

June 4, 2011 – Weekly Review

Weekly Review

In a holiday shortened trading week, the price of silver surrendered much of the previous week's gain and finished \$1.75 (4.7%) lower. Gold, on the other hand, rose almost \$6 (0.4%), closing again at the second highest weekly level in history. As a result of gold's outperformance, the gold/silver ration widened out to 42.6, also reversing silver's outperformance last week. My sense is that there is not much actual gold/silver spread trading taking place and the swings in this ratio are a result of silver's incredible volatility which I will address shortly.

I'm going to run through this section of the review fairly quickly, as I wish to discuss in length something new. The physical world of silver continues to exhibit the same signs of tightness that have become familiar. Movement in and out of the COMEX warehouses continues at a rapid rate, while the total level of COMEX silver stocks remains at near-historic lows. This turnover continues to suggest a tightness bordering on a hand-to-mouth basis with an attempt to maintain total inventories above the psychological 100 million ounce level.

Silver is still flowing out of the big silver ETF, SLV, as what appears to be the final stage of investor liquidation is completed. I continue to believe that the roughly 50 million ounce withdrawal of metal from SLV was intentional and this silver now resides in hands not inclined to sell anytime soon. Despite the vicious takedown in price over the month of May, US Silver Eagle sales rose to their strongest levels since January, accompanied by some of the highest premiums on record.

This week's Commitment of Traders Report (COT) revealed a divergence between silver and gold. In silver, there was a slight (600 contract) reduction in the total commercial net short position, mostly on some adding to longs by the raptors (the smaller commercials away from the big 8). This was during a reporting week when the price of silver rose more than \$2 an ounce. However, silver never did penetrate the 50 day moving average at \$39.26 and that explains the lack of speculative buying and commercial selling that is normal on rising prices. The main takeaway for the silver COT is that it is basically unchanged over the past two weeks in total open interest and in the total net commercial short position, despite very heavy volume and price volatility. I'll come back to this shortly. One last COT observation – I have the feeling that the raptors will not sell out much of their recently acquired long position until we cross the \$40 level, based on their past behavior.

In gold, the commercials did increase their total net short position notably, by more than 23,000 contracts, to a bit over 240,000 contracts. Most of the selling came from the gold raptors (17,000 contracts); with some new shorting by the 5 thru 8 largest traders (the big 4 added 1700). This was during a reporting week with a price gain of only \$10 or so. Looking at the past two reporting weeks combined provides a more complete story. In the two weeks from May 17, the low point in the commercial net short position, to the latest COT cutoff of May 31, the price of gold rose about \$55 (as anticipated by previous COT analysis). In that period the total commercial net short position increased by 33,000 contracts, with the gold raptors accounting for 31,000 of the change. The gold raptors swung from being 15,000 contracts net long to 16,000 net short in the latest report. It goes without saying that the tech funds and other speculators were the reciprocal gold contract buyers during this time.

This moves the COT market structure in gold to neutral territory, with room to move in either direction. Based strictly upon COT analysis, gold could continue up in price with more speculative buying and additional commercial shorting until we get into serious negative COT territory. Or we could witness attempts by the commercials to engineer gold prices lower to induce tech fund and speculative long liquidation. I know this is the primary driver of near term gold (and silver) prices, although I can't know the short term outcome. Over the two week gold rally of \$55, there was little relative change in any of the other verifiable gold holdings, such as the gold ETFs. The 33,000 net contract change on the COMEX represents 3.3 million gold ounces worth \$5 billion. Even though these are paper ounces, it is clear to me that this was the agent of the price climb. That's the rationale behind the COT.

Just to state the obvious, by remaining unchanged in the total commercial net short position over the past two reporting weeks, despite a \$4.5 silver rally, the silver COT set-up remains resoundingly bullish. Not to say that the crooks can't rig prices lower temporarily, but the cold hard data indicate we are at multi-year COT bullish extremes in many important measurements in silver. Once again, the reason such a large silver price rally didn't trip off technical and speculative buying, along with commercial selling is because we remained below the 50 day moving average.

This leads me to the subject of the day, what's really going on in silver? Using the COT observations above as a springboard, I'll attempt an answer by zeroing in on the most dominant and dangerous current feature in the silver market — High Frequency Trading (HFT). I'm not going to pull any punches — this high-speed computerized trading is perhaps the worst possible contribution yet by money-mad Wall Street rocket scientists. I'll try to make the case why it should be completely banned.

