Confirmation Bias

The latest buzz phrase making the rounds in investment circles is □confirmation bias□ □ the condition in which someone's preconceived view on an issue results in favoring information supportive of that preconception. In investment terms, this has come to mean strongly agreeing with other bullish views if one already is bullish or in only considering one side of an issue, such as whether gold or silver are manipulated in price or not. Increasingly, confirmation bias is hurled as an insult by one side or the other when genuine disagreement exists.

The truth is that confirmation bias exists in everyone because we all hold certain beliefs and prejudices. In fact, it would probably be impossible to hold any asset as a long term investment if one didn't have a positive confirmation bias towards that asset. That said, it is also true that misplaced belief or a faulty premise can prove particularly damaging in investment matters. Therefore, rather than attempting to eliminate belief in an investment premise, rigorous review must always be employed to guard against belief in the wrong premise. The only way to do this is by a continuous and objective review of the facts as those facts are uncovered.

This is particularly important to those, such as myself, who offer analysis and commentary to others on a specific subject. While being wrong is integral to the human condition, advising others adds much greater responsibility. It seems to me that the only way to cope with that greater responsibility is to stick with the facts to guard against one's confirmation bias being completely misplaced.

One strong belief that I've held for decades is that the price of silver is manipulated on the COMEX. The principal mechanics of the manipulation involve a collusive effort by one group of large traders, called commercials, to maneuver another group of large traders, called technical funds, in and out of futures contracts. Because the technical funds rely exclusively on price signals to buy and sell in enormous quantities and because the commercial traders have come to capture the pricing mechanism even before the advent of HFT (High Frequency Trading), the commercials control the technical funds buying and selling. Because such enormous quantities of COMEX silver futures contracts are transacted between the commercials and the technical funds relative to the amount of real silver being transacted throughout the world, the much larger COMEX paper market ends up dictating prices to real metal producers, consumers and investors. This is the opposite of what US commodity law intends, but it is the reality we must all deal with.

The incredible fact is that the control that the commercials hold over the technical funds is documented in the weekly public data provided by the CFTC in its Commitments of Traders Report (COT). This is the report that verifies that the technical funds always buy on rising prices and sell on falling prices, with the commercials always taking the opposite side of the technical funds' buying or selling.

In other words, the largest silver trading in the world and, therefore, the most influential to price occurs on the COMEX between one group of speculative traders only interested if prices are rising or falling and another group of traders only interested in taking money away from the first group. In the interim, the world's real silver producers, consumers and investors are held hostage to the two large groups of COMEX traders engaged in a high stakes private betting scheme.

While supported by the facts, since none of this is new, let me move on to more recent developments. Last week, I mentioned that the CFTC had fined and settled with JPMorgan charges that the bank submitted numerous false large trader reports that form the basis for the COT report. The settlement didn't disclose in which markets the false reports were filed, but seeing as JPMorgan is a large presence on the COMEX, it is reasonable to assume the bank filed false

reports in COMEX silver, gold and copper. In sort of a collective delayed reaction, reports began to circulate this week that the COT reports could not be relied upon. This struck me as erroneous conformation bias by those who always have dismissed and aren't familiar with how the reports are constructed.

I openly confess to believing that the large trader reporting system and the COT reports are among the most reliable government reports of all. I say this not only from studying the COT reports for more than three decades, but also from having filed numerous large trader reports on behalf of clients many years ago. There are relatively few large reporting traders (around 250 in COMEX gold and copper and less than 200 in COMEX silver) and every large reporting trader, by strict regulation must submit a daily report whenever a reporting position changes.

From the small number of traders required to submit reporting data to the fact that everything is computerized and recorded, the COT report is not difficult to assemble. I would submit that this is what enabled the CFTC to uncover that many of JPMorgan's reports were false. Further, since futures trading is zero sum and all long and short positions must balance, there is an additional built-in confirmation in that any trader reporting incorrectly would cause an imbalance in other traders' positions.

One question that has never been answered by those denying that the COT reports are accurate is why in the world would the CFTC publish data which provided proof of a silver manipulation by intentionally misreporting the data? There have been times in the past several years where JPMorgan held 40% of the short side in COMEX silver; why would the CFTC report that if it wasn't true? To those that may suggest JPMorgan's concentrated short position was even greater, perhaps that may be true, but the market share was great enough to prove manipulation as reported.

Finally, a subscriber pointed out the most obvious demonstration that the COT reports are accurate is that they provide the sole explanation for price moves, including the sudden swoon in silver and copper this week. Just this year alone, we have seen record and near record readings in COMEX silver, copper and gold, all characterized by record technical fund (managed money) long positions at price highs and record technical fund short positions at price lows in all three markets. What are the odds that extreme technical fund positions marked both price tops and bottoms in all three COMEX metals and this was merely coincidental and not causal?

More than ever before, the changing structure of the COT reports has come to represent the sole reason for price movement on the COMEX, with actual supply/demand fundamentals not mattering at all. That's why, despite allegations the reports can't be relied upon, more analysts and commentators than ever before have embraced the COTs as an important market tool. Ask yourself this if it were not for the remarkable changes in the COT structure this year in COMEX silver, gold and copper, what else could possibly explain the price moves to date?

