

## September 26, 2015 – Weekly Review

### Weekly Review

For a week that was quite notable for a number of reasons, the week's end wasn't particularly notable price-wise in gold and silver; as gold ended \$8 (0.7%) higher while silver finished 5 cents (0.3%) lower. As a result of gold's outperformance, the silver/gold price ratio widened out a fully point to 76 to 1, close to the most undervalued silver has been relative to gold in seven years, but still within a fairly tight trading range extending back more than a year.

In simple terms, contrary to what a reasonable person would imagine, given all the verifiable facts, silver remains deeply undervalued relative to gold (and just about everything else). The newest verifiable fact is the outbreak of a shortage in retail forms of silver, with no obvious shortage in retail forms of gold. Sure, the retail silver shortage is clearly reflected in premium increases and delivery delays in many items, but there has been no hint that the now months' long retail shortage is reflected in the relative wholesale price of silver and gold. I would ask you to think about that.

As well as anyone, I know there is a difference between retail and wholesale. I know how the price and scarcity of retail forms of silver reflect the shortage, just as much as the lack of premium increases and delivery delays in retail forms of gold indicate no shortage (despite a big buyer taking all the gold coins the US Mint can produce). Still, when I consider how similar silver and gold are in terms of why people invest in each (there are many different reasons), it looks somewhat shocking to me that a retail shortage in either would not be reflected in not just premium levels, but in wholesale relative price levels as well. After all, it is well known that investment demand is the main price driver in both metals and retail investment demand is never the opposite of wholesale investment demand.

As way of example, I would ask you to imagine the opposite of what we have seen recently, namely, a pronounced retail shortage in gold, with attendant delivery delays and historically large premiums, and no shortage in retail forms of silver. If it were retail forms of gold that were unavailable and not retail forms of silver, I would expect the wholesale price of gold to rise relative to silver and not for the wholesale price ratio to remain unchanged or indicating gold as being historically undervalued to silver. Admittedly, I find it hard to imagine a severe shortage developing in retail forms of gold and not in silver, but if it were possible I would expect the wholesale price of gold to rise relative to silver.

So why hasn't the wholesale price of silver strengthened relative to gold, despite the obvious retail shortage? If I think I didn't know the answer, I wouldn't have asked the question. The wholesale price of silver, just like the wholesale price of gold, is the COMEX price; meaning the wholesale price is determined by factors not related to actual supply/demand developments, retail or wholesale. The COMEX price is set by a very small number of traders engaged in a private betting game involving paper futures contracts, sanctioned by regulators whose prime mission is to prevent exactly what is occurring.

I'll get into this more in a moment, but the main responsibility I feel as an analyst is to point out the most important factors influencing silver and gold prices. And I'm pretty sure that is the goal of anyone analyzing and commenting on gold and silver. Some emphasize the threat of a financial system, stock market or dollar collapse; others point to the growing flow of metal from West to East and the low amount of registered metal in COMEX inventories. My own emphasis is the inevitability of a wholesale silver shortage. Regardless of how one might look at what's to come, it's almost mandatory to explain what has already occurred. And if there is a better explanation for why silver and gold prices have behaved as they have over the past decade and longer than COMEX futures positioning, I have yet to find that explanation.

As I have mentioned every week for the past four and a half years, the turnover or physical movement of metal being brought into or taken out from the six COMEX-approved silver warehouses continued this week, as more than 6 million oz were so moved. That's the equivalent of ten full container truckloads of silver being moved this week. And while sometimes a shipment of silver is physically transferred from one COMEX warehouse to another that is not usually the case, as most often there is no simple warehouse transfer involved; the silver comes in from sources outside the COMEX warehouse system and departs the warehouses for parts unknown. Annualized, the movement this week amounts to more than 300 million oz, or more than 35% of world mine production. Total COMEX silver inventories fell by 1.1 million oz to 167.5 million oz.

Once again, there was an increase in the silver inventories in the JPMorgan COMEX warehouse of more than 600,000 oz, which put those inventories beyond the 70 million oz mark, or almost 42% of total COMEX silver inventories. This delivery month JPMorgan has stopped (taken) 356 silver deliveries or nearly a quarter of the 1462 total silver contracts issued. Since March, JPMorgan has taken delivery of more than 3800 COMEX silver contracts or more than 19 million oz in its own name and has moved all of that metal into its own warehouse (in the eligible, or cheaper to hold category).

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Since the JPMorgan COMEX warehouse held no silver four and a half years ago, it is reasonable to assert that JPMorgan has acquired 70 million oz of silver over this time. Throw in the 100 million oz of Silver Eagles I claim JPMorgan bought from the US Mint over that time, as well as the 30 million in Canadian Maple Leafs I allege, and we are half way to the 400 million oz I claim JPM has accumulated without considering conversions from SLV shares to metal and skimming from the COMEX inventory movements which were the bank's prime mechanisms for acquiring metal these past four and a half years.

