

Weekly Review

The pattern of heavy trading volume and large price moves on Friday continued this week, as yesterday's rally brought a weekly gain of \$4 (0.3%) in gold and a sharper 80 cent (4.3%) gain in silver. I know the rally was attributed to the monthly employment report and I can see with my own eyes the direct connection as far as the timing of the report and price movement. But I must tell you that I continue to fail to see any real analytical connection between this general economic report – or any other reports – and gold or silver price movement. And until I see some real connection, it seems the reports (or Fed statements) are just a good cover story for setting off a computer generated HFT price jolt, up or down.

As a result of silver's outperformance this week, the silver/gold price ratio tightened in by a hefty 3 full points to just over 68 to 1. In keeping with the theme of price change yesterday, I don't think the sharp tightening in the silver/gold spread had anything to do with investors switching physical gold into silver or anything like that. Instead, the silver/gold price ratio tightened because the same computer trading that caused the rally yesterday also caused the ratio to change, nothing more, nothing less. Not only is this how prices get set, but get set artificially. And while I still profess ignorance as to short term price

changes, for a longer time I believe we will look back and marvel at how cheap silver got to gold because of the artificial pricing process.

The turnover or physical movement of metal brought into and taken out from the COMEX-approved silver warehouses surged this week to more than 8.2 million oz, as total inventories rose 1.4 million oz to 162.2 million oz. This is the largest level of COMEX silver inventories since last October and is up around 10 million oz over the past 4 weeks. Over that same 4 weeks, total COMEX inventory turnover came to nearly 26 million oz, so I am still focused on the turnover more than the total levels. Interestingly, the silver kingpin, JPMorgan, hasn't had much input into the past month's COMEX silver warehouse activities, at least as far as its own warehouse.

In terms of the continuing September COMEX gold and silver delivery process, there's not much new to report in gold, since there are only around 500 contracts still remaining open. The big story in the September gold delivery is still the large number of gold contracts (1773) issued by JPMorgan and stopped by Bank of Nova Scotia on the first notice day, in their respective proprietary trading accounts. This making of delivery in gold by JPM was very much a change in pattern from the large and consistent taking of gold deliveries by JPMorgan and its client(s) over prior months.

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

Also, the stage seemed to be set for some type of delivery showdown in the September gold contract about a month ago when open interest surged to more than 10,500 contracts in the traditionally sleepy delivery month. I'm still leaning to the conclusion that things were getting too hot or tight in physical gold and JPM changed tactics to cool things off.

There are a little less than 2000 contracts still open in the September COMEX silver contract, or close to 10 million oz. JPMorgan has stopped 141 of the 978 total silver deliveries issued so far, well off its pace of the past year and a half, but not to the point of issuing silver deliveries as was the case in gold. A lot can happen over the remaining course of the delivery process, but after the first few days, I'm also left with the impression (as I am in gold) that JPM isn't looking to enflame COMEX silver delivery tightness. (But these guys stopped telling me their intentions long ago and, in fact, never started).

The past month has seen about one million ounces of gold being withdrawn

from the big gold ETF, GLD, following an addition of nearly 11 million ounces before then on the big gold rally. In an increasingly abnormal world, the previous gold deposits and more recent withdrawals seemed normal and in synch with price and volume action. Not so in silver, where deposits of 10 million oz have been made in the big silver ETF, SLV, in the past month or less on what has been the same basic choppy price action as has been seen in gold. Thus, the silver deposits are more puzzling and the best explanation I can come up with is either the deposits were made to reduce the short position in SLV or stealth-like accumulation by a large investor or some combination of each. On the continuous scoreboard where bullish or bearish factors are listed, these SLV deposits seem decidedly bullish.

Sales of Silver Eagles from the US Mint can't possibly be considered bullish, other than confirming that JPMorgan was the big former buyer over the past five years before stepping aside the past few months. Sales in August were at the lowest level in years and if that is not explained by JPM stepping aside, I can't fathom a plausible alternative explanation. Longer term, little can change the starkly bullish conclusion that comes from JPMorgan accumulating 500 million ounces of actual silver over the past five years, other than its ultimate sale at sharply higher prices. That's the way these boyz roll.

