January 25, 2012 – A Political Disconnect

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One of the things I try most to avoid is political commentary. That's because no matter how objective you try to be, politics can get personal and you're bound to offend a large portion of the audience no matter what. But sometimes politics takes center stage and some commentary is required. After all, this is a big election year in the US and the President did give his State of the Union Speech last night. And there is certainly no denying that there is a strong political component behind the current battle shaping financial reform.

I admit to being appalled at the divisiveness that has taken hold in Washington, so I'll try not to add to the overall disagreements between the two major political parties. To do that, I'll concentrate my comments to just one party, the Democrats. I know that the Republicans have come out mostly against the Dodd-Frank Act's reforms, with the Democrats apparently in favor of the reforms that I personally favor, like position limits, but I choose not to go down that path. Instead, I'm going to explore a different political disconnect that I have difficulty in fathoming – the one between the President and the Democratic members of the CFTC.

While I didn't vote for him, President Obama says little that I can disagree with when it comes to my narrow world of the silver market. He speaks of a level playing field and that we should all play by the same rules. He seems determined to root out corruption and fraud and, especially, of cracking down on the largest financial organizations who may be victimizing less powerful members of society. Perhaps it's all a sophisticated con and fraud as many would suggest, but I have a pretty good command of understanding the English language and of sorting out charlatans and the President's words ring as true to me. What I can't understand is why the Democratic Commissioners at the agency, including Chairman Gensler and Commissioners Chilton and Wetjen, are not heeding the President's clear mandate.

I understand the Republican Commissioners' objections to what the President is pushing, particularly in this year's politically charged environment, but I can't reconcile why the commissioners of his own party are failing to enforce what are very clear responsibilities. I doubt very much that the President is telling the Democratic Commissioners privately something completely opposite to what he is saying to the rest of us so publicly. I also doubt that the President would exempt any market from the rule of law that was manipulated by the very large financial firms he publicly lambasts. Lastly, I doubt President Obama would look away from the ongoing crime in progress of the silver manipulation as the CFTC does every day.

Maybe there is a reason why the CFTC won't enforce the law and end the silver manipulation, but no reason could ever be good enough. Certainly, the Commission can't pretend that they weren't aware of the allegations, as they have been investigating for almost three and a half years. Despite this ongoing investigation, silver has been manipulated lower by an impossible 35% (in free market terms) on two separate occasions within the past 8 months. The main manipulator, JPMorgan, has been using these occasions to significantly reduce its concentrated short position. The new scourge of our markets, High Frequency Trading (HFT), has come to dominate daily pricing in silver so as to eliminate any and every legitimate actual supply and demand influence. We get cute talk of Â?cheetahsÂ? but little else. Thousands of public comments asking for legitimate position limits in silver of 1500 contracts are summarily brushed aside without the slightest acknowledgement. Call me naÃ¯ve and out of touch, but my own feeling is that the President would be shocked and disappointed were he to become aware of how unresponsive the members of his own political party on the Commission have been on silver.

Let me touch on market action over the past few days. As I was writing this piece, the price of silver and gold spiked up, ostensibly because of a Federal Reserve statement or some such thing. Perhaps that is the case, but that was not the prime cause, in my opinion. This move today in silver, like the move on Friday had more to do with the market structure and the silver manipulation than anything else. As I hope I have been conveying since the big takedown starting at the end of September, the move down and the resultant improvement in the COT market structure were one and the same. Silver went down in price so that the commercial crooks could buy a huge quantity of silver futures on the COMEX. Having done that, the market was configured to go up at some point.

Now the relevant question is who is buying and selling on these rallies? The answer, right at this moment, is that I don't know. I will know as future COT reports are released, but it is impossible to know right now. Last Friday's silver spike should be evident in the new COT to be released this coming Friday, but today's spike won't be evident until the following COT, as the cut-off for that report was yesterday. Even this Friday's COT is offering few clues as to what may have transpired last Friday, as the gross open interest for both gold and silver is unchanged from last week's report.

In any event, I can set the stage for what to look for. The key is what JPMorgan and the tech funds are up to. If JPMorgan has decided to increase its concentrated short position in silver and is selling aggressively on the way up, along with the tech funds buying new contracts, as has been the case in the past, then at some point the rally will fail. Maybe not right away, but eventually. But it is also possible that JPMorgan is not selling aggressively here and the tech funds may not be aggressively adding new long contracts. That would be unusual, but not impossible.

If JPMorgan is not selling but is, in fact, buying, then a very different scenario could develop, similar to how I have speculated in the past. If JPMorgan is buying and not the technical funds, then a very different and bullish scenario emerges. If JPMorgan decides not to put its head back into the lion's mouth and withdraws from manipulating silver, then a new silver chapter may have begun. Let me be clear Â? there is no way of determining for sure who is buying and selling today and this past Friday; only future COTs will reveal that. If it turns out that JPMorgan is buying back more of its short position on these rallies that would suggest much higher prices to come and maybe real soon. This goes to the heart of the silver manipulation. Take away the big silver short and you should take away the manipulation itself. I'm not saying that is the case just that it might be. I would play it, as I always do, like it may be the end of the manipulation, simply because if it is there will be little likelihood of second chances to get on board easily.

That's not to say that the commercials will roll over and play dead. I sense a profound lack of true liquidity since the MF Global disaster, in which the HFT operators are now responsible for an even higher share of total volume than before. I think that the HFT share of silver volume has approached 100% at times recently, rendering the silver market to its most illiquid state in my experience. More than anything else, this low true liquidity environment is behind the price spikes of Friday and today. In such a low liquidity environment we must be prepared for more price volatility, not less. We must be prepared for whatever may come, but we must also hang on to silver positions like never before. Be prepared for volatility that will rattle your bones. But volatility is a two-way street and up is one of the ways. So is up big.

Ted Butler

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Silver – $33.20

Gold – $1707

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