January 19, 2013 – Weekly Review

Weekly Review

In what seemed like a week not experienced for quite some time, there was a pretty decent upswing for gold and silver prices this week, as gold finished $22 (1.2%) higher, while silver gained an impressive $1.50 (4.9%). Silver finished higher every day this week and its relative outperformance compared to gold caused the silver/gold price ratio to tighten in to under 53 to 1. As is most always the case, silver accelerates gold on both upside and downside price movements. As a result, the silver/gold ratio generally tightens when precious metals' prices rise and widens when gold and silver prices decline. That's another way of saying that silver outperforms gold to the upside. Therefore, if you expect higher precious metals prices in the long run, you must expect silver to outperform gold. I think many gold investors accept this premise, but have not yet acted on their beliefs, according to the dollar investment holdings of each. That is perhaps one of the most bullish factors favoring silver.

There continued to be extremely heavy turnover or movement in the COMEX silver warehouses this week, as total inventories rose more than 3 million oz to just under 152.1 million oz. Since I have emphasized this COMEX warehouse movement for quite some time as being my prime indicator of wholesale physical tightness, I will not subject you to it again, except to note that I tried to cover it in an audio interview with Chris Martenson on Wednesday. As I explained to Chris, there's no doubt that the big inventory churn is occurring in silver and the most plausible explanation to me is hand to mouth tightness.

The two big silver stories of the week were the US Mint's announcement of a sell-out in Silver Eagles and the massive one-day deposit of 19 million oz into the big silver ETF, SLV. I'll deal with the Mint's announcement first and save discussion on SLV until after COT commentary.

In last week's review I indicated that I was hoping for the Mint to sell as many as 6 million Silver Eagles in January, as my guess was that was close to the Mint's production capacity, based upon their daily production rate over the past few years. I pegged the daily run rate at around 100,000 coins and combined with the curtailed sales in December and a little fudge factor, I thought if demand held up we could see 6 million coins for the full month of January, as we have for the past couple of Januarys. Since the Mint announced it ran out of their Silver Eagle inventory at just over 6 million coins mid-month, demand was even stronger than I expected, although I was obviously accurate in guessing the Mint's production or blank supply capacity. (OK, I was off by 7000 coins). More Silver Eagles may be available after the 28th, according to published reports.
http://www.usmint.gov/mint_programs/american_eagles/?action=sales&year=2013

The question now is will demand for Silver Eagles hold up, or are we in for a period of seasonal weakness? Time will tell, of course, but it is important to try to put sales of Silver Eagles into proper perspective. Clearly, I believe Silver Eagle sales are important, otherwise I wouldn't mention them regularly. And I still believe that my friend and silver mentor, Izzy Friedman, kicked off the frenzied level of demand witnessed since his article appeared in December 2007 http://www.investmentrarities.com/ted_butler_comentary/12-03-07.html I don't know that the premiums on Silver Eagles will climb as high as Izzy predicted, but I have learned not to rule out anything that he envisions.

There is no doubt that Silver Eagle sales have exploded since Izzy's article with the annual demand over the past 5 years running three to six times greater than that of the program's annual demand for the preceding 20 years. That's not something that can be said about Gold Eagles. In fact, the annual demand for Silver Eagles has become so large that it may represent the single largest demand factor in the total world silver supply/demand equation, which is remarkable no matter how you slice it. Who would have ever thought that annual sales of Silver Eagles would approximate total annual US silver mine production? Given the attractiveness of silver as an investment and the unique additional attraction of holding the metal in the form of Silver Eagles, I would expect future demand to remain strong. But it is important to remember that Silver Eagles are but one form of silver and that the US Mint's inability to keep up with demand at times does not mean, by itself, that there is a shortage of silver on a wholesale level. Such Silver Eagle sell-outs do suggest strong retail demand and perhaps strong overall silver investment demand and must be monitored closely. As I indicated Wednesday, let there be an unavailability of silver in another form, that of 1000 oz bars, and we're talking about a completely different story.

