February 12, 2014 – The Real Bear Stearns Story

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Let me start off by correcting an error I made in the weekly review. The good news is that I realized my error independently. The better news is that it doesn't change in any way the point I was making, namely, that JPMorgan has rigged the gold and silver markets by a controlling market share that previously was always prosecuted by the CFTC for being manipulative.

Relying mostly on memory, I wrote that JPMorgan had a short market corner in COMEX gold futures of 70,000 contacts or 20% of the entire net market on Feb 5, 2013. As it turns out, I was off by two months and 5000 contracts. In rechecking the numbers, JPMorgan was short 75,000 COMEX gold contracts in the December 4, 2012 (gold was $1700 on that date). This was still 20% of the net COMEX open interest (minus spreads). All the other numbers were correct, including the bank's 35% short market corner in COMEX silver of a year ago and on numerous other occasions over the past six years.

The important point is that it has been JPMorgan's outsized market corners in COMEX gold and silver over the past six years that is at the center of my allegations of manipulation. Throw in a 60% market share in OTC gold and other precious metals derivatives, along with evidence that suggest JPMorgan has amassed significant quantities of physical gold and silver and it's hard to not to see an ongoing manipulation. The data confirming JPMorgan's incredibly large market shares are so clear, moreover, that they can't be denied. Given that government data (CFTC and OCC) confirm JPM's market shares, the only way to undermine my allegations is to attempt to explain the market corners away.

The only way to partially explain away why JPM has been allowed to hold such controlling market shares is to claim that JPM is either hedging for clients or making markets. But in flipping from a 20% short gold market corner in Dec 2012 to a 20% long market corner 8 months later, the hedging argument goes out the window as it is impossible to reconcile what clients would be shorting so much in December and being long so much 8 months later. Remember, JPMorgan tried the same hedging excuse when the London Whale debacle was first reported, but dropped it immediately when it became obvious that it was nonsense. That leaves market making.

I've discussed this market making excuse on several occasions, most recently in September (see archives Â? Sep 14, 2013 Â? Weekly Review/Evil Market Making). The short version is that market making is permitted and encouraged to enhance liquidity and tamp down price volatility, but not to rig prices. A quick review of last year and prior years is that silver prices drop with a violence not seen in any other market; so much so that I took to calling it evil market making. Perhaps a better term would be bizzarro market making because in silver it had the opposite effect of what legitimate market making intends to achieve. If JPMorgan is practicing market making in silver they couldn't be doing a poorer job; that is, unless their main intent was to cheat traders for the bank's benefit by increasing price volatility.

I understand some wanting to make excuses for JPMorgan's undeniably large market shares in gold and silver. There is an instructive message here as well Â? since JPM's market corners can't be denied, all that's left is trying to explain it away any way possible. The excuses confirm that the market shares held by JPM exist and need explaining. Oh, and one last flimsy excuse is needed to explain, if these outsized market corners are so normal, why is there only one bank atop the gold and silver market heap? If this market making is such a legitimate business Â? why aren't other banks offering competition? I have a better question – why is JPMorgan so entrenched in gold and silver trading, when they are withdrawing from every other commodities business? (I say because they can't exit quietly as they are the market).

Six years ago, the well-known investment bank, Bear Stearns, financially imploded in a literal flash. In February 2008, Bear Stearns stock traded as high as $93; by mid-March, the company, basically insolvent, agreed to be taken over by JPMorgan for $2 a share (later raised to $10 after class-action lawsuits). In the annals of Wall Street, there was rarely a more sudden demise than the fall of Bear Stearns. The cause was said to be a run on the bank as nervous investors pulled credit lines and assets from the firm. Bear Stearns was said to be levered by 35 times, meaning it had equity of $11 billion and total assets of $395 billion. That means that there is a very small cushion if something negative suddenly appears.

Obviously, something negative and sudden did hit Bear Stearns in the first quarter of 2008; although there are remarkably few actual details of what went wrong. Since Bear had a significant presence in sub-prime mortgages and that market was in distress, it is assumed the fall of the firm was mortgage related. That may be true, but there was no general stress in the stock market through mid-March 2008 reflecting a credit crisis. As I said, Bear Stearns stock was as high as $93 in February. One would think there had to be some specific trigger behind the company's sudden collapse. http://en.wikipedia.org/wiki/Bear_Stearns

I would like to make the case (as I have in the past) that sudden and massive losses and margin calls of more than $2.5 billion on tens of thousands of short COMEX gold and silver contracts was the specific trigger that killed Bear Stearns. Let's face it Â? Bear was so leveraged that a sudden demand of more than $2.5 billion in immediate payment for any reason could have put them under. The facts support that Bear Stearns' gold and silver shorts on the COMEX are the most plausible reason for the sudden demise. Let me demonstrate the facts first and then explain what this all means today.