As already indicated, the COT market structure in silver was basically unchanged over the past two weeks, despite great daily price volatility. In addition, the volume traded on the COMEX over this same period, while down from the extraordinary levels at the beginning of May, was still extremely high in any historic comparison. Let's stop here and reflect on these stated facts, namely, unchanged COT structure, high daily price volatility and high volume. This means the overnight (long term) holdings in COMEX silver contracts (as represented by open interest) remained largely the same, while there was much trading and great daily price movement.

Since the existing open interest remained virtually unchanged over this two week period, we can conclude the existing positions didn't factor much in the high volume and volatility. Therefore, something else is responsible for the high volume and price volatility in silver. That something else is HFT, the rapid computer generated trading that not only accounts for the bulk of the trading volume, but also is responsible for the daily price volatility. Based upon observation and valued personal input from an established HFT trader, it appears that HFT accounts for 80% to 90% of total COMEX silver futures volume. I'd like to reference the actual data, but it is my understanding that the CME Group does not provide such data.

Ever since HFT kicked in with a vengeance in COMEX silver, starting about six months ago, the nature of the silver market has been changed; and not for the better. HFT trading has grown dramatically over the past six months, just as daily price volatility has grown in lockstep. It follows that if HFT trading accounts for 80% to 90% of the daily trading volume, it also accounts for 80% to 90% of the daily price volatility. So let me state the obvious ^ HFT is directly responsible for the increased price volatility in silver. And, no, your eyes have been playing tricks on you ^ whenever silver nose dives suddenly, either by 20 or 30 cents to a dollar or more, the cause of that dive was HFT. Everybody knows it; everybody sees it; even the regulators, who do try to look the other way.

In theory, HFT should also account for sharp price gains as well, but it rarely works out that way in practice. Silver has never jumped \$6 on a Sunday or any other evening, it has only fallen. Silver has never risen \$15 (30%) in a week, only fallen. It is plainly observable that HFT works more to depress the price of silver, than cause it to climb. It is when you take that observation and apply it to what else we know about silver that a very ugly picture emerges. It's enough to make you scream.

If this HFT computerized trading was being conducted by thousands of different market participants each expressing a varied input on the market, there should be little concern. This, after all, is the basis of true price discovery. But that is not what is present in HFT. Instead of thousands of different market participants, there is only a handful or two. Worse, the software algorithms used by this small number of traders is virtually the same; meaning there is one basic force generating the trading and price direction. This is concentration in its most extreme.

Long time readers know I've always made a big deal about market concentration. It goes to the very nature of manipulation. You can't have a manipulation without concentration. At the very heart of the US Anti-Trust body of law resides the principle of anti-concentration. Monopolies and concentration stifle competition and promote illegal price-setting. While I have made a big deal (and still do) about the concentrated short position in silver, I'm attempting to introduce something new today. There is now a sick concentration in COMEX silver trading volume, as well. With 80% to 90% of the daily COMEX silver trading volume suddenly and effectively controlled by so few, it is clear that the daily volume has become concentrated, in addition to the concentration in short positions in open contracts.

Who are these HFT traders? You guessed it Â? mostly the big silver shorts, led by JPMorgan and other dominant CME Group members. Only these big traders can afford the million dollar computer hardware and software to run the HFT algorithms. How has it come to the point where giant traders with documented concentrated silver short positions have been further allowed to dominate daily trading volume that causes sharp dives in the price of silver? It is so crazy and outrageous that it should make your blood boil. Believe it or not, I'm trying to contain my outrage. These HFT traders, led by the JPMorgan silver crooks, are like a band of outlaws in the old West who have come to control and terrorize a town and its citizens.

The central cause of this travesty of a group of crooked traders coming to dominate positions and volume by virtue of concentration is the CME Group. The CME has created this Frankenstein of a market. Because the CME is a for-profit corporation, it is concerned primarily with generating additional profits. Its revenue comes from trading volume, as the CME gets paid for every contract traded. Therefore, it will do anything to increase trading volume, including, I believe, promoting increased volume by illegal means. I would define illegal as including the promotion of practices encouraging concentration, which HFT does.

Let's face it Â? HFT is about massive concentrated computerized day trading designed to manipulate the price and bring in trading revenue to the CME. It's not about promoting true price discovery and an increase in legitimate hedging, the economic purpose of futures trading. At the exact same time that actual COMEX silver deliveries are hitting historic low levels, electronic volume has hit new highs. This means that COMEX silver is becoming a paper trading mechanism, as opposed to a legitimate futures exchange where real producers and consumers go to hedge. In short, the COMEX is more a bucket shop than a legitimate exchange.

