The Mechanics of a Price Explosion

When I first started looking into silver's supply demand fundamentals more than 30 years ago (as a result of a challenge by Izzy Friedman), I concentrated on just that a study of the metal's actual production, consumption and inventory status. But in searching for the explanation for the puzzling low price in the face of the most bullish circumstance possible in any commodity (the long term structural consumption deficit), I stumbled upon a mechanical reason for the low price the unusually large concentrated short position on the COMEX.

I have continued to study silver from a supply/demand perspective to this day, but have come to learn that changes in actual production and consumption have little to do with short to intermediate term price movements. When it comes to the price moves that garner the most attention, one has to look at paper futures market trading, not the actual metal fundamentals. That's the simple explanation for why I concentrate so closely on COMEX positioning and the Commitments of Traders (COT) Report.

I believe the actual fundamentals in silver dictate that prices should be much

higher, but that's been the case for nearly as long as I've studied the metal. I also believe that while the fundamentals are aligned with a price explosion, what will set it off will be the same futures trading mechanics that created the artificial price environment for the past three decades. Before I get into the mechanics and why I think we are close to a silver price explosion, please allow me to catch up on some unfinished business.

Increasingly, what I've long described as the “silver disease” or a world commodity being priced primarily by paper futures market trading, has come to infect other important world commodities. In a nutshell, the power of paper contract positioning between two specific groups of futures market traders – the managed money traders and the commercials who take the other side – has come to set prices. There are other mechanical factors, such as HFT and other computer-generated forces impacting prices, but those factors only compliment and exacerbate positioning between the managed money traders and the commercials.

The managed money traders are most usually the same in every market, registered with the CFTC as Commodity Trading Advisors (CTA's), but the makeup of the commercials can vary; with big banks dominating the ranks of the commercials in precious metals, but much less so in other markets. But the

game is largely the same – prices rise as managed money traders buy and fall when they sell.

I further contend that the commercials generally lead the managed money traders in and out of positions since most of managed money traders are technically oriented and buy and sell on price signals (which the commercials can usually set at will). From my long term observation, the commercials seem to fare much better in the profit and loss department than do the managed money traders and that goes a long way to convincing me that the commercials maneuver the managed money traders in and out of positions and not the other way around.

I'm not going to rehash the whole story today, but I did promise to update some recent large price moves in a number of markets. Back at the end of September, I wrote an article, "The Biggest Scandal" in which I describes how the price of sugar rose by 10 cents a pound (75%) in little more than six months, resulting in $35 billion being added to the annualized cost of the world's sugar consumers. The scandal was that the price rise had nothing to do with actual world sugar production or consumption and everything to do with the 250,000 paper sugar contracts bought by managed money traders on the ICE sugar futures market. I contended that the biggest scandal was allowing the

collective force of managed money paper contract buying to exert such a strong price influence on everyone else.

http://www.silverseek.com/commentary/biggest-scandal-15982

Here's an update on sugar and some other important commodities, like crude oil and copper. After hitting 24 cents a pound days after my article, sugar then fell by 25% (6 cents) as the managed money traders sold more than 120,000 contracts as prices moved lower. It may not sound like much, but a 25% price change for a world commodity in two or three months is extraordinarily large, particularly when there was no new actual supply or demand explanation. Moreover, the managed money traders were the unquestioned largest sellers of sugar futures contracts on the way down, just as they were the largest buyers on the price rise.

In mid-October, the price of copper shot up from under $2.10 a pound to over $2.70 a pound in less than a month, a remarkable 30% jump in a world commodity with an annual production value of $120 billion. You can look all you want, but there was no big change in world copper production or consumption over the few weeks it took copper to rise by 30%. But there was net buying of more than 100,000 copper futures contracts on the COMEX (plus even more

speculative paper buying on the LME and in China).

COMEX copper paper contract buying by managed money traders alone amounted to the equivalent of 1.25 million tons of copper, nearly one full month of world copper production and consumption. By the way, the COMEX copper buying by the managed money traders was the largest in history, as was the case in sugar earlier. Do you think it could possibly be just a coincidence that record large managed money buying and surging prices have become commonplace, particularly when actual fundamentals haven't changed?

Finally, the price of crude oil, the world's largest and most important commodity, surged from $42 to $54 per barrel, a rise of nearly 30% in little more than a month from mid-November. Yes, I am keenly aware of the unprecedented future production cuts agreed to by OPEC and non-OPEC producers, as I have studied oil and OPEC for more than forty years. But I am also aware that the managed money traders in NYMEX crude oil futures bought 150,000 net contracts, the equivalent of 150 million barrels of oil at the same time. In both COMEX copper futures and NYMEX crude oil futures, the managed money traders established all-time record large long positions, as they did in sugar earlier in the year.

My point is that I don't know how it could be any clearer that managed money and counterparty commercial paper trading exerts the greatest influence on price. The “lightbulb” that went off in my head more than 30 years ago about the influence of COMEX paper contract trading on the price of silver has only intensified over the years and has spread to most commodities – all while being in direct violation of commodity law, which holds that purely speculative trading should not set prices. We've gotten to the point where only speculative positioning determines price.

Where this all ends is anyone's guess and my guess has always been that it will be most dramatic in silver. The same mechanical paper market forces that have accounted for the price movements in sugar, crude oil, copper and gold, are not only present in silver but are turbocharged by a variety of factors. First is that silver is a particularly small market compared to the others, with its annual production valued at the tiniest percentage of one percent when compared to crude oil and around 10% of copper. In terms of above ground inventories, the value of available silver is less than half a percent of gold inventories. I believe silver's steep relative undervaluation to other commodities is related to its extraordinarily low price. This almost guarantees a much bigger relative pop to the upside when prices move higher.

