

Stubborn Facts<?xml:namespace prefix = o ns  
= "urn:schemas-microsoft-com:office:office" />

Over the past two trading days, the price of gold has been hit hard, as has silver. The sell-off came amid great volatility, with the price of gold having first traded above \$1900 before trading below \$1800 the ounce. Once again, much of the price decline occurred on downward price spikes in overnight electronic trading when liquidity is at its lowest. The sell-offs seem to come more when the markets are thin and rallies seem to occur more when full trading is present.

Anticipating great price volatility, after correctly analyzing the market set up responsible for that volatility, only slightly lessens the emotional impact when that volatility occurs. The price of gold had rallied more than \$300 due primarily to the unprecedented and aggressive commercial short covering on the COMEX. That buying from commercial short covering and speculative long liquidation on the rally resulted in a loss of liquidity that cleared the way for dramatic price moves in both directions, up and down. While the big commercials on the COMEX had taken a terrible beating on the short positions they bought back, they still had a much larger number of short contracts still open. Therefore, the big commercials short on the COMEX have a strong vested interest in bringing about lower prices, despite their aggressive former buying back of short positions.

I believe the reason for the emotional impact one feels when these sharp sell-offs occur is the collective sense that the sell-offs are deliberate and intentional; that they occur for reasons unrelated to the free market. Forget sensing that; there is enough factual evidence to make the case that these sell-offs are manipulative. What facts? Here are just a few.

First is the construction of the market, in that the short side is much more concentrated, or held in fewer hands, than the long side. This is particularly true in COMEX silver, where the concentrated short position of the four largest traders is more than 2.5 times larger than the concentrated position of the four largest longs. In most major futures markets (although not all), the concentrated positions of the largest traders long and short are relatively comparable. In some markets, the position of the concentrated longs is larger than the position of the concentrated shorts. That has never been the case in COMEX silver, as the concentrated shorts always have towered in size over the concentrated longs. Since there can't possibly be a manipulation without a concentrated position, it is impossible for there to have been a long side manipulation as the long side concentration isn't as large as the short side concentration. The dramatic sell-offs in COMEX gold and silver are not arranged by the longs; only the shorts could be responsible for such raids.

The dramatic sell-offs, particularly at times when the markets are thin, greatly outnumber in frequency any dramatic price rallies. One would think in a free market that dramatic sell-offs and rallies would roughly compare in frequency, especially when one considers that the general sweep of gold and silver prices over the past 5 or 10 years has been to the upside. That is clearly not the case. A subscriber and professional trader e-mailed me this morning that automatic trading halts had been hit last night in Globex gold and silver to the downside, due to the sudden and violent nature of the off-hours sell-off. Automatic trading halts are fairly rare and only occur on large sudden moves where someone is pressing the market aggressively. I asked him how many automatic trading halts had occurred in his memory to the upside. He said he couldn't remember any but would investigate. He reported back that, over the past year, there had been 18 automatic trading halts to the downside in silver, with only one halt to upside. In gold, there had been 4 halts to the downside and none to the upside over the past year. I would submit that it is impossible for that to have occurred in a free market. I would further submit that I may have understated the case when I referred to the CME Group as a criminal enterprise, interested in advancing its own interests and those of its most important constituent members to the detriment of the public interest.

Another fact is that there have been more collective public complaints and specific allegations about silver and gold manipulation to the CFTC than in any other commodity. I believe that people are smart, particularly those that try to

make themselves knowledgeable about specific issues. The public has educated itself about the silver manipulation and its complaints are as specific as it gets. Generally, the public's belief that the silver market is manipulated has spanned the years and has remained ingrained despite what were consistent rebuttals from the Commission that nothing was amiss. Now, it has come to the point where the public asks pertinent questions and raises substantive allegations with no response from the regulators. The Commission's refusal to address the will of the public undermines the rule of law and our trust in our institutions. And this is unrelated to the enactment and implementation of Dodd-Frank; these activities in CME gold and silver were just as illegal under the old law. This isn't a question of revising commodity law; this is about the CFTC doing the right thing and terminating what the public can see is a full-blown manipulation.

One of the things that Chairman Gary Gensler mentions consistently in public remarks is the need to avoid another AIG, where the undisclosed credit default swaps of that company nearly destroyed the financial system in 2008. But lately, I have been asking myself the question of what would have the regulators done differently had they known about AIG's credit default swaps before they went bad? I'm starting to think they may have done very little. Please allow me to explain.

Back on February 14, in an article titled "Hedging Insanity," I wrote of a Mexican mining company that had entered into short hedging swaps and

options that totaled some 70 million ounces of silver, among short hedges on other metals, including gold. At that time, silver was trading around \$30 and the silver portion of the metals' hedge book was underwater by \$300 million. Subsequently, the silver hedge was increased by 25 million ounces by adding more short call options. My current calculation is that the company is currently out \$750 million on the silver portion of the hedge book (more when the gold hedges are included). At \$50 silver, the silver portion of the hedge book will be underwater by more than \$1.5 billion. At \$100 silver, the company will be underwater by \$6 billion in silver alone. I don't know how a company of this size, Minera Frisco, could sustain such losses. This is, potentially, a "mini-AIG." Yet, to my knowledge, the CFTC has done nothing about this. Would any regulator have responded differently if AIG's credit default swaps book been fully known in advance? I'm not so sure.

The reality is that silver is manipulated by a large concentrated short position and those holding that position (JPMorgan) and the exchange will do what they can to the price for their own benefit. The regulators will continue to look away and ignore the law and the public interest. In spite of this crime in progress and miscarriage of justice and because of it, silver has and will prove to be a great investment. It's just that this great investment comes with the baggage of intentional take downs, same as has been the case for a decade. Continue to hold tight and continue to rattle the regulators' cages.

September 7, 2011 - Stubborn Facts

Ted Butler

September 7, 2011

Silver - \$41.65

Gold - \$1818