

## February 29, 2012 – Betting the Bank?

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It occurs to me that some still have not learned an important lesson from the financial crisis of the past few years. That lesson, as exemplified by the disaster caused by AIG in credit default swaps, is that it is dangerous to allow any one company to make such a large bet that would potentially cause it to implode and bring unnecessary financial harm to innocent participants and bystanders. Yet, that appears to be precisely the case with the recent demise of MF Global, whose oversized bet on European government debt triggered collateral calls that led to tens of thousands of innocent customers being shortchanged on their funds.

The main similarity between AIG and MF Global include their respective concentrated positions being largely unknown until it was too late. That's one of the things that Dodd-Frank promises to address, namely, more transparency and restrictions against unnecessarily large and uneconomic positions. That's all good for the future. Unfortunately, it is in the present that suggests we may have a problem. Specifically, the concentrated short position in COMEX silver held by JPMorgan may poise a systemic problem for all of us.

As I have been reporting since I discovered it from CFTC data and correspondence, JPMorgan inherited the giant silver short position when it took over Bear Stearns four years ago. Since then, JPMorgan has increased and decreased its dominant concentrated silver short position to control prices of world silver to its advantage. This is manipulation, pure and simple. JPMorgan's concentrated short position has ranged from over 40,000 contracts (200 million ounces) to 13,000 contracts in late December. Since then, it appears that JPMorgan has increased its manipulative silver short position by more than 9,000 contracts or by 70%, to more than 22,000 contracts (110 million oz). In doing so, JPMorgan may have greatly increased the systemic risk to the financial system. Please consider the significance of a 22,000 net contract short position in the market in which it is held, the COMEX silver futures market.

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22,000 contracts is such a large and concentrated position in COMEX silver futures that, by definition, it is manipulative to the price of silver. If this concentrated short position did not exist, the price of silver would be higher. Simply put, if the position needed to be voluntarily transferred to other sellers, it would take much higher prices to entice enough traders to replace JPMorgan. The 22,000 contract net short position is equal to 26% of the entire net open interest (minus spreads) in COMEX silver futures. In this day and age, it is hard to imagine a liquid commodity market where one participant is allowed to hold a 26% net share of an entire market. That's because if something bad were ever to happen to such a large participant forcing a sudden close-out of the position, the orderly functioning of the market would be jeopardized. True liquid and non-manipulated (free) markets are defined by great diversity in position holders, not in the concentrated holdings of a few. This is why position limits are so important.

It doesn't matter if JPMorgan is hedged elsewhere, because the COMEX is the world's leading and most transparent silver exchange and it sets the price of silver. JPMorgan's short position is on that exchange and, therefore, the price impact is on the COMEX. After four years of public accusations of them manipulating the price of silver, if JPMorgan were truly hedged and could offset their COMEX net short position at any time, why haven't they done so? Is silver trading that important to their overall bottom line that JPM is unconcerned about serious allegations? More importantly, what legitimate business does the US's largest commercial bank have in speculating in silver in the first place? JPMorgan should be out making loans and helping the economy to grow, not speculating in commodities.

If there were two people that I would have assumed had learned the lesson of the havoc that an oversized bet gone wrong could bring they would be Gary Gensler, Chairman of the federal commodities regulator, the CFTC and Jamie Dimon, CEO of JPMorgan, arguably the largest (by assets) and most important commercial bank in the US. After all, Gensler has raised the matter of avoiding the circumstances of AIG in most of his speeches over the past three years he has been at the agency. In fact, avoiding another AIG has been a major premise behind the Dodd-Frank regulatory reform process, of which Gensler has spearheaded. If anyone knows the potential perils that a super-concentrated position could bring to the financial system, particularly now after MF Global, it has to be Gensler. Dimon, one of the highest profile executives in the financial world, lived through the crisis and successfully navigated JPMorgan through it intact. He is said to be one of the most hands-on and effective managers around. Surely, these two men understand the implications of a large and concentrated speculative position. Something in my bones tells me that the resolution of the silver manipulation will have a lasting impact on both of their reputations.

There were no clear public warnings issued in advance of AIG or MF Global. Those events caught the regulators and the investing public off guard. In contrast, there has been nothing but public warnings to the regulators on the concentrated short position in silver. The CFTC has responded with multiple never-ending silver investigations that do nothing to resolve the situation. As the agency's own data indicate, the concentration on the short side of silver has grown markedly worse over the past two months.

But where do I get off claiming that JPMorgan's silver short position may constitute a risk to the financial system? After all, I had previously written that if JPMorgan rushed into the market to buy back their short position, they could do so without going broke. Even a quick move to \$50 or \$100 in the price of silver would not bankrupt them; at the worst it may cost them one or two quarters of net profits, as JPMorgan regularly reports \$4 to \$5 billion in quarterly profits. I still believe that to be the case. Such a circumstance could hardly be called a systemic danger to the rest of us. But the potential loss that JPMorgan might incur in covering its short silver position has nothing to do with the systemic risk I speak of. That risk lies elsewhere.

Of course, there is no question that JPMorgan is an integral component of the financial system. That alone makes it systemically significant. While JPMorgan could withstand any financial losses associated with a buy back of their concentrated silver short position, it may not be able to handle the full potential legal liability, including possible criminal liability, should it be found to have manipulated the silver market. Manipulation, as I intone regularly, is the most serious market crime possible. That's because manipulation impacts an incredibly large variety of countries, companies and people, only a very few of which are direct futures market participants.