But it is the particularly unique mechanical factors in silver that guarantee an extraordinary price move higher. Not only is silver a small market, it has been subjected to artificial price setting the longest and to the most extreme degree. This can be seen in COMEX silver futures having the most intense and long-lasting concentrated short position of all markets when compared to actual world production. In COMEX silver, the eight largest commercial traders hold a net short position of more than 420 million oz, nearly 50% of total annual mine production and not one of those commercial shorts is legitimately hedging or representing the interests of actual miners.

By comparison, the concentrated short position of the eight largest shorts in COMEX gold (now not all commercials) comes to 16.5 million oz, which sounds large at close to 17% of annual gold production, but not so large when compared to the 5.5 billion oz of real gold in the world; at only a quarter of a percent of total existing gold. By contrast, the concentrated short position in COMEX silver is more than 40% of all the documented world inventory of 1000 oz bars. This mismatch is undeniable as is my conclusion, namely, because silver has the largest documented concentrated short position of all markets, when that short position is attempted to be closed out, it will result in the most dramatic short covering in history.

Admittedly, these conditions have been in place for decades and still we haven't seen the silver price explosion I have long expected. So what makes me more convinced than ever that silver is still on track for a short-covering price explosion? The answer resides in the actions of the former largest silver short, JPMorgan. As I have been reporting for years, JPMorgan has been on an epic and massive buying spree of physical silver, having amassed more than half a billion ounces over the past nearly six years. Not only was this a masterful move by the bank, it further guaranteed that silver would explode at some point.

When JPMorgan first accumulated more physical silver than it held in short COMEX paper contracts (some time no later than 2012), it was “off the hook” as far as having any real price risk to a silver price explosion. At that point, silver became more set up for a price explosion than ever. So why haven't silver prices exploded before now? The best answer is that JPMorgan, having been so masterful and successful in neutralizing its former large paper short exposure, decided to press its advantage and continued to accumulate physical silver for as long as it could (since it knew it was holding a Royal Flush). Rather than quitting the game when it first achieved the near incredible accomplishment of neutralizing its COMEX paper short position, JPMorgan set out to make some real money in continuing to acquire actual metal for as long as it could.

As I've explained previously, there was no way that JPMorgan could have bought back its paper short position or accumulated 550 million oz of silver by just buying as many paper COMEX contracts as it desired. Futures contracts are derivatives contracts, meaning there must be seller for every contract bought. Having studied futures trading for more than 45 years, I can assure you that no single entity, including JPMorgan, would be able to buy 100,000 net contracts of COMEX silver futures (500 million oz), on consistently lower prices for any number of reasons, mainly centered on the impossibility of finding enough new paper short sellers to enable such buying. Besides, even the most casual observer of the COT reports would spot such concentrated buying quickly.

For sure, JPMorgan knew it couldn't buy back its paper COMEX short position straight out and the usual maneuvering of the managed money traders wouldn't come close to allowing it to cover its shorts and build a massive long position; not with other commercials and outside traders to compete with. It just couldn't be done. Buying physical, stealthily and persistently, was JPM's only option – an option that it has fully exercised.

I understand that what I just described could have led to a silver price explosion

any time over the past few years and that explosion did not occur, despite my expectations and the ability of JPMorgan to walk away from the silver price manipulation with not only no loss, but with a giant profit to boot. So why do I think the price explosion is more certain and closer at hand than ever now? The answer has to do with very recent mechanical developments.

As of the last COT report, JPMorgan now has, concurrently, its lowest silver paper short position and largest physical long position ever. In other words, JPM has never been better positioned for an upside silver price explosion. And that's the way JPMorgan's silver position should be considered □ on a net basis. Yes, it is possible for additional new price lows from here, in which JPMorgan reduces its paper short position and uses the time to acquire additional physical metal; but from a market structure perspective, the big managed money selling is behind us and that is the selling JPMorgan needs to buy back additional paper shorts. As I have been reporting for weeks, the managed money selling well is running dry, particularly as concerns new short sales.

More than ever, the next silver price rally that sets off managed money buying (prices moving above the important moving averages) will tell the tale. On all such rallies over the years, JPMorgan has added to paper COMEX short positions and has succeeded, in concert with the other large COMEX commercial shorts,

in capping every rally and then driving prices lower. One of these times it is going to be different, in my opinion, and JPMorgan won't add to its short positions. Without JPMorgan's participation the rest of the COMEX commercials don't appear strong enough to cap any silver price rally. Silver has been JPMorgan's world and without it lending a hand on the short side, that world will be changed forever.

The most remarkable thing about this is that all JPMorgan has to do, in order to cause silver prices to explode and for it to make the largest profit in the history of silver, is for the bank to do, literally, nothing. All it would take for silver prices to truly explode is for JPMorgan to passively step aside and not sell short additional contracts on the next price rally. That, I would submit, would be about as easy as breathing. On the next rally, should JPMorgan simply refuse to sell, silver will soar. I would remind you that JPMorgan is not required to sell.

Can I guarantee that JPMorgan will not sell additional paper contracts of COMEX silver short on the next rally? Of course not, as I'm an analyst, not a prophet or a deity. I can tell you that should JPM not add to short positions from here, the mechanics of the market dictate that prices will explode. And considering the growing attention and awareness to JPMorgan's easily proven accumulation of physical silver over recent years and its price control on the COMEX, it's hard to

imagine how more becoming aware of what the bank has been up to, is good for the bank in any way. Market crooks don't crave widespread awareness of their criminal activities and that applies to JPMorgan in spades. Maybe the next silver rally won't be the big one, but I'm betting it will be until proven otherwise.

Ted Butler

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Silver – $16.05 (200 day ma – $17.78, 50 day ma – $17.14)

Gold – $1143 (200 day ma – $1273, 50 day ma – $1213)