

November 9, 2016 – Inevitable Consequences

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A quick review of the extraordinary events since Saturday's article, in which I discussed the likely market reactions to a victory by either presidential candidate. On a Donald Trump win, I expected a stock market and dollar selloff on disappointed investor liquidation and a surge in gold and silver prices. I explained that the basis for my opinion was an expected sudden and negative change in investor sentiment. Additionally, there was ample evidence that the stock market had been selling off in a record string of consecutive declines directly related to Mr. Trump's rise in the polls, largely stemming from the revelation of an FBI investigation.

Less than 24 hours after my article, a new letter from the director of the FBI indicated the investigation was, essentially, closed and was thought to boost Mrs. Clinton's chances. In reaction, the stock market rallied sharply on Monday and Tuesday, with gold falling around \$30. This, I believe, confirmed the suggestion that there was a strong correlation between investor sentiment and Mr. Trump's prospects for election.

Finally, as news came out that Mr. Trump would win, the Dow Jones Industrial Average suddenly sold off by as much as 800 points in overnight futures trading, briefly hitting circuit breakers once referred to as "limit down". At that time (around 12:00 AM EST) gold had surged by more than \$60 and silver by 60 cents in exceptionally heavy overnight trading before pulling back. I don't think I've ever witnessed a stronger correlation between an election's outcome and market performance, including the price volatility since Saturday.

As I start to write this piece Wednesday morning, the DJIA is only down 200 points and gold is up around \$30, but still unchanged from Friday's close, while silver is up around 30 cents for the day and week to date. I'll report on the rest of the day's trading later. While the markets have roughly conformed to what I expected up until this point, not to the degree of selling by stock market investors I thought possible, nor an explosion in the price of silver and gold. On the other hand, I'm still of the opinion we'll see further stock market weakness and precious metals strength, although much depends on the composition of trading in COMEX gold and silver into last night's price spike.

The election and the high volume price surge in gold and silver came immediately after the books were closed yesterday on the COT reporting week to be published on Friday. As such, there two very different reporting weeks, the one that closed yesterday afternoon and the one that began last night. Since I believe that futures market positioning is the prime price driver for gold and silver, let's see what likely occurred in the reporting week just ended.

The price pattern in gold featured a strong rally last Wednesday thru Friday in which the 50 day moving average was penetrated to the upside, triggering off certain managed money technical fund buying and commercial selling. On Saturday, I estimated that around 20,000 net contracts were added to the commercial net short position thru Friday, putting us about midrange in the recent extremes of commercial shorting. On Monday and Tuesday of this week, gold fell below its 50 and 200 day moving averages, setting off managed money selling and commercial buying and erasing much of the new contracts put on in the rally thru Friday. It may already be ancient history, but this Friday's COT report on gold may show an increase of 10,000 contracts or less in commercial shorting.

Turning to silver over the reporting week ended yesterday, it feels different. For one thing, while gold's total open interest rose by close to 7000 contracts over the reporting week, the total open interest in COMEX silver futures fell by more than that amount, raising the possibility that JPMorgan has continued to cover short positions. JPMorgan not adding to short positions on a silver rally is the single most important factor in the silver price equation and, at least through yesterday's cutoff, it may be continuing. That's the key feature I'll be looking for on Friday.

Of course, the surprise election results and last night's and today's high volume price rally and pull back in gold and silver makes this Friday's COT report already out of date. It's not too much of a stretch to say that nearly a full week's trading volume in COMEX gold was contained in last night's and today's trading. Silver's trading volume, while very high, is not proportionately as high as gold's. The big question is who is buying and selling?

Yesterday, gold closed below its 200 day moving average, only to soar way above it and the 50 day moving average last night. Subsequently, gold fell below its 50 day moving average again. These are price moves, coupled with the extraordinarily high trading volume that must involve a pitched battle between the managed money and commercial traders. After all, that's what the data show in just about every single COT report, namely, an almost exclusive trading tango between these two groups of traders.

Therefore, a super surge in trading volume (like we've just seen) must involve these two groups of traders. And unless the core trading pattern over the past 40 years have suddenly changed, we can be reasonably sure that on big up moves, the managed money technical funds are the buyers and the commercials are the sellers. The question today is did the managed money traders sell out most of the gold (and silver contracts) bought last night already or do they still have many more contracts to sell on lower prices?

There is no question some of that liquidation has already occurred, indicating that the commercials have succeeded in whipping the technical funds into buying and selling at will, with the commercials picking up many tens of millions of dollars in what are, essentially, day trades. I know this raises the question of how darn stupid can the technical funds be to get continuously hoodwinked by the commercials? But that question is separate and distinct from the undeniable fact that the managed money traders have been hoodwinked to date. Let's face it - there's no chance that the managed money technical funds are snookering the commercials since the commercials buy low and sell high and the technical funds do the opposite. We can wonder why the managed money traders persist in continuing to shoot themselves in the foot, but not that they do persist in buying high and selling low.

There is a bright side if the technical funds have already sold and liquidated what they bought on last night's price highs and that involves putting them in position to do it again. The negative side is that the selloff from last night's price highs might continue and turn into the deeper price correction suggested by a still historic bearish market structure. In fact, the ability of the commercials to get the technical funds to behave in the manner of trained circus animals would seem to indicate that the commercials are in firm control and can achieve a complete selloff and cleanout whenever they decide.

