

## December 9, 2020 – The Flip Side to Shorting

Short â??em When Theyâ??re Up,

Short â??em When Theyâ??re Down

Yeah, Iâ??ve had those slightly revised lyrics from the Don Henley song, â??Dirty Laundryâ?• in my head these past few days, after uncovering that the 8 big shorts on the COMEX had taken to adding impressive quantities of new gold short positions on declining prices for the first time in history. Previously, of course, the big commercial shorts had only added new short positions on rising prices and had bought back those added short positions on lower prices. I also must add that the big commercials always (for decades) succeeded in making a profit on these shorting operations, or at the very worst, broke even.

That is, the big shorts always made a profit until the summer of 2019, when their apparent â??money machineâ?• stopped working. After loading up on the short side on rising gold (and silver) prices in June 2019, prices continued to rise, denying the big commercial shorts the opportunity to buy back those added shorts at a profit. Instead, the continued price rise in gold (and later in silver) created the largest losses for the big shorts in history, which now amount to more than \$11 billion.

As recently as at the mid-March price lows, the big commercial shorts were about even on their combined short positions in gold and silver. Since then, however, rising gold and silver prices have resulted in big losses, even though gold and silver prices peaked in early August and have retreated since then. What accounted for the turn in fortunes for the 8 big shorts? A number of things, not the least of which was a masterful double cross of the ages by JPMorgan, which after accumulating massive quantities of physical metals (25 million oz in gold and one billion oz in silver) over the past decade, managed to slither out completely from all of its COMEX short positions (after being the largest short since taking over Bear Stearns in 2008).

Not to minimize the power and cunning of JPMorgan, what stands out even more in the turn of fortunes for the 8 big COMEX shorts in gold was a remarkable transformation in the makeup of the counterparties to the 8 big commercial shorts. Whereas formerly the contest was always primarily between the 8 big commercial shorts and the traders in the managed money category, a new category of traders entered into the fray and appears to have completely upset the applecart of how things had been done. Of course, Iâ??m referring to the traders in the other large reporting category, a category that while not new, has nonetheless appears to have transformed the price setting equation in gold.

Prior to the past 8 months or so (say since April), while the net long position of the other large reporting traders had always been smaller than that of the managed money traders (except when the managed money traders got big net short), since then the net long position of the other large reporting traders has continued to climb to record levels, well above that of the managed money traders even as gold prices have pulled back. The â??man bites dogâ?• circumstance of the 8 big commercial traders adding to short positions on declining prices is only half the story â?? the other half of the story is the unprecedented amount of new buying by the other large reporting traders on lower gold prices, particularly since early August.

Just like it takes two to tango, every financial transaction requires both a buyer and a seller. While

often said, there can be no such thing as there more buyers than sellers or vice versa – every share or contract transacted must have a buyer and seller. What determines whether prices rise or fall is the relative aggression of the buyers and sellers. If the buyers are more aggressive, prices rise and if the sellers are more aggressive, prices fall. What's so fascinating about the increase in big 8 short selling as gold prices declined from over \$2060 in early August, down by \$300 into the last COT report, is that clearly the 8 big shorts were the aggressors on the sell side and caused prices to decline.

But even more fascinating is that the (sole) buyers on that gold price decline were the other large reporting traders on almost a contract for contract basis opposite to the big 8. Therefore, the most plausible conclusion for what took place was that the other large reporting traders patiently and methodically bought and accumulated what the 8 big shorts were selling. Talk about unprecedented!

Until now, it was always the 8 big commercials lying in wait for the managed money traders to exhaust themselves on the buy or sell side, with the big 8 traders methodically taking the other side of those transactions. But, it appears to me, the tables have now been completely turned and the other large reporting traders are doing to the 8 big commercials what those 8 big traders always did to the managed money traders – a double man bites dog turnabout. Unless I'm reading it all wrong, it looks to me that the other large reporting traders have finessed the 8 big shorts in a manner formerly reserved by the 8 big commercials. How fitting.

As to who the heck these guys (the other large reporting traders) are, aside from likely being related to the guys at whose hands Butch Cassidy and the Sundance Kid met their Waterloo, all we can know for sure is that they are in the category of speculative traders which trade for their own account and not others (otherwise they would be in the managed money category). And to be frank, I don't care who they are. I'm more concerned that they know what they are doing (I think they do) and have played the big 8. More than anything I wonder what the heck took someone so long in turning the tables on the manipulative commercials. I'm sure I'm not alone in having expected someone to show up long before now and to show up first in silver – but I'm not complaining, just a bit curious as to why gold first and not silver.

