December 28, 2019 – Weekly Review

Despite some late price weakness in silver on Friday, gold and silver prices rose fairly sharply in the abbreviated Christmas holiday trading week, with both ending at 8 week closing highs. Gold finished the week up by $34 (2.3%), while silver added 61 cents (3.5%). As a result of silver's relative outperformance, the silver/gold price ratio tightened by a full point to 85 to 1 (still sky-high and reflective of silver's gross undervaluation).

Both gold and silver decisively penetrated their respective 50 day moving averages to the upside this week, after trading below the same averages for nearly two and a half months. Total open interest in COMEX gold and silver futures rose strongly both into the Tuesday cutoff for the reporting week and after, suggesting aggressive additional managed money buying and commercial selling. As a reminder, I'll have comments on Monday's delayed Commitments of Traders (COT) report late that day (around 6 PM EST).

This week's strong price gains and expected additional managed money buying and commercial selling bring into sharp focus the most central theme currently in force for gold and silver, namely, how the unprecedented positioning changes of the past few months in COMEX futures will play out. For the first time ever, there was no great managed money selling and commercial buying on the price declines and downward moving average penetrations since the price highs of September. That strong managed money selling might still lie ahead, but what is unprecedented is that it hasn't occurred to this point.

Another observation about the strong price gains this week is what affect they had on the combined open and unrealized losses for the 7 big commercial shorts (excluding JPMorgan). Roughly $1.2 billion was added this week to the $2.5 billion open loss of last Friday, pushing the total open loss to $3.7 billion, or more than $525 million per trader on average. Certainly, this is not the largest open loss suffered by the 7 big shorts, as at the price highs of September, those open losses exceeded $5 billion. On the other hand, the open loss as of yesterday was double the open loss of $1.8 billion just three weeks ago. I'll have more on this later on.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses cooled off sharply this holiday-shortened week as "only" 2.2 million oz were moved. Total COMEX silver warehouse inventories increased by 0.3 million oz to 317.8 million oz, another new all-time high and another argument against increased COMEX silver inventories being bearish for price. No change in the JPMorgan COMEX warehouse (161.4 million oz).

The December total COMEX gold deliveries proved to be largest of the year by far, at 14,761, but that includes redeliveries, which deflate the number of true deliveries. One thing that I had been expecting was that Citibank would end up redelivering all 1493 gold contracts it stopped early in the month (all in its house account), since it had done so on four other occasions over the past year (imitating Goldman Sachs).

While expected by Citi's past practice of redelivering every contract it stopped early in the delivery month, I still have no idea why anyone would stop gold deliveries early in a delivery month, only to reissue every contract later that same month. I can think of illegitimate reasons for doing so (say, as a front for some other entity), but no legitimate reasons. All told, Citi has stopped and reissued 9212 total gold contracts over the past year.

https://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

As far as what to expect in Monday's COT report, gold and silver prices were strong into Tuesday's cutoff, with gold up $23 and silver up more than 75 cents. Total open interest over the reporting week increased by more than 31,000 contracts in gold and by nearly 17,000 contracts in silver, so it's reasonable to expect big increases in managed money buying and commercial selling in Monday's report (although spread positioning may have inflated the total open interest increases). Since the Tuesday cutoff, total gold open interest has climbed by a further 18,000 contracts and silver by roughly 2500 contracts.

Thus, there is no indication that the big commercial shorts have covered any of their concentrated short positions – to the contrary, there is every indication the concentrated short positions have increased. This further sets the stage for a dramatic resolution of an existing market structure that must be resolved. Either the big commercial shorts will prevail in the end and succeed in driving prices lower and inducing massive managed money selling on lower prices or they won't. The "or they won't" part includes the big commercial shorts taking it on the chin and buying back short contracts at higher prices and big realized losses for the very first time.

While no one knows how this will turn out, it goes to the essence of what has driven gold and silver prices for decades, namely, the changes in futures positioning between the big commercials and the managed money traders on the COMEX. As I have long pointed out, the popularity of the COT report has grown remarkably in acceptance among those who analyze the markets for a very good reason – knowing who is buying and selling is invaluable information. And there can't be much argument, up until now, how it always has turned out in the past, namely, with the big commercial shorts always winning or at least avoiding taking big realized losses.

