

May 4, 2011 - Just Like the Old Days?

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The decline in silver has been brutal and fear-inspiring. Let me try to dissect it and put it into the proper perspective. The best way to do that is to compare it to similar previous sharp declines. Conditions can and do change, but it is important to not forget the lessons of the past.

If there is anything universally remembered by long-time silver investors over the past ten years it is the series of price smashes to the downside that suddenly erased months of price appreciation in a matter of days or weeks. Those memories are not necessarily fond, but they certainly were educational and do provide a reference point for what we are witnessing now in silver.

Quite frankly, I "cut my teeth" on the regular pattern of gradual silver price gains followed by sudden price smashes. I wrote hundreds of articles explaining the interplay between the speculators versus their commercial counterparties on the COMEX, as recorded by changes in the market structure as depicted in the Commitment of Traders Report (COT). Not always, but often, I was able to warn of a pending sell-off due to a negative COT structure and pinpoint when the structure became constructive again. I think that past experience is helpful in understanding where we are in silver presently.

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While there are some strong similarities with past times in deciphering the price smash over the past few days, there are plenty of important differences as well. For sure, the current takedown has been a typical COMEX-generated production. In little more than ten minutes in the absolute least liquid trading time possible, light COMEX predatory trading took the market down almost 13%. That takedown resulted in the continuing follow through to the downside. I'm told the CFTC is looking into that trading, but then again, they have been looking into the silver manipulation forever. (Note to CFTC □ time to stop looking and start doing). While extreme, this COMEX price smash is remarkably similar to previous silver smashes where the commercials sold small amounts of contracts in order to start an avalanche to the downside, so that the commercials could buy at distressed price levels afterward.

Also similar is the general misunderstanding by the world at large of what actually occurred in these price smashes. That's because the world at large does not and cannot recognize that the silver market is manipulated. So when these price smashes occur, the world invents reasons for them other than the simple truth of a COMEX-induced manipulation. For instance, to this day, the reason accepted for the great 2008 silver price smash was physical liquidation during the financial crisis, while there was never any actual evidence of that liquidation. Currently, the most popular reason to explain this price smash is the series of margin increases. Yes, the CME Group knows just when to time the

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margin increases to coincide with maximum benefit to their important short constituent members. But if simply raising margins was all it took to cause silver to sell off, the COMEX crooks would have jacked them up long ago and the price never would have approached \$50. The truth is that the reasons typically given for the price smashes are tangential at best.

But it is in the study of the differences with past silver price smashes that I feel is most instructive now. For one thing, every previous silver price smash started when the speculators and technical trading funds were loaded to the gills on the long side and the commercials were loaded for bear on the short side. This time, as I reported on Saturday, both speculative long and commercial short positions are very low, in some categories at the lowest levels in years. For sure, those positions are lower now after the action of the past few days. This is not at all suggestive of a pronounced and extended move to the downside from here.

I know that many commentators publicly contend that silver is in a bubble due to heavy speculative buying. But the facts clearly undermine that contention. The facts are contained in the COT reports. If anyone knows of a better and more objective measurement of speculative participation please inform me of it. What the bubble thesis promoters are doing, I believe, is looking at the price spike up and assuming that it must have been speculators rushing in to buy that caused that spike. That's a reasonable assumption, but I have never seen anyone back it up with hard data. I don't doubt that there has been some

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speculative buying in the big silver ETF, SLV, but that is impossible to quantify. Certainly the data from the COTs indicate no such speculative buying on the COMEX, which is at the center of the silver manipulation.

In fact, as I have reported, the speculators on the COMEX have been selling on balance for weeks. More notably, the commercials, including JPMorgan, have been buying like crazy on the way up to over \$49. This is in marked contrast to what occurred in all previous silver price smashes. Also in marked contrast is that this commercial buying of short positions has come at great loss to the big commercial shorts. These guys never took silver losses in the past, but they sure are taking them now. A case in point □ the loss that JPMorgan took on the 6,000 contracts they sold in late February and recently covered in the very high 40's cost them \$350 to \$400 million or more. That's not on their whole position, just the 6,000 contracts they added at that time. (Of course, it is possible that JPMorgan stuck some hapless client with the loss, as is customary in bank dealings).

Even though silver investors feel frightened and crummy, my point is that never before have the commercial silver shorts taken such a financial beating. Even in the current sharp sell-off, which the commercials have induced and are buying into aggressively, they are still incurring steep losses, as these positions were largely sold short originally when silver was in the teens. I know silver investors are feeling financial anxiety currently, but it is important to remember the

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shorts have been savaged over the past 9 months. Most importantly, the commercial shorts have been proven to have been on the wrong side of the silver market and have moved aggressively to close out those losing short bets. This is unprecedented.

Quite simply, the commercials have been buying on the way up in silver prices and are now buying on the way down. This should be confirmed in this week's COT and Bank Participation Reports. When the commercials are buying silver no matter whether the market is surging or crashing, that sends out a strong signal. That signal is clear and unmistakable □ the commercials expect much higher silver prices soon. No one buys anything in the expectation it will go down in price. The commercials are buying silver, collusively and urgently, because they believe the price will be substantially higher soon enough. Amid all the talk that the silver bubble has popped, the commercials are putting their money on the line and are buying silver like never before. This buying signal should not be ignored.

