April 2, 2014 – The Smash Boys

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Unless you have been completely isolated from current events these past few days, you are undoubtedly aware of the robust debate arising from Michael Lewis' new book on High Frequency Trading (HFT), Â?Flash Boys.Â? Starting with a powerful segment on 60 Minutes, in which Lewis referred to the stock market as being rigged by HFT, rarely have I seen a specific financial issue garner as much coverage and emotion as this one. Here is a link to the 60 Minutes video http://www.cbsnews.com/videos/is-the-us-stock-market-rigged/

Lewis contends that the high speed computer trading that has come to dominate stock market trading volume is nothing more than front running and fleecing by HFT entities empowered by powerful computers and fiber-optic connections to various exchanges. Perhaps somewhat different than outright price rigging, HFT seems more like the skimming of tiny slices off very many transactions. Collectively, the tiny slices are said to amount to billions of dollars. The good news is that the release of Â?Flash BoysÂ? has resulted not only in wide debate, but also in an announced investigation by the FBI that, hopefully, may resolve the matter in time.

I would hope regular readers know where I stand on HFT Â? I find the practice abominable, as I've chronicled for years and I hope the current attention results in meaningful restrictions or outright abolishment. But rather than rehash the particulars of HFT today, I'd like to analyze the difference between HFT in the stock market and HFT in COMEX gold and silver (and other markets). The difference stems from the infamous Flash Crash in the stock market four years ago.

On May 6, 2010, the Dow Jones Industrial Average suddenly plunged 1000 points (about 9%) and quickly recovered, all quite literally within minutes. It was the largest point decline in stock market history and the reaction was immediate, as would be appropriate considering the threat to confidence in the markets and the financial system. High-speed computer trading gone awry was said to be the culprit and the regulators (SEC, CFTC and the exchanges) reacted immediately. Since that time, there has been no similar instance of a flash crash of such magnitude in the stock markets. http://en.wikipedia.org/wiki/2010_Flash_Crash

My own sense is that the regulators, exchanges and HFT traders privately agreed that there must be no further flash crashes in the stock market and that HFT was allowed to continue only as long as there was no repeat of May 6. I believe that all parties were aware that if the stock market experienced any further significant computer-induced crashes, everyone – regulators, exchanges and HFT traders – would be in jeopardy (as well they should). I can't prove what may have been agreed upon privately, but I can point to there having been no subsequent sizable stock market flash crashes to this day.

Since there have been no further serious flash crashes in the stock market since May 6, no one, including Mr. Lewis, can criticize HFT on that basis. Instead, the criticisms against HFT involve skimming, front-running and data flow allegations. Please don't assume I think these are minor violations, because that is not the case; I am just pointing out that Lewis is referring to market rigging in the sense of front-running and skimming and not in the deliberate manipulation of stock market levels.

But as bad as front-running and skimming may be, the deliberate manipulation of any market to an artificial price level is the most serious market crime possible. And that is the big difference between the current criticism of HFT in the stock market and my criticism of HFT in COMEX gold and silver. In the stock market, the rigging refers to front-running and skimming; in COMEX gold and silver, the rigging involves the deliberate setting of artificial prices by JPMorgan and the CME Group for their own benefit. Perhaps I missed it, but I don't recall Mr. Lewis referring to any specific entities in HFT as being market crooks and criminals; whereas I constantly refer to JPMorgan and the CME as such in COMEX silver and gold. What do I base my assessment on?

I refer to JPMorgan and the CME Group as being market crooks and criminals for manipulating COMEX silver and gold (and other) prices based upon government data indicating market share concentration and control and based upon the recurring instances of flash crashes in silver and gold. Whereas Mr. Lewis refers to HFT operators in the stock market as Â?Flash Boys,Â? in gold and silver, JPMorgan and the CME are the Â?Smash Boys.Â?

There have been no serious flash crashes in the stock market in four years; there have been too many HFT price smashes in COMEX gold and silver in that time. The most egregious price smashes were the two separate 30%+ price plunges in silver that occurred within a few days, in May and September of 2011. Twice silver fell by $15 in short order, or more than three times the percentage amount of the great May 6, 2010 stock market crash. Yet, unlike the immediate attention from the regulators that the 9% temporary decline in the stock market attracted, neither the CFTC nor the CME had any comment whatsoever on the two silver smashes in 2011, even though these were the largest price declines in commodity history and silver was supposedly under a CFTC formal investigation at those times.

