October 8, 2016 – Weekly Review

Weekly Review

It was the second big down week for gold and silver, as prices skid to four month lows. For the week, gold ended $59 (4.5%) lower, with silver off a much sharper $1.65 (8.6%). As a result of silver's relative underperformance (it's hard to write about gold's over performance), the silver/gold price ratio widened out by a substantial three full points to 71.5 to 1. This makes silver the most undervalued it has been to gold in four months as well, but still within the trading range lasting for two years. Looking out over the next two years, it's hard to imagine silver not rising dramatically relative to gold, but as far as the short term, I still take the Fifth.

One thing I am disappointed about, particularly in light of the growing attention to the Commitments of Traders (COT) Report, is the relative lack of public commentary about the specific cause of this week's price decline. Quite frankly, there has rarely been a clearer proof of what exactly drives gold and silver prices, as well as prices for other commodities Â? futures market positioning, period. It's gotten to the point where I'm becoming less concerned about whether enough people see it or not in how it all plays out in the end.

I'm resigning myself to the probability that most market observers will never come to see the managed money/commercial trading tango as what drives prices. On the other hand, I suppose it may not matter much in the overall scheme of things because whether great numbers of observers see it or not is separate from the merits of analyzing the futures market structure.

The fact (at least as I see it) is that significant changes in futures traders' collective positions equate to significant price changes more than any other factor. Therefore, dissecting past and present position changes, as well as projecting future position changes should remain at the core of any gold and silver price analysis. Someday, futures market positioning may not matter much to price, but to this day it is all that matters.

Let me run through the weekly format quickly to get to futures market positioning changes and the key question surrounding what happens next. The turnover or physical movement of metal brought into and taken out from the COMEX-approved silver warehouses slipped only slightly lower from recent weeks, as 5.3 million oz were moved this week. Total COMEX silver inventories rose again by 1.5 million oz to 174.8 million oz, another new one year high. There was no movement in the JPMorgan COMEX silver warehouse.

I did get some questions from a subscriber this week about why I focus on this matter of physical silver movement in the COMEX warehouses. The simple answer is that from the moment the frantic turnover began in April 2011, and has persisted to this day, it has not spread to other commodities, but has remained unique and specific to silver. April 2011 was also a time of record high silver prices and a developing physical shortage. It was also a time when I would come to pinpoint the start of JPMorgan's accumulation of physical silver. I may not know everything behind the unprecedented movement of metal in the COMEX silver warehouses, but there's a reason for the movement in silver and the lack of similar movement in other commodities, and I'm convinced it's central to the silver story as I perceive it to be.

Rather than drill down to the details of the October COMEX gold and silver deliveries, let me just say that I see some things that looks unusual, including the large number of gold deliveries this month (around 7800 contracts) but can't make heads nor tails of what it means, since JPMorgan has remained low key. However, I don't see the delivery specifics as influencing price, but as occurring as a result of price changes over this year. In other words, futures contract positioning changes set the price and the deliveries are in reaction or in response to the price changes.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

The same thing applies to changes in the holdings in the big ETFs, GLD in gold and SLV in silver. In SLV, we did get close to a 2 million oz withdrawal very early in the week in response to lower prices, but nothing since, which is somewhat strange. Even stranger are the flows in GLD, which never really declined much on recent weak prices and, in fact, rose by a very substantial 362,000 oz yesterday. Since the sharply lower prices of late should have resulted in net investor liquidation and declines in metal holdings, it's natural to wonder why that hasn't occurred.

My best answer is that the big price declines have touched off big changes in physical holdings and not the other way around. Prices are set by COMEX futures positioning changes and then other effects are felt. This is just another proof of the main problem, namely, that futures markets are the paper tail wagging the physical market dog. In this case, I'm pretty sure that the sharp price declines in gold and silver set off investor net selling, which should typically result in metal withdrawals.

The only plausible explanation for why we haven't seen greater metal withdrawals from GLD and SLV is that the liquidated shares were purchased by other investors seeking to hold those shares and the metal represented. Further, it would appear reasonable to assume the new buyers were bigger players and not the broad based public. My point is that prices are definitely set by paper COMEX trading, but once set, those prices can prompt changes in the physical market. A past example of this was the very sharp decline in price in gold starting in 2013, due to managed money selling on the COMEX, which resulted in a sharp subsequent reduction in the holdings of GLD and not the other way around. That it appears to be different (so far) this time is noteworthy, but it is still too early to reach broader conclusions.

