February 11, 2017 – Weekly Review

Weekly Review

Gold rose for the second week running, finishing $13 (1.1%) higher, while silver rose for the seventh consecutive week, tacking on 43 cents (2.5%). Both ended at their highest weekly closings since November. As a result of silver's relative outperformance, the silver/gold price ratio tightened in by a full point, ending just below 69 to 1; the most fully valued silver has been compared to gold since October.

Truth is that silver's relative strength, showcased yesterday, surprised me. Even though silver outperformed once the dust had settled on the trading week, until then, silver has appeared to lag gold. Plus, gold's COT structure has been much more constructive than silver's (true again this week) and weak overnight action on Thursday had me gritting my teeth for a silver thumping on Friday. Instead, silver put in a great performance yesterday and even seemed to support gold. The moral of the story? Leave short term price prognostications to the experts (of which I know not a one).

The big news of the week centered on new data from the CFTC in the Commitments of Traders (COT) and Bank Participation Reports, which featured another surprisingly bullish COT report on gold and a not quite so terrible report on silver. Let me run through usual weekly topics first.

The turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses moderated a bit this week, as Â?onlyÂ? 4.6 million oz were moved (that's still 240 million oz annualized). The twist this week was that much of the movement was of the Â?inÂ? variety, as total COMEX silver inventories rose by 2.7 million oz, to 181.7 million oz. I still view the movement to be the key feature and not the totals, unless someone wants to opine that growing inventories are bullish for price (we did rise in both price and total inventories this week). No silver was moved either in or out of the JPMorgan COMEX silver warehouse this week, but that was no real surprise as we are Â?in betweenÂ? traditional COMEX delivery months in silver.

Once again, more gold was deposited into the big gold ETF, GLD, with a continued notable lack of metal deposits into the big silver ETF, SLV. In addition, very sizable deposits have been made into the German gold ETF, XETRA, since year end. Following stable gold holdings for six years of between 1.5 to 2 million oz, the holdings in XETRA jumped by 3 million oz to 5 million oz, since Jan 1. I don't have any particular insight to what accounts for the sharp jump in the German holdings, but I still feel the deposits into GLD look normal (whatever the heck normal is these days), given the price rise in gold and a noticeable but not excessive pick up in GLD trading volume.

In contrast, the trading volume in SLV has been quite lackluster (until yesterday) and that would seem to account for the lack of metal deposits, despite silver climbing in price. I sense that some metal is due to be deposited into SLV, based upon yesterday's uptick in price and increase in trading volume, but neither would I be surprised if conversions of shares for metal (by you know who) resulted in withdrawals from SLV. In other words, trying to predict actual metal flows in SLV is even harder than predicting short term price changes, at least for me. For some reason, the changes in GLD, both recently and over the years, are more straightforward.

There was a pleasant surprise in this week's release of the new short interest report on securities, for positions held as of Jan 31, as the short interest in both SLV and GLD was sharply reduced. The short position in SLV declined by more than 2.6 million shares to just under 9.9 million shares (ounces), while the short interest in GLD plunged by 4 million shares to 5.6 million shares (0.5 million ounces).

http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%E2%84%A2

I don't keep a running log of this data, but the short interest in GLD seems to be the lowest in quite some time and the short interest in SLV is now close to the lower levels in memory.
I always consider it best when the short positions in these two ETFs are low, for a variety of reasons I'll not rehash now. While in the good news category, it's important to place ETF short positions in proper perspective, especially related to the main price driver, which is COMEX futures positioning. After all, the total short position in GLD is the equivalent of 5000 COMEX gold contracts, while the total short position in SLV is the equivalent of only 2000 COMEX silver contracts. In other words, the short (and long) positions on the COMEX for gold and silver are nearly 100 times larger than the short positions in GLD and SLV. Which do you think would have more influence on price?

Still nothing much to report on regarding COMEX deliveries this month, so I won't. Ditto sales of Silver Eagles from the US Mint, other than total sales are putrid. Ironically, there was some slight uptick in retail investment demand recently, which just highlights that broad retail demand is not what has driven the phenomenally large sales of Silver Eagles and Canadian Maple Leafs over the past six years.

The changes in this week's COT report featured another bullish surprise in gold, where the surprises have grown routine. Gold prices did rise by about $25 during the reporting week to multi-month highs, all the important moving averages (up to an including the 100 day moving average) were penetrated and total open interest expanded by 17,000 contracts, suggesting substantial managed money buying (both new longs and short covering) and requisite commercial selling.

