Weekly Review

Precious metals prices fell for the first time in six weeks, with gold down $29 (2.2%) and silver off by 10 cents (0.5%). As a result of silver's relative outperformance, the silver/gold price ratio tightened in by a full point and a half, to just under 66 to 1, another near two year high water mark in silver's favor. More than ever, I am unsure of the short term direction of relative silver/gold valuations and just as more than ever, silver looks massively undervalued long term.

Of course, gold and silver prices are up sharply this year, with mining shares staggeringly higher, so it's hard to get overly concerned by this week's small setback from recent price gains. But if you are not content to form long term investment perspectives by observing short term price action (which I'm not), you must look deeper than the immediate price activity otherwise, you end up changing your perspective almost daily. About the only thing more misleading for long term perspectives than relying on short term pricing is relying on the daily world and national news, which changes about as often. Which is why I avoid reliance on short term pricing or world events.

Looking deeper, gold and silver prices are still determined by COMEX futures contract positioning, with physical market activity warming up and appearing destined to take over at some point. I wish I knew the exact timing of the “some point,” but that will only be known in hindsight. Let me review some highlights from the physical world of gold and silver, before the latest evaluation of the COMEX futures market structure.

The turnover or physical movement of metal brought into or removed from the COMEX-approved silver warehouses came to nearly 5.4 million oz this week, as total COMEX silver inventories rose by 2.3 million oz to 152.7 million oz. The most remarkable facts about this physical silver turnover is how large and unprecedented it is in the world of commodities, and for how long the movement has persisted. Talk about the Energizer Bunny – the COMEX silver movement never stops. It's now been over 5 years that I have reported on this unusual physical turnover in every weekly review. Aside from the turnover reflecting a physical tightness in the wholesale silver market, the movement started at the precise moment JPMorgan began to acquire physical silver, along with opening its COMEX warehouse then as well. For sure, some things can be coincidental, but not many when it comes to JPMorgan and silver. The highly unusual physical turnover in the COMEX silver warehouses is directly related to JPM's accumulation of silver – it would be hard to argue otherwise.

The COMEX July silver delivery process grinds on, with neither the total number of deliveries at 1829 contracts, nor the remaining open contracts, around 740 contracts, looking particularly large at this point. Still, the delivery process looks tight due to a steady increase of new July contracts being opened since first delivery day. JPMorgan is still in second place with 525 silver deliveries stopped so far this month (HSBC is still the largest silver stopper with 813 contracts), but I get the impression it has been JPM mostly behind the new buying in July from the way deliveries have been allocated, namely, with JPM increasingly taking a larger percentage of daily deliveries.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

Where I thought JPM would look to stop 600 silver contracts for the month, I'd kick that up to 800 now. This is still far below the amounts JPMorgan had taken (all in its house account) in COMEX silver deliveries for the past year and a half and I can't help but feel that JPM doesn't want to push the physical silver envelope too far. The bank's recent buying in July appears measured and designed to extract as much physical silver as possible without impacting prices; almost surgical in nature.

There are not many contracts left to be delivered against in the COMEX July gold delivery process, as less than 100 July gold contracts remain open. The delivery month appears to have ended just as it started — with a customer(s) of JPMorgan stopping just over 3000 contracts (the spot month limit) and HSBC issuing just over 4300 contracts. JPMorgan and its customer(s) have stopped around 14,000 gold contracts (1.4 million oz) in the past two COMEX delivery months, which stands out like a proverbial sore thumb.

You don't have to go far to see JPMorgan's outsized influence in all things silver and gold, whether that influence is in futures or physical. And the big traditional August gold delivery process starts in a couple of weeks. By the way, JPMorgan moved another 185,000 oz of gold into its own COMEX warehouse this week, following the 130,000 oz moved in last week. Thus the pattern observed in silver, namely, the moving of metal following futures deliveries has emerged in gold as well.

