Weekly Review<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

Almost according to script, volatility reigned supreme again this week in gold and silver. Gold, after hitting all-time highs (over $1900) earlier in the week, fell by more than $200 into Thursday morning before coming back strongly by Friday's close. After the dust settled, gold finished a somewhat unremarkable $25 lower (1.3%) for the week. Silver mostly followed gold's volatile path this week establishing a more than $5 trading range before finishing $1.40 lower (3.3%). As a result of gold's outperformance, the gold/silver price ratio widened a bit to around 44 to 1. For the year to date, gold is up over $400 (29%), while silver is up $10.50 (34%). From year ago levels, gold is up $591 (48%), while silver is up $22.40 (117%).

I continue to believe that silver will outperform gold in the years ahead, just as it has over the past few years, accompanied with short periods of underperformance. This is not based primarily upon past price performance, but rather on the realities of supply and demand in the future. Gold's run to record prices has done nothing but enhance the value of silver and all silver investors should be rooting for continued gains in gold. No table pounding this week, but gold heavy investors should take advantage of the impressive rally in gold to switch some positions to silver.

Conditions in the physical silver market continue to flash signals of tightness. Turnover in the COMEX warehouse inventories remains extremely high with no dramatic changes in the total levels, now just over 105 million ounces. US Mint sales of Silver Eagles remain at maximum production capacity. The data from the big silver ETF, SLV, is particularly encouraging, with continued big movements in metal holdings reflecting tight wholesale silver conditions. Please allow me an attempt to explain something new concerning the SLV. Rather than new, I suppose it might be more of a confirmation of something I first raised a few months ago.

When silver fell sharply starting in early May due to the crooked takedown on the COMEX, the SLV subsequently recorded a total drop in metal holdings of some 50 to 60 million ounces into July. The price fall of more than $16 resulted in investor liquidation of this silver in the SLV. At the time, many considered these 50+ million ounces of silver sold to be an overhang on the market and would work against any price rally. I took a different conclusion and suggested that this silver was now in strong hands, meaning it would be unavailable for sale except at extraordinarily high prices. My reasoning was that whoever orchestrated the unprecedented and manipulative price smash in silver did so precisely to get hold of the silver liquidated. At this point, events would seem to suggest that the 50 million ounces did, indeed, find its way into strong hands.

Here's my reasoning. We have climbed more than $8 or so in the price since early July and the 50 million ounce slug of silver has not found its way back into the SLV. If the silver was bought for a small quick profit, it would have already been sold. Clearly, that has not happened. In fact, another point can be made about this "missing" 50 million ounces being in strong hands. The price of silver has climbed significantly since the July lows with virtually no net investor inflows into the SLV, the largest silver investor vehicle and stockpile in the world. In other words, the price of silver rose 25% on no visible investor demand for the SLV (including all other silver ETFs and funds). How can this be? How could silver climb 25% in price with no net new investment demand?

Most likely, it can only be because the 50 million ounces were in strong hands and not available for sale. It was more a lack of selling rather than new investment buying demand. I believe this holds extremely bullish potential. Silver just rose 25% in price on no obvious investor demand. This proves that silver is not solely dependent on investment demand and a combination of industrial demand and no net investment selling can still result in higher prices. When investment demand does resurface (soon, in my estimation), watch out to the upside. I admit that conditions could and will change in the future, but for now, the silver I thought was in strong hands appears to be in the hands of Hercules.

One final point on SLV. The latest short sale data for the two weeks ended 8/15

have been released and are inconclusive. There was a slight increase of some 600,000 shares (ounces), but following three previous fortnightly reports which indicated a 13 million share reduction in the short position, the latest increase is not yet alarming. I still think a 24.6 million short position in SLV, representing 7.9% of total outstanding shares, is fraudulent and manipulative to the price. But it will be future short sale readings that determine whether the Trust's sponsor, BlackRock, is intent on doing the right thing or not. By the way, the short position for GLD, the big gold ETF, declined slightly in the current report, but is still near the 8% level of total shares outstanding as in SLV. A short position of 8% of all shares outstanding is simply outrageous as it indicates no real metal backing on the shorted shares. There shouldn't be any shorted shares allowed for these unique securities, but anything over 1% is cause for regulatory reaction, if anyone can wake up the SEC or the CFTC.
http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

There were some significant changes in the just-released Commitment of Traders Report (COT), for positions held as of August 23, for both gold and silver. More than anything, the COT appeared to confirm many of my findings, both recent and in the past. Let's cover gold first.

In a reporting week which saw gold climb by more than $120 at its peak, the commercials further reduced their total net short position by 18,400 contracts. Importantly, the three categories of commercial shorts all partook in the panic short covering. The big 4 bought back 3000 contracts, as did the 5 thru 8, with the gold raptors buying back the balance of 12,400 contracts. While expected, this reduction is remarkable. I've spent a good deal of attention, including almost all of last week's review, to the unprecedented circumstance of the COMEX commercials buying on a big gold price rally. This is beyond a man bites dog headline. This goes to the heart of manipulation and the regulatory failure to deal with that manipulation.

From the COT report of August 2 to the current report, the total commercial net short position has been reduced by more than 57,000 contracts (5.7 million oz), as all three commercial categories bought short positions back aggressively. There should be no question that this commercial buying was the prime force behind the $300 surge in gold from August 1 thru the peak above $1900. There should also be no question that the commercials uniformly panicked and took massive losses on their buybacks, as the technical funds and other longs cashed out at massive profits. This had never before happened in gold market history. The bottom line in that the buying back of commercial short COMEX gold contracts caused the price to explode. I believe the commercials also bought back another large chunk of short positions on the big gold price decline after the Tuesday cut-off. Make no mistake whether the commercials are buying back on price rallies or declines, they are booking massive losses on the buyback. That has never occurred before.

