Position Limits<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

There has been a fair amount of public commentary on the recent vote by the CFTC to enact federally-mandated position limits on those physical commodities, including silver, which heretofore had been the responsibility of the various commodity exchanges. In addition, a number of you have asked about the specifics, including the actual levels of limits and the timeframe for implementation. It occurred to me that a brief summary of the issue might be in order, as position limits is a matter of critical importance to the future price of silver.

First, the proper term is speculative position limits, as there is no intent in commodity regulation to limit bona fide hedgers seeking to lay off risk in the markets. The basic economic justification for commodity futures trading is to allow hedgers to transfer unwanted risk to speculators willing to assume that risk. Of course, commodity law seeks to prevent speculators from masquerading as hedgers for the purpose of evading legitimate position limits or hedgers from exceeding true hedging requirements for the purpose of speculation.

The term itself is as self-descriptive as it gets; as its purpose is to limit speculative positions in regulated derivatives markets. But why limit speculators and how? While there is only one purpose for position limits, it sure is a good one □ to prevent or eliminate price manipulation by making it impossible for a large trader or group of traders to hold such a large share of the market so as to control the price. In other words, position limits prevent concentration, the sole cause behind any manipulation. A reminder □ manipulation is the most serious market crime possible; the equivalent of murder one or high treason. As far as being effective, legitimate speculative position limits, properly calibrated and enforced, are efficient beyond description, rendering manipulation virtually impossible. The key, of course, is in proper calibration and enforcement.

Unfortunately, there are few easy solutions for most of the problems in the world today. But when it comes to preventing manipulation in the derivatives markets, the solution is self-evident and as simple as pie. That's why position limits have been a cornerstone of commodity regulation in the US for almost 80 years. As I have been writing recently, the intent and effect of position limits is so pure and simple that it is hard to conceive of who might be opposed to them, save for someone with manipulative intent (think CME and JPMorgan). That's why the recent vote by the CFTC to enact position limits is such good news. The real mystery is why did we stray from federally-mandated position limits over the past 20 years and permit the large traders to make their own self-serving rules on how large their positions should be. Because of the recent vote, devoting time to that mystery has become somewhat moot.

The unabashed good news is that setting and enforcing speculative position limits is headed back to government control from where it never should have strayed. I know that the term government control carries some negative connotation, but ask yourself if it would be better if position limits were still to be set by the CME and JPMorgan? Again, properly calibrated and evenly enforced speculative position limits make a price manipulation impossible. That includes silver. Therefore, the case for terminating the silver manipulation which was predicated on the large concentrated short position of JPMorgan has greatly improved as a result of the CFTC vote. In fact, the only way the silver manipulation could endure is if the Commission either did not calibrated the level of the limit properly or failed to evenly enforce its provisions by allowing illegitimate exemptions for traders only pretending to be hedgers. There is a risk of that and we must stay alert over time. In the meantime, let me try to answer some of your specific questions.

There are two components to the current CFTC position limit proposal; one covering limits in the spot month and the other the limits for all months combined. The spot month (the nearest traded month in which immediate delivery can be made) limit is set at no more than 25% of deliverable supply. Aside from the difficulty involved in measuring deliverable supply, this component of position limits does not matter much to silver at this point, although it might some day. Because it doesn't matter much to silver right now, I don't spend much time on it. If it turns out later to be of importance to silver, I'll deal with it then. The spot month component could be in effect in a few months.

The position limit component covering limits on an all-months-combined basis is the key component in silver. The CFTC chose to approve a proposal from staff which involved a formula that would apply the same to all physical commodities. I understand that the Commission wanted to be as fair and non-controversial as possible, in order to get the position limit regulation on the books. Therefore, to appease the CME and large traders, the agency set limits higher than necessary to discourage opposition. They needed to get the camel's nose under the tent. In many ways, I understand and applaud the Commission's goal of treating all commodities the same, including silver. However, the circumstances in silver do cry out for the 1500 contract level that I proposed, along with thousands of you. But like the singer sang, you can't always get what you want. The question is – did silver get the position limits it needed? For the time being, I think yes.

