

August 7, 2019 – On The Brink?

At yesterday's (Aug 6) COMEX close of business, gold was up \$32 from Friday's close, while silver was up by 22 cents. For gold, it was another fresh six-year closing high. As a result, the biggest short sellers in COMEX gold and silver futures ended the day deeper into an unrealized loss position than any time other than the summer of 2016 and, in fact, not that far from the extreme open losses witnessed back then. As I start this article this Wednesday morning, gold and silver have surged higher still, so I'll update the numbers when I send this article out later.

Recently, I changed my methodology for calculating the open losses for the 8 largest shorts in COMEX gold and silver to exclude any open losses experienced by JPMorgan. I did this because JPM's massive physical holdings of silver and gold basically immunized it from any losses seen on its paper short positions. The remaining 7 big commercial shorts enjoyed no such immunization, since there is no evidence any hold meaningful quantities of physical metals.

The maximum amount of open losses incurred by the 8 largest COMEX gold and silver shorts (including JPMorgan) in 2016 was just under \$4 billion – close to \$3.8 billion, as gold hit \$1385 and silver close to \$21 back then. Had I not changed my methodology to exclude JPMorgan from my calculations, at yesterday's closing prices, the open losses would have been just under \$3.7 billion.

But even excluding JPMorgan, yesterday's close indicated a total open and unrealized loss to the remaining 7 big commercial shorts of nearly \$2.9 billion, up more than \$700 million since Friday, an increase of \$100 million per average trader. As of yesterday's close, the average total loss to the 7 biggest COMEX gold and silver shorts was \$400 million each. Obviously, the smallest of the 7 big traders had less of a loss, while the largest trader(s) had more of an open loss.

As prices fluctuate from yesterday's close, the open loss will rise or fall. Other things that can be said with certainty is that the open losses are overwhelmingly related to gold and not silver, as gold has climbed much more than silver, unlike the experience in 2016. Of the \$2.9 billion open loss held by the 7 big traders, nearly \$2.5 billion is attributable to their total 200,000 contract (20 million oz) net gold short position at an average price of \$1350. Their net short position in silver is 80,000 contracts (400 million oz) at an average price of \$15.20. Also, the big open loss is very recent, having occurred over the last seven weeks, as gold rose sharply from mid-June.

Also certain is that all open and unrealized losses must be immediately offset with equivalent margin deposits as the losses are incurred – no exceptions. This mark-to-market requirement is at the core of the CME Group's clearing system. Should gold and silver prices continue to increase, the open losses to the big shorts will grow, along with their required margin deposits. Should gold and silver prices fall sharply, the open and unrealized losses to the shorts will shrink and margin can be withdrawn. While no one has a lock on what future prices will be, the consequences of price movement are easier to gauge.

Should gold and silver prices move lower and the big commercial shorts are successful in inducing the managed money longs to sell below the key moving averages, the big shorts will, once again, snatch victory from the jaws of defeat and recoup all of their large open losses. This is the way it has always turned out, or nearly so. Certainly, this is the way it turned out in 2016 and on countless other

occasions.

But that's not to say that the big commercial shorts have always been completely successful, at least on an individual basis. The model case in point is Bear Stearns, which failed in early 2008. I still contend that Bear's failure came as a result of it being unable to meet the one or two billion dollars of margin calls on its COMEX gold and silver shorts on the run up in prices back then to \$1000 and \$21, respectively. The exact high point of prices came on the day Bear Stearns failed and needed to be taken over by JPMorgan.

Clearly, the odds of a big commercial short getting overwhelmed increase as prices and unrealized losses rise, such as at times like now. So, while there has never been a collective overwhelming of the commercial shorts, such an outcome is not impossible. All it would take is for the manipulative cohesion of the commercial shorts to break. Like any group, the COMEX commercial gold and silver shorts are only as strong as their weakest links. The Bear Stearns failure was unusual because it was the largest COMEX gold and silver short seller.

But if gold and silver prices continue to move higher, it's just as easy to imagine a smaller of the big 7 shorts finding it is unable to withstand growing open losses and margin calls and throwing in the towel. That would put additional unwanted pressure on the remaining shorts, creating other potential failures. Bear Stearns needed to be taken over by JPMorgan, but such a takeover seems much more unlikely today. The Justice Department seems likely to crack the whip on JPM for spoofing any day and seems very unlikely to allow a bailout of some commercial bank caught speculating on the wrong side of shorting precious metals.

I don't talk about it much because taken to its logical conclusion, a commercial failure to continue the ongoing COMEX short manipulation leads to thoughts of truly crazy prices, almost irresponsibly so. On the other hand, it may be irresponsible not to consider such an outcome. The truth is that commercial short selling on the COMEX has always capped and contained gold and silver prices. So what would happen if that price capping ability suddenly disappeared? What would happen, pricewise, if the short sellers of last resort suddenly stopped selling and, heaven forbid, actually turned buyers (to cover existing shorts)? Who would sell and at what price?

Quite simply, should the seven big shorts capitulate and look to buy back shorts instead of adding new shorts, it would be a shock to the system that would send prices, particularly for silver, absolutely bonkers. Please understand, this has nothing to do with the end of the world as we know it, the demise of the dollar, panic in the streets or any of that stuff. This is nothing more than the original thoughts I had about silver upon discovering it was manipulated by excessive and concentrated short selling on the COMEX and in the years of daily conversations I had with my dear friend and mentor Izzy Friedman. The real shock is how long the COMEX short selling manipulation has lasted.