It's somewhat ironic to me to see such a vigorous debate about the level of registered or eligible gold or silver in the COMEX warehouses (I'm not saying it's unimportant, just not to the level of the intensity of the debate) and to see no mention of what is one of the most extraordinary developments in the 30 years I have studied silver – the physical movement of silver in and out of the COMEX warehouses. And it's not just that someone seemed to flip a switch on and the frantic physical COMEX silver movement started and never stopped; that same someone never flipped on the physical inventory turnover switch in any other commodity. Most amazing of all is that the unprecedented COMEX silver movement, unique to all other commodities, is not only not debated – it's not even mentioned, despite being as visible as a teenage pimple outbreak. Go figure.

There was a last minute purchase of more than 100 new contracts in the expiring September COMEX silver contract the other day that caused a short term tightening in the Sep-Dec spread, but more such buying for delivery is required to impact the flat price. This might be a good time to comment on backwardation or the phenomenon of spot and nearby silver and gold prices becoming more expensive than more deferred futures months.

A true backwardation is one of the most bullish circumstances in a commodity as it indicates a physical shortage and the willingness of market participants to pay more for a commodity in the here and now than at a later delivery time. As such, many bullishly inclined commentators are quick to conclude a backwardation exists when that might not be the case.

The biggest factor in the level of spread differentials or the price between various futures months in –carrying charge– commodities, like gold and silver, is the general level of interest rates. Since full carrying charges are determined by the cost to carry inventory by taking delivery, financing the inventory and redelivering at a later date, the level of interest rates is the most important factor. Since we are, basically, in a near zero interest rate environment, spread differentials are necessarily tight. This gives the appearance that a backwardation may exist or may be developing, but that is rarely the case.

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Therefore, I would define a "true backwardation" by more practical terms. I would say a true backwardation exists when virtually anyone who owns gold or silver in the form of COMEX contract specifications (100 oz in gold or 5000 oz in silver) can easily sell and deliver either metal in a nearby delivery month and simultaneously buy a more deferred month for a cheaper price for a certain profit. In practical terms, a true backwardation would exist if any participant could sell gold and simultaneously buy a slightly more deferred month and lock in a few dollars profit or in silver, a ten to twenty cent per ounce profit. Less than that and it just looks like backwardation due to the tight spreads created by extremely low interest rates.

I did mention that silver spreads tightened dramatically at the beginning of September because the sudden tightness had nothing to do with interest rates but with first delivery day approaching. But true backwardation never developed. Also, I can envision a true backwardation developing quicker in silver, rather than in gold, because there is less silver than gold in the world and silver's industrial kicker; just like it is easier to imagine a silver retail shortage than a retail gold shortage (with no concurrent silver shortage).

There were reductions in the short positions in SLV, the big silver ETF, as well as in GLD, the big gold ETF, for positions as of September 15. The short position in SLV declined by 1.2 million shares, to 11.8 million shares (oz). The short position in GLD declined by 1.3 million shares to less than 12.3 million shares (1.2 million oz). These are among the lowest recent short readings and as such should be considered good news. My only concern is that the two weeks covered in the short report was a time of flat price action; both gold and silver prices rose immediately after the current report's cutoff date and short selling in both ETFs typically increases when that occurs. The only saving grace here may be that trading volume in these two ETFs wasn't especially heavy on the rally (it was in COMEX trading) so there likely wasn't the same need to short shares.

<http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99>

The changes in this week's Commitments of Traders (COT) Report were not what I wanted to see, particularly in silver, but neither were they unexpected. The prior week's report was quite bullish and gold and silver prices rallied sharply in the first three days of this week's report, their strongest rallies in months. That rally penetrated the 50 day moving averages in both gold and silver on high COMEX trading volume. Therefore, it was certain that there would be heavy managed money buying and commercial selling in the new report; the only question being which category of commercials sold "the big shorts or the raptors (the smaller commercials apart from the big 4 and 8).

I was hoping the commercial selling was exclusively the raptors selling long positions and not the big shorts adding short positions – and while the raptors were the main sellers, they weren't the exclusive sellers. On Wednesday I expressed additional hope that the sharp silver selloff on the cutoff date featured big 4 and 8 short covering. Unless there was some misreporting delay in not getting all the data on a timely basis, that hope of mine was dashed as well.

In COMEX gold futures, the total commercial net short position increased by 24,200 contracts to 57,200 contracts. The weekly change barely exceeded the bullish reduction in the headline number of the previous reporting week even though the rally in this week's reporting week was much more dramatic than the prior reporting week's selloff. I had expected a much larger increase in the commercial net short position in gold this week than reported, although I hadn't put out a specific number.