Then again, maybe the answer is something as simple as the 8 big shorts sold as many silver contracts short as they could or cared to sell short, knowing how dangerous the short side of silver is likely to be. The other large reporting traders in silver did buy around 10,000 net contracts on the price decline from the August price peaks, less than the 50,000 net contracts they bought in gold, but perhaps more proportionate than the raw numbers might suggest. On an equivalent ounce basis, 50 million oz of silver compared to 5 million gold oz is not particularly out of line. Plus, the smaller non-reporting traders in silver also sold close to 10,000 net contracts from the price peak in August, more than their counterparts in gold, perhaps explaining why there wasn't more big 8 shorting in silver.

The bigger question to me is why it took so long for some large traders to catch on and react to the artificially suppressed gold and silver prices. It is something that I expected would happen for more than 30 years. But, besides the ageless wisdom of it being better late than never, I also can't dismiss the thought that the waiting has made the situation more critical. Not only have the 8 big shorts chosen to increase their exposure to the short side in a manner that seems particularly risky (selling short to traders willing to buy on lower prices for the first time), they are doing so at a time when they are also deeply underwater – a risky gambit to say the least.

The fact that the other large reporting traders have taken the unprecedented step of buying as prices

declined suggests they are not much interested in a quick trade and don't plan to sell on a short term price pop, but rather intend to hold for more meaningful price gains. Of course, I'm speculating here, but it just doesn't seem like the other large reporting traders are behaving in a manner suggestive of a quick in and out trade. After all, the largest part of their buying has occurred on lower prices over the past four months, which hardly qualifies as a day trade. It's possible or perhaps even likely that these big buyers have come to grasp the manipulation and price suppression I've alleged for decades, either from what I've written or elsewhere and recognize the vulnerability of the big shorts.

The flip side to the extreme concentrated short selling in COMEX gold and, particularly in silver, is the vulnerability of the big shorts. While I have discussed this often in the past, it bears repeating that a short sale is an open transaction that needs to be closed out at some future time. As such, a short sale is much different from the sale of something that is already owned. When you sell something you already own that is a closing or ending transaction – no further action is required. But when you sell something you don't own or enter into a new derivatives contract on the sell side that constitutes an open transaction that someday needs to be closed out or finalized. There's no strict time limit for closing out a short sale (short derivatives positions can be rolled over indefinitely), but until it is closed out, the short sale remains an open transaction.

The only two ways a short position can be closed out is by delivering the item (share of stock or physical commodity) originally sold short or by buying back the short position. Until either of those two possible closing transactions occur, the short sale remains open and subject to mark to market margin considerations. If the price of the shorted item falls after one goes short, paper profits can be extracted and if the item sold short goes up in price, new money must be deposited proportionately – the process known as meeting a margin call.

Because the short positions in COMEX gold and silver are so concentrated – meaning they are held by just a handful of traders – this makes the short sellers more vulnerable to a large price move higher – a process known as a short squeeze. While instances of short squeezes are regular occurrences throughout financial history (and I'll cite a short squeeze currently underway in the stock market in a moment), the instances of short squeezes in COMEX gold and silver are quite rare and have always been nipped in the bud.

This past summer, there was a brief one-week or so occasion when the commercial shorts did start to rush to buy back decent quantities of their short positions in gold and silver and prices responded by surging to the highs, but the big shorts ceased their short covering and reverted to adding new shorts, quickly resulting in prices stagnating and moving lower. This is now a black or white situation – either the big shorts will be able to induce the large amount of outside selling on lower prices they need to buy back a significant number of their short contracts or they won't, in which case they are looking down the gun barrel of much higher prices on which they stand to lose many billions of dollars more. Doing neither does nothing more than delay the inevitable.

Since there has never been a genuine concentrated commercial short covering in COMEX gold and silver, no one can point to history for any guide for how high prices could climb in such a circumstance. The best we can do is to look for comparable instances of short covering in other assets. Fortunately, such an example has occurred in real time. That example is in the stock of Tesla, the electric car and Battery Company. The price of Tesla stock hit a (split adjusted) low of less than \$30 in the spring of

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2019 coinciding with its largest short position ever and has now climbed more than 20-fold to more than \$600 as the short position has been bought back and sharply reduced.

<https://www.cnn.com/2020/12/04/investing/tesla-short-sellers-elon-musk/index.html>

Yes, the price of Tesla stock has looked "high" for quite some time, but has continued to move higher (said as a disinterested observer who never had any position of any kind in the stock). I would note the impressive list of well-known market players which have taken short positions on the stock and who have come to rue the day they did short (at this point). From what I can determine, the single biggest force behind Tesla stock's phenomenal rise was short covering. The losses to short sellers of the stock are said to be upwards of \$30 billion – greater than the total losses to the 8 big shorts in gold and silver, but in the same tens of billions loss neighborhood.

