

The Set Up

This is a special time for investors in precious metals, particularly in silver. After a decade plus surge in price which enriched investors, those same investors have been tormented by three years of sharp price declines. In any asset class that experienced that extreme a degree of price history, it would be expected that collective sentiment would be downbeat; and so it is in gold and silver. But it's also true that throughout financial history most investment fortunes involve buying undervalued assets; and undervaluation is most often created by sharp price declines.

So which is it □ a time to avoid or a time to embrace silver as an investment? To me, there has rarely been a better time to buy and hold silver because the sharp price decline has created an undervaluation that I never expected would appear. That's not to say I have enjoyed watching existing holdings shrink in value, but that is an unavoidable circumstance of any asset undervaluation. But personal opinions may be a dime a dozen and understanding why an asset may be undervalued is more important than any guess about future price performance. If someone doesn't understand why silver is undervalued, it would seem a stretch to expect accurate future price predictions.

Fortunately, there exists an explanation for why silver prices have declined that is verifiable and easy to document, particularly the nearly three dollar drop since March. And I don't want to beat around the bush; as far as I can tell, there is only one reason for the decline in silver over the past few months. Usually, there are many factors that determine prices for world commodities; but not this time in silver. As always, the documented explanation exists in the weekly Commitments of Traders Report (COT) from the CFTC. But what makes the evidence special this time is just how specific the explanation has become.

Since the end of February thru today, two specific categories of traders on the COMEX, one buying and one selling, have exchanged ownership of 30,000 silver futures contracts, the equivalent of 150 million ounces (all rounded). I am not talking about day trading volume or phony HFT spoofing and trading which no doubt occurred and facilitated the transfer of ownership of the 150 million oz of silver; I am talking about 150 million equivalent oz of silver being sold by one category of traders and that same amount being bought by another set of traders.

First, I would submit that the amount involved, 150 million oz, being 75% of all

the world silver mined over these past three months and more than all the silver available for world investment on an annual basis, is more than enough to have caused prices to drop three dollars. There is absolutely no evidence that anywhere near 150 million oz of silver changed hands between two specific categories of traders over the past three months apart from the COMEX futures transaction.

The category of traders that sold the 150 million oz of equivalent silver over the past three months is the short side of the managed money category in the disaggregated COT report. These are the traders that I refer to as the technical funds and there are no more than 30 of these traders in this category presently. Please note that the 150 million oz of equivalent silver sold by the technical funds were not liquidations of long contracts, but new open short positions.

The category of traders that bought the 150 million oz of equivalent silver over the past three months is the category I refer to as the raptors, the smaller commercials separate from the 8 largest COMEX short traders (and who are likely to be among the 8 largest long traders). The raptors are my own special category of traders (which I've written about for years) and, basically, you can plot their holdings by subtracting from the concentrated net short position of the 8 largest traders the headline number of total net commercial shorts. In last

week's COT report, this calculation indicated that the raptors held 48,800 silver contracts net long, up from 19,600 contracts on March 4 (and probably more in the COT to be released Friday). There appear to be about 30 raptors in all, so they number about the same amount of technical fund traders.

http://www.investmentrarities.com/ted_butler_comentary/05-22-07.html

Whereas the technical funds sold short the equivalent of 150 million oz of silver, the raptors bought new long contracts of that amount over the past three months, meaning both positions are very much newly opened as opposed to being closed out positions. Both open positions, the technical fund short position and the raptor long position, are at the highest level in COMEX history as of the most recent report (and likely higher in Friday's report).

In a nutshell, the 150 million oz (30,000 contracts) of newly created open contracts between the technical funds and the raptors is what caused silver prices to fall \$3 since the end of February. As much as I pinpoint JPMorgan as being the prime silver manipulator, since the bank's net short position in COMEX silver has hardly changed over this time, I can't accuse JPM as being the active catalyst in the recent silver price drop. However, I will be very quick to accuse the bank, along with the 7 other large COMEX silver shorts, should that short position increase on any silver rally.

June 4, 2014 - The Set Up

It is rare when it is so clear that two specific trader categories accounted for, effectively, all the net positioning in any one market like exists in COMEX silver over the past three months; but the data are undeniable. What is also undeniable is that the technical funds' new short selling of 150 million oz is what caused the price to drop \$3; as there is no other plausible explanation. The only question is what motivated the technical funds to sell such a quantity of silver futures contracts? The answer is also clear □ progressively lower prices.

