

February 1, 2017 – Solving the Puzzle

Solving the Puzzle

As time progresses, it appears more certain than ever that silver will climb vastly higher in price over the longer term based on just about every objective measurement and reasoning available. I don't think I've run across a downright bearish long term view for the price of silver in quite some time. Considering how little actual metal exists in the world and how great is and will be the demand for this metal, I can't imagine how a reasonable long term negative case could be made. Perhaps because a higher long term price seems assured, more focus is placed on the short term.

In any event, the explanation for why silver is priced way below its long term eventual value is rooted in short term considerations, namely, the price-setting mechanism on the COMEX, the world's principle silver trading exchange. This, of course, is nothing new and is a continuing focus of these reports. I focus on COMEX futures trading because it is the primary price driver, which can be proven in the data and by simple observation. At the same time, I am equally convinced that COMEX trading shouldn't be the prime silver price driver and someday, likely, won't be.

Both convictions are based upon the same simple observation ? the size of COMEX silver futures positioning is disproportionately large when compared to real world supplies. No other commodity has the mismatch of such a large paper market relative to the amount of actual material produced or in world inventories as silver. It should be easy to imagine a larger market determining the price of something traded elsewhere. More paper silver is traded and held on the COMEX than on any other venue in the world, so it's reasonable that it would be the price setter.

The problem is that paper positioning shouldn't grow larger than the underlying host commodity from which the paper trading is derived (hence, the term derivative). If a derivatives market, such as COMEX silver futures, grows much larger than the underlying actual market, price control is passed to the larger market even though the derivatives market is supposed to follow the host actual market. Supply and demand for the actual commodity is supposed to set prices, with derivatives futures markets following the prompts from the actual market. But as the facts point out, the size of the COMEX futures market has come to determine the price of silver and not actual supply and demand developments.

Once a derivatives market grows larger in price influence than the underlying supply and demand of the actual market, as has been the case in COMEX silver for more than three decades, major distortions occur. The most visible distortion is in the nature of the trading participants. In the real world of any commodity, prices are set by the producers, consumers and middlemen of that commodity. The real world for silver includes miners, industrial consumers, fabricators and investors.

In the derivatives world of COMEX silver futures, there are few, if any miners, industrial consumers and fabricators participating. Certainly, there are investors in COMEX futures positioning, such as the core non-technical managed money and other traders I recently highlighted, but these investors are more passive than other participants and for the most part simply buy and hold. As such, long term investors in COMEX paper contracts don't exert much influence on price, which creates a vacuum of sorts which other more active traders have filled.

The traders that have filled the price influence vacuum in silver (and gold) are the technical fund managed money traders and the banks that trade against these technical funds. There are likely no more than 30 or so technical funds and counterparty banks on either side of the vast majority all COMEX silver trading and, in reality, no more than 10 traders on either side account for 90% of all COMEX trading. In other words, no more than ten traders on either the long or short side of COMEX silver trading determine the price of silver for the rest of the world. I say that's nuts and manipulative on its face. Yet it is as real as rain and will remain that way until it doesn't – or until the actual market takes the price reins from the distorted derivatives market by a physical silver shortage (with JPMorgan's blessing).

It's natural to ask how we reached the absurd state of massive derivatives positioning by a few large paper traders dictating prices to the entire world of real metal producers, consumers and investors in silver (and other commodities). The answer is gradually – this occurred over a long period of time. We're all the proverbial frog brought to a boil in a pot with water that started out lukewarm. The passage of time dulls us in many ways. But no matter how gradual or for how long this distorted price discovery process has evolved, when it ends, as it must, the end can't be gradual. It will end in a literal flash.

While many may disagree, I don't think all the big technical funds appreciate the role they play in the positioning game and their influence on price, although some must know by now. And, I'm starting to think, most of the banks which take the other (and usually upper) side of the positions the technical funds put on, may not fully realize what they are doing. I am certain that JPMorgan knows what it is doing, as no one buys more than half a billion ounces of actual silver at bargain basement prices by accident. But I haven't detected any physical buying of silver from anyone other than JPM.

JPMorgan is the smartest, most connected and powerful market crook of all. In silver (and gold), no one even comes close. It figured out that the only way of covering the big COMEX silver short position the bank inherited from Bear Stearns nine years ago was by physical accumulation. It was and is impossible for JPMorgan or anyone else to build up a 550 million ounce position in COMEX futures contracts because no one is capable of shorting such quantities in paper contract form ? it would stand out like a sore thumb. Having neutralized their original paper short exposure years ago, JPM continued to amass physical material for the purpose of an historic financial windfall, which it can achieve at will.

