August 29, 2018 – Unresolved

There was an interesting article in Monday's Wall Street Journal by Laurence Fletcher entitled, "The Big Hedge-Fund Strategy That Isn't Working." I'm not sure if the article is subscription-protected or not so while I'll provide the link, I'll also provide a brief summary, since it turns out to be direct confirmation of much of what I have written, both recently and over the years.

https://www.wsj.com/articles/the-big-hedge-fund-strategy-that-isnt-working-1535281201

Fletcher's article concerns the distinct lack of success over the past several years by trend-following technical funds, following earlier success. He mentions that the funds had attracted an enormous quantity of investor assets given their earlier success, some $300 billion in all, and a figure often quoted on these pages. He even names various funds, including Winton Capital and AQR, also mentioned here in the past. Most accurately, he highlights how the investment performance of these trend-following funds has been terrible over the last several years.

Fletcher does point to some potential reasons for the rotten investment performance of the technical funds, including their now-unwieldy large asset size and fees considered too high. In the interest of full disclosure, I did write to Mr. Fletcher, suggesting he look at other aspects of this issue, including the fact that because these funds had grown so large in the aggregate and because they traded as one entity, they were distorting prices, inadvertently or otherwise. I indicated that this raised substantive regulatory issues and how the CFTC completely sidestepped the issue, but perhaps an inquiry from the Wall Street Journal might garner a response.

Finally, I pointed out how the technical funds' actions were so predictable that I believed they were being led into and out of positions by their counterparties,

particularly by JPMorgan. I enclosed a copy of my recent article, "The Lemmings Rush to the Sea". Even though I was courteous and complimentary towards Mr. Fletcher and my comments were extremely germane to the subject at hand, I haven't heard back from him and rather doubt I will, considering my experience in such matters over the years. For some reason, that's just the way it is.

Regardless, I am encouraged to see such strong confirmation of my core findings. Of course, this is in addition to the literal explosion in coverage of the COT market structure analysis approach. The articles that don't include at least some mention of the unprecedented managed money short positions in COMEX gold, silver and other metals have gotten to be few and far between. This is as it should be. In case I wasn't clear, the hedge funds at the center of Fletcher's article are the same managed money traders which have built up record short positions in COMEX gold, silver and other metals.

Despite the growing attention to the role of futures market positioning, I remain confounded how so few see (or at least fail to comment on) the cause and effect nature of positioning on price. To a person, everyone commenting on the current unprecedented and massive short position of the managed money technical funds reaches the inescapable (and correct) conclusion that this should prove to be very bullish on price. Yet, for some reason, very few, if any reach the equally obvious conclusion that it has been the initiation of the massive short position that has caused prices to decline in the first place. That's something I do have trouble reconciling.

Regardless, it is beyond question that a massive and unprecedented managed money short position exists in COMEX gold, silver and other metals. It is also beyond

question that this open short position is very much an unresolved equation. Sooner or later, the technical funds' massive short positions must be closed out. Further, these managed money traders must close out their shorted contracts by buying back these contracts, since there is no possibility of satisfying the contracts by physical delivery. The only question is when and at what prices do the technical funds buy back their massive short positions.

If the technical funds collectively buy back their massive and unprecedented short positions at prices lower, on average, than what they shorted at, they will walk away with a profit. If the technical funds collectively buy back their short positions at higher prices than what they sold at, they will walk away with a loss. The outcome, as they say, will be the bloodless verdict of the market. An important point is that the final market verdict will only be known when the short position is finally bought back – price gyrations while the verdict is awaited causes continuous alternating feelings of either exhilaration or despair, but these gyrations matter little in the end.

I know the matter of the coming resolution of the massive managed money short position is nothing new on my part, but it remains the central feature to future price movement. In fact, it dawned on me as I was writing this missive that I used the title, "Still Unresolved" to describe a previous extreme market structure almost exactly two years ago (on Aug 26, 2016 – in the archives). The only difference was that the managed money position was the mirror-image of what it is today. Back then, the technical funds held a then-unprecedented massive long position in COMEX gold and silver; the exact opposite of the current structure.

