Oct. 26, 2009 – The Mathematics of Manipulation

The Mathematics of Manipulation

I write a lot about the silver manipulation. One strict rule I apply to myself is to back up my allegations with verifiable data. That's why I refer so often to the data released by the government itself, in the form of the CFTC's weekly Commitment of Traders Report (COT) and monthly Bank Participation Report. I admit that such an approach can get repetitive or dry, and is difficult to grasp at first, although I try to present my case in the simplest terms possible.

It would be much easier to make up sensational stories about the silver (and gold) manipulation and wrongdoing backed by rumors or unsubstantiated data. After all, Â?sexÂ? sells. But, at the end of the day, I believe unsubstantiated data leads you nowhere. Case in point Â? the CFTC is now on its third silver investigation in five years, based upon the allegations, backed by facts, that I have uncovered and you have pressed the Commission on. Yes, the manipulation still exists, but how many investigations have they initiated based upon the sensational stories over the years? Moreover, the very important issues they are currently considering, such as position limits and concentration, are precisely the same issues I have been presenting for decades. I'm not patting myself on the back Â? I'm emphasizing that in order to make serious allegations, you better have serious and substantial factual data.

Today, I will present new evidence that the price of silver is manipulated by trading on the COMEX. I will back up my allegations with data from the most recent COT report. By using the government's own data, as I have previously written, the questions of accuracy and substantiation are removed. First, allow me to present a short discussion on the mathematics of manipulation.

Manipulation is the artificial setting of price by one or a very few market participants holding a very large long (buy side) or short (sell side) position. Such a large position held by one or a small number of traders is called a concentrated position. The price is said to be artificial because it is different from the price that would exist if the concentrated position did not exist. Manipulation is the most serious crime possible because it negates the free market price signals of real supply and demand and misallocates resources. In other words, not only is manipulation illegal, it is illegal for very good reason Â? it screws up the functioning of the free market, which our economic system is based upon.

Therefore, the key to manipulation is concentration. So obvious is this connection, that the main commodity regulator, the CFTC, measures concentration as its primary safeguard against manipulation. In addition, the Commission publishes the concentration data weekly and monthly for all to see. The CFTC knows if there is no concentration, there is no manipulation, nor any reason to suspect manipulation. If there is a large concentration, then manipulation may be present and any questions about manipulation must be taken seriously

In fact, you could break the concentration/manipulation connection into simple mathematical terms. On a sliding scale, a zero percent concentration would indicate absolutely no chance of manipulation. A 100 percent concentration (the entire long or short side held by only one trader) would be pure manipulation. Neither extreme is practically possible, of course, but I want to set the parameters for the sliding scale. My point is the lower the percent of concentration, the lower the likelihood of manipulation. The higher the percent of concentration, the greater is the likelihood of manipulation. No tricks here, just straight talk.

The allegations I make about a silver manipulation are based upon the very large concentrated short percentage in COMEX silver futures. It is the largest concentrated short position of any major market in commodities of finite supply. (OJ futures traded on the ICE exchange actually have a larger short concentration, but OJ futures are not a major market, as COMEX silver is 25 times larger than OJ in terms of notional value). The large concentrated short position in silver is prima-facie evidence of manipulation. But the purpose of this article is not to rehash the high level of the short concentration in silver. In fact, I want to do the opposite – I want you to look at the low level of concentration on the long side of COMEX silver.

The new evidence of manipulation rests in the remarkably low level of concentration by the largest traders on the long side of COMEX silver, and then comparing that low level on the long side to the high level of concentration on the short side. Let me make an absolute statement upfront Â? in the current COT Report, for positions held as of Oct. 20, 2009, the four largest traders in COMEX silver futures hold a net concentrated long position that is the lowest of any other market. Please allow me to expand on that statement and then I'll explain what that signifies.

In the current COT Report, there are data provided for 133 different markets traded on 10 exchanges. The markets include everything traded that qualifies for COT inclusion. They include grains, meats, softs, energies, metals, stock indices, interest rates, currencies, swaps on energies, etc. Of all the markets traded, not just markets on commodities of finite supply, COMEX silver has the lowest net concentration on the long side by the 4 largest traders of every market. First, let me demonstrate how you can verify my statement, if you are interested (as you should be) in seeing for yourself.

