

September 21, 2016 – The Coming Crunch

As a consequence of a publishing schedule that includes Wednesday afternoons, this is one of those days likely to involve gold and silver price gyrations right after the conclusion of the Federal Reserve announcement today on interest rates. Since that will be several hours from when I've started writing this piece, let me comment briefly on the price action so far this week, before returning to an end of day evaluation. In the interim, I'm going to include an article I just wrote for Investment Rarities on the longer term prospects for silver.

Through this morning, gold and silver are up sharply for the day and week. At 10 AM New York Time, spot gold (\$1327) is up \$17 from Friday's close and silver is up 90 cents for the week (\$19.75). At these prices, silver has already penetrated its 50 day moving average to the upside and gold is only \$6 or so below its 50 day moving average. After going months with no important penetrations of the key moving average, there have now been multi penetrations over the past month in both gold and silver.

Should prices end the day at these price levels, the combined and collective unrealized loss on the commercial short positions in COMEX gold and silver futures contracts will have increased by the same \$800 million the commercials regained on last week's price decline. That would put the running total open loss to the COMEX commercials back to \$2 billion since my start date at the end of May. At its peak, the open loss was close to \$4 billion.

Best I can tell at this point, the buying seems to be by the managed money technical funds with counterparty selling by the commercials, with both sets of traders adding to existing positions. This is the same as it ever was and the net effect of which is an increase in the poker pot stakes in the great money game. It's always possible that the commercial shorts may have bitten off more than they can handle and the rally may lead to a resolution that features the commercials getting overrun, but the relative orderliness of the price advance so far doesn't suggest that. I'll come back to this later. First, here's the article I just mentioned.

The Coming Crunch

If one is going to hold any asset as a long term investment, then there must be a compelling reason for doing so, apart from wishing to see your investment grow in value. There has to be a principle long term vision or core belief about an asset that allows one to tune out the short term price fluctuations and hold for the long term; otherwise investors are likely to flip flop and risk losing their way. If you invest in stocks or real estate, you have to hold a long term vision about the companies or properties involved and the same goes for all other assets, including silver.

As it turns out, many hold silver as a long term investment for different reasons, such as for protection against future inflation, or as a prudent diversification from traditional securities, or as basic financial insurance against any number of monetary concerns. All these reasons are understandable and seem plausible to me and I would never dismiss them out of hand. However, I hold silver for a highly specific reason – the coming physical supply crunch.

And let me be even more specific than that – the coming supply crunch in silver I envision must be in the form of 1000 ounce bars, the industry and investment standard. Please don't think that other forms of silver are not suitable for long term investment, it's just that the price of silver is set by metal in the form of 1000 ounce bars and it is in that form that the crunch will occur. To be sure, I can't tell you exactly when the supply crunch for 1000 oz bars of silver will occur, but I see no chance that it won't occur at some point. Remember, I'm speaking of long term investments, not short term price fluctuations.

How can I be so sure that a supply crunch will occur in 1000 oz bars of silver, driving its price far higher than almost anyone can imagine? Due to a number of factors, which can be easily and independently confirmed, anyone can verify whether what I present is factual. And apart from these factors, we were on the cusp of a shortage of 1000 oz bars of silver only five years ago, which is why the price soared to nearly \$50 at the time. In a real sense, what I envision has already occurred or nearly so, making the prospect of it recurring more to the point.

Any supply crunch comes down to supply and demand, so let me deal with supply first. The known and fully documented world inventory of silver in the form of industry standard 1000 oz bars comes to under 1 billion ounces, worth less than \$20 billion. I am including every ounce of silver in every ETF and all verifiable world holdings, including SLV and the silver inventories in the COMEX-approved warehouses and all government holdings. I'm not leaving out an ounce of verifiable silver in this form. It is impossible for anyone to document that more than 1 billion ounces of silver exists in the world in the form of 1000 oz bars.

Of course, it is possible and more than likely that there exists more silver in 1000 oz bar form than the less than 1 billion oz that can be documented. After studying the matter closely for more than 30 years, I would estimate there are another 500 million ounces of silver in the form of 1000 oz bars, although no one can document that or any other amount, so I might be on the high end. Further, I believe JPMorgan owns most of the 500 million oz of silver that can't be documented, but that's a separate issue.

