Oct. 27, 2009 – Question from a Reader

Question from a Reader

Here's a question from a subscriber that was asked of me by another subscriber last week. It occurred to me that many might have similar questions, so I thought I'd answer it here. I had originally planned to answer questions publicly, but somehow never got around to it. I'll try to make it a regular feature. If you have any questions, chances are others do as well, so fire away. There is no such thing as a dumb question; only dumb answers. I'll try to answer them privately or publicly.

I haven't added anything to this email, but did eliminate some wording applying to an image that I couldn't reproduce Â?

It seems to me your detractors use a verbal illusion to describe the silver market. They say, “Yes there is a large short position but for every short there has to be a counter-party long. “After all”, they say, “these people aren’t trading with themselves, they are trading with a counter-party who is willing to take the other side of the trade. So how could this possibly be manipulation when another party is willing to take the other side of the trade?”

Would you or your friend Izzy consider addressing their argument in one of your future missives? Many of us have difficulty seeing the real picture. We know you are right (as evidenced by the present attack on silver which you predicted was likely to happen because of the huge short position) but when this happens that scares them out of their position at the worst possible time.

Your comments would be most welcome

Many thanks
Charlie

This is a great question. Basically, it tries to explain away my allegations of manipulation by excessive and concentrated short selling on the COMEX by asserting that I am overlooking the obvious explanation that renders my point moot. I should know that because there is a long for every short, that I am a real dunderhead for wasting peoples' time with my allegations.

No matter how many times I have answered this argument, it's one that won't go away. I think that's because the issues are complicated; futures contracts, longs, shorts, etc. These are not things normal people run across every day. Therefore, this unfamiliarity raises doubts when anyone states authoritatively that someone else (me) is wrong about the manipulation.

My first response is that those raising the issue about there being a long for every short as proof that there is no manipulation are usually not experienced in the field of commodity futures. That's not meant solely as a put-down, just a statement of fact. The primary regulator, the Commodity Futures Trading Commission (CFTC), has written umpteen letters, including long ones in 2004 and 2008, denying a silver manipulation, and offering many (bogus) reasons why silver was not manipulated. But even they wouldn't dare state that there was no manipulation because there is a long for every short. They know that would make them look like fools. Yes, there is a long for every short, but so what? That's basic and elementary, and has nothing to do with whether there is a manipulation or not.

Further, since there is always a long for every short in every derivatives contract, according to the detractors who raise the issue that should mean that there could be no such thing as manipulation ever. Yet we have seen many instances of manipulation in the past, so why didn't the long for every short argument prevent the historical instances of manipulation? Besides, the very mission of the CFTC is to guard against manipulation. Maybe the detractors raising the silly issue should inform the agency that a long for every short means they should rearrange their almost century-old regulatory mandate.

The real issue, of course, is not that there is a long for every short, but that the short position in silver is super-concentrated, while the long position is widely dispersed. Literally, without the current short position of just one trading entity, JPMorgan, the price of silver would be much higher. That's because it would take much higher prices to induce other sellers to enter the market. It's the classic proof of manipulation, namely if the price of anything would be much higher or lower if just one trader was removed, that's a market that was manipulated.

You'll notice that those raising the issue of there being a long for every short conveniently ignore the issue of concentration.

As I was about to post this onto the site, I received these questions from another reader. I haven't altered this email at all, even though it contains highly complementary personal comments. As a balance, I promise to also include any good future reader questions that may contain personal insults.

Hi Ted,

First, thank you for being sharper than a Ginsu Knife on the subject of the COT Report. You make life so much easier for me!

I have a question regarding what the parameters were vis-a-vis the COT Report when the Hunt Brothers tried to corner the market on silver back in, if I recall correctly, 1979 – 1980. Also, what did the CFTC do then, and why?

If they enforced some kind of limits back then, I wonder if they reacted at a lower or higher position limit? Thank you again!

Best regards,

Joe

To my knowledge, there was no COT data on silver back then, or at least I'm not aware of it. I wish I could retrieve the data, as it would make for interesting comparisons with the current structure. From what I have studied from that time, the Hunts and all their associates had a concentrated long futures position a third to a quarter of the concentrated short position of just a few big traders currently. I believe it is patently unfair, un-American even, that there should be a double standard between the treatment of a concentrated long position back then and a much larger concentrated short position today. There is a blindfold on the statue of justice for a reason; the law is not supposed to play favorites.

It was the exchanges (the COMEX and the Chicago Board of Trade) that forced the Hunts to reduce their positions, of course, with the approval of the CFTC. Afterward, the CFTC found the Hunts guilty of manipulation. Let me be clear Â? I think the Hunts were guilty of manipulation, even though there were plenty of shorts, Mocatta, for instance, who did not have clean hands. If it weren't for the Hunts, I don't think silver would have run to $50. But what's good for the goose should be good for the gander. The Hunts were guilty of manipulation because of a concentrated and dominant long position back then. How can a much larger concentrated and dominant short position not be manipulative today?

To specifically answer your last question, the regulators moved much quicker back then and at a much lower position than exist currently. It stinks.

As I get set to post this, silver has had its second sharp down day, falling more than a dollar over the past two days. This is, hopefully, no great surprise to subscribers. We have been in, and still are in, a high-risk/high-reward environment. We're getting very close to the important 50 day moving average in silver (around $16.35) for the first time in more than two months. A penetration of this level should trigger more tech fund selling. While there has been liquidation of tech fund long/commercial short positions on this decline, given the buildup in such positions over the past two months, there is potentially more to go. I don't deny that this is a painful process.

On the bright side, if we do get a full washout to the downside, another $2 or so, we should be left with a low-risk entry point that should be bought with reckless abandon. The most important measurement of a bottom will be the number of contracts liquidated first, price second. There should be no doubt in anyone's mind why we have declined the past two days, or why, if we decline a lot more, the reason for the decline. It's because of the structure on the COMEX. These big shorts need to close out as many of their short positions as possible. They can only do that by getting the tech funds to sell at progressively lower prices. If they do succeed in this endeavor, it will set up the buy point of a lifetime.

Ted Butler

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