

Weekly Review

In its strongest weekly performance in eight months, the price of gold surged by \$46 (4.1%), while the price of silver rose by an underwhelming ten cents (0.6%). As a result of gold's strong relative outperformance, the silver/gold price ratio blew out by nearly 3 full points to just under 76 to 1; back to the top of the ratio's trading range of the last year and a measure of how undervalued silver is compared to gold.

Of course, it wasn't at all the case that investors were switching from silver to gold, as what caused gold and silver price movement this week had absolutely nothing to do with anything related to switching – it was mostly a case of COMEX futures positioning, same as ever. As I hope I have been conveying, gold's market structure was extremely bullish and it was only a matter of time before we moved higher.

Being still highly convinced that silver will vastly outperform gold in the end, having silver underperform while gold prices are rising is the best news possible for a silver investor because it creates a greater silver relative undervaluation

without the pain of falling silver prices. As a silver investor, I hope gold goes to the moon because I know that will come to benefit silver eventually.

Unless one was cut off from current events completely, the big financial story of the week was the sudden weakness in world stock markets from China to the US. Over the last three days, the Dow Jones Industrial Average fell 1000 points, pushing the index to its sharpest weekly selloff in four years. I don't pretend to have a clue as to what happens from here in the stock market, but the possibility, at least, exists that equities could be in for rough sledding given the extreme and largely unknown leverage in the financial system and what many contend are historically elevated valuations. So, while not predicting what will unfold, later on I will try to describe what a severe stock market selloff might portend for gold and silver.

Turnover or the physical movement of metal being brought into and taken out from the six COMEX-approved silver warehouses cooled, but only slightly this week, as 3.7 million oz were so moved and total inventories fell 2.2 million oz to 170.4 million oz. Over the past two months, total silver inventories in the COMEX warehouses have declined by more than 13 million oz and now are at the lowest level in a year and a half. Over these same eight weeks, total silver movement in and out has been over 30 million oz (200 million oz annualized)

and that remains the sore thumb that few mention, same as it has been for the past four and half years.

Let me take another shot at trying to explain why the COMEX silver warehouse movement is so unique and crying out for attention. As you know, I believe JPMorgan has acquired a massive amount of physical silver over the past four and a half years, including, but not limited to the nearly 63 million oz it holds in its own COMEX silver warehouse. If you subtract this from total COMEX silver stocks (since JPM seems to have a death grip on this silver in that there is rarely metal taken out from this warehouse), there are less than 110 million oz in total.

I'm not suggesting all that remaining 110 million oz of silver is available for sale anywhere near current prices because in reality only a very small percentage may be available, perhaps 5% or 10% or so. Only some small amount of the COMEX total inventories, even if you adjust upward by much bigger percentages, is available for movement in and out, with the bulk of the silver being stored by investors and not available for movement. If the true "working" inventory of silver on the COMEX is in the 20 to 30 million oz range that means the actual turnover (200 million oz annually) suggests a complete turnover of working inventory every two months. In any business, a 100% turnover of

available working inventory every two months implies a demand that is white hot. By this measure, wholesale demand for physical silver is white hot.

The situation in the COMEX August gold contract remains of interest, as only a few days remain in the delivery period, spreads have remained tight and there have been few recent deliveries, even though close to 1500 contracts remain open. Undoubtedly, the contract will be resolved without major problems, but it is kind of amazing it has not been resolved by now and we have been “allowed” to see signs of tightness in gold. This is nowhere near the tightness that I sense in silver, which I believe may border on a genuine shortage, but is still noteworthy for gold.

Talk of “backwardation” in gold or silver is still premature, however, as the spreads on the COMEX are tight, but not that tight. True backwardation, in simple terms, occurs when any market participant can sell and deliver his metal on the COMEX and simultaneously buy that metal back in the form of a more deferred futures contract at a steep enough discount to guarantee a profit after all costs and fees. We're not close to that yet and should that occur it is more likely to occur in silver than in gold given all the signs of relative tightness in silver and its industrial consumption.

The changes in this week's Commitments of Traders (COT) Report were in keeping with price action during the reporting week. Gold had only one big up day during the reporting week ended Tuesday, having jumped by \$20 on the first day (Wednesday) of the reporting week before consolidating. Then again, gold's market structure was so strongly bullish, it was normal for there to be a bit of deterioration in the form of managed money buying and commercial selling. Silver was harder to read in that it penetrated its 50 day moving average to the upside for the first time in months early into the reporting week, before falling sharply on the cutoff date and ending the reporting week lower by 50 cents.

In COMEX gold futures, the commercials increased their total net short position by a modest 5500 contracts, to an even 30,000 contracts. This is still a low (bullish) reading. By commercial categories, let's call the selling a raptor affair as the eight biggest shorts bought back a thousand contracts and the raptors sold close to 6500 longs.

