

September 24, 2014 – The Dominant Pattern

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While it's impossible to recognize a pattern before it has formed, it's also usually no walk in the park to quickly identify the emergence of a new pattern, even when the data is readily available. Generally speaking, patterns are formed for a reason and, depending on the reason, could be significant to price. Remarkably, a number of special patterns have formed in silver over the recent past that look significant to me. Please understand that I'm not suggesting that I predicted any of the emerging patterns; I'm just trying to analyze them after the patterns were formed.

I'll not dwell today on the highly unusual and unique pattern of the physical transfer of silver into and out from the COMEX-approved warehouses over the past 3.5 years. Nor will I delve into the unusual pattern of metal holdings in the two biggest gold and silver ETFs, GLD and SLV, which despite exhibiting similar price changes, went in very different directions – actual metal holdings were down 40% in GLD and steady to up in SLV over the past 20 months.

While these patterns are easily verified and are increasingly recognized, to this point no conclusive price connection can be asserted. For example, I believe the unusual physical turnover in COMEX silver warehouse inventories represents supply tightness on a wholesale level and if I am correct and the pattern continues this will prove to be very bullish for price. But the simple fact is that it has had no discernable price impact to date. The same goes for the sharply lower GLD holdings versus steady to higher metal holdings in SLV.

But there is a pattern that has formed over the past two years that can be documented as having, far and away, the most dominant price influence on silver. Of special interest is that the most dominant price pattern in silver has also emerged in gold, copper, energies and many other markets. The dominant pattern is the rise of remarkably large positions by traders in the managed money category of the Commitments of Traders Report (COT). These are the traders I refer to as the technical funds, primarily because they approach the market on a strictly technical or price-activated approach, rather than by weighing supply/demand factors. At the core of the technical funds' approach is their attempt to latch on to a price trend early and build up positions as the trend continues, only abandoning the trade and reversing positions after the price trend changes direction.

I've written about technical funds and the COT Report for ages, so this may seem to be old stuff. But I'm talking about a relatively new pattern, namely, the emergence of collective short positions in the managed money category on a scale never witnessed before, particularly in COMEX silver. Simply put (and I recognize this is not a simple subject) and over the past two years, the technical funds have come to establish at times far larger gross short positions than they did in previous years. This is especially true in COMEX silver, but also true in COMEX gold and copper, as well as in other commodities.

There is no question in my mind that the increased willingness of the technical funds to hold much larger short positions than they previously held is the reason we have witnessed a series of new price lows in silver and other commodities. In other words, the only reason we are at and have seen the new price lows in silver is because of the record amount of technical fund short selling on the COMEX.

There is also no doubt in my mind that the technical funds are being herded onto the short side of COMEX silver, gold and copper by their counterparties, the collusive commercials which are buying every contract that the technical funds sell or go short. I have to stop here to make a point that has been bothering me lately.

As clear as the silver manipulation has become to increasing numbers of observers, it is important to recognize that it is not as simple (or complex) as some maintain it is. It is not commercial selling that is fueling the move to new lows, as the commercials have been buying hand over fist. Yes, the commercials get things rolling to the downside by HFT tricks and spoofing, but that's only to get the technical funds to sell so that the commercials can buy. That's spelled out without exception in the evolving COT data.

It's too bad that many observers and commentators (not subscribers) have failed to grasp this manipulation basic because it then leads to unprovable conclusions, such as it's the government driving gold and silver prices lower by having the bullion banks sell short. Perhaps there is government involvement in some way, but it is the technical funds selling short on price declines, not the commercials. The commercials only sell on price rises. All the data confirm this.

I can't help but believe that if the case was stated accurately, more might be done to end the manipulation. If more attention were focused on the facts and not on rank speculation, for instance, that China may be behind the silver manipulation or that there is an imminent COMEX delivery default pending, this scam would be over sooner, not later. That's because the facts prove manipulation conclusively.

Technical funds are speculators (and so are commercials in reality). The quantities of contracts being sold short by the technical funds are so massive that those quantities can't help but crush prices. This is what should be focused on and is shockingly clear in the dominant pattern of increasing technical fund short sales over the past two years.

Take the current decline in silver prices to new four year lows. From the July 29 COT to last week's report, technical funds (in the managed money category) sold nearly 34,000 contracts of new short contracts in COMEX silver, as silver prices fell nearly three dollars. I would not be surprised if the technical funds added as many as 5000 or 6000 new shorts in the COT report coming this Friday. It is not possible that the aggressive short sale (all on new price lows) of the equivalent of 170 to 200 million oz of silver wouldn't drive the price of silver lower. This is the guts of the silver manipulation, not wild conspiracy theories.

The important point is that the CFTC and the CME know that such large speculative positions are unduly influencing silver and other commodity prices to the point of manipulation and refuse to acknowledge that their own data prove the manipulation. If there is one thing the silver producers can do about the manipulation that is destroying shareholder value, it would be to ask the CFTC and the CME how they can allow this circumstance to continue. No holding back production or other costly exercises. Just ask the CFTC and CME how speculators can be allowed to sell short such massive quantities.

And I even think I understand why the technical funds have been selling short such massive quantities of silver and other commodities over the past two years. As I have indicated previously, I've had hands-on experience with technical funds going back more than 35 years. Silver has been moving lower for more than three and a half years, a sufficiently long enough period of time for all the technical fund price filters to show that the primary price trend is down.

