
Sep 7, 2009 – Razor's Edge

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I believe we are at a defining moment in the silver and gold markets. I'm confident that we will have sharp price moves immediately ahead. That's because certain factors have become so extreme as to guarantee great price volatility. I'm less sure as to the immediate direction that prices will move, up or down, as I am that they will move big. I realize that may sound like a bit of a cop-out or that I may want to appear correct no matter what happens, but that's not my intent. It's possible to see a number of very specific short-term outcomes, yet not be sure which one will materialize.

I also realize that subscribers are not interested in paying for someone to say "I don't know." So it would seem appropriate to spell out the specific outcomes I see and, most importantly, explain the factors behind those outcomes. This way, readers can consider the factors and decide for themselves. That doesn't mean I won't state my opinion clearly, namely, that the price of silver is going to explode shortly. I just don't know if we will witness a sharp and very quick take-down first.

For long term, buy and hold investors in either metal or mining shares or ETFs, it doesn't make much difference which one of my scenarios play out, straight up or a sharp step down first and then an explosion. Aside, of course, from learning what is really going on and not getting faked out of a position in a temporary down draft. Those investors accustomed to adjusting their positions with changing market conditions may have more to consider. More on that in a bit.

Let's start with the one and only factor that might bring about a sharp and very temporary sell-off.

Of course, I'm speaking of the current market structure on the COMEX, as indicated in the Commitment of Traders Report (COT). I know that many find the data in this report too complex and difficult to decipher, especially when I talk about it in "wonkish" terms, as I have done recently. But please bear with me, as it is of the utmost importance to understanding the coming price moves. I feel it is critical to explain why we may or may not have a short term sell-off.

On the surface, the COT structure is clearly negative. The speculative long position and commercial short position in silver is larger and, therefore, more bearish than it has been in a year. In COMEX gold, when we adjust for the price action, volume and open interest change since the Tuesday Sept. 1 cut-off, we are also near a yearly and all-time negative extreme reading. In an interview with King World News on Friday Sep 4, I tried to convey the negative COT structure, although I was careful to point out that this may not automatically crush the price, as it has in the past, due to other considerations. This has been a recent theme of mine.

http://www.kingworldnews.com/kingworldnews/Broadcast_Gold+/Entries/2009/9/4_Ted_Butler_on

The interview with Eric King is recorded at 4:30 Eastern Time, about an hour after the weekly COT report is issued. That usually gives me enough time for a flash reading, although I invariably find more in the report as I contemplate it over the next couple of days. Last Friday, the monthly Bank Participation Report was also released, for positions as of Sep 1, same as the COT. The Bank Participation was published a little later than usual on Friday and was not available to me by interview time. There were some very interesting data points in that Bank Participation Report that I feel you should be aware of. For the sake of clarity, I'll just give you my bottom line conclusions. (Those readers wanting greater detail are invited to email me.)

The details in the Bank Participation Report confirmed a recent speculative analysis of mine, namely, that the largest short trader in COMEX silver is not increasing its short position. This occurred despite an increase in the short position by the three next largest traders in the big four category over the past month. In gold, this same large trader has significantly decreased its short position (by more than 30,000 net contracts), while the other three traders in the big 4 category markedly increased their short position over the past month. So as not to beat around the bush, there is no doubt in my mind that the big trader I am referring to in gold and silver is JPMorgan.

This is a very unusual development. I do not remember ever seeing the largest short trader in silver and gold break ranks with the other large traders. Usually they buy and sell in near-uniformity. I picked up on this changed pattern a few weeks ago, and the new reports spell it out clearly. Of course, this pattern may have changed in the high volume price rally since the Sep 1 report cut-off, and if that turns out to be the case, I will acknowledge it when subsequent data are released. But let's assume the clear pattern that existed in the current reports has continued since the cut-off. What does that mean?

