

April 24, 2013 – Winners and Losers

### Winners and Losers

Sad to say, the main thing I've come to feel about this recent price smash in silver is that I (and many of you) have been through this before. It's like being forced to watch a bad movie for days on end and getting charged a good chunk of your net worth for doing so. I don't know if that makes it better or worse for holders in gold and copper and the other CME Group markets that happened to join silver this time in a giant price takedown. The one good thing is that having lived through the ordeal in silver before, there was always a happy ending in time, in the eventual new highs that followed all previous price smashes. While I see that happening again, that doesn't minimize the current pain.

Basically, anyone who bought and held silver since the fall of 2010 is under water on his or her purchase. In gold, buy and holders from early 2011 are likewise under water (except for purchases at the recent extreme lows). With silver down more than 50% from the April 2011 peak and gold down more than 25% from its later peak, all investors have become proficient at tallying up open losses. Since this recent smash in silver was accompanied by similar historic sell-offs in gold and other commodities, it demands examination.

One thing that I know for sure is that there was some specific cause for a market move some experienced observers described as occurring once in a lifetime. The move down was mostly a CME Group markets affair judging by the volume of trading and pattern of pricing on the COMEX, also with an extremely high volume ETF (GLD and SLV) component. There are many stories floating around about trading in London and elsewhere, but as usual, there is little in the way of verifiable data. There is nothing to suggest the COMEX and ETF activity wasn't at the heart of the price move, even if it wasn't exclusively the cause. So let's look there.

Since silver and gold are traded on the COMEX in the form of futures and options contracts, they are considered derivatives. ETFs, on the other hand, are structured as stock investments and are not considered derivatives (although options on GLD and SLV are derivatives). In all derivatives, there is a long side and short side to every contract. Therefore, all derivatives markets are said to be zero sum. This means that whenever prices go higher, all the longs make what the shorts lose and vice versa when prices decline. In ETFs and other stocks, there are usually only a small percentage of shares held short, meaning when the price goes up, all the owners gain (at least on paper) and only the few shorts lose. For stocks and ETFs, when prices decline all the shareholders lose except the few who are short. The important point here is that derivative contracts are zero sum in that whatever one side loses, the other side makes and this distinguishes derivatives from stocks and ETFs.

Knowing that one side gains what the other side loses in all derivative contracts, it is easy to determine the winners and losers with a high degree of mathematical certainty. We know, of course, how many contracts are open and how much prices move on any day and can calculate how much all the longs and shorts made or lost on any given day even though the trades remain mostly open. Further, thanks to the breakdowns in the Commitment of Traders Report, we have a good idea of what was made or lost by categories of traders. So the logical thing to do first is to determine who made and who lost on the recent takedown.

While I'm still leery that the last COT report was accurate that will eventually come out in future reports, so I won't dwell on it here. Since the big decline in silver and gold took place over two days, the COT report before the crash (as of April 9) will illustrate the winners and losers. In silver, on the two-day \$5 drop, the 8 largest COMEX shorts made, at least on paper, made around \$1.2 billion on their net short position of roughly 250 million oz. Within that category, JPMorgan made about \$500 million on their net COMEX short position of around 100 million oz. Other winners included the shorts (tech funds) in the managed money category, which gained about \$600 million. In COMEX gold, the 8 largest shorts gained \$3 billion on the \$200 price decline on their 15 million oz net short position.

Selected losers in the two day price smash included the raptors in silver, which lost \$750 million on their 150 million oz long position as well as anyone else who happened to be long. In COMEX gold, the biggest losers were the managed money gross longs who lost \$2.2 billion on their 11 million oz long position. All told, on the total net open interest in COMEX silver and gold (minus spreads), there was a net gain to one side (the shorts) and loss to the other side (the longs) of \$2.5 billion in silver and \$7 billion in gold over two days. Please allow me to reach some conclusions on this data.

