
March 3, 2018 – Weekly Review

Friday's strong rally brought gold and silver prices back from fresh lows through Thursday, but gold still finished the week down by \$7 (0.5%), while silver managed to end the week unchanged. As a result of silver's slight relative outperformance, the silver/gold price ratio tightened in by a fraction of a point to 80.2 to 1; a level which should invite disbelief at how cheaply silver is priced to gold given the actual facts surrounding each metal. The passage of enough time at any extreme level of valuation makes that valuation seem less extreme, but in the end what seems to be does not always prevail.

The key development this week was the downward penetration of gold's 50 day moving average for the first time since late December, starting on Tuesday and continuing for the remainder of the week. Even though the price drop on Tuesday (which was the cutoff day for yesterday's COT report) closely matched my expectations for the report, I hope you know it kind of pains me to write what I just wrote. Of all the things that occurred last week throughout the world, why the heck should the key development in gold and silver this week be the penetration of some arbitrary price average?

The answer, of course, is because the price setting process in gold and silver and many other markets has been hijacked and captured by massive paper trading between technically-motivated speculators (called managed money traders) and other speculators (called commercials and other reporting traders). The paper trading has completely overwhelmed the influence from actual supply and demand. Quite literally, a moving average penetration means much more to price than the closing of a major mine (as has occurred in silver in the past). That's nuts.

Please understand where I'm coming from; as an analyst I feel I am required to highlight the most important factors influencing price and that's why I focus on market structure as defined in the COT report. But I also know that this paper positioning has gotten completely out of hand and has distorted the price discovery process in ways never intended by commodity law. I'm convinced this won't always be the case and the actual fundamentals will matter someday, but until that day arrives, I feel I'm required to concentrate on what determines prices in the here and now. Still, I just don't know why it has taken so long for the market to register what is transpiring.

I keep thinking everyone will wake up to a price discovery process turned upside down (or from the Twilight Zone), but the slumber continues, despite some slight stirrings. As an example, here's a recent article by the crackerjack reporter from Reuters, Jack Kemp, who seems about to wake up to the fact that speculative paper positioning is setting many commodity prices; but then manages to drift off to sleep. No slam against Kemp, who is one of the best; but he somehow manages to miss the main point after describing the situation quite realistically. It is said that recognition of a problem is half the solution, but I'm beginning to question that maxim.

<https://www.reuters.com/article/us-commodities-speculation-kemp/fundamentalists-complain-about-a-new-generation-of-commodity-speculators-kemp-idUSKCN1GD5VS>

The turnover or the physical movement of metal either brought into or removed from the COMEX-approved silver warehouses surged to 7.8 million oz this week. Total inventories also surged, by 5.6 million oz, to 252 million oz, nearly erasing the previous week's sharp adjustment down. Total

COMEX silver warehouse inventories are now only 1.2 million oz below the multi-decade high set two weeks ago. There was a slight increase in the JPMorgan COMEX warehouse of 250,000 oz to 135.6 million oz, another new record high in that warehouse.

My sense is that this week's big increase in total COMEX silver warehouse inventories was the result of metal being brought in to satisfy an equivalent amount of the physical delivery requirements remaining in the March contract (around 1000 contracts). Perhaps I'm reading too much into it, but it feels like the metal was brought in late in the game and reluctantly, not by the choice of those short the March contract, but by necessity. That's in keeping with a tight physical silver market. I suppose the alternative explanation is that the silver was brought in this week because there was no other place to put a surplus of unwanted metal. But if physical silver is not in demand, why move it?

After stopping (taking) delivery of 447 contracts on first delivery day in its own account, JPMorgan has been missing in action in further silver deliveries. Goldman Sachs has remained the big silver stopper, taking in more than half (2209 contracts) of the total contracts issued so far (4205), all in its own house account. There used to be a 1500 contract limit on how many silver deliveries any one trader could take in any delivery month, but apparently exemptions are not that difficult to come by if you are Goldman Sachs (or JPMorgan). At this point, based upon the way the COMEX assigns deliveries, it doesn't look like JPM will take any more deliveries on the March contract, but that can change.

