January 27, 2016 – The Big Short

First off Â? a correction. In Saturday's review, I stated that CFTC Chairman Massad had not used the term Â?position limitsÂ? once in his speech on Friday regarding the agency's priorities for this year. An alert reader pointed out he did use the term once. My error. Of course, it would seem unwise to expect any genuine enactment of either legitimate position limits or, more importantly, legitimate enforcement of same. Or, for that matter, of any meaningful action by the CFTC towards the growing control of price via futures market positioning.

My basic gripe with the agency is that it has its head in the sand to the growing evidence of price manipulation in silver, gold and other markets as a result of massive speculation between two trading factions, small in number but very large in collective position size Â? the technical funds and their commercial counterparties (mostly big banks). I've postulated that the price-setting Â?diseaseÂ? of the technical funds all rushing into and out from markets has distorted prices in a way contrary to commodity law.

Now, new evidence suggests the silver price-setting disease has spread to the equity markets. An article in the Monday's Wall Street Journal detailed that the traders I usually refer to as the managed money technical funds prospered mightily during the stock and crude oil collapses this year, scoring gains of hundreds of millions of dollars on the downside (while a collective $2 trillion in market capitalization Â?disappearedÂ? from US equities).

http://www.wsj.com/articles/automated-hedge-funds-make-millions-in-januarys-market-selloff-1453721976

I have no concern about what profits or losses are taken by large traders; my concern is restricted to whether anyone's trading is harmful to the markets. The WSJ article appears content to report on the profits a few technical funds made during the stock market swoon. My concern is that the collective technical fund selling either caused or greatly exacerbated the decline, just as it does in silver and gold and elsewhere. How can anyone not see that concentrated bursts of computer-generated selling causes price to fall, whether it is the price of silver or the S&P 500 Index?

I even offered the only possible solution to the technical funds gone amuck Â? apply a collective position limit on such mechanical selling or buying, because these independent traders are operating as if they were one single trader. The technical fund traders' method of operation is much more harmful to the markets and other participants than it is beneficial and as such needs to be curtailed or eliminated. But with the CFTC dragging its heels on individual position limits and not even considering collective position limits, I'm afraid we'll need more than another flash crash or a 10% decline in the stock market before the agency realizes that the collective behavior of a few technical fund is detrimental to all of us.

The Big Short

Following many suggestions that I do so, I finally did get to see the movie, Â?The Big Short.Â? I had tried earlier, but it was sold out; this time, there were few others in the theater. Rather than critique the movie, which I found entertaining, my review is more of an analysis of the circumstances portrayed. I had read extensive excerpts from the Michael Lewis' book on which the movie was based (he the author of Â?Fast BoysÂ?) and was quite interested in the financial aspects covered.

While I was quite familiar with the content covered, it seems hard for me to imagine anyone not well-versed on the US residential real estate boom and bust grasping the full dimensions of the crisis in a single movie. Certainly, I was aligned with the movie's vilification of big banks and the regulators and the rating agencies because, in essence, that has defined the last three decades of my life. Absent that background, I'm not sure most of the audience would end up with a similar view. The average citizen is too involved in the complexities of daily life to even know when the banks are ripping him off. Again, the time restrictions and not the movie's content or visual production would be responsible for any lack of a clear message. After all, how many in the general non-financial world would even know what a short position is?

I suppose every movie has heroes and villains, but the protagonists here were hardly of the typical hero stereotype, since the hedge funds that did finally profit big in the end did nothing to aid the real victims of the real estate debacle. Sure, there are lessons to be learned from having to suffer with a market position before it pays off, but there was little redemption for the millions who lost their homes. And while the big banks were hardly portrayed in a positive light and the regulators and rating agencies were accurately treated as incompetent and self-serving buffoons; all that seemed to more make fun of what was a deadly serious outcome for many millions of fellow citizens.

Basically, the movie portrayed a very small group of speculators engaged in a financial struggle against a larger group of speculators, collectively represented as the banks. This should sound familiar since it is at the heart of what I have written about for decades. There are eerie similarities to the movie and what I have been engaged in for the past 30 years, right down to the title – only in my case, the Big Shorts in silver are not the good guys. In the movie they were the good guys – a few opportunists out to make a legitimate buck in a world they didn't create. Instead, the Big Shorts in COMEX silver create the price environment the rest of the world must adapt to, real producers and investors alike.

The main theme of the movie was that indiscriminant and reckless mortgage lending that led to the real estate boom and bust was bet against by a relative handful of speculators, even though multitudes were aware of how dangerously high real estate values had become and how insane was the financing that drove it. I attribute the small number of actual participants who bet that the housing and mortgage markets would collapse to the lack of legitimate investment vehicles at the time available to the public. The movie emphasized the custom and private club nature of the securities which prevented a wider participation. In addition, all the short bets were highly leveraged and subject to margin calls, almost at whim.

