
March 3, 2012 – Weekly Review/One Down, One to Go

Weekly Review

In a week marked by great volatility and extremely high trading volume, the price of gold and silver fell. Gold dropped by \$63 (3.5%), while silver was down 60 cents (1.7%). Despite the drop, gold is still ahead 9.3% for the New Year, with silver up close to 25%. While it is not usually the case for silver to outperform gold on a downside move, that was true this week as the gold/silver ratio tightened in further to just over 49 to 1. I still remain convinced that silver will outperform gold in the long term and maybe even the short term as well, but that is based upon many factors, the least of which is recent price action.

The problem with relying on the latest price action to determine when to buy or not is because if you buy when it feels right (usually when prices are rising), it then makes sense to sell when it doesn't feel right (usually when prices are falling). Many market participants do just this, including, but not limited to the technical funds; buying on the way up and selling on the way down. I'm not condemning this approach, as almost all of us do it at some time. But it's important to call it like it is and what it is is the difference between trading and investing. If you buy something because the charts look good, I suppose you have to sell when the charts look bad. Silver has so many important reasons why it should go substantially higher over time, that a bad chart would rank low on any list of factors. Besides, how hard is it to make a market that is manipulated look bad on the charts?

To highlight why I favor silver over gold, let me first help to make the bull case for gold, as I am not rooting for the price of gold to decline, just for silver to outperform. One of most compelling cases for gold that I have heard recently was by Donald Coxe, in an audio presentation he made yesterday. While I'm not sure I agree with his case for inflation, he made that case masterfully. Where I do agree with him wholeheartedly is in his portrayal of the credit default swap market's potential demise (as a result of the non-payout on the Greek default) as a good thing. As in good riddance.

<http://www.bellwebcasting.ca/audience/lobby/index.asp?eventid=70081727&lang=english&stage=8>

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The flood of money that Mr. Coxe thinks will wash over into gold, should also flood, in spades, into silver as well. And given the tiny amount of silver that could be purchased, relative to gold, the flood of money should have a much more profound impact on silver. Just this week, China revealed that its total foreign reserves had hit an astounding \$3.2 trillion. The growth in China's reserves was so large that it reduced the percentage it held in US debt by 10%, even though its US debt holdings actually increased in size. It made me think of an example I'd ask you to contemplate. What if China decided to put 1% of its total reserves into either physical gold or silver, or both?

One percent of \$3.2 trillion is \$32 billion. At current prices, \$32 billion would buy a little less than 19 million oz of gold. Undoubtedly, this is a large chunk of gold and a purchase of that amount should lift the price. By how much is anyone's guess, but 19 million oz only represents 0.6% of the world's total gold bullion inventory of 3 billion oz. If, however, China decided to buy, with the same 1% of their total reserves, \$32 billion worth of silver; at current prices that would amount to virtually the world's entire total inventory of one billion oz of silver. How the heck do you buy the entire world inventory of anything without launching the price to the stars? That, in essence, is why I believe silver will vastly outperform gold.

Conditions in the silver wholesale physical market continue to appear tight. COMEX silver inventories increased by 400,000 oz this week, but weekly turnover (the amount brought in and taken out) was five to ten times that amount. That this was par for the course is the key to me, as turnover points to tightness. I'll talk about deposits and withdrawals in SLV later in this report, but there are no signs that I see that indicate a surplus in wholesale channels.

US Silver Eagle sales remain punk, but retail demand is different than wholesale demand. We saw that in reverse a couple of years ago, when there were widespread shortages in many forms of retail silver with no strong signs of wholesale tightness. On a short term basis, retail demand means squat to wholesale prices. I do think that retail demand will return to previous recent levels in time, but for the time being that has not been the case. I think we have to get used to that. The bottom line is that on a wholesale physical level, silver looks as tight as I have seen it, save for the spring of last year.

