July 7, 2012 – Weekly Review

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In a holiday shortened week, the price of gold and silver fell sharply on Thursday and Friday after climbing sharply on Monday and Tuesday. Considering the strong start to the week, the ending was quite disappointing. At week's end, gold finished $10 (0.6%) lower, while silver declined 40 cents (1.5%). As a result of silver's underperformance relative to gold, the gold/silver ratio widened out to 58.5 to 1. Yes, I still favor silver over gold, while still considering gold to be set up bullishly.

There are always a wide variety of reasons publicly offered to explain daily price changes in every market, including gold and silver. In most cases, the explanations sound reasonable because they are intended to sound reasonable and little else. In other words, it's hard to argue with the daily public explanations for price movement, but they usually offer little true insight into what's really moving price. In fact, I've often heard the very same explanation given to justify both why an item has risen one day and fallen the next. I've long thought that we (the audience) demand instant explanations for price movements and as long as the explanations sound reasonable, accuracy doesn't matter.

It's no secret that gold and, particularly silver, have been unusually volatile on a daily basis recently, along with many commodities and other markets. It's also true that both gold and silver have been in a trading range for the past two months; gold in a $100 range between $1540 and $1640, with silver in a $2 to $3 trading range. It's not the trading range that is unusual, but the extreme daily price volatility. I don't recall so many days when gold rose or fell $20 or more or silver by 50 cents or more in a trading range. This is also true for other commodities and markets, like copper and oil. Given the long term nature and impact of supply/demand fundamentals on the price of any commodity, we can generally rule out such supply/demand factors as being behind the recent price volatility. If it's not supply and demand, then what is it causing prices to rise and fall so noticeably?

I think it's all this mindless High Frequency Trading (HFT). This is particularly true in silver. For little or no reason, silver prices shoot up or crash at any time. I know the HFT operators must be profit-motivated, but the problem is that what is good for them is bad for most everyone else. There is no doubt in my mind that the biggest silver manipulator, JPMorgan, is using HFT to benefit its concentrated short position. At the very least, the HFT-caused price volatility is unnerving to most other market participants, including silver investors and silver miners. I'm not going to ask where the regulators are while this is going on, having recently concluded that the CFTC has been captured by JPMorgan and the Working Group. Nor will I ask what the self-regulator, the CME Group, is doing as it is encouraging the HFT-induced volatility to collect trading fees. My only point is that the daily public explanations may sound reasonable, but it is strictly HFT behind the price volatility.

It sounds like a broken record, but conditions in the wholesale silver market continue to look tight and are not at all reflected in the price. Turnover in the COMEX silver warehouses continued torrid, with another 2 million ounces brought in and taken out and total inventories climbing by 200,000 oz to almost 146.2 million oz. To me, turnover equals tightness. There was a large one-day removal of almost 4.4 million oz from the big silver ETF, SLV, on Monday that did not look at all like plain vanilla liquidation based upon price patterns and volume statistics. The most plausible explanation is that the metal was needed more urgently elsewhere, fortifying my silver tightness thesis. Of course, it's only natural to wonder where the silver removed from the SLV is bound, even though that is usually unknowable. I can't help but speculate that it might end up in the COMEX warehouses, seeing how more than 1800 contracts (9 million oz) are still open in the current July delivery month, somewhat high after a full week of deliveries. This is something to watch going forward.

Sales of Silver Eagles from the US Mint came in higher for the month of June than I originally reported last week, on a late revision from the Mint. More than 2.85 million one-ounce coins were sold (up from the 2.5 million I reported). Sales for Silver Eagles continued to outpace historical demand relative to Gold Eagles, but off the pace for last year's record demand. It's too soon to get a bead on Silver Eagles for July, but the lower silver prices should help in increasing sales.

There was no Commitment of Traders (COT) or Bank Participation Reports published yesterday, due to last week's holiday. Both reports will be published Monday. I may publish a short comment on Monday, depending on how much of a surprise, if any, is contained in the reports.

