Following two weeks of price declines and despite a very late Friday price swoon, gold and silver prices finished higher for the week; gold ended $35 (2.7%) higher, while silver finished 30 cents (1.8%) higher. As a result of gold's relative outperformance, the silver/gold price ratio widened out to yet another slight new undervaluation mark for silver at 81.25 to 1.

The relative underperformance of silver compared to gold is obvious in that, despite Friday's late selloff, gold finished at levels last seen in 2016 and another $25 or so higher will put gold at price highs not seen since 2013. Should the price highs of 2016 be taken out, the great promise for much higher gold prices, in my opinion, is an outbreak of physical gold buying by momentum-type investors in the gold ETFs, principally GLD, as occurred in the gold price advance to $1900 in 2011. When it comes to physical gold buying, generally those in India pull in their horns on higher prices, with buying from China not evident on past gold price advances (although such buying has been seen in other markets, like stocks and the property markets).

Silver, by contrast, is barely keeping pace with gold and is still closer to its price lows than its price highs over the last few years. Whereas gold is knocking on five year price highs, silver would need to climb more than $5 (30%) to get to five year highs. That silver is capable of climbing that amount faster than any commodity and is a better value than gold are separate issues; the fact is that silver has lagged gold in price. The obvious question is why has silver lagged?

Obvious questions should have obvious answers and in this case it is clear that the greatest price driver of all, COMEX futures positioning, is the answer to why silver has lagged gold. Put simply, there has been much less managed money buying in silver than there has been in gold since the December price bottoms of each. In fact, there has been hardly any managed money buying in COMEX silver from December through the latest COT report, in contrast to fairly decent managed money buying in COMEX gold.

As to why there has been more managed money buying in gold than there has been in silver, there is an obvious (and simple) answer to that question as well. Gold prices have consistently traded above (I would say have been allowed to trade above) its key moving averages since late-December; while silver prices haven't. Even after a brief upward penetration of silver's key moving averages (the 50 and 200 day ma's) on Wednesday, silver prices closed below them for the week.

Not for minute am I lamenting the lack of managed money buying in silver to this point; I am just explaining why the price of silver has lagged gold. In fact, the lack of managed money buying in silver is a distinctly bullish factor because there is no reason to believe that buying has been anything but delayed and will, at some point, kick in. That's the whole purpose of COT market structure analysis, namely, be most bullish when managed money buying is at a nadir and be most cautious when it is at a peak. I'll get into the details in this week's COT report momentarily.

The turnover or physical movement of metal brought into or removed from the COMEX-approved silver warehouse was extremely active this week as nearly 8.7 million oz were moved. Total COMEX silver inventories rose by 2.9 million oz to 253.2 million oz, another new high extending back to the mid-1990's. As has been the case for quite some time, the standout feature to this week's physical silver turnover was JPMorgan.

Some 4.6 million oz were brought into the JPM COMEX silver warehouse, increasing the amount of silver held in this one warehouse to 133.7 million oz, another all-time high. About a month or so ago, I remember writing that the silver in JPMorgan's COMEX warehouse should be considered to be higher than the then-120 million oz, by adding the 14 million oz it had just taken delivery of in its own name on the December COMEX futures contract. This was true regardless of whether the metal was physically transferred into its own warehouse, as had been JPM's custom over the past few years.

That JPMorgan did move all the silver it had stopped in December is both expected, yet remarkable at the same time. That's because not only is it completely transparent that JPM is acquiring silver for its own benefit and risk, but also because the amount of silver that JPMorgan now holds on the COMEX is larger than any previous amount of physical silver ever owned by a single private entity. That includes the previous two biggest owners, the Hunt Brothers and Warren Buffett's Berkshire Hathaway. And JPM's 134 million oz on the COMEX is only a relatively small slice of its total holdings of around 700 million oz. It's possible that JPM will move in even more silver into its own warehouse, as it did take delivery of around 3 million oz for clients over the last few delivery months, but it looks to me like it has moved most of the silver it stopped in its own name.

Another developing standout feature in COMEX deliveries is what's occurring (or not) in the current February gold contract. Last week I mentioned that JPMorgan had been the biggest stopper (taker) of gold deliveries, having stopped 1337 contracts of the 1783 total contracts issued to that point, or 63%. Further, I added that JPM had taken nearly all the gold contracts issued in recent days, suggesting that it stood in position to stop most or all of the 1100 contracts remaining open (based on how the COMEX assigns deliveries). I also stated that whatever happened, JPMorgan was in control. Guess what? There are still more than 1100 contracts open in Feb gold and JPM is still in control.

Over the past five delivery days, exactly one gold contract has been issued, an unusually low amount and that contract was stopped by JPMorgan. What does this mean? It means, for some reason, those short the Feb contract have not delivered over the past week, even though the long (most likely JPM) stood ready to take delivery. That there is no obvious financial benefit to a short waiting (since prices have been locked in) to make delivery, is what makes the lack of deliveries unusual. As to why the shorts would delay, it could be they are making delivery arrangements of some type or intend to buy back short contracts before the end of the delivery period.

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

It is important to remember that this represents a potential "rubber hitting the road" moment should JPMorgan so decide it to be. That's because the longs (JPM) can do nothing and simply sit tight, knowing that delivery must be made by month end. This is the one feature that gives the COMEX legitimacy – the ability and requirement to make or take physical delivery on a futures contract. We're not talking about a lot of gold (110,000 oz) and it's hard to think that JPMorgan would dare disrupt or intentionally precipitate a COMEX delivery crisis, but the current "standoff' must be resolved. I'm just surprised it has persisted over the past week.

