May 14, 2011 – Weekly Review

Weekly Review

Amid continued historic price volatility, silver ended the week slightly lower (30 cents). Gold, not exhibiting the extreme volatility as silver, finished virtually unchanged for the week. As a result the gold/silver ratio finished the week almost unchanged at a bit over 42 to 1. But the closing prices didn't come close to portraying the violent price moves in silver, as there was more than a $7 difference between this week's high and low prices. I think I know how much this extreme price volatility is impacting silver investors and that will be a primary focus in this report.

Conditions in the physical market still continue to suggest tightness in silver, with big COMEX warehouse and SLV movements occurring daily. Despite (and because of) the big decline in silver prices, retail demand remains strong, with tight supplies in many forma, especially in Silver Eagles, where the US Mint has struggled to keep up with demand for almost 3 continuous years. Premiums on Silver Eagles are approaching the highest levels in history. After investors digest the recent price turmoil, I would expect demand to increase.

There were some notable changes in this week's Commitment of Traders Report (COT), although you had to dig deep in silver to uncover them. I had been expecting a big liquidation in speculative long positions, especially by the technical funds, and we did get that liquidation, but it came with a twist. One twist in this week's report was that the big technical fund liquidation of long positions wasn't offset by a corresponding big decline in the commercial net short position, as is usually the case.

I know the analysis of the COT can be too complicated for most investors. People have better things to do in life than deeply contemplate the meaning of this statistical data. But the data are important and tell us much about the market. Fortunately, the CFTC has actually improved the COT reports by providing greater detail over time. Unfortunately, the CFTC has continued to ignore important evidence in these reports that point very clearly to manipulation in the silver market. My approach with these reports is to simplify them as much as possible, but to stand ready to provide greater detail to any subscriber wishing to look closer.

The headline number, the total commercial net short position, did decline slightly for silver this week, by 1100 contracts. The raptors and the 5 thru 8 big traders bought around 2400 contracts, while the big 4 (JPMorgan) sold around 1300 contracts. It's always a concern when the big 4 in silver add to their concentrated short position, but the amounts weren't terribly significant this week, so we'll just continue to monitor this development.

To put this all in a broader perspective, the total commercial net short position is the lowest it has been in more than a year, back to March 2010, when silver traded at $16. Also, the concentrated short position of the big 4 is still the lowest it has been since November of 2006, when silver was trading around $12. On strictly a COT basis, the data point to silver being as cheap now as it was at $12 or $16 back then. Let me cover gold, then come back to silver.

In gold, there was a much bigger decline in the total commercial net short position of 18,500 contracts. This puts the commercial net short position on the lower (more bullish) range of the past year or so. In addition, the gold raptors (the smaller gold commercials apart from the biggest eight traders) have now swung to a net long position of around 7500 contracts, from a net short position of 30,000 contracts in the COT of April 19. While it is possible that the gold raptors can build up a bigger net long position (at lower prices) it is generally a sign for higher gold prices to come when these traders are net long.

Back to the silver COTs. The big changes in this week's report weren't obvious in the traditional (legacy) report. You had to review the newer and more detailed disaggregated version of the COT to uncover some important revelations. http://www.cftc.gov/dea/futures/other_lf.htm While there wasn't much of change in the total net commercial short position, the disaggregated report did indicate that the technical funds (in the managed money category) did sell a significant number (over 6000) of long positions. This brings the net long position of these traders to levels last seen in Feb Â? March of 2010, at $15 to $16 silver. There can always be more liquidation (amid lower prices) but this key category looks washed out. That's always a bullish sign.

The big surprise this week was that the big technical fund liquidation wasn't offset by more commercial buying. This was definitely a break from past experience. Once again, the disaggregated report provided the answer to the surprise. The standout and almost exclusive buyer of what the tech funds and other speculative longs sold, were the traders in the Â?otherÂ? reportable, but non-commercial category. These are large non-commercial traders handling their own money and not money from outside investors. They can be hedge funds or just large individual traders. The few traders in this category bought back more than 8,300 silver contracts they held short in the reporting week, by far the largest category of buyers of all.

Interestingly, these same non-commercial traders had added more than 6,000 contracts to their short position in the previous two reporting weeks of the COT, right up to the tippy top in silver prices. Then after the price was smashed by 30%, these traders bought back 8300 contracts (41.5 million oz) of their total short position, reducing that position by almost 60%. Hands down, these traders were the biggest beneficiaries of the silver price plunge. I would estimate they cleared close to $500 million on this trade that covered no more than 3 weeks. That's just in COMEX futures profits alone.

