

COMEX □ Why it's Corrupt

It is one thing to label (libel?) the world's most important precious metals exchange as the most corrupt; but perhaps quite another to prove it in terms beyond reasonable doubt. First, let me be clear in what I am asserting □ the Commodities Exchange Inc. (COMEX), owned and operated by the CME Group, has come to control and manipulate the price of gold and silver, as well as copper, for the sole benefit of certain exchange insiders, most prominently JPMorgan.

Through corrupt trade practices, the COMEX has stolen and captured the pricing mechanism for gold, silver and copper away from the influence of actual supply and demand fundamentals. Replacing the law of supply and demand as the price determinant, the COMEX has substituted a private club run by a few large traders who, in turn, dictate prices to metal producers, consumers and investors. The federal commodities regulator, the CFTC, is complicit in the price capturing, but the prime culprit is the CME Group. Ironically, it is data from the CME and published by the CFTC that prove price manipulation on the COMEX.

Because the price control of the COMEX is continuous, if silver prices are manipulated, as I allege, the manipulation is in effect whether prices are falling or rising. Gold prices surged 4% last Thursday (June 19) and silver by 5% in the single largest one-day price rally in months. Government data, in the form of past and future Commitments of Traders Reports (COT) demonstrate conclusively not only why prices exploded on that day, but also why gold and silver prices were lower into the price explosion.

It is important to understand that price manipulation is the most serious market crime possible. In fact, the US economy and body of trade law depend upon the price of any good or service being established in free market competition without artificial constraint. That's the definition of a free market. The whole concept of US antitrust and commodity law is to prevent an uncompetitive market share being controlled by a few market entities. If the price of any commodity is artificially set by anything other than free market competition in its production and consumption, it sends a false message to producers and consumers and distorts both current activities as well as future plans.

Particularly in silver, the COMEX violates just about every concept of a free market; from unnatural market share concentration to creating an artificial pricing scheme which overrides any impact from the actual production and

consumption of the metal. Those are strong words, but easily substantiated.

The first thing to understand is how and why the CME replaced real production and consumption as the price discovery mechanism with electronic trading for purely speculative purposes. The "why" is for the money and once you see that, the "how" becomes obvious.

The CME owns and operates the COMEX and other exchanges as a publicly-traded for-profit corporation. As such, its main motivation and purpose is to generate profits for shareholders. While there is nothing wrong with that in the abstract, a commodity exchange is a unique financial institution in that such exchanges, at least in the US, must be authorized by Congress and regulated by the CFTC. In addition, there is a strong front line self-regulatory responsibility bestowed on US commodity exchanges, like the COMEX, to make sure all trading is on the up and up.

These are not typical responsibilities for the vast majority of publicly-traded corporations and have come to create deep conflicts of interest between commodity law and the CME'S profitability. Please remember that commodity

exchanges have existed and have been regulated for almost a century in the US, while they have existed as publicly-traded, for profit corporations for only around a decade. It's taken that long to see there is something wrong with that set up.

The CME depends on increased trading volume for increased corporate profits. The only way to increase trading volume is to introduce new products and/or increase the trading volume of existing commodities. Introducing new products is easier said than done, as the most active markets have been around for many years. That leaves the only viable avenue for increased corporate profits as increasing trading volume on existing markets. While the CME has been very successful at increasing trading volume on existing markets, that success has created a problem for everyone in the world outside a few insiders at the COMEX.

The problem is that the CME has relied on High Frequency Trading (HFT) and other speculative trading schemes to pump up trading volume to drive corporate profits. This is a problem because it has forced the COMEX to cease accommodating real producers, consumers and investors in silver, gold and copper and instead to cater to those trading with HFT computers and to those speculating in large quantities of electronic contracts.

Real commodity producers and users have little use for the rapid short term speculative trading that has come to drive profits for the CME. Why would a silver mining company be involved in electronic trading measured in small fractions of a second? This can be seen in how little actual trading is done in COMEX silver by actual miners or silver users; I would estimate less than 5% of all COMEX silver futures trading is transacted by real producers and consumers of silver. More than 95% of COMEX silver trading is purely speculative in nature, with much of it nothing more than day trading by HFT algorithms.