Comparing this to silver, there is no question that silver investors know how painful it is to wait out the manipulation. I would hope the eventual resolution of the housing bubble would help convince investors of silver's certain resolution ahead. More important is that unlike the obstacles and difficulties in placing bets against overvalued mortgage securities, silver can easily be purchased without jumping through hoops and can and should be held on a cash and non-margin basis, eliminating the prospect of margin calls.

There was one thing I learned from the movie that I hadn't realized before that also bears a striking similarity to a major development in silver. Towards the movie's climax, the hedge fund mortgage shorts suffered intense financial pressure and margin calls due to the value of the swaps they were short rising in value instead of falling, despite an onslaught of negative news that should have resulted in lower values and profits to the Â?good guyÂ? speculators. If there was a touch and go dramatic stress point in the movie, this was it.

As it turned out, the price of the securities in question rose instead of fell because the banks had discovered the folly of being on the wrong side of the transactions in question and manipulated prices higher temporarily so that they could also load up on the short side. Once the banks were fully positioned on the short side, the price of the securities was allowed to plummet, rewarding both the good and bad short speculators; a happy ending for all, except the millions of innocent and not so innocent housing victims.

The analogy in silver should be clear. After manipulating silver prices to the downside for years, JPMorgan also came to discover the merits of silver as an investment and used its ability to manipulate prices to accumulate the largest privately owned stockpile of metal in history. The Big Silver Short, just like in the movie, saw the error of its way and flipped to buying as much as it could. Don't you love happy endings?

Finally, in the-you-can't-make-this-up category, I was startled at the movie's end. Having gone to the movie with a sense that it paralleled in many ways my efforts to expose the silver manipulation, I was shocked when the credits were rolled and Led Zeppelin's version of Â?When the Levee BreaksÂ? blared. I suppose this signified that any market or system can only take so much before breaking. I couldn't find a link at first, but I did remember writing an article with that title and referencing that very song many years ago suggesting the COMEX levee system would break in silver. After discovering the link to the article no longer worked, I was able to reconstruct a link by means of a beta version of the Internet service Way Back Machine (scroll down to the second article) Â?

http://web-beta.archive.org/web/20160102142419/http://news.silverseek.com/TedButler/1210018234.php

In rereading the article (and playing the song more than a few times), I was transported back to the time I wrote the article, May 5, 2008. This was a pivotal and fascinating time for silver. A week after I published the article, the CFTC released its second 15-page public denial that silver was manipulated by means of a concentrated short position on the COMEX, intentionally omitting that the biggest concentrated short in silver, Bear Stearns, went bust right at the highest price for silver in nearly 30 years and needed to be acquired by JPMorgan at the government's request. No mention was made in the CFTC's letter about the most significant development in silver since the Hunt Brothers in 1980.

Just a few months later, the CFTC would initiate yet another formal investigation into silver as a result of the shocking data in the August 2008 Bank Participation Report showing a giant concentrated short position by JPMorgan, but the investigation was stretched out for five years before being abandoned by the agency with no details ever being provided. Please don't take this as a rambling walk down memory lane, as I wish to point out something different. What started out as a shock at hearing an old Led Zeppelin song and looking up an old article, transformed into a consideration of perhaps the most important price period in the history of silver.

On May 5, 2008, silver was priced at $16.50, down from the near-30 year high of $21 in March when JPM took over management of the silver price from Bear Stearns. From May 2008, the price of silver worked its way back to $20 in late summer, only to tumble below $9 towards the end of the year (as JPM bought back many of its short COMEX positions). From $9, silver climbed to $49 by the end of April 2011; a gain requiring little more than two and a quarter years. From the highs of 2011, it has now been nearly 5 years on the grind down in price to under $14.

A forty dollar (and five-fold) increase over little more than two years, followed by a thirty five dollar (and 70%) decline over nearly five years, with the past two years locked in an ever-narrowing and contained price range. At the very least, that is one strange price history. Making it even stranger is any attempt to rationally explain it in terms of what transpired in the actual world of silver over this time. Let's face it – it would seem that there must be some obvious explanation for the price of a world commodity first exploding by hundreds of percent and then declining by 70% over a fairly extended period of time. After all, this is one highly unusual price history.

But I can't find the obvious explanation from the world of actual silver supply and demand. Yes, mine production has climbed over the past 8 years, but not out of proportion with increasing demand, both for industrial and investment demand. In fact, many, including the Silver Institute, term the current production and consumption balance in silver to be in deficit (although not as I define the word Â?deficitÂ?). In addition, because documentable world inventories of silver have shrunk, not grown over the past five years, no one can point to an actual oversupply of metal. Let's see Â? no increase of supply over demand and no increase in world inventories Â? that's not compatible with an oversupply.

That's not to say that there aren't plenty of other verifiable data on silver that we can draw upon to explain the unusual price history. The only problem is that most or all of the other documentable data on silver point to unusually high demand and tightness in supply, making the unusual price history out of this world in the strange category. Simply put, there is absolutely no compatibility between the known facts in silver and its price. What known facts?

