June 20, 2012 – Critical Question/Unusual Set Up

A Critical Question

I was asked an important question by a subscriber, in reaction to my conclusion that JPMorgan and the CME Group were given a green light to manipulate the price of silver by the Working Group. In essence, the subscriber questioned how I could assert that the Working Group would not be able to continue to assist in the silver manipulation indefinitely. The question was logical. After all, who could possibly stop the high government officials involved if they chose to continue to give JPMorgan the green light? Certainly, I can't name anyone who will stop them.

The silver manipulation may not come to an end because of a Â?who,Â? but will come to an end because of a Â?what.Â? The Â?whatÂ? is the inevitable force of supply and demand.
Over the long run, the most powerful force in the pricing of any commodity is the interaction between supply and demand. This force is so powerful, that we refer to it as the law of supply and demand. Silver is no exception to that law. Over the past ten years, silver's great gains have come because demand was greater than supply. That, plus we started at an unusually low silver price because a price manipulation was in effect when the bull run began. Of course, the short term movements in price can be separate and distinct from the longer term force of the law of supply and demand.

Any time the price of a world commodity is artificially set, it has a profound influence on supply and demand. A price artificially set too high will increase supply and reduce demand until a price-crushing surplus eventually appears. A price artificially set too low will increase demand and reduce supply until a shortage eventually destroys the artificial low price. But given the long term nature of the forces exerted by any artificial pricing structure, whether too high or too low, it's sometimes difficult to see that in the short term. This is especially true when whatever is behind the artificial pricing is pronounced.

I have alleged that the price of silver has been set artificially low largely by the concentrated short selling of COMEX silver futures contracts by a small number of commercial entities, particularly JPMorgan. Silver has recently come under more downward pressure due to additional paper short sales by JPMorgan. These short sales have the same effect on price as real metal being dumped on the market in the short term; but there is a big difference between paper and actual metal in the longer term. That's because the law of supply and demand is concerned with actual material, not paper contracts. These paper contracts do exert a short term influence on the price and that's what is measured by the Commitment of Traders Report. But it is not the COT one should look to for long term price expectations, as that is the province of the law of physical supply and demand.

I am suggesting that it is the impact on the physical supply and demand of silver that will break the paper manipulation of price. Sooner or later, but definitely eventually, any artificial price setting of a physical commodity will provoke enough change in supply and demand to destroy the artificial price. This is what has largely caused the price rise over the past five and ten years in silver, but the existence of concentration proves the silver manipulation still lives. Consider the price move over the past five and ten years to be a partial death of the manipulation, with the final termination still ahead.

The key to the long term price of silver more than anything else lies in its physical investment demand. Physical silver investment demand is largely what has accounted for the price move to date (5 to 10 years). That's what makes silver such an attractive opportunity; it is virtually the only industrial commodity that is also a prime investment asset. That combination is always potentially powerful, even during the times when silver investment demand has been dormant, like the last year or so. That's because you never know when investment demand might re-ignite. This is not a new theme of mine, but rather an issue I have highlighted in the past.
http://news.silverseek.com/TedButler/1201020133.php

The single biggest factor behind the price surge in silver and gold over the past five and ten years was the introduction of the exchange traded funds (ETFs), gold in late 2004 and silver in 2006. I know these investment vehicles bring out a variety of emotions among precious metals observers, but it is relatively easy to trace the price rise in each as coinciding with the introductions of the various metal ETFs. In November 2004, when the big gold ETF (GLD) was introduced, gold was priced at under $450. When the big silver ETF (SLV) was announced in mid-2005, silver was trading around $7. Since those times, some 80 million gold ounces, now worth more than $130 billion, have been accumulated by the worlds various gold ETFs and investment vehicles. In silver, some 600 million ounces, now worth $17 billion, have been accumulated by the various silver ETFs since 2006. (By comparison, there have been around 125 million ounces purchased in Silver Eagles since 2006. I absolutely love Silver Eagles as a silver investment asset; I'm just trying to objectively analyze what investment form has influenced the price the most.)

