

Feb. 16, 2010 – More Than 100%?

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A number of readers have questioned me about a calculation I made in yesterday's article, "A Crime Still in Progress." The calculation had to do with the four largest COMEX silver shorts holding a short position greater than the total net commercial short position. The questions had to do with how this could be? If more than one reader asks me the same question, chances are there are others with the same question who didn't ask. Since I believe this calculation is important, I'm going to address it here. (It was also suggested to me by a reader, before yesterday's article, that I offer a primer on the Commitment of Traders Report (COT) since I refer to it so often. I do touch on this here, although my prime purpose today is explaining how just four traders can hold more than all the other commercials.)

I admit this is a difficult calculation to grasp, because it is counterintuitive. How could a few hold more than the many? However, if I don't explain something adequately, then I don't feel I have done what I have set out to do. I analyze silver closely, perhaps too closely, but all the analyses in the world are useless unless they can be explained in understandable terms. You have an open invitation to question me on anything I write; it is part of what you are paying for. It is hard to learn if you don't or can't ask questions.

Let me try to explain mechanically the basis for the calculation. But please keep in mind that this isn't just about some arcane calculation; the real issue is what this calculation means to you, as an investor, and what it means to the silver market. First, I draw your attention to the source data for the calculation, the long form futures only COT for positions as of the close of business Feb 9. <http://www.cftc.gov/dea/futures/deacmxlf.htm>

I would suggest that if you've never actually done it before, that you take out a simple calculator and work through the numbers with me. Nothing beats learning something than by actually doing it, rather than just reading about it. Also, this way you'll keep me honest and not let me pull a fast one on you. One thing I would like to point out in general is how lucky we all are that the CFTC publishes this data on a timely basis and for free. It's all there for the taking and understanding. Not only that, the COTs have been greatly expanded and improved under the tenure of Chairman Gensler. These reports are invaluable and available to all. Yes, I realize I may be pushing myself out of a job if everyone grasps their significance.

The broad categories are reportable (large) and non-reportable (small). Large reportable traders are those which hold 150 or more contracts. The reportable traders are further broken down into non-commercials and commercials. For example, a large technical trading fund would be in the non-commercial category, JPMorgan would be in the commercial category.

The top line for the numbers is the gross long and short positions in each category (even though it doesn't say gross). In this report, the gross long position of the commercials is 34,830 contracts, with their gross short position at 72,630. Doing your first calculation, by subtracting the commercial gross long amount from their gross short total, you record their net short position of 37,800 contracts. Write that number down. If there's only one headline number in every COT for every commodity, it is the commercial net short (or net long) position. Lastly, scroll down a few lines and note that there are 36 separate traders holding short positions in the commercial category.

The next calculation you must do is to determine the net short position of the four largest traders. Right under the number of traders is the percent of open interest held by either the 4 or 8 traders on a gross and net basis. Forget gross completely and just find the net short percentage held by the 4 largest traders. That number will be 42.8. Using your calculator, multiply the total open interest of 118,593 (the very first number on the upper left top) by 42.8%. You will calculate that 50,758 contracts are held net short by the four largest traders. Now let's review what we have calculated.

First, we know that in this week's COT report, there is a total net short commercial position of 37,800 contracts (our first calculation). Next, we know that 4 traders (all commercials by process of elimination) hold a net short position of 50,758 contracts. Please suspend your intuitive doubts for a moment and focus on the math. These are hard numbers. The four largest commercial traders hold a net short position that is larger than the total commercial net short position; by more than 100%.

If you have trouble comprehending how this can be, it is not because of the math, which I'm sure you will admit is pretty straightforward. The fact is that you should have trouble comprehending how this can be for reasons not related to the math. What you should be trying to process in your brain is how can four traders hold a bigger net short position than the other 32 traders holding commercial short positions?

The answer is because these four large commercial traders hold such an obscenely dominant and concentrated position that it makes you disbelieve even simple mathematical calculations you do yourself. They hold such a large and disproportionate share of the market that it is almost beyond comprehension. You do the math and you still can't believe it. Let me reassure you that the fault is not your own. This is a situation, typical in silver, but very rare in other major markets. (It does occur in the orange juice market, but that is a minor investment market and I just mention it so the CFTC doesn't come back nit-picking).

Further, as large and manipulative as is the four largest commercials' concentrated short position that position in turn is dominated by one large entity, JPMorgan. As I indicated yesterday, I calculate that JPMorgan alone may be holding 32,000 silver contracts net short, or 85% of the 37,800 contract total commercial net short position. That's even crazier and more concentrated than the 50,758 contracts held by the big four.

The important issue is what does this all mean to the silver investor? I take the time to detail this issue because it is the most important issue of all. Silver is a manipulated market. The manipulation is to the downside, by virtue of the documented concentrated short position. This manipulation cannot last and will be terminated by regulatory action or by a physical shortage. I sense the end is close at hand. The manipulation argument is too clear to be ignored for much longer and the signs of physical tightness appear to be on us. When this manipulation ends the price of silver will soar. Take your time and do the calculations, but don't delay in securing a full silver position.

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