The formula for setting position limits on an all-months-combined basis is the same for every commodity. The formula is based upon the total open interest in each market, so it fluctuates daily, as the level of total open interest fluctuates. There are two calculations in the formula, with the position limit set at the combined total of 10% of the first 25,000 contracts of open interest (obviously always 2500 contracts), plus 2.5% of the open interest above 25,000 contracts.

Using the official open interest for yesterday in COMEX silver of 107,066 contracts, 2.5% of the 82,066 contracts above 25,000 equals 2052 contracts. Adding 2500 to 2052, the position limit formula, were it to be in effect, would result in a position limit that day of 4552 contracts in silver. That level will fluctuate as total open interest changes. In gold, yesterday's open interest of 443,723 contracts would result in a position limit of 12,968 contracts.

As far as the timing of the implementation of the all-months-combined position limits, it would appear to be at least a year or two from now. Upon first hearing of the time delay, most come to the conclusion that the silver manipulation will remain a crime in force for the next year or two. Perhaps that will turn out to be the case, but I don't think so. Markets have a way of discounting and adjusting to certain known events before enactment, even manipulated markets. Further, a trader would garner unwanted regulatory attention were he to play over position limits up until the deadline.

Of more concern is the current level of proposed silver position limits of over 4500 contracts (22.5 million oz). This level is three times the 1500 contract level requested by thousands in the public comments. The question becomes is the level so high as to negate the anti-manipulative protections promised by legitimate position limits? While I could make the case for 1500 contracts in my sleep, the staff's formula is a good first step in silver position limits. Everything is relative. 1500 contracts would be a better level than 4500 contracts, but

4500 is a heck of a lot better than what we have now, which is no limit at all, thanks to the CME which only seems to exist to reward its biggest members and punish the public by promoting manipulative trading practices . Certainly, JPMorgan is currently short more than three times the amount of the proposed silver position limit, so one would think they have some short covering in store or some fancy explaining to do. Time will tell, but my reaction to what just transpired is positive.

Speaking of reactions, an old friend called me yesterday to congratulate me on the passage of position limits (as did several of you). Mike and I go way back, to the time when I was a broker at Drexel Burnham in the late 1970's to early 1980's. (Where the heck did 30 years go?). We were friends before I picked up the silver manipulation trail and he was there every step of the way, as was Izzy. Mike asked if I didn't feel vindicated with the vote on position limits, as he knew I had proposed position limits for more than 20 years, pestering the regulators and anyone else I could think of. The funny thing is that I hadn't thought about it much, but when he asked, it set my thought process into overdrive. The CFTC just voted to enact position limits, exactly as I suggested (except for the actual level in silver). My mind flashed back and forth along the decades my campaign had lasted. Then it hit me. This was a monumental change for the Commission, much more than I had contemplated before Mike's call.

In petitioning the CFTC and the COMEX for silver position limits over almost a quarter century, not once did the agency ever agree with anything I ever wrote. It was never a case of, well, Mr. Butler, you make a good point on this, but we disagree on this other point. It was always the Commission vehemently disagreeing with absolutely everything I said or proposed. I often thought is it possible for someone (me) to be wrong about everything silver related? I don't ask you to accept my version on this. Instead, just look up the various public findings on silver from the agency, especially the public denials of silver manipulation in May of 2004 and 2008. And they disagreed with everything I said in a rather personally-insulting manner to boot, in my opinion, inferring that investors should be careful around me.
http://www.cftc.gov/files/opa/press04/opasilverletter.pdf

http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/silverfuturesmarketreport0508.pdf At the time of their first letter in 2004, silver was priced at $5.70. At the time of the second letter in 2008, silver was priced at $16.70. So much for them protecting investors from me.