It is the acquisition of so much physical silver that has set JPMorgan in the cat bird's seat and in position, not only to score in historic terms, but to also double cross the other big commercial traders it usually runs with. A friend asked this week if the other commercials knew or saw what JPMorgan had been up to in its massive accumulation of silver. My answer was how could they know or see what JPMorgan was up to, if they didn't do anything about it ? like buy silver themselves? I can't read anyone's mind, but as I said, I haven't seen any evidence of physical silver accumulation by anyone other than JPM. Unless I'm completely off base, the coming silver explosion will involve an epic double cross.

Is that double cross at hand? There's no way of knowing until after the fact, but the necessary preconditions have been met. Will (or has) JPMorgan add aggressively to silver short positions, joining in with its crooked COMEX commercial brethren in collectively fleecing the technical funds one more time or will it unilaterally decide that the time is up on the silver manipulation? All we can do is observe the flow of price and data as they develop, but we must know that one of these times will be the last time.

The price rally through yesterday which brought silver to its highest price in more than two and a half months was overdue and expected. Based upon the usual metrics (which haven't been particularly accurate recently), it would be reasonable to expect significant technical fund buying and commercial selling in this Friday's COT report, a deterioration in the market structure of silver and gold. That said, even a significant deterioration would leave much room for additional technical fund buying and commercial selling on much higher prices, based upon where the market structure stood this summer and more recently in late fall.

Therefore, the question of whether the big move up in silver is at hand is still very much an open matter. Of course, it is always possible, given a sufficient amount of managed money technical fund buying, that silver again may be rigged lower first before the big liftoff, but everything is always open. I could even see JPMorgan adding to silver shorts and then reversing course, if it thought it might provide some cover story in case anyone asked (?hey, if we thought silver was going to explode we'd never have added the shorts that we did?). All this is in the mind game category, of course, but what else is there? You or I don't control the price and can only control our own actions. Serenity teaches us to not fret about that which we can't control.

Regardless of whatever increase we may see in managed money buying and commercial selling in this Friday's report, it wouldn't result in a bearish market structure in silver or gold. Yes, it could lead to some type of temporary price rig to the downside, but should a price downdraft occur it is not likely to be the start of a serious drawn out downturn. Other markets, like NYMEX crude oil and COMEX copper, are sporting extreme record large levels of managed money long positions (suggesting those markets might be prone to a selloff). By comparison, COMEX silver and gold have miles to go in higher price and increased managed money buying before approaching record levels.

I would also point out that yesterday and today we penetrated to the upside the 100 day moving average in silver (\$17.54) for the first time in a year. (Gold's 100 day moving average is \$1232). As you know, I'm not a devout technical believer, but I am a devout follower of those that practice the religion (the technical funds). The technical funds are influenced by many moving averages of various longevity and the 100 and 200 day moving averages are generally highly regarded by these funds.

The fact is that we're running out of moving averages to be penetrated to the upside in silver and gold and when we run out completely, the technical funds should have no choice but to get maximum long. Maybe the commercials might try to cap prices before all moving averages are penetrated to the upside, but we're going back to the possibilities of short term selloffs which we know always exist.

To my mind, I've been foaming at the mouth bullish in market structure terms on silver and gold for the past two months and I believe I have represented that on these pages. The \$80 to \$90 gold and \$1.75 silver rally since December 20 has taken away some of my foaming, but not to the point of jettisoning any positions. The setup for a silver price explosion is intact, even if diminished slightly or derailed temporarily.

Finally, I'd like to follow up on the email exchange I wrote about recently where I gave Jody my opinion that I wouldn't wait for lower prices before buying silver, even though lower prices were always possible. Jody's response summed up my feelings better than the words I had written to her.

?Good morning Ted!

I just caught up on your two latest articles. What a surprise to see you mentioning our conversation. =) Thank you again for caring so much. It wouldn't have mattered if the price collapsed the next day, your advice is sound. There will be a time in the future when we'll look back and laugh about trying to save a few dollars. As you said, the future price will reward us fine.

Besides, making that purchase put my mind at ease. I was sitting on pins and needles afraid I would miss the boat in the event of a sharp increase. If the price does collapse tomorrow, then I'll just figure out how to buy more!?

Ted Butler

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Silver – \$17.60 (200 day ma – \$17.92, 50 day ma – \$16.68)

Gold – \$1210 (200 day ma – \$1267, 50 day ma – \$1178)

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