Perhaps the greatest difference in this silver takedown and the ones in the old days is the condition of the wholesale physical market. In the past, there was always enough physical silver available to the big commercials to allow them to play their manipulative games on the COMEX with impunity. But that is no longer true. I see clear proof of a wholesale shortage at this time. That proof can be found in the goings on in the big silver ETF, SLV. Specifically, the short

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position in SLV proves that there is a shortage of silver. Please allow me to explain (again).

Over the past month or two, the short position in SLV has grown by almost 20 million shares, to 36.7 million shares. Because the formula for the Trust is that one ounce of silver stands behind each share issued, this means that there are more than 36 million ounces of silver owed to Trust, of which 20 million ounces have been shorted very recently. The prospectus for the Trust reads that one ounce of silver must be deposited for each share purchased. Yet 36 million shares have been purchased that have no silver backing. The buyers of these 36 million shares/ounces abided by the rules and paid for their shares and that money was transferred to the sellers. But instead of buying the silver and depositing it with the custodian, the sellers pocketed the cash and didn't buy the metal as required. Why would the sellers do this? The most plausible reason is because there wasn't silver available to purchase. That's the definition of a shortage.

Of course, some may argue that the short sellers of the 36 million shares were merely making a bearish bet. But this is a bet that could have been made more practically in other venues, such as on the COMEX or the OTC market where you don't have to deposit physical silver. The fact that the buyers of the 36 million SLV shares paid for a security that promised full metal backing and they clearly did not get that metal backing constitutes fraud in my opinion. The fact that the

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short sellers were able to sidestep the purchase of 36 million ounces of silver that surely would have driven the price higher constitutes manipulation. To engage so openly in fraud and manipulation tells me that the short sellers had to have a darn good reason to do such a thing. Not having any choice because that quantity of silver was not available is hands down the best explanation.

This is the issue that I have raised with BlackRock, the Trust's sponsor and the largest money manager in the world. It is such an important issue that I believe it will determine the future of the SLV. If BlackRock does not immediately crack down on the fraudulent and manipulative short selling of the shares of the SLV, it raises great risks to itself on legal and reputational grounds. It doesn't appear hard to me to be able to show that the shorting of SLV shares constitutes a fraudulent conveyance. An investor who has lost money in silver or in the shares of SLV might have a very good case to recover damages. Of course, I'm not a lawyer, so please don't take this as any kind of legal advice.

Also, I don't want to appear as a bully. I don't pick on weaklings. I don't want this to turn into the adversarial relationship that has arisen with the CME Group and JPMorgan. I am encouraging BlackRock to fix something that needs fixing to help them and the shareholders of SLV, of which I am one. This is an issue that will make or break the SLV and it's up to BlackRock to do the right thing and eliminate the short selling of SLV shares. This short selling of SLV has given the COMEX manipulators a free ride to rig the price of silver lower.

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As I write this, the price of silver is still in a free fall, trading below \$40. I can't tell you what the absolute price bottom will be, but I think I can tell you some other things. My sense is that the market is close to exhausting itself on the downside. I do know that all past price smashes in silver over the years end when the last possible speculator liquidates or goes short. The COTs say we are close to that, if not already there. The thought of selling here is out of the question for me. It's more a matter of what to buy.

Based upon the market structure and my take on the physical shortage, I'm convinced that when the turn to the upside comes in silver, that turn up is going to be dramatic. I think there is a good chance that we will then go up as fast, or faster, than we just went down. I base that on the unwillingness of the commercials to ever go short big in silver again. These commercials will not put themselves in the same short position they have been in over the past 9 months. I'm sure they feel fortunate to have eliminated as many shorts as they have, even though it cost them a boatload of money. Their lack of selling in the future will create a vacuum on the upside that will allow prices to soar.

Long-time readers may remember a pet theory of mine that I had kind of forgotten about until this week. My theory was that before we get the real blast to the upside, amid the termination of the manipulation or a physical shortage,

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we would get an unbelievable shakeout to the downside. After that downside shock and after the last speculator that could be tricked and frightened into selling did sell, the commercial would just put their hands in their pockets and not sell on the upturn. That selling void would create the conditions for the final blast-off. This sell-off sure feels like the big one to me.

Three weeks, on April 13, I indicated that I had a feeling in my bones that silver, then priced not far where we are right now, could experience a \$10 to \$20 pop. We did get real close to the \$10 mark over the next couple of weeks, but not higher. I try to avoid short term calls, which can be quite random. While I did not expect a full retracement of those gains this week, I had been writing about the possibility of a sell-off generally. I am getting a new feeling that things are about to heat up to the upside in silver shortly.

A number of things are for certain □ conditions today are factually much better today than they were three weeks ago. For one, the COT structure is much better, with the commercial sitting on greatly reduced short positions and the speculators cleaned out from the long side. Certainly people feel much worse about silver today than they did three weeks ago. In the perverse world of sentiment, the worse everyone feels, the better it is. Finally, the short selling issue in SLV shares has exploded onto the scene.

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As an analyst, I believe it's my job to report and interpret the facts in silver in as objective a manner as possible. The facts are that silver is better positioned than it has ever been. This sell-off has hurt silvers investors financially and especially emotionally. That will soon be over and the important issue is not to lose positions. It is the silver price climb that is not over and is, in fact, made better by this week's developments. It's not just that the price is cheaper, it's much more important that the overall conditions are better.

Ted Butler

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Silver - \$39.50

Gold - \$1518