In essence, the market structure premise that I and many others adhere to is based upon the commercials always prevailing in the end and the managed money traders always failing in the end, even when they have amassed big open profits (like now). Recently, I have taken pains to describe the current lopsided market structures in gold and silver as being extremely bearish or bearish in conventional historical terms; however, with some very strong doubts that it will turn out as it always has in the past with the big commercials prevailing. But there should be little doubt that among those who have come to embrace the COT market structure premise, the vast majority expect the ultimate resolution to result in lower prices in which the commercials escape big realized losses.

A case in point is this public release yesterday by Tom McClellan, a longtime observer and COT analyst whose work I've come to respect. I've formed my own take on COT market structures as a result of simple observation over the decades and I would assume McClellan has done likewise. I think it's fair to say that both of us are in the camp that the commercials have always prevailed and it's wise to respect their positioning when it gets extreme. I do have some strong disagreements with what Tom wrote here and would ask you to read his take in order to understand what I take issue with.

https://www.mcoscillator.com/learning_center/weekly_chart/gold_cot_data_calls_for_more_of_a_drop/

McClellan states that a lot of the commercials in COMEX gold futures are the gold mining companies which sell against their production. As I've indicated in the past, there are very few, if any gold mining companies selling COMEX gold futures, either on their own or through a dealer. For one thing, most publicly-owned and listed gold (and silver) mining companies are subject to the rules of the Financial Accounting Standards Board (FASB), which requires public disclosure of any such hedging. I'm aware of no mining companies reporting such hedging in their public earnings statements.

Separately, should a mining company decide to sell COMEX futures to lock in a price for its production, even if it did so through a bank or dealer, it would come as a shock to the shareholders of that company. Most, if not all shareholders of mining companies hold the shares precisely because they expect higher prices for gold, leading to higher profits as a result. Take away the ability to profit on future increases in the price of gold (or silver) and many investors would quickly switch to companies not hedging their production. Have we all forgotten the disastrous experience of two decades ago when Barrick Gold and AngloGold hedged years of future gold production? Miners are not the commercial sellers on the COMEX – foreign and US banks are the short sellers.

Where McClellan is right is that the commercials have always prevailed, as this is the basis of the market structure premise; along with the managed money traders being the inevitable victims. But I would disagree that this makes the commercials the "smart" money and the managed money and other speculators the "dumb" money. Yes, I have consistently referred to the managed money traders as "brain dead" because their approach was mechanical and apparently devoid of human reasoning – but that's not the same as dumb in my opinion. And even if dumb has been the correct description of the managed money traders to this point, their recent refusal to sell suggests they may have smartened up.

Instead of "smart", I would call the COMEX commercials "crooks and manipulators" because they always sold enough gold and silver contracts short to eventually overpower any amount of buying the managed money traders came up with, until the managed money traders had exhausted their buying power and began to sell. I suppose you could call the commercials smart in some sense, but it is more a clear sign of manipulation on the part of the commercials than anything else. The commercial selling never had anything to do with fundamental analysis about gold being cheap or expensive, it was always strictly related to selling whatever the managed money traders would buy.

One big thing missed by McClellan (and just about every COT analyst out there) is the concentrated nature of the commercial short position in COMEX gold and silver. Nearly 92% of the total commercial net short position in COMEX gold futures is held by just 8 traders (as of Dec 17) and not one of these traders is a mining company. In silver, the 8 largest traders hold an astounding 142% of the total net commercial short position. The 8 largest COMEX gold traders hold 29 million oz short and an astounding 500 million oz of silver short. Any thought that any one of these traders (except JPMorgan) are selling against physical inventory is absurd – the numbers are too large, particularly in silver.

As a reminder, the existence of an extremely large concentrated position is the number one sign that a price manipulation is in effect. Looking at the total commercial short positions in COMEX gold and silver gives the impression that many different commercials in the business of mining gold and silver have collectively decided that prices are too high and must come down. In reality, however, 8 crooked banks have decided to sell short enough contracts to satiate managed money buying and only one of those banks (JPM) has enough physical metal to match its paper short sales.

All that said, it could very well turn out that the commercials will prevail again and succeed in rigging prices lower and inducing massive managed money selling. But that would have more to do with criminal market activity and manipulation than it would being smart. And while I fully stipulate that the crooked commercials could yet again prevail on this go around, that's not guaranteed. Enough things have changed to imagine a different outcome this time around. What things?