While the overwhelming likelihood is that this gold delivery standoff will quickly and quietly resolve itself, looming in the background is that JPMorgan owns much more physical gold and silver than it holds short in paper COMEX contracts and this puts it in position to let prices rip higher at any moment it chooses. And as soon as this gold delivery mini-drama gets resolved before month's end, we will be facing the traditional March COMEX silver delivery, with all eyes on you know who.

Turning to yesterday's Commitments of Traders (COT) report, the positioning changes were largely expected, coming quite close to my contract predictions in silver and off by a bit in gold, but with a few unexpected surprises. You'll remember that both gold and silver prices sold off during the first three days of the reporting week, before recovering on the last two days into the Tuesday cutoff. The biggest difference (as discussed above) was that silver remained below its key moving averages during the reporting week, while gold remained above its key moving averages.

In COMEX gold futures, the commercials reduced their total net short position by 10,900 contracts to 194,500 contracts (I guessed a reduction of 25,000 contracts). This is the lowest (most bullish) total commercial net short position since Jan 2 that would be considered neutral in recent market structure terms (although we're likely back to a bearish structure as a result of the rally since the cutoff, but not extremely bearish).

By commercial categories in gold, the changes were more bullish than the headline number indicated, in that the big 4 bought back 7500 short contracts and the big 5 thru 8 shorts bought back 10,100 short contracts. It almost goes without saying that it's better when the biggest shorts buy back the most, if you are hoping for higher prices. Rounding out the commercial trading equation was one of the big surprises of this week's report in that the raptors (the smaller commercials) sold off 6700 long contracts, reducing their net long position to 38,300 contracts.

What makes the gold raptor selling surprising is that prices were mostly lower during the report week and it’s unusual to see any commercial selling on lower prices. I remember being mildly surprised that the gold raptors sold off 1000 net contracts in the previous week’s COT report, also a week that featured big 4 and big 5 thru 8 short covering on lower prices. Try as I might, I don’t have a good explanation for why the raptors sold, so I won’t make something up. My sense is that it might have something to do with my general double cross premise, but in any event I don’t see it as bearish in any way.

The managed money traders sold 13,172 net gold contracts, including the sale and liquidation of 20,194 long contracts and the buyback of 7,022 short contracts. The surprise here was the short covering on prices that were mostly flat to lower, unlike typical managed money behavior. In fact, the short covering by the managed money traders, instead of an increase in short selling was what caused me to be off in my report predictions. I’ve been commenting about the very low level of managed money shorts before this report and with just over 16,000 short contracts now remaining open, it’s hard to imagine much lower levels.

In COMEX silver futures, the commercials reduced their total net short position by 8700 contracts to 21,900 contracts (I was looking for a reduction of as many as 10,000 contracts). This is the lowest (most bullish) reading since the December price lows and one of the lowest readings in history. Accordingly, the market structure in silver must be considered to be extremely bullish. Even with the expected deterioration on Wednesday’s rally, the silver market structure remains extremely bullish. That doesn’t mean that the crooks and shysters at JPMorgan won’t succeed in driving prices lower temporarily, making the market structure even more extremely bullish, just that if they do it won’t likely last long.

By commercial category, the big 4 increased their net short position by 2000 contracts and the big 5 thru 8 bought back 6600 short contracts, while the raptors added 4100 new longs to a net long position now amounting to 59,200 contracts. The shocking increase in big 4 shorting has an instant explanation (unlike the gold raptor selling or the managed money gold short covering) and it and the very large short covering by the big 5 thru 8 are explained by a managed money trader getting large enough to qualify being in the big 4 category this reporting week.

As a result, I'd peg JPMorgan's silver short position to be 25,000 contracts (admittedly, perhaps because I had that number in mind before hand), down 3000 on the reporting week, despite the increase in big 4 shorting. And since there is at least one managed money trader in the big 4 short category and maybe another in the big 5 thru 8 category, the concentrated short position of both the 4 and the 8 largest shorts (81,115 contracts) on a pure commercial basis (netting out managed money shorting) is very low indeed and that is also very bullish.

On the sell side of silver it was strictly a managed money affair as these traders sold 11,308 net contracts, including the sale and liquidation of 886 long contracts and the new short sale of 10,422 contracts. I was more surprised at the long liquidation than the new short selling. On a net basis, the managed money traders were net short (gross shorts larger than gross longs) to the tune of 8290 contracts. While not the largest managed money net short position in history (the record was 16,000 contracts in Dec), the few times that the managed money traders have been net short in silver have always resulted in a price rally once the short position hit its peak. The only question is if the commercials have finished luring the managed money traders onto the short side; the answer to which will only be known after the fact.

Thus, the dichotomy between the market structures in COMEX gold and silver continues and it is the resolution of this dichotomy which will dictate price action from here. Will the commercials wring the final drop of blood from the stone in silver (increased managed money shorting), perhaps aided by a smash to the downside in gold; or will JPMorgan decide that it's now time for gold to go uptown, making it more likely that silver will decisively penetrate its moving averages in a meaningful manner? I can't know which it will be; all I can know is how I'll play it – which is all-in, topped off with a kamikaze option kicker.

(A quick housekeeping note. We've had a recurrence of some not getting an email alert when new articles are posted, mostly due to ISP blocking. Please let us know if you don't get an alert and the easiest solution is to just log on after 3 to 3:30 PM EST on Saturdays and Wednesdays, as I tend to be pretty regular in my postings. Thanks).

Ted Butler

February 17, 2018

Silver – $16.60 (200 day ma – $16.83, 50 day ma – $16.71)

Gold – $1350 (200 day ma – $1283, 50 day ma – $1311)