

## September 3, 2011 – Weekly Review

### Weekly Review

Due to a stunning rally on Friday, the price of gold and silver vaulted higher for the week. Gold finished the week \$56 higher (3.1%), closing at a new weekly record level. Silver closed the week \$1.75 higher (4.2%), its best weekly finish since April. As a result of silver's outperformance, the gold/silver price ratio tightened in slightly to just over 43.5 to 1, still within the trading range of the past 4 months. Against uneven financial market returns elsewhere, gold is up 32.5% year to date, while silver is ahead 39.5% over the same time frame.

What was somewhat surprising about Friday's price action in gold and silver was that it came at the end of a slow summer week into a major US holiday and followed two low-volume and tight trading range days. While most published reports would attribute the spike in gold and silver prices to yesterday's disappointing employment report, the rally started some five hours before the report's release, just after London's opening. The price of gold and silver had already erupted well before the report and added to gains afterward. There would appear to be some other explanation for the jump in prices and my hunch is that it is related to the market structure on the COMEX, which I have been discussing recently and will add to in a moment.

As I have been noting consistently, conditions in the wholesale physical silver market suggest tightness. The turnover, or movement in to and out from, the COMEX silver warehouses was more frantic this week than ever, with full truckloads (around 600,000 oz each) arriving and departing daily. Total inventories nudged under the 103 million oz mark, but it's still the turnover that catches my attention and points to hand to mouth supply conditions. Once again, this turnover stands in stark contrast to the low number of deliveries and remaining contracts open in the September COMEX contract after the first three days of delivery. A subscriber and professional trader commented to me that the spread differentials between the September contract and other months was still wide, indicating no apparent tightness. Both the low number of deliveries, remaining September open interest and spread differentials argue against physical tightness and he rightly questioned me about it. My answer was that all things weighed together indicated that the spread differential was *wrong* and was the most prone to change suddenly. Spread differentials are determined by a very small number of traders on the COMEX and are subject to sudden price changes.

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There was some addition to the holdings in the big silver ETF, SLV, and if prices remain firm, there should be more to come. The 50 million ounces shaken from the SLV in the May takedown still appear to be in strong hands and have been unavailable to the market on an almost \$10 rally from the lows. Silver Eagle sales from the US Mint had an exceptionally strong month in August, as did Gold Eagles, reaching the best levels since January. Since I've detected a lull in US retail silver demand over the past few months, it is somewhat remarkable that the Mint has continued to sell-out Silver Eagles at maximum production capacity. My sense is that foreign demand and/or a big buyer may be behind the exceptionally strong demand for Silver Eagles. Combined with other silver coins (commemorative and proof coins) the US Mint should produce over 40 million oz of various silver coins this year, making them the largest single consumer in the world. I know the coins produced and sold by the Mint wouldn't normally be considered to be consumed as would metal in an industrial application, but since so few Silver Eagles or other US Mint commemoratives are ever melted, the effect is the same. This is silver taken off the market and kept off until and unless Eagles are available at a discount to the price of silver, something that has not occurred over the 25 year life of the Eagle program. Why melt a coin that you can sell at a premium to metal?

This week's Commitment of Traders Report (COT) for gold and silver came in roughly as expected, although not perhaps to the extent I was looking for. The total net commercial short position declined in both markets. The commercial net short position in COMEX silver futures was reduced by almost 2000 contracts during a reporting week that included a sharp \$3 interim price sell-off. All three commercial categories bought; the big 4 (JPMorgan) covered 650 shorts, the 5 thru 8 covered 1000 contracts, while the raptors added around 200 to a net long position now at 2200 contracts. I thought there would be more commercial buying on such a sharp and artificial sell-off, but this may indicate the speculative longs who were the sellers may be holding stronger than anticipated. The current level of the commercial net short position in silver, although up from levels before the recent price rally, still looks bullish to me.

The concentrated short position of JPMorgan and the other entities in the big 4 still looks manipulative to me. JPM's still controls 23% of the net open interest (minus spreads) in COMEX alone, while the big 4 control over 43% of the market. This level of concentration should be alarming in any market, but in silver especially so, since there is little economic reason to have been so short for so long in a market that has risen dramatically amid worldwide demand. A while back, when JPMorgan's silver short position did decline noticeably, it was thought they could continue to cover and even get net long considering the pace of their short covering. I'm sure JPMorgan would have loved to buy back the entire concentrated short position if that were possible at that time and price. But it appears it will take much higher prices for them to do so, in my opinion. In the meantime, they still appear to be stuck with a short position they'd rather not have.

In COMEX gold futures, the total commercial net short position declined by 13,000 contracts, during a reporting week that included a \$200 sell-off. There was a slight twist to which commercial categories accounted for the short covering. It was all big 4 and the 5 thru 8 traders doing the buying, with the big 4 buying back 7000 short contracts and the 5 thru 8 buying back more than 10,000 shorts. The gold raptors (the commercials apart from the big 8) added more than 4000 shorts after buying back a big chunk of shorts in the previous week's COT.