For one, the Justice Department and CFTC have announced that each is investigating precious metals activity on the COMEX, with a particular emphasis on traders from JPMorgan. Even though the DOJ and CFTC are doing everything in their power to avoid looking at the most serious signs of wrongdoing, namely, that JPM and the other large commercials have never taken a loss when adding short positions and that JPM has amassed virtual mountains of physical gold and silver at depressed prices, the odds have increased the regulators may be forced to confront the obvious.

No regulator is going to take overt action that might lead to the demise of JPMorgan or the CME Group, but I'd be willing to bet the serious issues have come up in private conversations and negotiations between the DOJ and JPMorgan. The gold and silver manipulation has lasted so long and has become so obvious so as to rule out it lasting indefinitely. While the Justice Department would never come down on JPMorgan with the blunt hammer it is capable of, neither can it openly address the issues on never losing and physical metal accumulation. Any behind the scenes action could lead to an ending of the manipulation.

Then there's the ideal position that JPMorgan finds itself in. Actually, JPM didn't find itself in its current position of holding more physical gold and silver than anyone in history, it worked diligently every single day for the past near nine years to get to its current position. No one buys any investment asset with the intention of selling it at a loss and that's truer for JPMorgan than just about any entity in existence. Add in the fact that JPM is in perfect position to double cross the other commercials (its prime natural competitors) and it would appear sharply higher prices could be instore. Remaining consistent, what JPMorgan does or doesn't do is the real key to future prices.

And don't forget the lack of selling by the managed money traders over the past few months, which in itself suggests something different may be afoot. I suppose it's possible for the big commercial crooks to squeeze out the recent managed money buying that has come into the market as a result of the decisive upward penetration of the moving averages likely to be depicted in Monday's COT report. But whether that leads to the kind of selling needed to get the commercial shorts completely off the hook remains to be seen.

The financial plight of the 7 big shorts (minus JPM) is still in question. The open losses to the 7 big shorts were larger at the beginning of September than they are now, but it's also true that JPMorgan had a larger short position at the price highs than it does now. Without the full participation and backstopping of JPMorgan on the short side, it's hard for me to see how the 7 big shorts can hold back the tide of rising metal prices. I'll be paying close attention to how many new shorts JPM has added in Monday's report.

Any discussion on COT market structure positioning that doesn't take the above items, including the concentrated nature of the short position, into consideration is missing something. Even including these items for consideration doesn't guarantee full knowledge of what's to come, but since when do analysts celebrate the avoidance of known facts?

The only reason there is such a large concentrated short position in COMEX gold futures and a much larger concentrated short position in COMEX silver futures is because no one, other than the 8 largest shorts, is interested in shorting gold and silver at current prices to the extent that the 8 largest traders have shorted. Otherwise, the concentrated short positions wouldn't exist and would be replaced by hundreds and thousands of other traders. Because so few are interested in shorting gold and silver at current prices, the burden of short selling must be assumed by the 7 or 8 biggest traders in order to protect their previous short sales.

Make no mistake, the 7 or 8 big shorts aren't adding to short positions for reasons other than to cap and control prices from moving sharply higher and generating even larger open losses and margin calls. The big shorts are forced to add even more short positions to prevent a price melt up. That as far away from being economically legitimate as it gets. For them to turn around and admit they are on the wrong side of the market and to try to buy back their shorts would only cause prices to soar and for their losses to mount – perhaps to the point of no return.

Yes, this is a highly dangerous game that never should have been allowed to get to this point and the regulators should be hung in effigy for sitting by and allowing it to happen for all these years and to the extreme level the market finds itself in. Adding new shorts for the sole reason of protecting previous shorts is a sure prescription for disaster for those doing the shorting at some point. Is this the point when it all blows up? I can't know and neither can anyone else. All I (we) can do is play it as best we can. For me, that means being prepared for either a near term commercial success in which prices get smashed again or a commercial failure in which prices finally and truly explode. COT report comments late Monday.

Ted Butler

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Silver – $17.83   (200 day ma – $16.36, 50 day ma – $17.28)

Gold – $1515   (200 day ma – $1419, 50 day ma – $1482)

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