Certain facts are clear Â? Bear Stearns did fail and was acquired by JPMorgan for a fraction of what it was worth months earlier due to a sudden cash crunch. I didn't know it then, but Bear Stearns was the largest short in COMEX gold and silver at the time of its demise. When I first introduced the idea that JPMorgan was the big short as a result of CFTC data and correspondence explaining the JPM takeover, it was somewhat novel; today, no one would dispute that Bear Stearns was the big gold and silver short before JPMorgan.

The facts also show that gold prices rose from under $800 in mid-December 2007 to $1000 to mid-March 2008, a gain of more than $200. Silver prices rose from under $14 in mid-December to $21 when Bear Stearns failed on March 17, 2008, a gain of $7. This was the highest price for silver and close to the highest price of gold since 1980. Obviously, a $200 rise in the price of gold and a $7 rise in the price of silver is not good if you are short, particularly if you are the biggest gold and silver short in the market, as Bear Stearns was.

Since we know that Bear Stearns was the largest short in COMEX silver and we also know how much gold and silver prices rose in that time period, all that has to be established is to determine how many short contracts Bear Stearns held in order to know how much money they were out and had to come up with in margin money. It is also a fact that all market participants on the COMEX, including the leading clearing member (which Bear Stearns was), must deposit additional funds daily to cover adverse price movements.

Thanks to historical Commitments of Traders report (COT) data from the CFTC, in the relevant time period (December 31, 2007 to March 17, 2008) the net short position of the 4 largest gold and silver shorts on the COMEX averaged 165,000 contracts and 60,000 contracts respectively. Bear Stearns held some significant percentage of those totals. My analysis indicates Bear held 75,000 net gold contracts short and 35,000 net silver contracts short during the relevant time period. Further, those are minimum numbers, as I think Bear's position could have been higher. I don't believe it is a coincidence that the percent share of the market held by Bear Stearns is remarkably similar to the market shares (corners) held by JPM subsequently and currently in COMEX gold on the long side.

A $200 adverse price move on 75,000 COMEX gold contracts would result in a mark to market loss and margin call of $1.5 billion. A $7 adverse price move on 35,000 COMEX silver contracts would result in a mark to market loss and margin call of $1.2 billion. Bear Stearns had to come up with $2.7 billion because gold and silver prices rose sharply in the first quarter of 2008 and the company bet the wrong way. That it couldn't come up with all the margin money for the losses in gold and silver, is the most visible reason it went under.

At this point, I would invite anyone to review my fact set and analysis. The only thing that is not absolute fact above is my calculation for what Bear Stearns held, which I'm prepared to substantiate. Certainly, I have seen no other fact-base financial explanation for what caused Bear Stearns to suddenly go under in mid-March 2008. It's clear to me that being so heavily short gold and silver put Bear Stearns under. Now let's get to the important part.

What happened to Bear Stearns, not coincidently, was exactly what I had warned the CFTC about continuously for the twenty years before the event. I'm not patting myself on the back (too much) but, instead, I'm sticking to the facts. Aside from the manipulative impact that a concentrated market corner would have on price, the biggest risk was what would happen if the largest short ran into trouble. The facts in the case of Bear Stearns indicate that the worst did occur, as the biggest short did go under.

As it turned out, during the relevant time period, I was in private email contact with Commissioner Bart Chilton. The contact arose out of my publicly writing to him (The Cop on the Beat series) in late 2007, shortly after he came to the Commission. None of our conversation had anything to do with Bear Stearns (I wasn't aware that Bear was the big short) and the only thing Commissioner Chilton indicated was that the Commission was considering silver matters closely and that there would be a finding published soon, although he couldn't tell me what the determination might be or when it would come out. The subsequent CFTC finding was released on May 13, 2008 and completely denied anything was wrong on the short side in COMEX silver due to large traders.
http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/silverfuturesmarketreport0508.

Here's the problem Â? the report lied in that it conveniently ignored the failure of the largest COMEX gold and silver short seller, by only considering events through Dec 31, 2007 and not through the March 17, 2008 date of Bear Stearns' failure, a clear lie of omission.
http://news.silverseek.com/SilverSeek/1261415180.php How could the CFTC issue a report on large traders on the short side of silver and overlook that the largest short trader of all went under because of that short position?

