

Buying Opportunity as Gold and Silver Shorts Reach Record Levels

Authored by Shree Kargutkar, Portfolio Manager, Sprott Asset Management LP

The Turkish lira has seen its value drop an astonishing 40% since the beginning of the year. The Argentine peso, the Brazilian real and the Russian ruble are the other victims of the emerging markets thrashing that continues to unfold.

As investors have fled the emerging markets and sought the safety of the U.S. dollar and U.S. equities, they have continued to increase their short positions in commodities. Most surprisingly, and **counterintuitively, bets against precious metals (gold, silver and platinum) have reached record levels.**

Yuan-Gold Link?

The People's Bank of China (PBOC) has kept a close eye on the emerging markets currency carnage. After seeing it's yuan decline by more than 8% since April 2018, the PBOC reacted by imposing a stiff 20% reserve requirement on forward currency contracts. With the PBOC making it more difficult to short the yuan, and with the inverse correlation between gold and the yuan sitting at a five-year high, **we wonder if traders are using gold as a proxy for shorting the yuan?** Other astute investment managers have suggested this dynamic as well.

Figure 1: Correlation Between Chinese Yuan and Gold at Five-Year High (2013-2018)



Source: Bloomberg. XAU, the ISO 4217 standard code for one troy ounce of gold, versus Chinese Yuan (CNY), as of August 20, 2018.

YTD Gold Shorts Up 275%, Silver Shorts Up 84%

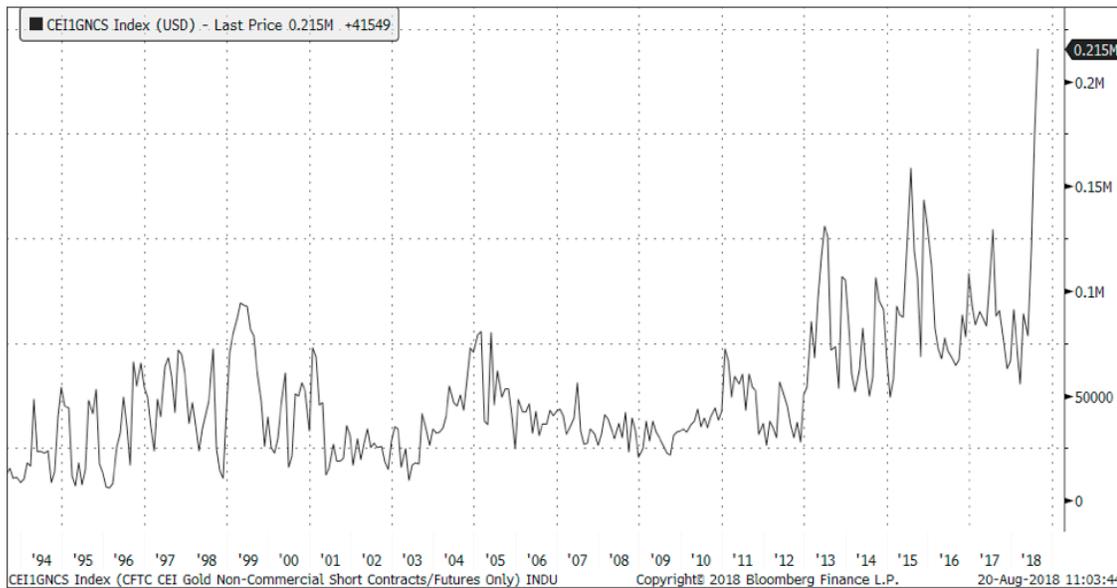
Net speculative positioning in gold has declined significantly, currently at a 15-year low. Net positioning in silver has recovered slightly from a 10-year low set in April 2018. With investor's sentiment at depressed levels, the short positioning in both silver and gold is catching our eye.

Sprott Gold Report

August 21, 2018

Short positions in gold are up 275% year to date. Investors are now short just over 215k contracts of gold or nearly 21.5 million ounces of gold. Short positions in gold have overwhelmed longs, whereby the net positioning in gold is now -3,688 contracts. The last time we saw a number this low and this negative was in 2001 when gold traded below \$300/oz.

Figure 2: Speculative Gold Futures Shorts on CFTC Have Reached All-Time Highs (2008-2018)



Source: Bloomberg. CFTC CEI Gold Non-Commercial Short Contracts/Futures Only as of August 20, 2018.

