Weekly Review

For the second week running and for the first week of the New Year, gold and silver prices ended higher; gold by $21 (1.8%) and silver by 50 cents (3.1%). As a result of silver's relative outperformance, the silver/gold price ratio tightened in by one point to 71 to 1. Silver's relative outperformance seemed somewhat strange according to the daily price action during the holiday shortened trading week.

The price of silver seemed to struggle relative to gold, at least for the last three trading days of the week, so it was somewhat surprising that the week's final tally would indicate that silver did better on a relative percentage performance basis. To be sure, the change this week in the silver/gold price ratio had little or nothing to do with physical market developments or changes in investor sentiment and everything to do with COMEX futures positioning. Despite yesterday's weakness, mining shares put in a strong performance during the first week of trading this year, no doubt aided by the end of tax-loss selling.

One thing that I would add about the perception (not the reality) that silver struggled in price relative to gold this week that encourages me is that when prices seem to struggle there is generally little aggressive technical fund buying. Usually, when prices are surging strongly, the price movement is driven by strong managed money buying, which while it causes prices to advance also sets the stage for eventual price declines when those same funds sell. In other words, because silver prices seemed to struggle this week relative to gold, I sensed bigger managed money buying in gold than in silver (since the Tuesday cutoff). More on this later.

The turnover or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses exploded this week, shredding my admittedly wild speculation last week of a turning off of the turnover faucet. From last week's 0.1 million oz turnover, the lowest I can remember, more than 8 million oz were moved this week as total COMEX silver inventories fell by a sharp 2.8 million oz to 180.7 million oz.

Both weeks included 4 business days and this week's turnover, when annualized, came to more than 400 million oz, nearly half of total annual world silver mine production or the total documented world stockpile of metal in the form of 1000 oz bars. Why so much physical silver is sloshing in and out of a few COMEX warehouses for the past six years running, with no such comparable movement in any other commodity begs for an explanation. Mine, of course, is wholesale physical tightness and the accumulation of metal by JPMorgan. Other explanations are continually solicited and appreciated.

The was a net addition of more than 1.1 million oz in the JPMorgan COMEX warehouse this week, increasing the total holdings in that warehouse to just over 83 million oz. (There was also a 64,000 oz increase in JPM's COMEX gold holdings, following last month's stopping of COMEX gold futures deliveries). Based upon the pattern set by JPMorgan over the past few years, I would expect another 6 million oz of silver to come into the JPM warehouse in the immediate future.

One other COMEX silver oddity this week was a bookkeeping adjustment indicating a 1.5 million oz decrease in the Delaware Depository warehouse. In my opinion, way too much attention has been placed on the periodic adjustments of metal from or to the registered and eligible categories because the actual metal never moved. This week, the COMEX reported an adjustment indicating a plain vanilla reduction of 1.5 million oz and nary a word was mentioned by those so vocal about adjustments where the total holdings don't change. Go figure. As to why 1.5 million oz disappeared, it could be an adjustment as a result of a yearend audit. With 4 or 5 million oz physically moving in and out of the COMEX silver warehouses weekly, 1.5 million oz in the face of the annualized turnover isn't much. Perhaps there will be an offsetting future adjustment, indicating this is a clerical matter, but such plain vanilla adjustments are rare.

The changes in this week's Commitments of Traders (COT) Report weren't particularly large, but somewhat surprising; with the surprises mostly of the bullish variety. I had expected unspecified increases in managed money buying and commercial selling in both gold and silver, given the price jump in each by the Tuesday cutoff. That did occur in silver, with gold surprising (bullishly) for a second week running. As a reminder, gold prices rose more than $25 during the four day reporting week, with silver gaining more than 40 cents.

Moreover, gold penetrated or closed above its 20 day moving average decisively on three of the four trading days in the reporting week, while silver penetrated its 20 day moving average only on the Tuesday cutoff, but failed to close above it. In the three trading days since the cutoff, both gold and silver closed above their respective 20 day moving averages. I do have some concern that this COT report might have been understated due to the large move on Tuesday and the holiday period causing reporting delays, but I must report on the data as published.

