

## September 10, 2010 – Weekly Review/The Duck Test

### Weekly Review

Amid continued volatility, the price of gold and silver fell for the week. Gold declined by about \$24 (1.3%), after trading at a new high over \$1900 earlier in the week. Despite the loss, gold finished at its second highest weekly close on record. Silver was much weaker, closing down \$1.75 (4%) and well off its highs of April. As a result of silver's underperformance, the gold/silver ratio widened out to just under 45 to 1, at the upper end of the ratio's trading range over the past 4 months. Silver is still slightly ahead of gold in percentage terms (34% vs. 31%) as measured on a year to date basis.

On a longer term basis, silver has generally outperformed gold and just about every other asset class more handily, despite it still being down almost 20% from the late April price highs. On the ten-year mark of that terrible day of American tragedy, this article highlights silver's stunning comparable returns – <http://seekingalpha.com/article/292458-market-performance-since-9-11?source=yahoo> The article didn't include the returns from other commodities or real estate over that time, but if it did silver's returns would have been even more impressive.

Like most of you, I remember that fateful day with deep emotion. Even 9/11 holds a special silver connection for me, as I remember getting quotes that morning (before the planes hit) from the same COMEX staffer I had gotten data from a million times before. Then the lines went dead. In the old days (before the Internet provided such data), I called the COMEX statistics department at least 20 times a day for maybe 15 years, getting prices, deliveries, hourly volumes, open interest, warehouse stocks, etc. I came to respect greatly the professionalism and attitude displayed by the staffers there. My gripe with the COMEX was always with the "suits" upstairs that allowed the silver manipulation to continue, not with the rank and file workers. Anyway, not having talked with her in years, I made a point of telling her this week just how relieved I was to hear her voice days after the tragedy.

I was writing actively about silver ten years ago, and I took the occasion to look back on what I was writing about then, which is not something I normally do, as I am usually more concerned with what I'm about to write. From what I can tell, I was pounding the table (some might say foaming at the mouth) in my bullishness on silver, especially compared to other assets. If you'd care to judge for yourself, this link is better for searching by date, although there are some duplicates around 9/11/01 <http://www.investmentsrarities.com/tbarchives.shtml> While I am delighted with how silver performed since then, I would remind you that past performance is no guarantee of future results. As always, you must decide for yourself if what I write (or anyone else) is factual and logical.

Conditions in the wholesale silver physical market still appear tight, despite what has been somewhat of a lull in the retail market. Days of no change in COMEX warehouse turnover have been followed by days of extraordinary movement. I still must classify COMEX silver inventory turnover as frantic, although that is not reflected in deliveries or spread differential changes. The actual physical movement of metal still resonates most loudly as tightness to me. There were some additions to deposits in the big silver ETF, SLV, and the new short position data should be released soon. Sales of Silver Eagles from the US Mint got off to a slow start for the new month, following a red-hot August and year to date, but I can't tell if that's reflective of demand or a reporting glitch.

This week's Commitment of Traders Report (COT) indicated an increase in the total net commercial short positions in both gold and silver. The monthly Bank Participation Report indicated that JPMorgan increased its COMEX silver short position by a thousand contracts or so. I would estimate JPM's silver short position to be at 22,000 to 23,000 contracts (110 to 115 million oz). In gold, the Bank Participation Report indicated that there was a sizable decrease in the US banks' net short position of some 22,000 contracts, which is in general conformance with the retreat from the short side that I have been reporting recently. By the way, I am still convinced that the price rise in gold, as well as the rise in price volatility, is directly related to the retreat of the big gold shorts. I am open to other explanations, but I have seen none more plausible to date.

In the gold COT, the total commercial net short position rose by 10,400 contracts during a reporting week that included interim gains of as much as \$80. This week's increase in the gold commercial short position follows four straight weeks of reductions. Importantly, the gold raptors (the smaller commercials apart from the eight largest traders) accounted for almost all of the increase by adding 9700 short contracts. The eight largest traders only added around 650 short contracts and are still holding their lowest gold short position in more than two and a half years (aside from last week). Therefore, it still appears that the biggest gold traders want off the short side. They may be retreating strategically, as opposed to throwing their weapons down and running away, but they are still basically retreating.

