

## May 7, 2011 – Weekly Review

### Weekly Review

This week was one for the record books again, but a different type of record than has been experienced recently. Silver plunged by more than \$12 (25%), its largest decline in 30 years. Gold's fall, in comparison was tame, as it fell by "only" \$68 (4.4%). As a result of silver's historic decline, the gold/silver ratio widened dramatically, out to 42 to 1.

I have been a strong proponent for converting gold into silver. I still am. I believe the real facts continue to suggest that silver will greatly outperform gold in the future. Accordingly, this sharp down take in silver provides a special opportunity for gold heavy investors to switch into silver at the best levels in months. As always, I am talking about converting fully paid for gold into fully paid for silver, no leveraged spread trading on margin. No holding silver on any type of margin (use call options for leveraged speculation). I know I have preached this no margin approach consistently to the point of being a nag, but along comes a week like we've just witnessed and I am left with the thought that I didn't preach it forcefully enough.

In contemplating this week's events, I am reminded of a term I believe was first coined by the famous commodity speculator, Richard Dennis of C&D Commodities, back at the time of the stock market crash of October 1987, in which many markets suddenly went haywire. He called it a "discontinuous event," like some great rogue wave that swamps even the largest ship. Back then, the chief culprit was program trading and the ill-conceived practice of portfolio insurance. While many markets were affected back then, this time the center of attention was primarily silver, although late in the week, the plunge in silver seemed to spread to other markets, like crude oil.

But it would be a mistake to equate the action in silver to crude oil. As I had written previously, there was documented evidence in COT data of an unusually large and historic speculative long position in crude oil futures. To expect that this large speculative long oil position could unravel at some point is reasonable. There was and is no unusually large speculative long position in silver futures, as I have been reporting regularly. Therefore, it is wrong to point to this as the reason for silver's plunge. And if you do eliminate an excessively large speculative long position unwinding as the cause of the plunge, you are forced to substitute different reasons. Those reasons are abundant if you look closely and without preconception.

I'm going to run through the usual material in these reviews quickly this week, but not because such material is not vital at this time. I have already issued comments on the activity this week and I want to add a piece I am contemplating making public (please give me your feedback on that).

Conditions in the physical silver market remain tight. COMEX silver warehouse turnover (movement in and out) remains high and indicative of tightness. The May delivery pattern is weird to say the least, however, with low deliveries and low remaining open interest. I can't automatically declare this a sign of tightness, but neither is it a sign of surplus or an indication that the owners of the COMEX silver inventories are looking to dump. Late reports on the retail front indicate an intensification of demand and growing supply unavailability. I would imagine that once folks adjust to the shock and fear of the sudden price drop to recognition that silver has been put on a blue light special sale, demand will grow even stronger.

There were huge physical out movements in the big silver ETF, SLV, to go along with the record volume this week. Over the past 10 days, more than 35 million ounces have been removed from the Trust, including a whopping one-day decline of 17 million ounces. Most, but certainly not all, of the silver removed came as a result of plain vanilla investor liquidation on the plunge in price. In fact, I've come to believe that getting this investor liquidation was at the heart of why the price was manipulated lower this week. I also believe that it is a mistake to assume that the 35 million silver ounces is somehow freely available to the market at current prices. This is not silver that is now lying on the streets of London abandoned like some street urchin in a Charles Dickens novel. This silver, like every other asset in the world, is very much owned by someone and that someone will determine when and at what price it may be sold. My guess is that this silver is now held in the strongest of hands, probably by whoever masterminded this silver plunge and expressly for that purpose.

I continue to believe that the central issue in the SLV is the short position in its shares. The removal of silver from the Trust has the mathematical effect of increasing the percentage of the short interest to total shares outstanding. We should get new short interest figures in the next week. I have not heard anything from BlackRock, the Trust's sponsor, but will continue to send them everything in which I mention their name as is my custom (as I do with JPM and the CME). I am more convinced than ever that BlackRock could be held liable for allowing this fraudulent and manipulative short selling to come into existence. They collect a large amount of money for being the Trust's sponsor and should do something worthwhile to earn that money, like protecting shareholders from predatory short sellers.

