

September 17, 2016 – Weekly Review

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Yet another Friday selloff contributed to gold ending the week down \$18 (1.4%) and silver finishing down by 25 cents (1.3%). As a result of the equal relative percentage price decline, the silver/gold price ratio finished flat at 70 to 1. Of more significance is the fact that gold closed at its lowest weekly finish in three months, with silver nearly matching that price pattern.

After surging in their best start in decades after yearend, gold and silver have traded sideways to lower over the past three months. Ask a hundred different observers to explain this price behavior and you're likely to get close to a hundred different explanations. Ask me and you'll get the same explanation for both the initial surge and the trading chop since COMEX futures contract positioning. Gold and silver prices soared in the New Year primarily due to massive and historic technical fund buying (and commercial selling) and have stalled as that buying and selling stabilized. The question is what happens next?

The answer depends upon future changes in COMEX positioning. According to my brand of market structure analysis, it would take massive new managed money technical fund buying to send gold and silver prices on a path resembling this year's early upward path. I'm leaving out sharp but moderate rallies followed by just as sharp setbacks, like we've seen over the past few months, as the commercials trick the technical funds in short term trading campaigns. If massive new technical fund buying does occur, it could overwhelm the commercial shorts in which case prices will explode.

The biggest risk for a selloff of significant proportions remains the same – the prospect of the managed money traders selling in earnest, both in terms of liquidating historically large long positions and adding to historically low short positions. Based upon past technical fund behavior, this is the way it has always turned out previously and forget this being the biggest risk for a selloff; it's the only risk (against more bullish factors than you can shake a stick at). I'll come back to this after running through the usual format and some new developments.

The turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses this week came to a "normal" level of 5.7 million oz or at an annualized rate of nearly 300 million oz. I've only reported on the frantic physical turnover in silver over the past five years because that's the only commodity featuring such high turnover. That's what makes the silver turnover so special.

It was mostly an "in" week, as total COMEX silver warehouse inventories rose by another 3.6 million oz to 169.3 million oz, another new one year high. From late June, COMEX silver inventories are up by around 19 million oz. I know the physical turnover is special and unique to silver, but I can't attach any price significance to the moderate growth in total inventories. How much price impact could 19 million oz have over three months compared to the many hundreds of millions of ounces of paper contracts held by the technical funds and commercials?

By the way, more than half a million ounces were deposited into the JPMorgan COMEX warehouse this week, suggesting to me that while JPM has backed off in its accumulation of physical silver, I haven't seen any signs of the bank disposing of physical metal. Although I'm convinced JPM would sell some physical silver if that enabled it to buy back more of its COMEX paper short position.

The September delivery process in COMEX gold and silver is mostly uneventful, even if there are some new contracts being added recently. JPMorgan is only the third largest stopper of silver deliveries this month, taking 340 of the nearly 2500 contracts issued so far. Up until this month, JPMorgan was practically the sole stopper of COMEX silver deliveries over the past year and a half. Seeing as JPM could remove all available physical silver at will, my impression is that it is laying back so as not to tighten the physical market (and perhaps make it easier to rig prices lower to set off technical fund selling).

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

Same thing in Silver Eagles where current sales are so weak after a five year run of absolutely phenomenal sales. I've listened to every explanation offered for how sales could be so strong for so long, only to plunge the past few months and none come close to my explanation of JPMorgan stepping aside (just as it has in COMEX deliveries). But I promise to maintain an open mind on the matter and if you have other explanations, lay 'em on me.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

On to the changes in this week's Commitments of Traders (COT) Report. I didn't offer any specific predictions for yesterday's report, but expect that most anticipated a reduction in the total net commercial short position and managed money long position. After all, gold and silver prices were down every day of the reporting week and penetrated the 50 day moving average in each to boot.

One look at a price chart of the reporting week should drive home the meaning of the term "salami slicing"; the series of fresh new price lows that compel technical funds to sell. If the new COT report hadn't shown commercial buying and managed money selling, quite frankly, I would have been unable to sleep last night because I would be at a loss for what to write today. I guess what I'm saying is that it would have been close to impossible for the commercials and technical funds not to have behaved as they did during this reporting week, barring some type of serious reporting error. After all, this is what market structure analysis is all about.

In COMEX gold futures, the commercials reduced their total net short position by 18,600 contracts, to 311,400 contracts. It can't be considered coincidental that the same three months that gold prices have chopped around have occurred as the headline number has remained near the 300,000 contract level, a level never achieved previously.

