Market Force Analysis™

COMEX INVENTORY DATA REVEAL AN ALARMING TREND

By Adrian Douglas

For more than 6 months I have been gathering data released daily by the COMEX concerning delivery notices and inventory levels of gold and silver. This data must be captured and recorded each day as there is no database of historical data available to the general public.

Studying data on a daily basis is not conducive to seeing the big picture so I have just completed a study of what can be discerned by looking at the entire 6 months of data. The results are very revealing.

First of all for those who are not familiar with the delivery process of the COMEX I will summarize some key information.

Only a small fraction of the contracts, less than 1%, that are bought or sold on COMEX ever go into the delivery process. The contracts are typically terminated by rolling them to a future month or by closing out the position (either selling a long contract or covering a short contract).

If a long contract is held into the delivery month then the contract holder is said to be “standing for delivery”. The holders of the short interest are then obliged to issue delivery notices to the longs between the first notice day and the last notice day. Anyone receiving such notice must pay in full for the contract. The long will then receive a numbered warehouse delivery receipt via the clearing house. The rules of the COMEX are that the shorts must honor the warehouse delivery receipts by delivering bullion that is in a form that meets the contract specifications and that the delivery must take place through a COMEX licensed warehouse facility. There is a possibility that the long could re-tender his warehouse receipt for cash settlement. Removal or deposit of metal into or out of the warehouse may occur days or weeks after the issuance of the delivery notice. So while day to day reconciliation of delivery notices and metal inventory movements is impossible over a long period of time reconciliation should be meaningful, provided that cash settlement is not very common.

The inventory held in the COMEX warehouses is split into two categories which are “registered” and “eligible”. The registered category is metal that is available to be delivered against warehouse receipts. This is essentially inventory belonging to the commercial dealers. There are many traders on the COMEX who sell gold or silver short but much of this is for speculative or hedging purposes; they are not doing it because they have gold or silver to sell. However, there are investors who buy long contracts and want to take delivery. It is, therefore, the commercial dealers, the bullion banks, who provide delivery against such long contracts.
The “eligible” category is inventory that is not available for delivery against futures contracts. It is being stored in the COMEX warehouses by its owners. Although some of this inventory may belong to the dealers for simplicity I refer to it as “customer inventory”.

	Silver		**Gold**	
	Registered (Dealers) Mozs	Eligible (Customer) Mozs	Registered (Dealers) Mozs	Eligible (Customer) Mozs
Inventory 8/6/2009	62.50	55.20	2.81	6.33
Inventory 2/12/2010	47.40	61.80	1.64	8.26
Cumulative deposits	1.15	29.20	0.88	2.36
Cumulative Withdrawals	16.30	22.60	2.04	0.43
Net movement	-15.15	6.60	-1.16	1.93
Monthly drawdown rate	-2.53		-0.19	
Months to zero inventory	18.8		8.5	
Delivery Notices Issued in period 8/09-2/10	33.5		2.8	

Table 1: SUMMARY OF COMEX WAREHOUSE ACTIVITY

Table 1 summarizes the data collected from August 6, 2009 to February 12, 2010.

What is immediately clear is that the cumulative withdrawals from the “registered” category (the dealers) are inferior to the amount of silver and gold obligations implied by the delivery notices.

In silver the equivalent of 33.5 Mozs of delivery notices were issued yet only 16.3 Mozs (49%) of silver bullion left the registered inventory over the same period. In gold, 2.8 Mozs of delivery notices were issued and only 2.04 Mozs (73%) of gold left the registered inventory. What happened to the difference? There are a few possibilities

1) the delivery receipts were re-tendered for cash

2) the deliveries have not been made yet
3) metal was leased from the customers (eligible inventory) and so the difference, therefore, appears included in the total withdrawals from the customer inventory
4) there were large deliveries between dealers not requiring any movement of metal in the registered category

Of these possibilities (4) seems the least likely. Why would a dealer stand for delivery only to leave the metal on the exchange?

Option (3) is a distinct possibility because the cumulative withdrawals from both eligible and registered categories in silver are 38.9 Mozs and in gold 2.47 Mozs which are very comparable to the delivery notice totals of 33.5 Mozs and 2.8 Mozs for silver and gold respectively. If the dealers are leasing metal to meet delivery this would be extremely bullish.

Options (1) and (2) are also possibilities.

So the conclusion that can be drawn from this data is that the metal being delivered from the registered category is not on its own high enough by a substantial margin to meet the obligations represented by the delivery notices. It is not, however, possible to say where the balance has come from.

But what is more important is that the data reveals a very shocking trend. That is that the registered (dealer) inventory is being drawn down at a phenomenal rate. In silver the inventory has dropped by 24% in 6 months while in gold it has dropped an eye-popping 41% in 6 months! The withdrawal to deposit ratio for registered silver is 14:1 and in gold it is 5:1. If this rate of drawdown continues the registered inventory of silver will be exhausted in 18.8 months and in just 8.5 months for gold!

This inventory drawdown is very revealing. Over the same period the open interest in gold increased 15% while in silver it increased 19%. By way of an analogy one would not expect a company with increasing orders to decrease its stock levels! Why would the inventory not be replenished when Open Interest is increasing? The most likely reason is a growing shortage of bullion.

This rapidly shrinking inventory is coherent with other indications of a growing shortage of precious metals. During the last two years the US mint has periodically suspended production of gold and silver eagles due to shortages of bullion, the COMEX futures have displayed contracting contango and/or mild backwardation, which is indicative of physical market stress. There is anecdotal evidence of the LBMA OTC market in London having difficulties in making deliveries and requiring central bank gold to do so. There are also rumors of large premiums being offered for cash settlement in lieu of the bullion. Sources active in the London market tell us it is difficult to find bullion in size. The Central

Banks have stopped selling and have become net buyers of gold. Furthermore, the politically connected Barrick Gold announced a panicked buying back of its hedges at the end of last year.

Investors should make sure they own physical bullion and not a paper substitute. When the music stops, and it looks like it could be soon, paper promises will not be honored with bullion. When a shortage becomes obvious to investors the price of bullion will be multiples of its current price. But those holding paper promises will not benefit. At best they will be paid in fiat currency and probably after months or years of legal wrangles, and most likely at the price on the day of default, not at the price on the day of settlement. Why accept anything but physical bullion?

I have previously written articles discussing how much "paper gold" has been sold, principally through the unallocated accounts of the LBMA although there are other vehicles that achieve the same end such as pool accounts, unbacked ETF's, futures, and derivatives etc.

http://www.gata.org/node/7911

http://www.gata.org/node/7908

I estimate that as much as 50,000 tonnes of gold has been sold that does not exist. That is equivalent to all the gold reserves in the world that are yet to be mined, or put another way, 25 years of gold production. That is the grand-daddy of all short positions! As physical market shortages lead inevitably to exposing this scandal there will be the grand-daddy of all short squeezes and the grand-daddy of a bull market in precious metals….but only in REAL physical precious metals and quality mining equities, not paper promises for physical metals. It would be a tragedy for an investor to have correctly identified the huge investment potential to wind up with nothing. It would be like winning the lottery to find that someone sold you a counterfeit lottery ticket!

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February 25, 2010

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