

September 24, 2016 – Weekly Review

Weekly Review

Erasing four weeks of lower closing prices, gold finished the week higher by \$28 (2.1%), while silver ended higher by 90 cents (4.8%). As a result of silver's relative outperformance, the silver/gold price ratio tightened in by two full points to 68 to 1, still within a broad trading range extending back at least a couple of years.

It would be hard not to assume that the relatively unchanged price ratio between the two metals over such an extended period of time reflected some underlying sound basis. After all, these are important world commodities that span the course of human history and involving billions of people daily – how could two such high profile commodities get severely mispriced? (As I contend).

The answer is simple – the process used to set the price of gold and silver is distorted, as is the case with other important world commodities. The distorted price setting process, of course, is the positioning of futures derivatives contracts on regulated exchanges, including the COMEX for gold and silver. Two main trading adversaries, the managed money technical funds and other speculators called commercials, have come to engage each other on such a massive scale on the world's most important exchange that their private betting game has come to dictate prices to the world's actual commodity producers and consumers.

Later, I hope to show how such trading dominated price this week, not only in gold and silver, but also copper, sugar and crude oil. But here's my point about the silver/gold price ratio being distorted – it can't help being distorted because the absolute price of silver and gold is distorted to begin with. You can't have manipulated absolute prices and free market relative comparisons.

For what it's worth, I don't see gold prices as being necessarily overvalued (or undervalued for that matter), but I do see silver as being undervalued, both relative to gold and relative to its own fundamentals. The principle objective measure of silver being more depressed than gold (or relative to any other commodity) is that silver has the largest concentrated short position in real terms of any commodity. As such, this helps make silver the most compelling investment of all.

The turnover, or physical movement of metal brought into or taken out from the COMEX-approved silver warehouses remained high, as 7.25 million oz were moved this week (380 million oz annualized). Total COMEX inventories rose once again, by 1 million oz, to 170.3 million oz, another one-year high water mark. JPMorgan's COMEX silver warehouse hasn't been particularly active of late, but did add another 180,000 oz this week. In terms of its COMEX silver holdings, JPM would seem to fit the profile of a long term silver investor, not a bad thing based upon the bank's track record.

There's not much to report in the soon to be ended September COMEX gold and silver deliveries. New contracts have been added to both as the delivery month has evolved, but not in numbers large enough to focus on. I don't want to drill down to details that will only confuse you, so let me just leave it at this Â? the main force in gold and silver Â? JPMorgan, has apparently backed off from taking the large quantities of gold it and its customers had taken over the prior months and was the big issuer in September. In silver, JPM has stopped only 364 silver deliveries this month, the least in more than a year and half. I don't think there can be real physical tightness in COMEX gold and silver absent JPM's involvement. Then again, JPM can get involved whenever it chooses, so this isn't the last chapter of the COMEX gold/silver delivery story, just an interlude.

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

The deposits and withdrawals of metal into and out from the big gold ETF, GLD, continue to look as they should, namely, in on apparent net investment buying and out on net investment selling, based upon conventional price and volume considerations. There does seem to be a lag of sorts in the deposits of silver coming into the big silver ETF, SLV, based upon the same criteria, but not to the extent seen in the past. But what strikes me the most is the disparity between the large continued physical movements of silver in the COMEX warehouse system and the delay or lack of movements in SLV. I can't help but conclude that the COMEX silver warehouse turnover has been white hot because that metal involves actual users, while SLV caters to investors. Actual users can't tolerate delivery delays, investors can.

Silver Eagle sales are still down substantially over the past few months to the lowest levels in years and I still can't come up with a better explanation for why away from you-know-who stepping aside. Forget better, I can't come up with any other explanation. That stepping aside by JPM does conform to the bank stepping aside in COMEX deliveries very recently and suggests JPM might have an interest in lower prices ahead. Of course, sales of Silver Eagles have little bearing on silver prices in the short term.

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

The changes in this week's Commitments of Traders (COT) report were largely along expected lines, even though I weenied out in predicting actual numbers. The downward price action during the reporting week suggested commercial buying in gold and not so much in silver, where prices were stable. We got the not so much in silver, even if the managed money selling and commercial buying in gold was a bit larger than I would have guessed if pressed.

