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PM SECTOR update - IT'S BAD NEWS AGAIN FOR BULLS...

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Silver showed surprising resilience in the face of a sharp dollar rally late last week, but any comfort that silver bulls may have drawn from this is believed to be misplaced, because its latest COTs showed marked deterioration to readings that are considered to be strongly bearish over a short to medium-term timeframe.

We'll start by looking at silver's short-term 3-month chart, on which we can see that it has been in fairly tight range for most of this month, after a sharp runup in the early days of the month. This range has been described by some as a "bull Flag", but continuing rather high volume and the form of this pattern suggests that it is instead a topping pattern – and it now looks like a small Head-and-Shoulders top.

Some have labelled the sideways pattern that has formed this month as a top, but it is thought to be a top area. It looks like a small Head-and-Shoulders top has formed, and the latest COTs are VERY bearish, implying an imminent drop.



Zooming out to a 6-month chart, we can see why a top might form here, despite the recent rally taking silver to a 3-month high, for silver is at the zone of resistance shown and also at a still downtrending 200-day moving average. Some observers have also described the pattern that has formed from July

through early October as a Head-and-Shoulders bottom, but again, the volume pattern is not consistent with this being a true H&S bottom

Some have labelled the pattern from July through September a Head-and-Shoulders bottom, but the volume pattern is not consistent with this interpretation. Although silver held up well late last week, considering the sharp rally in the dollar, the latest COTs are very bearish and suggest that it will soon break down from the tight trading range that has formed this month and drop. This range looks like a small Head-and-Shoulders top.

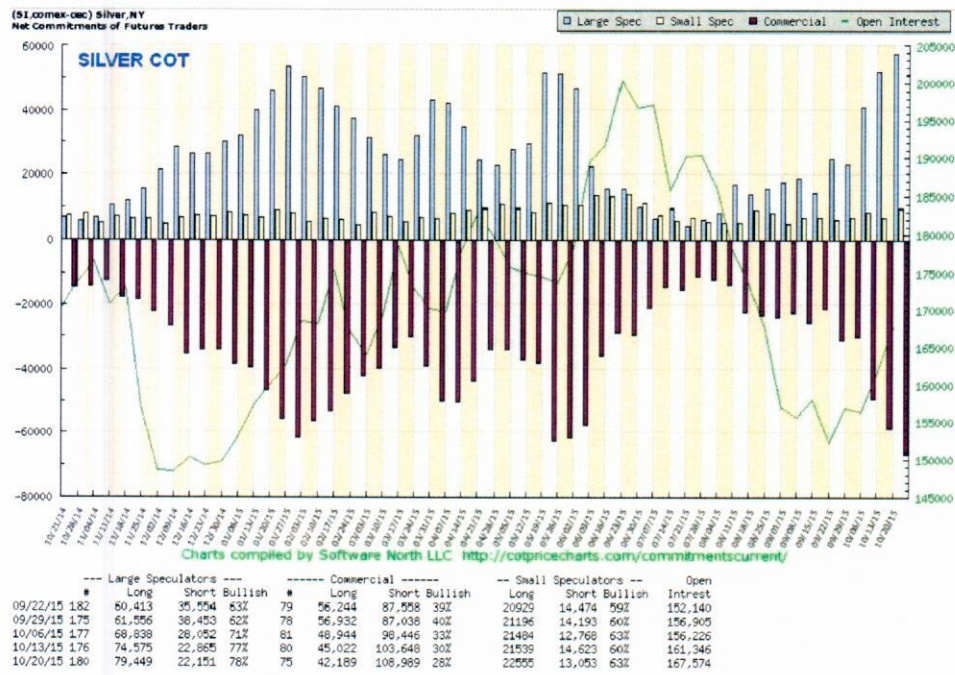


The 5-year chart for silver shows that there is still little to get excited about – it remains in a stubborn long-term downtrend, and until we see more solid evidence of this ending, such as it either breaking out from the downtrend, or a big increase in upside volume, it is considered safest to assume that the downtrend remains in force.



Now we come to the latest COT, which it has to be said, looks dramatically bearish, with the Commercials having ramped up their short positions to even higher levels, to at least a 1-year record. Experience shows that this means trouble, and with the dollar starting higher again, it looks likely that silver will drop hard, and soon.

