

April 13, 2010 – A Double-Cross?

### A Double-Cross?

The latest release of the Commitment of Traders (COT) and Bank Participation Reports confirmed a theme I have written extensively about recently. That theme was my hope and expectation that the big concentrated silver (and gold) COMEX short, JPMorgan, would refrain from selling additional contracts short on the next silver rally. The latest data indicate this to be the case. First, let me review the recent data and then get into some speculation as to why I focused on this specific theme and what it might portend.

For the week ended April 6, there was a large weekly increase of over 37,000 contracts in the total commercial net short position in COMEX gold futures and around a 5400 contract net increase in the silver commercial short position. In the three days from the Tuesday cut-off, I would extrapolate that another 30,000 or so net commercial gold shorts were added and another few thousand commercial silver shorts. Regular readers know that this deterioration creates the possibility of a sell-off. It is the tech fund buying of COMEX paper contracts and their eventual selling that sets the price of silver and gold, with the commercials maneuvering (manipulating) the tech funds.

This is usually the point at which I turn defensive and begin to warn of an eventual sell-off. Yes, I do hold some of those defensive feelings currently, given the COT deterioration, but I also hold feelings that it may be different this time. (Please review the March 6 article with that title). It all has to do with JPMorgan.

While there was notable deterioration in the commercial short position, none of it was attributed to JPMorgan. Through Tuesday, JPMorgan had not increased its silver short position and actually decreased its gold short position for the month, according my reading of the Bank Participation Report. This is in marked contrast to their previous behavior on price rallies. For instance, back in September, JPMorgan was the sole short seller of additional contracts for most of the rally. I would contend that going from being 100% responsible for additional short sales back then to selling no additional contracts on this rally is a notable turnaround. This raises a number of questions. For one, does the lack of selling by JPMorgan mean that they won't sell additional contracts short in the future? I don't know. However, if they do begin to add to their short position, it will be noticed and commented on (more on that in a bit). So, for the time being, let's assume JPMorgan will not add to their short position.

The next question is if JPMorgan is not selling, who is? Well, we know it is commercial selling. What is a commercial? Many people assume that any position held by a commercial is a bona fide hedging transaction. This is not true. The commercial category is a classification by the CFTC which denotes that the trader is engaged in the business of that commodity on a day to day basis. It does not mean that all positions held by commercials are hedge transactions. Commercials (big banks and others in silver) speculate like crazy, even though all their positions are classified as commercial transactions. Please keep this in mind when someone tries to tell you that all commercial transactions are legitimate hedge positions. Nothing could be further from the truth.

In my mind, there are three basic groups of silver commercials. Please bear with me, as I'm trying to describe how I see the market, which regular readers know can be quite unorthodox. One entity makes up one entire group due to the size of its position. Of course, I'm referring to JPMorgan, which holds roughly 30,000 contracts net short in COMEX silver futures, or the equivalent of 150 million ounces. The second group includes the next seven largest commercial shorts, the traders making up the two through eight largest shorts. As of the latest COT, this group holds almost 35,000 contracts net short; which, when combined with JPMorgan's position gives these two commercial groups a total net short position of almost 65,000 contracts, or the equivalent of 325 million ounces. (For regular students of the COT, this is the net short position of the eight largest short traders. All I'm doing here is asking you to mentally picture my breakdown of one trader as a group and then 2 thru 8 as a separate group, instead of grouping them in the conventional 4 largest and 8 largest categories).

The third group of commercial traders includes those smaller traders not listed in the largest 8 categories. These are the traders I refer to as the "raptors," or the 9+ commercial traders. I took to calling them raptors, years back, as they struck me as the smaller and faster version of the big 8 T.rex's who terrorized the silver and gold markets. These smaller commercials, while also victimizing the tech funds, did provide competition to the big 8; or as I refer to them here, the big one and big 2 thru 8. For the past three years, the raptors have been net long the silver market. For the past year, the raptors, as a group, have been net long anywhere from 9,000 contracts to over 20,000 silver contracts. Currently, the raptors hold a net long position of just under 13,000 contracts, which when subtracted from the almost 65,000 contract net short position of the 8 largest traders, produces the 52,000 total commercial current net short position. In other words, the 8 largest commercials hold a short position greater than the entire grouping of commercials.

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While the raptors have been net long in COMEX silver, they trade the same way as the bigger commercials. All commercials, regardless of size, always buy when the price is falling and always sell when the price is rising. Always. While this appears highly rational from an investing perspective, the real reason all commercials behave in this manner is because their main counterparties, the technical funds and other momentum traders, do the opposite. Because the tech funds buy on the way up and sell on the way down, the commercials are "forced" to trade the opposite of them. Some would classify this commercial trading as innocent "market making." I would remind you that commodity futures are an open outcry market, not a specialist system, like the NY Stock Exchange, where markets are supposed to be "made" or smoothed out by specialists. Market making has no place in an open outcry market. Let me be blunt "this commercial market making in COMEX silver is illegal and the regulators are negligent in allowing it.