For starters, there's the shrinking, not growing world inventories. Recorded world silver inventories have not shrunk by great amounts over the past four years, but they certainly haven't increased. One would think behind a big price decline for a commodity would be evidence of oversupply in the form of growing inventories. While that has been the case in crude oil, the opposite is true in silver. This can be seen quickly in focusing on the two biggest components of visible world silver inventories, the holdings in the big silver ETF, SLV, and in the COMEX silver warehouses. Together, more than 50% of the world's total visible inventories of silver resides in these two holdings.

Further, there is more recent evidence that the verifiable world inventories of silver are shrinking faster than previously. Over the past year, total visible world silver inventories have fallen 75 million ounces to 815 million oz. I'm not saying that this silver no longer exists; I'm just saying it no longer resides in verifiable inventories. I'm also not predicting whether visible world silver inventories will continue to shrink, stay the same or rise because no one can do that. All I or anyone can do is observe and analyze inventory developments. In observing the changes in world silver inventories to date, it doesn't take a rocket scientist of an analyst to conclude that the changes are not compatible with the price history.

The most important verifiable data about silver inventories has been the persistent turnover of physical movement of metal brought into and taken out from the COMEX-approves silver warehouses. Over the past five years, this physical turnover has been nothing short of unprecedented and frantic. In addition, the turnover pattern has occurred as well in SLV, although to a less frantic extent. This specter of physical turnover, virtually unique to silver of all commodities, stands out starkly and practically demands an explanation.

The two most verifiable facts are that world verifiable silver inventories are not growing and are turning over at an incredible rate. What does or can this mean? To me, it can only mean one thing Â? there is a great demand for silver, either from industrial users or a big investment buyer. If there was a broad based demand movement by the world's investors to buy silver, there would be clear evidence of that Â? it is not something that could be hidden. Yet there is no evidence of broad silver investment demand, either in Silver Eagles or COMEX futures or silver ETFs. By simple process of elimination, if silver is being bought and demanded in the form of Silver Eagles and COMEX and SLV inventory turnover, which it surely is, and there is no evidence of broad investment demand, then the demand must be much narrower and coming from a big buyer or industrial users.

The only explanation or narrative that is compatible with all the facts and the price history of silver over these past several years is the one that centers on JPMorgan. In fact, unless I'm missing something very basic, there is nothing about my JPMorgan narrative that is not compatible with silver's price history from 2008. This bank has come to own the silver market (quite literally) since 2008. JPM is responsible for just about everything in silver, including coming to accumulate hundreds of millions of ounces, more than has ever been acquired from the open market in history.

I don't pretend to know the inner workings of JPMorgan, but everything I think I do know convinces me that it acquired the silver I claim for one reason only Â? to make as much money as possible from its sale. To achieve that profit objective, the price must move dramatically higher. If there's one thing I've learned over the years is that it's tough to prosper when going up against the big boys. Buying and holding silver now is compatible with the interest of the biggest boy (and crook) of them all. No one can know when JPMorgan will let silver go to where it must go if JPM is to profit, but timing aside, I'd rather have this crook on the same side that I'm on.

I was asked if JPMorgan is buying large quantities of gold as well as silver. I don't know. I have seen some evidence over the past six months or so that JPM might be buying gold in the surge in sales of Gold Eagles from the US Mint since summer (which has continued) and in the bank taking almost all of the COMEX December gold deliveries (over 200,000 oz). Perhaps some clarity might come in this month's February gold delivery process, which starts Friday. In silver, the verifiable data suggests JPMorgan has been on an acquisition spree for nearly five years (if largely in hindsight), whereas the evidence in gold is much more recent.

It is important to remember that there are big differences between silver and gold and JPM stands to make much more, at least in terms of potential return on capital invested, with silver rather than gold. That's another way of saying that JPMorgan, just like anyone else, would get more bang for its buck with silver than gold. That's because in terms of the effective total dollar value of each, there is infinitely more gold than silver; on the order of 300 times more.

That makes silver much more prone to climb more in percentage terms. It would be nothing for silver to double in price as that would increase the total value of all the 1000 oz bars in existence by only $15 billion. If gold doubled in price, all the world's gold would increase in value by $6 trillion, a more unlikely event. Not that gold couldn't rise by that amount, but if it did, silver would do a lot more than simply double in price.

Much attention is being placed anew on the rapidly shrinking amount of gold in the registered category in the COMEX gold warehouses. I'm certainly not negative to gold based upon its market structure and overall tightness, as I hope I've conveyed. And while the sharply shrinking level of COMEX registered gold is compatible with other signs of tightness in the physical gold market, I'm reluctant to get overly excited about the level of registered inventories alone. Many are interpreting the drastic decline in COMEX registered gold inventories as strongly suggestive of an upcoming delivery problem or even a pending default, but there might be other explanations. As of today, the equivalent of less than 900 contracts worth of gold remained in the registered category (although more than 64,000 contracts worth of gold was in the eligible category).

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