

## January 29, 2011 – Weekly Review

### Weekly Review

Due to the sharp rally on Friday, the weekly pattern of lower prices in 2011 was finally broken in silver, with the price finishing up about 50 cents, after making new lows in the early hours of that day. Friday's rally in gold was notable, but fell short of putting it into the plus column for the week, as gold finished down a bit over \$7 on the week. As a result, the gold/silver spread tightened for the first time on a weekly basis in the New Year.

I promise I won't lecture too much on the need for gold-only or gold-heavy investors to switch to silver, but I would like to make one new observation on this matter. One of good arguments against switching to silver from gold is the general consensus that silver is more speculative and volatile than gold, which means while it outperforms gold in a rising market, silver also falls much faster when prices decline. I admit there is strong historical evidence of this. However, the actual current supply/demand circumstances in each strongly suggest that the past pattern may have now decisively tilted in silver's favor for both up and down markets. New evidence suggests silver's past underperformance in down markets is more than mitigated by its potential over-performance to the upside.

Over the past month, we have witnessed the sharpest downturn, in dollar terms, in gold and silver in many months. Usually, when gold sells off by more than \$100 an ounce, silver would truly get clobbered. This time? Not so much. At Friday's close, gold is down close to 6% for the year, while silver is down a bit over 9%. Last year, silver outperformed gold by a factor of almost 3, as its percentage gains were almost 3 times that of gold. It is hard for me to imagine how that outperformance by silver won't continue in the future, given the real circumstances in each. This current new experience suggests that silver may perform only slightly worse to the downside, but massively better to the upside compared to gold. This is a much different pattern that what previously existed. If you had to choose between investing in two stocks with those parameters, it should take you only a few seconds to decide which to hold. OK, no more lecturing – just if you haven't already made the switch, do so soon.

Please don't misinterpret my switch from gold to silver mantra as implying I am negative to gold. That is not the case. As I'll describe in a moment in the COT analysis, both gold and silver seem poised to explode to the upside. It wouldn't surprise me to see gold embark on a quick \$100 to \$200 run to the upside. But if that were to occur, silver should explode by \$10 or more. If you do the math, such an outcome would result in an investment in silver being two or three times more rewarding than the same investment in gold.

Tight physical market conditions still appear intact in silver. The frantic pace of physical movements into and out of the COMEX-approved warehouses continues unabated. The US Mint sales of Silver Eagles continues at a record pace, with a final end of month report due Monday. Various reports of tightness in other forms of retail investment silver continue to circulate. The liquidation in the big silver ETF, SLV, appears to have stabilized. I know it seems that the 16 million ounce reduction in holdings in the Trust over the past month implies that this amount of silver is now freely available to the market, but that is not the case, in my opinion. This silver is owned by someone (my guess is the big commercials) and it would be a mistake to assume it is available to the market at near-current prices. Just like I believe that the big shorts on the COMEX will be very reluctant to short on the next rally, I also believe that the new owners of the silver recently liquidated in SLV will be slow to sell that newly acquired metal except at much higher prices. One thing that convinces me this metal is tightly-held is the lack of any decrease in the short position in SLV shares, where the short position actually increased, despite the sell-off. This tells me the real metal is still in great demand.

<http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

The latest Commitments of Traders Report (COT) confirmed expectations of a further reduction in the total net commercial short positions in both COMEX silver and gold futures; this week by a further 2200 contracts in silver and 9000 contracts in gold. I had actually expected more of a reduction, given the price action during the reporting week, in which we spent every day below the important 50-day moving average in both gold and silver, the first time that occurred in both in many months. The price action included the "slicing of the salami," a term used by myself and my silver mentor and friend, Izzy Friedman, to describe a series of purposeful new price lows intended to induce technical funds and traders to sell, by the big COMEX commercial crooks. This technique was used quite commonly in the past when the commercials were near the end of a manipulated flush-out of leveraged longs. In fact, the slicing of prices during the reporting week convinces me that the commercial manipulators may have gotten all the blood out of the margined long stone that was gettable. That's what usually defines the bottom. Coupled with the sharp and sudden price rally on Friday, the path of least price resistance now appears upward.

As I have indicated, the character of the inevitable price rally following this most recent manipulated decline is the key question for investors. I'm still of the belief that the big commercials will refrain from aggressive new short selling, particularly in silver, on the next price rally. There is too little for them to gain by doing so, and much to lose. This suggests that the rally will be sharp, perhaps sharper than any we have experienced to date. The good news is that this will be measurable through future COT and Bank Participation Reports for all to see.

