

October 19, 2010 – COT Revelations

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I uncovered something I missed at first in the latest Commitment of Traders Report (COT). In turn, the revelation got me to thinking in a broader perspective about the whole issue of manipulation in the silver market. Let me be clear here – either you grasp the fact that the silver market has been manipulated or you don't. Those who do understand that silver is manipulated downward in price by concentrated short selling on the COMEX are essentially those who have bought and held silver from the \$4 mark on up in price. This, despite widespread denial of the manipulation by industry and the regulators for the past 20 years. Put another way, if I weren't convinced that silver was manipulated, I would have never publicly recommended that people invest in it in the first place. I wouldn't suggest that silver still be held if the manipulation weren't in force.

What I overlooked in the latest COT was that there was a notable change in the concentrated long position in silver. Naturally, since I believe the key to the ongoing manipulation and its termination lies in what the big concentrated shorts, like JPMorgan, do with their massive short position, I monitor that position closely. But sometimes we can learn from the big longs as well. What I observed in the latest COT was that a large non-commercial trading entity (most likely a hedge fund) liquidated a roughly 3,000 contract position in the reporting week. By studying recent COT reports from the date the big price rally began, around August 24, I calculate that this hedge fund made an impressive \$50 million in a matter of weeks. A very nice trade indeed. (For those interested in the details of this trade, you can derive them by studying the changes in the big 4 long category. As always, please ask me any questions you may have about my methodology).

A few thoughts come to mind. One, since this hedge fund booked about a \$50 million profit, other entities had to lose that amount, given that commodities futures trading is a zero-sum game. In this case, the loss came at the expense of those on the short side of the trade. This weakens the shorts, always a good thing. In addition, having booked such a quick big profit, one would think this trader would be interested in doing it again. As such, that should serve as a support for the silver market. Certainly, I wouldn't imagine this particular trader would wish to press the short side, but would be interested in buying silver contracts again to replicate the profitable experience.

I think this large trader's experience is a good proxy for silver market sentiment as a whole, where there are widespread expectations of a corrective sell-off after such a large rally. While these expectations of a sell-off are natural, that doesn't mean they must be realized. I'm still an agnostic about the certainty of a short-term sizable sell-off. It appears to me that those most vocal about a silver sell-off have been expecting that sell-off for the last \$5 of the rally. You must be emotionally and financially situated to withstand a short-term sell-off, but also be positioned if silver rockets from here. There is a long way to go before silver is overvalued and we must not get shaken out by short term considerations. But my point is that with many feeling a sell-off is due, like this hedge fund that sold, that is very constructive and supportive for higher, not lower prices. After all, the price of silver, despite the large sell-off today, is still a dollar higher than from where this hedge fund sold. It's good that the market could take such selling in stride. On a sentiment basis, my sense is that silver is far from being overvalued or overbought.

The revelation in the latest COT that I initially overlooked got me to thinking about a broader issue, namely, concentration and manipulation. I know many think I beat this issue like a rented mule, but it is the key to the market. I make a big point that concentration and manipulation go hand in hand. In order to have a manipulation there must be a concentrated position. Since we have such an extraordinary and unprecedented concentration on the short side of COMEX silver, that is the basic proof that silver is manipulated. But the converse of that is also true, namely, that if no concentrated position exists, no manipulation is possible. That's why the CFTC monitors concentration in all the markets they regulate.

This is what I would ask you to think about. The more concentration that exists in any market, the greater the likelihood that a manipulation exists. The less concentration that exists, the less chance there is of manipulation. In COMEX silver, there exists the greatest short-side concentration of any market ever, in terms of real world supply. Therefore, if a manipulation were to exist, it would exist in silver on the short side. This is the basis of my decades' old allegation. But what's fascinating is that there is so little concentration on the long side of COMEX silver. In fact, the long side of silver is among the least concentrated of all commodities of finite supply. I've mentioned this in the past, and the liquidation of the hedge fund long position causes me to reflect on this again.

If you take the time to review the percentage of the market held by the concentrated four largest long traders in every futures market for commodities of finite supply, you will see that silver is among the least concentrated. Only the soybean complex and an ICE natural gas contract are very slightly less concentrated than silver is on the long side. Even in very large markets, like the NYMEX's crude oil and natural gas contracts, the long concentration is more than it is in silver. Comparing silver to the other COMEX metals, both the gold and copper long concentrations are almost double that of silver. What does this mean? It means that only a short manipulation can exist in silver. It is impossible for there to be a manipulation on the long side of COMEX silver because there is so little concentration.

Further, it means that any talk that silver may be in a bubble is silly. A bubble means everyone and his brother Joe is in a market with both hands and feet. Nothing could be further from that than in silver. Not only is there not the hint of a long concentration among big traders, even the smaller traders haven't built up a notable long position. The non-reportable traders on the COMEX currently hold a much smaller long position than they have held on average over the past 25 years and did not increase their long position significantly in the latest \$7 rally. How can you have a bubble with no public participation?

That's not to say there can't be a sharp sell-off in silver. If we get one (and that's a big \hat{A} ?if \hat{A} ?), it will only be due to a last-gasp collusive manipulation by the big concentrated shorts, led by JPMorgan. Maybe they can pull it off, maybe they can't. Given their cumulative losses, they are desperate enough to try anything. But in the meantime, silver is gearing up for the real run to the upside, sell-off or not. Too many things are falling into place for silver not to run soon, both in the physical world and the world of regulation. I am particularly impressed with how silver has fared compared to gold on today's sell-off. Normally, silver accelerates to the downside relative to gold at times like this. Maybe it will, but not today.

One thing I am expecting is for the COMEX (owned by the CME Group) to raise margins on gold and silver soon, now that prices sold off today. I have a very low opinion of this exchange. I think it is an organized criminal enterprise that operates for the benefit of its big (short) members, and the public be damned. Normally what this exchange does is raise margins when it is in the shorts' interest. The CME didn't raise margins once in the big rally, as they should have as that would have hurt the shorts. Now that prices have sold off from the top, it is safe for the exchange to raise margins as it will now hurt the longs. It's a real dirty trick, but I've seen this on too many occasions in the past to expect anything less from this exchange.

If there is one man that understands the issue of concentration and manipulation and the exchange's protection of the big shorts, it is Gary Gensler, chairman of the CFTC. You can see that in every speech and action he takes. Now the question is what will he do about it? The answer should be forthcoming fairly soon, given the position limit deadline and the expectations of an announcement soon on the silver investigation. The silver manipulation is his biggest challenge and it will define his legacy.

The advice to silver investors remains intact. Hold long positions. No margin. If you must speculate on a leveraged basis, do so through call options. Don't fret about the short-term, but look to the long term. If these crooked COMEX shorts do have their way with silver again, let the regulators know they are not doing their jobs.

Ted Butler

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Silver – \$23.36

Gold – \$1331

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