This is the consequence of the CME seeking to pump up trading volume at all costs. By catering to speculative traders seeking rapid turnover over the needs of producers, consumers and investors seeking legitimate hedging opportunities, the COMEX has become little more than a private gambling parlor divorced from the price influence of actual silver supply and demand. It also explains how the price of silver can be so estranged from real world fundamentals □ the COMEX speculators setting the price have no interest in actual supply and demand, just the next price tick. This can be seen in the COT data published weekly by the CFTC.

The "hot" money category of the COT reports is the managed money category of the disaggregated report. This is the category of registered commodity trading advisors (CTA's) that mainly trade on momentum and price signals and is most responsible for price movement, both down and up. Most (but not all) of the traders in this category are what I call the technical funds which buy and sell when prices penetrate moving averages. Most of the buying on Thursday and Friday was by technical funds which bought to cover short positions and/or establish new long positions in gold and silver as several important moving averages were penetrated. In essence, this was the sole explanation for the price rally in gold and silver.

There has been a documentable pattern of technical funds selling 30,000 net silver contracts (or more) on big price declines and purchasing that number of contracts on price advances. All technical fund buying and selling is based upon price signals. This equates to 150 million ounces of silver sold and bought over days and weeks with no connection whatsoever to what is transpiring in the real world of silver production and consumption. Similar amounts of gold and copper COMEX futures dictate prices in those markets.

I doubt that any serious student or analyst of the COT reports would argue with anything I just wrote about the technical funds and the effect their buying had

on price the past couple of days and weeks. In fact, a good number (including me) wrote extensively about how the record number of technical fund shorts in silver virtually guaranteed a sharp short covering rally at some point. Some may argue with my contention that the technical funds are largely snookered into and out from positions by the commercials who control the COMEX price mechanism, but that is not material for this discussion.

The simple fact is that when the technical funds buy, they all buy in unison and that is usually the sole reason for prices to rise. When the technical funds sell, they sell in unison causing prices to fall - always. It's not hard to see why the technical funds trade in lockstep with other technical funds - they are all using the same price signals. And it's not hard to see why the commercials always take the other side of the technical funds collective buying or selling - the commercials are the only entities capable of being the technical funds' counterparties.

I admit that if the commercials didn't trade aggressively against the technical funds, prices would soar and fall much more dramatically than any price moves witnessed to date. Some, including the commercials themselves and the regulators at the CFTC and CME view the commercials counterparty transactions with the technical funds as legitimate market making designed to

smooth out price movements. While that may be somewhat true, a much bigger issue emerges.

The technical funds are speculators through and through. No one would argue otherwise. In their role as counterparties, the commercials are also speculators; positioning against the technical funds for nearly certain profit. The problem, in a nutshell, is that prices are being determined in a speculator versus speculator contest. By the very definition of the traders involved, no real producers or consumers or investors in the actual commodity are represented in the speculator vs. speculator contest in COMEX futures trading. Please think about that for a moment.

The CME Group spends millions and millions of dollars on lobbying and advertisements proclaiming their exchanges exist to make it possible for actual commodity producers and consumers to hedge their price risks. But instead of encouraging real silver producers and consumers to hedge price risk, the CME has instead devised and encouraged a trading system on the COMEX that facilitates a massive speculator vs. speculator private betting pool. Talk about false advertising. Worse, real silver producers are unfairly punished by the artificially low price that the private betting game has created. I am sure that real hedging makes up way less than 5% of the total trading volume and open

interest in COMEX silver.

The root cause behind the unlawful conversion of the COMEX into a speculative day trading scheme from a market designed by Congress to facilitate legitimate hedging is an old issue, but with a slightly new twist □ the absence of position limits. And this explains why the CME fights legitimate speculative position limits at every turn.

Most are familiar with previous initiatives concerning position limits; specifically, to establish limits on how many short contracts big commercials, particularly JPMorgan, could hold in COMEX silver. While the CME Group and JPMorgan fought to prevent or delay position limits in silver, at least JPMorgan does seem to have reduced its concentrated short position in COMEX silver recently (with all eyes on Friday's report). But I'm talking about position limits now in a new way.

There are about 30 or 40 technical fund traders in COMEX silver. When fully positioned each holds, on average, roughly 1000 silver futures contracts, either long or short. As such, no one technical fund holds anywhere near the proposed

(still not in force) speculative position limit of around 5000 contracts, or even, for that matter, more than the 1500 contract position limit that I have long advanced. So why the heck am I raising the issue of position limits when the average technical fund holding doesn't exceed 1000 silver contracts? Let me explain why.

