

## The Year to Date

I suppose every year can be considered unique in its own way, but so far this has been a particularly special year for gold and silver. After hitting all-time highs in gold and close to that in silver in 2011, prices for both generally declined for the next four years until year end 2015.

Shortly after the start of the New Year, gold quickly surged by \$200 to \$1260 by mid-February, its best start in history, and added another \$100 into July. Silver started this year slower, but had managed to exceed gold in relative percentage terms at the July highs, adding more than \$7 to that point. Since the July price highs, both gold and silver have pulled back; gold to the levels first achieved in mid-February, silver to prices first seen in late April.

My first rule of analysis is to try to best explain what has already occurred in the hopes of being prepared for what is about to unfold. After all, if you don't understand where you have been, how can you hope to appreciate where you are going? Therefore, the first order of business is to explain the price action in gold and silver to this point.

As hard as I try to consider every possible reason to explain this year's price movement, I keep coming back to the changes in the market structure on the COMEX as towering head and shoulders above any other reasons. Sometimes I think I may be predisposed and biased towards this market structure approach, having been immersed in it for decades; but when I attempt to remove it and focus on the various other popular explanations we all read about - I come up stone cold. These other things - inflation/deflation, currency, the economy, China/India, daily financial news, political developments, etc. - don't come close to explaining the price movement this year or most years, for that matter.

Further, changes in market structure (according to the COT report) as the dominant price driver have clearly spread to other markets with active futures trading, including the largest commodity market of all - crude oil. There can be no denying more refer to COT changes than ever before. Here's a recent report by another government agency - the US Energy Information Agency - that highlights the changes in a COT category in crude oil. The EIA is ignoring the managed money category, but that's beside the point.

<http://www.eia.gov/todayinenergy/detail.php?id=28472>

So what's the market structure explanation for this year's price moves in gold and silver and what does this portend for the future? We went into this year with the most bullish COT market structure in history, namely, the largest managed money short positions in COMEX gold and silver and the lowest commercial short positions on record. Therefore, it was just a matter of time before prices surged to the upside. We quickly got that surge in gold, later in silver, as the managed money traders rushed to buy back short positions and add new long positions. The commercials sold into the managed money buying, first to take profits on long positions and then adding shorts as the rallies progressed.

The first wave of managed money buying and commercial selling into March involved close to 200,000 net contracts of gold (20 million oz) and 40,000 contracts of silver (200 million oz). This buying drove prices \$200 higher in gold and only \$2 or so higher in silver and resulted in the commercials booking profits of more than \$1.2 billion and establishing a bearish market structure by early spring. At that point, the price of gold and silver were structured to move lower, according to market structure analysis.

However, the managed money traders still had plenty of buying power, as a result of very large investor inflows over the past few years and they then used

their large buying power, driving gold prices another \$100 higher and silver by more than \$4 higher into the summer. They did this by adding more than 100,000 additional net gold contracts (10 million oz) and another 40,000 silver contracts (200 million oz). I believe the commercials miscalculated and misjudged the extent of the managed money buying potential and came close to being overrun to the upside. I base this miscalculation on the fact that overall commercial open losses ran to nearly \$4 billion, the most in history, and one large commercial gold short actually bought back short positions at great loss for the first time ever. At that point in July, the commercials dug in and the managed money technical funds appeared to have exhausted their buying power.

Since the summer price highs, gold has retreated by more than \$100 and silver by more than \$3, as the managed money traders sold more than 100,000 net gold contracts and more than 30,000 net silver contracts. The selloff completely erased the commercials' open losses and the managed money technical funds' open profits, in addition to reducing the exposure of each. This recent selloff has brought not only prices, but the market structures as well, back to levels seen in March. Now what?

Of course, there is a big difference between accurately explaining what has

already transpired with what may occur in the future. Then again, describing what has occurred correctly is no small feat and provides solid grounding for looking ahead. Besides, there can be little question that the extremely bullish COT set up at year end (and on countless other previous occasions) gave as accurate a prediction for this year's rally as was possible; as did the extremely bearish structure most of the year for the recent price weakness.

Speaking strictly in COT market structure terms, here are the possibilities, as far as I see them. The selling by managed money traders and buying by the commercials through the last reporting week, gives both groups room to add to existing positions on a rally from here, also suggested by the technically oversold condition of each market. The big question is how far the rally which began last week might carry, both in time, price and added positions. The key question to me, comes down to how deeply in the hole the commercials will allow themselves to get into on this go-around should we rally further.

Having just escaped from a \$4 billion financial hole over the past few months (in which one large gold short didn't escape), my sense is that it would serve no purpose for the commercials to allow a repeat of that predicament. After all, this was the largest open loss the commercials had ever experienced in gold and silver. I suppose if we experienced a very sharp rally (over the 50 day

moving averages) in which gold and silver shot up close to the summer's highs on little actual managed money buying and commercial selling on the way up, with the actual buying and selling occurring only after the price advance, the commercials might engineer that. But even in that circumstance, that would create new unrealized losses of close to \$3 billion for the commercials just on their combined existing open short positions, making it highly unlikely for this to be an intentional maneuver. That would come close to qualifying as a commercial failure.

