

July 10, 2019 - Deliberately Looking Away

There are two great evolutions underway in the world of commodities that, while in full view, are misunderstood or overlooked by most observers. So important are these two developments that they threaten serious market upheaval when they are addressed, as must inevitably occur. Most remarkably, indisputable data published by the primary federal commodities regulator, the CFTC, prove beyond a doubt both occurrences are underway, even as the agency, along with the US Department of Justice, refuse to confront what is a clear violation of US commodity and antitrust law.

The two developments in focus include a broad artificial pricing scheme, or manipulation, affecting a wide swath of commodity markets and a more specific price manipulation involving JPMorgan in silver and gold. The illegal pricing schemes did not evolve overnight, but over a multi-decade period of time. That's one of the main reasons why so many have failed to appreciate what has occurred - it has been a gradual process. So gradual that, like a frog not jumping out of a pot of water being heated slowly, market observers and regulators alike have come to accept as normal the dramatic and illegal change in the price discovery process.

Simply put, commodity prices are now set and determined by excessive speculation in derivatives contracts by a handful of large traders and not by changes in actual commodity supply and demand. Derivatives contracts are entered into by two parties, a buyer and seller, and include futures and options contracts traded on listed exchanges and contracts traded over-the-counter, where futures contracts are called swaps. In essence, derivatives contracts are simply paper bets on price in the future and only rarely involve the physical delivery of the underlying commodity.

The problem is that the derivatives bets have become so large in the aggregate and

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so concentrated by the small number of traders engaged in them that they have come to take control of prices away from changes in physical supply and demand. The word “derivative” means derived from and derivatives’ pricing is supposed to be derived from the underlying host physical commodity markets. It was never intended that derivatives trading would become so large and concentrated among a relative handful of speculators that derivatives trading would dictate prices to the underlying host physical markets. That’s akin to the tail wagging the dog. Yet that’s precisely the absurd state to which commodities have evolved.

In some derivatives markets, like COMEX silver and gold, actual bona fide hedgers are virtually non-existent, except in name only. In other markets, like crude oil, corn and copper, any legitimate hedging is done in direct reaction to what the big speculators are doing, not based upon the risk-offsetting needs of the hedgers. This is completely at odds with commodity law and the free law of supply and demand. How did the price discovery process of virtually all commodities come to be perverted and where big speculators now set prices?

As indicated above, it has been a gradual process, beginning 30 or more years ago. The origins are simple enough and trace to the same broad movement of individuals and institutions automating and indexing investments, which has led to the dramatic growth in index mutual funds, 401K’s, ETFs and other forms of passive, as opposed to active investment management. Just as investors have turned to more automated and passive vehicles for traditional investments, as opposed to actively trading individual stocks, they have done so in commodity derivatives, like futures trading.

There are now a proliferation of commodity ETFs (exchange-traded funds) which use the futures markets as the backing of their funds on a specific commodity basis. The

late CFTC commissioner Bart Chilton referred to such funds as the “massive passives”, which took enormous long futures positions. More importantly, there has developed a number of large commodity trading advisors (CTA’s, registered with the CFTC), which pool funds from retail and institutional investors to actively trade in futures and other derivatives contracts, aptly classified as managed money traders in the weekly Commitments of Traders (COT) report. The movement away from individuals speculating in commodity futures to institutionalized commodity derivatives trading has been profound.

According to COT data for every actively traded commodity futures market, the trader category that has grown the most over the last 20 years has been the large non-commercial trading category (of which the managed money category, is, by far, the largest component). The non-commercial category has grown by hundreds of percent over this time, reflecting the broader move to indexing and passive investment. In fact, it can be proven that the commercial category has also grown only because the non-commercial (speculative) category has grown so large. Talk about the tail wagging the dog - commercial trading has only grown in order to keep up with the tremendous increase in speculative trading, not because legitimate hedging needs have increased.

Managed money commodity advisors are said to hold over \$300 billion in total investor assets under management. Given the extremely low margin requirements (5% to 10%) applied to commodity futures contracts, the leverage and collective size of positions bought and sold by the managed money traders are so large as to be epic. And because most of the managed money trading advisors adopt a technical price momentum strategy, they all buy and sell, essentially, at the same time. Thus, when these traders buy, they drive prices higher and when they sell, prices

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invariably move lower. This, alone, explains the growing awareness of and interest in the COT reports.

Recent examples of egregious managed money trading activity on price include the following - the rally in corn prices by over 30% in little more than a month on managed money buying of 2.5 billion bushels of corn futures, nearly 20% of the US crop. The fall in crude oil prices from over \$66 to \$51 (23%) in little more than 6 weeks, due to managed money selling of 220 million barrels of NYMEX oil futures. The fall in copper prices of 10% in six weeks, due to the managed money sale of more than 935,000 tons of COMEX futures, nearly 5% of annual world copper production. The actual production and consumption of all three commodities changed very little, if at all, over this time, making it clear that the enormous amounts of managed money buying and selling caused the price changes.

Why are the regulators not addressing this issue? In addition to the gradual nature the now perverted price setting process, there are other powerful forces tying the regulators' hands. For one, by refusing to even acknowledge or debate whether the managed money traders are setting prices, the CFTC has painted itself in a corner. To admit now that things have gone awry, the agency would be admitting it should have acted long ago, something no regulator is prone to do willingly. In addition, there are powerful forces benefiting from the manipulative large managed money trading - including the world's largest derivatives trading organization, the CME Group, which profits from the excessive speculation.