I thought I was being timid in my guess of a 25,000 contract increase in total commercial selling in Wednesday's article. Instead, the increase in the gold headline number was less than a tenth of what I had expected and even less in the alternative headline number of the net managed money long position. Even though I threatened to deliberately overstate expected deteriorations in the gold market structure for good luck purposes, I can assure you that I thought my original prediction wasn't overstated Â? I was simply wrong (and happy to be so).

In COMEX gold futures, the commercials increased their total net short position by a miniscule 2300 contracts to 134,100 contracts. Yes, this is the largest total commercial net short position in gold in seven weeks (since Dec 20), but gold has risen by more than $100 since then and the increase in the total commercial short position has amounted toÂ ..drum rollÂ Â . 100 measly contracts. The raw data are clear Â? on December 20 and a hundred dollars lower in price than the current price, the total commercial net short position in gold was 134,000 contracts. Here we are three months later, $100 higher, and with moving average upside penetrations up the wazoo and the commercials have sold only an additional 100 gold contracts? Huh?

I remember writing over the past few months (I can't remember exactly when), about the possibility that the commercials, having sold too early and too aggressively into gold's rally last year (and racking up $4 billion in open losses at the price highs), might refrain from selling too aggressively this time around and that would mean gold would jump more sharply in price as a result. I think we may have seen a variation of this possibility in that we are $100 higher in gold and the commercials haven't sold squat yet; but it has unfolded differently than I expected. The commercials haven't sold aggressively, to be sure, but the main reason for the lack of commercial selling in gold looks to be due to the lack of managed money buying, which I never anticipated. Same net result, but different nevertheless. More on this in a moment.

The changes in the headline number in gold were small, but under the hood a few features stood out that were even more bullish than the headline results. The 4 big shorts actually bought back 3200 short contracts, while the 5 thru 8 big traders added 600 new shorts and the raptors (the smaller commercials) sold off 4900 long contracts. It's never really bearish when the 4 biggest shorts don't add to short positions and hold as low a short position as possible; both which look to be the case in gold.

The biggest recurring surprise in gold is the continued lack of managed money buying to this point. This week, the managed money traders bought only 312 net contracts, including new longs of 1879 contracts and the most surprising new short sale of 1567 contracts. Whereas the total commercial net short position is unchanged since the price lows of Dec 20, the managed money traders have bought around 15,000 net contracts since then, but in this case the 15,000 net contracts on a $100 gold move is practically nothing. Even with the slight increase in managed money buying since Dec 20, they would have to buy an additional 150,000 net contracts to match their holdings of summer. If these managed money traders do buy that many gold contracts, the effect on price should be profound.

In COMEX silver futures, the total commercial net short position increased by a less than expected 3300 contracts, to 92,700 contracts (I was expecting a 6000 contract or so increase, along the lines of the previous week). This is the largest total commercial net short position since Sep 27. Up until now, I continued to label the market structure in silver as bullish to extremely bullish, despite the historically large headline number. I can no longer do so, given the 20,000 net contract increase in commercial selling and managed money buying since Dec 20 (on a $2 rally). With that many contracts having been positioned, no one could deny that the possibility of a selloff in silver hasn't risen. However, as I'll explain, the now-deteriorated market structure in silver doesn't persuade me to lighten up on long positions.

By commercial category in silver, the big 4 (read JPM) increased their net short position by 800 contracts, the big 5 thru 8 added 400 new shorts and the raptors sold off 2100 long contracts, leaving the smaller commercials net long by only 600 contracts Â? their lowest level since the summer price highs of $20+. Back then, the raptors did end up net short by less than 7000 contracts at the extreme, indicating that should they not exceed those extremes dead ahead, there is not much room for additional raptor selling in silver. That's one of the reasons I'm not inclined to lighten up in the face of a deteriorating market structure. I don't think the raptors want to be significantly short in silver (given the likelihood that prices could explode at any time) and, therefore, are not likely to exert great selling pressure on prices. And should the raptors not sell aggressively from here, as I suspect, it will make the actions of JPM organ and the other mega shorts in silver more significant than I've highlighted in the past.

Along with the concurrent release of the Bank Participation Report, I would calculate JPMorgan's silver short position to be around 23,000 net contracts. I was somewhere around 22,000 to 24,000 contracts as of the previous COT report, so this amount for JPM is somewhat of a relief that it wasn't larger. And I continue to believe that JPMorgan is not the largest short in silver, but in second place, likely behind Bank of Nova Scotia holding around 25,000 short contracts in silver.

