

March 11, 2020 – A Scared New World

It's hard to fully comprehend just how much sentiment has changed since Saturday's review. It reminds me of the line attributed to Hemmingway about how you go bankrupt – Gradually, then all at once. Applied to the current financial psyche, what may have been a gradual change in collective sentiment from confidence to wariness seems to have accelerated markedly, seemingly, overnight.

It was less than a month ago that the Dow Jones Industrial Average was at all-time highs and the popular consensus was that economic conditions were favorable. This week, the average suffered its largest one day point loss in history and borders on the definition of a bear market (down 20%) faster than any time in history. In addition, interest rates, already low to begin with, have plunged to levels deeper and quicker than ever observed. Oil prices, along with interest rates, the life blood of the world economy have plunged in almost unprecedented manner.

The two main focal points for the sudden turn to collective trepidation are growing concerns about the coronavirus pandemic and the sudden breakout of a price war for oil market share by Russia and Saudi Arabia, the two leading oil exporters. I feel unqualified in speaking of the coronavirus, except to say there are many amply qualified analysts and all of them have been relentlessly warning that the health and economic dangers have been widely underappreciated. To a man and woman, all their dire forecasts are becoming realized.

As far as oil, falling demand from China (due to the economic fallout from the virus) had already turned prices sharply lower, but it was the announcement over the weekend that Saudi Arabia was abandoning production quotas at the end of the month that kicked prices from the curb to the gutter. Not that it matters much, but I'm in the camp that there is no real war between Saudi Arabia and Russia, as both had to fully appreciate the consequences of their actions as it is simply implausible for either to have been as surprised as was everyone else. The intended target of the price war are the shale frackers in the US, the same target in 2014 when Saudi Arabia opened the spigots back then. This time, it would appear there is a much greater chance a significant percentage of US production will be curtailed, based upon the cuts in spending, drilling, stock prices and dividends over just the past couple of days.

As a result of Saudi Arabia and Russia abandoning production quotas, the likelihood for an extended period of depressed oil prices is large. Consumers will benefit and producers hurt, of course, but the wild card is the amount of low quality debt that has built up in the oil patch since 2016.

And it goes without saying that the economic headwinds caused by the coronavirus and the convulsions in the oil market are already reverberating in many sectors, including the travel and leisure industries. It's astounding to witness just how quickly we seem to be transitioning from what was called the best economy ever to talk of emergency bailouts and stimulus of all types. Yes, there were plenty of signs of gradual deterioration amid the backdrop of what appeared to have been maximum exposure to stock investment in general, but the suddenness of the downturn is still quite shocking.

This is exactly the type of environment, complete with promises of unlimited monetary and fiscal accommodation in which precious metals would be thought to be highly sought. And that has largely

been the case in gold, which, despite its weakness this week, had climbed to 7 year highs. But for silver, it is nowhere near a 7 year or any other meaningful upside price metric. In fact, this week silver has traded at what is, essentially, the lowest relative price it has ever been valued at compared to gold in the history of world civilization. That's what a silver/gold price ratio of 100 to 1 means.

The question, of course, is why has silver been such a price dog? And if you try to answer the question from that perspective, namely, looking at the price first and then trying to craft an intelligent-sounding explanation for the price, then the potential intelligent-sounding answers are nearly endless. Those intelligent-sounding answers include that silver is an industrial commodity, while gold is not, and silver industrial consumption has (or must have) plummeted, or that investors prefer gold (because it is more expensive?), or that there must be a lot more silver than gold or that investors must be selling silver in order to buy gold.

The simple truth is that when anyone tries to explain why a price has moved higher or lower by trying to explain why it moved after it moved, just about anything will sound intelligent. It may not be the real reason why the price actually moved higher or lower, but it will sound intelligent. The problem with that approach is that when the price moves in the opposite direction (which invariably occurs at some point), then even the most intelligent-sounding original reason is turned on its head. For example, if the reason for silver's extreme relative weakness is given as a collapse in industrial consumption, if silver prices jump, does that mean industrial consumption has just jumped? Industrial consumption doesn't change that way.