My general expectation is for some deterioration, or increase in the total commercial net short positions in COMEX gold and silver. There was a fairly strong rally in each on Monday and Tuesday, right into the Tuesday cut-off. Generally, price rallies generate speculative buying and commercial selling. I don't think the changes will be near as big a last week's (19,500 in gold and 5,000 in silver) and Thursday's and yesterday's sell-offs would have reversed some of the expected increase in commercial selling. I'd estimate JPMorgan's concentrated short position in silver to be in the 15,000 to 16,000 contract range.

The news of Barclays' settlement with the CFTC and other agencies for manipulating the Libor interest rate market continues to reverberate, as well it should. New reports suggest the manipulation could have existed for more than 15 years and more banks are in the gun sights of the regulators. The similarities to the silver manipulation are striking Â? a long term manipulation run by a collusive band of big banks for their own benefit. The relative size of the markets being manipulated aside, in many ways the silver manipulation is worse.

For one thing, the Libor manipulation would appear to be over; while silver continues to be a crime in progress. Another difference is in identifying the victims, in that Barclays has admitted to artificially setting rates in both directions, thereby aiding some while hurting others. In silver it is cleaner as the victims are those investors and producers hurt by the artificial low prices and deliberate sell-offs. In the Libor case, I have not seen it alleged that any one of the collusive banks involved held a disproportionate or concentrated market share, as does JPMorgan in silver. Lastly, while there were some scattered press reports of suspected wrongdoing in Libor going back a few years, there is no comparison with silver where many thousands of ordinary citizens had petitioned the CFTC for almost a decade to end the silver manipulation.

Comparing the two, the regulators should be deeply ashamed for their negligence in not dealing with the silver manipulation. I understand that the Barclays case was made easier by them quickly admitting to the charges and the existence of incriminating emails, but the regulators shouldn't restrict themselves to the low-hanging fruit in the selective execution of justice. Obviously, the Working Group did not have the same problem with going after Barclays as they do in going after the silver crooks at JPMorgan.

Since I can't discuss the COT today, let me instead try to explain the silver manipulation in a different way. Every day, roughly 2.5 million oz of silver are created throughout the world by mining and recycling by many hundreds of different miners and refiners. Also each day, approximately 2.2 million oz of silver are consumed industrially and in various other uses, like jewelry and coinage. There are tens of thousands of entities in the silver consumption category, much more if you count closer to the individual end user. The remaining 300,000 oz of silver is what is available for investment. Here too, the number of entities in this category is extremely large if you count individuals on a retail basis.

I'm going to focus on the 300,000 oz of silver available each day for investment throughout the world. This is the swing amount, or the silver Â?at the marginÂ? that should be the most important factor in determining the price. I say that because the many hundreds of producers and the tens of thousands of industrial and other users are going to produce and consume the same amounts of silver each day, regardless of the price that day. I'm not saying that price won't influence production and consumption over time, because that's how the law of supply and demand works. What I am saying is that silver mining and industrial consumption is a 24/7/365 proposition and on any given day very little change in either will occur as a result of a change in price. Producers produce and users consume roughly the same amounts of silver each day regardless of daily price changes.

There are several observations to make about the 300,000 oz of silver available to the world each day for investment purposes. In dollar terms, at current prices it comes to less than $10 million available to the world's investors each day. (By way of comparison, the amount of new gold available to those same world investors is around $220 million daily.) In terms of COMEX contracts, 300,000 oz is equal to 60 contracts, since each contract covers 5,000 troy oz. The amount of real silver available for investment each day and which should have the most important influence on the world price is the equivalent of 60 COMEX contracts. Yet COMEX has an average daily trading volume of close to 30,000 silver futures contracts or an amount 500 times greater than the amount of real silver available for investment each day in the world. Stated in different terms, the COMEX trades the equivalent of 150 million oz daily versus the 300,000 oz available in the real world.