First, if there was any intent to drive prices lower, that intent surely came from those who benefitted from the decline. After all, the longs didn't collude to lose billions of dollars. If we had a regulator or self regulatory organization ever question why gold prices fell in historic amounts, they wouldn't have to look at many suspects. That the CFTC and the CME Group are not up to even looking for potential wrongdoing is a shame on them and on the rule of law. This is not complicated and the suspects are not hard to find.

Second, the real damage extends far beyond the gains or losses that can be documented and verified on the COMEX. You've often heard me say that the futures pricing mechanism has come to dominate real world pricing in a manner never intended by commodity law; or that the futures market tail is wagging the real market dog. Let me illustrate that. In silver, the \$2.5 billion total net loss and gain on the \$5 price drop in two days on the COMEX, translated into a \$5 billion loss to holders of the world's one billion oz of bullion inventory and another \$5 billion loss on the roughly billion silver oz in coins and small bars. The COMEX silver futures \$2.5 billion tail resulted in a \$10 billion loss to real silver holders.

In gold, the comparisons are more shocking. Whereas \$7 billion was the total net gain/loss on COMEX dealings over two days, the \$200 price drop resulted in a \$1 trillion loss to the holders of all the world's 5 billion ounces of gold (to say nothing of the losses to holders of gold and silver mining shares). In other words, if COMEX was gamed for a price rig down (as I am convinced), it impacted by a factor of 150 times more (all losses and little gain) the non-COMEX real world. Of course, not very much of the world's real gold changed hands over those two days, but that just further proves the point that COMEX futures trading is influencing gold and silver prices to the extent of full price control. That's just another word for manipulation. One would think it should be the regulators making these points, but that is obviously not the case.

Finally, there is something intrinsically wrong when major markets, like gold, can move 15% in two days for no earthshaking or obvious change in fundamentals. The value of gold in the world dropped by more than a trillion dollars in two days mostly due to manipulative COMEX trading and not any big verified sale or purchase in the market for real gold. This is a level of illiquidity that should alarm everyone, most especially the regulators. For this reason alone, the regulators should be all over this selected neutron price bombing on the COMEX. Let's face it — the biggest beneficiaries of the price drop (as shown above) are the leading practitioners of the HFT computer scam. Clearly, JPMorgan and the other big shorts did not act in their (supposed) role of market maker in this decline, but rather as market destroyer for their own benefit. At a minimum, the CFTC should be investigating the obvious illiquidity in CME markets despite large phony reported volume. These markets are nowhere near as deep and liquid as the phony volume the CME creates through HFT. This is so obvious that it's hard to reach any conclusion other than the CFTC has become as crooked as the CME.

This also proves that, just like the —legitimate hedging backs up our big short— fairy tale, legitimate market making is absent in the big manipulative short positions on the COMEX. It has passed the point where the COMEX serves any real purpose other than to feather the commercial crooks' nest. As such, the world would be much better off if the COMEX ceased to exist. After all, what else does it really do except manipulate prices?

Of course, in addition to the magnified (and illegal) impact COMEX futures pricing has on the real world, there are other impacts and distortions as well. Case in point is the reaction the manipulative price drop has created in the real world of gold and silver retail buying. Some people look down their noses at retail versus wholesale buying, but it's unwise to underestimate the collective impact of the relative multitudes. I suppose there could be no other response (or proof) to the manipulative drop in price, according to the law of supply and demand, than the outbreak of physical buying that has emerged first in silver and now gold. But please don't lose sight that changes in price on the COMEX tail is causing the world physical market dog to react and not vice versa. Futures markets are supposed to discover prices, not dictate them to the world at large.

As I expressed on these pages before the big price smash, I was favorably inclined towards gold (but more so on silver) based upon the bullish COT market structure that exists. I have concerns longer term about gold due to the market capitalization issue and the tremendous amount of new cash necessary in investment demand to drive gold prices as high as many predict; but I was more bullish about gold than not. I was also wrong, as was anyone else who expected gold to rise (or at least not fall as much as it did). It is small consolation that I knew in advance why gold and silver would go down like they did, if they did fall sharply. That is, I knew it would be a COMEX affair if we ever got a blast to the downside like we just witnessed.

