December 9, 2015 – Prices Have Consequences

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Everything about the immutable law of supply and demand revolves around price. Too high of a price must eventually lead to a surplus; too low a price must lead to a shortage of some type. It's always difficult to time the consequences of price extremes in commodities that have long price cycles like crude oil or mineral extraction and often, like currently, the price consequences seem to overlap. For instance, the current low price of crude oil is a result of the formerly high prices that enabled the fracking revolution; but that same low price is now setting the stage for an eventual production shortfall that must lead to oil supply tightness someday.

In metals production, the daily news flow of planned cuts in output and employee headcount due to current low prices is a result of overexpansion based on the expected high prices that failed to materialize. Because future production capacity is now shrinking in response to current low prices, some day insufficient production capacity will drive prices higher according to the law of supply and demand. Hence the truism, Â?the cure for low prices is low prices.Â?

Ironically, the effect of future production capacity cuts should be bullish for the price of the commodities involved. In crude oil, however, the problem is largely insufficient storage capacity. Oil may be cheap, but if you buy the actual commodity, you must be able to store it economically and that has become a problem due to the past year's cumulative oversupply. Contrast that with silver or gold Â? where I don't think there has ever been or could be a lack of legitimate storage capacity. What's a bearish factor in crude oil, insufficient economical storage capacity, doesn't exist in silver or gold.

Of course, just like storage capacity, real world production and consumption plays little role in determining silver or gold prices. Something else is responsible for setting prices and that something else is what takes place on the COMEX. This COMEX pricing control has become even easier to demonstrate recently just by looking at the chart patterns in all four precious metals traded on the COMEX/NYMEX – gold, silver platinum and palladium. A simple glance at the charts will show you that recent daily price movements have been close to identical. All four precious metals topped out towards the end of October and proceeded to fall almost daily until making lows at the end of November. Then all four metals jumped up through their 20 day moving averages on Friday (after trading below that average for six weeks), only to fall back below that average the past couple of days.

This unmistakable lockstep price pattern can't be a coincidence and must be the result of some cause common to all these metals. That common cause can't possibly be related to actual production or consumption as all four metals have very different actual supply and demand profiles. The only possible common denominator is futures contract positioning, which is verified in the continuing flow of government issued COT reports. I know this is old news to subscribers, but is only just now becoming more widely known. Let me give you an example of what I'm talking about.

Late last week, I was contacted by the proprietor of the Gold-Eagle website who asked if I would do a short written interview on gold and silver. At the very beginning of my Internet exposure, almost 20 years ago in (1996), this same proprietor suggested I write articles on gold and silver for his site, which I ended up doing. There was no compensation involved and I wrote articles for the sole purpose of sharing what I thought I knew and in order to set the record straight on what I thought was an ongoing manipulation in gold and silver. A few years later, in 2000, I began writing for Investment Rarities and eventually started this subscription service and as a result submitted fewer articles to Gold-Eagle.

To make this short, I agreed to do the interview and was sent a series of questions related to silver that were more along the lines of things I don't usually write about Â? like the role of silver as money and as a hedge against inflation and the like. While I don't think there is anything wrong with these things, they are not what I usually discuss for the simple reason they are already widely discussed and I didn't see me adding any value by sticking to the interview script. So I said that his questions were on a different wavelength from how I viewed the market and sent along the last two articles to subscribers and asked if he could revise his questions in light of what I wrote in those two articles. Much to his credit, the proprietor came back with a series of questions that weren't altered in any way by me and took me all of 5 or 10 minutes to answer.

http://www.gold-eagle.com/article/straight-talk-interview-ted-butler

The point is that while this is a complicated issue, it is not impossible to comprehend once one is exposed to it. And that's why more are coming to see that the big commercials, led by JPMorgan, have dictated prices of all the metals traded by the CME Group. The guy at Gold-Eagle, clearly, hadn't been exposed to this prior to reading the articles I sent him and to his credit he seemed to grasp the gist of it quickly based upon his revised questions.

I'm further convinced even more will come to see how this price manipulation operates and with that growing collective vision it will prove impossible for JPMorgan to rig these markets indefinitely. Separately, I was quite intentional in labeling (libeling?) JPMorgan as the big crook. One would think, sooner or later, that JPM would react to being called crooks (along with the CME) Â? hopefully, by ending its crooked ways. I know some skeptics and manipulation deniers claim that JPMorgan or the CME can't be bothered with responding to claims that they are crooks, but if that is the case then it's the first time in history any large financial institution has ignored such allegations. I think there is a different explanation, namely, neither want to address this issue openly.

