February 25, 2017 – Weekly Review/Always Evolving

Weekly Review

For the eighth week of the past nine, gold prices rose, while silver made it nine in a row, the best such string of weekly gains in a decade; with both metals hitting three and a half month highs. Gold ended the week higher by $22 (1.8%), with silver finishing up by 36 cents (2%). As a result of silver's narrow relative outperformance, the silver/gold price ratio tightened in a bit to just over 68.5 to 1, the richest relative valuation for silver in nearly six months. But it's still much closer to the truth to label the silver/gold price ratio as range bound for the past couple of years.

It sure doesn't feel to me like silver has outperformed gold over the past few months. Instead, it's felt like silver has been dragged along by a gold rally that, in market structure terms, could be just starting. Regardless of how it may feel, the price ratio is a simple mathematical valuation measure (arrived at by dividing the price of gold by the price of silver). Since I regularly mention the ratio, it was appropriate for a subscriber to ask me this week if I thought there was price manipulation of the ratio.

My answer was that, of course, the silver/gold price ratio was manipulated, but not by any other reason than the fact that the price of silver and gold are individually manipulated and as a result, any ratio between them would necessarily be manipulated in some form as well. I went on to say, to my knowledge, there was no significant positioning or trading in the ratio, only gold or silver individually.

Certainly, there is no evidence of a large physical trade involving the silver/gold price ratio Â? where actual metal is continuously swapped by large numbers of traders. In fact, I don't think there is even a large paper trade in the silver/gold price ratio. As far as I know, there has yet to be a single trade in the much ballyhooed silver/gold price ratio contract that the COMEX introduced months ago. My point is that the short term changes in the silver/gold price ratio merely reflects the day to day contest between the managed money traders and the commercials and the ratio changes mainly due to that and not some special separate contest. As such, changes in the ratio are largely unpredictable in the short term.

The turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses cooled off a bit this past four day week to 2.7 million oz, the lowest weekly turnover in nine weeks. Total inventories didn't change much, dropping off by 0.1 million oz, to 184.1 million oz. All things being equal, I would have expected some increase in COMEX silver inventories this week, seeing how next week starts the traditional March delivery process, but when are all things ever equal?

There's still a trading day to go before Tuesday's start of the March COMEX silver deliveries in which holders of futures contracts can and will liquidate or roll over March futures contracts, but the remaining open interest in the March contracts seems a bit elevated to me. The good news is that we won't have to wait long to see if there might be a bit of pushing and shoving in this delivery process. One of these days we are likely to see pronounced physical tightness during a COMEX silver delivery month, although it's been a mug's game up until now to predict exactly when Â? which is why I've always steered far away from such predictions. Still, I can't help noticing that even among those who invariably declare an impending delivery default for whatever the current approaching delivery month may be for years on end, I have heard no such predictions for this March. Just sayin'.

With only two reporting days remaining this month, unless there's some unexpected surge in reported sales, this month's sales of Silver (and Gold) Eagles from the US Mint are so low as to be almost unbelievable. I would remind you that gold and silver prices have moved higher for the month and for the year to date, so the abysmally weak sales of coins stand out even more. Why are Eagle coin sales so low?

https://competition.usmint.gov/bullion-sales/

Such unusual circumstances demand analysis and explanation. For my part, I believe I have offered continuous analysis to explain that JPMorgan accounted for the bulk of Silver Eagles bought over the past six years, amassing 100 million Silver Eagles (and 50 million Canadian Maple Leafs), all of which were subsequently melted into 1000 oz good delivery bars. Over the past six years, reports from the retail front indicated weak demand and the persistence of such reports in the face of record sales of Silver Eagles and Canadian Maple Leafs is what led me to the JPMorgan connection.

When I first concluded JPM was behind the surge in sales, many doubted my findings and some continue to do so to this day. Ironically, the sharp recent falloff in US Mint (and Royal Canadian Mint) sales, at least to me, provides more proof that JPMorgan was the big (former) buyer. The mark of whether any premise or finding is valid lies in how it holds up to changes in circumstances along the way. By identifying that JPMorgan was the big buyer and not the retail public that created the probability that should JPM suddenly refrain from buying (as it is now doing), there must be a sudden and shocking decline in total sales, which has occurred.

For those who claimed it was strong retail demand all along and not JPMorgan behind the six years of record sales of newly issued silver coins from both mints, it would seem that they have the burden of proof to now explain the sudden falloff in sales. As I've contended all along, public behavior is broadly recognizable and there were no clear signs of strong retail demand away from the Mints' record sales of coins. Since I claimed there was no big retail demand all along, just big demand by JPM, my explanation for the recent falloff in demand is that the bank stepped aside. It seems to me that those claiming it was strong retail demand all along and not JPMorgan now have the responsibility of explaining why retail demand suddenly changed. I'm not holding my breath waiting for those explanations.

The changes in this week's Commitments of Traders (COT) Report were in the expected category in that there were increases in managed money buying and commercial selling in both gold and silver. Considering that total open interest increased by more than 12,000 contracts in each, for a change, only gold came close to a net change of that much, but the story of greater relative deterioration for silver on the rally to date is still the overriding feature.

