The Calm Before the Storm?

Gold and silver prices have fluctuated within a narrow range for the past two months; a trading range of around $40 in gold and a dollar in silver. Furthermore, compared to the price beating for the first five months of 2013, this year's performance is in marked contrast, with gold up close to $100 and silver essentially flat. While not completely dead calm, recent price behavior certainly looks that way compared to last year.

There is no greater influence on collective market sentiment than the recent price action. Price always sets the collective mood. And it's not just mood; there are so many momentum and technical traders motivated by price that there is a self-fulfilling aspect involved as well. A rising market invites bullish feelings (and buying) and a falling market results in the opposite. A sideways market, particularly after a pronounced price decline like witnessed in gold and silver last year, results in perhaps the worst collective sentiment of all. It wears you out. I believe that's where we are now in the collective mood about gold and silver.

There is good reason why price dominates the collective market mood; people feel better when their investments go up and worse when their investments lose value. While it is absolutely understandable that price dominates the collective mood, it also can influence and distort objective analysis of the facts surrounding a market. In other words, price action sets the mood, but that's not necessarily the same as knowing which facts are setting the price.

For instance, most observers (not subscribers) would assume that silver is down and out because there is too much supply compared to demand. After all, it is assumed that prices don't decline and stay down as much as silver prices have with no good reason. If you judged silver from afar, as the vast majority of investors judge most markets, you would assume the facts underlying the market were in conformity with the price. Certainly, there are facts dictating the price of silver; but I would submit that those facts are completely different than what most observers would assume them to be. And therein lies a great opportunity, because the price of silver has been set by reasons at odds with what the real supply/demand facts would dictate.

How is it possible to uncover situations where the facts are different from the collective perception? The only way I can imagine is by looking as closely as possible; something that is extremely difficult in any one market and almost impossible for any one person to do in many different markets. How many markets can you examine intensely and still go about the business of life? For me, silver is the market I look at most closely and is why I don't comment on many other markets.

Aside from looking closely at a market, you want to be sure you are looking at the facts that matter the most. Included in any list of facts that matter the most would be whether the facts were verifiable and have stood the test of time. I believe the facts that matter the most in silver are the verifiable facts surrounding the COMEX, including futures trading as reported in the COT reports and warehouse movements, as well as the data reported in the silver ETFs and official mint sales. I can't guarantee the data is always accurate, but I believe them to mostly be accurate based upon their record over time. I wouldn't know what data would be more reliable (certainly not anything from London or China).

Best of all, these data show why silver is in the price dumps and why that is not likely to last. Silver (and gold) go down in price when the traders called the commercials on the COMEX induce the traders called speculators and technical funds to sell contracts that the commercials then buy. Prices go up when the technical funds buy and the commercials sell. There is no way to determine beforehand exactly how far a price move will carry or when it will turn, but silver prices usually follow the commercial/technical fund trading tango.

Generally, when the commercials have bought and the technical funds have sold as much as each group can, a price bottom is made and a rally begins. In many measures, we have reached extremes in commercial buying and technical fund selling in silver as I have recently reported (the raptors near record long position and technical fund short position). In other measures, there is still a very large concentrated commercial short position by the eight largest COMEX traders of 320 million oz. Never have we seen such similar, yet opposing extremes.

Usually, the raptors buy and build up big net long positions at the same time as the big commercials buy and have reduced their concentrated short position. But that is not the case now. We've never had such a large net long position by the raptors and large concentrated short position by the 8 largest shorts as we do currently. I think this accounts for the current price doldrums; although perhaps stand-off may be a better description. By the way, we don't have near record extremes in the gold COT in any category, so I'm only referring to silver in this discussion, although I suspect silver and gold prices will move in the same direction. Gold being more neutral in COT terms allows it to move in either direction.

Complicating the standoff in the large raptor long position/large concentrated short position in COMEX silver is the potential amount of technical fund and other speculative selling remaining to be sold on lower prices. There is a limit to this selling and being close to past record extremes, as we are now, limits the amount of additional sales potential, thus depriving the commercials the opportunity to buy significant amounts of additional contracts. I didn't say that the commercials can't buy some number of additional contracts on lower prices, just not great amounts. Thus, the potential for some short term price risk still exists.

Also complicating matters is that everything about the concentrated short position in COMEX silver looks illegitimate. It can't be attributed to legitimate hedging either from miners or owners of silver; and even suggestions that the big 8 COMEX silver shorts (led by JPMorgan) are hedging other OTC derivatives is absurd, as that assumes some secret and invisible concentrated short position elsewhere that is being hedged on the COMEX.

The 320 million oz concentrated silver short position is 36% of all the visible silver bullion in the world's total ETF and exchange inventories (875 million oz) and 40% of total annual mine production (800 million oz). Can you imagine the outrage that would erupt in any market, say the stock market, if prices were down 40% and there existed eight traders (7 unidentified) holding a short position equal to 36% of total stocks in existence? And if JPMorgan was the identified king stock short, would it be swept under the rug?