It has taken me some time to see all this in the proper perspective, but that's better than not seeing at all. What I now see is deeply disturbing, but it answers questions and fills in blanks better than ever. Even though I petitioned the CFTC about the concentrated short position in COMEX silver for decades, they discarded those warnings like a used tissue. Then, when Bear Stearns went under for precisely the reasons I warned, the CFTC was not about to fess up to having dropped the regulatory ball in spectacular fashion, but instead kept everything quiet and denied any and all allegations, even though the facts were overwhelming.

This also explains why the Commission would never find anything wrong with JPMorgan's taking the baton fro Bear Stearns and continuing the manipulation scam. For the Commission to have later found that JPMorgan was the big crook in gold and silver, it would have led directly to the agency dropping the ball for decades previously. When the lie is big enough, there is the tendency to take it to the grave. I had hoped that Gary Gensler would change things when he became chairman in May 2009, well after the Bear Stearns' debacle, but this was an institutional lie obviously too big for him to tackle.

Since Bear Stearns was a failure that threatened the financial system, it necessarily invited the involvement of the nation's highest regulators, the Treasury Secretary and the chairman of the Federal Reserve, as the historical record clearly indicates. As such, both had to be aware of the gold and silver margin problem at Bear Stearns, although neither has ever openly indicated that. Additionally, since Bear Stearns was the leading clearing member of the exchange, you can be certain that the CME Group was at the very forefront of awareness in Bear's gold and silver matters Â? the CME was the one issuing the margin calls to Bear. Also, there is no way that JPMorgan wasn't aware of Bear Stearns' gold and silver predicament.

Therefore, these facts fully indicate that everyone at the top had to be aware that gold and silver shorting was at the center of the Bear Stearns' fiasco. Since the Feds requested JPMorgan's assistance, there can be no question that JPMorgan demanded (and received) permanent immunity from future gold and silver allegations. I never said JPMorgan was dumb.

Let me stop here for a moment to state the unspoken obvious. Had not the US Treasury Secretary, the Fed chairman, the CFTC, the CME and the head of JPMorgan agreed to bail out Bear Stearns and extend the gold and silver manipulation by preventing a free market resolution for covering Bear Stearns' short positions, the price of gold and silver would have soared to the heavens. Quite frankly, if the Feds hadn't bailed out, effectively, all the shorts by having JPMorgan backstop Bear Stearns I can't see how the price of gold wouldn't have exceeded $2000 and silver $100 or more on short covering (of which there was none into the price highs).

Instead, the Fed's gave the shaft to all the longs and investors in gold and silver by perpetuating the fraud of manipulation and the continuing danger to our markets and financial system. Had the Feds resolved the matter in free market terms by allowing the market to resolve the manipulation or by closing the COMEX we would not be sitting at $1300 gold and $20 silver. How long we sit here is anyone's guess, but the real takeaway to me is that this matter isn't fully resolved yet.
In hindsight, we came close to ending the manipulation as Bear Stearns failed, but concerted government action extended the fraud. We came close again in April 2011 when the physical silver shortage nearly undone JPMorgan as it had Bear Stearns. Therefore, the real resolution lies ahead. I think the appropriate expression is three times a charm.

What baffles me today is that no well-known journalist from outside the gold and silver world has yet picked up on what is an easy to document story of epic historical proportions in why Bear Stearns really went under and how the gold and silver price manipulation by JPMorgan continued since the day JPM took over Bear. I think the story has Pulitzer Prize written all over it.

On an unrelated matter, Ed Steer prompted me to comment on the latest short sale statistics for the big silver and gold ETFs, SLV and GLD. There was a sizable reduction in the short position in both securities. As of the cut-off date of January 31, the short position in SLV declined by a hefty 3 million shares (oz) to just under 16.5 million shares. The short position in GLD declined by an even heftier 5.1 million shares (500,000 oz), to just over 12.5 million shares.
http://shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

I remembered talking with Ed about it at the time, but never got around to writing about how the large metal deposit of 4.2 million oz into SLV and 240,000 oz deposit into GLD after Jan 15 may have been made to reduce the short positions in each ETF. When I wrote of the big deposits (weekly review of Jan 18) I only mentioned the possibility that the deposits were due to index fund rebalancing after the turn of the year. But seeing how the size of the deposits closely equates with the reduction in the short positions, I'm inclined to favor the short reduction explanation.

The reason I bring this up is that it indicates a short seller can extinguish a short position in SLV and GLD by depositing metal though an authorized participant. This is exactly the flip side of my argument that a short seller doesn't deposit metal when a short sale is made. As you know, I believe short sales shouldn't be allowed in hard metal ETFs, like SLV and GLD, as the short sales circumvent the promise of the prospectus that each share is backed by a specific amount of metal. Therefore, the sharp reductions are good news as more shares are fully-backed by metal.

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Silver – $20.30

Gold -$1293

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