That doesn't mean all the commercials won't still look to rig the price of gold lower, because it's still to their advantage to do so. But clearly, the biggest COMEX gold shorts have altered their past behavior of adding aggressively to short positions on price rallies at this point. A subscriber asked me if increased physical gold demand might have been behind the sudden rush to cover over the past month or so. I agreed that it could have been due to increased physical gold demand at the margin, but concrete proof of that is lacking in the normal run of data, such as deposits into gold ETFs. In the wishful thinking department, perhaps the regulators (CFTC and/or the DOJ) might have something to do with the big gold shorts' radical shift. Regardless of the catalyst, the future behavior of the big COMEX gold shorts will have everything to do with the gold price and price volatility.

In silver, it was a somewhat different pattern that emerged in this week's COT than occurred in gold. On an increase of around 2100 contracts in the total commercial net short position, the eight largest traders accounted for almost all (1800) of the increase. The big 4 (JPMorgan) added 600, while the 5 thru 8 largest traders added 1200 contracts. The raptors reduced their net long position to 1900 contracts by selling the balance of 300. I would contend that silver prices would have climbed far higher than the interim \$2 gain in the reporting week was it not for the manipulative short selling by JPMorgan and the big 8. I'll discuss that separately in a moment, but the bottom line is that silver is very much manipulated in price by JPMorgan and other big shorts, more so than in gold or any other commodity.

In an open public meeting this week, the CFTC confirmed that the issue of position limits would soon be dealt with (within a month or so). I can't tell you what the Commission will decide should be the proper level for position limits in silver, only that they will decide. It seems that the choice is between the staff's recommended formula which would result in a position limit between 4500 to 5000 contracts (22.5 to 25 million oz) or the 1500 contract limit (7.5 million oz) recommended by thousands of you in the public comments. I still don't see how allowing speculators to hold, long or short, 25 million ounces of silver derivatives when only a handful of real world producers and consumers make or consume that amount in a year is a real limit. It's good that we are reaching the point of resolution for this important issue and we'll deal with it as best we can. Of course, the exemptions to position limits, whatever the actual level decided, will be all important. The 4 largest shorts in COMEX silver hold just over 40,000 net short, so no matter how you break those holdings down, at least two or three of these big shorts will be over the limit, even if the position limit in silver is set at 5,000. I hope the Commission doesn't go back on its word that exemptions to position limits will be greatly restricted and rigorously enforced.

Speaking of public comments, the NY Times carried a story this week about how Dodd-Frank had created a booming business for law firms in submitting public comments on behalf of clients impacted by new regulations. It seems the cost from the law firms for submitting a detailed comment letter can run upwards of \$200,000 each. I guess we all got a great bargain in being able to submit comments suggesting the 1500 contract level in silver for free. I've read a good number of the comments submitted by various law firms and have to confess that in reading them, my eyes glazed over. Your comments calling for 1500 contracts in silver were much better written and more persuasive

<http://comments.cftc.gov/PublicComments/CommentList.aspx?id=965>

### The Duck Test

One expression most of us have heard (and maybe even used) is the duck test, namely, if it looks like a duck, swims like a duck, quacks like a duck, then it probably is a duck. I'll defer to Wikipedia for a more detailed discussion of the expression

[http://en.wikipedia.org/wiki/Wikipedia:The\\_duck\\_test](http://en.wikipedia.org/wiki/Wikipedia:The_duck_test)

Increasingly, I've come to consider the silver manipulation in terms of it being so obvious that it is like the duck test; if it looks like a manipulation, acts like a manipulation, and exhibits all the characteristics of a manipulation, then it probably is a manipulation. Because I try to be as factual as possible and provide as much verifiable data as I can, I know sometimes I don't keep it simple enough. Let's face it — manipulation is a complicated subject; so complicated that there is no simple legal definition of what it is. Just recently, the CFTC passed a new (and complicated) definition of what constitutes manipulation.

Today, I'm going to try to explain why silver is manipulated in price with just a few numbers and simple logic and definitions. Let me define manipulation as the creation of an artificial price level (high or low) due to a large and concentrated position. Concentrated means a large position held by one or only a few traders, as it is impossible for many diverse traders to manipulate a market. Many traders can influence a market and collectively cause a market to be mispriced, but that's not a manipulation in the legal sense. Also included in a manipulation is the implicit understanding that once the concentrated position is broken up, the manipulation not only is ended, but also the price of whatever was manipulated moves violently in the opposite direction of manipulation.