For starters, it means JPMorgan is retreating from its dominant role as the big short in gold and silver. I think they see the handwriting on the wall and/or the CFTC has read them the riot act. Neither would come as a surprise to me, as I have been convinced that the new chairman of the Commission, Gary Gensler, means business when it comes to enforcing commodity law. By that, I mean there is no way that any trader is going to be allowed to hold the large short positions that Morgan and other traders hold in gold and silver, once the new CFTC guidelines are published. If the Commission somehow allows the big shorts to continue to manipulate gold and silver, I think that would create an outcry of protest from the public.

The real question is can the other big commercial shorts in COMEX gold and silver maintain the manipulation without the support of Mr. Big? That's what I don't know and what will determine whether we have a price explosion forthwith, or whether we get a sharp, last-time shakeout before the explosion. And let me get more specific. Can the remaining commercials rig the gold and silver market low enough to shake out the technical funds in sufficient numbers of contracts?

To do that, they need to rig the market lower than the key 50 day moving average in each, currently \$945 in gold and \$14 in silver. In other words, in order for the crooked commercials to succeed in causing the technical funds and other traders to sell, they need to drive gold down in price by more than \$50 and \$2+ in silver. Can they do that, now that JPMorgan appears to be exiting the game?

As I said, I don't know. But that is all I think I don't know about this set up. There is no doubt that the plan of the commercials is to rig the sell-off. But can they succeed, especially when so many legitimate bullish factors have recently emerged? I will tell you (and the Commission) one thing for certain. If these crooked commercials do succeed in manipulating the market sharply lower to cause tech fund selling, then there is no way in the world they could have accomplished that feat without colluding among themselves beforehand. Let me be as blunt as possible. This is like someone alerting the police that a bank will be robbed at a certain time and place, and having the police ignore the warning. If Chairman Gensler allows this to happen without punishment to the commercial shorts, then he will have allowed a great market crime to occur. And don't think for a moment that this coordinated and collusive commercial short selling has any real producer backing, as there is no evidence that gold and silver mining companies are adding to production hedges. These new commercial short positions are all speculative, with no economic legitimacy, save to profit in an intentional sell-off.

If such a sharp sell-off does take place, it is very likely to occur in a very short period of time, literally days. The subsequent rally, in that event, should then be explosive and just as quick. That is one of the scenarios I foresee. The other scenario is that no such sell-off takes place at all. We just power higher. The commercials who are shorting silver are nuts. I am convinced they have no idea what they are doing. They see a quick profit if they can trick the technical funds into selling out at engineered lower prices (thus enabling the commercial shorts to buy back their positions). The commercials have run this scam so many times over the years that it is old hat to them. They think this is like clockwork, because it has always worked before. Anyone who studies the COT would have to conclude that they will succeed. I sort of expect it, myself.

But there is another angle here. What the commercials are shorting in unison, in order to make a quick buck, is more than just another item on an exchange ticker. Being short silver is not just another trade, as they think, but it is being short a vital and critical material that could go into shortage overnight. I'm convinced that those dealers shorting silver heavily have no real concept of what they are doing. These shorts are playing with fire. They could quickly find themselves in big trouble, especially without the support of the former ring leader. It's easy to imagine these uniformed, but large, shorts getting into trouble and then rushing to buy back their shorts in a panic. I can't quantify the exact odds that these commercial shorts will get overrun, but I can tell you those odds have never been higher. That's part of where the price explosion scenario comes from. But only part of the scenario.

What could really propel silver prices sharply higher at this point are developments from China along three fronts. Those are the legalization of ownership and encouragement for citizens to buy silver (and gold), the threat of export restrictions and the possibility of OTC silver derivatives default. All raise the prospect of tight silver supplies, precisely at the same time it appears that the CFTC may finally crack down on the COMEX silver shorts. This creates a powder keg for the price of silver.

What should investors do in the event either of my two scenarios materializes? Long term investors should sit tight, as they would do in any event. Definitely do not sell after a sell-off. Those more inclined to trade, might hold some dry powder in the event that we do see that sharp quick (and manipulated) sell-off. But it is also important, even for traders, that you have a meaningful long exposure in the event the commercials can't rig the price of silver lower before the price explosion. The prospects for silver are more exciting than I can remember, and it would be a shame not to have a meaningful position in place. Greater price volatility appears at hand. Good luck to all.

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