

February 1, 2020 – Weekly Review

Another late Friday rally pushed gold to its highest weekly close in nearly seven years and trimmed silver's early week price plunge to a much smaller loss. For the week, gold ended \$17 (1.1%) higher, while silver ended lower by a dime (0.6%), pushing the silver/gold price ratio out to 88.4 to 1. At silver's low this week, the ratio widened to over 90 to 1. I've just about exhausted my ability to express just how nuts-crazy it is that silver is as cheap as it is relative to gold, but I am resigned at this point to accepting the bloodless verdict of future prices to measure just how undervalued silver is.

First things first, the rally in gold this week pushed the combined open and unrealized loss to the 7 big shorts in COMEX gold and silver futures up by \$400 million to \$5.6 billion at yesterday's close, equaling the previous high-point of the loss back in early September. The average loss to each of the 7 shorts is now \$800 million, meaning the very largest shorts are out more than that, while the smallest of the 7 shorts are out less.

I can't help but repeat that when this short position was put on, starting in June, the collective profit objective of the big shorts was on the order of \$300 to \$500 million collectively (\$40 to \$70 million each on average). To now be sitting with a collective open loss of 10 to as much as 20 times the original profit expectation has to be considered, regardless of the ultimate realized outcome, a monumental blunder. Even those who claim (without any actual evidence whatsoever) that the 7 big shorts are somehow hedged, have to admit that even if they were hedging, the big 7 have forgone \$5.6 billion in profits had they not hedged. The real problem for the big shorts is that they are very unlikely to be hedging and that these are real losses.

This was a big week in many obvious ways (US political developments and overall market turmoil due to the growing concerns about the coronavirus), but even more so in matters directly related to gold and silver, including details in the new Commitments of Traders (COT) report and the CFTC's approval of proposed position limits. I'll get into both issues in depth after a very brief mention of the weekly turnover and the first two days of the February COMEX gold deliveries.

The turnover or physical movement of metal either brought into or removed from the COMEX-approved silver warehouses were a bit confusing to me, as early in the week there was a simultaneous 579,000 or so oz deposit and withdrawal on the same day in one warehouse (CNT) that was different by only 12 ounces, making me think it might have been a reporting error. Taking the one day deposit/withdrawal as legitimate, weekly turnover would have been 4.2 million oz; without it, the movement was only 3 million oz.

Total COMEX silver warehouse stocks declined by 0.7 million oz to 321.3 million oz from last week's all-time record highs. No change in the JPMorgan COMEX warehouse, but about 6 million oz were transferred from registered to eligible in other warehouses and I continue to contend that this represents that much more additional silver under JPM's control. In addition to the 161.4 million oz in the JPM warehouse, I maintain JPM controls at least 100 million oz in other COMEX warehouses, bringing the total amount of silver under JPM's control to at least 260 million oz, or more than 80% of total COMEX silver inventories. While my statement may seem outrageous to many, all it would take are a couple of phone calls (or subpoenas) from the DOJ or CFTC to ascertain if what I allege is true.

In the COMEX February gold deliveries, over the first two days, of the 4200 total contracts issued, JPMorgan stopped 2873 contracts or 68% (1543 contracts on behalf of clients and 1330 for its own house account). Clients of JPM also issued 1440 contracts and HSBC issued 1500 contracts from its house account. Get the feeling that JPM is the big dog in gold (and silver)?

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

Turning to the new COT report, it was very close to expectations, but with some surprises (of the juicy kind). The expectations were that given the price action (up a bit in gold and down in silver) that there would likely be some deterioration in gold (commercial selling and managed money buying) and the opposite in silver. That was largely the case, although the managed money traders were sellers, not buyers in gold.

One thing that was quite close to expectations was that the big drop in total gold open interest was mostly spread liquidation. Again, I don't know why so many spreads are put on up to two weeks before first delivery day and then liquidated into first delivery day, but I suppose it doesn't matter much since there is no obvious impact on price; but I continue to be amazed by those who read the big changes in total open interest as somehow meaningful.

In COMEX gold futures, the commercials increased their total net short position by 8900 contracts to 361,100 contracts. This is the second largest commercial net short position in history (after the 366,500 contract short position of Dec 31) and as such must be considered extremely bearish in historical conventional terms. Certainly, if gold prices plunge in the near term, this will be the reason why. However, that has been the case for months and to this point, no price plunge has occurred, suggesting something may be very different this time around.

As hoped for, JPMorgan appears to have swum against the small tide of commercial selling and I would calculate they bought back around 3000 shorts, reducing its net short position to 30,000 contracts (3 million oz). Against this paper short position, of course, one must consider that on yesterday's closing price for gold, JPMorgan is now ahead by \$9.7 billion on its 25 million oz physical gold holdings or close to double the open losses being suffered by the 7 big paper shorts. If Mister Rogers was discussing this on his neighborhood show, he would undoubtedly ask the children, "Can you say double cross?" The 7 big gold shorts are still net short 275,000 gold contracts (27.5 million oz).