Sales of Silver Eagles have picked up over very recent levels and seem to be driven by a return of general retail demand in reaction to the sharp recent price declines, rather than by a return of the great silver eater, JPMorgan. Sales of Gold Eagles, in contrast, are strong enough so as to suggest the presence of a big buyer. Should we see a return of sales of Silver Eagles in the 4 million oz per month range or higher, then it will be easy to pin it on JPMorgan as returning to buy after knocking the price down by dollars per ounce. Part of me says JPMorgan wouldn't be so openly brazen so as to do that; another part tells me JPM would do anything it wants to if it involved making a buck.

https://competition.usmint.gov/bullion-sales/

The changes in this week's COT report were in line with general expectations and I split the uprights in silver, but hooked very wide left in gold. The reporting week featured five successive intraday lows (salami slices) in gold and almost the same in silver, capped off by a real thumper to the downside on the Tuesday cutoff. Perhaps some of the data may have been delayed, but that will come out in subsequent reports and isn't important. I did see both good and bad in this week's report.

In COMEX gold futures, the commercials reduced their total net short position by 43,400 contracts to 271,200 contracts (I had predicted a 75,000 contract reduction, missing badly, but came a bit closer in managed money terms). Still, this was the largest weekly reduction in total commercial gold shorts since May 24 and among the largest weekly reductions in history; as well as being the lowest (least bearish) total since June 14.

By commercial categories, it was once again Three Musketeers mode, as all three categories bought back shorts (which is why prices were pushed lower in the first place). The big 4 bought back a very hefty 25,500 short contracts, the big 5 thru 8 bought back an even relatively heftier 10,400 shorts and the raptors (the smaller commercials) bought back 7500 short contracts.
The big 5 thru 8 short position is now nearly 50% lower than it was at recent peaks (in July) and further confirms to me that a trader in this category both added too many shorts than it could handle and was forced to cover at big losses at the gold price highs of the summer.

While I was somewhat disappointed that the headline number change in gold wasn't larger, I was encouraged by the steep reduction in the concentrated short position of the big 4. I hope I made this point clear last week, in regards to silver. I wasn't expecting such a large concentrated short covering so early because usually the raptors step ahead of the big shorts at first. That the biggest gold shorts stood out as aggressive buyers is encouraging because the sooner they cover what they can cover, the closer we are to a price bottom. That's because if any market is manipulated, then it is manipulated by the largest traders.

On the sell side of gold, the managed money traders accounted for many more contracts than the commercials bought, in selling a total of nearly 55,000 net contracts, including the liquidation of 37,386 long contrcats and the new short sale of 17,675 contracts. (Here I was Â?onlyÂ? off by 20,000 contracts and not the 30,000+ I was off in the headline number).

In COMEX silver futures, the commercials reduced their total net short position by 9,900 contracts, to 90,900 contracts (I had guessed a reduction of 5,000 to 10,000 contracts or possibly more, which proved to be true in managed money terms). This is also the largest weekly reduction in the total commercial net short position since May 24 and the lowest since June, but as is the case in gold, it's hard to call the new totals anything but still bearish on an historical basis.

Also as was the case in gold, all three commercial categories bought silver contracts as prices dropped, led by the big 4, which bought back a hefty 4000 short contracts. The big 5 thru 8 bought back 2800 short contracts and the raptors added 3100 new longs to a net long position now amounting to 9100 contracts. I would attribute all the big 4 buying to JPMorgan and yesterday's release of the monthly Bank Participation Report causes me to recalibrate JPMorgan's silver short position at 28,000 contracts.

As I indicated last week, a prime focus of my market structure analysis is JPMorgan's share of the concentrated short position for the simple reason that the bank is in position to double cross everyone else whenever it decides to let silver rip higher, due to its massive physical silver holdings. This week's report was especially encouraging in this regard. Still, since it would not willingly signal the market of its intentions, all I can do is read the public data for signs of what JPMorgan intends.

On the sell side of silver, it was all managed money selling, as these traders sold more than 12,000 contracts, including 8801 contracts of long liquidation and 3383 contracts of new short selling.

Undoubtedly, many more managed money gold and silver contracts were sold and commercial contracts bought in trading since the Tuesday cutoff, bringing us closer to a downside resolution. But it is still too soon to label the market structure in gold and silver fully resolved. This is the issue that I think about most. And if I had to be as specific as possible, the issue revolves around the 200 day moving averages in gold and silver.