To be sure, there is a reason why prices of silver and gold have moved as they have and not, as would be expected, based upon the overwhelming sudden collective uncertainty of recent days. The developments around us dictate that virtually no one would liquidate physical holdings of silver in order to buy gold or that anyone would liquidate physical gold holdings to rush to buy stocks or put the funds into interest-bearing instruments paying virtually no interest. Let's face it, current world conditions are exactly the type of conditions why investors rush to gold and silver - not run away from them.

So why haven't gold and, particularly, silver prices soared? The answer, quite remarkably, is evident in data published by the US Commodity Futures Trading Commission in its weekly Commitments of Traders (COT) and monthly Bank Participation reports. The data indicate, conclusively, that a relative handful of large traders, mostly banks (both US and foreign), hold such large short positions on the world's leading derivatives exchange so as to prevent gold and silver prices from reacting as would be expected. In COMEX gold futures, no more than 12 to 15 large traders control the entire commercial net short position, which has been at or close to record highs for months. In COMEX silver futures, the number of large short traders is even less (no more than 8) which hold even more than the entire commercial net short position.

Because the gold and silver short positions are held by so few traders, the positions are highly concentrated, meaning monopolistic and anti-free trade. The CFTC measures concentration because excessive concentration leads to price manipulation. But the agency has been profoundly silent on the matter of the concentration on the short side of gold and silver ever since its last public letter of May 2008 when it denied there was anything amiss; even though it knew the biggest COMEX gold and silver short seller, Bear Stearns, went out of business on the very day prices hit record highs two months prior.

Banks are not typically big short sellers in commodities, except in specialized energy contracts, but

they are always the largest short sellers in precious metals derivatives. This presents certain unique risks, particularly given the unusual circumstances of late. Today, a special meeting is scheduled at the White House with the heads of several large banks to discuss the condition and role of the banks in the developing financial and economic crisis buffeting markets. Certainly, the stocks of the big banks have suffered as much as any sector, excepting energy. While it won't come up at today's meeting, shouldn't the question be asked as to why a few banks are the big persistent short sellers in COMEX gold and silver?

Let me state it as bluntly as possible — the big banks, led by JPMorgan, and enabled by the CME Group and allowed by the CFTC, have manipulated the price of silver and gold (and other precious metals) to be lower through excessive and concentrated short selling. In turn, a dangerous outcome, in which prices may move sharply lower or higher, is in place as a result of the banks' excessively speculative short positions. In other words, prices will be determined by whether the banks succeed in crushing prices to salvage their reckless short bets or fail and send prices sharply higher.

This is not how markets are supposed to operate, but that can be said about a lot of things. All investors can do is deal with the facts as they are presented. The fact is that silver is cheaper relative to gold than it has ever been and ever is a very long time. Can it get even cheaper? Perhaps temporarily, but other facts dictate it must rise dramatically in price. What facts?

How about the fact that interest rates are now lower than ever and once the shock of how quickly they collapsed passes, it will be recognized that the investment landscape is now changed and, at the margin, some investors will be seeking alternatives. And after a ten year rush into common stocks, not just by individuals but also by corporations borrowing heavily to buy their own stock, a continued rush seems problematic. The shares may melt in value, but the debt remains. Gold looks good in such an environment, but an ounce of gold costs a hundred times more than an ounce of silver, the most in history.

On Saturday, I commented that there was a one day deposit of \$1 billion (677,000 oz) of gold into the big gold ETF, GLD. As you know, one billion dollars is not that big a deal in many ways nowadays, what with the hundreds of billions of dollars being tossed around by the Federal Reserve and US Government and the trillions of dollars suddenly erased from the value of common stocks. Going forward, it's not hard to imagine that there might be many days in the future where other one day billion dollar physical gold purchases and deposits are made, if current unsettled conditions persist.

