The Full Pants Down?<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

Anyone who has close friends or relatives who were born and raised in another country may know to what I am going to refer. When you converse with someone whose native language is different than your own, the conversation can be laced with a mixture of terms and expressions from more than one language. Or words in the same language are used that wouldn't appear to fit. Over time, the expressions become a normal part of future conversations, because they impart specific meanings. Such is often the case when I speak with my good friend and mentor, Izzy.

English is not Izzy's first language, as he speaks about 5 or 6 other languages. Which are about 5 or 6 more languages than I speak. So sometimes he comes up with expressions and terms that are unique because he thinks in many languages. I wouldn't think of correcting him on the matter of his choice of words, out of respect. I know what he means, and that's what is important between friends. Besides, I find the experience beneficial, as it forces me to pay close attention to what he is saying and think more about what I have to say in turn. In fact, some of the expressions he comes up with are so descriptive that they become a permanent feature of our own vocabulary, even though they may make no sense out of context. I even find myself coming to use his expressions. As some long-time readers may remember, "the moment of true"

refers specifically to that certain time to come when there isn't enough physical silver to go around.

The title of this article is a term that Izzy and I have used frequently in our conversations over the years. It refers to times like now, when the commercial short position is at extremely high levels. This condition, in the past, has always resulted in a sell-off in which the technical funds sell out long positions and the commercials buy back shorts. The alternative resolution is that the commercials are finally confronted with no choice but to buy back short positions to the upside, causing prices to explode. Even though it has yet to occur, it is always a possibility. They get caught with a full short position and are forced to cover with "full pants down."

There is no disagreement between Izzy and me that silver will explode in price. On that, there is never a doubt. The only difference, and I'm hesitant to call it a disagreement, is how the explosion occurs. Both of us recognize that we don't have a detailed roadmap for the future of silver. That is, we have a pretty good idea of where it is going in the long-term, but the short term is always tricky. But how the short position on the COMEX and elsewhere is resolved will determine the short-term silver roadmap. Let me lay out, once again, the two choices.

I have long theorized that the silver explosion would come shortly after a sharp COMEX sell-off, in which the technical funds and other speculative longs would be forced from their positions by price signals and margin calls. At that point, the crooked dealers, having bought back as many of their short positions as possible, would stand aside and refrain from selling short again on the subsequent price rally. This lack of commercial selling would create a selling void or vacuum, enabling silver prices to explode on very little volume. My theory assumed that the commercials knew exactly what they were doing and were in full control of the market at all times. I also assumed, because the biggest commercial shorts were also deeply involved in the wholesale physical silver market that they would know before anyone if a silver shortage was starting. Armed with this knowledge, the dealers would rig a final sell-off to purge the technical fund longs one final time. It goes without saying that my theory also assumed the prime regulator, the CFTC, would remain in a deep coma, oblivious to the crime in progress.

While it remains to be seen if the silver price explosion follows this theory, at the very least, any purchases made after such strong and cleansing price declines have provided unusually reliable low-risk buy points. (With the exception of last year's extraordinary move down). Certainly, we have not yet witnessed the true silver price explosion. Since it has always been possible for silver to explode with an extra- heavy short position, let's look at the current prospects for that. Will now be the time for what Izzy calls having the explosion

with the full pants down? Upfront, please know that I don't want to put words in Izzy's mouth. He has always maintained that it would be the silver shortage that will cause prices to explode. How the commercials are positioned at that time is of secondary importance to him, although he follows closely their position. Also upfront, neither Izzy nor I are predicting which way silver goes short term with such an extreme short position. In fact, we alternate our opinions daily between the sell-off first, followed by an explosion or an explosion straight-away. The truth is that neither of us knows.

But the case for the dealers being caught flat-footed with an extreme short position has some recent supporting elements. For one, conditions in the physical market look tight. COMEX silver warehouse stocks are near 2 or 3 year lows and a lot of metal appears owed to the big silver ETF, SLV, due to the naked shorting of its shares (near 30 million ounces). These conditions suggest shortage. Further, there are signs that the CFTC may be awakening from its long regulatory slumber, thanks to its new chairman, Gary Gensler. Certainly, he is aware of what is transpiring on the short side, thanks to the many hundreds of public contacts to him. Now it remains to be seen what he will do about. Also, the commercial short positions in gold and silver, thanks to recent additions and this week's price gains, have taken on important financial considerations. My estimates suggest that the commercial are holding these positions with open losses rivaling any previous open losses in history. Lastly, whereas I always assumed that the commercials really knew what they were

doing, the last couple of years have demonstrated that when these guys mess up, they really mess up. Examples would include Barrick Gold blowing $10 billion in shareholder money by shorting gold, to firms like Bear Stearns and Lehman Brothers disappearing due to unreasonably large leveraged bets in mortgages.

While it is possible that the dealer shorts could be overrun in both gold and silver, given their large short position, there are some important distinctions to be made for each market. There appears little chance of a true gold shortage, due to gold's lack of a large industrial consumption demand. Basically, all the gold ever produced still exists, while most of the silver has been destroyed or put into a form currently not recoverable. That's not to say gold can't soar in price, just that it won't be because of an industrial shortage. There is more gold aboveground than at any point in history. COMEX gold inventories are also the highest in history and there appears to be no difficulty in securing and depositing metal into any of the ETFs. This is in stark contrast to the situation in silver. Yes, there are more people in the world and more money floating around than ever before, and that is supportive of higher gold prices, just like it is for silver (only more so). So while it is possible for the dealers to be overrun in both, it would appear almost impossible for the shorts to be overrun in gold and not in silver. That leaves the possibility that the shorts could be overrun in silver, but not in gold.

One other consideration for something bad to happen to the silver shorts is the issue of potential changes in the position limits. As I indicated in "The Box Canyon," silver is the only commodity that demands a sharp reduction in the number of contracts any one trader can hold for speculative purposes. I am aware of no case being made for a similar sharp reduction in any other commodity, including gold. Because this issue is so specific to silver, it raises the possibility that it could impact silver alone, since the short side is dominated by the concentrated position of so few traders.

The important point is that the resolution of the giant short positions in gold and silver still lies ahead. If anything, the situation has grown more extreme. The very large increase in Tuesday's open interest in gold of some 33,000 contracts and almost 5,000 contracts should be reflected in tomorrow's COT and Bank Participation Reports. There is no way to know how we will resolve the extreme long and short positions, just that they will be resolved. I like it better when we are presented with a low-risk/ high-return circumstance. Now we have a high-risk/high-return condition. Subscribers must continue to be positioned accordingly – prepared for either a sell-off or an explosion.