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

On to the changes in this week's Commitments of Traders (COT) Report. Aside from expecting reductions in managed money long and commercial short positions in both gold and silver, I must confess to a much higher degree of uncertainty for this particular report than I indicated previously. Ironically, I am more uncertain after the report than before it was released. We did trade below the key 50 day moving average in both gold and silver every day of the reporting week, but we also experienced a high volume rally on the Friday (August 26) of the reporting week which accounted for any anxiety I had. Let me run through the report and then come back to my concerns.

In COMEX gold futures, the commercials did reduce their total net short position by 16,300 contracts to 301,200 contracts. This was close to the overall drop in total open interest over the reporting week that I mentioned on Wednesday, so gold came in close to my expectations, despite my hidden concerns. By commercial category, all three categories bought back short positions. The big 4 bought back 9300 shorts, the big 5 thru 8 bought back 5700 shorts and the raptors bought back 1300 shorts.

On the sell side in gold, the managed money traders sold more than 22,000

gold contracts, much more than the commercials bought, including the long liquidation of 17,870 contracts and new short selling of 4220 contracts.

While this was the largest weekly reduction in the gold commercial headline number in 14 weeks (since May 24), it is important to recognize that any reading around 300,000 contracts net short is historically extreme and typically bearish. That's where we've been for more than two months. Therefore, it's closer to the truth to say we been in a broad trading range in price and in a market structure historically extreme over that time in both gold and silver.

And while the concentrated short position of the 4 largest gold traders is down this week, even more astounding is that the big 5 thru 8 position is also down big again. From July 12, the net short position of the big 5 thru 8 is down from over 100,000 contracts to under 65,000 contracts this week. Against that record drop, the big 4 in gold have increased their net short position by 14,000 contracts, a necessary consequence of preventing a gold price explosion. Not only does this reconfirm the failure of a big 5 thru 8 gold trader, it represents a remarkable level of concentration on the short side of COMEX gold, despite this week's reduction in big 4 shorting.

Here we have the total commercial gold net short position at a historically extreme 300,000 contracts, with more than 202,000 of those contracts held short by only 4 traders. The math should jump out at you – two-thirds of the historically extreme COMEX commercial net short position in gold is held by only four traders. The COMEX is the world's largest gold exchange and as such would be thought to be comprised of many thousands of participants. How is it possible that only 4 traders can hold two-thirds of the entire commercial net short position? Is there no level of market concentration that is too much for the regulators, short of one trader holding 100% of one side of a market?

By the way, the concentrated short position of the four largest traders in COMEX silver is even more extreme than in gold – 72.6% of the total commercial net short position is by 4 traders versus 67.3% in gold.

In COMEX silver futures, the commercials reduced their total net short position by a very skimpy 2400 contracts to 95,700 contracts. If there was any surprise in this week's report it was in small reduction in the headline number, as I'll explain in a moment. By commercial category, the big 4 bought back 600 shorts, the big 5 thru 8 covered 400 shorts, and the raptors added 1400 new longs. I'd still peg JPMorgan as holding around 33,000 net short contracts and next week's release of the monthly Bank Participation Report will, undoubtedly,

help clarify matters.

Although the concentrated short position of the 4 and 8 largest silver traders are slightly less this week than last in terms of numbers of contracts, that was mostly due to the large drop (nearly 17,000 contracts) in total open interest. In terms of the percentage of the market held by each group, which is how the CFTC reports the data, this week set new records. The 4 largest traders held 36.7% of total open interest and the 8 largest traders held 53.8% (and even more if spreads are subtracted, as they should be). As I've said continuously, the CFTC is fine about publishing such data, but out to lunch when it comes time to considering what the data mean.

On the sell side in silver, the managed money traders sold only 3836 long contracts and added a scant 53 new shorts. I say "only" because we did trade below the 50 day moving average every day of the reporting week for the first time in months and I was half-expecting an orgy of managed money selling given those parameters. And therein lies my uncertainty and anxiety "there "should" have been a lot more managed money selling in both silver and gold.