The latest weekly Commitment of Traders Report (COT) for silver was a surprise, while the monthly Bank Participation Report released the same day was exactly as expected. The silver COT indicated that the commercial net short position was as close to unchanged as possible, while the net commercial short position in the gold COT declined by almost 9,000 contracts. Additionally in silver, there were very minor changes in the net positions held in the individual commercial categories, namely, the big 4, the 5 thru 8 and the raptors.

The reason I was surprised was because this report was as of the close of business on Tuesday, which included two very big and high volume down days on Monday and Tuesday. By Tuesday, silver had already declined by more than 13% in price and it was widely reported that long speculators were aggressively fleeing the market. This COT clearly said that was not the case. While I still expect that the next COT will show large speculative selling, I'd like to make a different point. This report does, at least, confirm my contention that the widely accepted premise that speculators abandoning excessive long positions was the wrong explanation. Further, since this COT indicated no such speculative long liquidation, the search for the real reasons behind the silver plunge should be intensified.

The Bank Participation Report did match my prediction in last week's review that JPMorgan would be holding their smallest net short position in COMEX silver since they took over the concentrated short position from Bear Stearns three years ago. My analysis indicates that JPMorgan was holding about 18,000 contracts net short on the COMEX, as of the close of business Tuesday. Most of their buyback took place on the move up to over \$49, as previously reported, although I suspect they have covered more since the Tuesday cut-off to the downside. (Here's a note intended for the CFTC. If the manipulators at JPM try to tell you that their buying to the upside prior to the crash proves that they had nothing to do with this week's plunge and you believe them, our country is surely doomed.)

I'd like to comment on the series of margin increases in silver this week by the CME Group. At first I dismissed the margin increases' significance. I am still convinced that the small increase in silver margin last Friday played little role in last Sunday's sudden \$6 swoon. But the continued and increasingly large subsequent margin adjustments have had an important financial and psychological impact on depressing the price of silver. Certainly, the margin increases have been given widespread publicity as a driving factor for the price smash. I even heard Jim Cramer on CNBC passionately defending the CME for having done the right thing in the manner in which they increased the silver margin levels so aggressively. I have a different take. To me, how the CME handled the silver margins proves they are either incompetent or much worse.

The incompetence issue arises from the fact that they clearly misunderstood and miscalculated the level of risk in silver before the plunge. That's clearly proven by the dramatic increases they ordered as silver prices fell. The management of the CME is consistent in its message that it knows the markets better than any regulator ever could and that they should be relied upon to be trusted with such matters as margins or position limits. This silver margin disaster proves that was a crock. In retrospect, it is clear that silver margins were much too low before the plunge and that the entity responsible for setting the proper level of margins, the CME, really screwed up. Not only did these CME screw ups misjudge the actual level of risk, they exacerbated the silver decline by dramatically increasing the margins when they did. Therefore, it seems to me that the CME shares culpability for the silver price plunge for the way they mishandled the silver margin issue. Of course, this is above and beyond all the previous things I've accused them of. And this is just if they were incompetent in their handling of the matter.

But there is a potentially much darker side here. If the CME had raised margins on the way up in silver prices, as they clearly should have in retrospect that would have prevented margins from impacting price this week. But to have raised margins on silver as prices were climbing would have put great pressure on the shorts and no pressure on the longs (rising equity in the longs' accounts due to increasing open profits would have covered any increase). Since the shorts are among the CME's most important constituent members, the CME "helped them out" by not raising margins. Instead, the CME waited until the decline commenced and then raised the margins like crazy which aided the shorts and punished the longs. No matter which version you choose, incompetence or manipulative facilitation, the bottom line is clear; the CME should not be allowed to set margins on anything.

