

April 6, 2011 – Standing in the Other Guy's Shoes

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Particularly at times like this, we invariably find ourselves trying to imagine what's really going on behind the scenes in the silver market. We do that by taking as many hard data points as we can identify and try to measure how they may affect the price. This is at the heart of analysis. We try to be as factual as possible and not invent or misinterpret the hard data. But no matter how disciplined we try to be in uncovering the facts, there's no way we can know everything; at the end of the day we must still speculate about what we don't know.

Speculation is not a dirty word, either in financial matters or in contemplating the future. In fact, it's unavoidable. The trick is in how you speculate. It's important to start with a foundation based upon solid fact and use logic in plotting out how you think things will unfold. If you start with a false foundation or use faulty logic, you are destined to end up wide of the mark. But if you start with a solid foundation and stick with a logical process, even if you get some things wrong along the way, you'll probably end up pretty close to whatever turns out.

Regarding silver, at the core of my foundation is that it has been artificially depressed in price for more than 25 years by an uneconomic and concentrated short position on the COMEX. Because all manipulations must end at some point with prices reversing violently in the opposite direction, I always *“knew”* that silver had to do the same and explode higher in price. I have had no regrets in attempting to do two things. From the beginning, I tried to alert the regulators and anyone else who would listen about the ongoing crime in progress. Starting about 10 to 15 years ago, I tried to convince people to invest in silver, because of the manipulation and the resultant powerful fundamentals.

With that as my foundation and now that events and prices seem to be in concert with how things should be unfolding, it is natural to speculate on how prices and events will continue to unfold. As far as prices, they still look higher, but with increasing volatility. As long as the silver users have still yet to panic, as long as the short position has yet to be radically reduced and the concentration dissipated, and as long as the silver investment story has yet to be widely disseminated and understood, the price still looks good to go on the upside.

But how about me speculating on coming silver events? And what is going on in the minds of the key participants, like at the CFTC, JPMorgan and the CME? After all, we are witnessing historic silver price changes that do conform with my expectation of sharply higher prices eventually. I often wonder what the heck are all these people thinking about current price patterns amid all the allegations of wrongdoing in the silver market. I'm forced to speculate, of course, on what they are thinking because very little is said publicly. Then again, I don't know what JPMorgan and the CME could possibly say.

The key is the resolution of the short position, both the concentrated holdings of JPMorgan and the other big commercial shorts, along with the silver short positions held by everyone else on the COMEX. Conservatively, there is a 500 million ounce net short position in COMEX futures (netting out spread positions). On the \$20+ move up since August, the total net short position in COMEX silver futures comes to \$10 billion. That's how much additional margin money the shorts have had to come up with to this point to maintain their positions. JPMorgan's share (or their clients) comes to almost \$3 billion. The big 8 combined (including JPM) are out almost \$6 billion of the total. While not unusually large in terms of all the money in the world, these sums are enormous for a market as tiny as silver.

Look at it this way — anyone who remained short for the rise since August is out more than double what the price of silver was back then. What were the shorts looking to make back when they held short positions at \$18 an ounce? Were they looking for silver to go to zero? Now they are out more than the total price they originally shorted at. Every short holder who held on since August has massively miscalculated the true risk/reward parameters of the trade. Normally in any prudent speculation, you look to make two or three for every one you put at risk. No one sane looks to lose 20 for every one or two you may make by speculating. My first point is that the silver shorts that have remained in their positions (which are most of them, according to COT data) were very wrong to have remained short.

Moreover, these silver shorts still appear to be at great risk. Not that we won't have volatility which includes sharp sell-offs, but the factors are still in place for sharply higher silver prices. This means that the massive losses accrued to date by the shorts could still grow dramatically. Let's face it — the \$20+ rally to date has hurt the shorts badly and left them in a weakened financial condition. In a very real sense, this weakened financial condition raises the odds of a short-covering panic to come. Just because the silver shorts haven't panicked as group yet, doesn't mean they won't in the future. Frankly, I can't see how we won't have a short-covering panic at some point.

With the facts of the losses to the shorts, both to date and potentially in the future, clearly visible, what are they planning now? My guess is that they don't have a genuine plan. Certainly, they didn't plan on being out \$10 billion collectively seven months ago. I don't think that being on the short side of silver was ever well-thought out. Maybe a big player like JPMorgan can or has found a way to dump the liability on someone else (maybe clients?), but that doesn't diminish the collective liability of the shorts overall or reduce the potential of a short-covering panic. If a significant number of silver shorts decide to give up the ghost and begin to buy back their positions that will run the price higher. That it hasn't happened yet is remarkable. That it could or will happen is one reason to not be surprised if prices suddenly spike higher.

So what's going on at JPMorgan and the Exchange? What are they thinking? I'm a big believer in putting yourself in the other guy's shoes whenever possible; to try to think things through from someone else's perspective. I think it's safe to say that JPMorgan and the CME Group wish this silver situation never evolved to the point it has. If either JPM or the CME or any silver short could just blink their eyes or click their ruby slippers (like Dorothy in the Wizard of Oz) and make the whole silver problem go away, it would have happened already. But that's not how things work. If you short anything, you must buy it back or deliver against it eventually. A short position is an open transaction; it is not a completed transaction until delivered against or bought back. I think that JPMorgan and the other big shorts at the CME are increasingly aware of the open nature of their short positions. It may be that they know higher prices will be necessary to induce others to sell so that they can buy.

