

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

Trying to keep it simple and in proper perspective are two goals I strive to achieve. With complex situations that is difficult at best, especially when all the facts aren't visible. My approach has been to first empathize the facts that are available and then speculate about what can't be verified by choosing the most plausible explanation(s). That's why I stress data like the Commitment of Traders Report in alleging that silver and gold have been manipulated by virtue of concentrated short positions on the COMEX. After all, this is public data available to everyone. The trick, of course, is to interpret the hard data correctly.

First, I'd like to touch on the issue of position limits and Friday's judicial setback to instituting those limits. Speculative position limits will eventually be enacted on those physical commodities, like silver and gold that currently do not have them. Even the securities lobbying group that won the lawsuit acknowledges the need for such limits. The legal case against the CFTC was strictly for delay purposes and in that regard was highly effective. Sooner or later, position limits will be enacted. But in silver, it was always more a case of whether the agency would ever stand up to the big silver manipulators, like JPMorgan. So far, the evidence suggests that the CFTC just doesn't have the stomach for doing so.

The data show that there is a lopsided concentration on the short side of silver not present in any other major futures market. This is the prime component in any manipulation. Not only do the biggest silver shorts hold three and a half times as many contracts as the biggest longs, Bank Participation Report data show that US banks are the biggest short sellers. Singling out JPMorgan as the biggest short has been easy since their takeover of Bear Stearns in 2008. Recent data show that JPMorgan is holding a net short position in COMEX silver that is six times the amount proposed for position limits by the Commission's formula. These facts should have prompted the agency to crack down on JPMorgan long before now.

The fact is that the CFTC has continued to ignore the clear evidence of a short side manipulation in silver. Certainly, no one at the agency even responds anymore to the growing awareness of the silver manipulation. I can understand those who never expect the agency to do the right thing when it comes to silver. In many ways, I agree with the thought that the CFTC will never lift a finger against JPMorgan. But it is important to remember that even though the agency may never move against JPM, the effort to get them to do so has hardly been a waste of time. In fact, I would contend that the effort to force the CFTC to end the silver manipulation (and their continued silence) has legitimized the allegations. Let's face it, in making public allegations about and to the CFTC, JPMorgan and the CME Group, we are at the very top of the financial hierarchy.

That these entities can't respond to the allegations openly is empowering.

In some ways, it doesn't matter if the CFTC will never move against JPMorgan for manipulating silver; that is no reason to stop pressing them to do so. I think I have been clear that it will be the inevitable silver physical shortage that will end the manipulation for sure. The chance of a regulatory solution, given the power and stature of the perpetrators, was always a long shot. But instead of just sitting around and waiting for the physical shortage to hit and encouraging people to buy silver, I felt pressing these entities would expand, explain and legitimize the real silver story. I think that's been highly effective as more are aware of the silver manipulation than ever before. Without taking the high road and going to those at the top of the regulatory and financial food chain, giving all a chance to explain otherwise, there would be no legitimate legs to the silver manipulation story. And while awaiting the physical silver shortage, I believe that continuing to press the regulators is still in order. The CFTC's main mission is to prevent market manipulation and it would be a mistake to not remind them of that. In addition to relying on the data published by the agency to prove a manipulation exists in silver, it is appropriate to use public statements from them for the same purpose.

During a long speech delivered in Rome yesterday, Commissioner Bart Chilton asked the audience for a show of hands as to what percentage of market share held by one trader would constitute manipulation.

<http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-70>

Commissioner Chilton certainly asked the right question, but he framed it in a way that avoided the obvious manipulation in silver. To be clear, Commissioner Chilton has been an outspoken advocate of position limits and the only commissioner to ever publicly reference a possible silver manipulation. To my knowledge, it was Chilton who prompted the initiation of the current silver investigation which began in 2008, well before Chairman Gensler appeared on the scene. Certainly, Chilton has been the only commissioner to respond to emails from the public. For all this, he gets high marks. Yet, he hasn't done enough and I hope he takes my comments constructively.

There is only one major futures market where a single entity controls more than 30% of the net open interest (total open interest minus spreads) or where only 4 traders hold close to a 50% market share. That market is the COMEX silver futures market and the disproportionate market share is on the short side; held mainly by JPMorgan. Maybe Chilton has a point about the "Massive Passives" on the long side in food and energy markets, but I see no COT data to corroborate an unusual concentration. The glaring fact is that COT data does show an unprecedented concentration on the short side of silver and Chilton is wrong not to acknowledge that. The same goes for Gensler who has also championed for the imposition of position limits.

I think I understand the reluctance of Chilton and Gensler to confront the

October 3, 2012 – Simple Equations

concentrated and manipulative short position in COMEX silver. Because the silver manipulation is on the short side, an end to it would cause the price of silver to explode. Putting myself in their place, I would be reluctant to say or do anything that would cause the price of any commodity to explode. I can just imagine the congressional hearings in which Gensler or Chilton would be skewered for causing silver prices to soar by lawmakers looking to score political points. More than any deep conspiracy theory, the prospect of being blamed for a silver price explosion is most likely what is holding Chilton and Gensler back from even mentioning the cold hard fact of a short side concentration in silver.

But with high office come responsibility and a sworn duty to country and the rule of law. Taking an oath of office to protect and serve means just that; there is no exemption due to possible political fallout. Those of you who correspond with Commissioner Chilton would be well advised to press him on the real concentration that exists in silver. That Chilton and Gensler possess the power of the bully pulpit is obvious. Instead of asking for a show of hands about a theoretical market share that doesn't exist, Chilton could have asked about the documented concentration on the short side of silver. That he didn't is a shame that I hope he rectifies.