One small surprise was that the managed money traders were net sellers (instead of buyers) of 3894 gold contracts, comprised of the selling of 4010 long contracts and the buyback of 116 short contracts. The explanation for how both the commercials and managed money traders could both be net sellers was the extraordinarily large amount of net buying by the other large reporting traders, which bought 16,291 net contracts (5618 new longs and the buyback and covering of 10,673 short contracts). The net long position of the other large reporting traders hit a record of 110,000 contracts, the largest in history.

While I have some reservations about the accuracy of the amount of reported short covering, even if the short covering were misreported, we would still be at a new record in the other large trader net long positioning, as this long position has been increasing steadily of late. This is quite unusual (as I've reported previously) because these traders have been much more likely to be big net long on gold

price lows, not price highs as is currently the case.

This may be subjective on my part, but these other large traders are speculating with their own money (as opposed to the managed money traders which speculate on behalf of others) and if any trading category were likely to sniff out anything unusual about to happen, it would most likely be this category. Stated somewhat differently, I believe this trader category to be more akin to sharks being attracted by blood in the water than other trader categories (excepting JPMorgan, of course) and these sharks may sense that the big shorts may be wounded and in trouble. I'm was happy to observe this pattern of unusual net buying by the other large traders also occurred this reporting week in silver.

Finally, there was another increase in the concentrated long position of the 4 largest gold traders of nearly 1100 contracts to 142,392 contracts, which also set a new record. Still, this record long position is more than 47,000 contracts smaller than the concentrated short position of the 4 largest traders (189,618 contracts).

In COMEX silver futures, the commercials reduced their total net short position by 5100 contracts to 89,200 contracts. Not by much, but this is the smallest commercial net short position since Dec 24. I'd peg JPMorgan's silver short position to be down a thousand for the reporting week to 15,000 contracts, as expected, but with a bit a speculative twist.

I strongly sense that JPMorgan bought back around 3000 additional short contracts on the day after the Tuesday cutoff, when in the very early hours of overnight trading, silver set new price lows and total open interest for that Wednesday dropped pretty significantly. Now whether this shows up in next week's COT report depends on what JPM does through next Tuesday, but as of now, I would peg JPM's silver short position to be down to 12,000 contracts, the equivalent of 60 million oz, against a physical long position of 900 million oz. JPM is still sitting good in the (double cross) neighborhood.

Against expectations that the managed money traders would be net sellers in silver, they actually sold more than expected in selling 8591 net contracts, comprised of the sale and liquidation of 5635 long contracts and the new sale of 2956 short contracts. As was the case in gold, the other large reporting traders were notable buyers of 3133 net contracts, comprised of 2128 new longs and the buyback of 1005 short contracts. While not a record, these other large traders have been notable buyers into silver's recent price weakness, suggesting to me they sense something about to go down, namely, a move up in price.

I won't dwell on it, but the least surprising factor to emerge in yesterday's COT report was the absolutely massive amount of managed money selling and commercial buying in crude oil and copper. Yes, I know the concerns raised by the coronavirus on oil and copper consumption, but not to see the manipulative add-on effect of speculative paper positioning is to miss the point.

Speaking of missing the point, let me turn to yesterday's historic passage of the new proposed position limit regime as voted on by the CFTC. As I believe most regular readers are aware, the issue of position limits has been a singular concern of mine for decades, one in which I have devoted more attention and effort than I can describe. How could it not be, since the establishment and enforcement of legitimate speculative position limits is one sure preventive measure against undue concentration and manipulation in silver? In terms of the issue of legitimate position limits, suffice it to say that not only have I been there and done that, I got every postcard and tee shirt possible.

Only because the issue of position limits is so important will I describe the particulars of what the CFTC just passed, but I doubt I'll bring up the issue again. Certainly, I have no intention of getting involved in the open public comment period this time as I did ten years ago. Back then, at least 5000 of the 15,000 public comments that were submitted petitioned the agency to set a speculative position limit of no more than 1500 contracts (7.5 million oz) for silver, instead of the wacky formula the CFTC proposed that resulted in limits three to four times as large. In other words, the agency ignored the plurality of public opinion. Of course, this is somewhat moot, since no position limits were ever established, despite the clear mandate of congress and the administration.

This time, the proposed formula for position limits is even more ridiculously large; at current total open interest levels in silver, the new formula would call for a limit of around 9500 contracts, or 45 million oz (and around 20,000 contracts in gold). As I've previously explained ad infinitum, the whole purpose of speculative position limits is to limit speculators' positions, so that they don't artificially affect prices. If limits are set so high, they can't limit anyone. One example I've used is that setting speculative position limits so high would be ineffective, like setting a 75 MPH speed limit in grade school zones.

To be sure, legitimate hedgers can get exemptions from position limits, but how many legitimate hedgers need to hedge more than 45 million oz of silver? There is only one silver miner, the most logical of silver short hedgers, that produces more than 45 million oz of silver annually. Any silver mine producer should be allowed, if it so chooses, to sell and lock in a year's production (although shareholders would likely protest), but why should any speculative clown that comes along be allowed to buy or sell such large quantities? And just because a clown speculator may be in the form of a bank, should it be allowed to sell short such quantities?

