

June 5, 2013 – Timing a Special Set Up

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Any casual observer would hardly sense it from the recent dismal price action, but the set up in silver and gold for a significant rally is quite compelling. Not only are there several important factors pointing towards a meaningful rally, there is also present a time-sensitive catalyst that could trigger the potential rally within the very near term. Yes, I know the dangers of combining price predictions with when those predictions may occur, so please be guided accordingly.

The main factor suggesting a significant price rally is the current structure on the COMEX in terms of the Commitments of Traders Report (COT). Long-time readers know that I have always stressed the importance between how the main players in the futures market have configured their positions and the resultant impact on price. The kingpins are the commercials and over many years there has been a remarkable consistency to silver and gold prices moving in the direction most favorable to this dominant group of traders. The commercials have been so successful in precious metals trading that the COT data clearly document a pattern of concentration and price control pointing to outright manipulation.

Let me set aside the manipulation angle and try to describe in different terms (thanks to a suggestion from a subscriber) the ongoing business operation of the COMEX commercials. Simply put, the commercials (led by JPMorgan) are in the business of accumulating as much inventory at the cheapest prices possible and then disposing of that inventory at the dearest prices possible, just like any ongoing business enterprise. In principle, there is little difference between the attempt to profit consistently for any typical mom and pop retailer and the commercials on the COMEX. The basic idea is to buy snow shovels in July when they are cheapest due to low demand and resell them in January when demand is high. Of course, mom and pop retailers don't resort to price fixing on world markets by means of high frequency computer algorithms and excessive market share in order to accumulate inventory cheaply.

Illegal methodology and price fixing aside, the COMEX commercials build and liquidate inventory on a continuous basis. Instead of snow shovels, they buy futures contracts for inventory. Instead of buying opportunistically in the off season when demand is low, the commercials create their own low prices regardless of the season. They are able to do so because the commercials' counterparties are mostly technically-oriented traders who sell when prices are low and falling and buy when prices are rising. Once the commercials secure as much inventory as cheaply as they can, they sit back and relax and wait until the season for selling out that inventory arrives. The commercials know that the season for selling will arrive, even more confidently than if they were waiting for the weather to change, because they control that season as well. It's really a perfect business; too bad it violates commodity and antitrust law. Lucky for JPMorgan and the commercials that they have the enforcers of that law in their back pocket.

The measure for when the commercials have low or high inventory is the COT report. Low inventory shows up when the commercials hold massive short positions and few long positions with gold and silver prices high and about to decline. The commercials' inventory is considered high when their short positions are low and their long positions are high. That's when it is likely that prices are about to advance so that the commercials' inventory can be disposed of profitably and the inventory process can begin anew.

Right now, with the commercials' gold and silver futures contracts inventory at record highs (low short positions and large long positions) it is reasonable to expect that prices are more likely to climb higher than ever before. Of course, it is always possible for the commercials to increase their inventory on still lower prices for a short while, so that must always be taken into account. But when the commercials' inventory is at record high levels (like now) it is prudent to prepare for the higher prices that will enable that inventory to be disposed of profitably. The best preparation we can take is to hold long positions that can't be taken away by lower prices; in other words, no margin.

For the sake of brevity, I'm going to stick to the COT discussion and get into the special timing consideration I led off with. But that is not intended to ignore other important factors influencing silver and gold at this time as a result of the recent price drop. Those other factors include a pickup in physical investment demand, especially from the East and the new threat to silver mine production and recycling supplies because of the new low prices. In general, the silver miners weren't setting the world on fire when silver was at \$30 an ounce and the nearly 30% decline in price over the past few months hasn't brought boom times to the silver mining industry. Of course, this is bullish for the price of silver as the cure for low prices is always low prices.

As I indicated in the weekly review, at some point in the future it is mathematically imperative that we will witness an upside penetration of the key moving averages. This penetration will be brought about by gold and silver prices rising or the moving averages falling or some combination of each. Please don't interpret any of this as an endorsement of trading along the lines of moving averages, as I am a fundamental kind of guy, interested in supply and demand and COT considerations.