Up to this point, I doubt any observer of the silver market would dispute any of what I've written since it is based on documented data in the COT reports. The only possible disagreement is in what comes next. Since the commercials on the COMEX have come to control the pricing mechanism (the raptors are big HFT practitioners) and the technical funds are slaves to short term price movements, the commercials, in this case the raptors have come to control the technical funds. Put differently, because the raptors control short term prices, they control the technical funds. The reason the technical funds hold record short positions in COMEX silver and the reason the raptors hold record long positions is due to the raptors orchestrating progressively lower prices (slicing the salami) to achieve this record outcome. The only other possible alternative explanation is that the technical funds are tricking the raptors into going massively long on the most undervalued asset in the world. That hardly sounds

plausible.

If you believe, as I do, that the raptors have the technical funds over a barrel and not vice versa, then it becomes only a matter of time until the raptors decide to ring the cash register by orchestrating higher silver prices which, undoubtedly, will cause the technical funds to buy back the record silver short position that they currently hold. Because the technical funds hold a record silver short position, this makes the current set up the best in history.

How many short contracts are the technical funds likely to buy back once prices turn higher? If these funds simply buy back the 30,000 contracts they have shorted since the end of February that will exert the same or greater price influence to the upside as was witnessed on the downside. In other words, were silver to rally to \$21 or \$22, the technical funds will more than likely try to buy back the entire 30,000 contracts they just sold short. So the real question is in how accommodative the raptors will be in selling the record long position they established in silver over the past three months.

The answer to how accommodative the raptors might be may reside in how

June 4, 2014 - The Set Up

methodical they were in buying their record net long silver position. Over the past 13 weeks as the price dropped nearly \$3, the raptors increased their net long position in 12 of those weeks (one week was unchanged). I don't recall a more persistent and determined effort by the raptors to assemble their current record silver long position. I can't help but conclude that the raptors didn't achieve their record long position in COMEX silver to sell out at \$21, when they could easily achieve much higher prices and profits by merely holding out for higher prices. Let me be clear □ the technical funds will certainly look to buy back all their newly opened short positions at \$21 or higher, based upon past behavior; but it is what the raptors intend that will determine the nature of the next silver rally. The raptors are in the driver's seat.

Certainly, it took a specially constructed silver price decline to create the record technical fund short position; it wasn't created by happenstance. Prices had to fall in a manner most likely to result in maximum technical fund response. The progressive nature of this silver price decline, where continuous new price lows were created is what prompted the record technical fund short position. The debilitating silver price action was like waving a red flag to get a bull to charge; successive new price lows gets technical funds to sell, period.

The facts are clear □ silver prices have stunk and the technical funds are now

holding record short positions. What's next? At some point silver prices will rally and likely rally hard. But there is always the chance for further additional technical fund selling since we're still flirting with the recent price lows. Perhaps Friday's employment report might be used for one final smash. Then again, trying to divine short term price moves is a mug's game.

The technical fund short position in silver has been more advanced than the corresponding technical fund short position in COMEX gold, but gold appears to have caught up in tech fund shorting the past two weeks. My only concern in gold is that if the technical fund short position in gold to mimic the record increase witnessed in silver, then there may be more technical fund selling to go in gold.

The important thing is to recognize just how historic has been the amount of technical fund short selling in COMEX silver. I never expected the technical funds to exceed former levels of record silver shorts by the amounts reported. But as painful (to existing investors) as the recent price drop has been, it is precisely the unexpectedly large tech fund shorting that has created what may be the best silver set up ever. Make no mistake, the technical funds must buy back, rather than deliver metal to close out their short position. As a result of the record technical fund short selling in COMEX silver, there is now

June 4, 2014 - The Set Up

automatically embedded the largest amount of potential buying power in history. Coupled with the record long position of the raptors, silver could and should surprise to the upside at some point soon. I hate how we got to this circumstance, but love the fact that we're there.

Therefore, it seems wise to be fully committed to silver at this time. Aside from the uncertainty always associated with very short term timing, the actual evidence is over weighted for a pronounced price rally and not a sell-off. About the only thing to avoid is holding on margin, but that is always the case. You never want to risk losing a position due to forced sales on lower prices, especially when prices are controlled by the COMEX commercials looking to buy on lower prices.

The setup is so pronounced that I've stopped thinking about what type of news could set off the coming silver rally. Let's face it □ there was no news to the downside, just orchestrated technical fund shorting. And there is no news necessary for prices to rise □ just prices high enough (say over \$19.50, the 50 day moving average) to induce technical fund buying. The setup is just that □ a coming event to be realized in due course.

June 4, 2014 - The Set Up

A brief housekeeping note ☐ I'll be travelling back to Maine over the next few days, so the Weekly Review will likely be delayed by a few hours on Saturday.

Ted Butler

June 4, 2014

Silver - \$18.80

Gold - \$1244