The big news this week was the price drubbing on Wednesday on the highest volume seen in quite some time. At intraday extremes, the price of gold fell by more than \$100 and silver by more than \$3. I don't want to spend much time describing how this was a manipulative move lower; orchestrated by the commercials on the COMEX because it was so obvious that was the case. The manipulative price smash that day had its origins in the recent buildup in the total commercial short position over the past two months, as I have tried to chronicle on a continuing basis. Given the growth of the COMEX commercial short positions in gold and silver, I hope no one was completely surprised by the deliberate takedown. You have every right to be outraged, as this represents a clear violation of US commodity law, but that is different than being completely surprised. In fact, I am encouraged by the general reaction to the sell-off, as many more observers and commentators see the mechanics of the COMEX manipulation than ever before. That certainly doesn't make the sting of temporary loss instantly vanish, but it bodes well for the future, as I hope to describe in a moment. Importantly, the high volume sell-off on Wednesday has improved the market structure greatly.

This week's Commitment of Traders Report (COT) was cut-off on Tuesday, which happened to cap not only a strong price reporting week, but also the highest close in price for gold in 4 months and for silver in 6 months. By any objective expectation, the total commercial net short position should have been at its highest level in gold and silver in many months, and it was.

In gold, the total commercial net short position grew by 16,000 contracts, to 245,400 contracts. Like last week, all three commercial categories participated in the short selling. The big 4 added 6,000 shorts, while the big 5 thru 8 added more than 3,000 contracts short. The gold raptors added 7,000 shorts, bringing their net short position to 35,600 contracts, the 2nd highest level in years according to my data. There should be no doubt that the commercials are acting collusively in selling to the technical funds and other speculators, a clear violation of not only US commodity law, but also according to the anti-trust provisions of the Justice Department. The game is simply this ^ the commercials sell short in unlimited quantities, waiting for the prime moment to smash prices and induce technical fund and speculator selling. On Wednesday, the cover story was the scheduled testimony by the chairman of the Federal Reserve, but it could have just as easily been a local weather forecast for partly-cloudy skies. In other words, any excuse would have done fine, but the Fed testimony was scheduled and few ever fully comprehend what is said anyway.

The proof that it was paper trading overwhelming and setting prices and not any real changes in the physical world of gold or silver supply and demand was that there were no discernible changes in the physical world of each. The biggest gold ETF, GLD, had zero change in physical holdings Wednesday thru Friday. The big silver ETF, SLV, was unchanged on Wednesday and actually had an inflow of 875,000 oz on Thursday. On Friday, the SLV had a tiny withdrawal of 120,000 oz which looked very much like a management fee payment. No physical changes, only paper changes; which was responsible for the price movement?

There was extraordinarily high trading volume in each ETF on Wednesday, so maybe there is yet to be some metal withdrawn from each; but usually such withdrawals would be made by now (in keeping with the requirements of the prospectus). My sense is that there was additional short covering in the shares of both ETFs, in keeping with recent trends and that might explain why no metal was removed in both GLD and SLV. If true, that's bullish. My main point is that last week's action proves again that the COMEX paper market is dictating prices to the world of real metal, as clear a violation of commodity law as is possible. Please forgive me for repeating this to you so frequently, as I know that you Â?get it.Â? Unfortunately, it is the regulators who don't appear to get it, no matter how clear it should be to them.

In silver, the total commercial net short position expanded by a hefty 5400 contracts, to 44,600 contracts. Through Tuesday, all three commercial categories got the office memo and sold, similar to gold. The big 4 (read JPMorgan) sold 2500 contracts short, the 5 thru 8 sold short 1300 contracts and the raptors sold out 1600 long contracts, reducing their net long position to 5600 contracts. Because the raptors (the smaller commercials apart from the big 8) are still net long, that means the big 8 hold a larger net short position than the total commercial net short position. The big 8 are now holding more than 50,000 net contracts short, or more than 250 million ounces. I know some pundits suggest that this is just new miner hedging, but when one goes to see which miners went short, none can usually be found. Miner hedging must appear in earnings reports and it's rare to find such hedging, particularly among miners listed on North American stock exchanges. In other words, the excuse of the commercials' selling being for hedging purposes is nonsense. This is not hedging of production; this is paper manipulation of prices.