While I'm on the subject of what I felt was wrong this week. Let me mention a couple of things in passing. The Wall Street Journal reported that George Soros and other prominent hedge fund managers were selling silver this week. Since Mr. Soros had not reported previously buying silver, the implication may be that he is selling silver short. We'll see how that turns out. No implication of short selling was needed in the announcement that Minera Frisco, the Mexican miner controlled by Carlos Slim, had increased its massive bet against silver by 25 million ounces. It now is short 95 million ounces, which is close to the annual silver production of all Mexican silver production. <http://www.reuters.com/article/2011/05/04/slim-silver-idUSN0410776920110504> It is my understanding that this amount represents almost four full years of projected silver production. It is also my understanding that guidelines under US commodity law (CEAct) disallow any producer from holding more than one full year's worth of production short on a regulated exchange. This position is obviously not held on the COMEX and it's hard to see how it could be considered prudent. I wrote about this in "Hedging Insanity" (in the archives, Feb 14). Sometimes big bets work out fine, sometimes not.

I hope none of this sounds like I am less bullish on silver, because I am not, as I hope I have conveyed this week. I just wanted to clear the air. Here's the separate piece I mentioned earlier, and sorry for the length of this review Â?

### First Fear, Then Anger

The historic decline this week in silver creates strong emotion. Watching great amounts of wealth disappear, quite literally in minutes amid disorderly trading conditions is a genuine fear for any investor. Worse is seeing no obvious legitimate reason to explain the carnage. If that doesn't scare you, nothing will. Especially if you already harbored unease about how the whole silver market operated.

But fear is an emotion that burns out fairly quickly. A human being can't stay in an intense state of fear of financial catastrophe without selling out at some point or mentally adjusting to the new level of price. Then the conditions that led to the fear in the first place are replaced by some other emotion. If evidence exists that the sudden financial loss could and should have been prevented, the new emotion becomes one of anger. Anger at who or what might have caused the loss and who should have prevented it. I think there is compelling evidence pointing to who and what caused this silver crash as well as who should have prevented it.

The first thing we must recognize is that this was an unusually intense price smash. Silver fell 30% for the week at its low, its biggest price loss in 31 years. The decline was highlighted by record trading volume on the COMEX and in shares of SLV. From any objective measure, the trading was disorderly, indicating little true liquidity despite the record volume. That's because much of the trading was conducted by high frequency trading (HFT) computer bots whose clear purpose seems to be to cause disruptions to prices. These are the same disruptive traders that caused the flash crash in the stock market last year. I believe it was these traders who started the price decline with the \$6 hit in 12 minutes on last Sunday evening. Their primary reason for existence seems to be causing prices to collapse.

Why these HFT cheaters are allowed to pollute our markets is beyond me. The only clear beneficiary to their trading is the exchange itself which pockets fees on every contract traded. After they crashed the stock market last year, I believe the HFT computer bots toned down their stock market activity due to regulatory pressure. That's fine, but why were they then allowed to infect silver trading with their disruptive practices? This is just one question I have about this week's events in the silver market and I will list them all in a moment. First I would like to get something off my chest.

I am appalled at what happened in silver this week for a very special reason. I can't say this latest blatant take down looks out of place for a manipulated market which I have been alleging for 25 years. We didn't need additional proof that the silver market was rigged, but this intentional price smash provided that proof in spades. Admittedly, I look at silver differently than most folks, but there was something very special about this week. The special reason I am particularly appalled this time is that this is the first silver price smash for the record books that took place during the tenure of Gary Gensler as Chairman of the CFTC. There have been some multi-dollar price declines since Gensler was confirmed in May of 2009, but this week's smash is the first mega-down move under his watch. That makes it very special to me.

As you know, I have put Gensler on a pedestal, repeatedly referring to him as the greatest chairman in CFTC history. Considering my past experiences with the agency, I still marvel at my transformation. I think he has done more than anyone ever to reform commodity regulation, including working diligently, although very quietly, to end the silver manipulation. As you also may know, I have generally come under great criticism and disagreement from many of you about my opinion of Gensler. I have respected that criticism and have used it to reflect on and test my continued belief in the chairman.

