July 27, 2011 – A Different View

A Different View

Some recent reader questions prompted me to rethink how I might present a broader view of silver. Not a different story, but a different angle on the same story. Try as I might, I can't come up with a new story for silver. Maybe I can come up with some new aspects, but no completely new story. That's because the story is the story; most always there's just one basic true version or most plausible explanation for how a market operates. Whether we ever discover that true version is another matter because it's not that easy. And unless something comes along to disprove it, the story should be considered as valid, especially if continuing events confirm it.

The core story in silver, in my opinion, is that it has been in a state of manipulation to the downside in price for more than 25 years. The cause of the manipulation is a concentrated short position on the COMEX, the leading precious metals exchange in the world. Because this short position is so large and is held by only a few big traders (led by JPMorgan in recent years), it meets the definition of being considered concentrated. In order for there to be a manipulation, there must be a concentrated position. Evidence has emerged to suggest that the silver manipulation is ending, although not yet dead, precisely because the concentration may be ending.

Towards the end of September 2010, the eight largest traders short in COMEX silver held almost 69,000 contracts net short, or the equivalent of almost 345 million oz. The price of silver then was near $20 and about to embark on a price journey that would see silver more than double in price. As of the most recent COT report, the eight largest traders had reduced their net short position to just under 225 million oz (45,000 contracts), or a reduction of 120 million oz. That the price of silver exploded over the past 10 months to levels not seen in 30 years concurrent with a big (35%) reduction in the concentrated short position is no accident. This is cause and effect. The first time in COMEX history that the big concentrated silver short position covered to the upside resulted in a monster price movement. That's what the data indicate.

I don't say the price move from under $20 to almost $50 was solely caused by the buying back of a significant chunk of the concentrated short position, but it was a very big and perhaps the biggest factor in silver's price climb. Moreover, the single most pronounced occurrence of short-covering of the concentrated short position took place in the week when silver moved to its highest point in late April. What the data and price action jointly indicate is the dominant role that the concentrated short position has had on the price of silver over the past 25 years. Simply put, the concentrated short position in COMEX silver was responsible for the decades of artificially depressed prices and its covering has been and will be responsible for the prices seen to date and the high prices to come.

The specific question I was asked that set off this thought process was Â?how do the big shorts, like JPMorgan, make money in this price rise?Â? The answer is they don't. Instead, they lose and lose big time. Shorts make money when prices decline, not when they rise. In pondering this reader's question, it occurred to me that I might be better able to explain the silver manipulation itself by presenting it in a different manner.

Let's face it Â? the entities I've accused of manipulating the price of silver, like JPMorgan and the CME Group, are among the most powerful financial entities of them all; they are the true masters of the financial universe. They are at the tippy top of the financial food chain. They have virtually unlimited access to financial resources. They are, by virtue of aggressive lobbying and political contributions, the dominating force in shaping legislation and regulation. They are staffed by the sharpest human talent and technological advantage that money can buy. In addition, they have the morals and ethics of a cockroach and a bag of dirty market tricks at their disposal, like HFT and after hours market control.

Yet, in spite of all these clear advantages, the big shorts have taken it on the chin in silver over the past ten months. It wasn't always so. For decades, the concentrated shorts made big money in silver on a regular basis. That's because the big commercial shorts had a golden goose in the form of the technical funds and other momentum-type traders which the commercials could run in to and out from the market at will, by dictating artificial price changes. To the extent that these technical traders can still be dominated by the commercials, we must expect that we will see sudden sell-offs in the price. But clearly, the power of the concentrated commercial shorts is on the descent as forces other than the technical funds have come to influence the price of silver.

Here's something that I'd like you to consider. Despite all their many advantages, the commercial masters of the universe have completely missed and misplayed one of the biggest financial scores of all time, namely, the more than ten-fold increase in the price of silver over the past years, to say nothing of them missing the tremendous relative outperformance of silver compared to gold. While I know scores of people who have made massive amounts of money in silver by objectively studying the facts, I can't think of one high-profile name entity who hit it big by investing in silver for all the right reasons. Even the world's most successful investor, Warren Buffett, managed to miss the big silver move by losing his immense silver position before prices soared. All the true success stories have been by the Â?littleÂ? guys. What could explain this?

