August 11, 2010 – The Latest Smash

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I had planned to send out a different piece today dealing with a long-term silver issue. But I thought it more helpful if I comment on the price decline this week. We must always try to maintain a longer term focus because that is where the real outcome and investment results will be determined. But sometimes it's the short term that gets our attention and emotion. This qualifies as one of those times. (I'll send the original article tomorrow.)

From Friday's close, silver has dropped 75 cents at today's low. Let me first discuss the decline in purely analytical terms and then in a measured, but more emotional manner. We declined over the past three trading days for one reason only; because the commercials were able to trick the technical funds on the COMEX into selling much of their recently acquired long futures contracts. As painful as these price declines always feel, this one wasn't completely unexpected. While I was hoping for quick $5 to $10 upside move, I wrote on Sunday that the recent deterioration because of tech funds buying could also result in a quick dollar or so sell-off. Contrary to my personal preference, we got the sell-off.

The good news is that the commercials appear to have succeeded in liquidating almost all or all of the roughly 6000 contracts that the tech funds had recently added long. That suggests we may be close to or finished with this intentional price drop. (Maybe one final thrust below the 200 day moving average around $17.70, maybe not.) More good news is that I sense JPMorgan played an active role in the price takedown and used the opportunity to further reduce its concentrated short position. This means, despite the pain of the decline, that the $5 to $10 price pop scenario is still intact.

Enough of the good news; the bad news is terrible enough. From a perspective of what's right or wrong, this latest price smash is rotten. It mocks the rule of law and makes us all the more cynical of the system, leading financial institutions and the regulators. It is normal to feel outrage at these repeated rig jobs. As always, the commercial traders banded together and pretended to sell massive numbers of contracts (emphasis on pretended) on the electronic market. This started the price snowball rolling down the hill and below the key moving averages, at which point the technical funds started selling on a programmed basis, as they always do. Knowing how and when the technical will sell, the commercials then, in a predetermined and cohesive manner, withheld the bids on the thousands of silver contracts they wanted to buy from the tech funds. The commercials set their collective bid at much lower prices than they would have normally, in order to maximize their net collective buy points.

Simply put, the commercials tricked the tech funds into selling thousands of contracts of silver, covering 25 to 30 million ounces, that the tech funds bought a week before. Some might say that's the way the markets work; that the commercials won and the tech funds lost. I disagree for a number of reasons. For one, what I just described amounts to collusion among the commercials. In fact, it is impossible for it not to be collusion, either on this recent takedown or on the hundreds of separate takedowns over the years. No free market explanation can describe the commercials' behavior other than it being collusive. Such market collusion is patently illegal.

In addition, the quantities of COMEX silver traded between the tech funds and the commercials are manipulative to the world price of silver. The world mines less than 2 million ounces of silver daily and consumes a slightly greater amount. The 30 million ounces of silver recently transacted (twice) between the tech funds and collusive commercials dwarfs the amounts in the real world. There isn't one ounce of this 30 million ounce paper transaction that is related to a legitimate hedge. The tech funds aren't hedgers by definition and, in fact, neither are the commercials. This is what I mean when I say that this big paper futures trading is setting the price of silver, not discovering it. This is a violation of basic commodity law. Our futures markets exist to allow risk transfer by real producers and consumers. This COMEX tech fund/commercial paper trading scheme has absolutely nothing to do with hedging silver production or consumption. It is purely an illegitimate private gambling racket that is setting the price of silver for all the real producers and consumers in the world. I'd like to see someone describe it differently.

At times like these, I think the market has lost its collective mind. How is it possible for the regulators not to see this? I know that the Enforcement Division has been given specific and substantial evidence that supports my allegations. Yet they won't act on it. I know that all the commissioners must understand this, yet they tolerate this crime in progress. I know that JPMorgan must recognize that they are involved in a criminal enterprise, yet they remain silent to these allegations. I know the COMEX and the CME must be aware of this manipulation because I send all the above this and every article I write about them.

But I take solace, as you should as well, in knowing that such an obvious and brazen scam cannot continue indefinitely. It may feel like it will last forever, given its longevity, but that's an emotional reaction, not an analytical conclusion. You should be outraged by what is transpiring. The correct manner for dealing with your outrage is let those in charge know how you feel. Write to them about this sell-off if you feel so inclined, but please save some energy for writing to them again in the near future with constructive comments on position limits. To become disengaged for any reason is not an option.

The correct manner for dealing with the investment implications of this latest smack down is different. You must suspend your feelings and focus on the facts. The tech funds are getting (or are) sold out. Their selling improves the market structure, no matter what it may feel like. The selling removes risk and enhances future profit potential. The silver market is in a better condition as a result of this selling, despite its manipulative roots. Please handle it accordingly.

Ted Butler

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