We have seen gold do well following previous spikes in short interest. With more than US\$25 billion of gold being shorted, any meaningful short covering should produce a significant price appreciation in gold.

Figure 3: The Current Opportunity: Inverse Relationship between Spot Gold and Gold Futures Shorts (2013-2018)



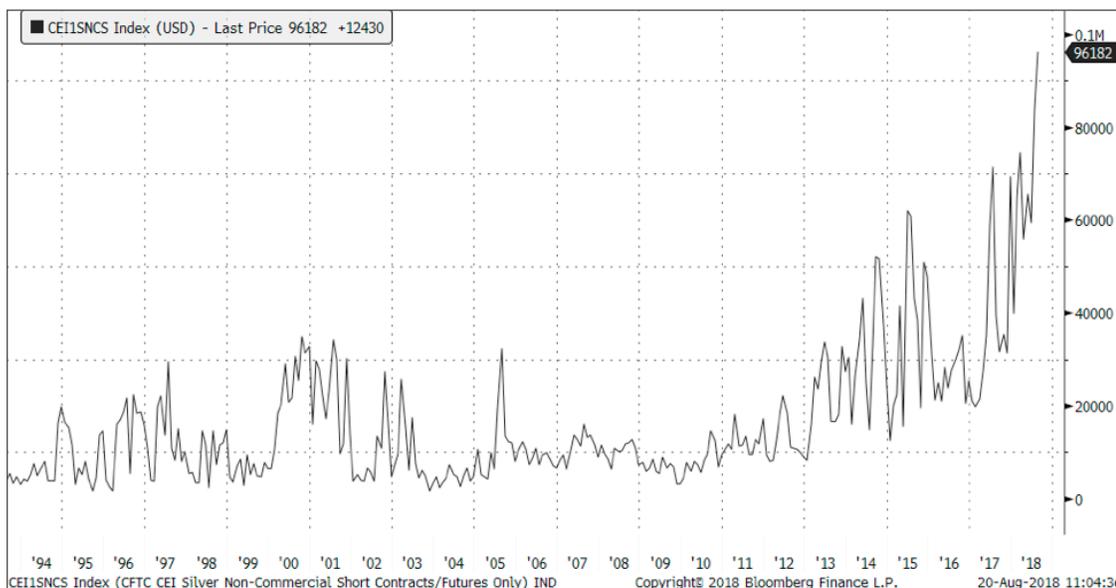
Source: Bloomberg. XAU, the ISO 4217 standard code for one troy ounce of gold, versus the CFTC CEI Gold Non-Commercial Short Contracts/Futures Only as of August 20, 2018.

Silver Futures Shorts: A Dangerous Game?

Interestingly, silver shorts, are also at a record high at the time of this writing, up nearly 84% year to date. The latest data indicates that investors are short over 96,000 contracts of silver, representing almost 480 million ounces. This number is astounding to us for many reasons. With 852 million ounces of silver mined in 2017, 480 million ounces represent over 56% of 2017 annual silver production. Out of 852 million ounces, 209 million ounces ended up in silver jewelry and 657 million ounces were used in industrial fabrication including silverware. The two uses of silver alone represent 866 million ounces, according to The Silver Institute: World Silver Survey 2018 and are larger than the annual mined supply. The gap in supply and demand is met by silver scrap.

Suffice it to say that **silver supply is tight**. There are no mines scheduled to come on in the next year or two which would increase annual silver output by anything close to 450 million ounces. Unless an asteroid carrying half a billion ounces of silver lands on earth, we believe the shorts are playing a dangerous game with little to gain.

Figure 4: Silver Futures Shorts at All-Time Highs (2008-2018)



Source: Bloomberg. CFTC CEI Silver Non-Commercial Short Contracts/Futures Only as of August 20, 2018.

An Extraordinary Opportunity for Contrarians

The bonfire of currencies has succeeded in distracting investors away from more important topics that underpin our bullish thesis on gold, namely, the escalating global trade war, rising geopolitical tensions and spiraling debt and budget deficits in the United States. Bearish sentiment towards the precious metals has reached its climactic phase. **If past is prologue, the current shorting frenzy in gold and silver futures will likely be followed by an intense short-covering rally.**

Shree Kargutkar is a Portfolio Manager at Sprott Asset Management LP, which is the sub-advisor for Sprott Gold and Precious Minerals Fund and Sprott Silver Equities Class.

Sprott Gold Report

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