With that in mind, I would ask you to consider the impact of a one billion dollar purchase and deposit in SLV, the big silver ETF, or any other silver ETF, or just a straight purchase of \$1 billion worth of physical silver. After all, a one billion dollar purchase of gold has gotten to be no big deal, based upon last week's one day purchase and deposit. And we've already established a billion dollars is not all that much in today's hundreds of billions and trillions of dollars environment. But please take the time to divide a billion dollars by \$17 (the current price of silver) and see how many ounces you come up with. The answer is 60 million ounces.

Now I would ask you to imagine where 60 million ounces of silver would come from? (Leave out JPMorgan). It was primarily the purchase of 60 million oz of physical silver in SLV from the fall of 2010 to April of 2011 that drove silver prices to near \$50. But more than 6 months elapsed back then and now it is quite possible such a purchase could be made in a day. Let me put it this way — it is possible a billion dollars could suddenly flow into silver (or anything else), but it is not possible that 60

million oz could be legitimately secured in a day. If that doesn't prove that the price is artificially depressed by the commercial crooks on the COMEX, then nothing will.

After trading above \$1700 Sunday evening, the 7 big COMEX shorts were able to turn the price of gold (and silver) lower through yesterday's close. With their backs up against the wall, the big shorts were able to bring prices down and reduce their total open loss to around \$6.5 billion, down from Friday's \$7.2 billion open loss. Prices are lower again as I write this and I'll update the big 7's scorecard when I send this article out later.

With yesterday's cutoff for the reporting week, all eyes turn to Friday's COT report. For the reporting week, gold rallied as much as \$60, before selling off and finishing the week about \$15 higher. Silver, on the other hand, was mostly lower, off as much as 60 cents at Monday's low and ending the reporting week about 25 cents lower. Trading volumes were mixed, fairly heavy in gold, not so much in silver. The real puzzle is the sharp reductions in total open interest in each.

Gold open interest fell more than 58,000 contracts and silver's total open interest fell nearly 10,000 contracts over the reporting week. The decline in gold open interest looked particularly strange in that typically (over the past year or so) total open interest rose when we were approaching a big delivery month (April this time) on a buildup in spread positions. Not this time. We're not approaching a delivery month in silver at this time, so the decline in total open interest is not as strange and does suggest continued managed money selling and commercial buying on top of last week's epic managed money selling and commercial buying.

Seeing as there is such a large managed money long and commercial short position in gold, the sharp reduction in total open interest points to managed money selling and commercial buying, but with no key moving averages penetrated to the downside, it will be curious to see if the managed money traders did sell as much as indicated by the reduction in total open interest. At least in silver, we've been below the 50 day moving average and re-penetrated the 200 day moving average Monday and yesterday. The declines in total open interest suggest the chance for substantial positioning changes in both gold and silver.

With the reemergence of the raptors (the smaller commercials apart from biggest commercial shorts) to the long side in silver in the last COT report, that's something I will be keying off, along with what head honcho JPMorgan and the 7 big shorts were up to, both in silver and gold. In the case of silver, where the 8 big shorts (including JPMorgan) have held a larger short position than all the commercials combined (meaning the raptors were net long), in gold the smaller commercials were also net short, along with the 8 biggest shorts. In the latest COT report, for instance, the smaller gold commercials were short an additional 58,000 contracts over and above the 8 big shorts' 292,710 contract net short position. Perhaps the big decline in total gold open interest was related to the smaller commercials covering shorts. We'll know more on Friday.

At publication time, the big shorts were able to guide prices lower still, easing their total open loss even more. Based upon today's prices, I would estimate the 7 big shorts reduced their total open and unrealized loss in gold and silver by a cool \$1.1 billion, to \$6.1 billion. This is still quite close to record losses and based upon bank stock performance, I would imagine there might actually be more, not less pressure on the banks, all things considered. Couldn't happen to greater bunch of swells.

Ted Butler

March 11, 2020

Silver – \$16.75 (200 day ma – \$17.05, 50 day ma – \$17.80)

Gold – \$1640 (200 day ma – \$1492, 50 day ma – \$1586)

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