Weekly Review

For the second consecutive week, gold and silver tacked on gains, with both achieving seven week highs. Gold added $29 (2.4%), while silver finished higher by 75 cents (4.6%). As a result of silver's relative outperformance, the silver/gold price ratio tightened in another one and a half points to under 72 to 1. Although silver is now valued stronger to gold than it has been in two months, it is more undervalued on any other longer term basis; making silver a more compelling relative investment value, in my opinion.

It was an unusual week, in that all the price action was on Tuesday with the rest of the week being flat to down. You may recall on Tuesday, both gold and silver decisively penetrated their 50 day moving averages on high volume; with silver having done so for only the first time in six months. As feared, there was significant deterioration in the market structure as defined by the Commitments of Traders Report (COT), as the headline number of the total commercial net short position increased notably in both gold and silver, raising some concern.

There may have been some mitigating factors when looking at the report under the hood and, more importantly, there appears to be present other factors away from the COT report that may come into play in the near term. Let me run through the usual format before getting into some of the week's other interesting developments.

It was another well above average week in the physical turnover among the six licensed COMEX silver warehouses, as more than 6.6 million oz either came in or were removed. Total COMEX silver inventories fell 1.3 million oz to 176.4 million oz, remarkably close to where these inventories, the second largest in the world (behind the SLV), began the year. I know I beat this issue to death, but please consider that the weekly movement of 6.6 million oz annualized is more than 40% of the world mine production of silver.

I also know that this unprecedented physical turnover is one of the unmentionable topics of the precious metals market despite being so unusual and so easy to verify. At the very least, I know that no one would undertake the time, effort and expense to move such an unusually large amount of metal into and out from the six COMEX silver warehouses unless it was absolutely necessary to do so. To me, absolutely necessary is another term for insatiable demand. In addition to the remarkable consistency of the unusual movement over the past more than 3.5 years, the data suggest it is actually increasing.

Another physical silver related issue that remains overlooked is the deposit/withdrawal pattern of metal in the big silver ETF, SLV, the world's single largest holding of metal. Despite the two best price weeks recently and on higher than normal volume, over that same time a significant amount of silver has been redeemed from the trust; more than 9 million oz. There's no way of me knowing if the metal was physically shipped out of the London warehouses or stayed in place as a result of a conversion of shares to physical metal ownership, a simple process for those who may be involved. In either event, the reduction in reported metal holdings in SLV is serious food for thought.

For one thing, the redemptions in SLV are completely counterintuitive to what normally occurs when prices rise and trading is heavy. Usually, net investment demand increases on strong buying and higher prices, necessitating the deposit of metal to correspond with the increase in new shares created by the investment demand. The best current example is in GLD, the big gold ETF.

While the redemption pattern in GLD has been pronounced over the past two years as investors sold on declining gold prices, there have been three straight days of metal deposits into GLD on the recent price strength and higher trading volume. In other words, the deposit pattern in GLD this week was completely normal; whereas the redemptions in SLV on the same or greater price strength and trading volume was as cockeyed as it gets.

Sometimes, increased investment demand can be blunted by the short selling of shares of SLV, which short circuits the need to deposit metal; but short selling would not result in redemptions in any event, only a lack of deposits. Therefore (and just like the COMEX silver warehouse turnover), one must question why metal has departed the SLV on price strength and increased trading volume? The only answer I have been able to come up with is that someone big has been buying shares of SLV and quickly converting those shares to metal to avoid the 5% ownership reporting requirement of the SEC. Someone big buying silver has been a recent theme of mine. Any and all alternative explanations are welcome.

Sales of Silver Eagles from the US Mint set a new annual record yesterday, but sales for the remainder of the year must be near an end. One notable feature to the Mint's reported sales this month has been a falloff in Gold Eagle sales and a continued lack of sales for Platinum Eagles (zero for two and a half months). The weak relative sales for Gold and Platinum Eagles compared to Silver Eagles would seem to enhance my big buyer premise, along with the unusual redemption pattern in SLV. While I have a sense that retail (and institutional) silver investment demand may increase soon, given world developments (more on this later), broad retail demand does not appear to be behind the record sales of Silver Eagles. That leaves the big buyer theory as the most compelling. http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

The changes in this week's COT report were in the expected, but unwanted category. From their respective low points in the beginning of November there has been a marked increase in the total commercial net short position in both gold (66,000 contracts) and silver (23,000 contracts); not usually good news. However, there are still some unusual internal COT measurements, as well as potentially disruptive world developments that may overshadow the deteriorating headline numbers.

In COMEX gold futures, the total commercial net short position increased by 27,200 contracts, to 116,600 contracts, the highest level since late August. Over the past four weeks, the total commercial net short position has expanded by 66,600 contracts (6.66 million oz). But I continue to note with great interest that despite this significant increase in the total commercial net short position, no actual new commercial short selling occurred in gold. I know that sounds contradictory, so let me try to explain it as simply as I can.

