

August 10, 2011 – The Public Be Damned

The Public Be Damned

Wild and volatile are words somewhat insufficient to describe fully how markets have behaved these past few days. This is especially true when it comes to gold and silver prices and their divergence. Truth be told, I welcome the parting of ways in the price paths taken by gold and silver, as they are similar, but different enough commodities to not be joined at the hip constantly. Of course, I am still of the opinion that it should be silver vastly outperforming gold and not the other way around, but rarely are one's market beliefs confirmed each and every day. That silver could be so weak while gold has been so strong is counterintuitive to me, but many things in life defy my preconceptions on a short term basis.

It's not just gold and silver that have been recently volatile, as many important markets have been likewise in upheaval, including world stock markets and big commodities like oil and copper. A few weeks ago I offered a spectacularly wrong prediction that oil could pop a quick \$5 or \$10 per barrel to the upside if the key remaining moving averages were violated. We didn't get that upside penetration and prices instead subsequently fell as much as \$25 at the extreme lows yesterday evening. While I now regret even bringing up crude oil, my speculation was based upon expected behavior by the technical funds and other momentum-type traders. As wrong as my oil speculation may have been, I am more convinced than ever that the interplay between these technical traders and their commercial counterparts still largely explain much of the recent volatility.

I try hard not to be stubborn and would never cling to a method of analysis that was consistently disproven. That's why I stick to COT analysis, as it generally explains most important market moves, even if short term predictions can sometimes be wide of the mark. In particular, I think the market structure in most markets has had a lot to do with the recent wild moves. In oil, there was still a large technical fund long position in place prior to the recent takedown, despite already serious liquidation in place at the time of my errant prediction. It was still dramatic speculative long liquidation behind this recent crude oil price smash. Likewise, it was technical fund long liquidation behind the recent dramatic price drop in copper, as prices plunged below moving averages. The way the COT analysis works is that the lower prices fall amid technical fund selling (and commercial buying), the better a buy that commodity becomes. The actual bottom, only certifiable in hindsight, comes when no more technical fund selling is possible.

In gold, a different pattern has emerged, that I first alluded to on Saturday. Price action and daily statistics continue to suggest that commercial short covering may be a major contributor to the stunning gains. Never have we witnessed such large price gains in gold after a large commercial short position was established. As I wrote on Saturday, the largest 4 commercial shorts in COMEX gold had bought back a notable number of futures contracts in the latest COT report, breaking away from the 5 thru 8 largest shorts and the gold raptors which both added to their short positions. This throws out hints that the gold commercial shorts may be in trouble. Certainly, it is easy to calculate that the almost hundred dollar jump in the price of gold on Monday and Tuesday has cost the 8 largest COMEX gold shorts \$2.5 billion in mark to market losses and margin calls. That's over \$300 million per trader on average. These sudden losses are unprecedented and suggestive that a real emergency may be at hand. While I can't be sure, it seems to me that the sudden outbreak of unease in world financial markets may have driven enough worried investors to buy protection in gold and that this physical buying may have tipped the scales against the big COMEX shorts.

I'd like to throw something out here that has occurred to me about this big up move in gold. It's no secret that I believe that gold and, especially, silver have been manipulated in price due to the large and concentrated short positions in each on the COMEX. Many of you agree with that premise. Where some differences arise is in who may be beyond that manipulation and why. The most popular version is that it is the US Government trying to suppress the price in order to help maintain the value of the dollar or some related reason. As you know, I have strong reservations that it is the USG behind the manipulation of gold and silver and instead it is the work of some large financial commercial crooks on the COMEX. It appears to me that the gold price action this week supports my take. Please hear me out and let me know if you disagree.

I would agree that the US Government could manipulate the price of gold and silver if it chose to do so. The US owns the largest stockpile of gold in the world and while it owns no silver any longer, it has the ability to sell or back those who could sell unlimited quantities of paper contracts short on the COMEX to cap and depress the price of each. It would be against the law for the US to do so, in my opinion, but who could stop them if they did? But if ever there was a time for the USG to depress the price of gold, it would have been this week. After the S&P downgrade on Friday evening, any big manipulator would have been ready to depress the price of gold first thing Monday morning (or Sunday evening). There has never been a more important time to manipulate the price of gold than this week. That the gold price surged instead strongly suggests to me that the US Government was never behind the metals manipulation. And if not them, then who? Look no further than the assorted commercial vermin on the COMEX.

