

## September 4, 2009 – Warnings Ignored

### Warnings Ignored

*Trouble with you is the trouble with me,  
Got two good eyes but you still don't see.*

*Trouble ahead, trouble behind,  
And you know that notion just crossed my mind.*

*Casey Jones*

*Grateful Dead*

A remarkable story recently appeared in a leading Chinese business publication that threatens to upend the world of commodities. It seems that the government of China may be preparing the way for state-owned investment funds to walk away or default on OTC commodity derivatives contracts held with foreign banks if those contracts cause loss to the funds. A good discussion of this issue can be found here, along with links to the original story and a related Reuters article <http://dealbook.blogs.nytimes.com/2009/08/31/china-derivatives-losses-trouble-ties-with-banks/?scp=7&sq=deal%20book&st=cse>

Even more amazing is that the obligatory follow-up story, in which the threat of default is invariably denied, actually confirms that China is seriously considering defaulting on selected OTC commodity derivatives contracts.

[http://www.chinaeconomicreview.com/dailybriefing/2009\\_09\\_02/SASAC\\_clarifies\\_statement\\_on\\_c](http://www.chinaeconomicreview.com/dailybriefing/2009_09_02/SASAC_clarifies_statement_on_c)

If there is going to be a default by China in select OTC commodity derivatives, silver is a prime candidate.

What makes the China story so remarkable to me is that it ties together and confirms much of the silver analyses I have published over the years. In addition, it points to the extraordinary situation that presently exists in silver, not just from an investment and regulatory perspective, but also from a view that impacts the strategic interests of nations, including, but not limited to, the US and China. As always, I ask you to decide for yourself based upon the facts and my speculation.

Here are the facts. There is an unusually large concentrated net short position in COMEX silver futures held by 4 or fewer traders, documented by CFTC data. There is no unusually large concentrated position on the long side. Other CFTC data indicate the concentrated silver short position is largely held by one or two US banks, at times reaching 25% of world production. This degree of concentration is unprecedented and not seen in any other commodity. Correspondence from the CFTC to elected officials identifies JPMorgan as the prime holder of the short position, with Morgan having inherited the position in its takeover of Bear Stearns. Requests to the CEO of JPMorgan to deny it holds the large silver short position on the COMEX have gone unanswered.

For years, the CFTC has investigated my allegations of manipulation in silver, and in 2004 and 2008, they denied such a manipulation exists. It is thought they will comment soon on the third investigation, begun a year ago. In none of the three investigations have they contacted me, although I was the impetus behind each investigation. Over the past five years, the silver short position has grown more concentrated. About six years ago, based upon input from my friend and mentor, Izzy Friedman, I first speculated that China was the big short behind the COMEX silver short position. Other articles followed on China and this theme.

[http://www.investmentsrarities.com/ted\\_butler\\_comentary/07-08-03.html](http://www.investmentsrarities.com/ted_butler_comentary/07-08-03.html)

More recently, in December 2007, I publicly and privately warned the CFTC and Commissioner Bart Chilton of what a disaster it would be if the foreign backers to the short position in COMEX silver decided to walk away from their obligations.

[http://www.investmentsrarities.com/ted\\_butler\\_comentary/12-10-07.html](http://www.investmentsrarities.com/ted_butler_comentary/12-10-07.html) In that letter, I wrote;

“these giant foreign silver shorts represent a grave and unique danger to our country, not just because they hold a controlling position in COMEX silver futures, but also because of the nature of that position.

In its own words, the New York Mercantile Exchange, Inc., (which owns the COMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals. As such, the NYMEX/COMEX is a financial institution important to the interests of our country. The highest regulatory attention should be placed on anything that threatened its existence. The 4 large foreign silver shorts represent such a threat.

If and when these four large traders decide they have had enough of the short side of silver, instead of covering their short positions or delivering actual silver, they could declare *force majeure* and simply walk away and leave the regulators and NYMEX clearing members holding the bag. Since they are outside the jurisdiction of the Commission, there is, currently, little to prevent this.”

I don't know how I could have been clearer in my warning. I don't know how the stories coming from China could highlight those dangers any clearer. Not only is the

concentrated short position clearly manipulative to the price of silver, the danger of a default has never loomed larger. Perhaps the recent price action is reflecting that growing awareness. In spite of this clear warning, the CFTC concluded, in May 2008, that there was nothing wrong in silver.

It is important to put the current situation into proper perspective. Here's my take. Sometime around ten years ago, the now-disgraced derivatives powerhouse AIG, through their China connections, convinced certain state-owned companies of that country to enter into massive OTC short contracts on silver. China's growing share of silver refining production was the cover story. The real purpose, however, was to give AIG backing for selling short silver contracts on the COMEX for the purpose of hoodwinking the technical funds into and out of paper positions on the COMEX. This worked like clockwork for years. Pressure from me and many readers, through then-New York Attorney General Eliot Spitzer quietly forced AIG to abandon and transfer their COMEX silver (and probably gold) short position to Bear Stearns, another large clearing firm, like AIG. The Chinese OTC silver short position was assumed by Bear Stearns as a counter-party and Bear Stearns then continued the COMEX manipulation and fleecing of the technical funds and other speculative traders.

The frequent complaints to the CFTC about the outsized short position and obvious manipulative trading activities on the COMEX were rebuffed by the Commission because Bear Stearns, like AIG before them, could show on paper that they had existing OTC offsets with China that "backed" the COMEX short positions. As has been shown in other financial scandals, like the Madoff swindle, bureaucrat regulators are often no match for well-connected and persuasive Wall Street power brokers.

When Bear Stearns collapsed in March 2008 (incidentally at the then-highest price for silver in decades – \$21), there was no one willing to take over their giant COMEX silver short position and the offsetting Chinese OTC contracts. Enter JPMorgan Chase. Remember, this was a time of great stress to the financial system and all efforts were directed to quickly fixing problems that arose. The giant silver short position at Bear Stearns was one such problem. With federal government guarantees against loss and criminal prosecution, JPMorgan did assume the role of master of the silver market. All this was revealed in subsequent Bank Participation Reports and in correspondence from the CFTC to various lawmakers. Since that time, JPMorgan has managed the giant silver short position. My speculation includes that Morgan has quietly offset its COMEX short position over the past year and a half with other unsuspecting parties in the OTC market.

What does this all mean and where do we go from here? Get ready for great and growing price volatility. I'll have specific market comments for subscribers over the next couple of days, once the new COT and Bank Participation Reports are released. But this much is clear – the long anticipated default of the massive OTC silver derivatives position by China appears to be at hand. It's hard to imagine a more profound event. All at once, the backing and excuse for the concentrated short position on the COMEX is exposed for the fraud it has always been. No longer can the CFTC pretend that the COMEX silver short position is backed by anything legitimate. Not when China, itself, is saying it may default. So many game changes have emerged in silver over the past few months that it is hard to appreciate them all. These recent announcements by China concerning its future intentions on select OTC commodity derivatives could be the most important of all.

I still have great faith that the new chairman of the CFTC, Gary Gensler, has every intention of doing the right thing and will adjust and enforce legitimate speculative position limits in COMEX silver. The new reports out of China make it more imperative that he do so quickly. The threat from China that it may default on contracts that back the concentrated COMEX short position raises the stakes immensely. Unlike his predecessors, and for the good of the country and market integrity, Chairman Gensler must not ignore these warnings.

Note to subscribers Â? because of the potential regulatory significance of this issue, I am putting this article out in the public domain. I'll have specific market comments available over the weekend.

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