

October 20, 2021 – Markets Malfunctioning

In the “old days”, it usually took some type of unexpected development to cause commodity markets to move sharply in price, like a sudden freeze in the Florida citrus belt or the coffee-growing region in Brazil, or a serious crop failure in an important grain-producing region. While those things can still impact markets today, we are seeing some fairly large price moves absent of any obvious dramatic short-term developments, particularly in the industrial metals and energy markets.

For example, recent moves in copper have been quite dramatic despite no obvious dramatic events, such as a sudden short-term disruption in production or a surge in demand. As I hope regular readers know, I have been quite bullish on the long-term price prospects for copper, even though I don’t comment on it frequently. While my bullishness for copper is definitely longer-term, given a perceived developing mismatch between copper production and consumption in the years to come, there have been some price fireworks on a shorter-term basis this year, largely driven by speculative positioning. One thing to keep in mind is that unlike silver, the largest market for copper is on the LME, as opposed to the COMEX.

While speculative (managed money) buying has greatly influenced copper prices on the near 20% price gain over the past two weeks, the reaction by the LME suggests something else. The London Metals Exchange instituted sudden delivery changes to deal with the “emergency” created by the surge in copper prices. Huh? A two-week rally and the exchange had to step in with emergency measures designed to relieve the burden on short sellers unable to fulfill contractual delivery requirements? Why is it that it is always the short sellers that are bailed out by the exchanges and never the longs?

I fully-understand that governments and regulators have a strong incentive to keep commodity prices as low as possible (whether this is acknowledged or not), so I can’t say I’m particularly surprised by the LME’s actions to bail out the copper shorts – although I was taken aback by how quickly the exchange rushed to the shorts’ defense. But these actions, along with measures taken by the government of China to rein in prices of copper and other metals and commodities (like coal) seem to frustrate the law of supply and demand, even if successful on a short-term basis.

The law of supply and demand holds that only high prices can eventually resolve any mismatch caused by not enough supply or too much demand. Any attempts to tinker with that law only result in markets malfunctioning. Sure, short-term measures designed to lower prices can succeed in the short term, but will hardly provide the long-term incentive required to increase production or curtail demand. What it comes down to is that government regulators and exchanges do whatever they can to keep commodity prices in check, but their actions are, essentially, counterproductive in the long run. In order to ensure an adequate long-term supply of a commodity, would-be producers need to be given the profit incentive to produce.

Silver investors are keenly aware of the bias shown by regulators and the COMEX against the \hat{A} longs and favoring the shorts. In fact, no market malfunctions more than COMEX silver. In some ways it is understandable, since the short sellers are generally the most important exchange members and insiders naturally protect one another; but it is hardly legitimate. And ultimately, the desire to protect the shorts and encourage the low prices which aid the shorts is incredibly counterproductive, according

to the law of supply and demand. It's just that the law of supply and demand can take longer to resolve a malfunctioning market than most silver investors can tolerate.

But the flip side to regulator and exchange bias in favor of low prices and the shorts is that when the day of reckoning comes, the price reaction is violent. The inevitable end result of prices kept too low for too long is shortage. No commodity has been kept lower for longer than silver and therefore, a shortage is guaranteed at some point. Ironically, we are now in a world where shortages have become common, but silver remains the one and only prospective shortage of an industrially-consumed commodity that is also a basic investment asset. While no one can pinpoint the precise moment of liftoff, silver's dual demand profile guarantees a more powerful price rise than commodities lacking in primary investment status.

Certainly, those most responsible for silver's too-low price over the past decade and longer seem to have done everything possible to best prepare for the final reckoning. At the top of that list is JPMorgan. I'm absolutely convinced that when JPM took over Bear Stearns in 2008, it was unaware of the true story in silver and was quite content to simply expand its former role as one of the big controlling COMEX short sellers to become the dominant short. Only after the price rise to near \$50 in 2011, in which JPMorgan was in the hole for several billion dollars at the price peak, did it come up with the criminally-genius solution of all time of buying as much physical silver (and gold) as possible to protect itself from future price surges.

When those physical holdings hit 1.2 billion oz of silver and 30 million oz of gold and JPMorgan had settled all potential claims against it by the Justice Dept and the CFTC, JPM moved to buy back and cover all its COMEX short positions by the spring of 2020. Now, JPMorgan is sitting pretty, holding more silver than anyone and with an enormous holding of gold. But JPMorgan doing so left its former price riggers on the COMEX on the hook and in need of a solution of their own.

Since the price highs of early February at which time the big COMEX shorts that JPMorgan abandoned and double crossed, have worked to depress silver prices and buy back their shorts the only way possible – by getting someone else to go short in their place. The remaining big commercial shorts had no real chance to replicate JPMorgan's criminally-genius solution of buying enough physical silver because JPM had already done that and got the T-shirt and there was not enough physical silver left. So, their only recourse was to get the managed money technical funds to go short by steadily rigging prices lower and that is what transpired. Now, we may be at the moment of truth in which we will learn if the former big COMEX commercial shorts refrain from adding back the massive numbers of new short contracts necessary to contain the next rally.

