January 12, 2011 – Show Time, Part Deux

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Tomorrow, January 13, the CFTC will hold a public hearing to vote on a staff proposal for position limits that was left unresolved at the December 16 open meeting. This hearing promises to be resolved with little expected fanfare, in contrast to the first meeting. I'll handicap the proceedings in a moment, but first I'd like to highlight a few new developments since the last weekly review.

As important as the issue of position limits is to silver (and certainly to me, personally), there is an issue that holds even greater sway over the price; the issue of physical tightness and looming shortage. If and when we get into a severe shortage of silver, it will take center stage as the key pricing factor, as it would in any commodity. Therefore, it is important to monitor any development that suggests a shortage may be at hand. Actually, there are a few such developments pointing to extreme tightness in silver that could easily boil over into a genuine full-blown shortage.

As I indicated on Saturday, reports from the Sprott organization indicated that it took more than 10 weeks to get delivery of the metal it purchased as a result of its silver ETF initial public offering (the last shipment being due today). Since my report, a public statement was issued by Eric Sprott in which he openly questioned the liquidity in the physical silver market as a result of the delay. As I have written previously, delays in the shipment of a commodity are an indication of shortage. In any non-manipulated commodity, any delays in deliveries are immediately reflected in the price. For there to be delays in silver shipments with no immediate impact in price is a further proof that the price is manipulated.
http://www.sprottphysicalsilver.com/News_Details.aspx?cid=9

I'd like to add my take on this development. In the interests of full disclosure, Sprott is a subscriber. Further, Eric Sprott and his organization have had favorable things to say about my silver research in the past, one of the very few Â?establishmentÂ? type organizations to have done so (my harping on the manipulation does not endear me to many of these organizations). In addition, Eric Sprott is an outspoken advocate for investing in silver. That makes me partial to him and his organization. It also goes to the point I'm about to make. Because Sprott is outspoken on silver, this makes him somewhat of a Â?squeaky wheelÂ? who could be expected to openly report on how long it took to get the silver he had ordered. Knowing this, the entities supplying the metal to Sprott would make every effort to get his silver delivered on time, in order to apply grease to a potential squeaky wheel. I'm convinced that in spite of every attempt to get the metal to Sprott as quickly as possible, it still required two and a half months because physical silver market conditions are ultra tight. This is just too long of a delay to conclude anything other than the wholesale silver distribution process is on a hand-to-mouth basis. There is no margin for supply disruption.

Next, there have been further notable withdrawals from the big silver ETF, SLV, since Saturday's article, of some 4 million ounces more. This brings the total to over 6 million ounces in just the last three or four business days. I thought the first two million ounce withdrawal may have been as a result of investor liquidation due to last week's sell-off. Now, I am of the mind that these withdrawals from the SLV are due to unusual demands from sources that need silver urgently. Helping to convince me is the just-released data on the short interest in SLV shares. With last week's sell-off, there normally should have been a reduction in the short interest, as there was in GLD. Instead, the short interest in SLV increased slightly. This makes the metal withdrawals from SLV appear to be less as investor liquidation and more as material was needed elsewhere. As a reminder, this removal of metal from the SLV does not mean metal can be removed at will by the shorts. In order for anyone to remove metal, he must first buy or own the SLV shares and then convert them to metal. I am postulating that instead of buying back previously shorted shares to close out those open short sales, there were buyers on last week's decline who were more interested in acquiring the metal instead. If I am correct, this is also highly suggestive of very tight metal circumstances.
http://www.shortsqueeze.com/?symbol=slv&submit=Short+Quote%99

Coupled with the high movements into and out of the COMEX silver warehouses, the Sprott delivery delay and the new withdrawals from SLV add up to a picture of the tightest wholesale silver market in memory. Throw in blistering investment demand, as evidenced by record Silver Eagle sales data, and the looming silver shortage may quickly overshadow regulatory actions and short covering by JPMorgan, although all should impact the price of silver greatly.

