

## October 7, 2015 – Should I Stay?

### Should I Stay or Should I Go?

The sharp price rally on Friday in silver and gold has continued, at least through yesterday. For silver, the rally (\$1.50+) was the strongest in months and was accompanied by heavy trading volume, both in COMEX futures and in the big silver ETF, SLV. Based upon simple observation, the rally must be considered a basic COMEX price production consisting primarily of managed money buying, mostly short covering (rocket fuel in substance, if not in fully-desired effect) and counterparty commercial selling.

At first, I thought it somewhat strange that there was no mainstream media reporting on the silver rally, but upon further reflection I thought it was about time no one tried to explain silver price movement as if there was some change in the fundamentals. Silver (and gold) prices only move based upon the COMEX commercials rigging prices higher and lower through the moving averages to get the managed money technical funds to dance to the music.

Based upon the price action (silver broke its 50 day moving average decisively and challenged its 200 day moving average in just three days) and heavy COMEX trading volume, it would seem there was a massive change in the market structure in silver and a pretty big change in gold as well. As a result of the price action through yesterday's cutoff for the this Friday's COT report, it's not hard for me to imagine a 20,000 net contract increase in the headline number of the total commercial net short position in COMEX silver and a 30,000+ contract change in gold. I'm hoping I'm way high and I'm still hoping that the crooks at JPMorgan didn't add aggressively to their manipulative silver short position, but I'm prepared to have my hopes dashed in both cases.

As a result of the expected increase in commercial selling in the upcoming COT report, it's hard to deny that the risk of a price selloff has grown. In the past, whenever the total commercial net short position grew sharply and important moving averages have been penetrated to the upside, it has generally only been a matter of time before a notable selloff occurs. Sometimes the selloff comes quickly, other times prices can continue to rise and/or some time can pass before the commercials can rig prices lower to induce managed money selling. I'm not trying to be negative about short term price prospects; I'm trying to be realistic in observing what has occurred previously. To be sure, if we do get a selloff, it will be an engineered COMEX affair and nothing else. It's usually at times like this when I'll raise the issue that a little defensiveness might be in order. While that might be where I should leave it, I'd like to explain why I won't be taking my own words of caution.

Having just described what I believe is a deterioration in the COMEX silver structure, I'd like to explain why I don't plan to get defensive at this time. First is the matter of price. This 4.5 year downward price manipulation has taken 70% off the peak in silver prices. At barely \$16, silver is far cheaper than any price I would have imagined and I've been convinced of a silver price manipulation for three decades, so I know the market is rigged. Certainly, there is not one shred of credible evidence that silver is overvalued or physically oversupplied in any way. In a likely worst case scenario, I suppose the price can fall back to where it was at the recent lows. While such a selloff will hurt psychologically, should it occur, the financial damage is already water under the bridge to a large extent.

Even after a few days of spirited rally, silver is still below the average primary cost of production. While that's not much help in the short term, it is important in the long term; and the price has been low enough for long enough that it is no longer purely a short term phenomenon. Current silver production may not have suffered much, but the persistent low price has greatly reduced or stretched the time table for future production. One mining company buying another's silver production stream does not increase overall production.

As always, when I talk about COMEX futures positioning, I am speaking of the main price driver. But there are two great price forces in silver and COMEX positioning, while it is the current dominant force and has been for the past 4.5 years, may not remain that way. That's because the other great price force, the physical market, may be about to make its presence felt in silver. In fact, this is why I intend to ride out the expected deterioration in the market structure. There are just too many signs coming from the physical side for me to ignore.

First, there is continued physical turnover (and now reduction) in the COMEX silver warehouses. I know I beat this to death, but it is so unusual and has persisted for so long (that same 4.5 years), that it deserves to be beat to death. What puzzles me most is that almost no one else raises the issue, even though it is unique to COMEX silver. At a bare bones minimum, some explanation is in order for a phenomenon that is unprecedented, easily documentable and is occurring in the second largest public stockpile of silver in the world. My bottom line conclusion is that this frantic inventory turnover is indicative of such strong physical demand that it can morph into an outright wholesale silver shortage at any moment. Once again, a genuine wholesale physical silver shortage will trump any and all paper maneuvering on the COMEX.