JPM's short position is about 5000 contracts more than it held a month ago, but still down substantially from the 32,000 contract level of September and was even higher in the summer. Two speculative thoughts. One, the 5000 contracts that JPM did add on the short side could have been neutralized by other derivatives offsets in the OTC market, where such sized transactions could be easily arranged. JPMorgan is certainly highly suited to effect such transactions Â? it is what it does daily.

Two, looming over everything is the fact that JPMorgan holds more physical silver than any private entity in history. Who cares if JPM added 5000 new shorts or that it now holds 23,000 total short contracts, when it holds the equivalent of 110,000 contracts long, in the form of 550 million actual ounces? This is the wildest of wild cards that guarantees that JPM will make a bloody fortune as and when silver prices explode. It can't even be a question that JPM is ideally positioned for an upside move in silver by virtue of its physical holdings. More of a concern would seem to be how Bank of Nova Scotia or any other big silver short would handle an explosion in the price of silver. This is what underscores the double cross potential.

The managed money traders bought about half of what the commercial sold, in buying 1697 net contracts, including 1191 new longs and the buyback of 506 short contracts. I still think a managed money trader is in the big 5 thru 8 short category. The gross managed money long position is now 78,000 contracts, up around 21,000 contracts from their recent absolute low position and therein lies any risk of a selloff. Still we are about 25,000 contracts away from the absolute high point of the managed money buying extreme of summer; so it's fairer to say that we're midway between recent managed money extreme high and low positions. Â?MidwayÂ? infers neutrality and not overt bullishness or bearishness.

Silver did close smack on its 200 day moving average on Friday, the first upside meeting of that average in a year, with gold only $30 away from the exact same setup. While silver has deteriorated more in market structure than has gold, the most glaring feature is by how little gold has deteriorated and not by how much silver has. Therefore, the key question at this time is what will the managed money traders do in gold when the 200 day moving average is penetrated to the upside? The alternative questions, of course, are why these traders haven't bought many more gold contracts to date and whether this lack of buying suggests they won't buy (or buy aggressively) even when the 200 day moving average is penetrated?

I don't pretend to know the answers to these questions, but I think I know the answers will matter more to price than anything else I see. If the managed money technical funds don't buy many more gold (or silver) contracts, the former primary price driver won't likely drive prices significantly higher. If these traders do buy 50,000 or 100,000 gold contracts or more, as they have in the past, it's hard to see how that won't drive gold prices higher.

The best explanation for why the technical funds haven't bought many more gold contracts by now is the one I've already given, namely, the importance of the 200 day moving average to technical traders. I suppose there are other possibilities to explain the lack of buying to date, such as a drastic revision of how the managed money technical funds allocate money to various markets, but I'm just theorizing and not speaking from direct knowledge. In any event, gold and silver have been prime components of the typical technical fund portfolio mix up until now and it's hard for me to imagine how this would suddenly cease to be.

My own past experience with these funds would suggest that no great revision of portfolio allocation has been made, even though my experience is now more than three decades out of date. When I did sell these funds to clients when I was a commodity broker way back then, one of pluses was that one could almost guarantee that if there were a substantial move, up or down, in the pre-defined basket of commodities traded, the technical fund approach would most likely capture that move. If, on the other hand, the different markets traded in a choppy fashion, with no clear trending move in either direction, then expect a bunch of continuing (small) losses.

There are now close to $300 billion invested in various managed money technical funds. I would imagine that the investors in those funds and certainly the brokers and financial advisors which recommended the funds to these investors would expect that if there were to develop a large up move in gold and silver that the technical funds would position themselves accordingly to profit from that move. If they didn't, I can't imagine the funds not being questioned (and perhaps sued) by fund investors and advisors.

Maybe I'm looking at this all wrong and there is something basic that I am overlooking, but I don't know what that something might be. Therefore, I still believe that technical funds will be buying aggressively at some point once the 200 day moving averages are penetrated to the upside in gold and silver. One good thing about the funds not buying big yet in gold is that without that big buying, there is not much reason to pressure prices lower. The COMEX rinse and repeat process revolves around inducing the technical funds to buy and sell. That these funds have yet to buy in gold precludes them from selling aggressively. Thus, the market structure setup is still extremely bullish in gold and while the silver setup isn't nearly as bullish, the combination is still powerfully positioned for higher prices on both.

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Silver – $17.93 (200 day ma – $17.95, 50 day ma – $16.84)

Gold – $1233 (200 day ma – $1266, 50 day ma – $1182)

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