In COMEX gold futures, the commercials reduced their total net short position by 3400 contracts to 117,600 contracts, yet another new low (bullish) level extending back to February. Once again, I am precluded from calculating the precise breakdown by commercial categories, due to the presence of managed money traders in both the big 4 and big 5 thru 8 gold short categories; but it is a near certainty that the concentrated commercial short positions are also the lowest (most bullish) since last February.

The biggest surprise of the gold COT report was that the managed money traders sold 6809 net contracts, nearly double what the commercials bought, including the long liquidation of 2809 contracts and the new short sale of 4000 contracts. Despite the increase in managed money short selling, the number of traders in that category declined by 6 to 48, further strengthening the idea that large traders have been behind the recent increase in managed money shorting and also strengthening the idea that one or two such traders are now in the big 4 and big 5 thru 8 short categories. It's hard to reconcile such managed money selling during a reporting week in which prices rose and this suggests to me the possibility of a reporting delay. On the other hand, any deterioration not reported or that has occurred since the cutoff will be coming from a more bullish market structure than previously thought.

That's the important point – the total improvements in the gold market structure since the summer highs, or the price highs at end of September or since Election Day – have been nothing short of monumental. Simply put, we've never had as big a reduction in the commercial net short or managed money net long position in gold than we had since summer. In addition to proving yet again that COMEX futures contract positioning is the prime if not sole price driver, it sets the stage for a very significant rally. I consider the price and market structure changes since Nov 8 to be particularly relevant, because so many different markets exhibited sudden price reversals, including stocks, bonds, the dollar and, of course, gold and silver. But embedded and superimposed in gold and silver price action have been the remarkable changes in market structure.

In COMEX silver futures, the commercials increased their total net short position by 1800 contracts, to 75,800 contracts. As was the case in gold, the good news is that I can't give you a precise breakdown by commercial category because it appears clear that a managed money trader is still in the big 4 short category. Yesterday's release of the monthly Bank Participation Report indicated to me that JPMorgan's short position remained close to the 18,000 contract mark.

As you know, that is the defining feature to me for how far any silver rally may carry. I suppose at some point, if JPM increases its short position by a bit, that won't necessarily be the kiss of death that a large increase would suggest. But for this week, any such concerns are not apparent since I don't sense any increase by JPM in the current report. The big 4 short category did increase by about 900 contracts, but it looks to me the increase was due to a managed money trader or another large commercial.

The managed money traders bought 3117 net silver contracts, including new long positioning of 3493 contracts and the new short sale of 376 contracts. As was the case in gold, although not as pronounced, the slight increase in managed money shorting came as the trader count drop by 1 to 23, suggesting the continued presence of a trader large enough to qualify for the ranks of the big 4. As was the case in gold, the big surprise in the silver report was the complete absence of short covering by managed money traders. I can't imagine this will hold true in future reports, particularly if prices rally further because, as of the close on the reporting day, any shorts added over the past few weeks (around 5600 contracts) were already underwater, with silver prices higher still after the cutoff.

There are still not tremendous numbers of managed money short contracts to be bought back, simply because very few were added on the recent drop below $16 by historical standards. Even with three straight weeks of increased managed money shorting, at 19,343 open shorts in the current report, we are still more than 20,000 contracts shy of the peak in managed money shorting at 2015's end.

To be objective, the reduced level of potential "rocket fuel" managed money short covering probably accounted for silver's seemingly subdued price performance relative to gold after the cutoff, seeing as the managed money short position in gold was much closer to historical price bottom levels. But big bull markets need more than short covering to sustain themselves and the advantage that gold has in having more managed money shorts to be covered than does silver should only be temporary. Still, it is nothing short of remarkable that so many managed money traders decided to skip shorting silver over the past couple of months. I would have loved to have been a fly on the wall, witnessing how that collective decision was reached.

