

May 9, 2012 – Knowing the Game

Knowing the Game

Especially at times of price pressure like now, it can be reassuring to know how the game is being played. I'm not speaking of the day to day price movements, but of the dominant forces that generally cause both short term and long term price movements. The price of world silver and gold is mostly set on the COMEX. Over the longer term, of course, other things will influence the price, such as production and consumption and investment demand. But these longer term influences don't change radically from day to day and it is usually unproductive to link those influences to short term prices. And sometimes, like now, world events would strongly favor a rush towards precious metals were it not for price-setting on the COMEX.

So how is the price of silver and gold set on the COMEX? The price is set as a result of the continuous competition between what are called commercial traders and speculators (aka non-commercials). However, the term commercial trader is a misnomer for the most part as these traders are usually just speculating. The way US futures markets are supposed to work is that hedgers (real producers and consumers) transfer price risk to speculators. In reality, it hardly works that way at all. Very few silver miners hedge production. Additionally, real hedgers don't trade excessively on a short term basis and such short term trading makes up over 90% of daily trading volume in silver and gold on the COMEX (and in other markets). Therefore, the trading is between two competing speculative groups, one being called commercials.

Perhaps the best way to view the commercials is as market makers who take the opposite side of any trade the speculators desire to buy or sell as a group. There must be a long for every short and vice versa and the commercials will take the opposite side of whatever side the speculators choose. The problem is that the speculators generally are influenced by technical price signals and even those speculators who aren't purely technical also tend to buy as prices rise and sell as prices fall. Almost all of the speculators are fiercely independent traders with no affiliation with other speculators. Even though there is no reason to suspect collusion among the speculators, the fact is that these very independent traders generally buy and sell en masse; buying on the way up in price and selling on the way down. The speculators are not trading as a group intentionally; that's just an unintended consequence of them all relying on price changes to buy or sell. The speculators take positions because they believe each trade has the potential to be profitable.

Very much unlike the speculators, the commercials have a completely different objective. Instead of focusing on the profit potential of any individual trade, the commercials' mission is to master and manage the speculators as a group. It's kind of like men are from Mars and women are from Venus; the speculators and the commercials have two completely different mindsets in their respective approach to the markets. The speculators are focused on the next trade and their positions; the commercials are focused on mastering the speculators. In my opinion, the speculators have no clue or may not care that they are the target of the commercials. This gives the commercials a big advantage.

Because the commercials have a leg up on the speculators in knowing how the game is played, the commercials have been able to develop a market approach very different from the speculators' approach. Unfortunately, many of the techniques developed by the commercials would appear to be flat-out illegal. In fact, I believe a strong case can be made that because the commercials' approach is of managing the speculators, the net result is market manipulation pure and simple. The first definition for manipulation I uncovered on Google says it all, "exerting shrewd or devious influence especially for one's own advantage."

The commercials, particularly in COMEX silver and gold, have perfected a number of techniques to aid themselves in manipulating the speculators, including the ability to set prices on a short term basis, particularly when the markets are thin (overnight) and by High Frequency Trading (HFT) at other times. These techniques have been discouraged by the regulators in many markets, but not in gold and silver. Having the ability to set prices at will gives the commercials a big leg up on controlling the speculators behavior. Think of it "one group of traders (the speculators) relies on price signals to buy or sell and the other group of traders (the commercials) has gained control of the price signals. It would not be an exaggeration to view the speculators as puppets and the commercials as the puppeteers. That this set up is anti-free market goes without saying.

Perhaps the simplest proof that what the commercials are doing is illegal lies in the fact that the commercials are collusive in their actions. In fact, collusion is required for the commercials to pull off their scheme. Let me define collusion as Merriman-Webster does, "a secret agreement or cooperation especially for an illegal or deceitful purpose." What simple proof can I give to show that the commercials are collusive? I think government data should do the trick.

It's no secret that I'm a student of the Commitment of Traders Report (COT) and other reports published by the CFTC for more than 30 years. These COT reports break down the weekly changes in positions held overnight (not day trades) by various categories of traders. Principally, the categories break down into commercials and speculators, large and small. Since we know that the speculators rely on price signals or emotion in buying or selling positions and are not affiliated in any way with one another, they can be eliminated as behaving in a collusive manner. Yes, speculators buy and sell at the same time generally; but there is no question that they are not colluding to bring financial harm to themselves. What about the commercials?

