September 10, 2016 – Weekly Review

Weekly Review

On yet another volatile Friday, this one to the downside, the price of gold and silver finished mixed for the week. Gold held onto earlier gains better and managed to finish $3 higher (0.2%), while silver slumped by 35 cents (1.8%). As a result of silver's underperformance, the silver/gold price ratio widened by nearly two full points, to just under 70 to 1. Last week the ratio tightened by 3 full points, making the volatility of the ratio even greater than changes in absolute price.

Remaining clueless about short term silver/gold price ratio movements would seem to be the only intelligent approach since the changes are just an outgrowth of computer trading gone wild on the COMEX. Longer term, of course, it's hard to construct an intelligent case for silver not to outperform gold. The funny thing about the long term is that it takes forever to arrive, but when it does it seems early in coming.

There were important and largely expected changes in COMEX market structure reported in yesterday's Commitments of Traders (COT) Report that have to be considered as the most significant feature of the week, but let me run through the usual weekly format first.

The turnover or movement of physical metal brought into or taken out from the COMEX-approved silver warehouses remained strong, as just under 6 million oz were moved, high for a four day work week. Total inventories surged by 3.5 million oz to 165.7 million oz, the highest level in a year. As you may know, it is now more than five years since I began reporting on the still highly unusual turnover in physical silver inventories on the COMEX, when it first developed. Since the turnover is still largely isolated to silver of all exchange commodity inventories, it demands some explanation and mine is still that it represents general physical tightness.

The wonder has been just how much actual silver has been shuffled in and out of the COMEX warehouses, where some weeks can see a physical turnover at a rate approaching 50% of annual world mine production. This physical turnover, of course, is connected to but also separate from the paper trading turnover on the COMEX, which is also the largest documentable turnover in silver in the world. Having both the largest physical and paper trading turnover in the world underscores the COMEX being the prime price setter of silver.

I bring this up in response to a number of subscribers asking about the prospects of a new gold or silver trading platform by the people considered to be the Â?good guysÂ? in Michael Lewis' Â?Flash Boys.Â? No doubt this might provide cleaner and fairer computerized paper trading than occurs on the COMEX, but the reports I've read about the new proposed trading platform don't reference the mechanics of physical delivery, without which the new platform won't be worth much, at least in my opinion. The problem with the COMEX is that it has a death grip on paper and physical turnover and that's what puts it in a position to control price. I hope I'm wrong, but a new paper trading only exchange isn't about to upstage the COMEX.

There's still not much new to report on the continuing COMEX September gold and silver delivery process. Gold deliveries look, essentially, done for September and silver deliveries are progressing normally, with around 1000 contracts still open. There have been a number of new silver contracts added in September since first delivery day and that always bears watching. JPMorgan is still stopping silver deliveries this month, but at a rate much more subdued than previously.

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

Rather than drill down to numbers that will probably just confuse, let me offer my take on what I think is going on. I think the wholesale physical market is tight enough that JPM is acquiring as much physical silver as it can without influencing the price. That the bank isn't acquiring much silver recently (and actually delivered a slug of gold) is more a sign of tightness than any change of heart by JPM. Specifically, I think JPMorgan stands to gain more if it can engineer lower prices to set off technical fund selling so that it can buy back silver and gold paper short positions. Demanding too much physical might frustrate paper short covering plans. The big question, of course, is whether the technical funds can be induced to sell on lower prices.

There's not much new to report as far as the deposits/withdrawals of metal in the big ETFs. The big gold ETF, GLD, takes in and redeems metal according to price and volume changes that must be considered typical to how things should work. It's a little different in SLV, but that might be more of a delay factor relative to changes in GLD.

Sales of Silver Eagles are still weak ever since JPMorgan stopped buying a few months ago. Without JPM's buying, one gets a more realistic take on the true level of broad retail demand. In terms of love and JPMorgan's buying of Silver Eagles, I suppose you don't know what you had until it's gone. Sales of Silver Eagles are not a strong price influence in the short term in any event and nothing will erase the incredible buying of Silver Eagles by JPMorgan over the past five years. To me, it is still a (criminal) masterstroke by the bank and extraordinarily bullish to price long term.

http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

The changes in this week's COT report were respectably close to the mark in terms of expectations in silver and very close in gold. Since the reporting week featured a sharp upward penetration of the key 50 day moving averages on impressively high trading volume and increases in total open interest, increases in the total commercial net short position were expected in COMEX gold and silver.