This week's events in silver have created what may be a seminal moment. I still hold a deep belief in Gensler's character and purpose, but it is important to judge how he and the Commission react to this week's silver price plunge. Certainly, Gensler doesn't answer to me, but he does answer to the public who he has sworn to serve and protect. The public was not protected this week in silver. I don't think he had any inkling beforehand about what transpired this week, but he is too smart not to grasp the significance of the silver price plunge and the circumstances that caused it. How he reacts to his first real-time case of blatant fraud and manipulation in silver will be a key test for him. I sure hope his reaction is different from the typical CFTC reaction before he arrived. You know, the three monkeys' see, hear and speak no evil reaction.

Gensler is fully aware that there have been more public complaints and comments and agency investigations concerning silver over the years than for any other issue in agency history. The public has done whatever has been suggested or required by the Commission to make its voice known on silver. Cumulatively, there have been tens of thousands of public and private comments to the Commission regarding silver, from position limits to pointing out specific instances of trading abuse. While I suspect progress has been made behind the scene, that progress is not visible to the public. Here we have a case where the public couldn't possibly be more vocal to the prime regulator about wrong-doing in silver and is then subject to the most egregious takedown in history.

Silver investors are not second class citizens, yet they are being treated as such. Generally, they are among the most God-fearing, family oriented, hard working, law abiding, productive and patriotic members of society. Chairman Gensler and the Commission know this from the comments that silver investors send in continuously. Then why are silver investors not offered equal protection under the law that the Commission has sworn to uphold? Is there something about "and justice for all" that specifically excludes those that invest in silver? If what occurred in silver this week had instead took place in the stock market, corn, cattle, or any other market, there would be non-stop congressional and CFTC inquiry and debate. Instead, silver investors are confronted with a non-stop barrage of propaganda indicating they were idiots for considering silver.

Please allow me to be blunt and specific. These are the questions that Gensler must confront and address?

One – the \$6 takedown in 12 minutes on Sunday evening on initial light Globex volume was clearly intended to get silver prices rolling downhill. It was something I had never witnessed before. There were no fundamental developments in silver to account for it. Therefore, this was not true price discovery, but price-setting and manipulation. What is the Commission's take on this event?

Two – the series of margin increases by the CME Group had the effect of adding downward pressure to a market already intentionally rolling downhill. At best, the margin increases prove that silver margins were previously much too low and the CME is incompetent and negligent in setting margins and that function should be taken away from them. At worst, the CME intentionally raised and timed silver margins to aid and abet its most important members in causing the price of silver to crash. In other words, the CME resisted raising margins on the way up as that would have damaged the insider shorts and waited until prices began moving lower to hurt the longs and reward the shorts. I've learned from experience that it is best to view the CME as a criminal enterprise. What is the Commission's opinion on this?

Three – the record high trading volume and 30% price smash indicate there was little true liquidity present. This is due to a disproportionate share of trading being performed by HFT computer bots. Why are these traders allowed to exist and control so much a share of silver trading?

Four – there has been much media and other commentary about silver being in a bubble that burst due to large leveraged speculative buying. This story has been repeated so often that it is now accepted as being true. Yet the CFTC's own data in the COT reports indicate that no such speculative buying occurred in silver futures prior to the price crash. Commodity law holds that it is a criminal violation to spread false market information. Why is the CFTC allowing this false market information to be disseminated unchallenged? By remaining silent and not setting the record straight, the Commission itself may be in violation of the law.

Five – while outside its direct jurisdiction, the Commission is aware of the allegations of manipulative impact the short selling of shares in the big silver ETF, SLV, has had on the price of silver. What is the Commission's position on this and has the agency referred this matter to the SEC or taken it up with BlackRock, the trust's sponsor?

Since the last official denial by the CFTC that anything was wrong in the silver market in May 2008, the agency has issued no further denials. Instead, they initiated a new investigation in September of 2008, but little has been said about the findings of this ongoing silver investigation. I think that the denials of a silver manipulation ceased primarily because of Gary Gensler's assumption of office two years ago. From day one, he has said and done the things which were consistent with the termination of the silver manipulation. That's why I have publicly (and privately) expressed my admiration and respect for

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