July 16, 2011 – Weekly Review and The Homestretch

Weekly Review

Gold and silver turned in impressive upside price action for the second week in a row. Gold climbed by $50 (3.2%) for the week, closing at yet another all-time high. Silver rose by $2.50 (6.8%), outperforming gold for the second week and closing at the highest level since the price assassination of early May. As a result of silver's outperformance, the gold/silver price ratio tightened in a point to under 41 to 1. Since December 31, gold is up 12% and silver by 27%, on top of even stronger gains in recent prior years.

Over time, it still appears clear to me that silver will outperform relative to gold, but the very short term is always iffy. Underscoring the volatility seen in silver this week, as recently as last Tuesday, the ratio had traded above 44 to 1, as silver was down near two dollars early in the week. I am still convinced that the price volatility in silver has less to do with it being a smaller market than it being a more manipulated market than gold. For instance, the level of uneconomic High Frequency Trading in silver is more pronounced than it is in gold. The only known antidote to the intentional HFT price volatility in silver is not holding on margin; the very same solution to dealing effectively with the overall silver price manipulation.

Conditions in the physical silver market continue to point to tightness. The movement of metal in and out of the COMEX repositories remains frantic, with total inventories nudging back over the 100 million oz mark. While there is much attention placed on whether the total or sub-category level is shrinking, I am still more impressed with the turnover. The long string of redemptions from the big silver ETF, SLV, appeared to be broken this week as a large 4 million ounce deposit was made. Additionally, the high trading volume in SLV, commencing with Wednesday's strong price advance, would seem to suggest that millions more ounces are now Â?owedÂ? to the Trust, for the first time in months. Back of the envelope calculations indicate the amount of silver owed could be 10 million oz or more at this point. It will be interesting to monitor future metal deposits in SLV and changes in the short share position. This week's stats from the US Mint still indicate that they are cranking out Silver Eagles at maximum capacity and in disproportionately larger amounts relative to Gold Eagles. All in all, silver still looks tight.

For the two weeks since July 1, the price of gold and silver has risen sharply; gold by more than $100 an ounce (7.3%) and silver by more than $5 the ounce (16%). These two-week price jumps were among the largest in history. Trying to objectively uncover the most plausible and obvious explanation for this large price rise in silver and gold leads me to the same one I usually uncover Â? the market structure, as defined by the Commitment of Traders Report (COT). It's not likely a coincidence that the COT structure flashed Â?spectacularly bullishÂ? changes two weeks ago, immediately followed by the large two-week price gains. I admit that trading activity on the COMEX is not the sole driver of price, but oftentimes it is the primary force. This was certainly the case over the past two weeks.

The latest COT report confirms the COMEX-centric influence on the price of gold and silver. For positions held as of Tuesday, July 12, we witnessed a notably increase in the total commercial net short position in gold, as technical funds and other speculators bought and commercials sold a net 42,200 contracts (4.2 million ounces). A large increase in gold commercial selling was expected and there has undoubtedly been more tech fund buying/commercial selling since the Tuesday cut-off, as gold made new highs primarily on such fund buying. This is the basic premise behind COT analysis.

Of the 42,200 contracts sold net by the commercials, the gold raptors (the smaller commercials) accounted for 30,500 (72%) of the total, swinging them from a net long position of 12,500 to a net short position of 18,000 contracts. This is as of Tuesday; the gold raptors must have sold more since then. It's generally not good for the gold price when the gold raptors build a big short position. While the big 4 gold shorts added more than 9,000 contracts to their short position, that position is still not large by recent historical readings. I get the feeling that the gold raptors have more control of the gold price than the big commercials currently.

Certainly, this is not a spectacularly bullish COT change, nor is gold any longer in a bullish COT structure. The gold COT structure is now neutral at best. Does this mean gold will decline sharply? Not necessarily, but there is much more risk than there was 2 weeks ago. Gold is not at extremely bearish COT readings, but will be quickly if current trends continue. I have always found it easier to identify price bottoms with COT analysis compared to tops. I'm not a Â?gold guyÂ? and have never recommended gold because I always found silver more attractive. I'm not about to start offering broad gold pronouncements now. On a strict-COT basis, gold is not the low-risk buy it was as recently as two weeks ago, although it can still move higher, perhaps sharply. My main concern with gold (aside from providing COT analysis to subscribers who request it) is how it may impact silver. A recurring thought of mine is how will a gold sell-off impact silver?

There was a 4,000 contract increase in the total commercial net short position in COMEX silver futures this week. This follows a 4,300 contract net increase in the prior reporting week. The one and two week increase was largely due to silver raptor selling of previously held long positions. On the combined two-week increase of 8,300 contracts, the raptors accounted for 6,800 contracts, or 82% of the total. The big 4 (read JPMorgan) did account for some 1200 contracts of the 8,300 sold, but such a relatively small number could be attributed to the other three entities in the big 4. I still think the key to silver will be if JPMorgan increases its concentrated short position, but not enough data are available to determine that yet.

I sense that there has been some deterioration, or increase in the total commercial short silver position, since the Tuesday cut-off, but not as pronounced as in gold. But even accounting for that and the 8,300 contract deterioration already recorded, the overall silver COT structure still looks bullish to me. The overall level of the total commercial short position is still relatively low and the concentrated short position is particularly low. Importantly, the technical funds have not built up a large gross long position in silver as they have in gold or in the past (using the managed money category of the disaggregated report). This is important because technical fund long liquidation is always the strongest force behind sharp price declines in silver. It follows that the smaller the tech fund gross long position, the less potential liquidation exists and less severe a possible price decline.