The changes in this week's Commitment of Traders Report (COT) were within expectations of a minor deterioration, or increase in the total commercial net short position, as prices rose in the reporting week for gold and silver. On the Tuesday cut-off, gold had climbed by more than $20 and silver by more than a dollar for the reporting week, with both having crossed over the 200 day moving average to the upside. This type of price action generally causes technical funds to buy and for the commercials to then sell to those tech funds.

In gold, the total commercial net short position rose by 6600 contracts, to 185,100 contracts. While the increase wasn't terribly significant, it was the largest increase in the commercial net short position since the end of November. By commercial category, the big 4 did nothing with the gold raptors and the big 5 thru 8 accounting for all the increase. The gold raptors added around 2500 contracts, increasing their total net short position to 7300 contracts, while the big 5 thru 8 added around 4000 short contracts.

Even factoring in some further increase in the gold commercial net short position since the cut-off, the market structure in gold is no worse than neutral to bullish by standards of the past couple of years. Unfortunately, that sounds wishy-washy on my part and that's because there is room for the price to move up or down short term, but with more room to the upside. Also, the fact that we've spent a bit of time below the key moving averages in gold (and silver) and have only just recently moved above those averages is promising, because there has been general liquidation of tech fund long/commercial short positions until this week. And we could get a further technical pop in price since we have not violated decisively the 50 day moving average to the upside yet in either gold or silver, having closed just beneath that moving average on Friday in both gold and silver. There I go, talking like a chartist again.

In silver, the total commercial net short position on the COMEX increased by less than 800 contracts, to 42,000 contracts. Given the price rise over the reporting week, I thought the modest commercial short position increase both notable and encouraging as not that many tech funds longs were added and subject to liquidation to the downside. I was further impressed with the breakdown by commercial category, although I'm not sure if my impression is good or bad. To be sure, one could read too much into such a small contract change in one week, but all the increase in the total commercial net short position and then some was due to big 4 (read JPMorgan) short selling as this category increased its short position by more than 1200 contracts. The raptors (the smaller commercials apart from the big 8) went the other way and added almost 500 contracts to a long position now totaling 16,300 contracts, the largest since mid-August. The big 5 thru 8 hardly budged, as is their usual custom.

Once again, I may be reading too much into such changes given the small contract amounts involved, but it encourages me that the raptors appeared to be buying to the upside. It also concerns me that JPMorgan may be tipping its hand in signaling that the bank intends to continue to be the only new short seller, commercial or otherwise, on higher silver prices. This is exactly what this crooked bank did on the $8 silver rally from the summer and the $10 rally starting December 2011. Any time there is only one new short seller in any derivatives market, the price manipulation warning flags must be blowing as if in a hurricane. That's because without that new single short seller, a tenth-grader could demonstrate why that constituted price manipulation. That the CFTC can't see it, no less stop it, remains an open scandal. I suppose we should be glad the agency doesn't monitor real hurricanes.

I would peg JPMorgan's concentrated net short position in COMEX silver futures to be 29,000 contracts (145 million oz). That's up a thousand from last week and down 9000 contracts from the peak JPM short position of 38,000 contracts (190 million oz) on November 27. Importantly, JPMorgan's current short position of 29,000 contracts still represents 29.6% of the entire short side of COMEX silver (minus spreads). Almost 30% of an entire market and the documented sole additional short seller on any price rally and the regulators pretend there is nothing wrong. I would contend that nothing could be more wrong. It's going to be fascinating to watch this unfold (much as it's been fascinating to date).

Basically it comes down to what JPMorgan can and may do that will determine the price of silver. But whatever the bank does, it should be visible in future data releases. They may try to rig prices lower in order to buy back more shorts at a lower price or add more short positions to cap silver price rallies, but doing nothing doesn't appear to be a viable alternative given their controlling market share. The worst possible outcome for JPMorgan and coincidently the best outcome for all silver investors is the onset of a genuine silver shortage, the signs of which seem to be more noticeable daily.

