

BIG MONEY MOVING INTO COMEX GOLD & SILVER CALL OPTIONS

By Adrian Douglas

In November 2005 when gold was trading about \$450 I predicted the mega-move in gold up to \$720/oz by noticing a very large build-up of call options in the HUI component shares

<http://www.marketforceanalysis.com/Published%20Articles/assets/Explosive%20Rise%20in%20Gold%20Mining%20Shares%20Coming.pdf>)

In August 2007 I identified a massive Gold call option build-up in the COMEX DEC 2007 contract and predicted a big gold move

([http://www.marketforceanalysis.com/Published Articles07 assets/COMEX%20GOLD%20OPTION%20OI.pdf](http://www.marketforceanalysis.com/Published%20Articles07/assets/COMEX%20GOLD%20OPTION%20OI.pdf)). Gold was trading at \$660/oz at the time and ran up to over \$1000/oz by March 2008.

In July of 2008 I noticed a similar build-up in the COMEX December Call options indicating a major upward move in gold before the end of 2008. Considering what transpired in the financial markets from July to December 2008, after I made this prediction, it made perfect sense. We now know, however, that two large banks, probably JPMorgan and HSBC, sold a massive amount of futures short in July 2008 equivalent to 10% of global gold production and changed the intuitive direction of the gold market into a counter-intuitive one. As a result the CFTC was obliged to take note and commenced an investigation into both the silver and gold markets on the COMEX for manipulation. So I think a rain-check is deserved on the 2008 market call until the CFTC officially declares the manipulation or the market blows up (I think the latter will happen before the former!)

It just recently came to my attention from two different confidential sources that JPMorgan and Goldman Sachs have been buying large amounts of Calls in gold and silver. This made me put on my gumshoes and take a serious poke around the COMEX option open interest once again.

Figure 1 shows the cumulative Open Interest across all strike prices for the COMEX Gold Call positions and the Put positions for the JUN 09 options.

JUNE COMEX OPTIONS OPEN INTEREST

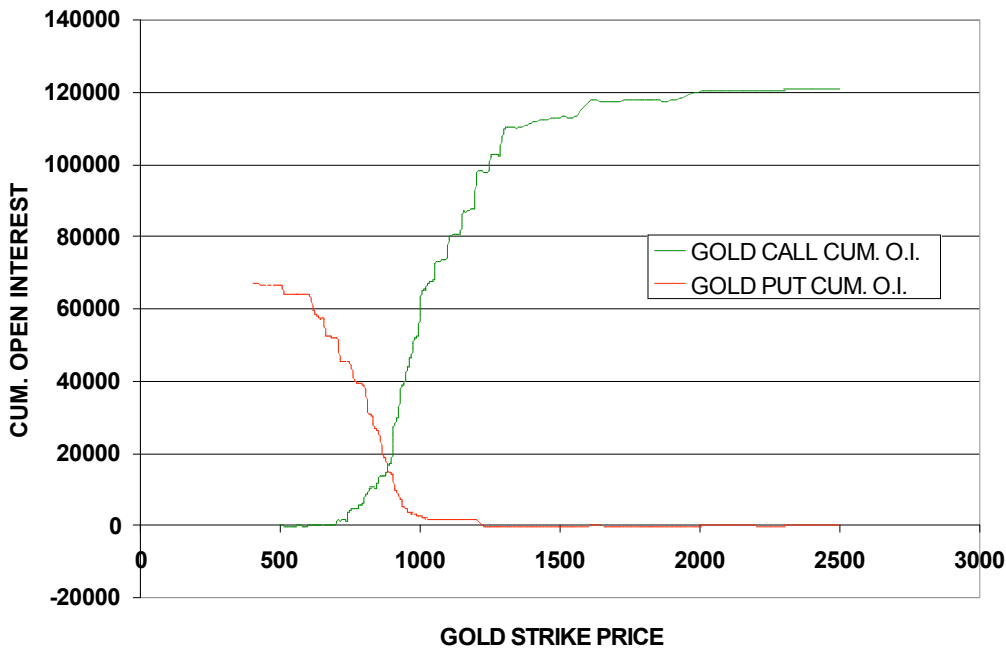


Figure 1

If you read up vertically from any value of the strike price to the red line it says how many Put options are in-the-money at that price and on the green line the total number of Call option contracts that are in the money. For example, at a gold price of \$750/oz a total of 40,000 Put option contracts would be in the money. For a gold price around \$1000 a total of 60,000 Call options would be in the money.