While it's clear that the regulators won't intercede and break up the illegitimate concentrated short position in COMEX silver, neither can they make it easily go away. And it appears that the 8 big shorts can't make it go away either, or at least they haven't until now. Not only can't the massive short position be explained in terms of hedging legitimacy, it also can't be explained in legitimate economic terms.

The price of silver is down 40% from a year and a half ago and down 60% from the highs of three years ago, to the point of falling below its primary cost of production; yet the concentrated short position has rarely been higher over the past three years and had been as much as 50% lower in the interim (May 2012). That makes the concentrated short position the main price factor behind sub $20 silver. I know that you can almost count on one hand the number of observers (apart from subscribers) aware of this fact, but that doesn't invalidate it as the prime, if not sole cause of the current price malaise. When you think about it, all this is quite remarkable.

To have, basically, the largest concentrated short position concurrent with the lowest price in the past three years should cause alarms to be sounded from every corner of the market; yet I am aware of no such alarms being sounded or even being discussed. The reason alarms should be sounded is two-fold; because this concentrated short position is clearly responsible for the low silver price and because it's hard to see how it can be resolved orderly. If this short position did not exist, it would be impossible for the price of silver not to be significantly higher. That's because it would take significantly higher silver prices to attract a sufficient amount of equivalent selling to replace the concentrated shorts. The most basic proof of price manipulation is if the price would be markedly different in the absence of the concentrated position in question. Without a doubt, the concentrated short position proves that silver is manipulated in price.

But the big question and opportunity lies in how the big silver short position is resolved. First and foremost, like all derivatives positions long or short, the concentrated short position in COMEX silver is an open position which means its closing must be contemplated. That's not the same as saying this position must be closed because that will be decided by the 8 traders holding it. But that also doesn't mean that the 8 traders wouldn't want to close it out, if only they could figure out how to do so without disorderly pricing.

Who the heck would want to be heavily and manipulatively short the most undervalued asset in the world? Yet that is the position which the 8 large shorts find themselves to be in. Even if they rig the price of silver lower that's no guarantee that the technical funds will sell much more or even if they did, whether the raptors will continue to step ahead of the 8 largest traders and deny them the chance to cover. I believe the 8 largest shorts are as much captive to their silver short position as is the price of silver captive to this short position.

I think this standoff is behind the low and stagnant price there is no easy way out. Nothing would surprise me at this point; not an attempt to rig prices lower and certainly not a continuation of the standoff. Neither would I be surprised if this thing gets resolved to the upside, seeing how we are locked and loaded for upside action. While I admitted that the big 8 shorts, since they are stuck in a position not easily resolved, may choose to extend the manipulation for lack of good alternatives, there are a number of factors working very much against them.

The first thing working against the big COMEX silver shorts is that their position is even being discussed at all. Few are discussing it currently, but few were discussing precious metals manipulation in general a short while back either. Now the topic of precious metals manipulation is more widespread than ever, although it can get confused and misguided at times.

With the concentrated short position in COMEX silver, there is nothing confused or misguided in any way. It is very specific and verifiable, right down to openly and publicly accusing JPMorgan and the CME Group for their roles in this scam. As time goes on, this will become a much more recognized market fact and that will put additional pressure on the 8 big shorts. You can be sure I will be doing my best to expose it. Plus, I can almost guarantee you that no legitimate explanation will be offered to explain how 8 traders can be short the equivalent of 40% of annual mine production with very little silver miner hedging existing. If they could have explained it, they would have explained it already.

But the strongest factor pressuring the 8 big shorts to cover is the coming physical silver shortage. Let a physical silver shortage emerge (again, as was the case in early 2011) and these 8 shorts will rue the day they ever heard the word “silver.” That's because if a silver shortage hits and the concentrated short position exists to the extent it exists now, it will be doomsday for the shorts.

Try as I may, I can't see it as being too late to even close the COMEX in such a circumstance, because that event it will cause an avalanche of legal woes in addition to market losses. When he was in his most uncharitable mood (quite rare for such a charitable man), I remember my old friend and mentor, Izzy Friedman, wishing that the big shorts would be full up (full pants down) when the shortage hit. Based upon current circumstances, he just may get his wish after all.

The recent silver price action has been dispiriting and emotionally draining, but its cause is not related to any oversupply of real metal as most would assume from the price action alone. Silver is down (but not out) because of the concentrated short position of 8 COMEX traders, mostly banks, both foreign and domestic. This short position is illegitimate and indefensible and, if my hunch is correct, will become more widely recognized in time. I don't know enough to tell you whether the dollar or the stock market will crash and burn or enough to tell you about future economic events, so I won't even try to do so. Even though silver should do well in overall bad economic times that is not something I'm rooting for.

I can tell you that without the 320 million oz concentrated short position in COMEX silver futures, there is no way the price would be under $20. I can also tell you if the inevitable physical silver shortage hits while this short position is in place, it will create a price storm of the most extreme historic proportions.

Ted Butler

May 21, 2014

Silver – $19.40

Gold – $1290