Since none of us should be holding our breath for action from the Commission (while continuing to press them), let me turn to the sure remedy for the

termination of the manipulation □ a physical silver shortage. I'd like to present a simple equation to demonstrate how easy it is for such a silver shortage to occur almost overnight. Importantly, I will rely on real-time demand data and not on theoretical investment demand that might come someday.

In the recent price rally, there has been interesting activity in the big metal ETFs; GLD in gold and SLV in silver. As expected with rising prices, there was good investment demand for these two big ETFs. Even though deposits of silver were delayed in the SLV (pointing to tightness) and such delays weren't noticeable in GLD, there were notable metal additions in the GLD as well. Only compared to the increased paper positioning on the COMEX were the metal deposits for gold and silver in the ETFs overshadowed. As was the case in silver, there were some notable withdrawals in the big gold ETF, GLD.

About a week and a half ago, I noticed two days in which more than 300,000 oz of gold were both deposited and removed from the GLD on different days. In terms of the amount of gold in GLD, 300,000 oz is somewhat insignificant compared to the total holdings in the trust of more than 42.5 million oz. Certainly 300,000 oz is a drop in the bucket compared to the 5 billion gold ounces thought to exist. Even in terms of average daily GLD trading volume (9 million shares a day), 300,000 oz is the equivalent of 3 million shares and doesn't seem excessively large. But in dollar terms 300,000 oz of gold is pretty big doings, worth more than \$500 million at current gold prices. One day

someone parted with (sold) 300,000 oz of gold in GLD shares and received more than \$500 million and vice versa the next day.

I would contend that \$500 million is a decent chunk of change for what were most likely two separate GLD transactions. These are not the size of typical transactions in GLD, but they did occur last week and there is no reason to suggest that such similarly-sized transactions won't occur in the future in GLD. If a single entity wishes to convert 300,000 oz of gold into \$500 million or vice versa, GLD is a mechanism for doing so. In fact, I detected no special price impact in the gold market as a result of these transactions. Nothing complicated here.

The point I am leading to is that while \$500 million can be transacted in gold via the GLD with no discernible impact on price, such a transaction would be impossible in silver or the SLV without a much more profound impact on price. The reason is simple □ while \$500 million can be put into and taken from the gold market with no obvious affect on price that is not the case in silver. \$500 million is equal to more than 15 million oz of silver and there is no way that a sudden purchase (or sale) of that quantity of physical silver would not reverberate in the price. Fifteen million oz of silver is more than 2 weeks of world mine production (versus a day and a half in gold) and it is not clear that any single owner holds that much physical silver, whereas there are hundreds of different entities that own 300,000 oz or more of gold. Since no one (that I

can establish) owns 15 million oz or more of silver, there is little likelihood that any single entity could sell that much metal, as they can in gold. Therefore, no single entity could sell 15 million oz of physical silver suddenly. The remaining question is what about the buy side – how hard would it be for a single entity to buy 15 million oz in a day? In my opinion, not very hard at all.

The two transactions I described in GLD which converted \$500 million into 300,000 oz of gold and then back again were unremarkable in many ways. These ETFs have made it easy to move money into metal and back out. There aren't many investors in size that can't or are precluded from investing in stocks. In stock market terms, a \$500 million single transaction is fairly common place and it occurs in GLD, as I hope I've shown. Any institutional or wealthy individual can buy or sell \$500 million worth of any stock they want. Except for silver. Even if a large investor had \$500 million and wanted to buy SLV, that buyer would have a hard time doing so without impacting the silver price dramatically. That suggests to me that, sooner or later, some large investor is likely to try.

Most of the big investors in GLD are relatively new to the gold scene, as they entered the gold market after the introduction of GLD in late 2004. The largest holder, John Paulson's hedge fund, bought GLD in 2009. Were it not for the creation of GLD and subsequent hard metal ETFs, I doubt many of the existing GLD holders would have purchased gold to start with. But because the share

structure made it so easy, many billions of dollars has flowed into precious metals ETFs. A big investor merely makes a phone call or clicks a computer mouse to buy or sell in quantities of \$500 million or more. That's how institutional investment transactions take place.

In the past, I have used the analogy of the mess you would make trying to put ten lbs of flour into a two lbs bag as a way of illustrating what a price mess (on the upside) would result from trying to put too much money into silver. The GLD transactions I discussed helped me quantify the potential silver price mess. There is no way that a real purchase of 15 million silver oz on any given day wouldn't result in a multi-dollar jump in the price. This assumes that the crooks at JPMorgan would not be shorting SLV shares and COMEX futures contracts (which is exactly what JPM would do). My point is that a legitimate transaction of \$500 million in silver on any given day would rock the price. And all that needs to occur for that to happen is for a large investor to say or click SLV, instead of GLD at the time of purchase. It doesn't matter a wit to the \$500 million of currency involved as to which it pays for, GLD or SLV.

What matters is that you can buy \$500 million worth of gold without a big impact on the price, but there is no way you can do that in silver. I don't think large investors in gold currently, particularly the newer ones, know that they can't buy equivalent dollar quantities of silver without causing the price to surge. I'm just speculating here, but when a few large investors discover how

October 3, 2012 - Simple Equations

small is the available quantity of silver for purchase, they will be inclined to figure the answer out for themselves, by placing the buy order. In that case, the manipulation could be ended overnight.

Ted Butler

October 3, 2012

Silver \$34.60

Gold - \$1778