The ratio of Calls to Puts is 1.81 so Bulls outnumber Bears dramatically. What is also remarkable is the amount of open interest. For example, 100,000 contracts would be in-the-money if the gold price runs to \$1250/oz in the next 30 days. This is an astounding amount of option OI considering the open interest in all the futures contracts stands at only 345,000 contracts!

Let's take a look at Figure 2 which is for DEC 2009

GOLD COMEX DEC OPTIONS OPEN INTEREST

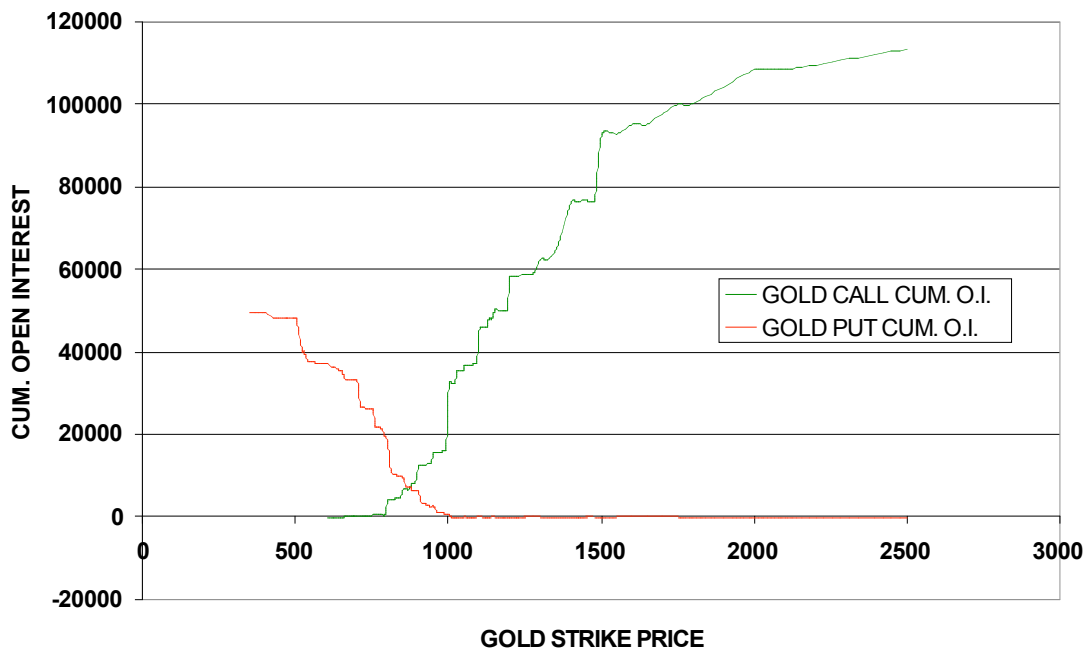


Figure 2

The bets by bulls outnumber those by the bears by a 2.3 to 1 ratio which is even more bullish than for JUN 2009. The Total Call option interest is 113,663 contracts which is very similar to JUN 09. Furthermore if gold is trading at around \$1600 by DEC then 100,000 contracts will be in the money!

I consider option players highly sophisticated speculators. Such large bets are likely being made by some large money interests who are buying out of the money options BEFORE going into the futures market. Buying long futures in large volumes will rapidly drive up the gold price but the massive open interest in the Call Options then allow access to much more futures contracts at the same price by exercising the options and then perhaps taking delivery of the gold. This is bolstered by sources revealing that JPM and GS are buying in quantity. So on the part of JPM this is likely a ploy to try to cover a chunk of their massive short position.

Let's now look at silver. Figure 3 shows the cumulative Open Interest across all strike prices for the COMEX Silver Call positions and the Put positions for the JUL 09 options. The ratio of Calls to Puts is 1.80 so Bulls outnumber Bears by 80%. What is also remarkable is the amount of open interest. For example, 18,800 contracts would be in-the-money if the silver price runs to \$25/oz in the next 60 days. This is an extraordinary amount of option OI considering the open interest in all the futures contracts stands at only 94,000 contracts!

