

January 26, 2011 - Strange Days

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The sell-off in silver and gold continued, mainly because it continued. By that I mean that I detected little reason for the sell-off from the first of the year other than it had picked up momentum and a life of its own, despite no discernable cause being traced to real world supply/demand fundamentals. In short, this is a classic COMEX jam job by the commercials to the downside. Don't be fooled by the now bearish rhetoric about silver's prospects. News and opinion follows price. Those bearish on silver now will be singing a bullish tune once prices start to rally. That's just the way the world works.

Like a bad cold or a case of the flu, the sell-off wasn't invited or welcomed by silver or gold investors (or by me). Nor was it a simple case of the free market at work. Far from it. This week's COT report will show just what the most recent COTs have shown, namely, that a very small group of COMEX commercials have been able to buy what many leveraged speculative long traders were forced to sell. Without belaboring the point, it is not possible for such a small group of commercial traders to bamboozle so many other traders so methodically and consistently without collusion. That the regulators can sit by and let this manipulation continue on the criminally-infested COMEX is shameful.

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That aside, it's hard not to be excited about the great buying set-up created by this manipulated takedown. Gold and silver have rarely been as oversold and washed out as they are as a result of this manipulated price smash. As many of you know, the actual bottom is always achieved when the last possible leveraged long who can be flushed out is flushed out. That event is only knowable after the fact, but if that hasn't occurred yet, we are so close to it that it is time to consider what will come after the inevitable turn to the upside. In other words, it is time to contemplate what the next rally is going to look like. I think it's going to be a sight to behold in silver.

In the latest weekly review, I tried to describe how aggressive and blatant the commercials were in causing the price to decline in order to allow them to buy as many contracts as possible. I pointed out that the buybacks of COMEX silver short positions were achieved only at great loss to them, despite the recent sell-off. This buying back of COMEX silver shorts at great loss to the commercials has continued. What I failed to mention was the likely behavior of these commercials on the next price rally. Let me do so now.

I believe that the commercial shorts in silver were blind-sided by the events in the second half of last year. They misjudged regulatory developments, industrial physical market demand (from Asia) and, most of all, growing investment demand. In short, they were almost overwhelmed and came close to having their short positions overrun by the rise in price from \$18 to over \$30.

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Because of the relentless demand, these big commercial shorts had to take it on the chin and were out billions of dollars on the way up. This recent decline, engineered by them expressly for that purpose, has allowed the commercials the opportunity to buy back some of their shorts. So, even though they are booking big losses on the close-outs, they are glad to eliminate further losses when silver prices rally anew.

What this means to me, is that these commercials, led by JPMorgan, will be very reluctant to increase their short positions on the inevitable silver rally. Please think about this. If my guess is correct, and the former short sellers of last resort refrain from additional short sales of silver on the next rally, what will that mean? It may create a selling void or vacuum (as I've long predicted) and that absence of selling would allow prices to soar. I just don't see these big commercial shorts putting their heads back into the lion's mouth and shorting aggressively on the next rally. And if they don't, the sell-side will suddenly be missing its former chief sponsors. That's a set up for big numbers on the upside.

A few months back, I commented on how the technical funds, in a very unusual move for them, had sold a significant number of their net long silver contracts (20 to 25 thousand) at a big profit, before the big 50-day moving average was violated on the downside. I postulated that the reason for their departure from the long side was due to the subjective override of their normal system signals because of the great distance between the then current price and the big

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moving average. They didn't want to lose the big profits they held on paper. (I don't know if I previously disclosed that I had witnessed this subjective override once before in silver in 1979, when I held a large book of technical fund accounts as a broker. That personal experience, plus many years of observing technical fund behavior, has formed the basis of my analysis on the tech funds. You didn't think I made this analysis up out of thin air, I hope).

Anyway, the tech funds liquidated around \$25 or less, on average, back in Oct-Nov. As it turned out, the price of silver continued to climb to over \$30. Now that we are decisively below the 50-day moving average (currently around \$28.50), an interesting new bullish possibility has been presented. Since the price of silver (and gold) is now well below the 50-day moving average, the next cross above the moving average to the upside may prompt the technical funds to reinstate their systems and buy, as the former great distance between price and moving average (and perceived risk) no longer exists. If the tech funds do come in to buy in force on the next upward penetration of the 50-day moving average and the big commercial shorts refuse to sell short (as I outlined above), greater price fireworks could very easily result.

There are some very strange things occurring recently, mostly in silver, but also in gold. First are regulatory developments, or the lack thereof. The position limit proposal by the staff of the CFTC is inadequate when it comes to silver. Of more concern, however, is the lack of direct response to the thousands of public

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comments requesting 1500 contracts as the proper limit and the valid reasons for such a limit. The Commission is being disrespectful to legitimate public opinion by refusing to openly discuss the issue. Also seemingly lost to the vagaries of time is the ongoing silver investigation, now the longest in agency history. I would respectfully remind the Commission that not only has it a responsibility to uphold and fairly administer the law, it is also important that the public perceive that the law is being upheld. I can tell from my correspondence and various readings of public sentiment, that the CFTC is currently held in low regard. That is not healthy circumstance.