Ironically, the classic definition of market manipulation was what occurred in silver in 1980. A very small number of traders, led by the Hunt Brothers, amassed such a large long silver position, that it caused the price to reach then-unrealistically high levels. The Hunts succeeded in driving silver prices higher, in effect cornering the market, because their concentrated position was so large. When the regulators moved against the Hunts and forced them to first stop buying more and then to dispose of the long position, the price of silver collapsed; falling faster and as much as it had risen. The Hunt silver manipulation had all the necessary ingredients — an artificial high price, brought about by a concentrated long position and the inevitable price collapse as the concentration was dissolved.

What we have today in silver is a mirror image of Hunt Brothers manipulation. Instead of a manipulation to the upside, we have a downward manipulation. Instead of a concentrated long position, there exists a verifiable concentrated short position. Instead of being manipulated by Texas oil barons, silver is manipulated by an important financial institution, JPMorgan. The key difference between the long silver manipulation of 1980 and the short silver manipulation of 2011 is that the 1980 version was completed and terminated; we're only half-way through the current manipulation in that it has yet to be terminated.

The actual size of the respective concentrated positions is remarkably similar. The Hunts were long about 20,000 contracts (100 million ounces); JPMorgan is currently short a larger quantity than what the CFTC found was manipulative in 1980. If you study the current COT Report (long form futures only), you'll see that the net position of the four largest short traders is 35.5% of total open interest (113,449), or 40,274 contracts (you must do this manually). (As mentioned previously, I estimate that JPMorgan holds 22,000 to 23,000 contracts of this net short position.) The four largest long traders hold a net long position of 13.1% of total open interest, or 14,862 contracts. Therefore, the 4 big shorts hold a short position that is 2.7 times larger than the long position held by the 4 big longs. This big short to big long ratio is more extreme in COMEX silver than it is in any other physical commodity market. That's a key proof of the silver manipulation; COMEX silver has been configured this way for years.

Some might argue that the high price of silver argues against it being manipulated downward. I understand that intuitive reaction and would submit that price alone is not the determinant of manipulation. The chief determinant is to what degree a concentrated position is present. As I just indicated, the big short position towers over the big long position to a degree not present in any other physical commodity. Besides, I believe the current price of silver will look low once the manipulation by JPMorgan and other large COMEX shorts is terminated. In other words, please reserve judgment as to what constitutes a high price for silver until after the manipulation is ended.

Perhaps the closest connection of the silver manipulation to the duck test is in contemplating the silver landscape without the current large concentrated short position of JPMorgan and the rest of the big 4. For the silver market to be immune from allegations of manipulation, the concentrated short position must be dissolved or transferred from the one to four holders to being held by many different participants. Manipulations are marked by concentrated holdings; free and fair markets are held by a wide diversity of participants. I would be the very first to agree that the silver market was not manipulated if there was not such an obvious concentration on the short side. For JPMorgan and the other entities in the big 4 to avoid the allegations of manipulation, their concentrated short position must be transferred to many different participants.

Please ask yourself this Â? how best for JPMorgan to shed its concentrated silver short position on the COMEX? Up until recently, JPM et al have largely reduced their short position by rigging prices lower and forcing leveraged traders to sell under duress. Yet, as silver prices have indicated by mostly moving higher, that's a losing game. The alternative is to buy to the upside, but that can get out of hand in a hurry. So the analytical question is at what price can the silver manipulators transfer their concentrated short position to a wide diversity of other traders willing to sell? No one could know in advance what price would encourage enough outsiders to sell out long positions or initiate new short positions to fully replace the current concentrated short position. But it sure isn't at current prices; otherwise there would be no concentrated short position presently. My guess, as a close observer of the silver market, is that would take at least \$25 or \$50 higher from here to dissolve the concentrated short position.

Against the backdrop of the duck test stand the front line regulators in the form of the CME Group and the CFTC. I'm hesitant to mention that the CME is a front line regulator, but as an exchange licensed by Congress that is supposed to be one of their prime functions. That it is so unresponsive to the silver manipulation is beyond shameful. Likewise with the CFTC, which presides over a manipulation that is increasingly obvious to more participants each day. In my opinion, you can't complain to the Commission too frequently. (For appropriate e-mail addresses, please see the article of August 10, The Public Be Damned)

Back on that terrible day ten years ago, there was no notable concentrated short position in silver. The concentration developed over the years afterward. Importantly, the existence of the concentrated short position makes the silver market more bullish today than it was ten years ago, before it rose ten-fold. I can't tell you that silver will rise ten-fold again, but I can tell you that the concentrated short position won't last for a fraction of that time and its dissolution will bring about sharply higher prices from here.

Ted Butler

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Silver – \$41.50

Gold – \$1860

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