The missing piece of the future price puzzle, I believe, is what the managed money technical funds will do if the 200 day moving averages are penetrated decisively to the downside in gold and silver. On Thursday and Friday, gold prices slipped below the 200 day moving average temporarily, but managed to finish on or above the average in late trading yesterday. Silver touched its 200 day moving average both days, but bounced off it in late Friday trading.

As I believe you know, I'm not technically motivated in my analysis of silver and gold and moving averages hold little importance to me compared to actual supply/demand factor. At the same time, since I am convinced that the actions of the technical funds and the commercials on the COMEX are what set prices and since the technical funds are mainly motivated by moving average penetrations, I can hardly dismiss the impact of such potential penetrations.

Penetrations of the 200 day moving average are much rarer and more infrequent than penetrations of the 50 day moving average, by mathematical deduction. In fact, the last time the 200 day moving average was penetrated to the upside in gold was in February of this year and the subsequent historically large managed money buying was the main reason for the gold price advance this year, as I hope I have conveyed. In silver, there was more of stutter step in its upside penetration of the 200 day moving average, but eventually a clear penetration accounted for the price rise this year as well.

If the decisive penetrations of the 200 day moving averages in gold and silver are what led to historic managed money buying this year (along with record investment inflows), what is likely to occur on decisive downside penetrations, which mathematically, must occur at some point, even if that doesn't happen in the very short term? In essence, this is all that I think of recently.

But since I'm not a technical analyst (more of a technical fund observer), perhaps I'm not the one to go to about what prospective downside penetrations of the 200 day moving averages in gold and silver may portend. In seeking out someone who would be much more qualified than me to speak of such matters, let me refer to someone I have held in the highest regard for more than 30 years, the famous technical trader and hugely successful hedge fund manager, Paul Tudor Jones. I have referenced Tudor Jones on these pages over the years and I can't emphasize enough how highly I regard him. Please take a few minutes to determine what he feels about the 200 day moving average.

http://mebfaber.com/2014/11/06/paul-tudor-jones-on-the-200-day-moving-average/

If the managed money technical funds are guided by the same signals that guide Tudor Jones (and I assume they are so guided), decisive downside penetrations of the 200 day moving averages could trigger off an avalanche of managed money selling. I don't believe the core non-technical fund managed money longs in silver and gold will rush to sell or sell short, but I am hard-pressed to rule out why the pure technical funds won't rush to sell on downside penetrations. Should we get an avalanche of technical fund selling, prices will and must move lower.

Further upping the ante at this juncture is that because gold and silver prices were so punk for years before the start of this year's price rally, the last time we had a decisive downside penetration of the 200 day moving averages after pronounced price rallies was years ago. This suggests there may be an underappreciation of the magnitude of potential selling.

Another thing that concerns me is the evolving money game on the COMEX, as I have been portraying it for months. As I indicated on Wednesday, the combined commercial collective gold and silver net short position flipped from a large unrealized loss to open and realized profits as a result of this week's price smash. Mathematically, that also means that the managed money traders' large unrealized profits over the past few months are now held at a loss.

At least in gold and silver, the open profits of the managed money traders this year were the largest in history, mostly due to the large number of long contracts they held. Now that the open profits have disappeared for the technical funds, their attention may shift to limiting further losses on remaining open long positions as well as establishing profitable new short positions if prices move lower. One thing in the technical fund playbook in my experience is the requirement to limit losses. To my mind, should we get lower gold and silver prices and the technical funds don't sell out losing positions, they could be held liable by their investors.

Not for a minute am I predicting what the technical funds will or won't do; I'm just imagining the probabilities, based upon what they have done in the past. But I can't dismiss the fact that should these managed money funds sell aggressively on downside penetrations of the 200 day moving averages, the prime beneficiaries of those lower prices and technical fund selling will be you know who Â? JPMorgan and the other COMEX commercial crooks. That's why I am encouraged by the pronounced short covering this week by the biggest shorts, because once JPMorgan buys back as much of its paper short as it can, it won't be long until dancing days are here again.

Since the 200 day moving average is the main focus currently, I'll record it instead of the 50 day moving average for a while. Also, I'm switching over completely to the COMEX December contract for pricing and will no longer adjust for spot prices.

Ted Butler

October 8, 2016

Silver – $17.60   (200 day moving average – $17.10)

Gold – $1258   (200 day moving average – $1257)

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