But only a fool would ignore the influence of technical trading in major price moves. A case in point is the recent brutal takedown in price these past few months; if there was not big selling from technical and momentum-type traders prices for gold and silver would never have fallen as much as they did. Specifically, the downward violation in mid-April of triple and quadruple bottom formations that held for years in gold and silver brought about an avalanche of technical selling that crushed prices and intensified bearish sentiment. Certainly, we did not sell-off sharply in gold or silver for fundamental considerations; it was strictly a technical free for all, brought about by those masters of price control, JPMorgan and the COMEX commercials.

But technical trading is not a one-way price street, as technically-oriented traders both sell and buy. They do tend to buy and sell in unison, even if they deploy slightly different variations of selling when prices are falling and buying while prices are rising. That brings me to the timing angle of when this extraordinary bullish COT set up might get kicked off to the upside. It all has to do with the key moving averages and when they might get violated to the upside.

There are an infinite number of moving averages that can be constructed in any market, with some garnering more traditional importance than others. If I had to pick the most important moving averages, I would choose the 50 day, followed by the 200 day, 20 day, 100 day and 30 day, in that order. Remember, this is based upon the observations of a non-technical guy.

At the time of the big two-day price smash in mid-April, the 50 day moving average in gold was approximately \$1600, while in silver the 50 day moving average was around \$29. As a result of the big two day price smash, which has been followed by mostly sideways price movement since then, the 50 day moving average has come down to around \$1460 in gold and to around \$24.40 in silver. As a result, the price of gold and silver is much closer to their moving averages than at any time since the two day price plunge. Further, over the next two weeks the moving average will decline to around \$1425 in gold and to around \$23.50 in silver based upon simple mathematical calculations. This will put us closer still to an upside price penetration of the 50 day moving averages.

This prospective price penetration is the timing catalyst that could set off a significant price run to the upside. What adds to the significance is the extremely bullish COT set up, coupled with the fact that we have been trading mostly below the 50 day moving average in gold and silver for six months or so, an unusually long time historically. That suggests the eventual penetration will likely be more significant than if we had been trading above and below the moving average regularly recently. There's never only one price that will motivate all technically-oriented traders, but enough technical traders abide by the 50 day moving average that buying by those traders could generate enough buying and price pressure to the upside so as to trip off other technical traders into buying. Remember, technical traders generally buy to the upside.

What raises the potential significance of an upside penetration of the 50 day moving average is the fact that we went down on technical considerations; so it's not unreasonable to suspect that we will go higher for those same reasons. Let's face it — we have seen (in the COTs) tremendous speculative selling, both long liquidation and new short selling. Many traders who liquidated and especially those who went short will be looking for a place to buy, either to establish new long positions or to close out short positions. The 50 day moving average is not the end-all and be-all for every technical trader, but enough traders are motivated by it that it could set off prices like a string of lit firecrackers. Should that occur, the extent of the price move will then be determined by JPMorgan and the other commercials (mostly the raptors).

Tell me whether JPMorgan will add aggressively to short sales on rising prices and I could venture an intelligent guess on what the price rally would look like. But only JPMorgan knows what they will do. Because what happens with the price of silver (and gold) is up to JPMorgan is, basically, what makes the bank the prime silver manipulator. The good news is that we should have clarity on just how crooked JPMorgan may be shortly, after the moving averages are violated and technical buying emerges in earnest. Certainly, if JPMorgan doesn't add additional short contracts aggressively on the coming silver price rally, prices should soar. And considering that the pending violation of the 50 day moving average is drawing near, that sets the stage for an explosive rally soon.

A few words on the effort to get the GAO to investigate the CFTC's handling of the silver investigation and their silence in the face of epic price smashes in silver, including the two 30% price declines within a few days in 2011 and the 10% price drop within a few minutes on the Sunday evening of April 14. It's hard to predict with certainty what will occur, but it is fairly easy to rule out won't be said, either by the GAO or the CFTC or by any elected representative you may contact.

For sure, what won't be said is that nearly five years is not enough time to finish a formal investigation or to determine if a US bank holding as much as 30% of any regulated futures market is too much of a market share. What won't be said is that two separate 30% price declines in a few days or a 10% decline in a few minutes are normal and customary for most markets. What won't be said is that it's OK for the CFTC to lie to the public by saying there was nothing unusual on the short side of silver in 2008 when the biggest short, Bear Stearns, went bankrupt because of their short position. And what certainly won't be said is that these matters are not of prime importance and don't need to be addressed.

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Silver – \$22. 50

Gold – \$1401

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