So Mike's call jolted me with the recognition that the agency that always disagreed with me on everything, just voted to enact the central solution I had offered all along. And it wasn't a case of me and many others suggesting position limits 20 years ago; as I recall, I was the only one. I can't reproduce on the Internet just yet the letters from 20 years ago to the CFTC and the exchanges (and their replies) on concentration and manipulation and the need for silver position limits, but there is a wealth of such letters going back ten years or so in the archives for really old articles available to subscribers. Unfortunately, some links don't work, but most do http://www.butlerresearch.com/insider/archive.asp

Here's a letter from early 2002 to the then-chairman of the CFTC (who would later become the head of the NYMEX/COMEX, if you can believe that). Now I know why some people complain that I say the same thing over and over. As you can see, the issue then and now was concentration on the short side of silver with the solution being legitimate position limits. I believe it's OK to stick to the same theme, if the theme is correct. http://www.butlerresearch.com/letter-to-cftc.html

The point of all this is not for me to stroke my own ego. Rather, the point is to emphasize the importance of an issue which has clearly stood the test of time. Concentration, manipulation and position limits have been critical matters all along. It is important that the CFTC has finally come to recognize and vote affirmatively to enact position limits, regardless of the actual level and date of implementation. Not for a minute do I put myself at the center for why the recent position limit vote occurred. If you want to get to the center, look at Gensler and Chilton. But it does feel satisfying (vindication is too strong of a word) to see the Commission vote to adopt something I had been wandering in the desert and muttering about for two decades. It's always good to recalibrate your beliefs with those of others. Thanks for the call Mike.

I'll have more to say about position limits in the future, given the significance of the issue, but let me turn to other matters. I can't help but notice the big withdrawal yesterday from the SLV of 3.4 million oz. This follows notable withdrawals from the Trust last week and a very large 6+million oz reduction last week from the Swiss silver ETF, ZKB. These withdrawals do not appear to be of the plain vanilla investor liquidation variety, but more a case of the metal being more urgently needed elsewhere. If anything, metal should soon be flowing into SLV, given volume and price action. My theme of physical tightness in the wholesale silver market appears intact.

While I don't like to predict short term price movements, the recent pop in gold and silver prices, along with other commodities, did not come completely unexpected by me. Recently, I have been overusing the term spectacularly bullish to describe the COT set ups in both silver and gold. Those set ups appear still to be in place. The only real negative for price is the ability of the commercial crooks on the COMEX to whip prices lower suddenly by means of illegal and excessive day trading (HFT). We will have to live with that for now. But it is important to recognize how much liquidation the commercials have already achieved, albeit illegally. This suggests no real payday for the crooks by taking prices lower now, only a time stall. Sell offs will come, but the structure of the market suggests such engineered sell offs should prove fleeting. Odds favor the next important move to be higher. Bottom line is that the risk/reward equation in silver is very favorable.

Two key things to watch in the future will be changes in the composition of the COT structure, particularly as it applies to the biggest silver short, JPMorgan and whether the commercial crooks resort to selling short additional shares of SLV. If JPMorgan increases its COMEX silver short position, we must stay after them like white on rice. The new share short position report just came out and indicated a slight increase (less than 120,000 shares) to 20.2 million shares of SLV held short. This is down from the high-water mark of 37 million shares (oz) held short earlier this year. It could very easily turn out that the silver manipulators, led by JPMorgan, having failed to disrupt the vote on position limits, may now turn to greatly increasing the SLV short position as a means of continuing the ongoing silver crime in progress. The crooks must not be allowed to employ this illegal tactic again as they did earlier this year. The shorting of shares in the metal ETFs is fraudulent and manipulative and we must attack any increase with a vengeance. As the issue of position limits has demonstrated, good things may come to those who wait. Let's hope it's less than a couple of decades.

Ted Butler

October 26. 2011

Silver – $33.40

Gold – $1722