By the way, I had to hunt down the exact formula that the Commission was proposing and only found it in the official posting in the Federal Register for combined non-spot month limits. The formula is 10% of the first 50,000 contracts of total open interest and 2.5% of open interest above that amount. In the case of silver, the formula would amount to a speculative position limit of 9548 contracts based on the total open interest of 231,933 contracts as of the current COT report. That's a far cry from 1500 contracts and is the equivalent of a 120 MPH speed limit in a school zone. For gold, the formula would call for a speculative position limit of 21,638 contracts at Tuesday's 715,539 contracts of total open interest. Thanks for nothing.

<https://www.cftc.gov/PressRoom/PressReleases/8112-20> (click on Proposed Rule: Position Limits for Derivatives to get the official entry in the Federal Register - page 14)

One sure clue that the agency was up to no good by setting position limits so high is that both Democratic commissioners voted against adopting this rule. Commissioner Dan Berkovitz, in particular, is an old (legitimate) position limits advocate, dating back to the days before he was General Counsel at the agency when position limits were first mandated by Dodd-Frank. In addition to the excessive amount of position limits proposed, he also dissented from allowing the CME Group to assume even greater authority on deciding what was legitimate in terms of hedge exemptions. As a standing commissioner, Berkovitz can hardly be expected to bad-mouth fellow commissioners, but I face no such restrictions. The commissioners that voted in favor of position limits are low-down, dirty rotten scoundrels out to do the CME's bidding.

While I have tried to spare no quarter in lambasting the just-passed proposed position limit regime, please be sure there is plenty more I can say that is negative and can come up with nothing positive. Now please allow me to explain why this whole attempt by the CFTC on position limits, even if weren't as utterly defective on its face as it is, amounts to a wasted exercise, worthy of no one's attention. I don't want to overuse my quota of clichés today, but the agency's attempt at instituting position limits makes the rearrangement of deck chairs on the Titanic look like a productive activity.

Just like moving chairs around a stricken and sinking ship serves no real purpose, neither does the CFTC's approval of position limits – because the damage has already been done. We already have the highest levels of concentration on the short side in COMEX silver and gold futures in history and enacting even legitimate position limits would be too late at this point (to say nothing of the illegitimate limits actually proposed). The whole and sole purpose of position limits is to prevent manipulation and undo market concentration. But enacting position limits, even of the legitimate variety, is way too late once manipulation and concentration already exist. It's like passing a law that icebergs aren't allowed to collide with ships after the collision has occurred.

In particular, what makes the passage of position limits so loony at this point is that it can't possibly undo the predicament of the 7 big shorts. Now maybe the big shorts can still succeed in rigging prices sharply lower and in getting big selling from the traders which are long, but position limits have nothing to do with that. I don't think the CFTC can dictate only that the big longs must reduce positions, while the even larger shorts don't have to reduce positions.

In silver, the 4 biggest longs are not that much above proposed position limits and well-below the level of contracts held by the biggest shorts. Besides, the 7 big shorts' problems are here and now, while it will be many months before the proposed limits are enacted, if ever. Changes in position limits are as much a help to the big shorts at this point as would be a rope thrown to a drowning man not attached to anything. The big shorts need relief and they need it now, not the lip-service of some pie-in-the-sky and ineffective help months from now. It's too late for position limits to undo what has already been done.

I don't know what the big shorts' breaking point is, but I'm fairly certain there is such a point. Back in June I commented (but did not predict) that if gold rose \$100, the big shorts would be in the red for \$2.2 billion, based upon their then-current short position. Now I can assert (not necessarily predict) that if gold rises \$50 from yesterday's close, the 7 big shorts (excluding JPMorgan) will be out an additional \$1.4 billion (27.5 million oz times \$50), even if silver doesn't move at all. That would make the open and unrealized loss to the 7 big shorts a nice, round \$7 billion, or \$1 billion on average to each trader. If that occurs, will that be the breaking point? I don't know, but unless these guys got some secret hedge that no one can substantiate, they will be that much closer to panicking or at least that seems to be my most reasonable conclusion.

Having been a position limits advocate and maven for decades, I fail to see how anything the agency just approved does the big shorts (or anyone else) even the hint of good. I'm sure much will be written about the proposed position limits in the immediate future, but I strongly doubt I will be adding to that commentary after today. Of course, please don't hesitate to ask any follow up questions or concerns you may have, but I'm done with the subject of position limits for now and choose to focus on what I believe to be important.

(On a housekeeping note, I am switching to the April COMEX gold contract for closing price purposes, which effectively adds about \$5 to the price. On a highly personal note, I ask if you might share some prayers for my brother-in-law, who suffered a nasty fall and needs all the prayers he may get).

Ted Butler

February 1, 2020

Silver – \$18.01 (200 day ma – \$16.68, 50 day ma – \$17.51)

Gold – \$1593 (200 day ma – \$1449, 50 day ma – \$1515)

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