Here's one more reason to favor silver over gold from strictly a COT market structure perspective. By the way, this comes from my good friend and silver mentor, Izzy Friedman. Izzy commented to me yesterday that the gold raptors don't appear to be very afraid of shorting gold and of risking getting hooked on the upside of gold. But the silver raptors don't appear very willing to build up a big silver short position no matter how high silver prices climb. Instead, the silver raptors seem very content to build up big long silver positions no matter how low prices may fall. The raptors are not afraid to sell gold short, but appear reluctant to sell silver short. What does that tell you?

The net COMEX short position of JPMorgan now appears to be around 24,000 contracts, up from 13,000 contracts at the price lows of December. It should be clear as day that without the additional short sale of 11,000 contracts (55 million oz) by JPM, the price of silver would have been substantial higher than it was on Tuesday's close of almost \$37. JPMorgan was short the equivalent of 120 million oz on Tuesday, 26% of the entire net open interest on the COMEX (less spreads) and 16% of total annual world mine production. Years ago, the copper market was found by the CFTC to have been manipulated by a trader from Sumitomo nicknamed "Mr. 5%". If 5% of a market can be considered a manipulative share, what the heck is 16% or 26%?

I don't want to dwell more on what happened in the latest COT, as that was as of Tuesday and what occurred on Wednesday changes things, perhaps significantly. After all, volume was extremely heavy on Wednesday and I wouldn't fall down shocked and surprised if as much as 50% of the buildup in the total commercial short position in gold and silver over the past two months was cleansed from the market. The real money question is Â? was that cleanout enough? Can we go higher in price from here or could we still have more cleanout ahead? The answer to both questions is yes. I tend to be an optimist, so I'm inclined to think the worst is past and we head higher. But even if I'm wrong, it's important to recognize the latest COT is old news by virtue of what occurred on Wednesday, as we now have a different market structure in place. It's also important to remember that even if the commercials can rig prices lower in the near term, the longer term risk/reward equation in silver is spectacularly configured to the upside. That means that the eventual gains to come in silver dwarf any possible amount we might sell-off in the very short term.

Most importantly, there should be no question that it was the commercials, all of them acting in concert, that were the big buyers after Tuesday. The price moves this week, as violent as they were, went strictly according to the manipulative script written beforehand. The commercials sold in unison on the way up in price and after selling as much as possible, they rigged prices lower through HFT tactics to complete the process and buy as much as possible on the deliberate break in price. This often-repeated pattern could not possibly occur without collusion amongst the commercials.

One Down and One to Go?

For the better part of a year, I have held that there were two key factors that were likely to determine the future path of silver prices. While there are certainly more than two important factors in the silver market, the two I am referring to are unique and signature issues of mine. One was the disposition of the issue of short selling in shares of the big silver ETF, SLV, and the second was the resolution of the concentrated COMEX silver short position of JPMorgan. These were the two issues I thought and wrote about more than any other in the recent past. Now, we may be down to one.

I admit that I may be somewhat premature, but it looks to me that the shorting in SLV issue is close to being resolved. Already down by close to 70% from the high-water mark of last spring and having declined unusually on a notable price rise, the short position in SLV is looking like a former problem. Coupled with the new-found quickened pace of deposits into the Trust, there comes a point when the data suggest a genuine change has occurred. The only reason for pestering BlackRock, the sponsor of SLV, in the first place, was to get the short position reduced and to prevent a recurrence of unlimited short selling in the future. There was a specific objective in mind and, thanks to you, that objective appears to have been achieved. The timeline couldn't have been more precise. I pestered BlackRock for almost a year and nothing happened; you pestered BlackRock and the short position suddenly came down. Make no mistake – this was a truly magnificent accomplishment.

