

## December 14, 2011 – No Holds Barred

### No Holds Barred

There are two important matters to discuss, each deserving a separate article, but circumstances interfere. So let me quickly discuss new developments in the MF Global disaster before dealing with the sharp sell-off in silver and gold.

Yesterday, the Senate Agricultural committee conducted an important hearing on MF Global, featuring testimony from victims, senior management of MF Global and the regulators. The highlight of the hearing and the attention of the press into today was the allegation by Terry Duffy, chairman of the CME Group, that MFG improperly transferred customer funds in the final days before bankruptcy and that the CEO of MF Global, Jon Corzine, knew of the transfers. Duffy's allegation came after long testimony by MF Global management that they knew nothing of any improper transfers and professed complete ignorance about the missing customer money of around \$1 billion.

I watched the entire proceeding and I must say that my take is somewhat different than what was represented in the press reviews afterwards. As always, I strongly suggest that if you can afford the time to do so, that you review the Senate hearing for yourself before forming your own opinion. Since the hearing lasted for 5 or 6 hours, let me give you a brief guide to save you some time. Fast forward to the 125 minute mark to where the MF Global CEO, COO and CFO begin their testimony (then there's a nearly two-hour break you can fast forward past as their testimony was continued after a break). The regulators testimony begins at the 361 minute mark and Mr. Duffy's remarks and allegations start at the 377 minute mark.

<http://www.ag.senate.gov/hearings/investigative-hearing-on-the-mf-global-bankruptcy>

Here's my take. I am still stunned that the missing segregated customer money has not been found or accounted for after more than 6 weeks. The MF Global CEO, COO and CFO appeared to me to be telling the truth when they repeatedly claimed that they never authorized any improper transfers of customer money and that they had no firm knowledge of what caused the money to be evaporated. If these guys were lying, then they were the best actors I have witnessed. As a result, I am more convinced than ever that the explanation for the missing money is as I wrote on Saturday, namely, the re-hypothecation financing in place at MF Global (and many other financial firms.) In other words, the customer money didn't suddenly go missing in the last few days of MF Global as everyone (particularly the CME) thinks; there was a systemic shortfall in funds all along that only became evident when the company paid out extraordinary amounts demanded by various creditors at the end. The customers were at the end of the creditors' line and came up short.

Even though the CME's Duffy insisted that he didn't feel the loss of customer money was due to an accounting systems error, that's just what it looks like to me. In fact, I'm hard-pressed to come up with a more plausible explanation other than the missing customer money was given to other creditors due to the financing system in place at MF Global. I can understand where Duffy is coming from because if the missing money is due to how MF Global was financed, then all eyes would turn to those who were responsible for auditing MF Global's finances. As MF Global's auditor and frontline regulator, the CME would seem to be liable. Therefore, it seemed to me that Duffy did everything possible to deflect blame away from the CME at every opportunity during the hearings, including inventing stories about Corzine's prior knowledge of customer transfers.

It's no secret that I am biased against the CME Group. To me, everything they do is conflicted. They set rules and create trading environments which favor their big customers and foster the silver manipulation. They turned their back on protecting MF Global customers; including making a cruel false promise of financial guarantees they had no intention of honoring. They fight, tooth and nail, against every attempt at genuine financial reform, including position limits. I think the allegations by Duffy against Corzine and MF Global, still unsubstantiated, are an attempt to shift the focus from the CME to someone else. Time will tell if the CME pulls it off.

I talk about MF Global, although I don't believe there is a direct silver connection. Yes, I think JPMorgan and the other collusive commercial shorts opportunistically used the troubles at MF Global to batter the price to buy low. But I don't think MF Global was brought down because of silver. The reason I write about MF Global is that I think it confirms many premises I hold about silver, including just how corrupt the CME Group has become and why they should be the last entity to be in a position of regulation.

The bottom line is that the CME is responsible for making whole the customer losses at MF Global, despite their attempt to shift blame elsewhere. That the CME has not done so is shameful. Further, the solution to the disaster at MF Global is simple – the order of payments to creditors of MF Global must be reversed and adjusted retroactively so that the 38,000 customers are paid first and then let the big financial firms who engaged in the re-hypothecation schemes at MFG fight over whatever remains. What kind of regulatory system would allow for innocent customers to be placed dead last in a creditor daisy chain? This is the central issue and it is highly disappointing that no mention of it has yet to be made. Hopefully, this will change as time goes on.

Now to the matter of the price smash in silver and gold. As I write this, we are almost \$4 lower in silver and \$150 lower in gold in two and a half trading days. As is usually the case, silver is down more percentage-wise than gold in the big decline, but not to an excessive degree so far.

