

September 7, 2016 – Back To the Brink

### Back To the Brink

I'm starting this piece Wednesday morning, when prices are mostly unchanged for gold and silver following the surge into yesterday's close. Since Friday's close, gold has jumped \$25 and silver by 70 cents. As of last night, the combined and collective unrealized loss to the COMEX commercial shorts grew by around \$1 billion to just over \$3 billion. Of course, I'll update the financial scorecard at the end.

It wasn't just any sharp rally, it was a rally that also included an upside penetration of the 50 day moving average in both gold and silver, after both averages were penetrated to the downside two weeks ago. As you know, I'm not much of a technical or chart analyst, but that doesn't mean I'm not aware of the force of collective technical fund behavior on price. After all, that's the basic thrust of COT market structure analysis and it would be foolish to overlook the main price driver of any market.

From basic observation and repetition, plus past professional experience, the 50 day moving average is the most important moving average (with the 200 day right behind) for the technical funds. "Important" meaning generating more contracts of buys or sells. All the traders in the managed money category are not technical funds, but many are and those are the traders that buy or sell on moving average penetrations.

On Saturday, I wrote how it was surprising to me that so few managed money technical funds had liquidated long contracts after the recent two week downside penetration of the 50 day moving averages in gold and silver, compared to what usually transpired in the past. I opined that if the commercials couldn't rig prices lower and induce substantial technical fund selling, those commercials might be up the creek without a paddle, although I wasn't in a position to know how it would turn out.

While I still can't know how the historically extreme COMEX market structure will get resolved, I do know that the commercials are much further up the proverbial creek, by virtue of yesterday's upside penetration of key moving averages on exceptionally high volume. Whether they have a paddle will be seen in the fullness of time.

The increase in total open interest in COMEX gold and silver futures on the rally thru yesterday's close was very large by any standard. The most plausible explanation is that the managed money technical funds and commercials did what they always do on high volume upside moving average penetrations — the technical funds bought and the commercials sold short in massive quantities. There is always room for surprise, but this week's COT report should show an increase in the total net commercial short position of perhaps 30,000 contracts or more in gold and 10,000 contracts or more in COMEX silver futures. This would put the headline numbers close to recent record readings.

This is an upping of the ante by no small degree. Further, I would expect an increase in the level of concentrated short selling by the largest four commercial shorts in gold and particularly in silver. I suppose I should temper my expectations by acknowledging that high volume and volatile Tuesdays (particularly when Monday is a holiday) can lead to delays in COT reporting timeliness. Regardless, the bottom line is that the stakes have risen greatly.

How these extreme market structures in COMEX gold and silver (and other commodities) get resolved is really all that matters for the price in the short term. If the commercials are in over their heads and fail to induce technical fund selling at some point to the downside, the upside, particularly in silver, looks almost unlimited. If the commercials are in full control and are deliberately luring in more technical fund longs on what appears to be salami slicing to the upside, lower prices lie ahead.

While this is the same old song in many regards, the actual numbers are so extreme as to suggest we are approaching a great climax of sorts to the whole technical fund/commercial tango in many commodity markets. It's not just COMEX gold and silver that are at historical positioning extremes; this has become the norm in many markets where managed money traders and their commercial counterparties have become the dominant pricing force. It all feels to me as if it may be reaching a collective crescendo. It is reminiscent of another almost incredible personal experience.

Just about 20 years ago, I began writing on the Internet about a dubious practice that I stumbled across that fit in with my even longer held COMEX price manipulation premise. The dubious practice was precious metals leasing, which was nothing more than a cockeyed Wall Street rocket scientist creation designed to benefit the bankers to everyone else's detriment. Reduced to its most simple element, precious metals leasing was just a wacky way of inducing mining companies to sell short gold and silver in the most disadvantaged manner possible.

Despite clear and compelling warnings from myself and others, many mining companies swallowed the bait from the Wall Street bankers (yes, the same commercials on the COMEX today), hook, line and sinker and greatly ramped up the level of what were, in essence, physical short sales of gold and silver. For years after criticism surfaced, the miners continued to add to precious metals leasing shorts. In time, the sheer wackiness of a producer selling years of future production short came home to roost and the physical short sales were bought back at great loss — many tens of billions of dollars. When you read of any resurgence in gold miner hedging, keep in mind that the resurgence does not include the physical shorting of metal of the past, as that form of hedging is as dead as a door nail.

If everyone took the time to think over and reduce the nutty premise of precious metals leasing to its most simple core, the practice never would have taken hold and the world would have been better off. It's that way with many things. And that's the way I believe it is with the futures market positioning I write about incessantly. There's no doubt the positioning has grown and is more of a price influence than ever before. That's evident in the number of commentators who write about the COT report. But there's a certain something missing from today's commentary about the issue of market structure that was also missing in the widespread discussion of precious metals leasing back in the day. It is that missing element that I have found myself reminiscing about.