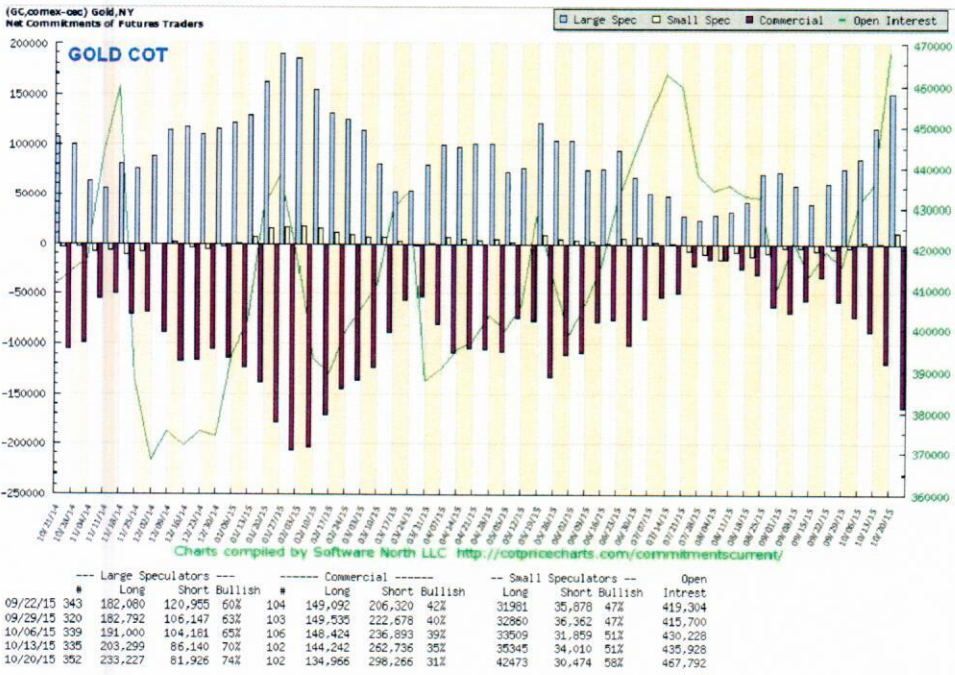
TROUBLE DEAD AHEAD - Commercials have at least a 1-year record short position, a situation which has always lead to a substantial drop in the past. So whatever fundamental reasons there are for being bullish on silver, the plain practical fact of the matter is that it looks set to drop substantially and soon. It looks like a good short here.



Click on chart to popup a larger, clearer version.

Gold's latest COT was pretty shocking too, suggesting that gold and silver are going to drop together, quite as one would expect. It is shown below...

Although not as extreme as silver's COT, gold's latest COT shows a BIG increase in Commercial short positions to levels that greatly increase the probability of a significant reaction soon.



Click on chart to popup a larger, clearer version.

While Adam Hamilton's latest on silver, entitled [Silver Undervalued](#) is quite convincing for the longer-term, as we have seen the COTs are telling a very different story for the short and medium-term. Putting these components together we can conclude that a sizeable and tradable drop in gold and silver is imminent, but also that such a drop will throw up a major buying opportunity for the bullmarket in the Precious Metals

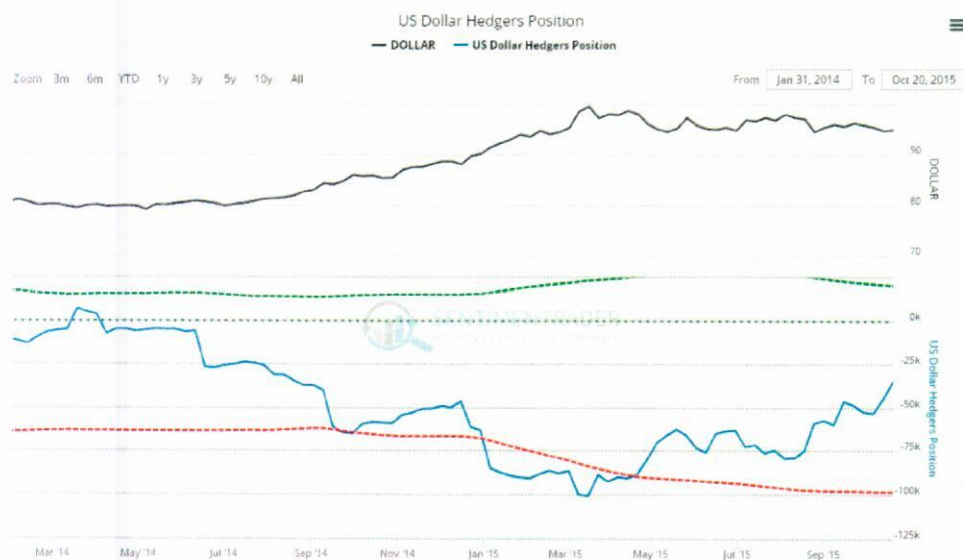
sector that is likely to start before too much longer, which will result from governments and Central Banks taking the line of least resistance in the face of towering debts and going for the Hyperinflationary Depression option. This option allows them to indulge in QE to their heart's content, so that they have no liquidity problems and can award themselves as much cash as they like, and stick the bill on to the ordinary citizen in the form of higher inflation later.

Next, we will take a look at the latest 6-month chart for the dollar index, which shows that it is starting higher again, having flirted with the danger zone, the key support near to 93. With the 200-day average still rising the sharp move up on Thursday and Friday may well mark the start of another major upleg – and it's not hard to see why with the head of the European Central Bank last week announcing that they will resume enlarging the gigantic sinkhole underneath the euro by embarking on another round of QE soon, which they have to do to avert an acute liquidity crisis. The dollar index is something like 57% made up of the euro.