The bottom line on the COTs is that the commercials are now less net short in silver and gold than they have been in a very long time. That the commercials have achieved these low short positions implies that there is relatively low risk and high profit potential currently. The COT structure suggests that prices could explode upward with the slightest provocation. The fact that more than the slightest provocation potentially exists in the form of developing world events only accentuates the bullish possibilities.

An article in yesterday's Wall Street Journal confirms my analysis on Wednesday for the cause of the recent massive decline in COMEX gold open interest, as being due to the sudden close-out of spread positions in the more deferred months of the gold contract.

[http://online.wsj.com/article\\_email/SB10001424052748703399204576108463818702014-1MyQjAxMTAxMDIwODEyNDgyWj.html](http://online.wsj.com/article_email/SB10001424052748703399204576108463818702014-1MyQjAxMTAxMDIwODEyNDgyWj.html)

Even though this story tracks remarkably close to my original spread analysis, I think there may be a lot more to the story than meets the eye. Whether more details emerge remains to be seen, but I would like to expand on the significance of the revelations to this point. For one thing, this episode provides stunning evidence of gross negligence in the CME Group's regulation of gold and silver trading on the COMEX.

I have consistently referred to the CME as a criminal enterprise in their regulation of gold and silver trading. I don't believe that the CME, which is designated as a self-regulatory agency (SRO), is fit to regulate anything where the public may be involved, because it is only interested in what's good for the exchange, not the public or the markets. Those are very strong words that I do not use loosely. I also make sure that whenever I do refer to the CME negatively, I send the top regulatory officials of that organization my comments (as I will with this article). I have yet to hear from them. Let me explain why I think this gold spread episode backs my contentions about the CME.

That the CME allowed one under-funded hedge fund to control 10% to 15% of the entire gold futures open interest borders on criminal negligence. This trader's spread position was uneconomic in nature and should never have been allowed to have been established for reasons other than it was grossly underfunded and served no economic purpose (other than to allow a crazy speculative bet). How it passed continuing regulatory scrutiny at the exchange is baffling. The only plausible explanation is that because the large volumes of contracts involved represented large income to the exchange, the CME looked the other way. This is the same explanation for why the CME has looked the other way for so many years of an increasingly obvious silver (and gold) manipulation. Because the manipulators are the most important members of, and generators of income to the exchange, the CME is not interested in disturbing important income flows by enforcing commodity law prohibiting manipulation. That the CME is given any role in regulation, due to their clear conflicts of interests, is beyond absurd.

Beyond the potential risks to the market that the huge and underfunded gold spread position represented, are more important considerations. The overstated open interest and its sudden vaporization caused false data to be disseminated, a very clear violation of commodity law. I read numerous reports which (incorrectly) interpreted the sudden decline in gold open interest to mean something different than what actually occurred. Despite this, not one statement from the CME was presented to clarify the issue in a timely manner. That's inexcusable. The artificial large open interest may have also falsely led many to believe that the COMEX gold market was larger and more liquid than was actually the case prior to its sudden liquidation. The CME has done nothing to clarify those potential false conclusions.

Most importantly, the artificially inflated open interest mathematically reduces the stated percentages of concentration held by the largest traders in the gold and silver markets. (There is evidence in the latest COT of artificial spreads being liquidated in silver as well). Concentration is largely the same as manipulation. That the CME allowed the true concentration levels in gold and silver to be understated by allowing the presence of phony spreads is inexcusable, quite apart from any selfish income considerations. This suggests another motive for the CME to have looked the other way in allowing these spreads to exist, namely, it reduced clear proof of a manipulation in gold and silver. I don't know what could be more serious than this possibility.

I am hopeful that the CFTC will level a significant fine against the CME Group for such an egregious breach of regulatory responsibility in the exchange's handling of the gold spread debacle. I am also hopeful that the CFTC will use this episode as a springboard to greatly reduce or eliminate the role the CME plays in commodity regulation. Let's face it Â? the CME is a for-profit organization interested in the returns to its shareholders. There is nothing wrong with this until that obvious self-interest clashes with the law and the public's right to fair dealings and a level playing field. Clearly, this gold spread debacle proves the public's interest is secondary to profits at the CME. Otherwise, the CME would have dealt with it long ago.

In closing, the set up in silver and gold looks exciting. The COMEX flush-out looks complete. Considering how corrupt the large commercials can be, it is always imperative to be prepared for whatever they may throw at the market in the way of dirty tricks. All in all, given the market structure, supply/demand circumstances, and the new heightened level of world tension, it is hard to imagine the price of silver and gold not escalating amid investor demand. It is even harder trying to imagine any rational person desiring to dump precious metals holdings in this environment.

Ted Butler

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Silver – \$27.95

Gold – \$1335

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