January 14, 2011 – A Rotten Day All-Around?

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It's hard not to reach that conclusion if you watched the CFTC meeting yesterday on position limits and witnessed the sharp sell-off in the price of silver. It's also hard not to make a connection between the two, with the most popular explanation seeming to involve the big silver shorts showing everyone who is in charge. Whatever the explanation, let me dissect what I think occurred in as objective a manner as possible. Let's deal with the bad stuff first.

The CFTC meeting went pretty close to what I had handicapped on Wednesday. The staff proposal was approved by a 4-1 Commission vote. The proposal involves a formula based upon total open interest (10% of the first 25,000 of open interest and 2.5% of the remaining open interest). In silver, this would amount to a position limit of around 5300 contracts, based upon current open interest. This is an economically stupid level for silver position limits and the staff should be ashamed for proposing it. It is three and half times greater than the 1500 contract level proposed by thousands of members of the public.

The Commission will next solicit public comments on this proposal for a soon to be announced 60-day period. While I reserve the right to change my mind, I don't feel inclined at this time to encourage anyone to comment again. Enough is enough. The public has responded repeatedly and in a uniform voice on the merits of a 1500 contract limit. I have looked closely, but I have seen not one objection to the merits of a 1500 contract limit (or the 1% of world production formula). I have also looked closely and I have seen no support for a 5300 contract limit in silver (except, perhaps, by the crooks at the CME and JPMorgan). Worse, the Commission has not seen fit to engage in an open and honest debate on this important matter. That is downright un-American and everyone at the CFTC should be ashamed of their behavior.

The sad truth is that the staff's proposal was only passed because it is a measure without substance and is only tentative at best. Given the current composition of the Commission, no meaningful reform on position limits is possible anytime soon. Nothing with teeth could garner a majority vote. The only reason this proposal passed is that it lacks substance and the true reform as intended by Dodd-Frank. Considering the potential good that could have been achieved and comparing that to what passed yesterday, it is hard to come up with a positive spin on the Commission's performance. (Hey, I said I was dealing with the bad stuff first).

As far as yesterday's price performance, it is hard to imagine a more intentional smack down. Silver declined by a dollar for no apparent legitimate reason, with most of the decline occurring after the regular COMEX close at 1:30 EST, when trading conditions are thin and susceptible to manipulative tricks. It is hard to imagine this move not being engineered by the big COMEX commercial crooks. In the highly unlikely event that this wasn't a manipulative takedown, the regulators should get off their duffs and investigate the high-frequency computerized trading responsible for such volatility. At best, this was another Â?flash crashÂ? in silver that does nothing but undermine the collective trust in the COMEX market mechanism. The regulators should be all over this suspicious and harmful trading like white on rice. Further, the apparent ease with which the commercials have been able to rig prices lower is disconcerting. They have thrown pretense aside and appear determined to rig prices lower, no matter how obvious.

It looks like the COMEX commercial crooks intend to force silver below the 50-day moving average, now approaching $28.40, with an eye towards forcing any remaining technical fund type longs to liquidate. I can assure you that the commercials have been steady buyers on the way down, as they always are, and will be buying in earnest should they trick the technical longs into selling below the 50-day moving average. This has been the essence and rhythm of the 25-year silver manipulation. How far the commercials may succeed in forcing the price lower so that they can buy is anyone's guess, but I am still of the mind that this is likely to be over soon. OK, that's the bad news. Let's get to the good.

As far as the CFTC meeting, there was one surprising and very encouraging development. There was palpable and genuine alarm and concern expressed by Commissioners O'Malia and Sommers, two staunch opponents of position limits, about the staff looking into the details of JPMorgan's swap book which justifies its giant concentrated silver short position on the COMEX. Heretofore, this function had been handled by the CME. Of course, neither silver nor JPMorgan was mentioned, but it was clear that any such inquiry was of great concern. As you may recall, this issue came up at the last hearing on Dec 16, and it led to my speculation that JPM's swap book was mostly with Chinese counterparties. Whether interests from China are holding positions in the OTC market with JPM is of secondary importance. The real issue is that JPMorgan has to have some excuse for holding the concentrated silver short position and it appears that CFTC surveillance staff is beginning the process of inquiry.

Even though the 5300 proposed position limit is a joke, JPMorgan's short position is so large, at 20,000 contracts or so, that an inquiry into its holdings must be made, based upon the position point plan introduced by Commissioner Bart Chilton. It is my opinion that whoever is the counterparty on JPM's swap book it will not pass the legitimacy test and this is the cause for the concern I observed at yesterday's hearing. This is a good development.

As far as the price drop, long term readers know that these price declines, while painful and infuriating, also strengthen the market structure. As weak technical longs are flushed from the market, the stage is set for the next rally. The bottom comes when the last technical and leveraged long is forced to sell. Given the blatant nature of the current takedown and all that is developing in the real world of silver supply and demand, it appears that the next rally will be explosive in nature. Let's face it Â? there is no real world justification for the current sell-off; it's all a COMEX rig job. We can't control or predict when the bottom will be made; all we can do is position ourselves for the next rally and not lose positions on the sell-off. The best way of doing that is avoiding margin, as always. If you need leverage, stick to call options. I'll have more in tomorrow's weekly review, but as bad as things may look at times, such as yesterday's CFTC meeting and the current sell-off, a closer look balances things out. This has been the real silver story on the journey up from $4 and will remain so as prices climb in the future.

Ted Butler

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Silver – $28.60

Gold – $1368

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