99% of the time, all the commercials buy and sell in unison. Some commercials may have long positions, other commercials have short positions; but they all buy and sell in unison. Each week, when I review the latest COT report, invariably the three categories of commercials that I use to monitor trading all buy in varying amounts or sell in varying amounts (last week marked a rare departure by the raptors in silver — that's why I said 99% of the time). There is very rarely any competition among the commercials; they all buy or they all sell. One for all, all for one. Because the commercials' game plan is to game the speculators, they must collude, as there would be no other way for the commercials to take on the speculators without collusion. Let me give you some examples of commercial collusion.

For one thing, the commercials never compete among themselves when buying or selling. That's because competition is the opposite of collusion. Because all the commercials are aligned against the speculators by choice and design, the commercials never reach for price. Why would they? The commercials know if they rig prices higher or lower, the speculators will react and come to them. In very simple terms (and this sell-off is a perfect example), the commercials just rig prices lower overnight and with HFT during the day and then wait for the speculators to come in to sell. It is simple cause and effect. The commercials put prices below recent levels on very low volume and then the commercials just sit and wait until the speculators sell in increasing volume. There is a tacit agreement among the commercials not to compete on price; they all know how to be patient and let the speculators come to them. The idea is for the commercials to demoralize the speculators and create the conditions that will force them to sell. Falling prices force speculators to sell. This is how the commercials can buy great quantities of silver contracts on lower prices and sell great quantities on higher prices, as they have over the years. It's quite the scam and made possible through the magic of collusion.

Some may say that this is just how markets work. That may be true, but it is not how markets are supposed to work. Futures markets are supposed to be for hedging of bona fide price risk, not as a collusive scheme for New York banks to rig prices and cheat speculators. The ironic thing is that US commodity law precludes such collusive gamesmanship and there exists a specialized federal agency, the CFTC, expressly created to prevent the collusion. To their and our great shame, this agency is truly out to lunch.

Let me be very clear about something. I write about the illegal collusion on the COMEX because that is where the price of silver (and gold) is set and any analyst not looking at the COMEX will not see the true story. But I have never encouraged or intended anyone to trade COMEX futures on margin. To do so is foolhardy. The only real chance a silver investor has is based upon full cash ownership of metal for the long haul. It's hard enough for many to hold through times like these on a full cash basis; margin makes it almost impossible. Please understand I'd prefer that the COMEX didn't allow the price of silver to be manipulated and I point out the illegality there as a way of getting it corrected. Short of that, I'd shed no tears if the COMEX ceased to exist. Such an occurrence, as I've written previously, would be wildly bullish for the price. No COMEX means no collusion and no manipulation.

Since I don't speculate on the COMEX (I did, many years ago), I don't have a built in bias favoring the speculators there. The speculators don't have a right to make a profit and neither do the commercials. But every market participant has a right that the game is played on a level playing field and according to the law. Concentration and collusion are not compatible with fair and free markets.

On the current price decline from Feb 28 (when silver was at \$37 and gold at \$1785) thru last week's COT, the commercials have collusively purchased 22,000 net contracts of silver (110 million oz) and as many as 75,000 net contracts of gold (7.5 million oz) on the COMEX. Speculators were duped into selling these quantities to the commercials on rigged prices through collusion. There were no verifiable silver or gold transactions in the world during that time that comes close to the quantities that changed hands on the COMEX. There were no supply/demand developments in the world to account for the price decline. Therefore, it is proper to claim that the COMEX set the price by virtue of the outsized change in positions, as documented in the COTs.

Let me try and demonstrate from a different perspective why this recent commercial buying of 110 million ounces of silver was clearly collusive in nature. In 1997, Warren Buffett bought a similar size amount of silver for Berkshire Hathaway. It was one of the most skillful purchases ever, as Buffett bought the silver while barely causing the price to rise one dollar from when he started to buy. He explained afterward how he never bought on new price highs and only bought on sell-offs. He did everything possible not to disturb the price, as would be expected. It took him 9 months or so to complete the purchase. It is impossible for Warren Buffett or any single trader to be accused of collusion while acting alone and independently. Now let's compare Buffett's purchase to the similar-sized position bought by the commercials on the COMEX over the past 2 months or so.

In the case of the recently purchased 110 million ounces (undoubtedly more than that now, given the price action this week), the silver was bought by as many as 40 different commercial entities, not just one. Therefore, collusion is possible, if not probable. Unlike the case with Warren Buffett who, as the world's most accomplished investor, was able to buy with only a 20% or so increase in the price, the 40 different commercials on the COMEX bought on a significant decline in price, as much as \$8 lower or more than a 20% decline. Buffett, acting alone, caused silver prices to rise 20%; the 40 COMEX commercials, acting as a cohesive unit, completely outdid Buffett and bought on a big decline in price in a fraction of the time. And not only that, whereas Buffett's purchase was a single one-time transaction, the multiple commercial entities on the COMEX have done this an incredible number of times in silver, both buying on the downside and selling on the upside. I would contend that such commercial feats would not be possible without collusion and without gaming the speculators. There is no other plausible explanation for how the commercials always buy together on lower prices and always sell as a group on rising prices; it's simply price rigging and collusion. I'm serious — if anyone has a legitimate sounding explanation for this continuous phenomenon of commercial trading uniformity that doesn't include collusion, I'd love to hear it.