Tomorrow's CFTC meeting is likely to be a letdown, at least in the drama department, compared to the last hearing which ended in disarray. This time it is very likely that the Commission will approve the staff's proposal and formula, perhaps unanimously. My guess is that the CME Group dropped its behind-the-scenes opposition to the staff's proposal after they were reminded that this is essentially the very formula originally advanced by the CME, with slight modifications. It's kind of hard to argue with something that you originally proposed yourself.
http://news.silverseek.com/SilverSeek/1253546222.php

While we will have to wait until tomorrow to learn of any special details, it does not appear that the staff proposal on position limits will take into account the thousands of public comments received by the agency calling for the limit in silver to be 1500 contracts, as advanced by me. That's too bad, as it indicates a disdain on the part of the CFTC for public opinion. After all, the Commission asked for public opinion on this matter on several occasions and received a near-unanimous response for a 1500 contract limit in silver. In my opinion, it is disrespectful for the agency not to at least recognize and acknowledge the will of the people. There will be yet another public comment period following tomorrow's hearing when, presumably, the Commission will again ignore the will of the people.

The staff's proposal for position limits will involve a modified version of the formula first introduced by the CME Group. The formula includes 10% of the first 25,000 contracts of total open interest, or 2500 contracts, plus 2.5% of the remainder of open interest. For silver, using the 136,931 contracts of total open interest in the latest COT report, that would result in an all-months-combined position limit of 5298 contracts (2500 + 2.5% of 111,931). The position limit would fluctuate with total open interest. That's a lot more than the 1500 contract limit mentioned by almost all in the public comments; in fact, three and half times more. Let me attempt to demonstrate why this CFTC staff proposal is economically unsound, to the point of actually being silly.

The whole purpose of speculative position limits is to limit speculators from having too much influence on the price of a traded commodity derivative. According to commodity law, prices on the futures market should be discovered by supply/demand conditions in the underlying cash or physical market and not be set by large speculative positions. In other words, the price should result by the interplay between the actual producers and consumers of a commodity and not by speculators. Therefore, it is necessary to limit the potential dominance of speculators over price by limiting the size of any one speculator to be no greater than that of a typical producer or consumer of the actual commodity. Commodity law intends that we shouldn't have a circumstance where speculators are permitted to hold, long or short, derivatives positions much larger than what typical real producers or consumers produce or consume. That's why the staff's proposal for silver position limits is economically unsound.

The staff proposed position limit of 5298 contracts (based upon a 136,931 total open interest) is equal to 26.49 million ounces of silver. It is important to put that quantity of silver into perspective. For one thing, such a limit represents more than 66% of the entire annual mine production in 2009 of the US, the world's eighth largest silver producing country. What kind of legitimate speculative position limit would permit any speculator the ability to hold such a large position? In fact, the 26.49 million ounce position limit proposed under the staff's formula would be larger than the annual production of all but the top ten silver producing countries of the world and larger than the production of all but three of the world's leading silver mining companies.
http://www.silverinstitute.org/production.php

It is clear that such a large position limit would be no limit. The example that I have long used is that such a limit is akin to setting a 100 MPH speed limit for a school zone. Why bother? Instead, the staff should just say that they secretly agree with the CME Group in that there should be no legitimate position limits in silver and that the manipulation should be allowed to continue. At least that way the CFTC wouldn't have to deceive the public into thinking their opinion on position limits mattered at all.

As obscenely large and therefore, entirely ineffective, that the staff's proposed silver position limits might be to most speculators, there is one shining redemption. In spite of the excessive proposed limit, it still would greatly impact the concentrated short position of JPMorgan, if the Commission was serious about cracking down on phony hedge exemptions to the proposed position limits. The one entity that could be restricted by the 5298 proposed contract limit would be JPMorgan which still holds an estimated 20,000 contracts of COMEX silver short. This may explain JPM's recent determined effort to reduce its silver short position. But it is hard for me to be highly optimistic on this point, seeing how large a propose position limit the staff seems to be advocating. Hopefully, we will learn more in observing the open hearing tomorrow. I suggest you tune in, either live or on a recorded basis later. I'll report on the meeting in the weekly review. Details on viewing instructions can be found on the Commission's web site about a half-hour before the scheduled start of the hearing at 9:30 EST at www.cftc.gov

I'm still of the opinion that the set up in silver is super-bullish and that we have seen the end of the New Year's intentional sell-off, as I outlined on January 5. So far, I missed the bottom by two days if, in fact, this sell-off is over. I'm not fond of making short-term predictions, as those that gaze at the short-term crystal ball sometimes wind up eating broken glass. That said, the market structure and physical market developments look strong in silver, with the only temporary negative being the treachery of the manipulative shorts and the CFTC's unwillingness to confront that treachery.

Ted Butler

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Silver – $29.55

Gold – $1386

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