The answer is obvious, at least to me. All the big commercial entities were too interested in their fleecing of the technical funds that they missed the big picture. They were so caught up in their short term scamming of the technical funds that they overlooked the real silver story. In fact, the commercials short-term maneuverings against the technical funds caused them to manipulate the price of silver and end up on the wrong side of the market. The commercials were so busy raking it in from tricking the tech funds in and out of the market that they didn't notice that the tens of thousands of contracts that they sold short on numerous occasions were denominated in ounces of silver. It's one thing to take 20 cents profit away from the tech funds by selling 20,000 contracts, but quite another when you get stuck holding 100 million ounces of silver short in a world where 100 million ounces of real silver is suddenly hard to find.

My point is that this may be the clearest proof of the silver manipulation to date, namely, the price of silver was contained when the big concentrated shorts were willing to hold or add tens of thousands of contracts short, but when these big shorts didn't want to hold or add short contracts, the price has soared. The only mystery is how the regulators can't or won't see it. The bottom line is that if the big shorts continue to retreat from the silver market, the price of silver will move higher. If these big silver short crooks do increase their short positions, they may succeed in causing a temporary price decline, but they should also be hauled off to jail. Past price performance proves these big shorts never had a true economic justification for being so heavily short silver and they certainly don't have a legitimate reason to be short today. The only reason for silver to decline in price will be dirty tricks from the commercial short crooks.

I did receive a large number of subscriber comments and questions related to the start of silver futures trading on the Hong Kong Mercantile Exchange this past Friday, July 22. This is one of the new Chinese venues for trading precious metals. There has been an inordinately large amount of commentary on the Internet about the potential bullish influence this new trading in China will have on gold and silver prices. I admit that, intuitively, that would seem to be the case. Previously, I was skeptical that this trading in China would have much influence on the price of gold or silver. I still am.

An analyst must objectively weigh all the factors that may influence the price. In my experience, it takes a considerable period of time before a new exchange takes hold and comes to influence price. It's not usually an overnight sensation. Furthermore, we must remember that the new futures trading in China is just that Â? futures trading. That means like all derivatives trading, futures trading involves buying and selling. For every new long contract bought, there must be a short as well. As such, expectations about futures trading in China being automatically bullish for price may be misplaced. I don't doubt for a moment that China will play a major role in the future course of gold and silver. Hundreds of millions of potential gold and silver investors must be considered when contemplating future prices. However, I do have my doubts about the future of futures trading in China. You just don't blink your eyes and establish a viable futures exchange. To highlight that point, the most successful futures exchanges here in the US date their origins from the Civil War, some 150 years ago.

An analyst must also seek out verifiable data in an attempt to weigh the facts. Fortunately, the Hong Kong Mercantile Exchange (HKME) does seem to provide such data. Unfortunately for those convinced that this exchange will have a sudden impact on price, the data indicate otherwise. If you take the time to study the amount of silver contracts open after three full days of trading on this exchange and convert to COMEX size contracts (5,000 oz), you'll see there are only 25 contracts open, amounting to less than 125,000 oz.
http://www.hkmerc.com/en/market_news_data/daily_volume_report/HKS/index.html
By way of comparison, the COMEX has a gross total open interest of almost 120,000 contracts or 600 million oz.

To be fair, we are only talking about the first three trading days in silver on that exchange. But the exchange has been trading gold futures for more than a month. In that market, the total open interest expressed in COMEX equivalent contract size (100 troy oz) is less than 650 gold contracts as compared to over 536,000 total contracts open on the COMEX. Interestingly, the HKME current gold open interest is down 50% from the first three trading days when gold trading commenced there. Plus, the volume on the HKME looks as phony as a three dollar bill to me, as it is dominated by spread trading designed to make the volume look much larger than it really is.

Look, I'm all for new bullish factors in silver. It's just that an analyst doesn't make stuff up. At least this analyst doesn't. Let's continue to monitor this development and others, but guard against seeing things that aren't there.

Ted Butler

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Silver – $40.60

Gold – $1616

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