As a result of the changes this week in the gold COT, some interesting observations can be made. For one, the net short positions of both the big 4 and the 5 thru 8 largest traders on the COMEX are now the lowest they have been since January 2009, when gold traded between \$800 and \$900 an oz. Historically, the net short position of the largest traders on the COMEX tends to be lowest at what has turned out to be low prices and highest at high prices. This is the prism through which I've always analyzed the COTs. For the biggest traders in COMEX gold to be holding the same short position they did when gold was \$1000 lower in price is remarkable. At a minimum, this tells us that the biggest commercials are wary of the short side of gold currently. It is generally thought that the biggest traders have the greatest access to market information. I don't know if that's the case here or if it's more of reducing short positions in light of the financial beating the commercial shorts have taken in gold recently.

Additionally, the reciprocal net long position of the technical funds in gold is now at levels last seen hundreds of dollars lower. The relatively low levels of the big 8 short position and the technical fund long position would normally be considered bullish. Since the beginning of August, when gold traded around \$1600, the total commercial net short position has been reduced by 70,000 contracts (7 million oz), with the big 4 accounting for 20,000 and the 5 thru 8 accounting for 30,000 contracts. The gold raptors bought back 20,000 short contracts as well. The technical funds were the largest sellers over that time as gold prices rose by as much as \$300.

I contend that this commercial buying of the equivalent of 7 million ounces of COMEX gold was the prime price driver, by process of elimination. Over this same period of time, the flows of metal into the big gold ETF, GLD, and other gold ETFs were largely flat. There were no demonstrable changes in world gold supply and demand fundamentals. The US Mint and other mints sold decent quantities of gold coins, but there was no obvious worldwide and grassroots rush to buy gold. There was upheaval in financial markets, but the dollar was relatively stable over this period. In objectively searching for the main reason for the big rise in the price of gold, the purchase of 70,000 net contracts by the COMEX commercial shorts towers head and shoulders above all other reasons combined. As I have been reporting, not only does the commercial short covering account for the gold price rise, it also accounts for the dramatic increase in price volatility. I can't emphasize enough how unprecedented the commercial short covering on higher prices has been. Whereas the commercial shorts have never even blinked and have only added to short positions on previous gold price rallies, this time they have rushed to cover for the first time in history.

Even if I've analyzed this accurately, what comes next is hard to predict, aside from stating the obvious, namely, it will be different than past patterns. A long time ago, I predicted that someday the COTs would cease to be working. I'd like to revise that to they will work differently. In the past, whenever the commercials built up a big short position in gold and silver (and other commodities), it was a sign of danger that they might rig a sell-off to flush out the technical funds and other long speculators. Like clockwork, the commercials always succeeded in driving the market lower at some point. But every time I warned of the danger to come, I also included the caveat that it was possible for the commercial to get over run in their obvious manipulative operation.

This year we have witnessed two distinct cases of the COMEX commercials getting over run, once in silver at the end of April and now in gold. From never occurring before, to happening twice in one year. For someone who has closely studied the COTs for more than 25 years, I must tell you that my head is spinning at this turn of events. It is usually difficult to fully measure the long run impact of a truly historic event. My sense is that this will reverberate for a long time to come, although I can't blueprint with precision of what is to come, aside from gold and silver price volatility. It's hard for me to see how we put this genie back in the bottle and that we revert to the old game of the commercials snookering the technical funds as if nothing happened. Something did happen – the commercials got killed and the tech funds scored big. To me, that constitutes the possibility of a permanent game change.

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Adding to a radical change in the game is the soon to be determined outcome on position limits by the CFTC. Tentatively scheduled for the end of this month or in early October, the Commission will hold an open public hearing to decide on the level of position limits in various commodities, including silver. There is little question that the issue of position limits is the most contentious matter of all in Dodd-Frank. It is the issue that has garnered the most lobbying and pushback from the industry. How the Commission will decide on the matter of silver position limits is unknown; what is known is that they will have to specifically deal with it and the thousands of public comments submitted. Ironically, had legitimate position limits been in place before now, the commercials on the wrong side of the gold and silver markets would not have suffered the severe losses to date, as they never would have been allowed to hold such large and dangerous short positions originally. In retrospect, the commercials should have argued for position limits instead of fighting against them tooth and nail. With smaller positions than they held, the commercials wouldn't be out the billions of dollars they are out currently. Funny how things can turn out.

One thing does appear certain; the coming resolution in the silver market. Gold is different, in that it is possible that most of the fireworks may be behind us, even though volatility should reverberate for a while. That's because we are not likely to face a shortage of gold at current prices. We can certainly go higher in gold, given the current market structure. But it is unlikely we will experience a physical gold shortage. In silver, the coming physical shortage appears inevitable, even more so when you factor in a looming user inventory buying panic added to short covering.

For the life of this subscription service and for many years before that, I have advised buying and holding tight to long term silver positions and to ride out the sell-offs. To many, I appeared to be only a cheerleader on a one-way mission with some unknown ulterior motive. Over the years, there were times when one could have sold and bought back cheaper. As it has turned out, however, buying and holding has been the most prudent course to have taken. I still feel that remains the proper strategy. All the factors that attracted me to silver originally are still remarkably in place. Those include the manipulation caused by a concentrated short position creating an artificial low price, the coming silver investment boom, the possibility of regulatory relief and the near-certainty of a physical shortage. Yes the price is up ten-fold from the lows, but it seems more prudent to focus on what's ahead, rather than on what's behind.

Ted Butler

September 3, 2011

Silver – \$43.25

Gold – \$1884

**Date Created**

2011/09/03