COMEX JULY SILVER OPTIONS OPEN INTEREST

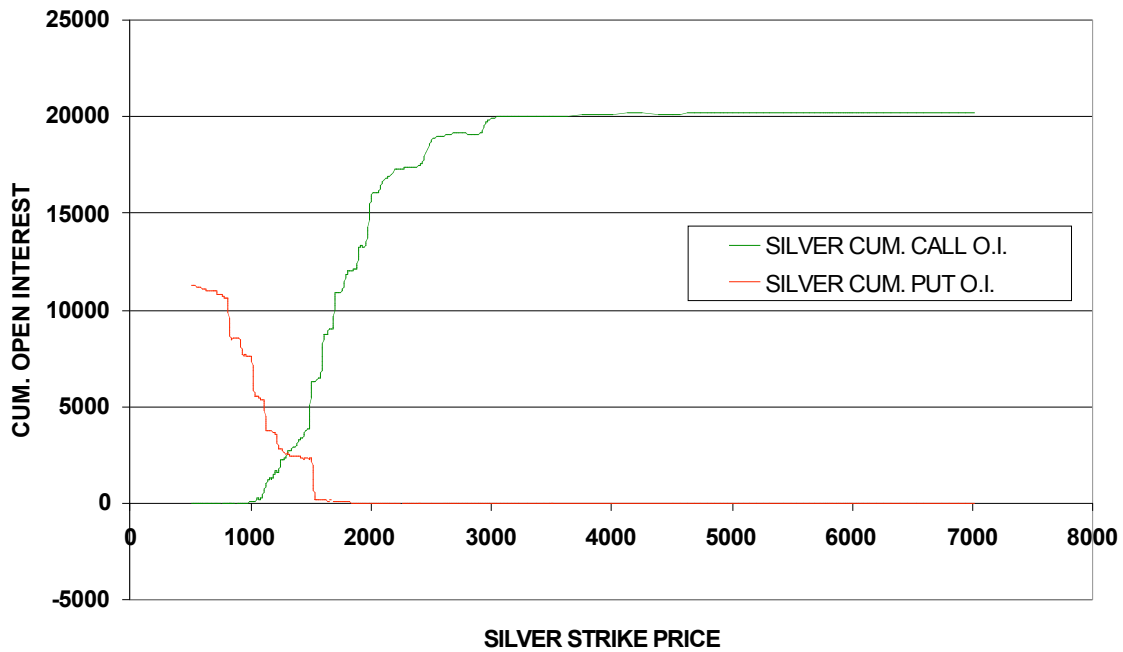


Figure 3

Figure 4 shows the cumulative Open Interest across all strike prices for the COMEX Silver Call positions and the Put positions for the DEC 09 options. The ratio of Calls to Puts is 1.68 so Bulls outnumber Bears by 68%. Again the total Open Interest in Calls is high at almost 25,000 contracts when the Open Interest in all futures currently stands at 94,000 contracts.

SILVER COMEX DEC OPTIONS OPEN INTEREST



Figure 4

I conclude that smart money is being placed for a massive rise in the gold price in the next 30 days and silver in the next 60 days (which probably means within 30 days for both metals) and again by December. I wouldn't be surprised to see a pullback in between the two events. This money could not go in to the futures market without blowing the lid off the price as it would represent such a large increase in open interest. Going into the out-of-the-money option market allows flying below the radar.

The CALL/PUT ratio on the stock market is usually a contrarian indicator because the average, unsophisticated retail investor will buy options and the average retail investor gets it wrong and chases the market move most of the time. Only sophisticated traders tend to be in the precious metals option market so when there is a huge build up betting on a particular direction that is typically a directional indicator as I have shown was the case for the last two big moves in the precious metal bull.

The flat contango in gold and silver suggests there is a shortage developing of precious metals for delivery. We know that two large banks hold almost 100% of the commercial net short position. They need desperately to cover their exposure if the market is about to make a big move. It looks as if that is precisely what is happening.

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April 29, 2009

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