Additionally, there is very little actual producer or user hedging on the COMEX, once you strip out big banks like JPMorgan that pretend to be hedging. Even if there were evidence of legitimate hedging, hedgers lock in prices for longer time periods and would make up only a small fraction of the 30,000 contracts traded on the COMEX daily. Hedgers don't day trade. My point is that there is no evidence that legitimate hedging is behind the 30,000 contracts, or 150 million oz of silver traded on the COMEX daily. Please remember that hedging is the economic justification for futures trading. If it is not hedging, then what accounts for the incredibly high volume of silver contracts compared to real world amounts? The answer is not only disturbing, but in keeping with allegations of a price manipulation.

The conclusion is that there is little legitimate economic purpose behind COMEX silver trading. There is no legitimate reason in hedging terms to trade the equivalent of 150 million oz daily when there is only 300,000 oz of real silver at stake. I've been around futures trading my whole adult life and I know more is traded than is produced or consumed in all commodities, but not to the extent seen in COMEX silver. Congress didn't intend to set the CME and the COMEX up as extensions of Las Vegas or other gambling venues with no purpose other than allowing big banks and hedge funds to gamble and play money games to the detriment of those producing, consuming or investing in the real commodity.

This is the way it looks to me. Many hundreds of real silver producers and many thousands of real silver consumers and investors should be responsible for determining the disposition and price of 300,000 oz of real silver daily. This is the group of entities that should be the market determining price and there is no concentration or collusion possible. Against this, there are maybe 30 or 40 large entities trading 150 million ounces a day of paper silver bets, with a very clear concentration by one or a few traders on one side of the market (the short side). The real producers, consumers and investors couldn't overtly influence the price if they tried; whereas the big paper traders can't help but dominate the price, given their size and concentration. It is clear that on any given day or over any shorter term time period a few big COMEX traders dictate and set silver prices, not the many in the real silver world. This is against the intent and spirit of commodity law and it shouldn't be necessary to explain why to any regulator.

The COMEX is a crooked cesspool that should be put out of business because it is not close to fulfilling its primary purpose of facilitating legitimate hedging. The COMEX should not be allowed to set the price of silver just because the CME has greased the skids to allow disruptive and non-economic High Frequency Trading and a massive concentration on the short side. HFT and concentration are counterproductive to the interests of legitimate hedging.

This is new for me. Previously, my criticism of the COMEX and the silver manipulation was intended to reform the uncompetitive and illegal practices on the exchange with the hopes of preserving an important American financial institution. That was behind my decades' long effort to see legitimate speculative position limits enacted in COMEX silver. I was (and still am) convinced that if a 1500 contract position limit was adopted for silver and that limit was enforced to exclude phony hedge exemptions, the manipulation would cease to exist. Naturally, I had high hopes when CFTC Chairman Gary Gensler began agitating for position limits in 2009. Unfortunately, that process became so watered down by agency concessions and push back from JPMorgan and the CME that I no longer have high hopes for legitimate position limits in silver.

Since the silver manipulation has become so ingrained on the COMEX, I don't see any realistic chance that it can be reformed. Therefore, the best opportunity for reform would come from shutting it down. Let me be very clear here Â? the COMEX should be shut down because it doesn't come close to fulfilling its basic reason for existence. There is no evidence that significant silver producer and user hedging takes place on the COMEX, if you exclude the big banks from the hedging category (which you should). Certainly, there can't be any significant bona fide hedger component in the daily trading volume, as hedgers don't day trade and day trading makes up more than 90% of daily volume.

Instead, the COMEX has evolved into a high-speed trading racket intended to reward speculative insiders and to artificially set the price to those insiders' advantage. Since the COMEX has morphed into an exclusive and collusive private club of paper traders, the real silver world would be a better place if the COMEX did not exist. Then, prices would be determined by the supply/demand interplay between producers, users and investors and not by the algorithm of the moment.