In developments since the Saturday review, there still appears to be a tightness surrounding the December COMEX delivery process, particularly in gold. Despite what can only be described as reporting errors in the remaining open interest in the December gold contract over the past few days, there are still more than 2000 contracts open and JPMorgan has emerged as practically the sole stopper (taker) of delivery notices. So far this month, JPMorgan has stopped 212 of the 244 gold total contracts issued. These are very small numbers in terms of total contracts in every way but in the percentage of contracts that JPM has stopped. The small number of total contracts delivered, along with a pronounced tightening in the spread differentials between the nearby months underscores the tight physical premise.

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

On Saturday, I indicated that the high volume price rally on Friday should result in metal being added to the big gold ETF, GLD, and in the big silver ETF, SLV. That has yet to occur and, in fact, a decent withdrawal of metal occurred in GLD on Monday (nothing has been added or withdrawn in SLV). Perhaps metal will still come in over the next few days in SLV as a result of what looked like net new buying on Friday. If not, there may be increases in the short positions in either ETF (although this shouldn't be reflected in the short report to be issued later tonight). I can't help but conclude the lack of metal deposits is a further indication of physical tightness.

One thing I must revise is my strong conviction that there would be no further improvements in the COT market structure in the report to be issued Friday. On Saturday, I stated that we wouldn't see, for a long time to come, a lower total commercial net short position in COMEX gold futures than the record 2900 contract mark set in the last COT report. Now I'm not so sure that there won't be some improvement.

No doubt there was managed money buying and commercial selling on Friday in all four precious metals markets, but on closer review it turns out that Friday was the only day of real rally in these metals with the two reporting days both preceding and following Friday not suggestive of managed money buying and commercial selling on those four other trading days. I'm not looking for blockbuster changes in the headline numbers of the commercial or managed money net positions, but it is possible that there will be slight increases or decreases. How's that for wishy washy?

The main point is that the COT market structure in all metals, including copper, is still super bullish and this week's report is unlikely to alter that in any meaningful way. I admit to thinking that Friday's across the board precious metals rally could have been the start of the big move up and with the benefit of hindsight that was not the case. But neither does the failure to rally in the days since Friday suggest that the rally can't or won't ignite at any moment. And it's not just a case that prices could rally; it's well beyond the point that prices should rally.

The perverse nature of the COMEX price manipulation is that, in terms of market structure, lower price action strengthens a bullish structure, while higher prices tend to weaken a bullish structure. That's because the managed money technical funds are always sellers on lower prices, with the commercials always buying. I know this gets old after more than four and a half years of truly rotten price action in gold and silver; but rotten price action can have the most profound consequences of all.

While silver and gold prices have had nothing to do with real world supply and demand and everything to do with COMEX positioning, that just creates a different set of consequences. One potential consequence is the possibility of a melt up in prices, particularly in silver. I know that sounds crazy considering recent price action, but I just established the perverse nature of rotten price action on the market structure. The fact is, collectively, the metals are configured in the most bullish of market structures in modern history, according to COT data.

Doesn't it follow that the best chance for a price melt up would seem to be highest when those that control the market are best positioned for a melt up? Since the commercials are positioned better than they've been in years, the only real question is the extent of the coming rally. That's not to say the commercials can't delay the coming certain rally for a time longer, possibly including slight new price lows, but the main focus should be on the inevitable price rally to come. The extent of rally depends on whether JPMorgan and the other big commercial crooks add to short positions, particularly in silver.

Given the lockstep nature of price movements in the COMEX/NYMEX metals, it wouldn't be surprising to me to see all the metals surge upward in the very near term. After all, they all certainly fell in unison. But looking a bit ahead and assuming that JPMorgan doesn't add to short positions aggressively, at some point we must see a genuine divorce in the price of gold and silver from the price ratio prevailing over the past year and longer.

No doubt both metals have been manipulated lower in price due to COMEX positioning, but if that manipulative positioning ends (as would be the case if JPMorgan and the big commercials don't add to short positions), some other forces must come to dictate prices that are related to how much real metal exists in the world. Gold will move higher, probably more sharply than most people imagine, but it is already collectively valued in the trillions of dollars. The law of numbers suggests that the larger the collective value of an investment asset and the more of it that is held by the world's investors, the more contained price rallies and selloffs tend to be. That would seem to explain why gold's price performance over the years has been more subdued than silver's, both up and down.

The total investment stock of silver is measured in the very low tens of billions of dollars, a pitifully small amount given the total investment sums in the world today. In addition, being a vital and indispensable industrial commodity, silver could and should be driven into a physical shortage by investors and industrial consumers alike. As a result, the baked-in consequences of the too low price in silver are more profound than most everyone realizes, as hard as that is to focus on when price action is dismal.

Ted Butler

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Silver – $14.15 (50 day moving average – $14.99)

Gold – $1074 (50 day moving average – $1116)

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