The other big silver news story this week, away from the US Mint, was the large one-day deposit of 19 million oz into the big silver ETF, SLV. To my knowledge and away from 20+million oz deposit on the very first day of trading of the SLV, this was the largest single day deposit into the trust. There was a 20 million oz deposit on the very last day of 2007, but the metal came out the next day or two and I always considered it to be a reporting error. In all truth, I assumed the deposit this week was also a reporting error and still lean that way, although it has been two days since the deposit and no correction has been forthcoming. Therefore, I suppose it is real and I must try to figure out what it means. I will do so, but I will not fall down shocked and surprised if it is later revealed to have been a reporting error. In that case, the following should be disregarded.

While the big SLV deposit received widespread reporting and attention (as well it should have), there was little concrete analysis for how it occurred or what it meant for silver. That's for good reason, as there was no indication that such a large deposit would or should have occurred. In simple terms, the deposit made no sense. There was absolutely no tip-off from a price or volume perspective that such a large deposit was forthcoming. One of the things I calculate on a running daily basis is SLV volume and price action with a specific eye towards detecting metal inflows and outflows. I've done that since the SLV started trading almost seven years ago and have become pretty good at it, as it has nothing to do with short term price predictions and relies on data after the fact. I'm quick to report if I think the trust is ?owed? metal, based upon volume, price and short sale statistics. In the eight trading days up to the deposit, volume was basically tepid and price action non-descript. That would not be the case if someone was buying as much as 20 million ounces of physical silver in a short period of time. Therefore, the deposit can be considered strange and out of place.

Assuming I'm not missing anything obvious and the reported figures are accurate, I'll try to imagine the circumstances behind the deposit from a speculative perspective, which I suppose is better than no perspective at all. By ruling out that the deposit didn't result from plain-vanilla investment buying (no big volume or price rise), we must consider how the deposit could have occurred mechanically. First, it had to be some type of large negotiated transaction off the exchange or away from normal trading venues. The trouble with that is while it's easy to imagine a willing large buyer (given all the current factors in silver) it's much harder to imagine a single big seller willing to part with that quantity of silver at current prices. I don't know of a documented single holder of metal or single holder of any ETF that owns 20 million or more ounces. I'm not kidding when I tell you that the circumstances behind the deposit are strange.

The recurring thought that I keep coming to is that the big deposit has something to do with the short position in SLV, which I admit to obsessing about anyway. Perhaps the big short in SLV (and it almost has to be one big short in this example), rather than buy back previously shorted shares, instead took the time to assemble a big enough chunk of metal to deposit and close out the short position that way. That would also imply that the short position was bigger than has been reported which is believable to me, thanks to the distrustful DTCC. The size of the deposit, considering the historical record of the trust did not appear to come from everyday open and transparent transactions. I suppose I should write to BlackRock, as they should be providing an explanation for their $10 billion+ ETF, but the last time I wrote to them I received a very threatening letter from their high-priced New York lawyers (with offices in Menlo Park and Paris). You'll forgive me if I think that one over a bit.

Almost nothing about the big deposit is negative to the price of silver, including the question of where the heck did someone come up with 19 million oz of silver? That's because, even if someone did come up with that much silver, then there is now 19 million less ounces than can be further come up with from this point. Who ever bought the silver wasn't buying due to the price-momentum approach of chasing higher prices; the buyers bought nearly $20 below the peaks of 2011. That suggests a long term approach with not much concern for lower prices in the short term; in other words, a strong holder.

The truth is that the big deposit into SLV was strange and it may take some time to figure out. Like most things in silver, it will probably come to make sense in due course. Still, it was a head-scratcher for me. Here's the link from that audio interview with Chris Martenson, which took place Wednesday afternoon, before the SLV deposit was announced. Good thing too, as how often could I say I don't know if asked about it and not sounded out to lunch?
https://s3.amazonaws.com/cm-us-standard/audio/off-the-cuff/off-the-cuff-66s9ywn.mp3

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Silver – $31.90

Gold – $1685

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