All three commercial categories in gold bought back short positions – the big 4 bought back 2700 short contracts, the big 5 thru 8 bought 2400 and the raptors bought back 13,500 short contracts. This is as of the Tuesday cutoff; undoubtedly, there has been additional commercial buying through yesterday. My biggest concern, away from the overall level of total commercial net shorts is that the 4 biggest commercial shorts still hold such a large percentage (67%) of the total net commercial shorts. If any market is manipulated, as I believe COMEX gold and silver to be, then it has to be manipulated by someone big and no one is bigger or more manipulative than the 4 traders so designated by the CFTC.

On the sell side of gold, the managed money traders sold an even heftier 26,500 net contracts, including 20,061 contracts of long liquidation and the new short sale of 6497 contracts. The sale of this many managed money gold contracts sets up the possibility of another sharp rally up through the 50 day moving average in which the managed money traders then buy as commercials go short more. It also sets up the possibility of continued managed money selling on still lower prices.

In COMEX silver futures, the total commercial short position was reduced by only 2900 contracts to 96,700 contracts, still at nose-bleed bearish historical extremes, as is the case in gold. The standout feature was that the raptors were the only commercial category which bought silver contracts, as these smaller commercial traders added 5200 contracts to a net long position now measuring 10,000 contracts. The big 4 added 1800 new short contracts and the big 5 thru 8 added 500 additional short contracts. I'd peg JPMorgan's short position to be 32,000 contracts after the report this week.

On the managed money side of silver, these traders sold more than 9,000 net contracts, including the liquidation of 5206 long contracts and the new short sale of 3928 contracts. As a whole, the commercials only bought 2900 silver contracts, but the managed money traders sold over 9000 contracts. Let's look a bit deeper.

Both in terms of numbers of contracts and as percentages of total open interest, the concentrated short positions of the big 4 (74,090 contracts and 38.2%) and of the big 8 (106,674 contracts and 55%) are the largest in history. The price of silver is still down by nearly 60% from its high five years ago, yet the short concentration is larger than ever. Oh, and not one of the concentrated shorts is a legitimate hedger, just big banks speculating excessively and gambling with government guaranteed depositor money.

In a reporting week in which silver fell in price each day and penetrated its 50 day moving average and in which managed money traders sold heavily, only the smaller commercial traders I call the raptors bought of the three commercial categories. What I would ask you to consider is what the price of silver would have been if the biggest concentrated shorts hadn't added to their short positions or actually bought, as is usually the case when the managed money traders sell heavily?

What stands out to me is that in a down reporting price week, the largest 8 concentrated commercial shorts were still required to add 2300 new short contracts. The 8 concentrated gold shorts bought relatively small numbers of contracts back, but at least they bought into managed money selling. In silver, fairly large managed money selling didn't allow the biggest concentrated shorts to buy any short contracts back and, in fact, the concentrated shorts in silver needed to sell enough additional contracts short to drive prices as low as they got.

Let me make this simple and invite any alternative explanations. In a reporting week in which silver fell as much as \$1.30 (6.5%), the 4 and 8 largest concentrated shorts were required to add 2300 new shorts. I think it is mathematically and practically impossible for these new short sales not to have pressed the price lower. There is no doubt in my mind that this represented a deliberate attempt by the large concentrated shorts in COMEX silver to set silver prices low enough so as to make it easier to rig still lower prices in which the big 8 will be finally able to buy back shorts. Sell some additional contracts short now so that they can buy more contracts later at lower prices. I can't even conceive of a different motive away from sheer desperation to keep prices low at all costs before a complete commercial failure. All that remains is observing if the price rig is successful or not.

There were a number of announcements and newspaper stories that pertain to issues covered here that caught my eye this week. One was the announcement from the CME Group that it intended to initiate futures contract trading on the silver/gold, platinum/gold and platinum/palladium spread price ratios. In the interest of preserving analytical objectivity, let me report on this in the good, the bad and the ugly format.

<http://www.kitco.com/news/2016-09-15/CME-To-Launch-Gold-Silver-Ratio-and-Spread-Contracts-Next-Month.html>

First, the good ^? in terms of futures trading, this sounds like a pretty good idea and I'm surprised no one thought of it sooner. Currently, one has to simultaneously hold a short contract of one metal and a long contract of another metal to effect a ratio trade, so trading just one single contract that incorporates the changes in price ratios is a lot simpler. For those (not me) desiring to trade the silver/gold price ratio on a short term and highly leveraged basis, the proposed new contracts seem pretty clever. Most newly proposed contracts fall by the wayside or fail to catch on ^? these may fare a little better.

As to the bad, I would imagine the same high odds of failure await the average investor who decides to take a plunge and bet on price ratios short term as exists in other futures trading. Given the zero sum nature of derivatives trading, the few tend to make what the majority loses and few investors are wired for the risks of futures trading. It is said that only one out of ten succeed in futures trading speculation and that, in turn, 90% of those who speculate in futures end up losers. Additionally, the new contracts will be cash or financially settled, as opposed to offering a physical delivery feature ^? which happens to be the key mechanism legitimizing COMEX gold and silver contracts. That mechanism is completely missing in financially settled price ratio contracts.