With the benefit of hindsight, we now know that the technical funds squandered away a near $4 billion open profit on long gold and silver positions by the fall of

2016; just as they squandered away any other serious open and unrealized profit in gold and silver, regardless of whether they were long or short. This is the reason, as the Wall Street Journal confirmed, that their investment performance has been terrible. Will they squander away their current big open profits on the short side? Time will tell, but I continue to bet that the technical funds will maintain their remarkably consistent and miserable streak of squandering large open profits and converting those open profits to realized losses.

There are some important developments at the CFTC, the federal commodities regulator. These, most emphatically, do not include the rash of announcements today by the Enforcement Division of new wrist slaps and light fines for spoofing and manipulation of precious metals prices on the COMEX, including but not limited to, separate charges against Deutsche Bank and UBS. The CFTC, after years of denying anything untoward on the COMEX, seems now to be spitting out precious metal manipulation charges on a regular basis. This is ironic since most observers of gold and, especially silver, knew all along what a corrupt cesspool was the COMEX.

Of course, the new Enforcement Division charges are more annoying than meaningful, since they are penny-ante and avoid the real gold and silver manipulation revolving around JPMorgan. It's been about a year and half since I wrote to Enforcement Director James McDonald about the unique role of JPMorgan and how this crooked bank never took a loss when trading COMEX futures and was amassing epic quantities of physical metal at prices it had manipulated lower. To McDonalds's great shame and disgrace, JPMorgan poured on the juice after his arrival, making more under his watch than anytime previously. Well done, Jamie.

The big news at the CFTC was certainly not the assorted petty and meaningless

charges of precious metal manipulation, but the Senate approval of two new Commissioners, bringing the Commission to five full members for the first time in years. In particular, one of the new Commissioners, Dan Berkovitz, filling one of two minority slots reserved on the Democratic side, is no stranger to the agency, having served as general counsel when Gary Gensler was chairman.

It has been reported that Berkovitz was lined up to be appointed a Commissioner since early this year, but I chose not to write about it as I didn't want to jinx it. In short, I strongly believe he is one of the few good guys in regulatory circles. In fact, while he was general counsel, he was one of the regular email recipients of the articles I sent twice weekly to the agency, JPMorgan, the CME, etc. When he left the Commission, I thanked him for his service. Obviously, he'll be back on my regular mailing list starting today.

Even before Dan Berkovitz served as the agency's general counsel, he established a strong record as a fierce proponent for legitimate speculative position limits. Before joining the agency in 2009, he was counsel on the Senate Permanent Subcommittee on Investigations and played a lead role in a seminal report on position limits in the wheat market that I happened to write about back then. This predates the start of this subscription service by a few months (where does the time go?).

https://www.investmentrarities.com/ted-butler-commentary-june-29-2009/

In short, Berkovitz's main interest is position limits, which as many of you may know, was my obsession for many years as the one sure antidote to the silver manipulation. As such, his appointment as a Commissioner brings new life to this most important issue. In fact, I can't conceive of a better candidate for the job. Despite my strong admiration for Berkovitz, I also recognize that conditions have changed radically

since he was last at the agency. Before, he was very much a part of the majority, under Gensler, pushing for legitimate positions limits; only to have failed in the end.

Today, Berkovitz is in a distinct minority at an agency that seems hell-bent on not disturbing JPMorgan's and the CME Group's stranglehold on the ongoing manipulation. As such, I can't help but wonder why he would even attempt to alter the present course, seeing as it looks so hopeless from my perspective. Then again, nothing ventured is nothing gained. At his core, he has proved to be a dedicated public servant and I wish him nothing but the best. If anyone can see how distorted our markets have become due to the excessive speculation of the managed money traders and JPMorgan, surely it is Berkovitz. Welcome back, Dan.

