Uncertainty in the Gold and Silver Markets: Low Prices Will Cure Low Prices?

By Bill Holter
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It looks as if another COMEX expiration has come and gone without any "fireworks". I must say, I in no way expected what has occurred, the longs evaporated unlike any time past AND with the knowledge that physical supplies are very tight. Were this any other market, a short squeeze for the ages would have been forced. With less than one week to go, silver had almost 300 million ounces contracted for and gold 16 million. These bled down to almost 20 million silver ounces and just over 1.1 million gold ounces as of Friday. Silver is in the clear so to speak because COMEX claims 65 million ounces in available inventory. Friday's action saw another bleed as gold also looks to be coming in under the existing inventory with only 500,000+ ounces standing versus 870,000 inventory ounces held.

We have seen this happen many times before where the open interest bled down heavily going into first notice day, but never anything like this. The open interest for both December contracts was staggering with just one week to go… but then just evaporated. What happened was VERY odd because in past expirations, though total open would shrink slightly, much of it would be rolled into the next active contract. This has not happened and makes very little sense because there is almost zero cost (premium) to move out to the next contract? This expiration saw THE biggest build in open interest, followed by THE biggest evaporation ever. With virtually no contango cost whatsoever, the lack of "roll" is astonishing. Were these longs bullish going into the last week of trading… and collectively changed their minds? While I thought I was "on to something" with the outsized OI, apparently I was on "to nothing"? Some will say I cried wolf, something VERY different has happened even though we ended with the same result. Arriving at this "same result" was unlike any expiration week I know of.

I think the best question is "what" exactly were they trading? Were they really trading gold and silver? I think it is quite clear with gold for example, no, these trades were and are nothing but trading pieces of paper back and forth. COMEX claimed to have 870,000 ounces of deliverable gold yet contracts outstanding for over 15 million ounces with only 5 days left. Who in their right mind would buy a contract which promises delivery of an asset where even the exchange itself admits to not have enough of what is contracted for to go around? By the way, Friday saw another 40 ton sale which broke the "price" by $20. Over the last month, we have seen three separate 40, 80, and another 40 ton operation performed all within 15 minute windows. Who would ever sell in this fashion if they wanted to sell at the best price possible? Why not sell all of this "gold" spread out through the day and not damage the price (and psychology)? The answer of course is obvious for anyone willing to see, the sales had a purpose of "setting" a price, a LOWER price.

Switching gears to the real world, gold and silver are both in very tight supply. Gold forward rates in London went more negative on Friday (and again even further today) than ever before with the exception of 1999 when the Washington agreement was announced .

For GOFO to go this far negative suggests a very severe shortage on the institutional and central bank level. It is very important to understand what this will most likely morph into… a short squeeze or some sort of buying panic for real and tangible metal. Unlike the COMEX which can “instantly create supply”, this cannot be done in the real world. For example, the 40 tons which was sold on a shortened and sparsely traded Friday will take one full week for the entire world to produce! I view this disconnect of “price versus supply” as one that will, must, be rectified. I will speak to this “rectification” shortly. First, lets look further into the “real” world supply situation.

As of this past week, Silver Eagle and Maple sales are on track to at least meet last year’s record sales

and are now running FIVE times higher than in 2007 (before the financial crisis began)! We also know GOFO rates are the most negative with the exception of one time in history. The silver inventory in Shanghai plunged again this past week and is now again under 100 tons. For perspective, this inventory was over 1,100 tons just over a year ago and has been bled by over 90%. In just 2 days last week, 21% of the inventory was withdrawn …and what’s left is now “worth” under $50 million (with a lower case “m”). Silver contracts in Shanghai are also in backwardation, another perfect example of short supply. Refiners in Switzerland are running flat out 24/7 due to Asian and Middle Eastern demand and to top things off, India just eased restrictions on gold imports. When added together, China, Russia and India are taking nearly 150% of global gold production via physical purchases. To put it in further perspective, China has the financial ability to purchase ALL central bank gold reserves at current “prices” THREE TIMES OVER!

So, what is my point? Something very drastic has to and will happen. One market or the other is very wrong. Either the paper price is wrong …or, the physical market is wrongly displaying all the signs of a supply shortage. Can you figure out which one is wrong? Is it the market where “gold” can be created at will or the one where it is actually dug up out the ground? I will say this in my opinion, I cannot understand who in their right mind would trade a COMEX gold or silver contract? Would you gamble in a casino where you knew the games were rigged …and not in your favor? What is the purpose of trading pieces of paper that the exchange itself admits they don’t have enough metal for everyone? Will these contracts save your bacon through a financial implosion? During a dollar or currency crisis (which is exactly why gold is purchased to begin with), will capital fiercely try to enter COMEX contracts or the real metal.

Further, assuming you do “win” on your gold contracts (a poor assumption) and the inventory is overwhelmed (a good assumption), COMEX has already told you they will “cash settle”. So you “make” $1 billion dollars, you get the check, it clears, your bank stays open (lucky for you) and does not bail in your “winnings”. If physical gold has become hoarded and gone into hiding because of a currency crisis, you will be “given …more” of what the problem was in the first place. What exactly did you win? More currency of a bankrupt issuer? In the extreme, ask any Zimbabwean if they would have given up even 1/2 roll of toilet paper for $1 billion Zimdollars? The answer of course is “no”, being a “Zimbabwe billionaire” may not even entitle one to a dinner of beanie weenies!

The disconnect between “price and supply” is exactly what an Austrian economist would predict. If you price filet mignon below that of chicken, the supply of filet mignon will eventually disappear. This is what we are seeing with gold and silver. “Price” does not matter if you cannot get any product just as supply does not matter if the price is too high. Too high prices will eventually bring out more supply just as low prices will cure low prices. Low price has already, and will create excess demand and also cause a shrinking supply since mines cannot make money producing at these levels. While COMEX can and has created the price, they cannot create the supply necessary to satisfy the greater demand. COMEX, by forcing the price too low have set in place the fundamentals for a “re pricing” in explosive fashion.

When it comes to gold, we are at the point now where even central banks are displaying a lack of trust in each other. I plan to discuss this along with “deflation” and what the collapsed price of oil might mean. The Saudis are creating a low price of oil by producing more supply than a weak global economy currently needs. This current low price will cure itself by blowing up the U.S. shale industry…and thus lowering supply coming to market.

To finish, the Swiss had their chance to leave the rigged casino. They voted “no” and will instead stay to play the tables until the whole casino burns down. Shame on them! Friday’s action saw a $25 drop in gold and was followed by another $15 Sunday night/Monday morning. Gold has recovered ALL but $5 of both day’s carnage by early this morning. If gold were to close above $1,190 (+$5 from here) it will be a sign of strength. Were gold to close today over $1,200, it would negate ALL of the Friday/Sunday trading and create a very odd looking outside day (remember, the two previous Fridays were outside days also). Were gold to close over $1,200 today, it would then have absorbed the outlandish (fraudulent) 40 tons sold on Friday to crush the price. Action like this would be a sign physical supply and demand are finally overwhelming the price “fixing” mechanism! Please remember this, “price” ALWAYS affects both supply AND demand, you are seeing this in real time!

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Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in

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