In silver, we have not seen yet a corresponding rush to buy physical metal and the scales have not been tipped against the big concentrated shorts. This has allowed the big COMEX silver shorts to continue to dominate and control prices. In a self-reinforcing pattern, the subdued and controlled silver prices discourage new safe haven buying and encourage further selling liquidation, particularly by nervous and disappointed silver margin players. This is a temporary situation and will end when the last of the nervous leveraged longs are flushed from the market. The good news is that much silver liquidation has occurred already.

It is important to try to understand, as much as possible, what are the dynamics behind the large price moves recently. It is human nature to accept any plausible-sounding reason offered if it is in conformance with the price direction. In a big price move, we demand an immediate explanation and then we accept any explanation offered, even if it doesn't stand the scrutiny of further analysis. For instance, big price declines in copper and crude oil are immediately explained and accepted as being due to weakness in the world economy. Yet we know that the world economy and copper and oil fundamentals can't possibly change quickly enough to be the real explanation. Please allow me to offer what I think is the real cause behind all the crazy price volatility and then to suggest something constructive you might want to do about it.

What's behind the volatility is unbridled speculation and computer-type HFT trading gone wild. Oil didn't drop \$20 a barrel or copper 25 cents a pound because there was a sudden fall-off in demand or increase in supplies. This was all about speculative trading gone haywire. Let me be more specific. The whole premise of the economic justification behind commodity futures trading has been bastardized. US law has sanctioned the trading of commodity futures for the express purpose of allowing legitimate producers and consumers to hedge or transfer their price risks to speculators. But the wild price swings we are witnessing are not related to legitimate hedging. The volatility is as a result of speculators battling speculators, with real hedgers largely on the sideline. This is relatively easy to demonstrate.

The big price moves are the result of moving averages and other technical signals being violated. Technical funds and other momentum type traders rush into and out of the markets, often on an intra-day basis, as a result of these price changes. Against those technical type traders are aligned the "commercials" that take the opposite side of these transactions. But these commercials are also speculators and are not the legitimate hedgers they purport to be. Real producers and consumers don't hedge based upon changes in moving averages on a daily basis. Real hedgers don't day trade. Real hedgers don't engage in HFT. The fact is that the commercial traders are just trading against the tech fund speculators and this makes the commercial traders speculators as well. This is an important distinction. It is why the big commercials in COMEX gold may be in trouble, namely, they weren't hedging in the first place and their short speculation may have been a serious miscalculation because it wasn't a legitimate hedge originally.

If my analysis is correct, then most of the volatility is due to one giant sick game of unbridled speculation. The speculators include not just the obvious and visible speculators, but also the commercials pretending to be hedgers. These commercial speculators in drag include the largest banks, like JPMorgan. How has it gotten to the point where our insured deposit taking institutions are among the biggest speculators? This speculative trading activity on the part of banks has greatly increased the current price volatility and increased the dangers of systemic risk. How is that good?

We've gotten to this point because our financial system structure has encouraged more and more speculation on the part of our important financial institutions. Leading us on the way to ruin is the criminal enterprise, also known as the CME Group, which has become dependent of encouraging more of the mindless daily speculative trading to fatten its bottom line. So harmful is the CME's role in all of this that in order for the CME to be blessed, the public must be damned.

What can we do about this sorry state of affairs? Quite simply, what we have been doing, namely, to petition the regulators to enforce the laws governing manipulation and disruptive trading practices. I know that many are tired of petitioning the CFTC because there has been little visible response from them regarding the silver manipulation. Yet I am still convinced that this is the best and perhaps only constructive route. I'm not going to beg you to contact them if you feel it's a waste of time. Likewise, I'm not going to promise you that the agency will do the right thing, as that's up to them. All I do know is that silver is manipulated by virtue of a concentrated short position on the COMEX and that is against the law. You must always do what you feel is right, regardless of how it may turn out or how many times you tried in the past or whether someone else will also do the right thing.

I know I'm going to send this article to the CFTC (as well as to the CME and JPMorgan). I invite you to do likewise if you are so inclined or write in your own words and ask them to break up the concentrated short position in silver. I would ask that you remain respectful if you do write so as not to distort the intent of your message. I know most of us are sick and tired of the silver crime in progress and the regulators failure to deal with it, but you must rise above your emotions to be effective.

Ted Butler

August 10, 2011

| | |
|--|----------------------|
| ggensler@cftc.gov | Chairman Gensler |
| mdunn@cftc.gov | Commissioner Dunn |
| bchilton@cftc.gov | Commissioner Chilton |
| jsommers@cftc.gov | Commissioner Sommers |
| somalia@cftc.gov | Commissioner O'Malia |

Date Created
2011/08/10