The first conclusion to be reached is that the commercials miscalculated in selling gold contracts short. Because of this miscalculation, the gold price has been subjected to unnecessary and artificial price movements. We have historic price volatility in gold because of the commercial's collusive miscalculation. Clearly, the commercial miscalculation occurred because all these commercials were speculating and not hedging. We are witnessing unprecedented volatility in gold because the commercials speculated excessively. Does the CFTC need a paint-by-the-numbers instruction book to understand this?

The second conclusion I would draw from the commercials short side miscalculation is the likelihood that they will not be quick to repeat this epic blunder. The commercials will not be quick to put their heads back into the lion's mouth, especially since the lion just bit those heads off. This was no close call for the commercials; this was an unmitigated financial disaster. This would suggest greater volatility to come as future commercial COMEX gold short selling should not emerge on price rallies. I think the commercials' abandoning further additional gold short sales was behind the stunning rally in gold prices late Friday. If I am correct, continue to expect large price movements in gold. Based upon the current COT report and my extrapolation since the cut-off, gold has now moved into a bullish market structure from a neutral position. This does not mean we won't see sharp sell-offs, just that much of the liquidation has been completed.

It was a different, but still a confirming story in the silver COT report. In a reporting week which featured a more than $4 increase at its peak, the total commercial net short position increased by 6400 to 47,100 contracts, the highest level since mid-April. Much of the 6400 contract increase was due to the silver raptors (the smaller commercials apart from the big 8) selling of 3300 contracts of long positions, reducing the raptor net long position to 2000 contracts. This was fully expected. What wasn't expected was that the big 4 (read JPMorgan) increased their net short position by a sizable 2700 contracts to more than 40,000 contracts (200 million oz), also the highest level in four months. By my calculations, JPMorgan held at least 22,000 contracts (110 million oz) of the 40,317 contracts held short by the big 4.

These are the figures as of the August 23 cut-off. On the subsequent sharp decline after the Tuesday cut-off, I believe this week's increase in the commercial net short position was largely reversed. Therefore, I would still classify the silver COT market structure to be bullish at this point. However, I would like to dwell a bit on the implications of this week's increase by JPMorgan in their already extremely concentrated silver short position. The first point I would make is that without this additional short selling by JPMorgan the price of silver would have soared well passed the $50 mark. In other words, JPMorgan single-handedly prevented the price of silver from climbing further during the reporting week. If JPMorgan hadn't sold as aggressively as it did, no other sellers would have emerged unless prices went significantly higher. This is why concentration goes hand in hand with manipulation. It can't get more manipulative than to have one entity primarily responsible for price action. That's the case with COMEX silver and JPMorgan.

Ten days ago, I wrote about Commissioner Bart Chilton's email response to those who wrote to him and about a recent interview he did which indicated he felt a concentrated position of 20% to 30% would be manipulative. I'm certainly not interested in punishing Chilton for his good behavior in being responsive on this issue and I hope he doesn't take it that way. He is to be commended for speaking up on this important matter. But, given his position, he also has a responsibility to have the facts straight. In his response and interview, he suggested there may be a concentrated COMEX silver position of 10% or so at times, but implied it was nowhere near 20% or more. The data in the current COT report indicate otherwise.

Once you subtract all the spread positions (as appear in the disaggregated futures only report), the net true open interest in COMEX silver futures is around 94,000 contracts. If JPMorgan holds 22,000 contracts net short, as my calculations indicate, that means that JPM holds over 23% of the entire market. This is a level above which Commissioner Chilton would conclude manipulation. I'm not trying to put words in Chilton's mouth or to put him on the spot, but I am very much trying to put the agency itself on the spot. I am trying to make this the black or white issue that it is. Does more than a 20% net share of a regulated futures market represent manipulation or does it not? Does JPMorgan have more than a 20% net share of the COMEX silver futures market? These are questions that require a yes or no answer. If my calculations are wrong, I will fully admit to being wrong. If my calculations and reasoning are correct and Commissioner Chilton's take is on the mark, then the CFTC needs to end this crime in progress forthwith.

I am still surprised that the commercials' miscalculation on the short side occurred first in gold and not in silver. I'm not surprised with their collective miscalculation, as that is in accord with the history of banking; just with the sequence. What caused them to miscalculate first in gold was the magnitude of the dollars involved, which runs into the many billions of dollars. The stunning price developments in gold appear to be purely a money problem not a physical material problem. The gold commercial shorts miscalculated the dollar risk and consequences of a rising gold price. That miscalculation is behind the gold rally to date and the price volatility to come. When, not if, this gets replayed in silver, it won't be solely a money problem as it is in gold. In silver, it will be a material problem as well. Gold is not rising due to a physical shortage, but due to a financial squeeze on the shorts. When the short covering panic descends on silver, it will be accompanied with a physical shortage as well. In my opinion, that's going to make all the difference in the world. A subscriber asked me to speculate on silver price action over the next few months. Volatility will remain great, due to the ongoing criminal manipulation, but I'll be real surprised if we don't take out all prior historic highs by a wide margin.

Ted Butler

August 27, 2011

Silver – $41.50

Gold – $1828