One of the most visible reactions in the real world to the COMEX price smash has been a marked increase in gold and silver buying on the retail level. So far, the surge in retail buying has been more pronounced in silver than in gold, but retail buying in both has jumped. This is reflected in growing premiums and unavailability of certain forms of metal, again more obvious in silver. Yet, silver has been the weakest metal recently, with the silver/gold price ratio punching up to over 62 to 1. This means silver is priced lower, relative to gold, than at any time since the fall of 2010. In a word, recent silver price performance stinks. What gives?

The pronounced relative price weakness in silver is due to the fact that it is the most manipulated commodity. I'm open to other explanations, but I can't find them. Certainly, no one would argue that retail buying has been relatively much stronger in silver than in gold, not just very recently, but for the past few years. In fact, the US Mint has said that the main reason they can't produce more Silver Eagles is because they can't get adequate supplies from those providing the silver blanks the Mint stamps into coins. In this article the Mint sheds light on its production capacity for Silver Eagles, saying they are capable of producing 4 to 5 million Silver Eagles a month, if they could just get the blanks. <http://www.coinworld.com/articles/printarticle/silver-american-eagle-planchet-suppliers-elus>

The Mint has had difficulty on a number of occasions over the past few years in keeping up with demand for Silver Eagles (ever since Izzy wrote about them). Now we know that the difficulty is due to an inadequate supply of blanks. Since the law holds that the Mint must produce Silver Eagles in sufficient quantity to meet demand, the Mint is in at least technical violation of the law (and to those who can't get Silver Eagles, more than just technical violation). Let me offer a constructive suggestion to the Mint to avoid this recurring problem in the future — at the very first opportunity, please lay in a supply of 10 million or more silver blanks as a reserve against future spikes in demand. Either that or get the CFTC to end the manipulation which would result in a higher free market price for silver. The only reason for blow-out silver (and gold) demand is because the price has been pushed artificially low by the COMEX crooks.

It's no secret that I have and do suggest a switch from gold to silver because the facts suggest that silver will greatly outperform gold in the future. As a reminder, I have not and am not suggesting now that anyone trade the silver/gold ratio on a leveraged basis by buying a silver contract and shorting a gold contract. As much as I feel that silver will outperform gold in the long term, I also know that anything can happen in the short term, including watching the ratio widen out from here. I am suggesting converting fully-owned and paid for gold positions into fully owned and paid for silver positions. I also recognize that due to the more extreme premiums being attached to many forms of silver relative to gold that the "real" silver/gold ratio is not as wide as what is quoted on the COMEX.

It is correct and proper to take note of the kick-up in physical demand in silver and gold as a result of the takedown in prices, as well as the growing knowledge that something is amiss in the pricing mechanism on the COMEX. It is also important to recognize that a market as illiquid and detached from the real world of metals that COMEX has become on the downside, must also be that illiquid and detached on the upside as well. In other words, illiquidity is either a market condition that exists or doesn't exist. Any market that falls 15% (gold) or 20% (silver) in two trading days is, in and of itself, not a market that is liquid. And any market that can fall by those percentages in two days is a market that can rise by that much and more.

Here's an update on some recent developing stories. The redemption in shares of GLD and the reduction in metal holdings in that ETF continues. Since year-end, more than 8.1 million oz, worth more than \$12 billion, has been removed from the trust. With almost 19% of the gold in GLD redeemed, the percentage reduction now equals the big decline in the SLV starting in May 2011 on the first historic price plunge in silver that year, when nearly 60 million oz came out of SLV. Just as was the case in SLV back then, I believe the gold that has come out of the GLD has been largely purchased by the bullion banks, aka Authorized Participants (AP's). It is important to remember that in both cases, the AP's came to buy the metal on price concessions by the share sellers, namely, on mark downs in price.