While we wait for the certain resolution of the massive managed money short position in COMEX gold, silver and other metals, there is little to do aside from monitoring the ongoing contest and preparing ourselves as best as we see fit. For me that involves continuing to load the boat with otherwise reckless out of the money call options on SLV. The only thing that makes this approach less than reckless is my strong conviction that the resolution of the unprecedented technical fund short position will be with these funds tripping over themselves to buy at some point. When that point might be I don't know, but the vision of massive numbers of technical fund buy orders attempting to squeeze through a very narrow door to the upside is fixed in my head.

As always, my mention of buying call options is in no way intended as an invitation for anyone to do the same, as this is as close to the most extremely risky strategy as is possible, save for holding positions on margin, which should always be avoided. My only reason for bringing up the issue is as a demonstration of how I feel about silver

at this time.

As far as what this week's new COT report might indicate, for the first time in quite a while, no new price lows were made in gold and prices were up as much as $20 over the course of the reporting week. As such, it I quite possible that we will see some managed money buying and commercial selling for the first time in quite some time, although I am much more an observer of the data and not predicting what the results might be.

Silver came closer to making new price lows and finished barely unchanged for the reporting week, so the likelihood of managed money buying is less than in gold. Trading volumes were on the lighter side in each, especially when rollover spread volume was factored in for silver. There is some room for a surprise, given the large drop in total open interest in silver over the reporting week; but it would appear the reduction in total open interest was related to spread liquidation and not outright positioning.

We are bound to see some managed money buying and commercial selling at some point, seeing how extreme the managed money selling has been since June 12, but it is important to keep things in perspective. There's no way to neutralize and resolve eleven weeks of cumulative managed money selling and commercial buying in a week or two (unless prices and trading volume truly exploded). Therefore, the market structure in gold and silver and other metals still looks locked and loaded to the upside, awaiting only the trigger of somewhat higher prices. Sometimes, I have the sensation that someone in the space control center keeps hitting the ignition switch to activate the rockets on a Saturn V on the launch pad, but there's some type of loose connection that needs only to be jiggered with to set the price rocket off.

That said, while someone is jiggering with the ignition wires trying to figure how to make the right connection and set this baby off, prices can stagnate and even sell off. However, we are not in the least structured for a major price decline.

Despite the stagnation in prices over the past few days, gold has managed to close above its 20 day moving average each day, more a result of the decline in that moving average (now under $1208 basis December), than by price strength alone, but that still counts as an upward moving average penetration. Importantly, on today's close, gold is less than $20 below its key 50 day moving average, a moving average it has been below for more than four months, an unusually long time. The unusually long period of time that gold has remained below its key moving average is largely responsible for why there has been so much managed money shorting and why, whenever that moving average is penetrated to the upside promises to be an equally potent buy signal.

Silver has yet to penetrate its 20 day moving average, now at $15.01, and is further away from its 50 day moving average, by 80 cents, but when the price of silver begins to run, upward moving average penetrations can come in the blink of an eye.

I'd also like to mention that while the precious metals and copper are threatening or beginning to threaten upward penetrations of their various moving averages, the US dollar index is threatening to penetrate its 50 day moving average to the downside. It's certainly not the principle thrust of my analysis, but a decline in the dollar index is certainly compatible with a surge in precious metals prices.

Finally, on the money scoreboard tracking of the newly-added managed money short position since June 12, today's closing prices for gold and silver indicate not much change from Friday's tally of the technical funds being ahead by $508 million. Gold is

the big money contributor in the managed money scoreboard and it is unchanged from Friday, while silver is off about ten cents from Friday’s close at publication time, boosting the technical funds’ combined open profit by $25 million or so to $533 million, still down from $950 million two weeks ago.

Ted Butler

August 29, 2018

Silver – $14.68 (200 day ma – $16.36, 50 day ma – $15.54)

Gold – $1212 (200 day ma – $1292, 50 day ma – $1231)