In COMEX gold futures, the total commercial net short position increased by 11,800 contracts to 139,600 contracts. While this is the highest commercial net short position in more than two months (since the Dec 13 COT report), the glaring takeaway is still how incredibly small the increase has been considering the roughly $120+ gold rally over that time.

The best news is that this week's slight deterioration in gold, as well as the apparent continued managed money buying since the Tuesday cutoff, strongly supports my belief that the managed money traders in gold would eventually buy on higher prices. Make no mistake Â? the prime component of my bullish outlook on gold resides in big managed money buying to come. Since it has now finally appeared to have started, the question shifts to how much managed money buying will come.

A month ago, the price of gold was nearly $75 below its 200 day moving average, having fallen sharply since Election Day amid countless stories connecting the decline to US election results. On Friday's close, gold's price was less than $10 under the 200 day moving average and back to levels that existed before Election Day. At the very least, it would appear that the election didn't have all that much to do with the price of gold to begin with, other than providing a convenient cover story for the price takedown into December.

Something to consider Â? on the price plunge after Election Day, gold has spent every single trading day (nearly 90 in total) since then below its 200 day moving average. Should past patterns prevail, aggressive new managed money buying should emerge on a decisive upward penetration of the 200 day moving average. The pattern is largely the same in silver, except for the past ten days or so. My point is that this is a fairly long stretch to have been under this key moving average and it wouldn't be unreasonable to suggest that an upward penetration might have more force than typically seen.

Back to the gold COT report. By commercial category, the big 4 only added 600 new short contracts. I probably don't need to explain why this is bullish on its face, but it has to do with the largest and most dominant short traders behaving as if they expect higher prices. Aside from last week's COT report, this week's concentrated net short position by the big 4 is the lowest in a year. The raptors (the smaller commercials apart from the 8 largest traders) did most of the selling, in liquidating 14,800 long contracts (which is different than adding new shorts) and the big 5 thru 8 actually bought back 3600 shorts, although it looks to me like that was due to managed money short covering by the trader no longer in the big 5 thru 8 category.

On the buy side of gold, there were no surprises as the managed money traders accounted for net buying of more than 14,400 contracts, including buying 6900 new longs and the buyback of 7517 short contracts. Undoubtedly, there has been significant additional managed money buying since the cutoff, but based upon the data in the current report, there may still be 200,000 net contracts of managed money buying and commercial selling to come should positions climb to the levels seen in the summer. Of course, there's no guarantee that the managed money traders will buy that much. Then again, there's no guarantee that they couldn't buy even more than that, either.

In COMEX silver futures, the commercials increased their total net short position by 3200 contracts to 102,200 contracts. This is the largest total commercial net short position since Aug 9 and only slightly less than 7000 contracts less than the all-time record amount the week before that. Back then, silver was trading for more than $20 (not that $20 is too high of a price).

By commercial category, the big 4 (read JPM), added 2000 new shorts, while the big 5 thru 8 added 1800 new shorts as well. The raptors bought back 600 shorts from a net short position now standing at 1700 contracts. I think the 8 largest traders are now exclusively commercial, as opposed to including a managed money trader and as is customary. Both the managed money traders and the commercials are purely speculative in essence, it's just that Â?commercialsÂ? sounds less speculative than Â?thieving, no good, crooked banksÂ?.

I'd peg JPMorgan's net short position at 28,000 contracts, according to my usual methodology, but there are still two long weeks to go before I can calibrate that against the next Bank Participation Report. This is the largest short position for JPM (barring any surprises in the BPR) since October, but still about 8000 contracts less than what held by the bank at the summer's peak. JPMorgan has now increased its silver short position by the upper level of my 5000 to 10,000 contract Â?worry pointÂ? and for that I am disappointed. However, there are a number of strange things going on and despite the increase in JPM's silver short position the warning flags of a double cross are still a mast.

On the buy side of silver, it was a complete managed money affair, as these traders bought more than 5200 net contracts, including 5670 new longs and the new short sale of 404 contracts. At 89,710 contracts of gross long positions, the technical funds have now added 32,000 new long contracts since the lowest levels of longs back in December. Including the buyback of short positions since then, the managed money traders have purchased nearly 40,000 net contracts of COMEX silver futures over the past two months. This is the buying that drove prices higher by roughly $2.50 over this time.

Now I would ask you to consider 40,000 net COMEX contracts in terms of its metal equivalent, which is 200 million oz of silver. Over the past two months, CFTC data indicate that the managed money traders bought the equivalent of 200 million oz of silver. Wait a minute Â? over the past two months, the world has only mined 150 million oz of actual silver and 90% of that was consumed by industrial users and other fabricators, leaving only 15 million oz or so available to the world's investors. Yet, the managed money traders bought (and the commercials sold) more than 13 times more silver than was available for investment. Can these numbers be real? Investigate for yourself.