To be clear, the silver manipulation is a two-edged sword; it artificially causes sharp sell-offs and depressed prices, while promising to lift prices dramatically when, not if, it is terminated. I have spent time today explaining one edge of the sword in how average COMEX daily volume runs 500 times greater than the true net amount of real world silver that needs to be priced each day. No other market has such an extreme similar circumstance of daily trading to real world supply and demand. Plus, there seems to be more HFT activity in silver than in any other market in percentages terms. Throw in the unique concentrated short position in silver and it would appear silver could be manipulated forever. So let me look to the other edge. To my mind, this is the real reason to be invested in silver.

Let's go back to the numbers I used above. The world produces 2.5 million oz daily from mining and recycling and uses 2.2 million oz in industrial and all other fabrication requirements. This leaves 300,000 oz a day (around 110 million oz a year) for investment purposes. There are also more than one billion oz of silver bullion in the world that could be available for sale at some price, but let's focus on the 300,000 oz of new silver coming to market every day. All things being equal, if there are not enough buyers for that silver; prices should sag until the lower prices stimulate sufficient demand. (This is not what is occurring when COMEX silver suddenly dives 50 cents or a dollar in minutes, of course. That's all HFT manipulation).

Conversely, if there is more demand for the 300,000 oz of new silver available to the world each day, prices should rise until they are high enough to choke off demand. The problem is that investment demand is different than industrial demand, in that it comes in big waves and chunks, whereas industrial demand doesn't vary much from day to day. Plus, higher prices stimulate investment demand, unlike industrial demand. The key here is that investment demand can erupt and grow stronger on higher silver prices, while the amount of new silver produced each day in the world that is available for investment is fairly rigidly fixed. This sets up the silver show down that has been building for years and decades.

The world has been buying all the new silver available for investment and then some, for most of the past six years, up until May 2011. That's why prices had climbed so much until that time, despite the silver market being in a manipulative state. The sudden and illegal takedown in price, starting on Sunday evening May 1, 2011, succeeded in turning off silver investment demand. The suspension of silver investment demand permitted JPMorgan and the other manipulators to have a free hand at driving prices lower since then. My friend and silver mentor, Izzy Friedman, had a great observation long ago, namely, if there were one extra bushel of grain or ounce of silver on the physical market, the commercial shorts could drive the price into the dirt. It was only an actual shortage that would cause prices to explode. I've come to accept Izzy's observation and think that is exactly what has and will occur in silver.

During April 2011, we hit the wall in silver for the first time in history. By that time, investment demand had completely overcome the world's physical ability to satisfy that demand. Prices raced to near $50, causing JPMorgan and the other big COMEX shorts to begin to panic and cover short positions. Without drastic action, the world silver user community would be next to have panicked, rushing to build physical silver inventories at the first signs of a delay in silver shipments to them. Then, the silver price fire would have needed to burn itself out and prices would have surely risen into triple digits. Instead, we got that drastic action in the government-condoned price smash starting that Sunday evening.

The only question is if you feel that what occurred in the price smash starting last May is a permanent solution or a temporary fix? To me, it looks clear to have been a temporary (and illegal) solution and it's just a matter of time before unlimited physical silver investment demand reasserts itself and once again overwhelms the limited daily investment supply. There's just too much money and too little silver in the world for the money not to overwhelm the metal at some point.

When I look around the world today, compared to May 2011 or any other prior time in my life's experience, I see more of chance of widespread silver investment demand than ever before. I don't know when a silver investment rush will start or what the specific catalyst will be. I do know now that we were knocking at the door in April 2011 as a result of six years of investment demand up until then. I also think I know that the next time investment demand knocks the silver door will likely be blown off its hinges. I can't tell you what the crooked shorts and HFT con artists will do in the short term, but at some point 300,000 oz of new silver a day won't be enough. In a nutshell, that's why I hold silver.

Ted Butler

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Silver – $27.10

Gold – $1585

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