Since it is always true, or at least for 90% of the time, that technical funds sell as prices penetrate moving averages to the downside, there is little doubt that these funds were strong sellers in silver yesterday and sellers in COMEX copper today as key moving averages were violated in both markets. If we don't show a significant reduction in the commercial net short position in this Friday's COT report in silver, it will most likely be due to a reporting delay. In contrast, COMEX gold penetrated its important moving averages last week with no downside follow thru this week. As such, it doesn't appear that the technical finds were big sellers this week in gold and won't be unless and until new price lows are seen.

The main characteristic of the early summer price rally in gold and silver was in

how aggressive the commercials were in selling into technical fund buying to the upside. So effective were the commercials in capping prices that recent price weakness has now put the current price below the average cumulative price at which the commercials sold, particularly in silver. In other words, the commercials' average selling price is above current prices, especially in silver.

Here we are, below the effective primary cost of mining silver and the commercials are profitable on sales made close to $21, but only because they never allowed the price to go higher. The flip side of that is that the technical funds amassed a record long silver position at prices close to $21 (something I didn't imagine was possible at such low prices) and the odds would suggest the technical funds will sell out on lower prices and at a net loss. That could only occur in a manipulated market.

While it's not guaranteed that the commercials will flush the technical funds from the long side in COMEX gold, silver and copper on lower prices, the probabilities point that way. Even if we bounce in the very short term, it is likely to involve the commercials setting up the technical funds for an eventual clean out. I don't enjoy reporting at times like this and hope that my guesstimate of the probabilities turns out to be wrong. However, this has nothing to do with my long term expectations for silver, as I intend to show in future articles.

I mentioned on Saturday that I would comment on any future developments in the COMEX-approved gold warehouses following some unusual movements last week. For the last three and a half years, most of my attention has been on the unprecedented turnover in the COMEX silver warehouses. While I am still focused on the silver movement, there was some unusual movement for a change in the gold warehouses.

On Monday, it was reported that close to 600,000 oz of gold were removed from the warehouse owned by JPMorgan, one of the largest one day movements in memory. At close to 7% of total COMEX gold inventory, the report turned heads (including mine) in that it couldn't be related to this month's total deliveries against the August contract, which as of Monday were around 225,000 oz. As it turned out, the initial report looked to be error as Tuesday's warehouse report was adjusted upward by nearly the same amount of Monday's decline.

But yesterday's report also indicated that nearly 400,000 gold oz were brought into the warehouses, including nearly 300,000 oz into the JPMorgan warehouse. This had the effect of increasing total inventories in the COMEX gold warehouses to over 9 million oz, the highest in more than a year. You may

remember that in the first half of 2013 on the historic price decline, total gold inventories on the COMEX fell by close to 4 million oz to 7 million oz, in accordance with the 18 million oz reduction in the big gold ETF, GLD.

Where Monday's initial reduction of 600,000 oz didn't make much sense (until it was corrected), yesterday's 390,000 oz deposit did seem to make sense. Before that deposit, there were still more than 4000 contracts open in the August delivery month and yesterday's deposits looked to be designed to deliver against those open contracts. In fact, more than 1200 contracts were delivered this morning that appeared to be related to yesterday's deposit. As such, it could be reasonably concluded that the big gold deposit was made to satisfy delivery demands which would be bullish on its face.

I'd like to add some thoughts that struck me about the COMEX gold deposit of nearly 400,000 oz, assuming this doesn't also turn out to be in error. While smaller than Monday's incorrect report of a 600,000 oz withdrawal, this is a very large amount of gold in some ways and not so large in other ways. One maximum truckload in silver is 600,000 oz, so 400,000 oz of gold could be moved in one truckload, if necessary. As it turns out, 600,000 oz truckloads in silver are a very common occurrence, so by this measure this wasn't a large amount of gold. Also, relative to all the gold bullion in the world, 400,000 oz is a

very small percentage.

But in terms of dollars, 400,000 oz of gold is a large amount – $520 million to be exact. Maybe not that large for the likes of JPMorgan, which produces a quarterly profit of around $5 billion and other large banks; but $520 million is large for most other entities. Make no mistake, gold (or silver) deliveries and warehouse movements involve actual metal, unlike 99% of COMEX paper trading. One may not be able to understand all the nuances and particulars of COMEX deliveries and warehouse movements due to a lack of complete transparency; but it can be ascertained that such deliveries and warehouse movements involve real metal.

Since I have an admitted bullish confirmation bias towards silver, I couldn't help but think of yesterday's gold deposit worth $520 million in silver terms. Anyone who could afford to buy $520 million worth of gold could just as easily afford to buy $520 million worth of silver instead. In fact, from numerous vantage points, an increasing number of investors have voted for silver as seen in ETF flows and sales of bullion coins. Therefore, it's not unreasonable to imagine that $520 million could have flowed into silver instead of gold. But whereas $520 million would buy 400,000 oz of gold, the same $520 million would have accounted for 26 million oz of silver. Same dollar amount; but a wicked different amount of

metal.

Where $520 million worth of gold didn't have much immediate impact on price (today's gold price action is undoubtedly futures trading related), $520 million worth of silver would have likely blown the roof off the silver market. I can't see how a single purchase of 26 million ounces of real silver wouldn't add many dollars to the price, even if the crooked commercials sold much more in paper futures contracts. In essence, that's at the heart of the difference between gold and silver and the best reason to hold a bullish confirmation bias in silver. In today's world of almost unlimited financial buying power, someday some unknown entity, possibly not intending on forcing the price to rise will try to buy a certain amount of physical silver that will do just that.

Ted Butler

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Silver – $20.05

Gold – $1309