The real story here is not that the managed money traders bought so much Â? the real story is that the commercials sold so much. Buying something you don't own is not illogical; selling something you don't own and have no reasonable prospect of securing is nuts Â? except if you know the game is rigged. That the regulators allow managed money traders to buy quantities of silver that don't exist is unfortunate. That those same regulators allow speculators (the commercials) to sell short such quantities is criminal and a danger to orderly markets. 200 million ounces is more silver than exists in the COMEX warehouses and an amount impossible to buy in real terms.

Only COMEX silver has this mismatch between futures positioning and real world equivalents Â? no other commodity, including gold. In gold, the total commercial net short position is the equivalent of less than 14 million ounces (140,000 contracts). In dollars, that's a large amount – more than $17.5 billion at current prices. But in terms of all the gold ounces in existence, which are measured in the billions of ounces, 14 million oz is less than a half of one percent of all the gold ounces in the world. By contrast, 200 million oz of silver is about double the amount bought by either the Hunt Bros or Warren Buffett and should anyone try to buy 200 million actual real ounces of silver in a hurry – say two months or less Â? price would quickly exceed $100 an ounce. By dealing in COMEX paper equivalents, the normal price implications of the law of supply and demand are evaded Â? much to the everlasting shame of the so-called regulators.

I'm not looking to beat this to death, but the problem in COMEX silver is two-fold. One, none of the participants are legitimate producers or consumers or hedgers of any type; every COMEX trader is speculating in some way. Two, the quantities traded on the COMEX bear no relation to the amount of silver produced, consumed or in existence in the real world. This is guaranteed to end badly in some way (not for silver investors) at some point Â? just don't ask me when.

Always Evolving

One thing that I think about often is the evolving nature of the futures market structure in various commodities. While there is a repetitive pattern (the wash, rinse and repeat cycle) in which the commercials take on the managed money traders, the timing and size of positioning extremes are always changing. Short term timing is always challenging, so what I think about most is the size of the managed money/commercial positioning, particularly in relation to historical extremes. But even here, previous records can be shattered.

This is important because, if one gets bearish because the market structure is getting closer to historical extremes, as is the case in silver, prices can still trend higher than expected if the position grows larger than at previous extremes. A big part of my market structure premise is that when positions come close to previous extremes, the price move is close to termination and subject to reversal. But at the same time, we all know that records are made to be broken and when that occurs, price tops and bottoms can go further than expected. Perhaps some recent examples Â? both bullish and bearish – might better explain this.

After Election Day, on the big price smash from $18.50 to under $16 towards the end of December, the market structure in COMEX silver turned extremely bullish, in my opinion. Opinion is subjective, of course, and there were many who argued that the COT market structure in silver was bearish in December due to the large headline number of near 80,000 contracts in the total net commercial short position. There was historical justification for the bearish opinion and I fully acknowledged it at the time.

However, I was persuaded otherwise, based upon details under the hood – mainly how the managed money traders were refraining from adding new short positions for the first time in years. I tried to distill it down to an Â?either orÂ? Â? either the managed money traders would add aggressively to silver short positions and drive prices notably lower – or they wouldn't and in which case silver prices had no good mechanical reason to continue to decline substantially. Having distilled the question down to would or wouldn't the managed money traders add aggressively to short positions going into the end of December, I went on to Â?guessÂ? that they wouldn't and that would lead to rising prices. This time I guessed correct and silver prices rose from late December, but I could have just as easily been wrong. (I still have the Easter Bunny costume from a few years back when I guessed wrong on what the silver raptors would do at the time). My point is not my luck at guessing correctly (or not), but that the equation was distilled correctly.

Currently, with the commercial net short position in silver much deeper into the bearish category, bearish price expectations are stronger. Certainly, if silver prices do get hammered, few should fail to recognize the influence of the bearish market structure. But here's where the always evolving market structure could prove otherwise Â? should managed money traders now buy many more new silver contracts than they did previously, the upward impact on price from here could still prove formidable. In fact, that's my current distilled mechanical premise Â? if the managed money traders turn tail and begin to sell COMEX contracts, the price of silver will fall Â? should many more be bought instead, the price will rise. That may not sound especially profound, but it is the main price driver as I see it

The biggest difference to me is that back at the December price bottom, I was convinced the managed money traders would not add aggressively to the short side. Now, I'm not sure what these traders will do, even though I think I've defined the premise correctly. So mostly, I look for clues for which it will be Â? turn tail and sell for the managed money traders or add many more longs. Here, I look for signs in other markets, with gold as a prime consideration.

I have been considering the still bullish market structure in COMEX gold as positive for silver; unlikely to lead silver lower in prices and more likely to lead silver prices higher if enough new managed money buying comes into gold, lifting gold price higher. And should managed money traders increase their net long position in COMEX gold to the record levels that existed over the summer, then close to 200,000 net contracts could be bought. Undoubtedly, such buying, should it occur, would exert a powerful upward force on gold prices and perhaps silver in turn (since both seem joined at the price hip m

Date Created
2017/02/25