I was always partial towards the manipulation ending when the commercials were minimally short, while Izzy always opted for the full pants down scenario or when the commercials were maximum short. But we always agreed there would be a sudden ending regardless. Given the current potential financial stress to the 7 big shorts, Izzy may prove to be prophetic. It will be a shame that if Izzy's version does come to fruition, he will not be in a position to see it.

Maybe I'm focusing on the wrong thing, but there has to be consequences commensurate to the decades of price manipulation. I just don't see how it's possible that when this manipulation

ends, how it isn't an earth-shaking event, at least to those responsible for the manipulation. And thanks to the data published continuously by the CFTC, there is no question as to who has been responsible for the ongoing manipulation, namely, the big concentrated shorts in COMEX gold and silver futures. Further, it isn't rocket science to calculate the running financial gains and losses to the biggest players - just multiply the price change by the number of contracts held. That's the basis for the running financial scoreboard.

It also seems reasonable that there must be some threshold or limit to the growing open losses and margin calls to the 7 big COMEX gold and silver shorts. We do know that these shorts are largely banks, both foreign and domestic. What's most remarkable is the thought that banks speculating on the short side and manipulating gold and silver is somehow normal and acceptable. I think that's because the scam has lasted for so many decades that we've all become used to banks manipulating gold and silver prices. But the thought that financial institutions ultimately backed by taxpayers are shorting and manipulating gold and silver is preposterous on its face. What monarch died and bequeathed to the banks the right to perpetually manipulate and control gold and silver prices? None to my knowledge. It's just one of those things we all have come to accept because it was always so. How fitting it would be if even before it is collectively recognized what a scam the banks have long pulled off in gold and silver, the whole thing blows up in their face because they finally miscalculated on the short side.

How ironic it will be that despite the lack of regulatory intercession to bust up an ongoing manipulation that should have been busted up decades ago, the whole scam unravels because the 7 big shorts overplayed their advantage and didn't know enough to quit when their collective short positions were low enough to walk away unscathed? I guess it's just too hard to quit a game that you've never lost at, until you lose big.

That's not to say that it's safe to declare the seven big shorts are dead yet. Like Count Dracula, until you drive the wooden stake through their hearts, the big shorts can never be underestimated, particularly considering what they stand to lose should they collectively fail. But it sure seems like they are on the brink of failure, based upon the price action so far today.

Up to and including today, the big damage to the 7 big shorts has come from gold, not silver. But should there be an actual collective failure by the big commercial shorts to contain the price rise, I'm still convinced silver will truly shock to the upside. Some things gold has going for it is that there is not any hint of concentration on the long side, as the concentrated long position of the 4 largest traders in COMEX gold futures is close to half of the concentrated short position.

This means that the some big trader isn't manipulating gold prices higher and there is no one on the long side the regulators can go after. Besides, even though gold is up sharply over the past two months, at \$1500 it is still close to \$400 below its peak in 2011. Moreover, gold traded above \$1500 for two full years, 2011 and 2012, and the world didn't end.

Even though there had developed a large concentrated long position in COMEX silver around \$15, that paper long position appears to be in the process of being converted into physical via the silver ETFs. And even with today's rally to \$17, silver is still more than \$30 below its peak in 2011 and is barely above its primary cost of production. No one forced the big shorts to establish a massive concentrated short position in silver at such low prices (around \$15) and the thought that these shorts need to be somehow bailed out is repulsive.

At least through yesterday's close and the cutoff for the reporting week, I don't detect any move by the big shorts to stop adding shorts or to begin buying back existing shorts. Accordingly, I would expect significant new commercial shorting in gold in Friday's new COT report given the \$40+ gain over the reporting week and the sharp increase in total open interest of 37,000 contracts. It's possible that there was some commercial short covering in today's trading, but it's way too soon to know for sure. Silver, on the other hand, didn't do anything pricewise during the reporting week and total open interest remained unchanged, so I wouldn't expect much overall positioning change in Friday's report.

In other markets, it will be surprising if copper doesn't set new managed money shorting records in Friday's report and it also will be surprising if the managed money traders haven't sold crude oil futures heavily. Both would be bullish, although it's hard to pinpoint exact price bottoms. But I am still of a mind to ignore all the bearish talk on copper and crude oil that appears when prices sell off and focus on the real reason prices went down, namely, managed money selling.

Returning to the ongoing money scoreboard in gold and silver, it's not just that the big commercials are taking a more serious hammering than in 2016, other things are different as well. These other things include JPMorgan preparing for an up move like never before (despite selling recently), a very different world today than seen in 2016 (or any other time for that matter), an ongoing Department of Justice investigation into precious metals spoofing and a potential new sheriff in town in the form of a new chairman at the CFTC. All this plus the emergence of a single big buyer or buyers in silver. Still, the most pressing matter for the big shorts is a growing outsized open and unrealized loss sustained as a result of the big up move in gold and silver prices.

As I approach the deadline for sending this article, the price of gold is up more than \$30 from yesterday's close and silver is up by more than 70 cents. So from Friday's close, the combined loss of the 7 big shorts has grown by \$1.6 billion to \$3.75 billion, the most these traders have ever been in the hole. That works out to an average loss of \$535 million per entity, with the loss over the past three days amounting to more than \$225 million per trader on average.

While no one can be sure of how this will get resolved, we can, at least, control how we handle it. For me, that means playing it like silver is still dirt cheap at \$17, although I know the big shorts are probably quite desperate to seeing it slammed down.

(As a reminder, I'm quoting December gold, which is still \$12 above spot)

Ted Butler

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Silver – \$17.20 (200 day ma – \$15.15, 50 day ma – \$15.42)

Gold – \$1518 (200 day ma – \$1305, 50 day ma – \$1389)

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