The last time gold penetrated its 50 day moving average to the downside was back in May, when gold prices fell around \$100 from the \$1300 interim top on roughly 80,000 net contracts of commercial short covering. From there gold shot up more than \$170 and the commercials added 125,000 new shorts. This time, the 50 day moving average was decisively penetrated on a price fall from the top of around \$70, but only 40,000 commercial shorts have been bought back, half the level in May.

It's mostly the same story in silver □ on the \$2 price drop in May from the then \$18 top, some 20,000 net commercial contracts were bought back. From there, silver prices rose more than \$4 as the commercial sold more than 38,000 additional net contracts. This time, on the \$2 drop in silver prices from \$20.50 last month, only 14,000 contracts have been bought by the commercials.

Since we started from much higher price levels in the gold and silver price decline this time around and particularly since we started from a much higher level of total commercial net shorts in each this time, I would have thought a penetration of the 50 day moving average in each would result in much more managed money selling and commercial buying than previously. Instead, we got the opposite □ much less commercial buying this time. What gives □ especially after Friday's rally?

In essence, this is a new twist on top of the extreme level of the commercial short position. This makes the ultimate resolution much more critical. Best as I can tell, it boils down to one of two outcomes. Either the managed money traders won't liquidate on lower prices this time around, leaving the commercials up the creek without a paddle; or the commercials will still be able to induce managed money selling at prices lower than we've seen to date. In any event, the new twist of the lack of managed money selling where they have always sold before only sharpens the whole matter of resolution which I've highlighted for months.

In many ways, it's much easier for me to become resolutely bullish when the managed money technical funds are extremely short and the commercials least short, as was the case at yearend, or back last September or the countless times before that when the market structure was bullish. Sure, those times are characterized by desultory price action and poor collective sentiment, but it's easy for me to confidently expect higher prices in time. Having seen how those low price and bullish market structures typically get resolved, quite frankly, I have always been grateful for such setups. And just as often, when the market structure got bearish, sooner or later it was eventually resolved to the downside. I can't feel grateful at this point because this is not a time of a bullish market structure.

But if the gold and silver managed money traders don't liquidate on lower prices, the usual COT game is over, or at least radically changed. The lack of substantial managed money selling to this point raises that possibility. I guess the possibility always existed that the commercials could get overrun and that someday the COT report would matter less, if at all to price movement. I'm not saying a commercial overrun to the upside lies ahead, but the lack of managed money selling to this point has me scratching my head.

In fact, that's mostly what I think about, namely, are the commercials still in control? By virtue of its massive physical long position in silver (and perhaps to a lesser extent in gold), JPMorgan is immunized against financial disaster, but the same can't be said of the other big commercials. (Just ask the big gold short that bit the dust). On the other hand, a commercial failure in gold and/or silver would be an event of epic proportions and, by definition, suggests it will be avoided.

Looking at other markets, the level of managed money participation has grown enormously (How Prices Get Set), yet the commercials seem firmly in control of getting the managed money traders to do the commercials' bidding. In copper,

crude oil, the grains and other markets, the managed money traders have and are operating as the commercials command and I have detected no signs of the managed money traders varying from their usual technical script. And I can't see why the managed money traders may have broken ranks with their prior behavior only in gold and silver, but that's what the COT data suggests.

So call me undecided. The level of commercial shorts in gold and silver point to an eventual selloff, just as has been the case for months, but if the recent reluctance of the managed money traders to sell on lower prices prevails, then why would we selloff? If there's something going on behind the scenes that pertains only to gold and silver, then it remains behind the scenes to me. Most likely, we may be experiencing a delay in eventual managed money selling to come, but hey ☐ you never know. I may not know for sure how this is going to get resolved, but I do think I know this resolution is what matters most to the price of gold and silver.

As far as the running money scorecard, this week's gain in gold and especially silver set the commercials back around \$400 million in total combined and collective unrealized losses, bringing to \$2.1 billion my back of the envelope total open loss calculation.

Ted Butler

September 3, 2016

Silver - \$19.45 (50 day moving average - \$19.60)

Gold - \$1325 (50 day moving average - \$1336)