Away from short covering, there are still great numbers of potential new long contracts to be added to both gold and silver by managed traders on higher prices. To get to the peaks of managed money long contracts seen this summer, more than 150,000 gold contracts (15 million equivalent ounces) and more than 40,000 silver contracts (200 million equivalent ounces) would need to be bought. This excludes short covering by managed money traders or buying (short covering or new buying) by traders other than managed money traders. Strictly on a COMEX market structure basis, the upside looks explosive and I spend much of my time contemplating how and if the commercial counterparties will fully engage potential buying that was real buying just six months ago.

Granted, the commercials have an easier time capping and suppressing prices as long as the key moving averages are defended and kept from penetration to the upside. And once the commercials have absorbed and sold into all the managed money technical fund buying thrown at them, as occurred this past summer, the commercials have a relatively easy time guiding prices lower to generate managed money selling.

The hard part for the commercials is deciding how aggressive they should sell into managed money buying when the total potential buying threatens to be very large, as appears to be currently. It's hard for me to imagine that the commercials wish to repeat the aggressive early selling they engaged in last year, which put them $4 billion in the hole on open losses, before succeeding in rigging prices lower. It would seem better for the commercials to hold off and sell only at much higher prices to avoid digging as deep a financial hole as they dug for themselves last year. Of course, any holding back of commercial selling would result in very sharp rallies on a mechanical basis, as I have tried to describe previously.

As much as I am convinced that COMEX futures market positioning has been and is the main price driver and that the potential for a massive move higher for silver and gold is embedded in the current market structure; it's a big world out there and I can easily envision the real world overcoming the unnatural COMEX dominance of price. Despite any temporary selloffs amid shorter term position changes, it appears to me that world circumstances have become so extreme and uncertain that it is not hard for me visualize non-COMEX forces converging to push gold and silver prices much higher. I don't articulate it often, but this is the foundation for why I believe that silver never looked better for an historic price advance than it does now.

Record stock market valuations and debt levels, political, economic and currency concerns are the perfect formula for a rush into precious metals. Considering the overall poor performance of gold and silver for years, along with the good performance of competing financial assets in general, the great numbers of investors guided by performance have not been plowing into gold or silver, but those other assets. No matter what happens, at this point it's hard for me to envision a wholesale dumping of precious metals by investors disappointed by past performance, because the disappointment has run for years.

On the other hand, should investors become concerned with declining stock or bond prices at some point, there is plenty of potential disappointed selling given how good performance has been to date. Some portion of any disappointed equity selling could find its way into precious metals, long considered a safe haven in troubled times. And precious metals are considered a universal safe haven, not confined by borders. In addition, the mechanisms for converting cash into physical metals already exists in the form of ETFs, which have been around for more than a decade.

Finally, any movement into precious metals, kicked off by higher prices on the COMEX or world events, will run smack into the most bullish feature of all the incredibly limited amount of physical silver that exists. The actual amount of investable silver is no more than 1.5 billion oz (in 1000 oz bar form) worth a piddling $25 billion at current prices. But please don't confuse that with the amount of physical silver actually available for investment, because more than 90% of the physical metal that does exist is not available for sale at anywhere near current prices. If there is a rush for physical silver, as seems almost inevitable at some point, the competition for ownership will be fought over the 10% that might become available for sale no more than 150 million oz or much less at any point.

Just as there is a mechanical feature to positioning on the COMEX for futures contracts, there is also a mechanical feature to physical metal ownership. It is the reality of what will happen to price once a rush to physical metal develops by investors and industrial users alike that is so exciting. No one recognizes this better than the market master (and crook) JPMorgan and fully explains why the bank came to own a third of all the investable silver in the world. Say what you wish about JPMorgan, but no one would ever accuse it of being dumb or not looking ahead, certainly not me. Don't listen to what I say, heed what JPMorgan has done.

Ted Butler

January 7, 2017

Silver – $16.50 (200 day ma – $17.80, 50 day ma – $16.96)

Gold – \$1173 (200 day ma – \$1270, 50 day ma – \$1199)