

September 5, 2015 – Weekly Review/Price Ratio

Weekly Review

It was the second straight down week for gold and silver, with gold down \$11 (1%) and silver ending 5 cents (0.3%) lower. As a result of silver's slight outperformance, the silver/gold price ratio tightened in by a point to 77 to 1, but still remained within spitting distance to the most silver has been undervalued relative to gold in seven years. I'll have some separate comments on the price ratio later.

Considering all that is happening in world equity markets, it would be surprising that gold and silver prices have been so subdued, were it not for the certain knowledge that prices are fixed on the COMEX. As bad as the price manipulation may be, at least it provides the one beacon of explanation for price behavior. We can debate how long the manipulation may last, but that is very different than what we would debate in its absence. I would submit were it not for the COMEX price manipulation, I wouldn't even try to explain the gold or silver market. In fact, the most amazing thing is that there are still some who profess it doesn't exist.

The single most insightful clue into the genuine condition of the wholesale silver market continues to be the turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses. This week, turnover surged to nearly 6.3 million oz, as total inventories declined by a steep 3.3 million oz to 167.9 million oz. While not low by longer term historical levels, this is the lowest the total COMEX silver stocks have been in a year and a half and is sure to draw attention should the decline continue.

I'm scratching my head a bit as to why COMEX silver inventories have declined by more than 15.5 million oz over the past two months, as I don't believe there are fewer 1000 oz bars in existence; it's just that there are fewer in the COMEX inventories. In fact, I would contend that COMEX inventories should be growing over time, seeing that there is no strong evidence of an actual silver deficit, as existed prior to 2006 when we had less silver in world inventories as we did each year for 65 consecutive years. The best explanation I can offer is that the metal was more urgently needed elsewhere and that's why it was taken from the COMEX warehouses.

I still believe the main story is the grinding physical movement or churn of silver into and out from these warehouses. Even this week, on a notable reduction of 3.3 million oz, turnover was almost double that amount. Not in any way does this point to anything but tight supply conditions in the wholesale physical silver market.

Deliveries against the current September COMEX silver contract look light but tight, if that is possible. There have been only 804 contracts delivered so far and only 500 or so remaining open, but the spread differential between September and December continued to tighten to a half penny on yesterday's settlement. JPMorgan has taken nearly 25% (194) of the total deliveries issued, continuing its pattern of openly taking COMEX silver deliveries this year, but remains only the third largest stopper this month. It wouldn't take much, in my opinion, for a big buyer to upset the manipulated silver market by demanding delivery, but we will probably only see concrete signs of that after prices surge higher.

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

There were also 2.5 million oz removed from the big silver ETF, SLV, this week, even though prices were flat and trading volumes were subdued; thus in keeping with the often counterintuitive deposit/withdrawal pattern unique to SLV. As was the case with the continued churn in COMEX silver inventories, the most plausible explanation I can come up with is that the metal was more urgently needed elsewhere, or shares were converted to metal to avoid SEC reporting requirements. These are, of course, the two main mechanisms by which I believe JPMorgan has accumulated the bulk of the 400 million oz of silver it has over the past 4.5 years — skimming off metal in the great COMEX silver warehouse churn and buying and then converting shares of SLV into metal, both mechanisms designed to acquire metal sans public reporting.

It's no secret that the US Mint is straining to keep up with demand for Silver and, for the past few months, Gold Eagles. Silver Eagles are an old story as the Mint has struggled with keeping up with demand for the past four and a half years, ever since JPMorgan began buying them in size. Demand for Gold Eagles is much more recent, but dramatic nonetheless. Over the past three months, the monthly rate of sales of Gold Eagles have jumped nearly fourfold over the monthly rate of the previous four months.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

One thing that can't be denied is that we are in a pronounced shortage in many retail forms of silver, led by Silver Eagles and 90% "junk" coins, the premiums of which have jumped to the highest levels since 2008. Premiums and delayed delivery times have stretched to extreme levels on most retail forms of silver. This is no minor matter. There are many rushing to declare that this is not a "real" silver shortage, but merely represents a temporary production bottleneck caused by an inability to produce the blanks the Mint needs to stamp out Silver Eagles. (Junk coins, of course, haven't been minted for more than 50 years and it does look like they will never be truly available except at some sharply higher price of silver).

I believe those downplaying the current shortage in many retail forms of silver are underestimating its significance. While I still believe the current bout of shortage was kicked off by JPMorgan, it looks more intense than any I've seen in the past (and I've seen a few). Admittedly, this round of retail shortage hasn't lasted for very long time wise (only a month or two), but for the first time I recall, dealers are running out of lower premium substitutes for Eagles and 90% coins and, as a result, losing sales. This is not a circumstance that can last indefinitely without impacting wholesale prices eventually. And I'm pretty sure that when a wholesale shortage does arrive, the naysayers will likely characterize it as a temporary bottleneck in getting 1000 oz bars from the mines and refiners to the market, as there's plenty of silver ore in the ground.