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

I'm still convinced JPMorgan was in position to take many more March silver contracts for delivery until just prior to first delivery day when it concluded there may not be enough physical silver available for it to demand without disturbing prices. I base this on spread differentials and paper liquidation in the March contract going into first notice day. Why would JPM back off from doing anything to cause silver prices to rise, given its massive physical long position? For the simple reason that it stands a much better chance of buying back paper short positions in greater equivalent quantities than what it would gain by pressing for physical deliveries in the March contract. And yes, this is a very short term consideration on JPM's part.

Over the past week or so, close to 5 million oz have been deposited into the big silver ETF, SLV. Not only is this counterintuitive in the face of declining prices, about the only rational explanation is my long-held premise of the deposits being made to reduce the existing short position on the trust. Not all the deposits were made before the Feb 28 cutoff for the next short report, but a good chunk (3.5 million oz) were made and may be reflected in the next short report on March 9, although this is a hard report to predict (at least for me).

Just as a reminder, I've given up reporting on sales of Silver or Gold Eagles from the US Mint because sales have evaporated since you know who stopped buying. As and when things change, so will my focus.

Turning to yesterday's Commitments of Traders (COT) report, it couldn't have come closer to my published predictions on Wednesday of 25,000 contracts in gold and 5000 contracts in silver by most counts. Truth be told, when I hit the send button on Wednesday's article, I immediately began berating myself for being so specific and not qualifying sufficiently enough that my predictions are guidelines to describe what I think occurred - there are no gold stars or cookies awarded for accurate predictions.

Putting specific contract numbers on what may have already transpired positioning-wise is just my way of testing myself to see if I have an accurate handle on what the managed money traders and commercials may have been up to, particularly on larger price moves. An important takeaway this reporting week was that, effectively, all the positioning changes likely occurred on the Tuesday cutoff day, when gold first penetrated its 50 day moving average. The first four days of the reporting week were dullsville.

In COMEX gold futures, the commercials reduced their total net short position by 15,100 contracts to 199,800 contracts. (As I'll try to show in a moment, the net selling of 25,436 contracts by the managed money traders which came much closer to my contract prediction is more important, but not just because it was closer). On the cutoff date, the total commercial net short position in COMEX gold futures is still larger than it was as recently as two weeks ago and as such, must still be considered overall bearish. Although I will add here that trading since the cutoff has likely pushed the gold market structure into neutral overall.

By commercial categories in gold, both the big 4 and big 5 thru 8 actually added shorts, never a particularly bullish sign; to the tune of 3700 contracts and 1700 contracts respectively. Following three weeks of raptor (smaller commercial) selling, this week the raptors accounted for all the commercial gold buying by adding 20,500 new longs to a raptor net long position now amounting to 42,700 contracts. One quick conclusion - it was the raptors (and other reporting traders) most responsible for the price decline on Tuesday and not the 8 big shorts. But I would imagine that the big 8 did some decent net buying in trading after the cutoff.

On the sell side of gold, it was all a managed money affair as these trader sold an aforementioned 25,436 net gold contracts, including an evenly divided sale and liquidation of 12,923 long contracts and the new short sale of 12,513 contracts. Neither change was unexpected. The remaining number of managed money longs of more than 177,000 contracts was still large, while managed money shorts of less than 28,000 contracts were still small as of the Tuesday cutoff date. Undoubtedly, managed money longs are lower and shorts are higher since the cutoff.

The reason the managed money traders sold many more contracts than the commercials bought was because traders in the other reporting category bought 13,232 net gold contracts, fairly evenly split between new longs added and short contracts bought back. As I've previously written, this action reflects growing competition with the commercials in getting a piece of the managed money action. Over time, the smaller commercials (the raptors) have grown ever more competitive with the big 8 in taking the other side of whatever the managed money traders do as the raptors observed and adjusted to the incredible mechanical regularity by which the managed money traders bought and sold on repetitive price prompts.