In other physical developments, no sooner had I concluded on Wednesday that the "poker pot looked right" in terms of physical deposits into the big silver ETF, SLV, when more than 5.2 million oz was deposited that day. This brings to 15 million oz the amount of metal deposited in little more than a week. Had the deposit been made before Wednesday, I would have been even surer that not much more was owed to the trust at this time. Much more gold, in dollar terms, has been deposited into ETFs this year than in silver and continued inflows remain the wild card. It will take higher prices and broad investment demand to generate additional physical ETF buying in gold and silver, precisely the opposite of what the big concentrated shorts on the COMEX would appear to desire. Therein lies the conflict.

Sales of Silver and Gold Eagles still stink this month, despite decent reports of decent retail demand. I'll keep this story short JPMorgan has continued to refrain from buying and that's why sales have dropped off the cliff. As to why, I can only conclude because JPM thinks it's to their advantage for some reason.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

I didn't handicap the changes in this week's Commitments of Traders (COT) Report, but they didn't look out of line with price action during the reporting week ended Tuesday. Gold prices dipped late in the reporting week and the reduction of nearly 15,000 contracts in the commercial net short headline number looked reasonable. Silver prices were more flat than anything else during the reporting week but stronger than gold, so the increase in the commercial short position wasn't completely unexpected, although the increase in net managed money buying was proportionally much larger.

In COMEX gold futures, the commercials reduced their total net short position by 14,800 contracts to 325,500 contracts (32.5 million oz). Seeing as the commercials increased their net short position by 14,000 contracts in each of the previous three weeks and by more than 300,000 contracts since the start of the year, no one should be celebrating this week's reduction. By any measure, we are still at nosebleed bearish extremes in COMEX positioning, with the only saving grace being that if the commercials fail to hold the manipulative line, the failure would be explosive to the upside. As a matter of fact that is virtually all that matters.

By commercial categories, the big 4 bought back nearly 11,200 short contracts and the raptors (the smaller commercials apart from the big 8) bought back 11,500 shorts as well. This meant that the big 5 thru 8 shorts didn't get the weekly commercial memo, as these traders added 7900 new short contracts. Even though there was a reduction of nearly 15,000 contracts in the total commercial net short position, the concentrated short position of the eight largest gold traders only declined by 3000 contracts from last week's all-time extreme. In fact, the percentage of the total commercial net gold short position held by only 8 crooked commercials rose to nearly 89%. Only a heavily-medicated or otherwise influenced regulator would fail to react to such an extreme concentration.

On the sell side in gold, the managed money traders accounted for almost 95% of the contracts that the commercial bought, in selling 14,000 contracts, including the long liquidation of nearly 4000 contracts and new shorting of nearly 10,000 contracts. Given how large the gross managed money gold long position is (296,000 contracts), I would have thought there would have been more long liquidation. As it stands, from the start of the year, the managed money technical funds have bought nearly all of the 300,000 net contracts (30 million oz) sold by the commercials. The unmistakable conclusion, while not new, is that these two narrow groups of traders dictate price change. Also true and not new is that this is nuts and price fixing on its face.

In COMEX silver futures, the commercials increased their total net short position by 1400 contracts to a new record of 100,100 contracts, breaking the 500 million oz mark for the first time. That's as much silver as exists in the SLV and in COMEX total inventories combined and is also 60% of total world mine production. I understand the significance of breaking new round number barriers, but the real story here is not the 500 million oz total commercial net short position, but the fact that more than 487 million oz of that position (97.4%) is held by only 8 traders, mostly crooked banks (pardon my redundancy). Just for laughs, I'd like to see a new 16 page letter from the CFTC explaining this short concentration away.

By commercial category in silver, the big 4 actually bought back 400 short contracts and the big 5 thru 8 traders bought back 200 short contracts as well. All the commercial selling came from the raptors, who added 2000 contracts to a net short position now amounting to 2700 contracts. With not much of a change in the big 4 position, I'd peg JPMorgan's concentrated net short position still at 30,000 contracts or 150 million oz.