Under the hood the numbers were a bit worse than the headline number indicated, as managed money traders bought 13,347 net gold contracts,

including 3568 new longs and covered shorts to the tune of 9,779 contracts. However, these numbers need to be put into perspective. On the cutoff day (Tuesday), this still represented an extremely bullish gold market structure and largely explained the surge in gold prices since the cutoff, as prices rose by more than \$45 over the past three days.

The question, therefore, is what type of deterioration or managed money buying and commercial selling have we seen in gold over these past three days as volume surged and the critical 50 day moving average was penetrated to the upside for the first time in months? If I had to put a number on it, I would guess as much as 40,000 contracts thru Friday's close. If I'm close, that would bring the gold market structure to neutral to bullish, but not necessarily bearish.

One thing is for sure □ gold acted much better than silver over the past three days and the only real explanation is (you guessed it) COMEX positioning. It's kind of sick, the better prices behave, meaning go up, the more deterioration we have in the market structure. The worse prices act, the better the structure.

In COMEX silver futures, the commercials increased their total net short position

by a modest 1200 contracts, to 23,400 contracts. As was the case in gold, it was a raptor affair in silver, as the 4 and 8 biggest shorts (not necessarily all commercials) reduced their net short position by a combined 3100 contracts, as the raptors sold out 4300 longs.

Under the hood and unlike what was the case in gold this week and silver over the past couple of weeks, the managed money traders were close to flat on a net basis, selling close to 1900 longs and buying back nearly the same amount of short contracts. With managed money longs at close to 40,000 contracts and shorts also at the same level, the silver structure is bullish. Unlike the significant deterioration that I assumed occurred in gold since the cutoff, there appeared to be no similar managed money buying and commercial selling in silver by virtue of the rotten relative price action in silver these past three trading days.

Bottom line is that gold's market structure appears to be less bullish than silver's, but not by a wide factor. The one thing that I must point out is that the very large open profits held by the managed money shorts in COMEX gold and silver at the recent price lows, more than \$400 million in gold and \$300 million in silver, now appear to have largely evaporated. Any surge in price from here will cost remaining managed money shorts real and perhaps significant losses.

If there's a recurring theme in my COMEX positioning structure analysis, it is that open managed money profits (whether on the long or short side) exist for some meaningful period of time and then disappear in a relative flash. It is still premature to call this current chapter resolved, but recent gains in gold and silver prices don't indicate the managed money traders are running the show.

Before getting into what the turmoil in the world's stock markets may mean to gold and silver, I must comment on a development this week that I find significant. As I intone incessantly, I believe the managed money traders, because they trade in unison and in absolutely enormous quantities, exert an influence on the price of many commodities contrary to the forces of supply and demand of the actual market.

I further believe that the federal regulator, the CFTC, and the designated self-regulator, the CME Group, are incompetent at best and criminally negligent at worst in enforcing commodity law by not considering managed money traders as the unified single trader that they have become in practice. Even though a number of gold and silver miners took my suggestion to write to the CFTC about this issue, those miners were ignored by the Commission.

One of the commodities away from gold and silver where I have detailed the same distortion of the price discovery process by the managed money traders is COMEX copper. As I reported previously, since May 19, managed money traders have sold 70,000 net contracts of COMEX copper or the equivalent of nearly 900,000 tons of copper, a truly massive quantity and almost singlehandedly responsible for the 20% decline in copper prices over the past three months. Yes, I know I have been virtually alone in pinpointing this factor as the prime catalyst for the copper price decline, but that may have changed this week.

Unless he was channeling me (I don't think he's a subscriber), the CEO of the large mining entity and trading giant, Glencore Plc, seems to have reached the same conclusion as me for what's driving copper prices. As Ivan Glasenberg said on an earnings conference call, the flow of actual copper supply/demand and inventories has had little to do with the decline in copper prices and instead he blames it on hedge funds.

<http://www.bloomberg.com/news/articles/2015-08-19/copper-bear-raids-jump-after-1st-half-price-sag-vexes-glencore>

Granted, Glencore is suffering mightily as a result of the downdraft in prices and some may suggest he's looking for a scapegoat to take the blame away from him. Maybe so, but I don't have any vested interest in copper prices, other than knowing that the price discovery process on the COMEX is broken, just as it is for silver and gold. I am highly encouraged to see one of the sharpest guys in any room, Glasenberg, agree with me; not because I'm looking for validation, but because the facts are clear and what is happening is so wrong it's not funny. The problem is not enough industry leaders know the real story of how prices are being set. But it is also always true that you can't begin to solve a problem unless you first recognize it. It's a very good thing that Glasenberg sees the problem.

Now on to the turmoil in the world's stock markets. I'm neither long nor short the stock market, so I don't have any particular ax to grind. I will say that many people whose opinion I respect seem to make a convincing case that historical equity overvaluation combined with leverage and derivatives positions grown out of control worldwide have at least created the possibility of a stock market meltdown at some point (and maybe soon).