Almost every day, or at least every week, a reader will write to me advancing the theory that JPMorgan is short silver at the direction of the US Government, usually with the explanation of capping the price to defend the dollar or to diminish inflation expectations. The great numbers of these unsolicited (but appreciated) contacts and the consistency of this explanation give me pause to reflect if this is correct. Those writing to me have obviously thought this out carefully. While I admit that this could be the case, I am still of the opinion that it's not the US Government behind the silver manipulation. As I've explained in the past, all governments are reactive, not proactive. Could any government come to be involved in a cover up after the fact? Yes, I would stipulate that is a normal occurrence. But I just don't see, based upon my life's experience, the government masterminding a 25 year manipulation of a market as has occurred in silver. Plus, I hope I'm correct as if it was the US Government from the get go, then that would be criminal in the most serious sense.

I'm still of the opinion that this silver predicament snuck up on JPMorgan after they acquired Bear Stearns. Maybe they had some assurances from the Treasury Dept or the Fed as to liabilities when first assuming the COMEX short position, but those assurances or guarantees expired as JPM came to play the silver market after the takeover. To me, both JPM and the CME are arrogant about competitors and other market participants and it is this sense of self-importance that has led to the silver predicament they are in. Instead of genuinely attempting to resolve the silver manipulation, they looked down on anyone suggesting anything was wrong. After repeatedly denying that a problem may exist, it is very hard to admit you were wrong. If you are arrogant to boot, it becomes impossible. I sometimes try to speculate about what each is thinking, but I quickly conclude it doesn't matter. That's because, regardless of the motivation, there are still only two ways to close out a short position, deliver or buy back.

So my speculation about JPMorgan and the CME Group is that I don't speculate too much. I know that the end of the silver manipulation will bring higher prices. I know the shorts must eventually buy back or deliver silver, although it is possible that there might be a COMEX default as well. I think the majority of long position holders will only sell out at much higher prices. This will enable the shorts to buy back, albeit at punishing prices. I don't spend much time contemplating what legal liabilities may confront the big shorts or the Exchange, but I do confess to thinking about it at times. I don't trust JPMorgan or the CME and we must remain alert to any and all dirty tricks by them to get people to sell silver at less than free market prices.

I still reject suggestions that CFTC Chairman Gary Gensler is interested in sanctioning the silver manipulation. I admit that I may be proven wrong eventually, but that is not yet obvious to me. If there are anyone's shoes I try to picture myself in, it is Gensler's. I still see him as trying mightily to do the right thing, although he is in a difficult position given the nature of the silver problem. This is certainly not a new thought of mine and I have written about it often. In 2009, I likened Gensler as to heading a bomb squad seeking to diffuse the silver manipulation.

<http://news.silverseek.com/SilverSeek/1257430207.php>

Given the opportunity, it would be easy for me (and probably you) to just take after the silver crooks and end the manipulation and let the chips fall where they may. After all, this is a clear crime in progress and must be terminated forthwith. But the exercise is about putting yourself in the other guy's shoes. Surely, there are all sorts of high level considerations that complicate the urge to just barge in and shoot up the joint. Based upon what has transpired to date, maybe Gensler is doing more than he is being given credit for. He assumed office just shy of two years ago. Let's look at the record during his tenure.

The record is mostly positive with only one negative, namely, that the concentrated silver short position has remained largely intact, although down from record levels. Therefore, the silver manipulation continues. The positives include a steady movement towards position limits and a clear and continuous verbalization by Gensler of the importance of guarding against concentration in any market. This occurred against a backdrop of universal industry and Commission rejection (with the notable exception of Commissioner Bart Chilton). Gensler may still fall short of enacting legitimate position limits in silver, but there has never been a CFTC chairman in history who has championed the idea previously. Since the public comment period has closed (there may still be some written comments mailed in that need to be recorded), the deadline for action is now measured in months. Relatively soon we will know if we get legitimate position limits in silver or not. That will be the litmus test by which to judge Gensler.

Lastly, the price of silver has almost tripled since the lows seen shortly after he came into office. I'm sure that's not a metric he would look at, as Gensler has stated frequently that the CFTC is not in the pricing business. Nor should they be. But, of course, the price is important to silver investors and its climb takes away some of the sting of the manipulation being a crime in progress. It's hard to feel bitter as profits grow.

The key to the silver manipulation has always been to get to true free market prices with no concentration on either the long side or the short side. Because silver has been artificially depressed in price for so long, the market has shown increasing indications of being starved for material. The only known remedy for a commodity in short supply is to get the price higher to encourage more supply. The recent price action suggests that is occurring. But after such a prolonged manipulation, perhaps something else might aid the move to increased silver supply.

Here's a great constructive suggestion from my good friend and silver mentor, Izzy Friedman. Actually Izzy made this suggestion to me years earlier. In order to encourage investors to sell at some point and provide additional material to alleviate any silver shortage or user buying panic, Izzy suggested that the government reduce or eliminate any taxation on silver profits. Please think that over for a moment. Aside from the obvious self-serving nature of tax breaks for silver investors, what better way for the government to ease a possible shortage to industry? Tax policy has always been about tailoring behavior to benefit the citizenship at large. The incentive of favorable tax rates on the sale of silver would help bring more metal to the market. It sure beats the alternative which so many suggest to me, namely, a confiscation of silver by the government. Izzy is more concerned with the USA than just about anyone I know and I believe his suggestion is as constructive as it gets.

Ted Butler

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