A standout feature to the gold and silver market on the COMEX has always been the concentrated short position of the 4 and 8 largest traders which are invariably in the commercial category. The concentrated short position is more pronounced and manipulative in silver, but both markets are characterized by the fact that the 8 largest shorts in each market usually comprise a larger net short position than the total commercial net short position. In other words, if the 8 largest shorts in COMEX silver and gold didn't exist, there would be no total commercial net short position at all — there would be no headline number as we know it. Stated differently, without the 8 largest shorts in COMEX gold and silver, there would be a commercial net long position in each market.

What's interesting in COMEX gold (as I remarked about last week) is that the 8 largest shorts have not added to their dominant short position either this week or over the past 4 weeks even as the total commercial net short position has grown by 27,220 contracts and 66,600 contracts respectively. In fact, despite the pronounced increase in the headline number, the concentrated short position of the eight largest traders is lower than it has been in 4 or 5 years or longer. I admit that this could be a temporary aberration and the big 8 in gold may resume shorting gold on higher prices, but usually all the commercial categories trade in unison and if the new pattern of commercial discord is more than temporary, it might signal change is afoot.

By gold commercial category, it was all the raptors (smaller commercials) who sold long positions this week to the tune of 28,600 contracts with the big 4 actually buying back 8300 shorts, while the big 5 thru 8 adding 7000 new shorts. On the buy side, it was mostly a technical fund affair, as traders in the managed money category bought a net 22,000 contracts, including the buyback of more than 9000 short contracts.

While I equate the increase in the total commercial net short position and the counterparty technical fund net long increase as a deterioration of the market structure, at the same time it is the strongest (if not sole) explanation for why gold prices advanced as much as $100 from the lows in early November. I mention this because it explains the rationale for analyzing the COTs in the first place.

In COMEX silver futures, the headline commercial net short position expanded by a very significant 8800 contracts to 35,400 contracts; like in gold the highest (less bullish) level since late August. 8800 contracts is the equivalent of 44 million oz, close to the record of what the US Mint will sell in Silver Eagles this year and more than the annual silver mine production of the US and all but 4 or

5 of the leading silver producing countries. I'm pretty sure, based upon price and volume patterns on the COMEX that the 44 million ounces was transacted on one day (Tuesday). A small group of COMEX speculators transferred, on one day, the ownership equivalent of more than 5% of world annual mine production and there is scant evidence that even an ounce of that was directly related to legitimate hedging.

For the reporting week, the raptors were the main commercial sellers, peeling off another 5200 long contracts, while the big 4 added 3200 new shorts and the 5 thru 8 added the remaining 400 new shorts. While I am mostly disappointed with the additional new short sales by the big 8 (as that is the key), I still note that from late October price lows (around $15) the two dollar increase in the price of silver occurred without any increase in big 4 or big 8 new short selling. As was the case in gold, from the recent price lows the resultant increase in the total commercial net short position in silver did not come from new shorting by 4 and 8 largest shorts (although it did this reporting week).

Once again, the technical funds accounted for much of the buying in silver this week as managed money traders bought almost 5600 contracts, including nearly 5000 more shorts bought back, extinguishing another load of rocket buying fuel. From the record managed money short position of Oct 28, 27,000 contracts of technical fund shorts have been bought back on what must be considered an anemic price rally. The only consolation continues to be that the raptors accounted for 24,000 contracts of what the technical fund shorts bought and the big 4 and big 8 accounted for none of it. This is still the main silver COT story of the past six weeks.

It still looks clear that the technical funds, in marked contrast to what I predicted, made out big time and a good number of raptors were crushed for the very first time. I don't know how this isn't a game changer, in two respects. One, now that the technical funds have closed out so many silver short positions profitably and mostly lower than current prices, whatever reason(s) they had for doing so would seem to make it unlikely for these traders to reinstate those short positions on still lower prices.

Maybe that's wishful thinking on my part, but whatever made them depart from waiting until the moving averages were penetrated to the upside would seem also to discourage them from establishing a big short position on yet lower prices. The most plausible explanation for why the technical funds bought back so many short silver contracts (prematurely) was because their collective profits were so large and potentially at risk so as to prompt them to ring the cash register. That would seem to argue against them shorting heavily on lower prices and if that's true would suggest a lessened risk to the downside.

It looks even clearer that the raptors who I believe got hurt so bad and were forced to liquidate at very large losses are no longer in position to rig prices lower for the express purpose of inducing technical fund short sales. One constructive aspect to the silver COT report is that since Oct 28 there has been apparently no build up at all in the technical fund long position. This also lessens the odds against a serious price decline because there doesn't appear to be any fuel to the downside from technical fund long liquidation since so few long contracts were bought. Yes, I know there has been a deterioration in the COTs and I certainly know how crooked and manipulated the COMEX is, but under the hood, I don't see compelling evidence of big prospective technical fund selling. On to other developments.

