May 25, 2022 – Baby Formula and Silver

Given the extreme reliance on a product the most vulnerable segment of the population is dependent upon, itâ??s understandable that the current shortage of baby formula is also the most emotional of the many shortages witnessed over the past couple of years. (Iâ??m still scratching my head over the toilet paper shortage). Having helped raise three children and assisted when called upon for grandchildren, I recall the most trying aspect of feeding babies a bottle was making sure they were burped afterward, not the supply of formula. I canâ??t imagine having to worry about securing adequate supplies of formula.

Of course, the current shortage of baby formula is but one of a recurring pattern of shortages that have cropped up over the past couple of years, tripped off by the outbreak of COVID and extended by such disparate factors as weather, war and changing financial considerations. One explanation for the outbreak of specific product shortages, like has occurred in semiconductors and everyday consumer and industrial products is the complexity created by the wide variety of products offered and their manufacture and distribution. In the case of baby formula and most other shortages, breakdowns on the supply side appear to be the culprit and not a sudden surge in demand brought about by too many hungry infants.

Never before have the citizens of the world been offered as many different products as they are today and the production and supply lines necessary to deliver these products have proven to be more fragile than once thought. Considering the decades it has taken to reach our current levels of complexity and sophistication in just-in-time manufacturing and distribution and the concentration that involves, it would appear doubtful that the current spate of shortages will disappear anytime soon.

On the broader picture of basic world commodities, also impacted by many of the same forces responsible for specific product shortages, the actual and prospective shortages evident are more obvious than any time since World War II. Every commodity from energy, foodstuffs and industrial metals is either in a current shortage, with demand pressing on or exceeding the limits of supply or about to enter such a state. It would appear that only a deep worldwide depression could disrupt the intensifying development of product and basic commodity shortages â?? not a prospect to be rooted for.

As for the causes for the spate of specific product shortages, on the demand side it has mostly been a case of steady and strong demand, punctuated with bouts of extra demand to protect against future unavailability (think toilet paper and baby formula). On the supply side, decades of â??lean and meanâ?• production and inventory processes typify the inability to meet demand. In the case of world commodities, many years of inadequate returns on invested capital has prevented any short-term boost in supplies. Simply put, whether talking about specific products or world commodities, there are no short-term fixes to magically increase supply.

According to the law of supply and demand, the key economic principle of any free market system, the main cure for supply struggling to meet demand is higher prices, with the main check on runawayprices being competition and the willingness of consumers to pay the higher prices demanded. Atleast, thatâ??s the way itâ??s supposed to work. Too often, non-competitive and anti-free marketpractices also play a role.

Take, for example, yesterdayâ??s record settlement (nearly $1.2 billion) by Glencore with the CFTC for the manipulation of crude oil price benchmarks from 2007 through 2018. Glencore, founded by the late Marc Rich, is also a major force in silver. While the CFTC and Justice Department (and other world regulators) deserve credit for going after Glencore, the settlement also serves as a reminder that long-term price manipulation exists in markets despite the existence of laws and regulations designed to prevent such market illegalities.

https://www.cftc.gov/PressRoom/PressReleases/8534-22

In other words, the Glencore settlement for manipulating oil benchmarks should prompt the CFTC and Justice Department to take the public outcry about a COMEX silver manipulation all the more serious than has been the case to date. Letâ??s face it, there was no public outcry that Iâ??m aware of about Glencore manipulating oil prices â?? yet, yesterdayâ??s settlement demonstrates such a manipulation existed. In COMEX silver, the public has been non-stop in its conviction that the price has been manipulated for decades and the best the CFTC has been able to come up with is to stop arguing that no such manipulation exists. But thatâ??s a far cry from ending the silver manipulation â?? and preventing or ending manipulation is the main mission of the agency.

The main difference between the illegalities admitted to by Glencore in crude oil and COMEX silver is that the proof of manipulation in silver is evident in the CFTCâ??S own public data â?? the weekly Commitments of Traders (COT) reports, which have indicated both the largest concentrated short position of any commodity in real world terms, as well as the commercial traders never having bought back short positions on higher prices. This would seem to suggest the CFTC can publish data proving a price manipulation, but is unable to comprehend what it is publishing.

Likewise, the difference between the shortages in everything from baby formula and semiconductors and the developing shortage in silver is that there is no evidence that prices were too low in the case of baby formula and semiconductors, whereas it can be shown that silver prices are too low by many objective absolute and relative price metrics. And there is absolutely no force evident in baby formula and semiconductors artificially depressing prices â?? while the concentrated short position in COMEX silver stands out like a sore thumb â?? fully capable of inducing complete silence when the regulators (the CFTC and the CME Group) are asked about it.

I suppose it will only be when the developing wholesale shortage in silver fully reflects the retail shortage already existing that the regulators may swing into action. Even then, I would imagine a great reluctance on the part of the regulators to acknowledge the long-term manipulation of silver prices on the COMEX. But a number of factors may point to a different take on the part of the regulators from times past. For one thing, four of the five commissioners are brand new and already seem to indicate a concern for important matters, like market manipulation and preserving (restoring) public confidence in the integrity of our markets. One would think that a newly-appointed commissioner at the outset of a public service career might have a greater interest in doing the right thing, as opposed to someone with long tenure as the silver manipulation continued.