Similarly, the two separate HFT gold and silver price plunges in April and June of 2013 were also far more severe than the May 6 stock market flash crash and, yet again, the CFTC and CME were mute as JPMorgan raked in billions of dollars. The only possible explanation between the regulators' actions in the stock market and the lack thereof in precious metals trading is that regulatory response is discriminatory based upon which markets are impacted. Stock market declines make everyone rally around the flag; silver and gold price smashes make everyone look the other way.

If there is one glaring difference between HFT activity in the stock market and the HFT price smashes in silver and gold it is that JPMorgan is always the prime beneficiary of silver and gold plunges by virtue of its dominant market share. In other words, the HFT winners in the stock market appear to be varied and changing; in gold and silver, the big winner in the orchestrated take downs is always JPMorgan and, by extension, the CME, since JPM is the CME's most important customer.

Considering the fiery debate following the preview and release of Mr. Lewis' book, perhaps there is room for optimism in exposing JPMorgan and the CME as the Smash Boys. I admit that the reaction and uproar to Â?Flash BoysÂ? revolves around many more observers being affected by the stock market than are impacted by silver and gold prices. Yet the allegations against the Smash Boys are far more serious and specific. Who would have thought someone could openly label JPMorgan and the CME as market crooks and get away with it for years on end? Imagine, if you can, the reaction had Mr. Lewis labelled any specific entity as being crooked in his book.

Perhaps most promising of all is that what Mr. Lewis covered was largely known by most active market participants and observers, yet his revelations clearly reached an audience unaware of HFT; most likely due to its complexity. I can certainly relate to that in the silver and gold manipulations; yet the day may come when enough can see it to end it before a physical silver shortage hits.

A brief update on sales of Silver Eagles from the US Mint. On Saturday, I speculated that there might be one last update on Monday, since that was the last day of the month and recently the Mint had been reporting big sales on that day. We didn't get an update on Monday, but yesterday the Mint did update total sales for the month of March with a big addition. The Mint reported that it sold 5,354,000 Silver Eagles for the month.
http://www.usmint.gov/about_the_mint/index.cfm?action=PreciousMetals&type=bullion

This is the highest total of Silver Eagles sold in any Â?regularÂ? month in the 27 year history of the American Eagle Bullion Program. There have been three Januarys where more Silver Eagles were sold than were sold this March, but those Januarys always Â?borrowedÂ? sales from December as the Mint retooled for coins with the new yearly date. The 5.3 million coins sold this past month indicate a daily production run rate or blank availability never achieved before by the Mint of more than 170,000 coins per day.

Even more astounding continues to be the amount of Silver Eagles being sold relative to sales of Gold Eagles. Year to date through the end of March, more than 95 Silver Eagles have been sold for every one ounce of Gold Eagles. This is almost double the rate of 2013, which had the highest recorded relative level of Silver Eagles to Gold Eagles in history to that point.

There is still an open question as to who is buying all these Silver Eagles. Since it does not appear to be plain vanilla retail demand, the alternative explanation is that the Silver Eagles are being bought by someone big. And whenever anyone suggests someone big is doing anything related to silver, one's attention should turn towards JPMorgan. That's because in every aspect involving silver, JPMorgan is always Mr. Big (or Mr. Pig). That includes market share, making or taking COMEX deliveries and everything else in between, probably including Silver Eagles.

In a late breaking development, the Wall Street Journal reported today that JPMorgan's head of commodities, Ms. Blythe Masters, will be leaving the bank following the sale of its commodities business expected to close in the third quarter. From all published reports, JPMorgan will be retaining its gold and silver trading operations. http://www.zerohedge.com/news/2014-04-02/goodbye-blythe-masters

The only continuing concern for lower prices is the market structure on the COMEX and what JPMorgan intends following its recent heavy selling in COMEX gold and silver. This Friday's Commitments of Traders and Bank Participation Reports should show a reduction in the commercials' total net short position with the only real question being how much more to go, in terms of lower prices and further commercial buying? Only one entity has the answer to that question.

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Silver – $20

Gold – $1290

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