To be sure, such a possibility does not reside at the core of why I hold silver; but neither is it true that I discount completely that a severe stock market decline,

should it occur, could have a strong impact on gold and silver. I know that many hold gold and silver primarily as financial insurance and I respect and understand the thinking behind that motivation and fully acknowledge if things get dicey in the equities market, many will rush to gold and silver as safe havens. And while I am still convinced that this week's price gain in gold was primarily attributed to new buying and short covering by managed money traders on the COMEX, I did detect a hint of potential safe haven buying in gold that might develop into something more serious should equity market turmoil continue.

I intentionally left out earlier the fact that the big gold ETF, GLD, witnessed deposits of more than 190,000 ounces over the past two days due to an increase in net new buying of shares in response to the jump in gold prices this week. This is entirely normal and the way it should be as this is how this ETF is structured. Since I have detected on past occasions a one day delay in deposits following obvious net new buying, I'm inclined to think more deposits of gold may be made as a result of trading through yesterday. By the way, because silver price action has been so relatively punk this week, I've had no expectation, based upon trading volume, of any deposits of metal into the big silver ETF, SLV.

So even though I am certain that gold prices rose primarily due to positioning on the COMEX, I am also certain the kick up in gold prices touched off net new buying of shares of GLD which, in turn, dictated actual gold deposits (or the alternative – an increase in short selling of GLD shares). Consider it a type of chain reaction in that it is somewhat of a mechanical process; higher gold prices on the COMEX can cause net new buying to come into the hard metal ETFs which should result in actual metal deposits. In fact, now that I think about it – this is the precise type of mechanical approach I employ on a regular basis in trying to drill down to exactly what causes price to rise and fall.

One of the mechanical situations I've thought of often in the past is what I would call the –narrow door syndrome– – the circumstance of what the impact on price would be if great numbers of buyer or sellers tried to rush into or out from any market suddenly. Just like hundreds of people can't enter or exit through a narrow passageway in a timely and orderly manner if all rush the door at once, neither can great numbers of investors buy or sell in unison without great effect on the price.

In fact, all great stock market crashes have resulted from the narrow door syndrome, namely, everyone trying to sell at once or alternatively, selling in one venue sets off chain reaction selling of a different sort (derivatives or

margin call selling, for instance). And this is principally at the heart of the possibility of a severe stock market selloff □ selling begets other selling. Again, I'm not predicting that will occur, just that the possibility exists.

But there are narrow doors and then there are other narrow doors. The possibility of a narrow door for stock market sellers is related but different from the narrow door I think exists in silver. Should a sudden flight to safe havens develop, it would be reasonable to contemplate what form that flight might take in gold and silver? In other words, if a number of investors flee world equities and some of the outflows are directed to precious metals, where is that buying likely to be directed?

For a number of reasons, I think a good amount of possible money fleeing the stock market is likely to be directed to the two big ETFs, GLD and SLV. And any net new buying of shares of either must result in actual metal being bought and deposited into the trusts, just like occurred in GLD this week. But gold and silver and their respective ETFs, while very similar are also different in many ways. One of the biggest differences is that the silver door is much narrower than the gold door. That's because there is much less silver available for purchase than gold in dollar terms.

The 190,000 gold ounces deposited in the GLD over the past two days comes to more than \$200 million. As, when and if \$200 million is directed to SLV, that would amount to 13 million ounces of silver needed to be bought and deposited into the trust on a mechanical basis. I would contend that 13 million ounces of real silver would have a much greater impact on price of silver than would 200,000 ounces of gold on its price. There's been no recent equivalent buying in SLV because silver prices have been contained relative to gold, but it would be expected that buying would occur on a decisive move up from current price levels or if a flight to silver as a safe haven develops. In either event the mechanical process could get kicked off.

Years ago, a friend, Carl Loeb, coined the most descriptive phrase possible for SLV, calling it the "Death Star" capable of eventually devouring all the 1000 oz silver bars in the world. In fact, back in early 2011, purchases of metal by SLV were the primary cause of the developing silver shortage then. The Silver Death Star has been sleeping as prices have been manipulated lower over the past few years, but is nowhere near dead.

Make no mistake – it is demand for 1000 oz bars that will move the price of

silver more than any other form. A surge in demand for Silver Eagles or other forms of retail silver will most likely result in retail shortages and soaring premiums, but will not necessarily impact the price of silver. A surge of buying of 1000 oz bars, as is the form of the SLV, will cause silver prices to surge.

Last week, I outlined how an investor with a billion dollars to invest had to take measures to buy silver first in derivatives form to keep prices from spiking. Any surge of buying in SLV, be it as a reaction to upside price action or the narrow door of investors looking to buy silver as a safe haven will have an unavoidable greater impact. There is a self-reinforcing cycle in GLD and SLV where net new buying for any reason begets demand for physical metal and sets off a mechanical chain of events driving prices higher, but no market door is narrower than in silver.