If my reading on the short position problem in SLV is correct, that means only the concentrated short position of JPMorgan remains as a key issue. One down, one to go. One of the great things about the apparent resolution of the SLV shorting issue is that it is empowering. It should show you that it is not impossible to bring about change, even when aligned against those at the top of the food chain. What matters most is the validity of the argument. It was clearly wrong that there was such an outsized short position in the shares of a hard metal ETF and there were no cohesive and logical arguments supporting the heavy short selling.

Likewise, it is clearly wrong for JPMorgan to hold the outsized concentrated short position it holds in COMEX silver. Just like BlackRock couldn't provide a compelling argument in favor of a large short position in SLV, JPMorgan can't offer a justification for its concentrated short position on COMEX silver. If it could, it would. Up until now, JPMorgan and the regulators at the CFTC and the CME Group have adopted the silent treatment, perhaps hoping that the remaining critical issue will just go away. It won't. That's because of the validity of the issue, namely, that an important financial institution is not above the law and can't be allowed to continue to manipulate a market.

Many of you have written to me recently, suggesting I change tactics in dealing with the regulators and JPMorgan. While I am always open to constructive suggestions, it appears to me that I should do what works best. What worked in the case of the SLV shorting was doing the same thing until it had the desired effect. If you get thrown off the horse, you dust yourself off and get back on. Sooner or later, you won't get thrown off anymore. I think the same applies to JPMorgan. They are wrong in being so heavily short COMEX silver and I intend to make that the issue until that, too, is resolved.

Even if there is US Government involvement and whether that involvement is overt or reluctant, the concentrated silver short position is wrong and clearly illegal. That means the CFTC will have to deal with it at some point, as it is their prime mission to prevent market manipulation. That JPMorgan, the CFTC and the CME Group have been silent on the matter is a sign of weakness on their part. That's because the concentration issue is valid; otherwise the CFTC never would have initiated the silver investigation in the first place. I still believe that the people at the CFTC, both the commissioners and the professional staff are dedicated to doing the right thing. They just need encouragement.

Putting myself in their shoes, I would also be intimidated at the prospect of confronting JPMorgan and setting off a silver price explosion, were I a regulator. But at some point, the evidence and public pressure will become so overwhelming that it will force the regulators to act. All I read on the Internet is how JPMorgan is manipulating the silver price and there is virtually no legitimate counter-argument as to why silver is not manipulated. That circumstance did not exist 10 or 20 years ago; it has only evolved to that now. Precisely because there is no legitimate counter-argument against the fact that silver is manipulated in price or even no legitimate and open debate, it is only a matter of time before the manipulation is terminated. The termination may only come with the shortage, as always has been the case, but that is no reason to stop pressing JPM and the regulators in the interim. Why just sit around and wait passively?

Finally, a number of you asked me about the news concerning the coming or not coming exchange in China (PAGE). As a general rule, if I don't write about something, it usually means I don't think it's that important. I certainly don't want to be in the position of regularly commenting what others think and say. After all, who the heck am I to pass judgment on what others write or say? Openly disagreeing with others doesn't strike me as very professional. I write about what I think is important and why; not in critiquing others. Besides, I always admit I could be wrong about anything projecting into the future.

All that said, I do remember commenting briefly in the past that I didn't think a new futures exchange in China or elsewhere would likely change things much, at least in the short run. Starting a new exchange or introducing a new futures contract doesn't automatically translate into a successful venture. In my experience, there has only been a one in ten success ratio with new futures contract introductions. You don't have to go any further than the experience at the COMEX, which has the most successful (albeit manipulated), precious metals contracts in the world. The COMEX has four silver contracts listed and traded, but only one can be considered successful. The other three are on life-support. If the world's leading precious metals exchange has trouble coming up with successful new contracts, the odds against a complete newcomer are formidable.

http://www.cmegroup.com/daily_bulletin/Section62_Metals_Futures_Products_2012042.pdf

I hope I'm wrong and the new exchange in China leads to the end of the silver manipulation, but I'm not holding my breath. I'm not saying that the purchase of silver in China is not an important long term factor; I'm just saying a new futures exchange there doesn't mean much to me. I've seen too many come and go to get excited.

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Silver – \$34.80

Gold – \$1712

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