Now the competition has come to include other large (reporting) traders vying with the commercials

(big 8 and raptors alike) for a share of the managed money bounty. The bears feasting on the banks of the managed money salmon run have come to include all sorts of strange bedfellows â?? big and small commercial crooks, as well as outside mom-commercial feeders. Thatâ??s how obvious this whole COMEX paper positioning scam has become. My main point is that the whole ecosystem depends on the managed money food supply, which to this point has actually grown despite what might be considered over-feeding by a growing army of diverse predators.

In COMEX silver futures, the commercials reduced their total net short position by 5000 contracts to 14,500 contracts, the equivalent of just 72.5 million oz. (In terms of pre-report predictions, there was no way I could have come closer). This is the lowest (most bullish) commercial net short position since August of 2015 and among a handful of record commercial net short positions. As expected, an extremely bullish market structure in silver got even more extremely bullish, both in this report and in subsequent trading since the Tuesday cutoff.

By commercial categories in silver, the big 4 actually added 800 new shorts, but as was the case in the prior reporting week, this did not appear to be commercial shorting, but rather the handiwork of a big 4 short of the managed money variety. The raptors were the standout buyers, in adding 4800 new long contracts to a net long position amounting to 70,000 contracts, the highest level of raptor net longs in all the years since I first started closely following the raptors. To call this extremely bullish would be an understatement. The big 5 thru 8 shorts bought back 1000 short contracts to round out the commercial categories.

Iâ??m leaving the JPMorgan net short position at 27,000 contracts, but I believe (and hope) it may be less than that, perhaps significantly so (dare I say 20,000 contracts or so?) I am also hopeful that next weekâ??s Bank Participation Report will help clarify matters concerning JPM. It goes without saying that the smaller the JPMorgan paper short position the more bullish it is for the prospective price of silver. As I indicated earlier, I believe JPMorgan has backed off from demanding more physical silver deliveries in the March contract so as not to interfere with its more immediate goal of buying back as many paper short contracts as possible. At this point, JPM buying back one or two thousand short COMEX contracts is a lot easier than picking up 5 or 10 million oz of additional physical metal. Hopefully, this will be seen in the next Fridayâ??s Bank Participation report.

On the sell side of silver it was actually merrier (in the more the merrier category), as the managed money traders sold 5,913 net contracts, including new longs of 476 contracts and the new short sale of 6,389 contracts. The small addition of new longs tends to validate the remaining number of open longs (36,647 contracts) as being the new core non-technical fund long position. Managed money shorts, at just over 53,000 contracts as of Tuesday, still leave anywhere from 7000 to 12,000 potential contracts to be shorted before the previous peaks are seen (both times in 2017), but those targets are now less based upon trading since Tuesday. Even with some potential room for new managed money shorting, I would note that this weekâ??s net managed money short position (16,436 contracts) is the largest (most bullish) on record, exceeding the net short position of this past Dec 19.

How much more bullish can the extremely bullish COMEX silver market structure get? No one knows for sure, of course, but the whole point of quantifying previous records being hit or exceeded as logical targets would suggest not by significant amounts. We can identify the most probable supply of new salmon feedstock as being how many more new managed money short contracts can be lured into the market; with the feeders on them being a combination of formerly big commercial shorts, new raptor

longs and other large reporting traders. If the salmon are running, all the bears eat well.

Even though the silver market structure is already white hot bullish, the gold market is not similarly structured. Therefore, it is still most probable, but hardly guaranteed, that further managed money selling in gold might drive the remaining few silver salmon into the clutches of the various traders ready to catch and eat them. It will take new price lows in gold and silver to coax all the managed money salmon to join the run, but that's what price and positioning change is all about.

That's been my recent analytical premise and while it has played out that way to date generally and on this move specifically, it's always possible for JPMorgan to end the game unilaterally, given its massive physical positions in both gold and silver. That's why I choose to be all in on silver (no margin please), while awaiting to commit the last (at this point) of the remaining stash of mad option money I set aside some months back.

Ted Butler

March 3, 2018

Silver – \$16.50 (200 day ma – \$16.84, 50 day ma – \$16.81)

Gold – \$1323 (200 day ma – \$1288, 50 day ma – \$1324)

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