Therefore, it is not illogical that the technical funds would hold their largest short positions in silver now from a technical fund perspective. (I'm not a technician, but that doesn't mean I can't understand why they do what they do). Further, from an individual technical fund perspective and based strictly on the price trend, I suppose silver short sales might seem to make sense. But, as I have indicated previously, the problem is not with any individual technical fund; the problem is on a collective basis, because the technical funds act as one, since they all use similar systems.

Whereas the commercials are acting with easy to prove collusion in orchestrating the technical funds' actions, that doesn't seem possible in the case of the technical funds, as no one would collude if such a collusion were to the detriment of the participants. History has shown that when technical fund positions (either long or short) reach extreme readings, the next big market move is against the collective technical fund position. History also shows that when the commercials hold an extreme position, the next major market move is invariably in the price direction that favors the commercials. I don't think I've ever seen an exception to that pattern in silver or any other commodity. So, from the point of view of which counterparty, technical fund or commercial, is behaving collusively it would seem clear that the consistent historical victor (the commercials) is colluding.

That's not to say that individual technical funds are not sometimes winners (when they break from the technical fund majority before the rest) or that the technical funds collectively do not hold large open profits before price trend reversals. In fact, that is most often the case and exists currently. Since the technical funds only add positions when they are on the right side of a price trend, it's almost axiomatic that they hold enormous open profits on maximized positions.

Currently, I would estimate that the technical funds have an average price of around \$19.50 on the estimated 40,000 short silver contracts added since the end of July. With almost a two dollar open profit on the equivalent of 200 million oz, the collective technical fund open profit is close to \$400 million currently. This also means that the commercials have an open loss of a similar amount on new long positions bought minus the profits on existing short positions bought back and covered.

And this is just for COMEX silver; when one adds in the current open profits that the technical funds hold on short COMEX gold and copper positions, the collective technical fund open profit and commercial open loss amounts are well over a billion dollars. With such sums at stake, I find it unnecessary to conjure up a government conspiracy involvement, whether one is present or not. In my opinion, such sums are sufficient to motivate white-collar crooks like JPMorgan, the CME and the other collusive commercials. A bank like JPMorgan, which prospers by collecting billions of dollars from overdraft fees on checking accounts, would not need much motivation to participate in a rip-off of technical funds considering the amounts involved.

But open profits and losses are different from realized or closed out profits and losses. Since history shows that big open profits held by the technical funds and the reciprocal open losses held by the commercials are almost always reversed in the process of converting open to realized, concentrating on the open aspect alone can be seriously misleading. It's not how large the open profits or losses can stretch that matters (unless you are on margin); what matters is in the manner of how open positions are closed out.

As much as I'm convinced that the commercials are the true manipulators, history argues that when the technical funds move to convert their massive current open profits to realized profits, those open profits will vanish in the relative blink of an eye, as will the commercial open losses suddenly disappear. That's because there must be a buyer for every seller and vice versa, as I wrote recently.

The technical funds have sold short nearly 200 million oz of COMEX silver contracts over the past two months, with the commercials almost exclusively on the buy side. Let's anticipate what happens next, thru the prism of historical experience. Not if, but when the technical funds move to buy back their massive collective short position as they must (since they can't deliver physical material), the only practical seller to the technical funds will be the commercials which have been buying on progressively lower silver prices. This matchup is preordained; it must occur at some point.

The technical funds (when they are finished adding to short positions) must buy as massive an amount of silver contracts as they sold short over the past two months. The only entities capable of satisfying the technical funds coming silver buying binge are the same commercials who just bought everything the technical funds went short. The only question is at what price the commercials will accommodate the technical funds when those funds move to buy back.

Specifically, will the commercials sell to the technical funds on stinking \$2 or \$3 silver price rallies like occurred in June-July and February to merely eliminate open commercial losses and eke out a relatively modest profit or will the commercials look to extract a literal pound of flesh from a group of traders that is far more vulnerable than anyone realizes? It is the undeniable vulnerability of the technical fund shorts and the demonstrated ruthlessness of the collusive commercials that more represents the current set up than anything being written today.

I don't know at what price the commercials will sell when the technical funds move to buyback and cover their massive short positions. I do know that the technical funds must buyback at some point and that the commercials are the only potential sellers. I'm prepared to be disappointed in that we may witness a marginal silver rally as has occurred recently, but it is impossible for there not to be a rally of some sort.

I'm also prepared for this certain coming silver rally to be the launch pad for the real silver blast off. The one thing I know for sure is that the nature of the coming silver rally, small or large, is entirely in the hands of the commercials and if they decide this next move up in silver will be the big one, it will be the big one without question.

Most remarkable of all is that this dominant pattern of massive technical fund short positions has little to do with the physical side of silver, which happens to be the lead-pipe cinch for eventual shockingly high silver prices. Two or three months ago, I was forced to acknowledge that the COT market structure did not appear to be supportive of higher silver price and that I was disappointed that the commercials sold as aggressively as they did.

But the market structure has changed completely by virtue of the massive increase in technical fund short selling in silver (and gold). Accordingly, it's hard to imagine how the structure could improve dramatically from here, although there's always room for slight improvements on slight new price lows. Silver prices have continued to move lower than I imagined, as has occurred at other times over the years; but the actual eventual price low is now much less important than the continued improvement in the market structure.

I can't guarantee the next move up in silver will be the big one or even that we've seen the lows, but the greatest certainty for a rally of any magnitude has always been a maximum technical fund short position and that's where we are now.

Ted Butler

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Silver – \$17.70

Gold – \$1218

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