Silver held up surprisingly well when the dollar rallied sharply on Thursday and Friday. However, the latest silver COT, which is very bearish, suggests that this resilience won't last and that silver will drop back, perhaps hard, and very soon.



Although the US dollar COT is still in middling ground, it has improved significantly in recent weeks as we can see on its latest chart below, increasing the probability of a sizeable dollar rally from here...



Click on chart to popup a larger, clearer version.

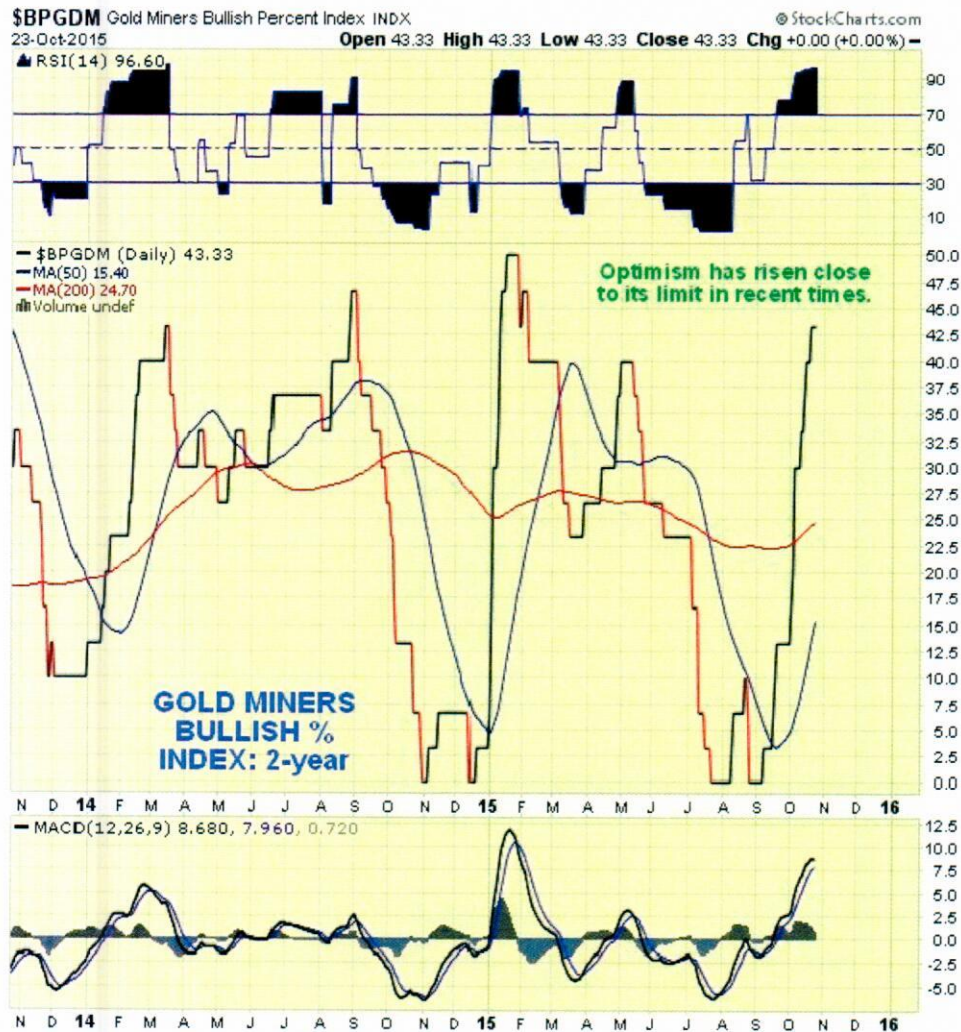
ProShares Ultrashort Silver, code ZSL, is a good inverse ETF to play the expected drop in silver...

ZSL looks set to rally from the small base that has formed this month, as silver drops back. It is believed to be at a good entry point here.



Although PM stocks are certainly oversold relative to the metals on a long-term basis, optimism towards them has rocketed from 0% to 43% in a matter of weeks, which is considered to be too far, too fast, making them vulnerable to a downturn, as the following chart for the Gold Miners Bullish % Index makes clear...

HOPE SPRINGS ETERNAL IN THE BREAST OF A GOLDBUG - but it looks like their optimism has risen too far too fast, especially given the latest bearish COTs for gold and & silver, so it looks like another rinse cycle is about to start.



Having been forced to crawl back into our hole after being shaken out of DUST twice in quick succession, in the recent past, the latest gold and silver COTs are suggesting that we can dare to venture out again and give it a go. DUST appears to have been forming a low base pattern, and looks ready to take off strongly higher very soon as the PM sector drops back again.

With COTs for both gold and silver so bearish now, and a small base looking to have formed in DUST, it looks like time for those who are up to it to give it another go. Good entry point after Friday's drop, with the option of placing a stop beneath the recent low.



End of update.

Posted at 11.15 am EDT on 25th October 15.