

Sep 21, 2009 – Another Showdown

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As expected, the Commitment of Traders Report (COT) deteriorated to new historical negative readings in gold and another marked negative reading in silver. That is, the commercial traders on the COMEX increased their short positions against technical fund and other speculative buying. Thus, the stage is further set for a dramatic resolution. I am assuming that subscribers are as prepared as possible for either a sharp sell-off, both financially and emotionally, or a silver price explosion.

To summarize, the price run up since July of \$100 in gold and \$5 in silver was primarily due to speculative buying on the COMEX. In gold, some 100,000 net paper contracts were bought, or the equivalent of 10 million ounces. In silver, over 27,000 paper contracts were purchased, or the equivalent of 135 million ounces. In addition, another 30 million ounces were bought by shareholders in the big ETF, SLV. These shares were, in my opinion, sold short by commercial interests because the physical silver to deposit was not available. Therefore 165 million ounces of silver was bought by speculators and investors since July and sold by other speculators, called commercials.

The buying and selling of the 10 million ounces of gold equivalent and 165 million ounces of silver equivalent is the principle, if not sole, reason for the price rise to date. Beyond doubt, this specific trading set the price in gold and silver. This is contrary to commodity law. Because these transactions are in the form of futures contracts (plus the short SLV shares) we know that they are "open" transactions. They must be closed out at some point. The only question is will the technical funds and speculators blink first and sell in a panic to the downside, as usual, or will the shorts finally get their comeuppance and panic to the upside. Therefore, not only did the buying and selling of the 10 million ounces of paper COMEX gold and 165 million ounces of paper COMEX silver and short SLV shares illegally set the price on the upside, the unwinding of these open contracts will also set the price again, either up or down. In other words, the price gets manipulated both when the open positions are established and then again when they are liquidated. Is this a great system, or what?

I recognize that I write about this aspect of the market repetitively. That is intentional. I believe this is the key to understanding the real story in silver and that subscribers will benefit immensely in grasping it and positioning themselves accordingly. But the resolution of the current open positions is not the showdown referred to in the title. There is another showdown developing. This other showdown is definitely related to the current open position showdown between the speculative longs versus the commercial shorts, but is still separate and distinct.

A few days ago, I wrote of the white paper published by the CME Group (owner of the NYMEX/COMEX) which put forth its proposals on the issue of excessive speculation and position limits raised by the CFTC. I characterized the CME's paper as obnoxious, self-serving and insulting, particularly to Chairman Gensler of the CFTC. Upon further reflection, I think I may have understated my criticism of the paper. I left out my previous observation that exchanges have a deep and impossible to resolve conflict of interest when it comes to position limits or any type of trading restrictions. An exchange will never propose any trading restriction because it means lower profits from trading fees. To expect anything different is like expecting a fox to guard a chicken coop.

This point was further brought home in separate testimony last week by the chairman of the CME to the House Agricultural Committee

[http://cmegroup.mediaroom.com/file.php/295/Terry+Duffy+9-](http://cmegroup.mediaroom.com/file.php/295/Terry+Duffy+9-17+written+testimony+before+the+House+Comm+on+Ag.p)

[17+written+testimony+before+the+House+Comm+on+Ag.p](http://cmegroup.mediaroom.com/file.php/295/Terry+Duffy+9-17+written+testimony+before+the+House+Comm+on+Ag.p) The testimony is somewhat dry and arcane, but it shouldn't be difficult, especially in the sections on position limits and increased powers for the CFTC to guard against manipulation, to see that the CME wants the CFTC to butt out. That's the gist of it, namely, that everything is fine and no change is necessary. The CME holds that the commodity price run up last year and subsequent collapse had nothing to do with excessive speculation, but was due strictly to real world supply and demand. Anyone who disagrees doesn't know of what he speaks, according to the CME.

This has set up a showdown between the CME and the CFTC. It is a showdown that must and will be resolved, probably in the relative very near term. That's because the issues have become very specific, such as, who should set position limits, what should those limits be, and who should be exempt from those limits. No doubt, there are powerful forces on either side, all pushing for their own interests and agendas. Those forces include market participants, lawmakers, and even members of the Commission itself. Make no mistake — the resolution of this showdown will greatly impact silver investors.

What is so remarkable about this particular showdown is that I don't recall a similar showdown in my lifetime. I have not witnessed a time when an exchange and its regulator have been in such opposition. I've only experienced a system where the regulator rubber stamped whatever the exchange desired and a revolving door guaranteed employment for favors rendered. From my reading of history, I think the last time such a conflict existed was in the 1930's, when rampant speculation led to the Commodity Exchange Act of 1936.

Given my own personal experience, I would normally give the edge in this showdown to the more powerful entity, the CME. Who could stand up to this exchange's money and influence? Perhaps it is the optimist in me, but this time I'm inclined to go with the CFTC. That's because of three reasons; legislative support, being on the right side of the issue, and Gary Gensler. Legislative support has never been stronger for cracking down on excessive speculation, given the events of the past year. The law and common sense dictate that the only way to curb excessive speculation and prevent manipulation and concentration is through prudent position limits. Further, the new chairman of the CFTC seems the right person to pull this off. Still, it is a close call as to who will prevail, the regulated or the regulator. I know the chairman has the support of Commissioner Chilton, but I have my doubts as to the other commissioners.

I want to end this on a constructive basis. I send all my articles involving regulatory matters to Chairman Gensler and Commissioner Chilton. I can't say that I know if they read them. Here's a constructive suggestion just for them. Many hundreds of silver investors have written to you asking you to reduce position limits in COMEX silver to no more than 1500 contracts and to throw out the phony exemptions to those limits. I previously explained why the COMEX silver accountability limit, on any possible objective measurement, was out of line with the limit of every other commodity of finite supply. To date, the voice of the people has not been acknowledged. To be fair, I know that the Commission did not establish these silver position limits, the exchange did.

My suggestion to Chairman Gensler is to force the CME to respond to the public as to what the specific proper silver position limit should be and why. Force them to step up and be heard on this specific issue. Don't do their dirty work for them. Even though the CME is licensed to exist through Congress, it is disdainful to the public. It hides behind the CFTC on this specific issue, leaving it to the Commission to defend the indefensible silver limit and the short side concentration. Then it turns around and undermines your agency when it suits their greedy self interest. The CME is lobbying hard to continue to be the main regulator of commodity trading, with the CFTC in a subservient role. Let them start by publicly addressing the COMEX silver position limit.

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