After three days of the heaviest trading volume and price appreciation seen in months in the big silver ETF, SLV, it was reported yesterday that silver holdings fell by 1.5 million oz. This continues a recent (also near 4.5 years old) counterintuitive pattern unique to SLV. Normally, price appreciation and heavy trading volume in SLV would be thought to result in metal deposits, not withdrawals, because that's when net new buying is most likely to occur. In fact, based upon the trading volume in SLV from Friday through Tuesday, my back-of-the-envelope calculation was that the trust was owed as much as five million oz, with no withdrawal expected.

The most plausible explanation for the withdrawal is that a large player (JPM) was a purchaser of shares in SLV and quickly converted the shares into metal to hide ownership. If there are no deposits over the next few days (if prices hold up), it will also be likely that there was an increase in shares of SLV shorted, although that data won't be included in the new short report due this week. The actual withdrawal of metal from SLV and lack of deposits suggest tightness in the physical wholesale market, as does the COMEX silver warehouse turnover.

Since the SLV is, by far, the largest physical holding of silver in the world, that means signs of physical tightness exist in the two stockpiles that make up more than half of all the visible silver in the world (850 million oz). It's not like I'm obsessing on some obscure or debatable warehouse statistics that have recently come into vogue. I'm dwelling on the two largest silver inventories on the face of the earth and on highly unusual patterns that have persisted for years.

And I continue to detect signs of physical tightness in COMEX deliveries, both in silver as well as gold. This is not a traditional delivery month in COMEX silver, but October used to be a traditional month in COMEX gold and still retains some measure of being traditional, but reduced in the size of dealings. With more than a week gone in the October gold delivery process, only 126 contracts have been issued (of which JPMorgan stopped 43 in its proprietary trading account) and 1500 open contracts remain.

I remember commenting on how tight the August gold delivery turned out, with Goldman Sachs having to wait until the very end of the month to get full delivery of the 2500 contracts (250,000 oz) it stopped (also in its house account what happened to banks getting out of commodities?). It is still my belief that gold is tight enough that anyone trying to take another 2500 COMEX gold contracts for delivery would impact prices higher. Nothing about the October gold delivery process negates my belief.

However, I feel obligated to point out that tightness in gold and silver are different. Both metals, to be sure, are manipulated in price on the COMEX and both appear to be indicating various signs of tightness. But it's hard for me to conceive of a true physical shortage in gold, since it is not industrially consumed and total gold inventories are at historic highs by definition. That's not to say that gold can't climb higher in price if physical buyers are more aggressive than physical sellers. But where I can see gold prices move higher by hundreds of dollars, as it has in the past; I have trouble seeing the thousands of dollars of price advance predicted by many. Every thousand dollar increase in the price of gold increases the value of the world's total gold holdings (5.5 billion oz) by \$5.5 trillion. I don't see that occurring any time soon, but maybe I'll be wrong.

It's different in silver, because the vast majority of the metal produced is consumed industrially or put into forms from which it is hard to retrieve. And because more than 90% of the 10 billion ounces that existed in world inventories 75 years ago has been vaporized, silver inventories went from being more plentiful than gold inventories to the opposite today. There is no way that is reflected in price.

But what sets silver so apart from gold is that at some point it is almost guaranteed that the industrial users of silver will panic and rush to build physical inventories at the first signs of delivery delays. I can't see how that can be avoided forever and maybe not even for much longer, given the apparent signs of physical tightness.

This discussion ties in with the topic of the potential delivery default on the COMEX and it's important to put this into proper perspective. The potential for a contract delivery default, while remote, does exist in silver, but much less so in gold. As it turns out, this can be traced to silver's industrial consumption profile. It is openly suggested that a single buyer could demand such a large amount of metal that the sellers of those contracts would be unable to supply the physical metal and force the COMEX (CME Group) to shut down trading or change the rules and let the shorts off the hook.