The systemic risk surrounding JPMorgan is centered on its potential legal liability should it be found to have manipulated the price of silver. There's no question in my mind that JPMorgan has, in fact, manipulated the price of silver; the question involves if it will ever be found to have done so in a court of law. Specifically, will the US Government find that JPMorgan has manipulated the price of silver? In my opinion, that has always been the key question because without a US government finding (by the CFTC and/or the Department of Justice) of guilt or forced settlement, outside civil litigation against JPMorgan will likely prove unsuccessful. That's why I have persisted in petitioning the CFTC to address the silver manipulation, despite the agency's obvious desire not to do so.

I can understand the CFTC's lack of interest in moving against JPMorgan because of the systemic importance of the bank. Many will conclude that will always be the case and, therefore, the agency will never move against JPMorgan. I can appreciate that sentiment. But I also know that dealing with manipulation is the CFTC's number one priority and, in terms of the rule of law, the agency may soon have no choice. That's because the evidence of manipulation grows stronger and more observers see it on an almost daily basis. Take today, for instance, when silver suddenly plunged over \$3 (and gold over \$70) for no good reason other than a deliberately rigged drop in price on the COMEX designed to induce speculative selling. If someone tries to describe what happened today in non-manipulative terms, that person should be laughed at. Instead, there is widespread understanding of why we dropped suddenly in price because it has occurred so regularly.

It is this growing public awareness that clashes with the reluctance of the CFTC to confront JPMorgan. Because the silver manipulation has become so obvious and the data is so compelling that silver has been manipulated by the concentrated short position of JPMorgan and the collusion of the commercials, I believe this will force the CFTC into bringing charges against the bank. There will come a time, and we may be close to it now, when a critical number of observers and market participants force the agency to act, lest the Commission loses its relevancy.

If there's one question I have been asking myself over the past two months is what would have provoked JPMorgan to greatly increase its concentrated short position to 22,000 contracts from the 13,000 contract level it held near the end of December? The most plausible explanation is that JPM had no choice but to sell an additional 9,000 silver contracts short otherwise silver prices would have exploded. But it recently occurred to me that, at the core, the real motivation may have been related to what I wrote above, namely, JPM's concern about legal liability.

When silver prices get truly uncorked and free from manipulative price-fixing, it should be easier for many more observers to come to realize that the price had been manipulated previously. When that occurs, JPM should be in the gun sights of attorneys everywhere, including those from the US Government. Anyone ever hurt by the former artificially depressed silver prices may have a claim against JPMorgan and others (the CME Group). World silver mining companies, in particular, could be seeking big damages for years' worth of manipulation. This is the great risk to JPMorgan. If criminal charges are involved (since manipulation can be a criminal offense), the potential toll on JPM could conceivably threaten its continued existence as a going concern. That is no small matter. Don't get me wrong — I'm not sitting here rooting for the country to lose a systemically important bank. Nothing could be further from the truth, as we have enough problems without that. My concern is that this should have been nipped in the bud earlier and the sooner we terminate this ongoing manipulation, the better.

As to why JPMorgan may have sold short so aggressively over the past two months, there may be a special motivation, also aligned with the premise above. In early December, lawyers for JPMorgan filed a motion for dismissal of the class-action civil lawsuits against it for silver manipulation back in 2008. In the interest of full disclosure, I am not involved in any way with these civil lawsuits against JPMorgan, other than having publicly laid out in advance the premise for the manipulation on which the suits were based. In truth, the lawsuits didn't look like they were laid out impressively to me, but I'm not an attorney. I've heard that the judge's ruling on the motion for dismissal could come by the end of March. It would seem to me that JPMorgan would have particular interest in seeing the price of silver stay depressed while the judge was deciding, as an explosion of price might have led to conclusions of manipulation and influence the dismissal decision. If I am close to the truth in any of this, then JPMorgan's strategy is similar to betting the farm.

As a way of defusing what may be a dirty market trick that may lay ahead, I won't be surprised if JPMorgan and other big silver shorts attempt to use a possible dismissal of the civil lawsuits as some type of proof that silver hasn't been manipulated and as a reason to smash the price. (Not that they need any special reason to attempt to smash the price). I was always amazed how little mass media attention was recorded when the civil lawsuits were brought against JPMorgan originally; but I will not be amazed if great media attention is given to its dismissal. That's just how things work in a crooked world. I am still convinced that any civil lawsuits against JPMorgan or the CME Group only have a chance of being successful after the US Government brings charges. That said, I hope I am wrong and the current class-action lawsuits prevail in extracting guilt and damages against JPM.

In closing, a few more words on today's price smash. Exactly when the crooks will strike is always an open question. Sometimes, it's on a Sunday evening when no one is around, other times it's in broad daylight with an attempted cover story of comments from a Fed chairman. It doesn't matter, as it's always the same at the core — an artificial market move caused by a concentrated short position and a collusive group of speculators (called commercials) waiting like jackals to pounce by surprise.

Also as always, the COT structure analysis explains in advance these big price drops. I am not suggesting, for an instant, that the COT structure predicted today's smash, but it certainly explained it. The few comments I have received so far on this drop suggest to me that more see the reason for this smash than ever before. And while I don't intend to get into the short term price prediction business, I find the very heavy volume in gold and silver today as healthy and suggestive that many recent participants to the long side were quick to sell and run. The fear of getting caught in a ten dollar price smash is still vivid in many minds, as the memories of 2011 still loom large. Of course, if many sell quickly, then subsequent selling pressure will abate.

Ted Butler

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Silver – \$34.80

Gold – \$1710

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