# March 29, 2017 – Market Mechanics

When trying to understand complex equations, itâ??s always helpful to consider things in the simplest terms possible before getting into more detailed analysis. Few things are more complicated than modern financial markets, so perhaps that is even more reason to consider the simplest mechanical structure of such markets before drilling down to the details. The simplest and most basic of equations common to all markets is market capitalization, which is the total dollar value of any market at any point.

Every investment asset has to have a total market capitalization, whether the market is real estate, stocks, bonds or any other asset, including gold and silver. The formula for market capitalization is as simple as it gets â?? the total amount of the investment asset that exists multiplied by the current price of the asset. Deriving the market capitalization of asset classes makes historical and prospective comparisons possible, particularly as regards relative comparisons between different assets.

This thought process was initiated by a recent article written by John Hussman, who Iâ??ve referenced favorably in the past. Hussman has been and is currently quite bearish on the stock market for valuation reasons and while I do not consider myself competent enough to offer opinions on markets away from silver and gold, I must say I agree with Hussmanâ??s take. But more to the point, he describes stock market capitalization in terms that I found instructive in sticking to the simple formula. The US stock market, for example, is worth roughly $34 trillion presently.

http://www.hussmanfunds.com/wmc/wmc170327.htm

Since every market has to have one, letâ??s look at the market capitalizations of gold and silver (something Iâ??ve done frequently over the years). Itâ??s relatively easy to compute goldâ??s total market capitalization due to the metalâ??s uniqueness of it not being a commodity that gets industrially consumed and, therefore, used up. Given goldâ??s overall high price per unit (troy ounces), we can be sure that no one intentionally discards the metal. From a variety of reputable sources, it has been established that there is roughly 5.7 billion oz of gold in all forms throughout the world, including jewelry, coins and bullion bars. The simple formula for market capitalization dictates that all the gold in the world (at current prices of $1250 per oz) is worth just over $7 trillion. By the way, each year the world produces $125 billion of new gold (100 million oz) that gets added to market capitalization.

Much of the gold in the world is in forms, like jewelry or religious or historical articles, that is not price sensitive or likely to be sold; so for analytical purposes, goldâ??s market capitalization should be reduced by half to get down to a more realistic market cap. Of the $3.5 trillion of gold in the world in bullion or coin form that could be considered as potentially price sensitive, roughly a third of that is held by governments as official monetary assets. That still leaves $2.5 trillion worth of gold in private hands.

If anything, I may be understating the amount of gold potentially available to the market. Prior to reading this story about the theft of a massive gold coin worth over $4 million from a museum in Berlin, I would have included this gold as not being price sensitive or available for sale. In an instant, however, the theft made the gold in the coin very much available to the market, if the thieves donâ??t get caught (and soon).

[http://www.telegraph.co.uk/news/2017/03/27/giant-gold-coin-worth-almost-4-millionstolen-berlin-museum-dawn/](http://www.telegraph.co.uk/news/2017/03/27/giant-gold-coin-worth-almost-4-millionstolen-berlin-museum-dawn/)

Where the market capitalization formula is fairly straightforward in gold, because just about every ounce of gold mined throughout history still exists in some form; determining silverâ??s market capitalization is much more difficult. No, not because the simple multiplication is difficult from a price perspective, but because the amount of physical silver thought to exist throughout the world is much more difficult to ascertain. We do know that, thanks to industrial consumption over the decades, most of the previously produced silver throughout history has been eaten up and is gone forever. This can be seen in the great drawdown in published world inventories over the past 75 years. Perhaps as many as 40 billion ounces of silver was mined and produced over the full scope of history, but more than 90% of that metal appears to be gone.

It can be argued endlessly, about how much silver might exist in jewelry or teapots that could conceivably come to market at some future undetermined high price, but no one knows for sure. Thatâ??s why Iâ??ve come to believe that the only real form of silver that can be measured or that matters in the first place is metal in the form of 1000 oz bars. This is the standard industrial and investment form of silver.

As I have long estimated and most leading statistical sources confirm, there is thought to be roughly 1.5 billion oz of silver in the world in the form of 1000 oz bars. Included in this total would be all documented world silver inventories in ETFs, such as SLV and other similar investment vehicles, plus all exchange inventories, such as the COMEX warehouses. The total documented portion comes to just under 1 billion oz, with more than half of that in the SLV and COMEX inventories, plus another half billion oz of metal thought to exist but not publicly disclosed (mostly owned by JPMorgan).

The total world inventory of 1.5 billion oz of silver in 1000 oz bar form has a total market capitalization of under $30 billion at current prices (1.5 billion oz times $18). Compared to the market capitalization of other assets, like US stocks ($34 trillion) or gold in the world (from $3.5 trillion to $7 trillion), the market capitalization of silver is so small that it sounds like a joke. Why would anyone compare a market valued in the trillions (thousands of billions) of dollars with a market valued in the low tens of billions of dollars?

Yes, after industrial and other fabrication demands are deducted from the newly mined silver, 100 million oz are added to world silver inventories annually, the same amount of metal added to gold inventories; but there is a big catch. One hundred million ounces of gold adds $125 billion to gold market capitalization each year, while 100 million oz of silver adds less than $2 billion to silverâ??s already tiny market cap. The glaring mismatch between gold and silver market capitalizations is so wide that, in some ways, itâ??s a wonder anyone would compare the two metals; yet the silver/gold price ratio is widely followed and referenced. I get the feeling that very few have ever sat down and contemplated the most simple of market comparisons, namely, relative market capitalizations.