In COMEX gold futures, the commercials increased their total net short position by 28,800 contracts, to 330,000 contracts. (I had guessed an increase of 30,000 contracts). While we didn't establish a new record as I thought possible, this was the second highest commercial headline number in gold in history (behind the 340,200 contract level of July 5). I also expected an increase in the concentrated short position of the four largest traders in both gold and silver and there were large increases in each, also to the second largest levels ever.

By commercial category, the 4 largest gold shorts added 7600 new short contracts, as did the raptors by 16,900 contracts and the big 5 thru 8 traders by 4300 contracts. On the buy side, it was the managed money traders by an even larger amount, as these traders bought nearly 38,000 net contracts, including 25,012 new longs and the short covering of 12,929 contracts. The sharp increase in managed money buying took us close to previous historic extremes set about a month ago. A near record commercial net short position and near record managed money long position is historically not the formula for sharply higher prices.

In COMEX silver futures, the commercial added 3900 contracts to a net short position now totaling 99,600 contracts. (I guessed 10,000 contracts, but came much closer in terms of managed money buying). By commercial category, the big 4 increased their net short position by 2800 contracts and the raptors (the smaller commercials apart from the 8 largest traders) sold 1400 long positions. This left the big 5 thru 8 as buying back 300 short contracts.

Only by the slimmest of margins did this week's concentrated short position of the big 4 (72,309 contracts) and the big 8 (104,379 contracts) fall short of the previous record established on Aug 2. About the only surprising development was that the release of the monthly Bank Participation Report forces me to recalibrate JPMorgan's silver short position to the 30,000 contract mark from the 33,000 contract level I had been using. Not a particularly big deal, but somewhat of a surprise in the face of what was a fully-expected report.

On the buy side of silver, the managed money traders bought 7389 net contracts (closer to my guess of 10,000), including 5848 new longs and the short covering of 1541 contracts. Make no mistake, the commercials are massively short and the managed money traders are massively long and this has been the market structure for months in gold and silver and represents the only real threat of a selloff. A few thoughts on what this all means.

First, I did mention some concern about whether all the actual positioning that took place on last Tuesday's sharp price spike would make it into this week's COT report on a timely basis.
And while the actual results are close enough to previous predictions so as to suggest there was no reporting delay, something bothers me a bit. The trading the next day, this past Wednesday, which is the first day of the new reporting week featured lower prices and lower trading volumes. Despite that, total open interest rose a sharp 7800 contracts in gold and half that amount in silver, reinforcing feelings not all the data was included in the holiday shortened reporting week. Meaning there may have been more commercial selling and managed money buying than just reported.

Much more important is trying to interpret what really occurs in market structure changes. The whole purpose in looking at the data that I do look at is to figure out the bigger picture. We know that two main groups of traders (commercials and managed money traders) dominate COMEX gold and silver trading and hold nearly identical and opposite positions. What one side loses, the other gains and when the current historically extreme position of each is resolved, how it is resolved will determine the price levels of gold and silver, at least to my mind.

On Wednesday, I titled that day's article as Â?Back To the BrinkÂ? because as of Tuesday's close, the sharp run up in price added $1 billion in additional unrealized losses to a combined commercial open loss of $3 billion. All things considered, were I to pick a title today it would be Â?Back From the Brink.Â? That's because the selloff by week's end erased the $1 billion in open losses facing the commercials on Tuesday's close. For sure, the commercials are still out $2 billion as I write this, but from their perspective that's a lot better than being out $3 billion.
A billion here and a billion there and pretty soon you're talking real money.

But it's not just that the commercials ended the week flat in my running unrealized loss ledger; there's the matter of reporting week positioning changes. As I just reported, the commercials and the managed money traders added impressively to their respective short and long positions in the reporting week. Those positions, clearly, were added close to the price highs of the week and that means that as far as this week's positioning is concerned , those that added short positions (the commercials) are much better off on those added positions than are those who added long positions (the managed money traders).

The only unresolved issue that matters is whether the commercials can escape from the unprecedented open losses they hold and exit their extreme short positions in gold and silver on lower prices. Conversely, will the managed money traders be able to ring the cash register and close out open profits at higher prices? Time will tell and I remain unsure of what the actual outcome will turn out to be, although I believe this metric is what matters most. While the future is always largely unknown, I can speak with more clarity on what transpired this week.

In the question of who bested who this week, the commercials had the upper hand over the managed money traders. The commercials ended the week unchanged in total unrealized loss terms, but every short gold and silver contract they added this reporting week is already in the black (and, in fact, some of those added short positions may have already been bought back at a profit yesterday). Conversely, any managed money long positions added in this reporting week is in the red.