Should retail silver demand remain strong, sooner or later, demand is going to be directed to larger denominations, first to 100 oz bars of silver (which is occurring) and eventually to the form of silver that matters most "1000 oz bars. Sure, all things equal, I would rather have two monster boxes of Silver Eagles (500 to a box) than a 1000 oz bar; but at some high level of premium and delivery delay, a lower cost bird in the hand becomes attractive. I think we may be there already or very soon.

It appears to me that there is a growing potential convergence of demand for 1000 oz bars greater than I previously imagined. I always "knew" that larger investors would find their way to silver because its merits were so compelling, particularly those investors fleeing stock market volatility and therefore likely to buy ETFs, like SLV. I also knew that industrial users of silver would likely panic at some point if physical silver deliveries were delayed enough and build actual inventories of 1000 oz bars. But I never really considered that demand for 1000 oz bars would trickle up from investors unable (due to premiums and delays) to secure retail forms of silver until now.

Make no mistake, this developing retail shortage appears confined to silver, not gold. Although sales of Gold Eagles are surging, it still appears to me that demand is coming from a big buyer and not broad numbers of smaller investors. At least, I am unaware of any sharply increasing premiums or delivery delays on retail forms of gold. That may change and if it does, the evidence will be apparent; but up until now, silver is in the spotlight. And if demand for retail forms of gold mimics what has occurred in silver to date, that will only reinforce demand for silver and exacerbate what is a growing silver retail shortage.

The changes in this week's Commitments of Traders (COT) Report were in line with my expectations of not knowing what to expect. The price action during the reporting week was quite subdued and that was mostly reflected in the changes in the headline number of the total commercial net short position.

In COMEX gold futures, the total commercial net short position increased by 6500 contracts to 69,100 contracts. This is the largest commercial net short position in two months (since June 30) and represents an increase of 54,000 contracts since the historic low in gold commercial shorts four weeks ago. The total increase is notable and somewhat worrisome, but on a longer term basis, still looks more bullish than bearish, although neutral might be closer to the truth. The raptors (the smaller commercials apart from the big 8) accounted for almost all the net change, as they sold out 7700 long contracts.

The managed money traders didn't account for any of the buying behind the commercial selling and what they did do was uncharacteristic in extreme. Managed money longs sold and liquidated close to 7000 contracts while managed money shorts bought back a near identical number of short contracts. Usually, when managed money longs sell, managed money shorts usually add to short positions. I don't recall a previous instance of such behavior where they moved in opposite directions and I'm just glad it occurred in a week where I had no firm expectations.

In COMEX silver futures, there was a slight reduction in the headline number of the total commercial net short position of 1400 contracts to 22,600 contracts. This is still a bullish reading by historical parameters. The big 5 thru 8 shorts accounted for most of the headline reduction, but that appears due to continued managed money short covering, rather than commercial short covering.

In fact the managed money shorts reduced their short position again, by more than 2800 contracts to just under 35,000 contracts. We're now down by 20,000 contracts from the peak in managed money short covering with nothing to show in terms of what should have been rocket fuel type buying. I can't say the managed money shorts did particularly well on their previous record short position (as they did last year), but too many slipped out the back for my liking. About the only positive aspect is that it looks unlikely these traders will add additional shorts aggressively on new silver price lows and that may encourage the crooked commercials to stop pressing prices lower. Managed money longs added 1300 new longs, but at 39,000 contracts long, this position is still just below the 40,000 contract level that has prevailed for a year and still looks unlikely to me to succumb to large selling on lower prices.

I still consider the COT market structure to be bullish to a bit neutral, rather than bearish, but that structure doesn't guarantee against deliberate stabs to the downside in price, very similar to what we've been experiencing. And I'm still hopeful that conditions in the physical market, particularly in silver, will exert more of a price influence ahead than usual. In fact, the only thing still missing in the signs of continuing tightening in physical silver is a price rise. Because the price is still clearly controlled by price manipulation on the COMEX, as and when control is wrested away from COMEX futures positioning control by the physical market, it is hard for me to see how the break will be gradual and not sudden and dramatic.

The only expectation I had this week in COT position changes was in the crude oil market where I expected a marked increase in managed money buying, mostly of the short covering variety in NYMEX crude oil futures. I didn't put a number on it, but the total of nearly 21,000 net contracts bought by managed money traders. Including more than 15,000 contracts of short covering was largely in conformity with my expectations. Certainly implied in my Wednesday comments on oil was that managed money traders would be the trader category with the biggest position change and that was the case.