Finally, while I have painted a picture of excessive large speculative trading by the managed money traders as being behind the perversion of the price setting process in commodities, in reality, the managed money traders are largely being scammed

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and defrauded by their trading counterparties, the commercials. Because the managed money traders are slaves to technical price signals, buying as prices rise and selling as prices fall, they are easily bamboozled and cheated by their commercial counterparties, which know how to rig the price signals that will prompt the managed money traders into buying or selling. This is easily seen in the poor public performance record of the managed money traders. The managed money traders may be big, but they have not been profitable in commodities trading in recent years.

The solution to the managed money traders distorting the price discovery process is so simple as to be alarming for why it hasn't already been implemented. Speculative position limits are a longstanding feature of US commodity regulation and if applied on a collective basis to the managed money traders which trade in unison (by technical signals), the perversion of the price discovery process would end immediately. But by deliberately ignoring the issue, the regulators haven't even arrived at acknowledging anything is wrong.

While the regulators, both the CFTC and the DOJ, are deliberately ignoring the broad price manipulation caused by excessive speculation by the managed money traders, they are also ignoring a much more specific market crime being perpetrated by the giant US bank, JPMorgan. While it may not be the prime commercial counterparty to the managed money traders in most commodity derivatives contracts, JPMorgan certainly is the leading commercial counterparty in silver and gold. So much so that it has never taken a loss in COMEX silver and gold futures trading since becoming the dominant short seller upon its takeover of Bear Stearns in 2008. Let me repeat that so there is no misunderstanding - JPMorgan has an impossibly perfect trading record in COMEX silver and gold futures trading for more than a decade - never

once taking a loss.

All told, JPMorgan has made cumulative trading profits of upwards of \$5 billion in COMEX gold and silver trading over the past 11 years, by always adding enough new shorts to quash every rally and causing prices to decline broadly since 2011. But even that perfect trading record pales in comparison to JPMorgan's magnificent criminal achievement of the ages, namely, it has not only achieved big trading profits on the COMEX since 2008, but since 2011 JPM has used the depressed prices it created to accumulate the largest physical silver and gold holdings in history (by a non-governmental entity). All told, JPMorgan has acquired 850 million ounces of physical silver and as many as 25 million ounces of physical gold.

It is not possible to imagine a more blatant manipulation - systematically depress prices by excessive short selling in COMEX futures contracts, pocketing \$5 billion in profits and then turning around and use the resultant depressed prices to scoop up \$50 billion worth of physical metal on the cheap. After profiting mightily on manipulative short sales on the COMEX since 2008, JPMorgan now stands to profit by many tens of billions of dollars on a gold and silver rally. Talk about the perfect crime.

Making the crime even more perfect, of course, is that the regulators are content to look the other way, most likely out of fear of crossing JPMorgan or upsetting the distorted price discovery process. The former commissioner Bart Chilton lost his fear of speaking out about JPMorgan just before his recent passing, but he was the first and only inside official to do so. Along with the CFTC and JPMorgan, now even the Justice Department seems determined to avoid dealing with what has to be the financial crime of all time. Not one of them can come out and refute any of these

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allegations out of fear of being dragged into a debate they know they can't defend - so the only way of dealing with it is to ignore it and hope too many more don't become aware of it.

Giving credit where it is due in a seemingly unrelated case, I can't help but note that the recent arrest of word-class sleazebag Jeffrey Epstein appears to be the result of diligent reporting by Julie K. Brown, an investigative reporter for the Miami Herald. From what I've read, without her reporting, there would have been no arrest. Similarly, the first mainstream media reporter to highlight the facts about the distorted price-setting process in commodities and JPMorgan's specific criminal fraud in silver and gold might break these two developments wide open.

In developments since the weekly review, there have been another 4 million oz of silver deposited into the big silver ETF, SLV, bringing to more than 12 million oz the amount of metal deposited into the trust in the last two weeks. I had estimated the SLV was owed 10 million oz, but can see now that trading volume remained high, despite lackluster price action, suggesting the possibility of stealth accumulation. All told, over the past 4 weeks, some 30 million oz have flowed into the combined listed world silver depositories, about half of which found its way into SLV. Someone is acquiring physical silver and if I had to guess, its initials begin with a "J".

As far as what to expect in Friday's COT report, gold and silver prices finished moderately lower over the 4 day reporting week, with the highest volume day being Friday, July 5, when prices sold off sharply. Since silver did trade below two of its three key moving averages (the 100 and 200 day) that day and gold did not approach any of its key moving averages, I would imagine more managed money selling and commercial buying to have occurred in silver proportionately. As far as numbers of

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contracts, at least 5000 in silver and, hopefully, more. As always, I'll try to draw a bead on what the uber-crooks at JPMorgan may have been up to, since this is their world.

Lastly, the news report of a cargo ship owned by JPMorgan being seized due to the discovery of a massive amount of cocaine was sent to me by a number of readers, so thank you. I do remember writing in the not too distant past in response to doubts that JPMorgan could hide \$40 or \$50 billion of physical silver and gold on its books, that it could hide an aircraft carrier if it so desired. I guess that's not exactly the same as a cargo ship loaded with cocaine, but it isn't that far away either.

Ted Butler

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Silver - \$15.24 (200 day ma - \$14.99, 50 day ma - \$14.87)

Gold - \$1416 (200 day ma - \$1283, 50 day ma - \$1331)