Why are we down so much? It is clear to me that this is a COMEX-generated move, deliberately designed and executed for one intended purpose – to force leveraged longs to sell, so that the commercials can buy, both to cover shorts and to add to longs in both gold and silver. I don't flash buy and sell signals as it is something I choose not to do, but sometimes I offer explanations in advance. In Saturday's review, I explained how gold came to rest slightly above the 50 day moving average and how that might prompt the commercials to rig prices lower through that level (\$1710), in order to set off technical fund and trader sell orders. The commercials didn't waste much time, as we blasted through that level early Sunday evening/Monday morning (when it is easy to rig prices).

What I didn't explain was that the next logical downside trigger point in gold for selling by the technical funds and traders was the 200 day moving average (\$1610). This particular moving average had not been broken in gold for almost three years, back to when gold was under \$900. The longer a moving average remains unbroken, the more significance it holds to technical traders. This level has now been broken as well, encouraging those holding gold on technical or price movement grounds to sell. This selling begets other selling as fear of further losses resonates through the market as prices plunge. The price declines step up demands for more margin, prompting further long liquidation.

Given human nature and our collective demand for easy to understand explanations for why prices are falling there will be, for sure, all manner of supply/demand explanations given to justify the price rout. But there have been scant signals from the real world of supply and demand to account for the decline in gold and silver prices. At the core, this is strictly another COMEX-commercial rig job. That it has been highly successful for the commercial crooks is unfortunate in many ways, but encouraging in other ways (which I'll discuss in a moment). The proof that it is another COMEX rig job is fairly easy to demonstrate in past and future Commitment of Traders Reports (COT), as the commercials are always big buyers on these price smashes. We have only gone down in price so that the commercial could buy. It's not possible that the commercials can always be big buyers on such declines for any other plausible explanation. That the CFTC sits by, even though it has been armed with new anti-manipulative regulations is as shameful as it gets.

If there is an easy explanation for the price smash in gold (the deliberate rig below important moving averages), what about silver, which was already well below all its important moving averages before the selling commenced this week? The only thing I can offer is that silver is more illiquid and easier to manipulate than gold. No matter what the COT structure may be in silver, if gold suddenly falls \$150 in a few days, it should result in a sharp sympathetic price decline in silver as well. And the commercials have such a strangle-hold on the smaller silver market, that I believe that silver was brought lower at times (like Sunday evening and earlier today) for the express purpose of pushing gold lower. The commercial crooks know just how to use one market to influence another. From any objective reading of the COT structure, silver is spectacularly bullish. Lower prices only re-enforce the bullish structure.

A number of subscribers have written to me asking why the commercials can't continue to dominate and manipulate silver prices indefinitely. Since this was before this week's price smash, I would imagine that many hold that question, especially those relatively new to the silver market, say over the last year or so. I think it may be somewhat easier for long term silver investors to come to grips with the current price action (he said through blood-stained tears), but I would imagine relative newcomers as having a particularly hard time on this decline. That's unfortunate and something I wish I could alleviate or erase, but all I can do is attempt to analyze and explain based upon the facts as I know them. Prices can and do go lower and higher than any of us expect and our responsibility is to prepare for the extremes as best we can. Not holding on margin is a big first step. So is adjusting mentally that silver is a crooked market.

So can the commercials do this forever? I don't think so. However, I think you need to look further than the recent price action and look under the hood to fully answer that question. The last eight months or so reminds me of a time, some ten years ago, when many doubted that silver could ever break higher than \$5 because of the commercials' tight grip on the short side. This was despite ragingly bullish fundamentals, including a documented structural consumption deficit. Actually, it was more difficult back then in terms of time because the flat line in price lasted for years. But in spite of the commercials' manipulation, the fundamentals drove prices higher, even though the manipulation remained in place. I can't help but see it the same way now.

On a short term basis, these commercials can do just about anything they please, as is evidenced in current price action. But they have not and will not be able to contain silver prices indefinitely. Certainly, the history of the past five and ten years bears that out; but what about the next five or ten years? For the answer to that, we have to look under the hood.

First, there is the COT structure. It was great in silver before this last leg down and this recent selling has only strengthened the structure further. Let's face it — this sell-off wasn't a rig job orchestrated by silver investors and speculators on the long side; these investors and long speculators were the intended victims. Being forced to sell because of the intentionally lower prices automatically reduces the amount of potential future selling from these silver investors and speculators. It doesn't feel that way while it's occurring, but the elimination of future selling is always bullish.

It's hard to pinpoint in advance the exact price bottom or bullish extreme in the silver COT structure. It can stay bullish (or bearish) for longer than one may think. But once it is as bullish as it is in silver right now, it cannot turn bearish without higher prices. Yes, it can get more bullish if prices drop more (as they have this week), but that's different from getting bearish. The COT structure explains too much and has been a reliable indicator for too long for me to abandon it now. In addition to currently indicating that silver has much more price room to the upside than it has to the downside, the COT structure confirms the state of the silver manipulation better than any other indicator I follow. Nowhere is this truer than in measuring the role of JPMorgan and its concentrated short position.