Even though I think I know how corrupt are the big banks and how compromised our regulatory and political processes have become, I was genuinely shocked at the inclusion of the exemption apparently granted the big banks in the big spending bill said close to passage. Forget not knowing whose worse Republicans, Democrats, Congress or President, I know I feel violated by all of them. This was a spending bill for cryin' out loud and there is no justification to resorting to such underhandedness under the cover of night. The action made

me ashamed to be an American and explains why our politicians are held in such low regard by the people, as they appear to be the best (big bank) money can buy.
http://www.bloomberg.com/news/2014-12-12/wall-street-s-win-on-swaps-rule-shows-resurgence-in-washington.html

A number of readers asked my opinion on the story circulating about the CME Group instituting various circuit breaker regulations on various metal futures on the COMEX and NYMEX.
http://www.zerohedge.com/news/2014-12-11/what-do-they-know-cme-implements-gold-precious-metals-circuit-breakers-400-wide

Seeing as the CME and the COMEX are the main mechanism of the gold and silver price manipulation, it is prudent to be wary of anything they propose in precious metals trading. And I would agree that any changes the CME propose are most likely for their, as opposed to our, benefit. That said, I don't think the circuit breaker changes are of real significance. Before I explain why, please know that sometimes I feel like the adult who comes home unexpectedly early only to find a full-blown keg and toga party which his teenage children have arranged without permission. I confess to much more preferring chugging beer and skinny-dipping with my teen friends than in cutting off the music and sending everyone home. I don't want to rain on anyone's parade, but these proposed changes by the CME are much ado about nothing.

There are no effective daily price limits in COMEX and NYMEX metal futures and there haven't been in nearly 20 years. Instead there have been a series of circuit breaker rules that bear little resemblance to true daily price limits. In the old days (there I go sounding like the adult again), there were firm daily price limits in force. As and when a daily price limit was hit (up or down), trading mostly ended for the day, unless one was willing to sell on a limit up or buy on a limit down. The main purpose of daily price limits was to give market participants a day to think things over and chill out. If the market news was significant enough, limit moves could run for days, most often with ever expanding limits (spelled out before hand). As I said, those were the old days in the metals.

The circuit breaker revisions that the CME is proposing have nothing to do with daily trading limits. If those circuit breaker limits are hit, the no trading chill out period is for a few minutes, not for the whole day, and will expand as often as necessary to generate trading. I understand the general distrust of the CME (and believe I have contributed to it), but I believe too much is being read into the proposals. After all, there were similar circuit breakers in effect for the last several years, including May 1, 2011 and every big sell-off in COMEX silver and gold. Please don't interpret this as me favoring or opposing hard and true daily trading limits because it's a complicated issue and I don't have a firm opinion. And please don't also think of me as an old adult spoilsport.

One issue that I don't think is much ado about nothing is what is occurring to crude oil prices. In contrast, I think there is not enough appreciation for what is going on. From the peak in June, West Texas Intermediate Crude is down almost $50 a barrel, on Friday's close of under $58. Incredibly, the last $20 of the decline has come in only the last three weeks. As I explained previously, oil is a funny commodity in that once it gets knocked off its equilibrium its price moves can be extreme. Oil is also, by far, the largest commodity and is truly what makes the world go round. You almost have to take out a pen and paper and do the math yourself in order to appreciate the dollar impact of oil.

More than 90 million barrels of crude oil are produced and consumed daily. At $108/bbl., the world's oil production and consumption came to almost $10 billion or more than $3.5 trillion annually. At $58/bbl., the daily production/consumption value drops to $5.2 billion or less than $2 trillion. Should current prices remain at or below current prices, at least $1.5 trillion will be saved by consumers and lost to producers. While a significant amount of the

90 million barrel per day production is exported from oil-producing countries to oil-consuming countries, it's not just net oil exporters who will suffer. Even in countries that are net oil importers, like the US, the oil producers of our country will suffer due to the severe drop in price.

As I wrote previously, the number of oil consumers are massively in the majority compared to the number of oil producers by some large factor such as 1,000 or 10,000 or more consumers to every one oil producer. Therefore the financial pain will be felt much more acutely by the producers, even though the total savings and lost revenue are roughly equal between the consumers and producers. Therein lies a big potential problem and the case for world financial instability.

It seems to me that the pain to the producers is just starting to be felt. The cause of the coming pain seems obvious in the shocking price decline to date; but because not enough time has evolved, the true effect of the price drop is only beginning to be felt or comprehended. It seems clear to me that in the long run, oil production will be reduced enough to restore price levels to former levels as that is the history of oil pricing. I just don't know if the production cuts will come as a result of voluntary cuts by Saudi Arabia and other OPEC members (including prospective members, like Russia) or by involuntary production cuts by North American producers (thru bankruptcy). I would define the long term as six months to a year or two. It brings to mind the old Fram oil filter commercials of pay me now or pay me later; only with the inevitable production cuts.

One thing I am becoming more convinced of is the financial instability the crash in oil prices may bring in the interim. The potential instability seems to be coming at a particularly unusual time in that over the past four or five years we have built up extreme valuations in some assets (think stocks and bonds and real estate) and at the same time other assets have been unusually depressed (think gold and silver). The analogy of markets being akin to boats being overloaded on one side comes to mind in that investors tend to move with force to one side of the boat or the other. Once overloaded on one side, there exists the possibility of an event to come along and cause them to rush to the other side in a hurry, bringing imbalance to various markets.