell-off in history. Whatever happened to protecting and serving the public?

If we do experience a sharp sell-off in silver and gold, it will not be for any other reason than the commercial shorts rigging prices lower for their own benefit. It won't be because of the Fed or the dollar or anything else; it will be due to commercial paper manipulation on the COMEX. That's the clear danger now present in the market. But in danger often also comes opportunity. Izzy called it the Full Pants Down. He also always maintained, as do I and countless others, that the physical market will one day trump the crooked COMEX paper silver market. Above all else, a physical silver shortage will bust the market to the upside. If that physical silver shortage happened to arrive just as the biggest silver shorts were most exposed on the short side, no prayers or divine intervention would help them.

For sure, we have strong evidence of danger in the extreme commercial net short position of COMEX gold and silver. However, if the wholesale silver market is as tight as the COMEX inventory turnover and lack of deposits into SLV suggest, then the opportunity of explosively higher prices may also be at hand. Accordingly, it's hard for me to see how this can be resolved quietly and without extreme price volatility.

In addition to the one year anniversary of the historic price smash in silver, we are now at the four year anniversary of the CFTC silver investigation. That investigation was initiated due to revelations of the massive concentrated silver short position of JPMorgan. Four years later, JPM's massive concentrated silver short position remains at the heart of the silver manipulation. A month ago, the Financial Times ran a story suggesting the probe into JPMorgan would be dropped due to insufficient evidence. I chimed in that the CFTC would likely find no wrongdoing. It may turn out that the phony investigation will still be dropped, but considering how JPMorgan largely doubled its manipulative silver short position in the interim, any CFTC announcement of no silver manipulation will be scoffed at by larger numbers of observers than otherwise.

One of the main forces that could make the current circumstance of danger/opportunity tilt towards opportunity is the possibility that a super large investor could pick up the scent of JPMorgan being vulnerably exposed on the short side of silver. It is still amazing to me how that hasn't occurred yet. It does not matter if it is JPMorgan acting alone or with the benefit of US Government backing; the vulnerability resides in the fact that a physical shortage trumps a paper short position, regardless of who the paper short may be. All such a large investor would have to do is buy physical silver in sufficient size anywhere in the world. It sounds simple because it is. You can short paper until the cows come home and with the effect of capping prices if the buyers agree to stick to paper purchases (like future contracts). But if enough buyers demand physical, the sellers must deliver physical silver. How that hasn't occurred yet is a bit of a mystery, but therein also resides the opportunity. Buckle up.

Ted Butler

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Silver – $34.70

Gold – $1773

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