The biggest factor suggesting that the long-term silver manipulationâ??s demise may be close at hand is the current market structure between the main players on the COMEX, namely, the commercials and the managed money traders. Rarely has there been a more bullish set up than currently exists in COMEX silver (and gold, copper and platinum), defined as minimum commercial shorting and managed money buying. This preordains a rally, with the only question being whether the biggest commercials add aggressively to short positions or not â?? as I hope Iâ??ve made clear. Nothing else really matters.

Turning to other developments, yesterdayâ??s release of the new short position on stocks indicated a very slight decline in the short position on SLV, the big silver ETF, of half a million shares to just over 36.5 million shares (ounces, minus the 8% cumulative net management fee discount). At 6% of total shares outstanding, this remains a quite high short position at this particular time (as of the close of business May 13).

https://www.wsj.com/market-data/quotes/etf/SLV

Iâ??ll skip the part about me expecting a much bigger reduction in the short position on SLV and how Iâ??m glad I didnâ??t venture a prediction, having learned this is one report Iâ??m incapable of handicapping and get to what matters most. I have little doubt that the reason the short position on SLV is as high as it is, is because there is not enough physical silver available to deposit into the trust (or conversely, were the 36 million oz to be deposited and not held short, prices would be much higher). I base this on the remarkably large reduction in the total commercials net short position in COMEX silver futures.

Over the years, there had been a similar pattern of decreases in both the short position on SLV and the total commercial net short position in COMEX silver futures (as reflected in the COT reports) on lower silver prices and vice versa on silver price increases. This made sense, as the same big shorts on the COMEX were likely the same as the big APâ??s shorting shares of SLV (with the very largest, JPMorgan, the biggest operator for many years). Recently, however, the old familiar pattern has been blown out of the water, as we have seen the exact opposite â?? a very large reduction in commercial shorting on the COMEX, yet no corresponding large reduction in the short position on SLV.

In searching for the most plausible reason to explain this phenomenon (and please chime in if you have an alternative explanation), it seems to involve the physical silver difference between COMEX futures and SLV. The main counterparties to the commercials on the COMEX are the managed money traders which buy and sell strictly paper contracts on mechanical price signals, primarily moving average penetrations, in the hopes of making a profit. While there is some degree of mechanical technical positioning in SLV, investors in this ETF are longer term in nature and thatâ??s reflected in the fact that futures are more geared to short-term trading than the share structure of SLV and other ETFs.

If the managed money and commercial traders operated the same way in COMEX silver futures and shares of SLV, then there would be much closer similarity in the rise and fall of comparable short positions. The difference is that very few futures contracts result in actual delivery, where shares of SLV are supposed to have the full backing of physical silver from the moment of purchase. It just stands to reason that the recent sharp departure between the established pattern of similarity of the comparable short positions has to do with pronounced tightness in the wholesale physical silver market. The shorts in SLV are short as much as they are because they canâ??t secure the required physical silver to deposit without causing prices to rise. A more bullish factor would be hard to find, particularly considering the current extremely bullish market structure on the COMEX.

As far as what to expect in Fridayâ??s new COT report, considering that gold prices moved back above the key 200-day moving average for four of the five trading days in the reporting week ended yesterday, it would be reasonable to expect some deterioration, or managed money buying and commercial selling. However, trading volume was particularly light and that works against there being substantial managed money buying. Perhaps Iâ??m too optimistic about there not being significant deterioration, but even the quite-substantial drop in total open interest of 25,000 contracts looks more related to spread liquidation than a big net positioning change.

Silver prices did not rally anywhere near-close to any of its three key moving averages and total open interest changed little, so any changes in silver should be less than in gold â?? although some raptor selling shouldnâ??t be shocking considering silver prices did move higher by $1.50 from the lows of the prior reporting week.

Once there have been very significant positioning changes in the COMEX market structure, as has been the case over the past month or so, it takes near-equivalent (or greater) price moves in the opposite direction and enough trading volume to offset the previous positioning, something not yet obvious. Time alone has nothing to do with resolving an extremely bullish or bearish market structure â?? only offsetting positions.

Admittedly, it does get frustrating when awaiting the resolution of an extremely bullish market structure, such as now exists in COMEX silver, gold, copper and in NYMEX platinum, but thatâ??s a function of our own impatience and not anything else. Worse, even the current extremely bullish market structures that now exist could possibly get even more bullish on still-lower prices, but current readings donâ??t strongly suggest that.

Regardless of how long it may take before the current extremely bullish market structures in COMEX silver and other metals are reflected in higher prices, itâ??s always important to recognize the bigger picture and that the developing silver physical shortage is only made more certain by the continued low prices. Shortages are occurring in products and commodities whose prices are quite high. Thereâ??s no way in this world that the coming full physical silver shortage can be avoided with continued low prices. That is, if you believe that in the long-run, the law of supply and demand must prevail (as I do).

The slightly higher gold and silver prices since Friday increased the total open loss to the 8 big COMEX gold and silver shorts by $200 million to $8.1 billion.

Ted Butler

May 25, 2022

Silver – $21.95Â Â (200 day ma – $23.61, 50 day ma – $23.84, 100 day ma – $23.84)

Gold – $1850Â Â Â Â Â (200 day ma – $1838, 50 day ma – $1906, 100 day ma – $1885)

Date Created
2022/05/25