May 19, 2012 – Weekly Review

Weekly Review

At the end of a particularly volatile trading week, the price of gold came back to finish $10 (0.6%) higher, while silver finished 25 cents (0.9%) lower. Of course, measured from the price lows of Wednesday, there was quite a spirited rally in both metals after a sickening decline to start the week. As a result of gold's outperformance relative to silver, the gold/silver price ratio widened out to just over 55.5 to 1, the cheapest silver has been relative to gold on a year to date basis.

The underperformance of silver relative to gold has created a special opportunity to switch gold positions into silver on a long term perspective. I say this even though I expect gold to rally smartly based upon market structure and world economic considerations. Therefore, it may sound odd for me to suggest switching gold positions into silver (metal for metal, no margin) if I expect gold to rally smartly. But history has shown that the very best time to make such a switch is precisely as gold embarks on significant price rallies. That's because silver usually outperforms gold on price rallies and underperforms when both metals decline in price. As I hope I have conveyed, my reasoning for favoring silver goes way beyond that, including physical demand and possible manipulation resolution considerations. But there is something to be said for keeping it simple and most, if not all, past significant price rallies have featured silver outperforming gold. I would expect it to be no different this time around.

There were some interesting developments in the wholesale silver market. First, the turnover or churn in metal being brought into and taken out from the COMEX-approved silver warehouses remained active this week, as total inventories increased by more than a million ounces to 141.7 million ounces. That this unusual turnover has come to be normal for more than a year still astounds me. The most plausible conclusion is a form of hand to mouth supply/demand situation that points to physical tightness, a precondition to shortage. Even though total inventories have increased since the start of the year, the rapid churn in inventories strongly suggests that little of the total inventory is readily available for sale at current prices, necessitating new material be deposited to satisfy continued demand. As always, any alternative explanation is welcomed and even solicited by me.

The standout development in the physical world of silver was the unusual deposits this week into the big silver ETF, SLV, of some 6 million ounces. At around 310 million ounces, the total holdings in SLV are largely unchanged since the big 50 million ounce withdrawal of a year ago, so the timing of the recent deposits is what catches your attention. I don't recall many big deposits into the Trust when silver prices have been so weak. Investors are human, with silver investors being no exception (usually) and they generally sell when prices fall sharply, as that instills fear. In SLV and other ETFs, sharply falling prices usually lead to metal withdrawals, not large deposits. What gives?

I can only come up with two plausible explanations for the big deposits and not withdrawals. Perhaps the most plausible is the most obvious; that there was big net investment buying of shares of SLV, mechanically necessitating the deposit of metal into the Trust as dictated by the prospectus. I would argue that this is very bullish as it suggests that the buyers were attracted by the sudden discount in silver prices and may be of a different breed than the typical investor. Further, I'm convinced that there had to be some decent plain-vanilla selling on the big drop in silver prices because the drop was so severe and had to scare some to sell. This makes the net buying of shares (evidenced by the big deposits) even more impressive and bullish.

The other plausible explanation is that the deposits were made as an offset against and covering of a chunk of the SLV short position. I won't get into my anti-SLV short selling rant today, but the quantities of this week's deposits match up with them possibly being used to close out SLV short positions. There are only two ways to close out SLV short positions; buy back the shorted shares or deposit metal through an Authorized Participant. If the recent deposits were made to extinguish shorts, that's also bullish in my opinion because no one closes out a short position unless there is an expectation of rising prices. Of course, not much of this should be reflected in the next short interest report as much of the deposit came after the May 15 cut-off. I'm not trying to see only the bullish side of the SLV deposits, but I just don't see more plausible explanations than the two I've offered. However, I'm open-minded and would love to hear any alternative explanation you may have.

While Silver Eagle sales from the US Mint are still limping along for the month, I have detected some pickup in demand in reaction to the sudden price markdown. I had mentioned some signs of life in overall retail demand recently (by bigger retail investors) and those signals intensified this week. It's funny how things progress at times and I would not be shocked if the pickup in retail investment demand created by the price sell-off continues and intensifies as and when silver prices rise. I can't help but to interject that the buying in SLV and the increase in retail demand are fully consistent with my long-held premise that silver prices are rigged on the COMEX. This last COMEX-induced phony silver sell-off brought prices to levels that caused physical demand to swell; without the sudden crooked sell-off, demand wouldn't have suddenly increased. The tail should not be wagging the dog and COMEX commercials shouldn't be allowed to set the price of silver.

The changes in this week's Commitment of Traders Report (COT) were expected and improved the market structure. Several important historical extremes were achieved in both gold and silver on the sharp sell-off during the reporting week. Before highlighting the changes and what they may portend, I thought I might offer some general comments on the COT. The report itself is purely objective, consisting of a numerical representation of the holdings of traders by category in every reporting market. Any analysis of the report (including mine) as to what it may mean for future prices is purely subjective. It is important to know the difference. And it's also important to know the thinking behind any subjective COT analysis.

When I started studying the COT some 30 years ago, the accepted methodology at the time was much different than how I analyze the report today. The thinking then was that rising total open interest on rising prices, particularly when large speculators were increasing long positions was the most bullish circumstance possible. As long as the large speculators were buying, that was the reason to buy and stay long. I learned over time that all that was true until the large speculators reversed their positions, because then prices collapsed. Looking deeper, especially in silver, I came to learn of the silver manipulation precisely because of the regular COT pattern of the commercials out-witting the speculators. I began writing on the Internet that the best time to buy was when the speculators held a small long position and the commercials held a small short position. Believe it or not, that went against the prior thinking.

