August 8, 2010 -Just Slip Out the Back Jack?

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I'd like to provide a few follow up comments for subscribers on the new Commitment of Traders (COT) and Bank Participation Reports and how they tied in with my recent discussion on silver and JPMorgan. First, both reports confirmed my analysis that JPMorgan had closed out a significant number of its massive concentrated silver short position on the COMEX. In somewhat of a surprise, JPM appears to have also closed out a significant amount of its concentrated COMEX gold short position as well.

My guess was that JPM had reduced its silver short position by 10,000 contracts from June 29 (not a Bank Participation report date) to 24,000. The actual number was an 8,000 contract reduction to 26,000, close enough. In troy ounce equivalents, JPMorgan reduced its short position by 40 million ounces to 130 million ounces over the past five weeks. This is an impressive reduction and leaves JPM with its lowest COMEX silver short position in more than a year and not that far from its lowest short position since it inherited the Bear Stearns short position in March 2008. As a way of contrast, the high point of JPM's short position was over 200 million ounces, both at the time of the Bear Stearns acquisition and again in December 2009.

As impressive (and encouraging) as the reduction may be, it must be recognized that 130 million ounces still represents almost 19% of world mine production, an amount of market concentration unequalled in any commodity of finite supply. There can be no doubt that such a concentration must be manipulative to the price, in and of itself. JPMorgan still has a long way to go in reducing its concentrated and manipulative short position in silver.

Still, the short covering to date by JPMorgan is impressive, even more so in that the reduction took place both on price declines and price increases. This indicates to me a determination to be rid of this silver short position. Let's face it, JPMorgan hasn't seemed able to explain away or defend its concentrated short position, even after numerous public allegations. If one can't explain or defend a position, abandonment seems a logical alternative. The only question in my mind is whether JPMorgan will increase, even temporarily, its silver short position ever again. I thought this once before, back in May, but JPM fooled me by temporarily increasing its COMEX silver short position before the current impressive reduction.

But conditions are different now than they were in May, thanks to the enactment of the new financial reform law. I know there have been numerous reports of how the big banks avoided the worst of the proposed restrictions in the law, including a splashy new piece in the Rolling Stone magazine. I couldn't disagree more with those accounts of how the banks got off easy. At least in commodities, and particularly in silver, this new law changes everything. Not a day goes by that I don't become more impressed with how commodity regulation will be changed. I still credit Chairman Gary Gensler of the CFTC as the architect of that change. That the majority still doesn't comprehend what's in store is amazing to me.

One entity that apparently does appreciate the change is JPMorgan. After spending more than anyone to lobby against commodity derivative reform, it is my opinion that they know full well how their efforts have largely failed. There will be legitimate position limits enacted in silver and JPM's exemption to those limits will be denied. While everyone seems to doubt this, JPMorgan knows what lies ahead and is taking action to prepare for it. In my opinion, JPMorgan is covering its silver short position now because of the new law. Of course, if JPMorgan increases its silver short position in the future, my analysis is wrong and I will admit it at that time. For now, I remain convinced that JPM covering its silver short position is no fluke and they have no intention of ever increasing it again. They are trying to slip out the back Jack or to make a new plan Stan (with apologies to Paul Simon). To conclude that this development is bullish for the price of silver would be a severe understatement.

In my recent King World News interview, I did report on deterioration in the latest COT, as technical funds bought and commercial (other than JPM) sold. Most of the commercial selling was by the smaller commercials, which I refer to as the raptors. These raptors were not increasing a short position, but selling from a net long position. As a result of their recent selling, the raptors now hold one of their lowest net long positions in years. In addition, the 5 through 8 largest short traders hold one of their highest net short positions in years, precisely because JPMorgan is holding the lowest short position in more than a year. Further, the 2 through 8 largest traders (a category which must be inferred) hold a very large short position, again because JPMorgan reduced its short position. I know this must be a bit confusing, but bear with me a moment longer.

In the interview, I suggested that we could have a dollar sell-off in silver or a $5 to $10 rally. Here is how I am coming up with such different possible outcomes. Anytime the technical funds add to long positions, they become at risk for the commercials yanking the rug out from under the market and forcing the technical funds to sell on the downside. This is the rhythm of the market. Of course, the commercials are acting collusively and illegally in these market rigs to the downside, and it is outrageous and shameful that the CFTC has been blind to the obvious. If the commercials made a stand and banded together now, my guess is that they could get the technical funds to cough up what they just bought on a dollar decline.

However, given the low level of the remaining raptor long positions, combined with the high level of the 2 through 8 short position, there is not much potential commercial selling, away from JPMorgan. In other words, if JPMorgan is serious about further reducing its short position, or at least not in increasing it, there doesn't appear to be much potential commercial selling left in the market. In this case, any further technical fund buying, or buying from JPMorgan, or buying from any other source, could have an out-sized impact on price to the upside. And as wrote months ago, if JPMorgan does abandon its manipulation of the silver market (as it should), the remaining commercials could and should panic on the upside at some point.

In essence, what I am suggesting is that the commercials may succeed one more time in temporarily manipulating the price of silver lower through collusion, or they may fail spectacularly if JPMorgan finally abandons its manipulation of silver. It is important to remember this is only a question for the short term, because on a long-term basis, the silver manipulation will end and end abruptly. This also explains why, in spite of continuing to pay close attention to the COT, I am inclined to ignore and ride through possible price corrections. This is not the time to risk being underexposed to the long side of silver.

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August 8, 2010

Silver – $18.45

Gold – $1205

Date Created
2010/08/08