When I sit down and contemplate the market capitalization of gold with the market capitalization of silver, the one unmistakable conclusion I reach is that it will take a lot less investment buying to cause the smaller market to jump in price relative to the much larger gold market. I donâ??t know how any other conclusion could reasonably be reached. And once you factor in that one entity, JPMorgan, now holds more than a third (600 million oz) of the worldâ??s 1.5 billion oz in the form of 1000 oz bars, the implications for eventual silver outperformance relative to gold would appear unquestionable. At least it appears that way to me on a simple market mechanical basis.

In no way does this negate my strongly bullish feelings on gold, as I hope Iâ??ve made clear recently. My bullish opinion on the price of gold is directly and almost exclusively related to the extremely bullish market structure that exists on the COMEX. There is no such similar bullish structure present in COMEX silver futures, but other factors continue to suggest there could be a surprising upside move ahead in silver (either with or without one final shake out to the downside).

Very recently, Iâ??ve been contemplating the philosophical question of â??if a tree falls in the forest, but there is no one around to hear it, does it make a sound?â?• Before you assume Iâ??m going daft, let me explain why this thought keeps popping into my head. For more years than I care to recall, there has been continuous talk about a coming delivery crunch or short squeeze in COMEX silver and/or gold. Iâ??ll even go so far as to acknowledge that I was probably originally behind such talk in silver in very early articles, although the likelihood of a physical delivery crunch or default in COMEX gold always looked much more problematic and less likely to me, given the lack of strong industrial demand for gold.

Whatâ??s got me contemplating the silence of crashing trees in the forest is that we just ended the tightest and, therefore, closest to an outright physical squeeze in a COMEX silver delivery than ever before and I have yet to read one independent word of it anywhere. How can this be? How can it be that every single close observer of silver not be focused and commenting on what just transpired in the just-completed COMEX March silver delivery period?

For the record, the data show that one entity, JPMorgan took (stopped) 3428 silver deliveries this month or more than 17 million physical ounces for both itself (2689 contracts) and on behalf of a client(s) (739 contracts), out of the total 3855 contracts issued this month. This is the most silver taken by one entity in memory and happens to be way larger than the 1500 contracts permitted by COMEX regulations. Most importantly, and as I have mentioned previously, I also got the distinct impression that the shorts which did make delivery, struggled in doing so.

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

Adding to the silence is the fact that JPMorgan has been the primary stopper of COMEX silver deliveries for years in its own name, so this monthâ??s deliveries is only a continuation of a pattern that should have been widely recognized and commented on long before now. Iâ??ll be frank with you â?? whether considering the stark lopsided differences in the market capitalizations in silver versus gold or the unmistakable signs of physical tightness in the March silver deliveries â?? I donâ??t understand the widespread lack of recognition. I just donâ??t get it. (As I was finishing this article, I did notice an article today about JPMâ??s stopping delivery on COMEX silver this month, so maybe Iâ??m not losing my mind after all).

Regardless of my failure to understand, I am convinced these are the most important factors of all and go a long way to negating any conventional bearish implications of current futures market positioning. Iâ??m not saying short term selloffs are a thing of the past, but if there exists the connection between the March silver deliveries and the genuine physical tightness I perceive, any such selloffs should prove brief. Genuine physical tightness in silver is the great equalizer for paper games. Besides, the paper silver game seems to be changing as well, given my premises of a change in managed money behavior and the resultant danger to the 7 big COMEX shorts.

As far as what to expect in this Fridayâ??s COT report, whatever the changes, they should go a long way to clarifying my recent premises about the core managed money longs, as well as what the biggest shorts may be up to. Through yesterdayâ??s cutoff, silver added 65 cents for the reporting week, about what it added in the previous reporting week when there was a surprising reduction in managed money longs and commercial shorts. I would be thrilled should that occur again this week, namely, a reduction in the total commercial net short position, but with silver prices penetrating its 200 day moving average Monday and yesterday and total open interest up sharply for the reporting week, the safe guess would be for a substantial increase in the headline number. Of course, I will place special attention on what JPMorgan was up to Vis a Vis the 7 other big COMEX shorts.

Gold never penetrated its 200 day moving average during the reporting week, although it did kiss it yesterday and finished higher by $12 for the reporting week. As such, there should be an increase in commercial selling as well. But even a large increase in the total commercial net short position in gold shouldnâ??t be close to enough to turn the market structure in gold bearish.

About the worst possible price outcome I can see if there is a large increase in the net short commercial position in both gold and silver, is a sudden sharp selloff designed to flush out whatever new managed money longs were established in the past week, similar to the price downdraft over the first two weeks of March. But if there is no big buildup in managed money longs in silver and gold in the reporting week ended yesterday, then the likelihood of a selloff is reduced, if not eliminated. In any event, should the signs of physical tightness in silver be genuine as is suggested in the March deliveries, and/or should there be the core long silver managed money position not about to be sold on lower prices, then all talk of a selloff becomes misplaced. Throw in the possibility that the 7 large silver shorts may be trapped and likely to panic at some point and any talk of a selloff becomes absurd.

If there are added managed money longs to be liquidated in gold and silver that will be the only reason for a selloff. But if no such selling occurs and JPMorgan decides the time is nigh for silver to run, then run to the upside is what weâ??ll do.

Ted Butler

March 29, 2017

Silver – $18.23Â Â Â Â Â Â  (200 day ma – $18.08, 50 day ma – $17.59)

Gold – $1253Â Â Â Â Â Â  Â  (200 day ma – $1263, 50 day ma – $1226)

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