Since the orchestrated smash in silver prices starting in May 2011, physical investment demand in silver (and gold) has been made dormant. It's just a fact of human nature that investors get excited and motivated to buy as investment prices rise. The intentional price smash of a year ago put physical investment demand to sleep. But sleep is not the same as death. It appears that those latecomers to silver investment were flushed out fairly quickly following last year's manipulative price smash and existing silver holders have turned into strong holders. The stage in now set for new investment demand to emerge as the real silver story has never been better. With world financial conditions suggesting a safe haven move into silver like never before, the only thing missing to jumpstart silver investment demand is a move up in price. Nothing can change easier or faster to influence a buying decision than rising prices.

Despite the concentrated short selling by JPMorgan and the daily price abuse by the HFT rip-off artists on the COMEX, there are signs of renewed silver investment demand. Metal holdings in SLV, while still down from the peaks of last spring, are at eight month highs and may indicate additional buying as and when prices rise. What guarantees the end of the manipulation is not a change of heart by the Working Group but a return to physical investment demand in silver. When that investment demand returns, neither the Working Group nor any other manipulative force can prevent silver from finishing the run that was interrupted last May.

An Unusual Set Up

Over the past month, a different pattern has emerged in COMEX silver than I have witnessed in the past. From the May 15 Commitment of Traders Report to the most recent COT (as of June 12), the 4 largest commercial shorts in silver (read JPMorgan) have added more than 6,000 net short contracts on the lower prices that have averaged around $28.50/oz during this time. Generally, commercial traders only sell silver contracts on rising prices and they buy on lower prices.

Adding to the unusual nature of the selling by the big 4 (JPM), other commercials (the ones I refer to as the raptors) have been net buyers of 5,000 COMEX silver contracts over the same four week period of time. The buying by these other commercials on the falling silver prices is normal; what's not normal is the additional short selling by JPMorgan on those same declining prices. Because JPMorgan appears to be the sole commercial seller, it is solely responsible for the declining silver prices. I previously made the point that this is price manipulation pure and simple, as no free market should ever have only one seller. But there are other observations to make.

One observation is that 6,000 COMEX contracts represent an enormous amount of silver, some 30 million oz. That's greater than the position limit of roughly 5000 contracts proposed by the CFTC's formula for silver. In other words, it looks to me that JPMorgan increased its silver short position on the COMEX by more than a full position limit. Since JPMorgan's short position looks now to be in excess of 17,000 contracts, that means that JPMorgan is holding a silver short position that is more than three times the level of the proposed position limit. No wonder they are fighting the enactment of position limits tooth and nail.

But the observation most unusual is how this new concentrated short selling by JPMorgan promises to be resolved. It would appear that JPMorgan may have painted itself into a corner, similar to the position JPMorgan found itself in as a result of its recent ill-fated credit derivatives debacle. In that well-publicized disaster, JPMorgan took on such on usually large position that it distorted the pricing of a class of credit default swaps. The price distortion attracted the attention of other hedge fund speculators who took advantage of the mispricing; taking the other side of the trade and, in effect, ganging up on JPMorgan and forcing it to admit to the world that it had been out-foxed.

The possibility exists that JPMorgan may have repeated the same error in silver that it made in the credit default derivatives mess. Even if there is some type of government sanctioning of JPMorgan manipulating the silver market, if other trading entities have taken on JPM in silver, any sanctioning may prove no defense against JPMorgan being taken to the cleaners by other commercial traders. JPM may be in the same position now in silver that it was early in their credit derivatives predicament, namely, vulnerable to a squeeze. In that case, silver prices may soar.

At some point, JPMorgan will have to stop adding to short positions in silver and may be forced to buy back. With other commercials as the counterparties and not just the tech funds, JPMorgan may discover it is in a pickle, as it was with its credit derivatives miscalculation. Because the counterparty long position is held more by other commercials and not just technical funds, it should prove harder to be liquidated on lower prices than is usually the case. It is the component of the long position held by other commercials that makes this an unusual set up.

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Silver – $28.10

Gold – $1608

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