Since only about 15% of the managed money contracts sold on the downside move in oil prices of \$20+ since the end of June were bought back this reporting week, the market structure is far from fully resolved. The problem is that changes in COT market structures are not conducive to short term trading signals, whether in crude oil, gold or silver. You can never know for sure if managed money traders will continue to buy as prices move higher or if lower prices will cause them to resell any contracts recently bought. This may sound a bit like doubletalk Â? it could up or it could go down Â? but please let me make the point of all this.

I singled out crude oil and managed money buying because of the sharp jump in price of oil during the reporting week and the complete lack of any documented changes in actual oil supply or demand by making a prediction on what the new COT report would indicate before it was released (that turned out to be correct). But in reality, I witnessed many tuned-in oil analysts on TV and in news reports that identified short covering by managed money traders as the cause of the oil price jump. Not for a moment would I suggest I was alone in my observation.

But where I am alone enough to feel I am in exile, is in making the connection between the sharp jump in oil prices due to managed money buying being de facto price manipulation. The tuned-in oil analysts knew it was managed money buying (short covering) driving oil prices higher, but none stopped to consider what that meant. It meant oil prices were being driven by purely speculative buying and that, on its face, is manipulation.

Our commodity markets were never intended to become a speculative playground where prices are determined by sudden bouts of speculative buying and selling. But that's exactly what has developed over the years. I think it's the gradual nature of change that has prevented what are usually smart people from appreciating what has occurred. None of them, certainly including the regulators, are putting what is occurring into proper perspective. None are appreciating what is really going on.

For me, it's different. I have so many decades' worth of understanding and appreciating the silver (and gold) COMEX manipulation that I can spot it quickly when it develops in other markets, like copper or crude oil. And to be frank, I'm no longer confident many others will come to see it. In terms of silver, I'm more confident than ever that the manipulation will end, just that when it does and afterward, I'm not sure it will be widely recognized even then.

The Ag/Au Price Ratio

Whenever any price or price indicator sets an historical extreme of some significance, it is natural for commentary to be generated about it. As a result of moving to extremes not seen in seven years, there has been increased commentary about the silver/gold price ratio which had widened out to 80 to 1 recently. Perhaps that is not the correct word, as most of the commentary seems to consist of charts depicting the price history of the ratio; which dating to late 2008 shows the silver/gold price ratio of having fallen from over 80 to 1, to 30 to 1 in April 2011 and now back to close to 80 to 1.

In other words, silver went from being extremely undervalued relative to gold back in 2008, to becoming much less undervalued (some might say overvalued) in 2011, to once again being extremely undervalued relative to gold today. Since the creed of the intelligent investor is to buy sound assets when they are most undervalued, the main message from the current extreme reading of the silver/gold ratio is that silver is the most undervalued it has been in seven years and should be bought.

Depending on one's own thoughts, some expect the value of gold to continue to climb relative to silver based upon the price trends already in force or because one believes gold to be a monetary metal and not silver. Since I'm not a devout chartist or monetary adherent, I'll try to explain why I think silver will soar relative to gold and why this is an opportune time to sell gold and put the proceeds into silver.

That's no knock on gold, as I expect it to do well compared to most other assets in the years ahead; but nowhere near as well as silver. To my mind, gold is the perfect money by which to buy silver and take advantage of the historic undervaluation of silver to gold. I'm much more of a commodity guy than a monetary analyst, but switching gold to silver is switching one form of money into another form, like a transfer of a currency into another currency thought to be undervalued.

One thing must be kept in mind \hat{A} ? while the price ratio between gold and silver fluctuates regularly, virtually none of the change in the silver/gold price ratio is as a result of actual switching between the two metals, as I'm advising. Instead, the price ratio fluctuates as result of a simple arithmetic calculation that continuously divides the current price of gold by the current price of silver. The price of gold and silver fluctuates constantly, mostly as a result of positioning changes in COMEX futures, and it is the continuous change in the individual price of each metal and the automatic arithmetic division that causes the price ratio to change.

It may seem that investors are selling silver and buying gold when the price ratio is rising, like recently, or that investors are buying silver and selling gold when the price ratio is tightening, but that is not the case. Certainly, some very small amount (less than 1%) of leveraged futures trading may involve a long position in gold and a simultaneous short position in silver or vice versa, but that is not what moves the ratio. What moves the ratio is the constant independent price fluctuations in COMEX gold and silver futures and the arithmetic calculation.

My point is that it is a mistake to view any increase or decrease in the silver/gold price ratio as being the result of investors buying or selling the actual metals because very little of that occurs. Just like the actual supply/demand fundamentals matter little in determining the price of gold or silver, there are no actual fundamentals behind changes in the silver/gold price ratio. Instead, changes in the ratio are captive to the ongoing perverted price discovery process on the COMEX.

It is easy to prove that very little actual switching of gold into silver or vice versa takes place by the law of numbers. Additionally, this same law of numbers provides compelling incentive for why one should switch gold in

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