If a single speculative trader went long or short 30,000 contracts of COMEX silver futures in a short period of time (days and weeks), causing the price of silver to rise or fall dollars per ounce, no one would argue that wouldn't manipulate the price or violate the intent of position limits. 150 million ounces of silver suddenly bought or sold on the COMEX would, most certainly, jolt the price up or down. Even the CME and CFTC would react strongly if a single speculator suddenly bought or sold 30,000 COMEX silver contracts.

But what's the difference between a single speculator suddenly buying or selling 30,000 COMEX silver contracts and 30 separate speculators suddenly buying or selling 1000 contracts each if they are all operating as a single speculator? I'm not suggesting that the 30 separate technical funds all buying or selling at the same time are colluding among themselves (as the commercials are, indeed, colluding), but the net effect on price is the same whether they are colluding or not. The sudden purchase or sale of 30,000

contracts of COMEX silver has the same impact on price irrespective if transacted by one entity or 30 entities simultaneously.

The intent of speculative position limits is to limit the influence of purely speculative trading on price. Since the technical funds are operating on basically the same price signals to buy and sell, they are, in effect, operating as one entity and as such must be subjected to position limits on a collective and not only on an individual basis. The sick thing is that the CME (and the CFTC) know this collective technical fund trading pattern is manipulating the price of silver up and (mostly) down, but pretend not to notice for two very obvious reasons. Any restriction of technical fund trading would reduce trading revenue to the CME and, moreover, deprive COMEX commercial insiders of the rich pickings the technical funds provide to their commercial counterparties.

That's why the CME is corrupt and how I can say that openly without rebuttal or retaliation. But I'm not a prosecutor or enforcement official; I am an analyst who can only point out how and why the price of silver (and gold and copper) is manipulated on the COMEX. The solution is simple □ treat technical funds who operate as one entity as one entity for the purpose of speculative position limits.

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Congress never intended a regulated commodity exchange system centered on growing profits to the exchange operator (the CME) to the detriment of real commodity producers, consumers and investors. If you agree, please write to your elected officials, particularly those on agricultural and finance committees, and insist that technical funds be subject to speculative position limits on a collective basis, since they trade on that basis. To be sure, I am not depending on the CME and CFTC to do the right thing as far as enforcing position limits in a fair manner; I'm just trying to shine a light on corrupt practices.

A quick update on developments since Saturday's review. The real standout feature is what may be developing in the physical silver market. Heavy turnover or movement of metal to and from the COMEX-approved silver warehouses continues unabated, as it has for the past three years. My friend, Ed Steer, has picked up on this issue recently in his daily letter, much to his credit, along with the unusual lack of deposits in the big silver ETF, SLV. It is nothing short of astounding that there have been withdrawals of several million ounces of silver from SLV where there should have been deposits of several millions of ounces instead. I don't quite grasp why others haven't focused on COMEX silver warehouse turnover and deposits/withdrawals in SLV.

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Now that we have largely used up most of the rocket fuel of technical fund short covering on the COMEX, the only upward price impact from the technical funds would be if they built up long positions. Friday's COT report should be instructive, but I am prepared for major deterioration in the form of big increases in the total commercial net short positions of COMEX silver and gold. If I could choose when I would most like to be wrong, it would be on this week's report.

While there was a minor reduction in the short position in SLV reported yesterday, this was largely expected due to a deposit of metal within the reporting period ended mid-June. As of June 13, the short position in SLV declined by 683,000 shares, to 13.5 million shares (ounces) or 4% of total shares outstanding.

<http://shortsqueeze.com/?symbol=slv&submit=Short+Quote> .

Of more concern is how much the short position in SLV may have increased on the high volume price blast of June 19 and 20, particularly since there has been a significant quantity of metal withdrawn from the trust and not deposited as would be expected on a high volume price advance. The new short report won't be available until July 10.

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Since the technical fund short covering on the COMEX that has carried silver \$2 higher appears to be behind us, the most important remaining bullish potential is for physical tightness leading to shortage. The only reason I look at COMEX silver warehouse turnover and the deposit/withdrawal situation in SLV, including the short position, is the implication for physical silver tightness. After all, these two stockpiles of physical silver are the largest in world, totaling more than 500 million ounces or more than 57% of all the known visible silver bullion in the world (875 million oz). No other silver stockpiles come close in importance. Let there be no misunderstanding □ nothing will cause silver to soar in price like a physical shortage.

Ted Butler

June 25, 2014

Silver - \$21

Gold - \$1320