The recurring question in my mind has been, Â?are the commercial shorts in full control or are they hanging on by their fingernails?Â? I still don't know the answer, but this week's activities must be chalked up to the commercials' advantage. I mentioned on Wednesday that the commercials may have deliberately rigged prices higher to induce technical fund buying as one of only two possibilities (the other being a commercial failure). I couldn't know then how the rest of the week would unfold, but now that we do know, the only logical conclusion is that the commercials were deliberate and intentional in rigging prices higher in order to add to short positions. As I stated then, that would suggest lower gold and silver prices to come.

What made the rally into Tuesday's close extra special is that prices for gold and silver penetrated each's 50 day moving average to the upside, after two weeks' worth of closes below those averages. The penetration of the 50 day moving average in either direction to a managed money technical fund is akin to waving a red flag to an angry bull Â? you are going to get a certain reaction. I know this, you know this and the commercials and technical funds know this as well. I think if the commercials were truly at risk of getting run over, they would not be inclined to wave the red flag of a price rig up through the moving averages and invite certain technical fund buying.

I also can't help but believe that yesterday's renewed selloff back below the same critical 50 day moving averages further confirms the commercials as being in control. Admittedly, we have been in a standoff for months in a market structure resolution yet to be decided and only a fool would proclaim how it will turn out for sure. But as far as the week that just was, it has to be scored in the commercials' favor.

Please don't misinterpret what I am saying. I am not rooting for the commercials as they are as crooked as a June day is long and I still believe the technical funds should be greatly restrained by collective position limits. But I have no control over anything except trying to measure which side will prevail in the end. As I said, this week's nod goes to the commercials. Whether the commercials will look to take quick profits on newly shorted positions to the downside with the hopes of reestablishing those shorts later or whether the commercials look to press prices sharply lower from here remains to be seen, as does the failure and over run possibility. It's just that we're all captive to our own collective experiences and mine still point to the commercial inducing sufficient managed money selling to escape the financial hole they currently are in.

I continue to be astounded by the changes in managed money positions in other commodities, most notably, crude oil and copper. More than 45,000 net contracts of managed money selling occurred in crude oil, pushing prices lower during the reporting week. No other category of trader changes positions as much as the managed money traders in crude oil, not even oil producers or consumers. Therefore, it's easy to make the statement that oil prices are determined by futures speculators since the largest traders in NYMEX crude oil are, by definition and CFTC classification, speculators.

In COMEX copper, I think I've uncovered something quite unusual. By the way, none of this is intended as suggestions for trading crude oil or copper and only meant as a general understanding of how markets function. As a result of record managed money shorting, copper prices have fallen by close to 20 cents a pound (nearly 10%) over the past couple of months. Nothing unusual about that as managed money positioning on the COMEX is the prime price driver of copper and these traders sold around 70,000 net contracts, or the equivalent of 875,000 tons of copper.

What's unusual is who is on the other side of the managed money shorts in copper. As it turns out, the other large reporting trader category is increasingly aligned against the managed money traders in COMEX copper, making up about 50% of counterparty positions. The other reportable trader category is comprised of large reporting speculators trading their own money (as opposed to the managed money traders who handle the funds of other investors). This other large trader category doesn't usually stand out in gold and silver and other commodities, but it certainly stands out in COMEX copper.

As far as what this means, I'm convinced that the trading patterns of the managed money traders has become so influential on price given their large size and predictable outcome, that it has attracted outside speculators looking to game the technical funds in COMEX copper. In other words, large speculators have come into copper to expressly bet against the managed money technical funds. And from the looks of it, these other large speculators have cleaned up against the technical funds for a year or longer. I think this is a testament to how predicable the technical funds have become and I can only think Â? what took so long? It's also very much in keeping with my feeling that we're approaching some type of climax in this whole excessive managed money positioning, which includes one last shot to the downside in silver.

Finally, the Federal Reserve, The Office of the Comptroller and the FDIC announced some recommendations concerning banks and commodities trading. I remember posting a public comment (at subscriber Jim H's suggestion) two years back, arguing that JPMorgan should be thrown the heck out of gold and silver trading, but it doesn't look like the Fed took my advice (big surprise). From my reading of the announcement, nothing is likely to change as far as the silver and gold manipulation from the banking regulators' perspective. Oh well, I wasn't counting on their support anyway.

Ted Butler

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Silver – $19.10 (50 day moving average – $19.70)

Gold – $1328 (50 day moving average – $1337)

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