What I've just described applies to both gold and silver, but silver is also different in that I am convinced that JPMorgan does hold one-third of the world's total silver bullion inventory, as a result of five and a half years of persistent accumulation. While I do believe JPM has also been acquiring physical gold, there is no way that JPM could ever come to own a third of all the world's gold. Plus, recent signs that JPM may not be adding new silver shorts is more than intriguing. The worst case to me is still one final selloff and complete cleanout and that is something that should not be feared because it should lead to a monster rally; although admittedly it would involve the pain of lower prices temporarily.

On Saturday, I commented on the sharp price rally in copper and how the rally was solely due to aggressive buying by the managed money traders. Copper has continued to rally sharply and the only plausible explanation is continued aggressive technical fund buying. For the reporting week ended yesterday, an additional 30,000 net contracts appear to have been bought by the managed money traders based upon increases in total open interest, both in the form of new longs and short covering. Copper prices have also exploded higher again today, the first day of new reporting week, on the highest daily volume yet.

Over the past 12 trading days, copper has advanced by nearly 40 cents or 20% in price, a particularly large advance for such an important world commodity. There has been no fundamental developments to account for the price rise to my knowledge, apart from the aggressive futures contract buying by the managed money traders on the COMEX. I would estimate, over the 12 day trading rally, upwards of 80,000 net COMEX copper contracts have been purchased by the managed money traders. This is the equivalent of one million tons of copper, 20 days of world copper production and 5% of annual production.

Generally speaking, the changes in the annual production or consumption of important world commodities, like copper, crude oil or other minerals, vary by a percent or two at most; and that's over the course of a full year. COT data shows or will show that the equivalent of 5% of the world annual copper production or consumption was bought by the COMEX managed money traders over little more than two weeks.

It would be impossible for 5% of the world production or consumption of any important commodity to be bought or sold by one narrow class of trader for that amount not to greatly impact the price. Therefore, it's beyond debate as to what just caused copper to explode in price – verifiable managed money buying. And if you are aware of any legitimate alternative explanation, I would be most grateful and downright shocked to hear of it.

The problem is that the managed money traders, by CFTC definition and classification, are purely speculative in their dealings; meaning that a small group of speculators just suddenly bought 5% of world copper production causing the price to soar. I can see why actual copper miners might not object to copper prices rising strongly, whatever the reason. On the other hand, copper consumers would object most strenuously if they were being forced to pay 20% more for a critical material strictly due to speculative trading games. And besides, as and when the managed money traders turn aggressive sellers, copper prices will fall due the same speculative gaming pressures, reversing who is getting gored – copper producers or consumers.

What's wrong is that speculators shouldn't be dictating prices, higher or lower, to real world producers and consumers; it should be the other way around. It's nothing short of remarkable how so few recognize this paper tail wagging the actual market dog. One thing such paper trading dominance results in is an artificial price environment. Sometimes the price is artificially high, sometimes the price is artificially low; but always artificial in some manner. It is the continuous price artificiality that is so at odds and harmful to future supply and demand. Real producers and consumers need price to reflect actual fundamentals in order to properly adjust to future needs. Relying on temporary price spikes and declines caused by speculative futures traders is insane.

On the plus side of this crazy price setting mechanism is that it sets up the likelihood that a commodity can become so extremely and artificially priced that it presents a special buying opportunity in and of itself. I believe that's the case in silver. In addition to silver's unique circumstances, primarily that there is so little of it and what little exists is owned to a large extent by JPMorgan, its price has been artificially depressed for so long that it is a great buy on that basis alone.

When I started writing this article, gold was up close to \$30 after being as high as \$60 higher overnight, forcibly penetrating all its important moving averages to the upside and inviting a tide of managed money buying. Prices have now given up all the gains and gold prices penetrated all its important moving averages to the downside, a very rare occurrence. It is probable that the commercials made not tens of millions but hundreds of millions of dollars today in selling high to the managed money traders first and then buying from those same traders at much lower prices.

While silver has very large volumes and large price moves today, it has behaved in a more stable manner than gold, somewhat unusually and its moving average penetrations today have been confined to its 50 day moving average. For the week, gold is down about \$30, while silver is unchanged. That said, it's usually a mistake to focus on price movement alone and not the underlying actual changes in market positioning. The DJIA is now up more than 200 points, a full 1000 point turnaround from the lows of last night. So much for a turn in investor sentiment, but I wouldn't rule out a helping hand from interested parties (which could have been at work in gold and silver as well).

A couple of housekeeping notes. I did an interview with Chris Martenson from Peak Prosperity last week that you might find interesting and in keeping with what I write about here. I hadn't talked with Chris in some time and I got the impression he was taken back a bit with my assertion about JPMorgan buying 550 million oz of physical silver. Then again, the last interview we did was about six years ago.

<https://s3.amazonaws.com/cm-us-standard/audio/PP-Off-the-Cuff-Ted-Butler-11-2-2016.m>

Finally, I'll be making my seasonal trek back to Florida this week and Saturday's review may be somewhat abbreviated and posted later than usual, but I plan on publishing a weekly review. Also, I'm listing the 50 day moving average in silver and 200 day average in gold, since these are the closest to current price. Sorry for any confusion.

Ted Butler

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Silver – \$18.40 (50 day moving average – \$18.51)

Gold – \$1274 (200 day moving average – \$1277)

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