Normally, I am not opposed to anyone making a great trading gain. And if this half billion dollar trade was simply a matter of great trading insight and execution or even blind luck, I wish the winners well. But this recent silver price plunge occurred under some highly unusual circumstances, pointing clearly towards manipulation. This price smash had Â?intentionalÂ? written all over it. Now irrefutable government data reveal a few traders on the COMEX picked up a quick and cool half billion on this intentional price smash. That amount of money, I would contend, would qualify as sufficient motive to rig prices lower for anyone.

Certainly, it is not just the amount of money at stake, but it is very possible that these same traders may have been involved in the High Frequency Trading (HFT) which I'll discuss in detail in a moment. Remember that $6 sudden drop in 12 minutes on a recent Sunday night? Well if any of these traders who hit it big were involved in that manipulative dirty trick and any the COMEX dirty tricks that followed, then I don't think they deserve to keep their gains. I think they deserve to go to jail.

This is from data just released by the CFTC. I have long complained that while the CFTC does a great job in publishing this data series, it doesn't read or understand its own data. A handful of traders just made half a billion dollars on a quick short side bet on a price plunge that has created non-stop commentary and media attention and complaints from the public. All this in a commodity, silver, that is the subject of more complaints about manipulation than all other commodities combined.

I will send this article, as I always do, to the head of Market Surveillance and the director of the Enforcement Division at the CFTC. I'll include a message that they might try to connect the dots on this trade. Was it skill or luck or something else? I don't want to call it a smoking gun; but this whole thing is real suspicious.

Regardless of any connection between HFT computerized trading and the short windfall on this trade as a result of the intentional silver take down, there is very much a connection between the downside volatility in silver and these HFT traders. They are ruining the silver market as they will ruin any market in which they are allowed to operate. It has gotten to the point these HFT traders have spooked or made angry any silver investor aware of their existence. I wrote the following yesterday, before I became aware of the big non-commercial short trade, but it still applies.

Quick Math and Simple Logic

Recently I have made the case that high frequency computerized trading has had an uneconomic and manipulative impact on silver prices. To back up my assertion I'd like to use the actual trading statistics from Wednesday's (May 11) COMEX trading. Silver fell almost $3 (8%) in price that day, an unusually large amount for a commodity with no fundamental news to justify the price change. I'll compare silver's statistics Wednesday to those of gold, which had a price decline that day of $15 (1%).

Wednesday's official trading volume on the COMEX for silver futures was 147,410 and the gold futures volume was 205,770 contracts. In terms of ounces, 147,410 contracts equal 737 million ounces of silver (5000 oz per contract). 205,770 contracts in gold equal 20.58 million ounces (100 oz per contract).

In terms of production, silver's COMEX volume that day was the equivalent of the entire world annual mine production (740 million oz). Gold's volume was 25% of annual world production (80 million oz). Therefore, in terms of world annual production, silver's volume was 4 times greater than gold's volume. I make these comparisons of paper trading to metal in the real world because these markets exist to hedge price risks to real metal. Futures trading is not supposed to be based on the 24 hour Las Vegas casino gambling model. All derivatives must be related to and in proportion to the host markets from which they are derived.

In terms of total known world inventories, Wednesday's trading volume in silver was the equivalent of almost all the world's bullion known inventories (basically the sum total of all the holdings in the ETFs and COMEX inventories.) In gold, the volume Wednesday was less than 1% of all the gold known to exist in bullion form (2.5 billion ounces out of a total 5 billion gold ounces.) Therefore, Wednesday's trading volume in silver was more than 100 times greater than gold's volume relative to known world bullion inventories.

Finally, despite this ultra-high volume in silver, the open interest declined by only 416 contracts. Open interest is the total number of all contracts currently in existence, each of which has a long and short holder. The change in open interest is the measurement of change in positions held over from day to day. Traders approach the market in different ways. Some are position traders who buy or sell a contract and then hold to that position for certain periods of time, ranging from days to weeks to months or more. These are the traders who make up the open interest. When these position traders initiate a new position or liquidate a previously held position it will be reflected the change in open interest that day.

Other traders are day traders that buy and sell contracts during the day, often many times over, but end each day flat or not holding any open contracts. Thus, the trading that day traders do is never reflected in the open interest, since they basically never hold overnight positions. Day traders account for a large share of the daily trading volume in every active market, often upwards of 90% or 95% of daily total volume. Since most investors and hedgers are longer term holders by nature, it's kind of startling when you first discover this fact, which is born out in simple logic.

By definition, position traders generally hold their positions rather than trade them frequently; day traders trade actively and hold nothing overnight. Therefore, day traders control volume and influence price constantly during the trading day and position traders only do so on the days they put on or take off positions. So, the first conclusion to reach is that if you are looking to explain Wednesday's $3 drop in the price of silver you must generally look to the day traders and not to the position traders. This is true not just for Wednesday's price drop but all the dramatic price drops we have seen recently in silver.