The funny thing is that the CFTC and the exchange have the power to take just such emergency measures and have, on rare occasion, done so in select markets. So, it's not unreasonable to discuss the matter. But on a practical basis, there's plenty the CFTC and the CME could and would do to prevent a large buyer from demanding delivery to the point of market disruption; starting with ordering the large trader (or his clearing broker) to liquidate positions. This is the one thing the regulators watch like a hawk — telltale signs of a delivery congestion. Moreover, none of big participants on the exchange, particularly those which are clearing members would knowingly assist in arranging for a trader to threaten a delivery default. I'm sure, for instance, that Goldman Sachs took its big August gold delivery to the limit the regulators approved and no further.

I also know firsthand the repercussions that can arise from coming down on the wrong side (regulator wise) of demanding delivery on a large amount of contracts where actual physical supply is limited. Therefore, it's not wise to dwell too deeply on the likelihood of a delivery default, particularly in gold. After all, the gold wouldn't be needed by industry, but by investors or speculators. The easiest solution for any mismatch is also one of the oldest — mark prices up to the level that it cools off further demand and increases the amount offered for sale. But as you might suppose, it's different in silver.

I believe the likelihood of a big investor or speculator being allowed to threaten a delivery default in COMEX silver to be as remote as in gold (or any commodity); it just isn't going to happen. And even though I recently suggested publicly that a large investor could turn \$1 billion into \$5 billion by buying silver and taking delivery on the COMEX, I was very careful to suggest it would take some time in taking delivery on futures contracts to avoid the stigma of attempted manipulation. As I said, no big speculator would get to first base in threatening a COMEX gold or silver delivery default.

But what about silver industrial users? Should a wholesale physical silver shortage develop and not one large, but many different silver users rushed to take physical delivery on COMEX futures contracts — what would or could the regulators do? In my opinion, not much that would truly alleviate the situation. The regulators couldn't tell a diverse group of legitimate market participants to liquidate an excessively concentrated position, because no such concentration would exist. Some might suggest the COMEX futures contracts might be converted to cash settlement (others continue to suggest cash settlement exists currently, but that is so wrong it is painful to even discuss). Regardless, if a COMEX silver contract owner stood for physical delivery and was denied in any way that would be a contract default in the clearest declaration possible.

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My point is that the industrial demand profile in silver suggests that even the most remote chance of a COMEX delivery default, should it occur, is much more likely to occur in silver than in gold. While the regulators can order any large speculator to sell and not take delivery, how the heck can they do that with legitimate users? And while the chance of a silver delivery default is as remote as me flying for the Russian Air Force, were such an event to occur, it would prove the existence of the decades' long silver manipulation like nothing else.

One thought I've had lately is in the similarities I see presently with what occurred in the late summer/early fall of 2010. That was the time silver advanced in price from levels slightly above where we are currently to nearly \$50 six months later. Not everything is the same, but some are, including that the big rally into April 2011 was not driven by managed money or any other speculative buying on the COMEX, but more by physical demand, not limited to, but highlighted by the 60 million oz bought in the SLV on the run up.

That buying in SLV and the price rise occurred on a continuing basis, and I don't recall there being so many other signs of physical tightness in silver at that time, like exist today in the COMEX silver warehouse turnover and the counterintuitive deposits/withdrawals in SLV. And that says nothing about the most striking bullish factor of all – the 400 million oz that I believe JPMorgan has accumulated over the past four and a half years. This bank sure wasn't long physical silver at the top in 2011, otherwise we never would have sold off.

So in the face of a certain massive increase in managed money buying and commercial selling which increases the chance of selloff, the extremely depressed price of silver, along with the clear signs of physical tightness persuade me to disregard the acquired inclination to get somewhat defensive. I just don't want to be caught looking for a potential \$2 decline and miss the \$10, \$20 or more move to the upside. It's always about risk versus reward.

Ted Butler

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Silver – \$16 (50 day moving average – \$14.86)

Gold – \$1146 (50 day moving average – \$1120)

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