More specifically, many of you have written to me questioning if I have altered my former high opinion of Chairman Gensler and Commissioner Chilton, who I have held out as good guys in the fight for legitimate position limits and ending the silver manipulation. I can't say I am not wavering a bit, but my sense is that they are still on the righteous path. After all, we wouldn't even be discussing position limits were it not for Gensler and Chilton. I would imagine that they are both concerned and hopefully torn about the latest blatant manipulative takedown by the crooks at the CME Group and the stress it causes to innocent silver investors. My advice to them is to turn up the heat on the manipulators before the agency is dragged into disgrace by the coming silver shortage.

Other strange happenings in silver include the unusual move in spread trading over the past week, when we witnessed historic tightening. Add this to the

continued frantic turnover in COMEX silver warehouse movements, reports of delayed silver shipments and the aggressive buying by the COMEX commercials and all the signals seem to point to a looming silver shortage. In fact, the only truly strange aberration in the recent occurrences is in the price action itself. Everything adds up to a price that should be exploding higher, yet it declines sharply, thanks to JPMorgan and the other COMEX crooks.

Also in the strange category is the growing widespread public commentary by those respected in the precious metals community of the silver (and gold) manipulation on the COMEX. More strange is the lack of any denial by those accused of the manipulation (JPMorgan and the CME Group) to the growing chorus of allegations of wrongdoing. There has even been silence in the face of the numerous lawsuits filed against JPM for manipulation. This is something that I never expected to witness. I've been waiting to have my head bitten off by those I accuse of manipulation; instead those accused have remained mute, while growing numbers have joined in decrying the manipulation.

The latest strange occurrence is the sharp drop in gold open interest yesterday, when over 80,000 contracts suddenly disappeared. Making the historic drop even more notable was that most of the decline was centered on the more deferred months with very little trading volume reported to support the liquidation. These were clearly spread transactions that just vaporized large amounts of open interest. Unlike what occurred in silver, there was no

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noticeable spread price change accompanying the massive gold spread liquidation. In fact, over the past week, while silver spreads changed in price dramatically, gold spreads didn't budge at all.

I've read the early commentary and inquired of those in the know for an explanation for the sudden liquidation of these gold spreads and I would like to offer my own. As I wrote recently, I had written privately to some high officials at the CFTC back in early November, warning them of the inordinate amount of spread positions in COMEX silver and gold futures. I warned them that in a silver shortage, the large number of spreads could come to cause severe financial pressure on the clearinghouse system should we move into a pronounced backwardation in silver. (That backwardation has not actually occurred yet, but the dramatic silver spread move over the past week gives a strong suggestion that it might.)

I also wrote to these CFTC officials (strictly on a good citizen basis) that while backwardation was less likely in gold, given the improbability of a physical gold shortage, the large amount of gold spreads open on the COMEX had to be largely uneconomic in nature and that the CFTC should jawbone the traders holding these uneconomic spreads to close them out. I can't say that the CFTC took my advice and asked those spread traders to liquidate, but then again I can't say that the CFTC didn't take my advice either. What I can say for certain is that the question of whether these gold spreads were uneconomic in nature

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appears to have been settled. For such large quantities of spreads to be suddenly closed out with virtually no impact on gold spread pricing (unlike in silver) would indicate they were uneconomic and phony to begin with. As a reminder, I have long contended that the presence of phony spreads in large quantities has the effect of severely understating the true concentration on the part of the manipulators.

As I was finishing this piece, I got an email from a subscriber with questions I have been asked a lot lately.

Ted,
I have a couple obvious questions:

1. Who can stop JPM or the CME now that they know the CFTC has no teeth (or why would they stop)? I really feel like they have been given a hall pass and now are running amuck with no supervision.
2. How serious is the shortage if miners can still produce the metal? Isn't the real question whether the miners still have the metal to provide to the ETFs?
Are the miners having any difficulty mining silver?

John

John,

Even assuming that the CFTC has given the bad guys a pass (which I'm not ready to do yet), what will stop the crooks are two things. Sooner or later, they will run out of leveraged long victims to liquidate. Second, the crooks can't bluff the physical market. When we hit the physical wall, nothing can stop the price

from exploding.

Miners are going to mine as much as they can; it is what they do. But supply is only half the supply/demand equation. Demand, both industrial and investment, is poised to overtake all that the miners can produce. I always assume silver mine output will remain high, to remain conservative. But if you study the production history of any metal, there can easily be interruptions to that production. It hasn't happened in silver in a long time, but it is possible for silver mine production to be interrupted, at least temporarily. In that event, the impact on price should be substantial.

In closing, these sell-offs are no fun, despite the opportunities they create. They are particularly distasteful when you know they are created intentionally and the regulators apparently sit by and allow the law to be violated. All we can do is deal with it the best we can. That means not to lose positions to the COMEX crooks. You do that by holding on a cash basis, no margin. If you must speculate on a leveraged basis, call options are the way to go. If you are angry enough (as you should be) about the intentional sell-off, feel free to give the regulators a piece of your mind. Obviously, they need to be motivated more than they have been to date.

Ted Butler
January 26, 2010

Silver - \$26.85
Gold - \$1328