Today, from everything I read, it has become widely recognized that it is better to buy silver and gold before the speculators plow onto the long side on the COMEX and before moving average and other technical indicators flash buy signals. Also becoming more widely recognized is the COT connection to the silver manipulation. Although more seem to see the connection every day, it is still amazing to me that some still look askance at the manipulation premise while embracing the correct COT approach. Why do they think the commercials always win? Of course, there are still others who look askance at the COT analysis or the manipulation allegation in any regard. These are usually commentators with little futures experience and/or a closed mind.

This week in gold, the commercials reduced their total net short position by 12,500 contracts, to just under 139,000 contracts. This is another multi-year low number for the total commercial net short position. The big 4 bought back 5700 contracts and the gold raptors about the same amount. The big 4 now hold their lowest net short position in years at close to 95,000 contracts, while the raptors hold a net long position of over 5000 contracts, the most since Jan 3. On the flip side, the speculators, both large and small, hold their lowest net long positions in years. According to how I and many now evaluate the COT, gold is spectacularly bullish by any historical standard.

In silver, the total commercial short position was reduced by 2000 contracts to just under16,000 contracts, effectively at the low levels of December, which, in turn, were decade extreme readings. The big 4 (read JPM) accounted for about 650 of the 2000 commercial contracts bought back during the reporting week, with the raptors adding 1000 contracts to a net long position now totaling 17,800 contracts. New silver COT extremes in this week's report included the lowest big 4 short position ever in my memory, as well as the lowest net long position ever by the little guys. In terms of a low commercial net short and speculative net long position being considered bullish, then it hasn't been much better than it is now.

I would estimate JPMorgan's concentrated net short position to be around 11,000 contracts at the Tuesday cut-off, the lowest since taking over Bear Stearns in 2008. At its peak, in December 2009, JPMorgan was short more than 40,000 silver contracts; so the reduction is significant. More significant, of course, is what the prime silver manipulator intends to do on the next silver rally. I know I beat it to death, but that will determine the fate of silver prices. That's what makes JPMorgan the prime silver manipulator.

One thing I haven't mentioned to date was the reason behind the unusual selling by the raptors a few weeks back, when they sold more than 4500 long silver contracts on what had to be considered lower prices for the first time ever. In that same reporting week, the big 4 (JPMorgan) bought back around 3500 contracts, as I commented on at the time. What I didn't comment on was my speculation as to how this raptor selling and buying by JPMorgan might have occurred. To me, it's simple Â? it was a pre-arranged (and uncompetitive) and illegal transaction. More to the point, it's also a simple enough matter for the CFTC to verify, involving just JPMorgan and several raptors. Then again, I doubt that the CFTC could see it, even when pointed out to them, considering how they can't see how their own data prove the silver manipulation.

Still, there is always reason to hope that the silver manipulation has become so obvious that even the CFTC might see it someday. The NY Times reported on Friday that the agency will announce that they are investigating JPMorgan's recent derivatives debacle, combining with other regulatory and law-enforcement agencies in a joint late arrival. Considering that JPMorgan has basically mimicked what AIG did in almost destroying the financial system a few years back, I suppose it's good that so many watchdogs are investigating, even if it's after the fact. Maybe in investigating JPMorgan for the nutty and irresponsible derivatives trading in question, I suppose it's possible for the Enforcement Division of the CFTC to accidently knock over a file cabinet containing JPM's crooked silver trades, while they are looking for something else. I stipulate that it is unlikely the agency will ever find the silver manipulation by looking for it intentionally.
http://dealbook.nytimes.com/2012/05/18/c-f-t-c-said-to-open-inquiry-into-jpmorgan-loss/

I did have a twinge of disappointment when I first glanced at the new COT numbers, because given the horrific and methodical price bloodbath and the previous week's results, I thought there would be even more speculative selling and commercial buying. For instance, I was somewhat surprised that the speculators didn't increase their short positions more in the managed money category in silver. But everything needs to be put into perspective. The COT readings have been spectacularly bullish and there is a practical limit as to how much speculative selling the crooked commercials can induce by rigging prices lower. This is what I mean by comparing how much speculative selling the commercials can arrange to how much blood you can get from a stone; there's a limit.

I don't know if I've ever shared this with you before, but I have always thought that despite all the illegal tricks that the commercials have up their sleeves, near the end of any commercial campaign to thoroughly liquidate the speculators, the crooked commercials don't know for sure the actual amount they can force to be sold to them. The commercials just rig prices as low as possible and see what shakes out. If, by rigging prices even lower, no new speculative selling is uncovered, the commercials then know they got the last drop of blood from the stone. That thought is what crossed my mind after the last COT report (including the sharp sell-off into Wednesday). At some point lower prices don't mater any more. We may be at that point. My belief is that the commercials will stop rigging prices lower when there is nothing in it for them (in terms of inducing new speculative selling).

All the important signs indicate that we should move sharply higher in silver and gold prices, particularly in light of the market structure and current world conditions. Certainly, it's hard to imagine a much better COT structure than we have now in silver (and gold). I know that many suspect that JPMorgan can buy back even more silver short contracts than they have to date considering how many they have covered on this latest manipulative sell-off. But there must be new speculative selling for that to occur and I sense we are at or close to the bottom of that barrel.

The key is what happens on the other side, when prices start to rally (which may have begun). Without aggressive selling by the raptors and new short selling by JPMorgan, silver prices should explode. I always suggest, at past times like this, that the safe bet is to assume that JPMorgan won't add to their silver shorts on the next rally. I know that has never occurred, but based upon how badly JPM shot themselves in the foot with their new derivatives disaster; they just might choose to cease manipulating the price of silver at this time. In that case, it's hard to see how we won't have sharply higher silver prices.

Ted Butler

May 19, 2012

Silver – $28.65

Gold – $1591

Date Created
2012/05/19