Bottom line, there are no more than 1.5 billion ounces of silver in the world in the form of 1000 oz bars, worth less than \$30 billion. Not only is this a pitifully small amount of money in world inventory terms (gold inventories in all forms come to more than \$7 trillion), very little of the silver is actually available for sale, except at much higher prices. For instance, if anyone tried to buy even 10 to 20 million ounces of silver in the physical form of 1000 oz bars in a hurry, to say nothing of higher amounts, the impact would be seen in sharply higher prices. My point is that the supply of 1000 oz bars of silver is much more limited and restricted than most everyone is aware.

But why am I zeroing in on silver in 1000 oz bar form and ignoring metal in other forms? Is it some sort of gimmick designed to trick folks into buying silver by making it appear there is less silver than in real terms? There may be silver in other forms, such as smaller bars and coins or noninvestment items containing silver, but those forms won't matter in a supply crunch because the two principle buyers will only be interested in buying 1000 oz bars. The two principle buyers, as has been the case all along, will be the world's investors investing in silver ETFs and the world's industrial users and fabricators needing silver to stay in business. These two classes of buyers define what form of silver will be most demanded and not any gimmick by me.

The SLV isn't going to buy boxes of Silver Eagles and neither will the silver industrial users. Every big buyer throughout the world, just as they do now, will deal in 1000 oz bars, including all ETFs and users, including those attempting to buy via COMEX futures contracts. Let's face it Â? it's a 1000 oz bar silver world and not of any other form.

What guarantees the silver supply crunch at some point is not some complex and hard to imagine new set of unusual circumstances; but a simple extension of what already exists. The formula is as simple and it is inevitable — investment buying is a heck of lot easier to crank up than cranking up the physical supply of 1000 oz bars and once the world's industrial users can't get timely delivery of physical material, the rush to buy 1000 oz bars will be turbo charged. Only silver has this dual — investment and industrial — demand and the only form that will be demanded will be metal in 1000 oz bar form. As far as how high the price of silver could climb when the supply crunch hits, pick a number and plan on guessing way too low.

I've studied silver closely from every possible angle for more than three decades and the one thing that hasn't varied is my conviction of an inevitable supply crunch. If there is a better reason for buying and holding silver as a long term investment, I've yet to uncover that reason. I would invite and even challenge you a bit to verify or contest my main reason for holding silver. It could result in a life-changing financial windfall.

As it turns out, I also did a brief interview with Jim Cook, President of Investment Rarities, a couple of weeks back that was made public, but never provided to subscribers. My apologies for the oversight.

<http://www.silverseek.com/commentary/jim-cook-interviews-ted-butler-15932>

I'd like to revisit an issue first discussed in Saturday's review; the matter of the managed money technical funds and where all the money came from that has made them the prime price driver of many world commodities. I'm hoping this article isn't subscription protected, as it provides insight into an issue central to the price prospects for silver, gold and other commodities.

http://www.nytimes.com/2016/09/16/business/dealbook/investors-stick-with-assets-that-mimic-hedge-funds.html?ref=dealbook&_r=1

The managed money funds do just that — trade or manage other investors' money, in this case, as commodity trading advisors (CTA's) dealing in futures contracts. (By the way, managed money, technical funds and CTA's are one and the same). These CTA's buy and sell futures contracts on regulated commodity exchanges on behalf of the investors in these funds. The concept behind these funds appears sound, namely, to trade a wide variety of different commodities, either from the long or short side in the hopes of catching a few big moves to overcompensate for the more frequent smaller losses on positions quickly closed out. The overriding philosophy is sound, let your profits run and cut your losses quickly. In addition, nearly all CTA's employ strict money management guidelines, that is, they maintain diversified positions and never bet the ranch on any one position.

As I have disclosed previously, some 35 years ago, this type of business represented a significant percentage of my income as a commodity broker for Drexel Burnham. I mention this not only to demonstrate some hands on experience with CTA's, but also because it allows me to compare how the managed money industry has progressed. In 1980, the very largest of the managed money futures traders held assets under management (AUM) of no more than \$25 million. Today there are a number of CTA's with assets under management amounting to one thousand times that amount, or \$25 billion. In fact, it would be no great exaggeration to claim that the total AUM for all managed money future traders is around \$250 billion or more and that has to be a lot more than one thousand times greater than all such assets in 1980.