In COMEX gold futures, the commercials reduced their total net short position by 20,800 contracts to 290,600 contracts. This the lowest level of net commercial shorts in gold in 14 weeks and the near 40,000 contract reduction over the past two reporting weeks would normally allow for a rally. And that was most likely the explanation for the sharp rally in gold immediately following the Tuesday cutoff, where I would estimate all 40,000 commercial short contracts bought back through Tuesday have now been re-shorted. I'll come back to the changes since Tuesday after covering what transpired in the just completed reporting week.

By commercial category, the big 4 bought back 6400 short contracts, the big 5 thru 8 bought back 1300 short contracts and the raptors bought back 13,100 short gold contracts. Thus concludes two weeks of one for all, all for one commercial collusion (minus, of course, the former big 5 thru 8 gold commercial no longer a musketeer). In terms of concentration, I would point out that the percentage holdings of the four biggest COMEX gold shorts (201,165 contracts) of the total commercial short position (290,600 contracts) grew to more than 69%, the most concentrated in history. (Yeah, of course, it's even worse in silver at 76%).

On the sell side of gold, there was, for the second week running, more managed money selling than there was commercial buying. This week, the managed money technical funds bought nearly 30,000 gold contracts, consisting of 25,512 contracts of long liquidation and 4318 new short contracts. Over the past two reporting weeks, the commercials bought back nearly 40,000 contracts, while the managed money traders sold more than 56,000 net gold contracts.

Among other things, the large two week sale by the managed money traders in gold causes me to recalculate the short term realized profits to the commercial shorts in gold and silver up to \$200 million from a recently revised \$150 million. This is peanuts compared to this week's increase in the commercials unrealized and open loss, but the peanuts do add up over time.

The other thing that comes to mind is that seeing the large number of managed money gold contracts sold through Tuesday may suggest even more would have been sold had prices continued to fall from Tuesday forward, rather than rally sharply as they did. This invites the question of whether the commercials rigged prices higher starting Wednesday in order to reposition the technical funds on the long side or were selling in desperation to contain prices. This is the same main question over much of this year about whether the commercial shorts are in control or are hanging on by their fingernails. If I had the choice, I'd step on the commercials' fingers myself, but it isn't up to me. All I can do is measure the ongoing battle and await the resolution.

In COMEX silver futures, the commercials added to their total net short position by less than 300 contracts, to a new total of 96,900 contracts. This was the smallest weekly change in more than a year and a half and one of the lowest on record and, therefore, meets expectations of not much of a change. The change in commercial categories were also so minor so as skip over. The main takeaway is that the COMEX commercial short position is still super large (bearish) and super concentrated. The big 4 and 8 commercials are still short up the ying-yang and only a few hundred contracts shy of last week's all-time extreme.

In keeping with the small change in commercial positioning, the managed money traders' net change was also in the hundreds of contracts and not worthy of detailed analysis. The big question is what occurred since the Tuesday cutoff, on the sharp rally Wednesday and Thursday. Through yesterday, I would estimate that the commercials added around 40,000 net short contracts in gold and as many as 10,000 net shorts in COMEX silver. This puts us back, effectively, at historic bearish market structure extremes in both COMEX gold and silver. It also raises the consequences of a commercial failure to the red line.

I know I have been preaching from a soap box about the futures market positioning of the technical funds and commercials, not just in gold and silver, but in other markets as well, such as copper, sugar and crude oil. My contention is that the size of the collective positions of the technical funds and the counterparty commercials is so large as to set prices and to exclude actual commodity producers and consumers from the price discovery process.

It has gotten to the point where every large price move in any reporting week in any commodity can only be explained by managed money/commercial positioning changes. This reporting week is no exception. As was the case just explained in COMEX gold and silver, a quick look at the price changes in copper, sugar and crude oil also confirms that managed money positioning changes dictated and determined prices in the reporting week. In every case, the changes in managed money positions were, by far, the largest trader category change. In COMEX copper, net buying of 17,000 contracts by managed money traders accounted for the price jump of 7+ cents (more since the cutoff). In sugar, net managed money buying of more than 15,000 contracts added nearly two cents to the price. In crude oil, managed money net sales of nearly 42,000 contracts more than coincided with a two dollar drop during the reporting week; it caused the drop.