Before I fully grasped the inherent evil that encompasses HFT trading, I referred to the CME as a criminal enterprise. Now, I see no good reason why the CME is allowed to exist under the laws of the US. Worse, the CME is designated as a Self Regulatory Organization (SRO) which means that they are supposed to protect the public's interest. But the Â?SÂ? in SRO has only come to mean self interest and selfishness. As bad as HFT trading has become, the CME is in the process of expanding it, thereby strengthening the strangle hold the big commercial silver crooks now have on the daily silver price. Clearly, they have no shame.

The Department of Justice made a monumental error when they allowed the Chicago Mercantile Exchange (CME) to merge, first with the Chicago Board of Trade and then with the NYMEX/COMEX. Now we are all experiencing the results of the DOJ's folly. The mergers have created a monster that fosters concentration in positions and trading that undermine the concept of free markets. It's hard to believe that the DOJ's Anti-Trust Division could have been so short sighted.

The DOJ made a serious mistake in allowing the CME to morph into the supreme promoter of market concentration in every form. But that mistake still pales in comparison to the negligence exhibited daily by the primary regulator of commodities, the CFTC. I don't know how the Commission sits by while such blatant examples of price manipulation in silver occur daily. First, it was the concentration on the short side of silver, now it is the obvious concentration of volume among so few firms.

I had high hopes for redress on the silver manipulation ever since Gary Gensler became chairman two years ago. I'd be lying if I said my hopes haven't been deflated. While I still hold Gensler and Commissioner Bart Chilton in high regard, I have been very disappointed with their lack of action to the recent events in silver. It's now up to them to honor their oaths to protect the public interest. Almost every speech and public statement issued by Gensler over the past two years included reference to AIG and the role its concentration in credit default swaps contributed to the great financial crisis. It's not right to reference AIG repeatedly without referencing JPMorgan and the CME Group in silver.

On a broader basis, I am offended by the Commission's silence about the highly unusual factors involved in the historic takedown of silver staring Sunday evening, May 1. I presented five simple questions about the silver takedown that many of you also asked about.

<http://news.silverseek.com/SilverSeek/1304873055.php> What bothers me the most about the silence on the part of the Commission in the face of serious and legitimate concerns is that it fits the definition of the worst insult possible in a democracy, namely, the Commission's behavior is un-American.

Maybe I'm too idealistic and naïve, but I was blessed to be raised by American values. Yes, I grew up in a time of upheaval and great change, from the struggle for civil rights and Vietnam to the modern day, but that's how values are formed. Those values include believing in equal rights, equal justice under the law, and the right to petition the government. When it comes to silver, however, I am experiencing a collision between how the CFTC should be acting, according to my values and how they are actually behaving. What the Commission should be doing is openly addressing the longstanding allegations of wrongdoing in silver, at the very least to dispel public concern and finally put the matter to rest. What the Commission (including Gensler and Chilton) is doing instead, is remaining silent in the face of legitimate public concerns. I admit it has been a very effective strategy on their part, if their intention is to ignore the will of the people and perpetuate a crime in progress. I still hope Gensler's and Chilton's silence, at least, has a different cause (like drawing up charges against the silver crooks).

As far as what you can do about this, especially my new allegations of concentration in COMEX daily trading by HFT operators, the advice remains the same. Make sure the Commissioners and your elected officials know how you feel. Email and write to them and keep on writing to them. Don't you call the CME crooked yourself; as that might bring you trouble. But let your elected officials and the Commission know that I am calling them crooked. Send them this or any of my articles. Ask your senator or congressman to make the CFTC respond to these serious allegations of concentration and manipulation in silver. Tell them that it is un-American for the CFTC to remain silent.

Please don't interpret any of this as indicating a change in my bullish take on silver. As I indicated on Wednesday, there are forces in place which I believe will drive silver substantially higher (although I do admit I wish I sent the update after the HFT crooks took it down \$2 or \$3 and not before). Yes, this HFT trading is a new manipulative tool designed to depress the price of silver. And yes, it has been effective. But it is also a temporary dirty trick which will wilt in the face of silver physical tightness and shortage, to say nothing of responsible regulation. Just like the concentration on the short side, the concentration in daily trading serves to depress the price of silver, but at the same time makes it a more attractive buy and guarantor of higher prices to come. Just like walking and chewing gum at the same time, it is possible to be outraged at the silver manipulation yet attracted to the artificial low price it creates.

Ted Butler

June 4, 2011

Silver -\$36.20

Gold – \$1542

ggensler@cftc.gov

mdunn@cftc.gov

bchilton@cftc.gov

jsommers@cftc.gov

somalia@cftc.gov

Date Created

2011/06/04