As I indicated in Saturday's review, JPMorgan appeared to have reduced its concentrated silver short position in last week's COT, buying from the raptors who were selling out long positions. I missed commenting that this was in accord with my long standing premise that JPMorgan would buy from the raptors at the outset of the big move up in price. This will only become clear on the next silver rally, as will the related open question of whether JPMorgan adds to their concentrated short position. I would like to revise JPM's short position lower than the 15,000 contracts I mentioned over the weekend. My guess is that they may be down to 13,000 contracts or so, but that won't be verifiable until the COT report a week from this coming Friday (as today's high volume sell-off came after the Tuesday cut-off).

The status of JPMorgan's silver short position has been a key factor in the market since they acquired Bear Stearns' short position in March 2008. This short position and the silver manipulation are almost one and the same story since that time. At its peak in December 2009, JPMorgan's silver short position hit over 41,000 contracts. As I have long contended, JPMorgan wants out from being short silver. If my guess of their current short position is close to the mark that means JPM's manipulative silver short position is lower by almost 70% from the peak. Either on this price decline or on the price bump that comes after the bottom is hit, JPMorgan is in position to have reduced the short position further, perhaps effectively eliminating it. If that turns out to be the case and they don't sell aggressively short on the next silver rally, the silver manipulation could turn out to be terminated. I'm sure that the collusive commercials, as a whole, may have further dirty market tricks up their sleeves, but without the silver manipulation's kingpin in JPMorgan, it is hard for me to envision how the manipulation continues. I would expect if the manipulation's end is in sight that would be reflected in sharply higher prices. In fact, this sell-off and the commercial buying associated with it is nothing less than a confirmation of sharply higher silver prices to come. No one ever buys anything they don't think will move higher.

Away from the COT and the COMEX manipulation, other factors under the hood suggest sharply higher future prices. The price of anything goes up or down depending on buying and selling forces. Just as the COT structure suggests a lack of future potential selling (because of the current speculative selling), the structure of the silver market apart from the COMEX, points to diminished future selling of real silver and the potential for strong buying to come. While selling pressure mounts on lower prices with assets held on margin until that selling is exhausted, selling pressure for assets held on a fully-paid basis also dries up at some point on lower prices.

As I've written previously, there is not much silver bullion in existence to begin with; something around one billion ounces. In dollar terms, that's less than \$30 billion today. Because this is such a tiny amount of money compared to other asset markets, it necessarily limits the amount of potential sale. For example, if you needed to raise money, you could get a lot more from a market like gold where total world bullion is still valued close to \$5 trillion. On sharp price breaks there is some selling from those afraid of further price declines. But as prices get lower, long term holders become more reluctant to sell and even consider buying if prices get low enough. If you own something that you value and you don't have to sell, you hold tighter as prices fall. This is particularly true if there are few attractive alternative investments to switch to. At some point to the downside, the supply of this selling dries up and is overcome with buyers attracted to the low price. I sense we are close to that point currently.

It's a well-known observation that investors prefer to buy after prices stabilize and begin to move higher. In investments, higher prices stimulate buying. It's no different in silver. At some point, prices will move higher and this will attract new investment buying. What is less appreciated in silver is that the last few years have seen structural changes in the silver investment market, in that there are more choices on a world-wide basis for investors to buy silver more conveniently than ever before. ETFs and other investment vehicles that hold more than 600 million ounces today largely didn't exist six years ago. On the next good run up in silver prices the investment structure is in place to funnel money into silver like never before. And remember, the move up in silver prices from \$5 was mostly due to an increase in investment demand. While there may be fall off in industrial silver demand if the world falls apart economically, that demand has not collapsed yet, despite continuous predictions of that occurring over the past ten years. And in the event of such a collapse it would seem to be even more of a reason to buy silver as a safe haven asset that is no one else's liability.

I know this sell-off is painful and alarming to silver investors, particularly newer investors. The sad fact is that it was intended to be painful as that's what the silver manipulation is all about — fear and financial terrorism. I wish I could eliminate the pain, but that is not in my power. I have spared no effort in getting to the heart of the manipulation and I wonder at times why I haven't been sued for my accusations against JPMorgan and the CME Group. I think it relates to me not trying to intentionally harm either organization, but rather to get them to stop doing something illegal.

Amid the pain of the intentional sell-off and the unnecessary harm it inflicts on innocent investors does come some good. This market has been flushed out to a degree rarely seen before. Obviously, we are much closer to a major bottom than we are to a major top. Because of the cleanout, the risk/reward ratio is phenomenal. Due to the price being closer to \$30 and not \$4, I can't quite resurrect my dimes to the downside, dollars to the upside mantra of yesteryear, but adjusted for price it feels the same to me. I don't mean to sound callous, as I have great concern and empathy for those feeling scared, but this experience might help you navigate the greater price volatility to come to the upside in the future. If you can get through this with your nerves and position intact, you should be well-positioned for the future.

Ted Butler

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Silver – \$28.80

Gold – \$1568

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