The levels of concentration on the short side of COMEX silver are still alarming, and clearly manipulative. Of the total net open interest of 96,000 in COMEX silver futures (after spreads are removed), JPMorgan still holds over 31% of the entire market and, combined with the next 7 largest shorts, over 67% of the entire market. After a year and a half of a silver investigation, private and public meetings on the issue and countless speeches by Chairman Gensler on the evils of concentration, no one has been able to explain why such a level of concentration is not manipulative. Try to imagine if such a level of concentration by one or eight traders existed in the oil futures market or in bond or stock market futures, what kind of outcry would be heard.

So what about JPMorgan not selling and the title of this piece? Since all commercials always sell on the way up in price and always buy on the way down, when the biggest commercial doesn't do what it always has done before, it bears scrutiny. Especially when I had been expecting (hoping) that this aberrant behavior would emerge. Let me first explain why I expected JPMorgan to refrain from selling more silver contracts short. It's simple "their short position is too large and, therefore, manipulative. At some point, it has to be capped, if not completely unwound. JPMorgan's concentrated silver short position is undeniable. I was able to first identify them as the big silver short back in 2008, after the August 2008 Bank Participation Report, Treasury OCC derivatives reports and CFTC correspondence to lawmakers explaining the Bear Stearns takeover. Now, JPMorgan's concentrated short position is so obvious that it is referenced daily on the Internet and even in the popular press. The CFTC is aware of it, although they refuse to do anything about it. JPMorgan is aware of it (I send most of my articles, including this one, to Jamie Dimon, CEO of JPMorgan). Silence has not been an effective strategy to date. At some point, JPMorgan and the regulators must deal with this manipulative short position. That point may be now.

I believe JPMorgan not increasing its short position on the impressive rally over the past two months portends great change in silver. Since the price lows of early February, JPMorgan has not sold an additional silver contract. The 2 thru 8 group has sold 7,000 additional contracts short and the raptors have sold 7,000 of their long positions, but the biggest short, JPM, hasn't sold anything. I don't think this is accidental. I don't think anything JPMorgan ever does is accidental. I think they want out of this short silver position, as they certainly should. Being short big in silver is stupid. JPMorgan is not stupid. They got roped into this position with their takeover of Bear Stearns. I'm even told that Bear Stearns silver traders are still managing the JPMorgan silver position, if you can imagine that. Certainly, JPMorgan can deny any or all of this, but don't hold your breath.

What about the double-cross? My speculation is that the other commercials were not aware that JPMorgan decided to refrain from selling additional silver contracts on this rally. These other commercials, both the 2 thru 8 largest traders and the raptors, just did what they normally do, namely, sell on rallies. The central question is if the two groups can manage the silver manipulation without the support of the largest manipulator, JPMorgan? My guess is no, especially if the physical silver wholesale market is as tight as it appears to me. If ever there was a time when the commercials could get overrun to the upside (something that has never happened in silver), it would appear that time could come when the biggest contributor to the manipulation is not participating any longer. At a minimum, the failure of JPMorgan to join in on the commercial selling on the upside does not make the other commercials stronger, only potentially weaker. There is much more of a likelihood that the remaining commercials still selling could panic and start to buy back their shorts when they realize the "Godfather" has stopped participating in the scam.

No one knows if JPMorgan will continue to refrain from selling additional contracts short in silver. If they do resume selling short we must pester them and the CFTC like never before. I certainly plan to turn up the heat in that case. Some have suggested that JPMorgan will just lie and place its shorts through other commercials. I don't think so, as this is so blatantly illegal that even the lowest level of CFTC safeguards will detect this. We do know that all three commercial groups (JPMorgan, the 2 thru 8, and the raptors) will be buying on any sell-off they can create. That, you can take to the bank. How much tech fund selling can they create is the only question. So, we have all three commercial groups ready to buy on lower prices, with only the tech funds as potential and limited sellers. All against a backdrop of a tightening physical market.

Let me sum all this up. The increase in the total commercial short position is troubling. The lack of increase in JPMorgan's short position is exhilarating. The resolution of this 25 year silver manipulation still lies ahead of us, but is much closer than ever before. Every day more are aware of it. Every day the lack of substantive explanations for and coherent denials of the concentration become more obvious. Can the crooked shorts engineer another sell-off, with or without JPMorgan, to trick the tech funds into selling once again? Maybe. However, if they do, that sell-off is likely to be brief in duration. At this point, it's just not worth the risk of missing the big one to the upside for fear of a possible temporary sell-off. As I hope I have conveyed to subscribers over the past few months, don't even think of letting go of any long-term silver positions. And get your comments in to the CFTC and plan on sending more soon.

Ted Butler

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