Here is the first link to go to for the COT data –
http://www.cftc.gov/marketreports/commitmentsoftraders/index.htm

Next, go the Current Legacy Reports, Futures Only. The long format sections will contain the concentrated data. Start with Commodity Exchange Incorporated and click on the long format link. There will be three commodities listed, starting with silver, followed by copper and gold. If you go to the bottom of the silver data, you will find the concentrated section. It is titled, Â?Percent of Open Interest Held by the Indicated Number of Traders.Â? You can do all sorts of computations with this data, but today we are not going to do any computations, as I'm going to make this as simple as possible. Ignore the Â?By Gross PositionÂ? data, and focus on the Â?By Net PositionÂ? section. Net is much more important than gross, because it automatically removes spread positions. Look for one figure only Â? the net long position of the 4 or less largest traders. You should find the figure of 12.5%. While you are on that page, scroll down to copper, then gold. Doing the same exercise, you should find the net percentage for the 4 or less largest long traders in copper is 32.8%, and for gold it should be 21.4%.

If you take the time to repeat this exercise for all 133 markets, you will not find any market with a net long concentrated position by the 4 largest traders less than the 12.5% level in COMEX silver futures. This is the substantiation to my statement that COMEX silver has the lowest percent of concentration on the long side of any market. To be sure, I am not trying to represent that silver always has the absolute lowest reading of all markets. But it does currently, and is always near the very lowest of all markets.

So what does it mean that COMEX silver has the lowest level of concentration on the long side? Not that anyone was suggesting it, but it certainly means any notion that silver may be artificially inflated in price by concentrated buying is patently absurd. In fact, using my sliding scale on concentration (the lower the better), silver is the purest free market of all Â? on the long side. The more participants a market has, the less chance of manipulation and the more liquid it is. The fewer participants a market has only decreases true liquidity and increases the odds for manipulation.

The most important point to be made about the extreme low level of concentration on the long side of the COMEX silver market is in comparison to the extremely high level of concentration on the short side of that same market. No market has a greater mismatch between the concentrated long and short positions than does COMEX silver. A reasonable person should ask why there is such a mismatch between concentrations on either side of silver. Why would there be such a small concentration on the long side and such a large concentration on the short side?

The answer is obvious. For there to be a comparable concentration balance between the long and short sides in COMEX silver (as is the case in most markets), it would take something to encourage more traders to sell short, so that the very largest traders wouldn't have to hold such a large percentage of the short side. That Â?somethingÂ? is higher prices. Price is the motivator in the free market of supply and demand. The reason there is such a concentration on the short side is because only a few large traders agree that the price of silver is high enough to sell. Plenty agree it should be bought, as evidenced by the data, but only a few agree it should be sold. That's not the definition of a free market, where there should be many participants on both sides of the market. That's the definition of a manipulated market. Without the few crooked sellers in COMEX silver, the price would be much higher.

All that remains is how the CFTC and the CME (owner of the COMEX) respond to the issue of position limits as they apply specifically to silver and the allegations of manipulation. Many are concerned it will be business as usual and the issue won't be openly addressed. There is fear that position limit restrictions will only apply to the long side and not to the short side, even though the Commission's own data, as detailed above, indicates the opposite should be the case. There is a real mess in silver that the CME and many at the CFTC are trying to avoid dealing with, so the fears are legitimate. I am still hopeful that the new chairman, Gary Gensler, will do the right thing. But that is up to him, not me.

One thing is for sure Â? the silver mess will be resolved, regardless of what actions may be taken in the near future. That resolution will mandate shockingly higher prices. Nothing can prevent those inevitable higher prices. The only question is how the CFTC will deal with that which is undeniable. The Commission's own data continue to spotlight the short side concentration. That concentration is incompatible with the repeated public statements of Chairman Gensler. For his sake and the sake of our markets, I hope it is the concentration that is broken, and not his words.

Ted Butler

October 26, 2009

Date Created
2009/10/26