While this process occurs, it is bearish to the price of gold as shareholders of GLD are basically dumping shares at lower prices. But once the process is complete it automatically becomes bullish as all or most of the metal is now likely in stronger hands. The 8.1 million oz of gold that has been sold in the GLD is still owned by someone and that someone wanted the metal more than the liquidating shareholders. The bullion banks wanted it more than its former owners (even though they didn't have to pay up for it) and that's what puts it in stronger hands.

Yesterday, there was a big chunk of silver (4.2 million oz) that came out of the SLV, the first notable decline since the two-day price smash. The problem is that if it was plain vanilla shareholder liquidation (as I believe is the case in GLD); it should have come out sometime last week, even after allowing for the usual delays in SLV reporting. The price lows until now were recorded on Monday April 15 for gold and silver and it looks more like another conversion of shares to metal by my Mr. Big. Even though silver has been stinking up the joint relative to gold since year end price-wise, SLV holdings are still up close to 10 million oz or 3%, compared to the 19% reduction in gold holdings in GLD.

The decline in gold inventories in the COMEX warehouses continues, with those inventories down almost 3 million oz from the recent peak near year end of 11.5 million oz. Shipments in and out of metal inventories are hard to interpret definitively and I can't do so with the gold inventory decline. I don't see how it sets up for a COMEX delivery default, but I suppose anything is possible. One thing I do know for sure is that declines in COMEX gold inventories (or in GLD) do not mean there is less gold in the world. It may mean the gold is in stronger hands, as I suspect is the case in GLD. It also raises one key point in why I favor silver compared to gold.

One main issue favoring silver over gold, like the coming silver shortage and industrial user buying panic, is the investment money flows required in each. If you remember, I estimate that 5 million gold oz must be purchased throughout the world for investment each month to absorb new supply. In silver, the amount is 10 million oz each month. It might be instructive to review what those amounts translate into in dollar terms after the big price declines in each.

Using the current gold and silver price as I write this, or \$1425 in gold and just under \$23 in silver, the world needs to buy a little over \$7 billion worth of gold each month for investment in order to maintain the price of gold (all other things being equal). This is down from \$8 billion when gold was around \$1600/oz. In silver, the 10 million oz needed to be purchased for investment (in 1000 oz bars) by investors throughout the world now comes to \$230 million, down from \$300 million when silver was priced at \$30/oz. In other words, the joint price reductions have had a disproportionate impact on silver, making it much easier for the necessary silver investment demand to be met.

Yes, I know that the commercials have been kicking silver around much more negatively than in gold or any other commodity. My answer remains that because silver is the most manipulated market in the world that when the crooks at JPMorgan and elsewhere stop that silver manipulation I won't have to explain the manipulation as much any longer, as everyone who looks should see by the price explosion that silver was manipulated.

One last observation. Years ago, when I first started writing for Investment Rarities, my good friend and silver mentor, Izzy Friedman, made a prediction that was way out there, like many of Izzy's predictions. He predicted the day would come when IRI would beg me to stop writing bullishly on silver because they couldn't find enough metal to sell. No one has begged me to stop, but I am hearing that getting hold of silver to sell is currently very difficult for dealers everywhere. That's why silver premiums have exploded. It is impossible to predict how long this will last, but I don't see it ending very soon, given the dent that demand has made in dealer inventories as a result of the vicious smack down in price. The one solution for a free flowing silver supply is free market prices. That's some distance above us; some great distance.

On a housekeeping note, Saturday's review might be a few hours or so late (maybe even into the next day). My son is getting married (to a special woman) on Friday and I couldn't be happier. Check that Â? the marriage and \$200 silver would make me happier, but I'm sure you get the point.

Ted Butler

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Silver – \$22.95

Gold – \$1426

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