Some differences between the losses to the short sellers of Tesla stock and the 8 big shorts in COMEX gold and silver are that I am aware of no reference to the Tesla short position as being anywhere near as concentrated as the short position on the COMEX. The shorts in Tesla seem to be well-dispersed among many speculators, as opposed to the short position in COMEX gold and silver being held in a remarkably small number of hands (always the hallmark of manipulation). Along those same lines, there's the matter of the motivation of the short sellers in Tesla compared to the 8 big shorts in COMEX gold and silver.

Not for a minute do I believe that the primary motivation of the well-known short sellers in Tesla stock, like Jim Chanos, David Einhorn or Dr. Michael Burry (of "The Big Short" fame) was to deliberately manipulate the stock lower. I'm sure they all felt the stock was wildly overpriced and they sought to make a profit by selling the stock short and seeing the price adjust downward to what they felt was a more appropriate stock valuation. Clearly, they guessed wrong (to this point), but there's no law against being wrong (otherwise all of us might be in jail).

It's different with the 8 big shorts in COMEX gold and silver, as I have yet to hear an intelligent-sounding case for sharply lower gold and silver prices. Instead, every day I seem to hear another new compelling case for higher gold and especially silver prices. The only compelling case for lower gold and silver prices has been reduced to whether the 8 big shorts can succeed in rigging prices lower (like today).

There's a big difference between guessing wrong and shorting a stock that defies one's expectations and a few traders colluding to massively short gold and silver futures with the only intent being to prevent prices from rising. In the case of the shorts who guessed wrong on Tesla, there was no crime in guessing wrong; in the case of the 8 big shorts in COMEX gold and silver, there is no guessing that prices might move lower, only collusive intent to create lower prices.

Even though there has never been collective short covering by the big concentrated shorts in COMEX gold and silver and these big shorts have, obviously, remained in control today, all the signs point to them losing control and most likely in the near future. It was many years that Tesla stock remained in a tight and largely unchanged price channel, before erupting more than 20-fold in the relative blink of an eye. I have trouble imagining the price of gold erupting by such an amount, simply because there is more than \$11 trillion worth of it in existence, but a 20-fold increase in the price of silver seems a lot less far-fetched, considering there is only \$50 billion worth of it in industry standard form.

Moreover, a coming clash and struggle over available physical supplies is certain to erupt at some point between investors and industrial silver consumers for the very first time, not something possible of occurring in gold (since there so few industrial gold consumers). To this point, I ran across an article on solar power that set me back a bit. While I've been aware for some time that the amount of silver used in a typical solar photovoltaic panel has been decreasing, that will matter little if the number of such panels increases sharply in the future. That seems quite likely if this article is correct and the cost of installing solar panels has dropped by nearly 90% over the past ten years to the point of solar now being cheaper to produce electricity than from fossil fuels, including natural gas and coal.

<https://ourworldindata.org/cheap-renewables-growth>

As far as what to expect in Friday's Commitments of Traders (COT) report, since gold and silver prices were stronger over the reporting week ended yesterday, gold by as much as \$60 and silver by as much as dollar, it is most plausible to expect deterioration in their respective market structures (managed money buying and commercial selling).

Of course, with today's sharp selloff, the new COT report is already yesterday's news as much of the deterioration that occurred thru yesterday is most likely already reversed. I don't know of any way to predict what the 8 big concentrated shorts and other large reporting traders may have done in Friday's report (or today), as neither category is as predictable as the managed money traders, who typically buy on higher prices and sell on lower prices. However, it goes without saying that the 8 big shorts versus the other large reporting traders is the key matchup and most likely future determinant of price.

As far as the performance of the 8 big shorts since Friday's close, today's deliberate price smash erased what had been growing losses to the big shorts on Monday and yesterday and at publication time left the 8 big shorts better off by around \$330 million, reducing their total losses to more than \$11.2 billion.

In Saturday's weekly review I mentioned the existence of a concentrated short position that was growing irrespective of price direction was a danger to the market in that it created unnecessary market instability, meaning the likelihood of sudden price selloffs for no apparent or legitimate reason - simply the attempt by the 8 big shorts to stave off the inevitable price explosion to come. As debilitating and draining as this repetitive manipulative behavior seems, particularly since it is in full view of the regulators, it's important to look ahead.

A year and a half ago, even the most bullish Tesla investor most likely did not envisioned a 20-fold increase in share price. From everything I look at, the short position in silver is much larger and the fundamentals are much better than what existed in Tesla. All that's missing is the start of a capitulation by the 8 big shorts; a capitulation that seems more assured to come than ever.

Ted Butler

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Silver – \$23.90 (200 day ma – \$20.83, 50 day ma – \$24.24)

Gold – \$1835 (200 day ma – \$1810, 50 day ma – \$1883)

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