Sorting Out the Stories<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

I guess the theme of this article is to try and make sense of some recent news and address a number of questions readers have asked me about, including things I've written about. I have not tried to put this in any particular order.

One recent story revolves around the high concentration of ownership of copper stored at London Metal Exchange (LME) warehouses. It has been reported that a single trader may own up to 90% of the copper on deposit at the LME, with the name of JPMorgan suggested as the owner (I've also seen BlackRock mentioned). As you may know, copper prices have recently traded at historic highs, and the concentrated ownership has raised the question of whether someone is attempting to manipulate the price of copper higher. There have even been suggestions that JPMorgan may be using copper to offset their concentrated short silver position on the COMEX.

I don't buy these suggestions. It seems implausible that JPMorgan would openly attempt to manipulate the price of copper, even though I do accuse them of having manipulated the price of silver. The copper purchases appear to have been made in preparation of the introduction of a physically-backed ETF (exchange traded fund) or two. While that copper metal buying could very much influence the price, it would be a stretch to suggest it was done with manipulative intent. Please remember that it is the LME itself that is providing the details of the copper ownership and if it felt there was any wrongdoing then it would undoubtedly be addressed. But the story does bring several points to the forefront.

One is the matter of concentration. When I speak of concentration, I am referring to a large entity controlling such a large position in the futures or derivatives market that it influences prices in the host or physical market. There have also been cases of manipulation where an entity held both a concentration in derivatives and in physical holdings, such as the Hunt Brothers in silver. I'm not aware of any manipulation cases that involved only physical ownership with no derivatives exposure, and I'm not sure if the futures regulator, the CFTC, would even have jurisdiction in a physical only case. I suppose anything's possible, but the amount of physical copper in the LME warehouses only amounts to 2% or 3% of world annual copper production, so I would imagine it would take much more than that in order to prove manipulation. There is no law that I am aware of that limits the amount of an actual commodity that someone may purchase or own outright. There are laws against manipulation using futures or derivatives either in conjunction with physical ownership or not. Again, if someone owned a truly outrageous percentage of a world commodity and for no reason other than to control the price, I suppose it could be attacked on anti-trust grounds, but that does not appear to be the case here in copper.

Another story readers have questioned me about concerns a report suggesting JPMorgan is transferring its concentrated short position in COMEX silver to foreign banks. I've studied the data closely and do not come up with that conclusion. JPMorgan is clearly reducing its COMEX silver short position and that has contributed to the recent price rise, but there is no compelling evidence that it is merely a transfer of that short position to foreign banks. In the most recent Bank Participation Report, the US banks (JPMorgan) did reduce their net short position by around 4,000 contracts as previously reported, but the foreign banks only increased their net short position by 1,200 contracts. Besides, if there were such an arrangement in place, it would require overt false statements to the CFTC on large trader reporting requirements, something almost unimaginable for reporting financial institutions.

One big story that has retreated somewhat from the news is the status of the position limit proposal by the CFTC. As you know, last Thursday's meeting ended abruptly with no vote on the staff's proposal. The Financial Times reported earlier this week that a revised proposal was circulating privately among the five commissioners in the hopes that some consensus could be reached soon. Because the law is clear as to the deadline to implement position limits, I'm sure we will hear something soon. This is a real hot button issue for silver and I will deal with it as it develops. The other very big issue will be what the CFTC finds when it opens JPMorgan's swaps book.

One great question from a reader was in him asking me what a swap was. In this context, a swap is just a private futures contract between two parties that is not transacted on an exchange, or subject to the safety of the clearinghouse system. Let me try to make this as simple as possible because it's important for you to understand. In fact, this is the central issue of the Dodd-Frank Financial Reform Act.

Because the financial system was almost destroyed in 2008 by unregulated derivatives (such as the credit default swaps held by AIG), Congress and the President mandated that previously secret and privately transacted derivatives be made more transparent and openly transacted on exchanges and platforms backed by a clearing system. Instead of one entity privately guaranteeing a derivatives contract to another entity with the details of the transaction known only to those two parties, the new law mandates, as much as possible, that the transactions take place in the open with the combined guarantee of many. The many in this case is the clearinghouse a consortium of large financial institutions that back all exchange-traded futures contracts. By definition, a clearinghouse arrangement is much safer than the guarantee of a single entity strength in numbers, as it were.

This is what Dodd-Frank is all about when it comes to derivatives. It is a noble and worthy goal that will benefit us all. I firmly believe that Chairman Gary Gensler of the CFTC deserves a medal of honor for his role in trying to bring this about. (I will reserve a medal for his handling of the silver manipulation until a later date, although I suspect it may be a joint presentation to him and Commissioner Bart Chilton). The only entities that could possibly be against the introduction of financial reforms promoting greater transparency and safety would be those damaged by such openness. Of course, that includes the big banks and financial institutions that stand to lose profits by having to disclose how much their markups will be. Obviously, markets that are more competitive and transparent yield less profit mark-ups, than do markets where your customers are in the dark. Banks (and all businesses) always charge more if the charges are hidden. That's why the banks have been the main obstacle to financial reform. That, in essence, is what this financial reform is all about the banks against everyone else.

It's almost the same match up in silver, where a few banks and other financial institutions make up the bulk of the short side, with everyone else largely long. I've speculated that the biggest COMEX short, JPMorgan, has been able to justify its concentrated short position to the exchange (the CME Group) because it is holding swaps (private futures contracts) that offset its COMEX short. I've further speculated that these private swaps may be held by Chinese interests. Hopefully, we will soon find out how close to the mark my speculation has been. But there should be no misunderstanding that the basic premise behind Dodd-

Frank is to make transparent these opaque swaps markets, in silver and all other markets.

I do plan on a number of articles to review the past year and preview the New Year in silver, hopefully with the unique perspective that I strive for. The schedule for the weekly review may be altered a bit, due to the upcoming holidays and the delayed-release of the COT for the next two weeks, but not dramatically. We seem to have hit a range-bound quiet patch this week, but under the hood the circumstances in silver still appear spectacular to me. While I sense an intent to keep a lid on silver prices by the big short interests through the daily sharp sell-offs, I feel this will not last for too long. Based upon physical market developments, the COMEX market structure and regulatory changes, we still seem set for upside surprises, albeit with continued attempts by the shorts to induce selling. Please remember that low trading volume does nothing to alleviate a growing physical shortage. We are ending a remarkable year for silver and about to enter an even more remarkable new one. Best to you and yours for the holidays.

Ted Butler

December 22, 2010

Silver – $29.30

Gold – $1386