It goes without saying that it is always possible for an out of the blue event to completely override COT market structure considerations, but if there is a way to predict that, it escapes me. I'm not saying that can't happen, just that it can't be accurately foretold and points to the advantage/requirement of maintaining core long term positions.

Another possibility is that we enter into or continue a series of "scam within a scam" price movements, in which sharp but smaller price rallies allow the commercials to skim money off the table by orchestrating market moves inducing the managed money traders to first buy and then sell at a loss. Because the managed money traders always buy on higher prices and sell on lower prices, this leaves them susceptible to this type of repeated hoodwinking.

While this is admittedly highly subjective, my main sense is that the commercials will eventually clean out the managed money traders on a final selloff, although the timing is always uncertain. Also admittedly, I held these feelings much earlier in the year, when the market structures in gold and silver first turned bearish, only to witness the surge in prices into summer on record managed money technical fund buying. That can certainly happen again, but if it does, it will suggest the commercials may be losing control since there is little plausible reason for them to allow it if they are in control. Should prices approach the highs of summer that would also raise the prospects of a double cross by JPMorgan.

Should it turn out that my premise of a selloff featuring heavy managed money selling comes to fruition, I am still of a mind that it will be the final cleanout, to be bought as aggressively as practical. Not only because all such past cleanouts over the years have proved to be excellent buy points, but because I believe the commercials were shaken to their core (ex-JPM) by what transpired this summer. As I've explained previously, because the commercials were staring into the financial abyss at the price highs, they would never willingly replicate that circumstance again.

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This means, to me, that the commercials are very unlikely to sell to the managed money traders as aggressively in quantity and at such low prices as they did earlier this year. Stated differently, as and when the managed money traders turn to the buy side in earnest (as they will someday), to avoid the massive unrealized losses experienced this year, the commercials will only sell at much higher prices. Even if the next move isn't the final move higher (as I postulate), it still should be a heck of a move. But to get into that position, the commercials need a deeper cleanout to the downside first.

Turning to developments since the Saturday review, the new short report for stocks indicated further reductions in the short positions of the big silver ETF, SLV, and the big gold ETF, GLD. For positions held as of Oct 14, the short position in SLV declined by nearly half a million shares to less than 11.3 million shares (ounces), while the short position in GLD fell by 700,000 shares to 7.3 million shares (700,000 gold ounces). These are historically low short positions, particularly for GLD, and as such take a back seat to COMEX positioning. Let's hope it stays that way.

<http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%E2%84%A2>

I continue to highlight changes in the COMEX market structure as the prime



price driver because that is what the data indicate, but I am also convinced that this is not the way it will always be and perhaps not for long. The idea that world commodity prices are set by a few large paper traders and not by the forces of real supply and demand is nothing short of abhorrent. Because paper trading price control has actually strengthened and become more blatant, I'm convinced that will shorten the time it remains in force. But that doesn't mean real fundamental factors have permanently retreated from exerting price influence; such real price forces are just temporarily overshadowed.

Particularly in silver, fundamental forces are quietly at work, even if that is not evident in price to this point. Aside from JPMorgan's massive physical position built up over the past five and a half years, the continued industrial consumption of the metal has worked to prevent excessive supplies from developing. In fact, this is the key difference between gold and silver, namely, that most of the world mine production of silver is used up and, therefore, not available to investors. It's just that silver industrial consumption on a daily basis is slow and steady and not as noteworthy as big changes in paper positions on the COMEX. But it would be a mistake to overlook industrial consumption as a very important factor in the future silver price equation.

As an example (and courtesy of Ed Steer), this article from The Telegraph from

the UK, makes the startling observation that 500,000 new solar panels were installed every day over the past year throughout the world. Silver is not used for the conversion of sunlight into electricity, but is needed to transmit the small amounts of electricity produced per panel efficiently. Of course, there is no mention of silver in the article specifically, but that's the way it has been over the decades I have studied the metal. Regardless, that's a lot of solar panels and a lot of silver. And that much less metal available to world investors.

<http://www.telegraph.co.uk/business/2016/10/25/global-renewable-power-capacity-overtakes-coal-as-500000-solar-p/>

As far as what Friday's COT report will likely indicate, gold and silver price action through yesterday's cutoff was among the flattest in memory, suggesting no dramatic changes in the new report. Prices did hold mostly above the 200 day moving averages in gold after dipping below that average during the prior two weeks. Based upon price action and increases in total open interest, after three consecutive reporting weeks that featured sizable reductions in the total commercial net short position in both markets, it seems to me that we went the other way this week by a bit. Accordingly, I'd expect an increase in net commercial selling of about 10,000 contracts in gold and 5000 contracts or so in silver.

Ted Butler

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Silver - \$17.65      (200 day moving average - \$17.31)

Gold - \$1267      (200 day moving average - \$1268)