I'm just talking about one week; when you review this on a longer term basis it becomes even clearer, namely, that the managed money technical funds, by virtue of the collective size of their total positions, dictate prices (along with the paper commercials). Over months, the positioning changes amount to many tens of thousands and even hundreds of thousands of net contracts. This means that real producers and consumers can just go suck eggs when it comes to price influence. Let me give you an example of how crazy this is.

In sugar (not a CME group commodity), more than 250,000 net contracts have been purchased by the managed money traders since March, the largest buying by any category. This has resulted in sugar prices rising roughly 10 cents a pound to nearly 23 cents per pound or an increase of around 75%. The world produces and consumes roughly 170 million metric tons of sugar annually and at 15 cents a pound, where sugar was priced at year end, the total annual world production was worth roughly \$55 billion. The 10 cent per pound price increase caused by managed money futures contract buying (should it remain) has increased the total value of the world's sugar crop by more than \$35 billion to \$90 billion.

I don't have any interest or connection to sugar producers and I try to avoid sugar as a consumer where possible. I don't have an axe to grind when it comes to sugar pricing. But it is absolutely and certifiably insane that no more than 100 paper sugar traders can have an impact of \$35 billion to actual producers and consumers which are probably completely unaware of why prices changed so much. I have every intention of making this the big deal I believe it is, but also recognize that the perpetrators of the current distorted commodity price discovery process have a vested interest in seeing things continue just as they are. I'm speaking of the exchanges, the regulators and the managed money and commercial traders involved in this pricing process gone mad.

On to something completely different. Regular readers know I approach silver and gold much differently than most precious metals commentators and analysts, based primarily on my commodity background and experience. I'm more of supply/demand and mechanical process guy than I am someone interested in world financial and political happenings. It's not so much that I am not interested in such things, but rather that I know how little I (or anyone) truly knows about such things. Besides, life is short and I choose not to dwell on the gloom and doom approach to these things, even though I know it's pervasive in precious metals.

In short, I believe silver is an outstanding long term investment on strictly supply/demand considerations and future world trends. I can't guarantee that the world is not about to go up in flames, but I'm not going to succumb to that way of thinking and begin preaching doom. Along those lines, a good friend sent me a video that looks at the future that just about knocked my socks off (thanks Pat). I never thought I would link a video that lasts almost an hour, since I rarely watch them myself, but I suppose there's a first for everything.

<https://www.youtube.com/watch?v=Kxryv2XrnqM>

The video covers a seminar presentation earlier this year in Norway that deals with disruptive transformations. While I try to remain objective, I tend to see a silver connection in most things and this was certainly the case here. The word "silver" wasn't mentioned once, but to me this presentation was on silver. First, the presenter, Tony Seba, gave examples of great disruptions that already occurred, including the demise of film photography to digital imaging. Silver, as you know, was the integral ingredient in photo film and photography was the leading demand for silver for more than 100 years. It is still amazing to me that silver prices soared only after the demand for it in photography had already hit the skids, attesting to the metal's incredibly broad range of industrial applications.

But the seminar looks ahead and what is presented is nothing short of extraordinary in the way it anticipates future changes, primarily in transportation and energy production and mostly concerning things electrical. Since silver is the world's best conductor of electricity, it is hard to see how it wouldn't play a key role in every aspect of what's predicted. I can't say everything presented will turn out as predicted, but I can find no fault in the logic and facts of the argument. If you don't come away more bullish on silver after watching the presentation then I apologize for wasting your time. At the very least, there is a lot of optimism about the future contained herein, if you can stand the change of pace.

Finally, this week's rally put the commercial shorts in COMEX gold and silver deeper under water than last week in terms of unrealized losses and only a bit larger than Wednesday's calculations. All told, I'd put the commercials total open loss at \$2.3 billion, up \$1.1 billion from last Friday. At the same time, the commercials have now added significantly to short positions since Tuesday's cutoff. This puts them in position to profit again should they succeed in turning prices lower and at much greater risk should they fail to do so.

My feeling, for what it is worth, is that the commercials are in control and can still cause the managed money technical funds to buy and sell by rigging prices. My hope is that the commercials will fail (or at least get any downward price rig over quickly). Silver looks better than ever for the long term (as supported in the just listed seminar) but still captive to short term price manipulation.

Ted Butler

September 24, 2016

Silver – \$19.75 (50 day moving average – \$19.60)

Gold – \$1338 (50 day moving average – \$1334)

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