I don't doubt for a moment the treachery and manipulative intent of the big commercials and the raptors for rigging sharp price declines. After all, they have many crooked tools at their disposal, such as HFT, as well as a corrupt infrastructure backing them in a complicit criminal exchange (CME Group) and a timid regulator in the CFTC. Certainly, if we do suddenly sell off sharply in silver, we already know why in advance, namely, the dirty rotten commercial crooks on the COMEX.

Yes, I am concerned with the deterioration in the gold COTs and that a COMEX- rigged gold sell-off might drag silver down. I am also concerned that the large gains of the past two weeks leave room for some type of sell-off. But I am most concerned about getting faked-out and selling and then missing what may be an important up leg in silver. Everyone must decide for themselves, but the risk/reward ratio is just too favorable to me to abandon silver at this point. Prepare for battle stations and price volatility ahead, but that means don't overextend or hold on margin. Call option holders should bank some profits where possible to deploy on sell-offs, but still maintain a bullish posture.

The Homestretch

As I've written previously, we are in the homestretch towards resolution of the issues of position limits and concentration in silver. This has been in the making for the entire two years since I started this service. (One early article in the archives is titled, Â?The Box CanyonÂ?). Long-time readers know I have a two decade interest in silver position limits and concentration.

The issues of position limits and concentration have also dominated the tenure of Gary Gensler as chairman of the CFTC. Even before Dodd-Frank was enacted, it was clear that position limits and concentration were of utmost importance to Gensler. In mid-2009, he came out of the gate with a singular focus on these very much related issues, in speeches and in holding a series of public meetings. It's no secret that I sat up and took notice of what Gensler was saying and doing, as I never even heard any past CFTC chair utter the words position limits and concentration. (Except in denying to me there was any problem with either in silver). As a result of Gensler's efforts on position limits and concentration, I took to calling him the greatest chairman in CFTC history.

While not on the agenda for the next CFTC open meeting on July 19, the matter of position limits should be dealt with soon. I can't tell you how the issues of position limits and concentration in silver will be resolved, only that they will be resolved. And resolved fairly soon. As related to silver, there are only a limited number of outcomes. The Commission will approve the staff recommendation of a formula calling for an all-months-combined position limit equal to 10% of the first 25,000 contracts of total open interest, plus 2.5% of any remaining open interest, or some other level. With a total futures open interest of 112, 795 contracts (as of the latest COT), the staff's formula would result in a position limit of 4,695 contracts in COMEX silver (2500 + 2195).

In response to the Commission's solicitation for public comment on this and all proposed rules under Dodd-Frank, the public's response was overwhelming in number and uniform in intent. More public comments were received on the matter of position limits (over 13,000) than on all the dozens of other proposed rules combined. A large number of those comments (4,000 to 5,000) specifically requested that the Commission adopt a 1500 contract limit in COMEX silver, for reasons I had outlined in earlier articles. I did not see any public comment that requested a specific number of contracts limit in any other commodity, although it is possible I missed it.

As you may be aware, there is presently a great new battle raging over the enactment of Dodd-Frank. There has been aggressive lobbying from the financial industry (prominently including the CME Group and JPMorgan) to delay, water-down or kill many provisions in the Act, especially concerning derivatives regulation. No single issue is more opposed by the financial industry than position limits. There has been more lobbying on this issue than on any other. Rarely has there been such a clear line of demarcation between what the public has collectively demanded and what the financial industry desires. I have to call it a mismatch of epic proportions.

The financial industry has lobbied frequently and aggressively against position limits, mostly in personal meetings and calls with Commissioners and staff. To my knowledge, there has not been a single personal meeting or phone call between the agency and a member of the public in favor of having a 1500 contract limit in silver. Certainly, I haven't met with or talked with anyone at the CFTC during the consideration period. This process doesn't sound particularly fair to me, but that's another issue. Still, when you consider the stark fact that the financial industry has complete open access to the Commission, while the public has no access (save for submitting public comments) only a fool would not consider that an advantage to the financial industry. Hence, who would dare suggest that the public will would prevail?

Despite the epic mismatch between the interests of the financial industry and the public, I welcome the coming resolution on position limits. I would have preferred making the case for 1500 contracts in person, in a genuine give and take with Commission staff, but that wasn't my call to make. I am happy that I had the opportunity to present my case in articles and that so many wrote to the Commission. There is no doubt that, on the merits, the Commission and staff should insist on a 1500 contract limit in silver. But in this world, things don't always get resolved on the merits. At a minimum, however, there should be some acknowledgment by the Commission and staff that such great numbers of public comments requested a silver position limit of 1500 contracts and the reasons for that limit. Not to do so would appear to constitute a clear violation of the Administrative Procedure Act.

But the main reason for my welcoming of the coming resolution is that it should answer the question of whether I've been correct in my assessment of Chairman Gensler. Based upon his own words and actions, he is most concerned with protecting the public from fraud, abuse and manipulation in markets under his jurisdiction. No market in history has been subject to fraud, abuse and manipulation than silver. There has always been a concentrated position behind every manipulation. The concentrated short position on the COMEX has been the force behind the decades old silver manipulation. The only solution to concentration is legitimate position limits. How Gensler and the Commission deal with silver position limits will be clear to all shortly. I'll learn to live with having misjudged Gensler in the event the financial industry crooks prevail. But the disappointment that the public will was disregarded is going to last for a good while. Even the coming price spike in silver will not completely wash that disappointment away. Of course, it will help.

Ted Butler

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Silver – $39.25

Gold – $1594

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