What's missing in the current widespread commentary about futures market positioning by the technical funds and commercials is taking the simple step back and asking what it represents in its most distilled form. The reason precious metals leasing lasted for as long as it did was that it was viewed in terms different than what it was — a physical short sale. The bullion banks, the miners and the central banks all thought only in terms away from the actual short sale of physical metal — a very dumb approach to take as it turned out.

Likewise, the excessive futures market positioning by the managed money technical funds and commercials has grown so large and price influential that despite widespread coverage, few have taken the simple step back to consider what it actually represents — illegal price setting. Not just in silver and gold, but in many important markets, like copper, crude oil and grains. I guess it's similar to the boiled frog syndrome, in which gradualism results in recognition coming too late.

Because technical fund market participation has grown over the decades, few recognize the price force it actually represents. But it's only a matter of time before enough properly evaluate this price force to result in a massive restructuring of the practice. Simply put, it is absolutely nutty and indefensible that technical funds should have any price influence, to say nothing of being the main price driver. In fact, it's absurd that futures market positioning has reached the state it has.

I knew precious metals leasing was a bad idea whose demise would come in time, just as I know the price dominance of managed money/commercial futures positioning will also end. How long before the oil producing companies and countries rise up against crooked NYMEX price setting? And if the farm community understood that corn prices are as low as they are due to managed money futures selling on the CBOT, there would be farmers descending on Washington, DC demanding a stop to the practice. Such outcomes may be in store, unless the excessive speculation ceases.

I'm more convinced than ever that this whole futures positioning price-setting process is coming to a head. I know I have been writing about it for decades, but I don't see it as sustainable. And where I studied it mostly as it affects gold and silver prices, I am astounded how it has come to dictate the prices of even more important commodities. The basic premise of precious metals leasing was as dumb as dirt and letting speculative futures positioning dictate commodity prices is on a whole different level of dumbness. Things this stupid can't last forever, especially when they are contrary to the spirit of commodity law.

In essence, the real question is how does the collective futures positioning price setting flame out? Will it end with the technical funds or the commercials as the last man standing? I'm surer of it ending than in who will be in the driver's seat at the end of the trip. Given the current structure in gold and silver, it's still a tossup who wins this round, which looks to me increasingly as the final round. Will the commercials finally get overrun for the first time in history or will they finally induce technical fund selling to the downside for what could be the last time?

All we can do is look to the data and decide for ourselves what is more likely. Don't feel bad in not knowing, as no one who did know would tell you. This is about the probabilities as we see them ourselves. On the side that favors the commercials failing for the first time and being forced to buy back short positions to the upside is the fact they were out a combined \$3 billion as of last night and had a significant casualty recently in the demise of a big 5 thru 8 gold short holder. The commercials being this deep in the hole on the short side of gold and silver argues for their failure.

On the side of enough technical fund longs finally getting liquidated to the downside lies the historical precedent and the overall duplicity and criminality of the commercials and the CME Group and CFTC. Further, a commercial failure would be nothing less than catastrophic to everyone associated on the commercial side, which definitely includes the exchange and the regulators. No matter what the resolution turns out to be, it will likely involve some type of climax this time.

There were large deposits yesterday of metal into the big gold ETF, GLD (450,000 oz) and the big silver ETF, SLV (2 million oz). Remarkably, this is just as it should have been in the face of new net investment buying on the price surge. More metal may be deposited, but as it is, yesterday's deposit in SLV has brought total silver holdings in the trust to 361.5 million ounces, perhaps equaling or slightly exceeding the peak in holdings in April 2011. Year to date, holdings in SLV have increased by roughly 60 million oz.

I still don't see anything particularly noteworthy in COMEX gold and silver deliveries this month, nor have I noticed any truly standout features in actual gold or silver supply/demand terms. And if any recent economic reports explain gold or silver price movements, the explanation is lost on me. More than ever, gold and silver prices are set on the COMEX in the manner I've detailed exhaustively.

Today's slight decline in price only slightly lessens the \$3 billion in unrealized losses held by the commercials in their combined gold and silver open short position. Of the \$1 billion in additional open losses created by yesterday's rally, that only amounts to \$200 million or so of relief. At publication time, that puts the commercials in the hole by \$2.8 billion since the June price bottom. The commercials had been out \$3.8 billion at the peak in prices, so they have some room between now and the worst they have been out. But there is also no question that the commercials have never been out close to these amounts before and that's the really big deal. In every real sense, the commercials are back to the brink.

This is all coming down to a test of wills and the long term financial fortunes between the managed money technical funds and the commercials. Regardless of who prevails in the end, it's crazy that the rest of the world goes along with the prices set by these two groups of large speculators. Then again, there was a time when precious metals leasing didn't seem crazy to that many.

Ted Butler

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Silver – \$19.85 (50 day moving average – \$19.65)

Gold – \$1346 (50 day moving average – \$1336)

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