By commercial category, the raptors sold 17,200 long contracts and the big 8 added 7000 new shorts (5700 of which were by the big 4). That mix wasn't terribly at odds with what I was hoping for, but the raptors were far from the exclusive sellers. Under the hood, gold looked even better, as managed money buying was only 12,000 contracts or half of what the commercials sold, including the buyback of 8800 shorts and the purchase of 3200 contracts of new longs.

While there has been additional managed money buying and commercial selling since the cutoff on Tuesday, this week's deterioration was nowhere near what I had expected, particularly on the managed money side. Unless the managed money buying since the cutoff was completely disproportionate with what occurred during the reporting week, gold's market structure may be better than I would have expected at this price juncture.

In COMEX silver futures, the headline commercial net short position increased by a very large 10,000 contracts, to 31,300 contracts. This is the largest (least bullish) headline number since June 9, although it is not large on a long term historical basis. 10,000 contracts are the equivalent of 50 million oz, an extraordinarily large amount of silver to change hands in, essentially, three trading days. For instance, I talked today of 6 million oz being a lot of silver to be physically moved in COMEX inventories this week and made note that JPM added 600,000 oz to its COMEX warehouse total of 70 million oz which took 4.5 years to assemble. I didn't mention it, but the US Mint appears to be struggling to produce 4 million Silver Eagles this month, even though it is running its production flat out. Yet, a handful of commercials sold 50 million oz of silver equivalent this reporting week on a one dollar rally. Isn't it obvious that COMEX positioning (and no, I don't mean trading volume, I mean positioning) towers in size over real world amounts? How could that not be the main force on price?

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By commercial category, it was mostly the raptors doing the selling, in that they liquidated 8400 long contracts. But the four largest shorts added 2900 new short contracts, much more than I hoped for (the big 5 thru 8 bought back 1300 short contracts and that had to be managed money related).

Under the hood and very much unlike what occurred in gold, the managed money traders bought much more than the commercials sold, by buying nearly 12,700 contracts, including the buyback and covering of nearly 11,600 shorts. The managed money traders bought 63.5 million oz of silver equivalent this reporting week and all we got to show for it was a fleeting (so far) one dollar rally. Where the heck did I get off in calling managed money short covering as rocket fuel to the upside? Nearly 60 million oz of short covering in one reporting week and that buying barely lifted silver prices by a dollar. Some rocket fuel.

The truth is that managed money short covering was every bit the rocket buying fuel I purported it to be, as every contract bought by these technical funds was purchased "at the market" and on successively higher prices. This was and is my definition of rocket buying fuel "at the market" buy orders as prices move higher. Why silver prices only advanced by a dollar (and \$35 or so in gold) was not that the managed money technical fund buying was any less urgent than expected; it was strictly a case of the commercial selling being much more aggressive and that was what blunted and capped the rally. This is hardly new and I have always identified it as the key variable even in knowing it must end someday. Also as is always the case, knowing which day it will end is impossible in advance.

More than anything, the aggressive commercial selling is the epitome of manipulation, as no one ever sells anything for less than could be attained in the face of rocket fuel buying "unless there's a hidden motive. It still grates on me to hear the manipulation deniers drone on about not hearing about allegations of manipulation when prices have moved higher. Not only is that not true, it's proven to be not true by government data. Commercial selling to cap the price is as manipulative as it gets.

While I am disappointed with the increase in big 4 additional short selling in silver, even assuming JPMorgan is a big part of it isn't necessarily the end of the world (or the end of the silver rally). I should know more when the next Bank Participation Report is released in two weeks, but even if it is the crooked hand of JPMorgan serving as the short seller of last resort in capping silver prices, circumstances have changed mightily over the past four years.

There is less doubt about JPMorgan acquiring physical silver as it has turned into the biggest stopper this year of silver deliveries on the COMEX in its own name and it is clear the bank has moved that silver into its own warehouse. Since this year's deliveries and subsequent movement have occurred well after I made my case that the bank was buying silver by the truckloads, my allegations seem more credible. As such, if JPMorgan now owns as much silver as I contend, unless its COMEX silver short position expands by multiples of what it stands at now (75 to 100 million oz), a silver price explosion forthwith wouldn't hurt the bank in the least. Knowing how conniving and duplicitous JPM can be, holding a large short position in COMEX futures contracts while holding a much larger physical position still leaves the bank net long in a big way. There is virtually no way the regulators can monitor JPMorgan's long physical silver position and if silver prices explode, JPM can point to its short position as losing big, but not have to acknowledge what it is making on its physical position.

Ted Butler

September 26, 2015

Silver \$15.10 (50 day moving average – \$14.81)

Gold – \$1146 (50 day moving average – \$1116)

**Date Created**

2015/09/26