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Market Comments

Given the strong price rise at the start of the past week on decent volume, some deterioration was expected in the market structure for COMEX gold and silver. That is, it was expected that long speculators, in the form of technical funds and smaller traders, would have bought futures contracts, while the dealers (commercials) would have sold short additional futures contracts on the price rise. What was unexpected was the extent of the deterioration in gold.

The Commitment of Traders Report (COT) released Friday, for positions held as of Tuesday August 4, indicated a sharp increase in the net speculative long and commercial short position of more than 25,000 gold contracts (2.5 million oz). This increase pushed the total net speculative long/commercial net short position to its highest level in more than a year, to 228,000 contracts (22.8 million oz). The basic premise of COT analysis is to be aggressively bullish when the commercials hold a small net short position and cautious when they hold a large short position. Since the commercials are more net short than at any time in the past year, the COTs are flashing warnings of a gold sell-off.

When a gold sell-off may materialize is always uncertain, but the close proximity of the key 50 day moving average, only some \$12 below Friday's closing futures price of \$955, suggests it could come at any time the dealers decide. This is both good news and bad news. The bad news is that a liquidating gold sell-off could come at any time. The potential good news is that we don't have to fall a great amount price-wise before the potential liquidation commences. The greater the price is above the key

moving averages the further the price must fall before real liquidation occurs. For instance, back in the beginning of June, when the COT structure almost equaled the current gold structure, the price was some \$70 above the level of the 50 day moving average at that time. In other words, we needed to fall \$70 back then, which we did, in order to penetrate the 50 day moving average and generate liquidation. Now, \$12 should do the trick. Of course, there is no way of telling in advance how far we may drop below the moving averages, once penetration occurs. It's different each time, as this chart indicates.



In silver, the deterioration was less dramatic. For the week, the net commercial short position increased by 3,000 contracts (15 million oz). While we are at COT levels where recent sell-offs have occurred, we are not anywhere near historical COT extremes, as we are in gold. In fact, my primary concern for a silver sell-off rests on it being pulled down by a gold sell-off. As in gold, the 50 day moving average in silver is not as far below the current price as it has been in the past. As the chart indicates, we're only 50 cents above the key moving average currently. Back in June, when the COT structure was materially worse than it is now, we were 5 times more, or \$2.50 above the 50 day moving average (which was subsequently violated)



What the respective charts and COT structures in gold and silver suggest to me is a theme I recently wrote about in my D-I-V-O-R-C-E article. I see the price of silver and gold soon decoupling. The gold COT structure is much more bearish than the structure in silver, as has been the case for all of this year. The only real question in my mind is if they part price paths now, or after one more joint trip to the downside. If gold does sell-off, will it pull silver down as well, as it always seems to do (and vice

versa), and then silver pulls away on the subsequent price rally? Or does silver prove to be immune to a gold sell-off (if and when it occurs) and they part company in the here and now?

In addition, the big 4 short traders in silver have shown a reluctance to aggressively add to their short position on the recent rally. On the roughly \$2.50 rally from the lows of mid-July to the recent highs, the big 4 added virtually no short contracts. And the Bank Participation Report, also released on Friday, indicated that the one or two big US banks reduced their short silver position, month over month, while the total commercial net short position increased slightly over the same period. (To be fair, this was also the case in gold). This is encouraging, as it may suggest that the big US bank(s) may be ending its control of the silver market. Considering the dramatic developments that appear to be occurring at the CFTC with regards to speculative position limits, it would seem logical that the big shorts may be pulling in their horns.

It's not just the COT market structure that leads me to conclude the coming parting of ways in the gold/silver price relationship. As I indicated in my previous article, examples of relative strength in physical silver buying compared to gold are evident in ETF and US Mint coinage statistics. Here's another one. Since Mid-March, the net addition in gold holdings in the big gold ETF, GLD, is now flat, having recently reduced its holdings notably. Over that same five-month time period, the big silver ETF, SLV, has added almost 30 million oz (almost 12%) to its holdings. There appears to be determined buying of physical silver (as there should be) compared to gold, and I sense this will continue.

Later this week, I will probably have another article on the coming break in the gold

and silver price relationship, but let me summarize these comments with what the current developments in the COT structure may mean to subscribers reading this. In the future, I will try to respond to those who have asked me what I think about various mining stocks and how to gain leverage to the coming silver price rise.

For now, let me just say this. You want to have a maximum or near maximum long exposure to silver on a long term basis. Yes, the price may suffer one more set back in the near-term, if we have a sell-off in gold, as is suggested by the gold COTs. Any silver sell-off in that case, should we get one at all, should prove short lived. Any such silver sell-off should be bought aggressively; even possibly employing leverage to the extent an investor may be comfortable with that. Do not ever employ leverage if there is any chance you might be forced to sell any such leveraged silver positions due to lower prices generating a margin call. One way to gain leverage and avoiding possible margin calls is by buying call options, say on SLV or with COMEX call options, or by buying silver junior miners.

Since I am concerned that a gold price decline may pull silver down, I may seek to protect aggressive silver long positions with some type of gold hedge to the downside. It's hard for me to see how gold can advance strongly in price without silver advancing even more. It's easy for me to imagine silver advancing strongly in price, due to its own circumstances, and gold failing to keep pace.

The current 228,000 commercial net short position in COMEX gold futures is not a structure that historically has supported strong gold legs upward, although anything is always possible. On the other hand, the current 39,000 commercial net short position in silver is not that negative on an historic basis (although there have been silver sell-offs this year from this level). The average investor should never even

consider a straight short gold position, as there is too much risk under a "what if" scenario. There are some "safer" ways to position for a gold sell-off against long silver positions, such as put options or ETFs structured to the downside, to temporarily ride out a negative COT structure. Please remember, these are examples, not recommendations. Most readers shouldn't mess with such strategies, and should focus on the long term upside in silver. That's where the real money will be made. Don't ever do anything that might throw you off balance and jeopardize your core long term silver position.