For sure, the managed money shorts will look to cover (and add longs) as silver prices rise and also for sure the smaller commercials (the raptors) which are long will sell off their longs at a profit. The only unknown is what the former big commercial shorts will do – either add the aggressive new amounts of silver shorts or not? I'm of a mind that they won't – based upon everything going on in the world – but it's not up to me.

A new thought occurred to me regarding the malfunctioning COMEX silver market. It is beyond obvious that the only reason silver has been as depressed in price as it has been is due to paper positioning on the COMEX. Mine production has been flat to down for years, industrial consumption flat to higher and investment demand the most ever over the last two years. How can prices not be sharply higher, if not for the COMEX paper positioning? And while the big COMEX commercial shorts have snookered the

managed money technical funds onto the short side in a big way, the short position presses the price regardless of who holds it.

My new thought is this â?? while I donâ??t believe for a moment that the managed money shorts had any intent to cause silver prices to be depressed (as did the big commercial shorts) â?? it doesnâ??t matter what their intent was, the net effect has been to depress prices nonetheless. Iâ??m not suggesting that the CFTC should have any say in determining why anyone would short silver or any other market, but that it must intervene and disallow any position that artificially dictates price. The CFTC and the CME Group should be boiled in oil for allowing anyone to artificially suppress silver or any market. I think the managed money traders are as dumb as dirt for getting as heavily short silver as they have, but thereâ??s no law against doing something dumb â?? unless it artificially controls price.

So far this week, silver has rallied fairly sharply. Yes, itâ??s still down \$2 year-to-date, but three weeks ago, it was down \$5 year-to-date. While thereâ??s no way of handicapping prices on a short-term basis (although we all try), silver would need to double or triple before thoughts of overvaluation should be entertained. But silver prices are still controlled by COMEX positioning, until signs of physical shortage can be fully-substantiated and relied upon.

As far as what to expect in Fridayâ??s COT report, itâ??s wise to prepare for significant deterioration in silver (less so in gold) and be pleasantly surprised if the managed money buying (short covering and new buying) and commercial selling is less than I fear. What I fear is managed money buying (mostly short-covering) in excess of 10,000 contracts.

Iâ??m a bit troubled by the increase in total silver open interest of 4000 contracts through yesterdayâ??s end to the reporting week because all things being equal (although they rarely are), pure managed money short covering and raptor long liquidation should have resulted in a drop in total open interest â?? increasing the odds that some big commercial shorts may have added new short positions. While Iâ??ll be pleasantly surprised if the deterioration in silver is less than I fear, itâ??s not necessarily the end of the world if itâ??s even more.

I was fairly certain that the managed money shorts could never escape their excessively large short position with collective profits and still feel that way. I suppose itâ??s possible for the managed money shorts, after they are finished buying back positions at a loss, could then be duped into re-shortening on still lower prices, but based on whatâ??s transpiring in the real world of commodities and financial markets, that looks unlikely. Â Regardless, I will be playing it as if silver keeps rallying and never looks back and if prices get smashed instead due the former big commercial shorts adding aggressively to shorts, dealing with that then.

Last nightâ??s nearly 4.2 million oz redemption in SLV looked extremely counter-intuitive considering price action and trading volume and reeked of a conversion of shares to metal by a large holder to avoid SEC reporting requirements â?? which, if accurate, is decidedly bullish.

There was an interesting interview of Paul Tudor Jones on CNBC this morning with his main takeaway being of the threat that rapidly rising inflation portends. His concerns for inflation running hotter for longer were also confirmed by David Einhorn later in the day. Jones favored bitcoin over gold, with Einhorn favoring gold with no strong position on bitcoin. I am still waiting for a high-profile investment personality to mention silver.

Speaking of bitcoin and crypto currencies which have surged to new highs and a total market capitalization in excess of \$2.6 trillion (with a capital $\hat{\cdot}$) and which I (still) don't understand, I'm not convinced that cryptos compete with gold and can't see how they would compete with silver, whose market cap is less than \$50 billion (for all the 1000 oz bars).

Markets are all connected in some way and I've long thought that much of the credit for sharply rising residential real estate prices over the past few years had to do with the sharp increase in stock market values. Man's (and woman's) basic needs of food, shelter and transportation have undoubtedly been influenced by growing wealth from the stock market, particularly for shelter. After all, how much more can one eat, as opposed to moving up to more expensive digs (that deluxe apartment in the sky).

My point is that just like stock market appreciation spilled into residential real estate, so too is it likely that stock market appreciation and crypto appreciation eventually spill over into other assets including silver, where given the small size of the market, even the slightest inflow from the much larger already highly-appreciated markets can have a profound effect.

As far as how the 8 big COMEX gold and silver shorts are faring this week, prices at publication time indicate that their total loss from Friday has grown by close to \$700 million to \$9.3 billion.

Ted Butler

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Silver – \$24.45 (200 day ma – \$25.58, 50 day ma – \$23.27, 100 day ma – \$24.77)

Gold – \$1786 (200 day ma – \$1797, 50 day ma – \$1778, 100 day ma – \$1799)

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