The managed money traders bought many more contracts (4882) than the commercials sold, including 2949 new longs and the covering of 1933 short contracts. Once again, the managed money traders set new all-time records for both gross and net long silver positions (92,979 and 85,867 contracts respectively). Managed money short positions, at 7112 contracts, are near the lowest levels in years and can't go below zero in any regard.

That's the problem in both COMEX silver and gold, market structure-wise. With both the managed money gross and net long positions so large in gold and silver and with the gross short positions being so low in each, it's hard to see where technical fund buying can come from to drive prices higher. Obviously, the prospect for higher prices is much better when the managed money long side is low and the short side is high, because that portends great potential buying power. The opposite exists now.

I'm not ruling out a march to higher prices in the immediate future should a physical crunch kick in or the emergence of a black swan event sufficient to trip off massive physical and ETF buying. But in the absence of either a crunch or event occurring, the only price path significantly higher in market structure terms rests on massive new technical fund buying or the big commercials turning tail and rushing to cover shorts under financial distress. The technical funds can always increase record long positions by some unknown amount, but the fact that long positions are already historically high suggests not by much. And massive additional technical fund short covering is mathematically impossible.

So it comes down to whether the big concentrated commercial shorts, or some of them, can find themselves in the position of being forced to cover on further rising prices. Call it a commercial failure or the full pants down, but that's the outcome necessary to drive prices explosively higher, with or without big additional technical fund buying. Since it would seem that such a commercial overrun would likely occur at a time of maximum commercial financial stress and since such financial stress has arrived within the past weeks, I've taken to calculating a financial scorecard to record the commercials' status in financial terms.

Last week at this time, the commercials were collectively underwater to the tune of around $2.5 billion for the year by my back of the envelop calculations for COMEX gold and silver short positions combined. This is the most the commercials had ever been in the hole in my decades of constructing a running mental scorecard. So if the premise that the commercials, or some of them, would be forced to cover at a time of maximum financial stress, last week was a prime time for the failure to occur. After all, the failure to meet a margin call would most likely occur at such a time.

Unfortunately, this week's decline in gold prices has taken the commercials off the hook to a certain degree or by around a billion dollars. The running math is simple the change in price for the week multiplied by the commercial short position. This week's gold price drop of $29 (more on a COMEX settlement price basis) times 32.5 million oz (the COMEX total net commercial short position), plus the slight drop in silver and advantageous closed out positioning means the commercials are "only" $1.5 billion in the hole a week later. Additionally, if there was any scramble by some commercials to scrounge up margin money to cover open unrealized losses last week, there would be no such scramble this week.

I want to be clear in what I'm saying – I am not predicting how the still extreme positioning on the COMEX will be resolved – I am focusing on the measurement of financial stress to the commercials since this is the most the commercials have ever been stressed. It's hard for me to imagine the commercials, or some of them, covering on rising prices unless forced to do so. Most assuredly, the extreme positions on the COMEX will be resolved with technical fund selling of some type: either to the downside as usual or for the first time, to the upside as commercials initiate a rush to cover. The technical funds will sell at some point and the commercials will buy – price will be decided by the manner of and who initiates such selling and buying.

Just because the commercials recouped some open losses this week, doesn't necessarily get them off the hook completely. But being realistic, I would think financial stress to the commercials would develop only after last week's peak losses were exceeded, or by gold prices up by $30 and more, or some combination of gains in the price of silver to put the commercials more than $2.5 billion in the hole. That can easily occur and occur soon, but until it does it would appear the commercials are weathering the storm at this point. I'm not rooting for them to succeed, I'm looking for the financial silver (or gold) spike to be driven into their hearts and that didn't occur this week.

As always, the only potential negative for price is if the commercials rise from the near dead and rig prices low enough to set off technical fund selling. Considering how stretched things appear, it looks to me like the next $50 or more in gold or dollar or two in silver up or down will set off the resolution one way or another. And yes, this has nothing to do with higher long term silver prices to come.

Ted Butler

July 16, 2016

Silver – $20.20 (50 day moving average – $17.69)

Gold – $1337 (50 day moving average – $1285)