Also in the bad category – at current levels for the silver/gold ratio, I would imagine most would prefer buying silver/selling gold and that means those taking the other side of most transactions would be the same crooked commercials who manipulate prices ordinarily – this just gives them more leeway to manipulate without the requirement to deliver physical metal. In my opinion, these commercial crooks don't need more opportunity to manipulate. I think silver will outperform gold long term and suggest swapping physical gold positions for silver, but the last thing I would do is to suggest anyone do that on a short term basis and with great leverage (essentially, on borrowed money).

Finally, in the ugly category, these new contracts are completely lacking in any legitimate hedging substance and are clearly intended as purely speculative instruments. Not to be a scold, but the economic justification for regulated futures trading and the reason congress authorized it in the first place is for price risk to be transferred from producers and users to speculators. What legitimate producer or user holds unwanted price risk based upon the silver/gold price ratio?

As it stands now, very few, if any legitimate producers or users deal in COMEX gold and silver contracts for legitimate hedging purposes, but at least there exists the possibility of hedging. The hedging possibility doesn't exist in ratio futures, despite the CME's statement of some imagined – macroeconomic risk. I understand the CME is looking to boost its revenues by encouraging additional speculation, but to portray that attempt as filling a legitimate hedging need is quite a stretch. In fact, it's a lie that the CFTC should prevent from coming into existence.

A far more important issue was reported on in the Deal Book section of the NY Times. The article is about mutual funds that mimic hedge funds without the drawback of lockups, which prevent immediate withdrawals of investor money. Most hedge funds have redemption – gates – which prevent instant investor liquidation, sometimes stretching to a couple of years. Understandably, the idea that one can't liquidate immediately must be considered a detriment for investment.

The new mutual funds are referred to as – liquid alternatives – in that investor funds can be liquidated in a timely manner. So attractive is this feature that a rush by retail investors over the past several years have swelled total assets of these mutual funds into the hundreds of billions of dollars, although there is now concern about recent redemptions, given some subpar performance. Those readers with questions about the managed money technical funds (hopefully everyone) should pay close attention because some good answers are contained in the article.

http://www.nytimes.com/2016/09/16/business/dealbook/investors-stick-with-assets-that-mimic-hedge-funds.html?ref=dealbook&_r=0

One question that I've had all along was where all the money was coming from that flowed into the managed money technical funds. It was the surge in assets under management that enabled the managed money traders to take the unprecedented and massively large positions these past few years and I think I got my answer as to where the money was coming from. The article described a rush by retail investors into these funds, but that only occurred as a result of there being few investment alternatives in our near zero interest rate world. Not having good investment alternatives drives money to all sorts of strange destinations, obviously including into liquid alternative technical hedge funds. Additionally, guidance from stockbrokers and financial advisers who get paid higher commissions on the sale of these funds helped encourage the retail investment surge. No moral outrage here ^? that's just the way the world works.

The bottom line is that money has flowed into these liquid alternative hedge funds like never before and as a result their futures contract positions have reached unprecedented levels. One prominent managed money technical fund, AQR, is featured in the article and I have gone to their website in the past to check what positions they hold. As of yesterday, AQR indicated that its biggest commodities holdings were in gold, soybeans and sugar. And when I looked up the holdings of the managed money technical funds in sugar (which I hadn't done in ages) I was shocked at how large the holdings were. Those who have questions about the technical funds should read the article and check out the website of AQR.

<https://www.aqr.com/>

My big gripe with these funds, of course, is that regardless of how they attracted such large investor deposits, the net result is that their collective futures market positioning has become the prime price driver. That's crazy and illegal and everyone involved in this market travesty, including the regulators, the exchange, the technical funds themselves and their crooked commercial counterparties are responsible. Where the heck are the adults? Just because these technical funds have experienced massive inflows of investor money, does that grant them the right to distort prices for important world commodities?

The last article I'll reference is another Deal Book article about Lawrence Fink, the CEO of BlackRock, sponsor of the big silver ETF, SLV. The article is about Mr. Fink and BlackRock and not about SLV. I don't know if the Deal Book articles are subscription protected (I subscribe to the Times) but this one goes on to describe Mr. Fink as a Wall Street rock star and how thanks to him, BlackRock is now the world's largest money manager with assets under management of \$5 trillion.

<http://www.nytimes.com/2016/09/18/business/dealbook/at-blackrock-shaping-the-shifts-in-power.html?ref=dealbook>

Readers may remember how

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