Basically, the phenomenal growth of assets under management, while a boon to those managing these assets, has resulted in obvious and unintended consequences rarely acknowledged. Because the number of commodity futures markets in which to trade has remained fairly static over the past 35 years, the massive growth in managed money assets has meant much more managed money is trading per market. After all, it is a lot easier to add tens of billions of dollars to assets under management than it is to create new world commodities in which to trade.

The obvious result of more managed money trading in essentially the same number of commodity markets means more money and, therefore, more price impact on each commodity market. It's undeniable that the managed money technical funds (and their commercial counterparties) make up a bigger percentage than ever before in the markets they deal in; that's easily confirmed in the CFTC COT data. With the managed money traders holding the largest market share in many commodity futures markets in history, only someone with an agenda would argue that these traders aren't the prime price driver in futures trading.

What the Deal Book article explained was where all the money came from that has been driving prices, particularly over the past few years. I have been reporting for quite some time how the managed money traders (and their commercial counterparties) have been establishing record extreme positions, alternating between the long and short sides of COMEX gold and silver. By no means has this been limited to COMEX gold and silver and, in fact, record managed money positions are now common in most commodity futures markets. It seems I get new confirmation on this regularly.

I mentioned on Saturday how large the managed money position had grown in sugar futures, without providing any details, so let me do so now. The price of world sugar (the type traded in futures) has experienced one of its largest rallies in history this year, rising around 10 cents a pound, from under 13 cents to nearly 23 cents recently, a gain of over 75% in six months. On that rally, the managed money traders bought more contracts (250,000) than ever before, in setting new records for gross and net long positions. I admit to not following the actual supply and demand factors in sugar, but neither do the technical funds which don't base trading decisions on fundamentals in the first place.

The price pattern is undeniable. Record managed money short positions equate to severe price lows; record managed money longs equate to significant price rallies. The problem is that this is no way for commodity prices to be determined. On its face, it is artificial and manipulative and it is hard for me to see how legitimate actual commodity market participants will accept this price setting arrangement for long. The exchanges and regulators who refuse to even acknowledge what is clearly borne out by their own data are as corrupt and derelict as any bank opening phony accounts or any drug company unnecessarily jacking up the price of life saving medicines.

This commodity price manipulation by managed money futures traders and their commercial counterparts has flown under the radar for most market observers, but that doesn't make it any less real. There is a practical and effective limit of how far a convoluted and uneconomic set of circumstances can exist. The commodity pricing scam I've described here is something that will be addressed in some manner, particularly as more wake up to it.

In the meantime, the stage is already set for what promises to be one heck of a price resolution in silver, gold and other commodities. Even though we can't know exactly when the resolution of extreme market structures will arrive, we do know they must be resolved at some point. If history and logic are any guide, the managed money technical funds will eventually close out record positions, either long or short. It is only then that we can judge the resolution. Did the technical funds win or lose?

The Deal Book article points to generally subpar managed money performance overall, but it is also possible, especially in silver, for outside forces to intervene and cause the commercials to get overrun to the upside. I don't see those forces presently, but must admit that by the time they are obvious, the impact on prices will have been evident.

We ended a reporting week yesterday that featured price action and changes in total open interest that suggested some further reduction in the total commercial net short position in COMEX gold futures, but not so much in silver. I'd rather not put numbers on the prospective changes for this week's COT report. However, it would appear there was significant managed money buying and commercial selling today, but today's positioning is a matter for the report a week from this Friday.

The Fed interest rate decision, announced just moments ago, did lead to further gains in gold and silver, with gold penetrating its 50 day moving average to the upside, usually an irresistible invitation for managed money technical fund buying. Based upon the prices in place as I send this, gold has added \$4 or so from earlier levels and silver around a dime. Accordingly, I'd put the mark-to-the-market open combined loss of the commercials at \$2.2 billion, up a billion dollars from Friday and with a significant increase in existing positions being added today.

Ted Butler

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Silver – \$19.84 (50 day moving average – \$19.63)

Gold – \$1331 (50 day moving average – \$1333)

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