Make no mistake; the silver (and gold) market is manipulated by the illegal trading practices, concentration and the collusion of the COMEX commercials. A manipulated market is a crooked market. The biggest single commercial crook in the silver market is JPMorgan, one of our nation's most important banks. JPMorgan has bought at least 50 million of the 110 million ounces bought so far, reducing their big short position to perhaps their lowest level since they inherited the position from Bear Stearns in 2008. There is no way that JPMorgan is not involved in the current silver smash and in every collusive move by the COMEX commercials over the past four years. The chief enabler of the silver manipulation is the CME Group, which has created and encouraged the HFT trading devices used to rig prices and has ignored the easy to verify collusion on the part of the commercials, their most important constituents. Without JPMorgan and the CME, I doubt the silver market would be manipulated. But silver is manipulated in price and we have to come to grips with that fact. Silver was manipulated when it was \$4 and at \$49 and at today's price. It will remain manipulated as long as the short concentration exists and collusive trading practices continue.

What can we do about this as investors, market participants and citizens? I can only speak for myself, but I am not selling silver here or lower. I don't know how low we may go from here and there is nothing I can do to prevent a decline, so I'm not going to obsess over it. As new funds become available, I'll buy more silver. I'm in it for the long run or until I see signs that silver is free of manipulation and exhibiting signs of overvaluation. That's very far from the case presently. The COT structure was bullish before this last sell-off and is even more bullish now. Try to remember that the collusive COMEX commercials are buying, illegally in my opinion, but buying nevertheless. No one, not even a crook, buys anything that he doesn't expect to rise in price. Certainly at past extremes of commercial buying, it invariably turned out to be a good time to buy. The key test will be if JPMorgan sells short additional contracts on the next meaningful silver rally. Although that rally may not feel close at hand, I can assure you that we will get it eventually and the answer to what JPMorgan will do. When the rally does come it should prove to be explosive if JPMorgan decides to quit manipulating the price.

As market participants and citizens, it doesn't cost anything to contact the regulators. You don't have to put yourself at risk by labeling JPM and the CME as crooked, but you have every right and obligation to petition the regulators about the pertinent questions. I'm emphasizing something relatively new here, the impossibility of the commercials' behavior being anything other than collusion. This goes along with previous questions of mine concerning the level of concentration on the short side of silver that resulted in the CFTC initiating the stalled investigation. The "impossible" 30% to 35% price declines last year also involved commercial collusion, but this recent sell-off seems every bit as collusive. It is amazing that more and more new proof is revealed that silver is manipulated on the COMEX all while a formal investigation is open.

Three years ago, Gary Gensler became Chairman of the CFTC. I was effusive in my praise for him, calling him the greatest chair in agency history. I still don't doubt that he is the smartest and most market savvy chairman ever, but when it comes to silver, he has been an unmitigated disaster. He ignored the clear will of the people in disregarding their thousands of petitions for a 1500 contract position limit in silver and didn't have the decency to have the agency explain why. Gensler has not uttered one word about the two massive takedowns in silver last year and how that can't happen to a world commodity without manipulation and collusion. If it was any other commodity, he and the Commission wouldn't have remained silent, indicating a disregard for the equal application of law. Worse, he has allowed a crime in progress to continue to infect our regulated markets, even though that is the agency's prime mission.

The director of the Enforcement Division, David Meister, has been in office for almost one and a half years. The silver investigation was initiated two years before his arrival, but it's his responsibility now. The allegations of manipulation in silver are unusual in that they have been made based upon public data from the agency, in the form of concentration and collusive trading. But most unusual of all is the continuing nature of a crime in progress; every officer of the law should know that priority must be placed upon eliminating current and future damage to the public ahead of retribution and fines for long completed transgressions. If Director Meister doesn't see the collusion I have described above, perhaps he can explain how the COMEX commercials continuously pull it off. Or how out-sized market concentration doesn't matter anymore.

I'm considering making this article public given the regulatory nature of it, but I am sensitive to subscriber objections. Please let me have your input.

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Silver – \$29

Gold – \$1585

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