I know for certain that this is an important concern for all silver investors because this unnatural volatility quite literally scares the dickens out of them and causes some to sell silver they otherwise wouldn't have sold were it not for the extreme price volatility. The really rotten part about this is that I believe the intent behind the volatility induced by day traders is precisely to scare investors into selling silver positions both on the COMEX and in the other markets, like the big silver ETF, SLV. If my belief is accurate, that's abuse, fraud and manipulation of the highest order.

Who are these silver day traders? The most dominant and controlling are the high frequency computerized traders (HFT). These HFTs are a handful of financial entities, which include JPMorgan and the big shorts that use powerful computers and software algorithms to day trade on steroids. There is an undeniable influence this trading has on depressing silver prices as opposed to lifting them. That's what the sudden price drops out of nowhere are all about. You would have to be blind not to see that this day trading has smashed the price a lot more than caused it to rally recently. Is it not just a coincidence that smashing the price is a benefit to the big shorts who are also HFT traders. Certainly, there are not thousands of ordinary investors behind this activity; this is confined to just a few market controlling entities.

It was HFT trading thought to be behind the stock market flash crash of last May. Now it has come to infect the silver market. This activity benefits only the few traders looking to see the price of silver smashed and the CME Group which collects fees on every contract traded. Yet all of us are captive to it.

Please think about this; in a day and age when we are trying to move to full transparency and level playing fields, Wall Street rocket scientists have concocted a technique that is run in the dark, damages the market, frightens legitimate investors out of positions and benefits only the HFT cheaters. This is absolutely outrageous and the CME and these traders should be shut down and held liable for any losses they caused. That the CFTC is sitting by and doing nothing is akin to muggers beating on little old ladies in front of the police station. This trading has nothing to do with providing true liquidity. That is proven by the almost out of control daily price volatility. Get rid of these manipulative traders and the much of the unnecessary and deliberately created volatility will disappear.

In the meantime, we must live with and adapt to it. Although this HFT trading is uneconomic and disruptive, is has help to create a bargain price in silver. This crooked trading will suddenly fold when silver is confronted with true physical shortage which the depressed price will hasten the arrival of. It's just that all we hear is transparency this and level playing field that. When are those ideals supposed to trickle down to the average investor? And when are the regulators going to protect the public?

I know that many silver investors are disappointed because of the recent shellacking that silver has taken. And I suppose I have been harping more than usual on the new aspects of the silver manipulation, including the shorting of SLV shares and this crooked and disruptive HFT trading and the CFTC's failure to come close to its mission of protecting the markets and the public. In fact, a long-time subscriber told me he detected a darkening of my mood about recent developments in silver. He has a valid point, as I am disgusted with these crooks and the regulators' impotence in dealing with them.

But I would be negligent if I let that disgust convey in any way to you a loss of bullishness in my outlook for silver. The truth is that I am more bullish as a result of the recent wrongdoings. The COTs are great. They may get even better if there are any more speculative longs to flush out, but there can't be many left. The physical story remains tight as a drum and a shortage can be exposed at any time. That the manipulative tricks are being exposed as quickly as they arise is great. More people realize silver has been rigged to the downside than ever before and are speaking out about it.

All these developments should make you stop and think. Please ask yourself this question, as it is one I ask myself continuously. What's behind all these big financial firms and traders and the CME Group and now BlackRock seeming to conspire and work towards depressing the price of silver? Why do they all remain silent in the face of so many allegations of manipulation? Why can't the CFTC man up and do the right thing or at least openly answer or debate the key questions about silver?

Taken together, I keep coming up with the general conclusion that this proves that all is not right in the silver market and what's not right is the price. The right price is much higher than the current price. All the efforts to depress the price are the very reason to be bullish. Big entities are working against the price rising for the simple reason they are on the wrong side of the market and can't get onto the right side without blowing the price sky-high. I'm more certain of that than just about anything. In fighting the price rise they are sometimes successful (as is the case in this recent drop). But the record shows that the shorts are fighting a losing war, as we are still almost ten times higher than the lows of the decade. That's still better than anything else, despite the recent drubbing.

Readers should take my recent rants for what they are, namely outrage that the dirty tricks are becoming so blatant. But please remember that I was just as outraged at the manipulation when we were at $4 and that didn't stop me from pounding the bullish table for silver. The price has changed, but so have the circumstances. The bottom line is that my outrage is still there along with my bullishness for silver.

Ted Butler

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Silver – $35.30

Gold – $1495

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