

January 29, 2020 – Simple Questions, Straight Answers

It is important to try to reduce even the most complicated of financial questions down to the simplest terms possible. Otherwise you risk becoming engulfed in a fog of confusion. Today, I will try to reduce the enigma of low silver prices into three simple questions.

The first question is why is silver so cheap? I don't think it's productive to debate whether silver is cheap in price, as the surest indication that it is grossly undervalued is by relative comparison. Measuring similar items against one another eliminates most external subjective explanations for why any item may be considered cheap or expensive. In the case of silver, not only does it have an extremely relevant benchmark comparison in gold, the comparison goes back thousands of years, far longer than any other relative measurement around. It's hard to argue that the silver/gold price ratio, now quite close to levels indicating silver is cheaper relative to gold than at any time in recorded history doesn't prove that silver is cheap.

And it's not just compared to gold that silver must be considered cheap; when measured against anything remotely comparable to it, silver is massively undervalued. Here, we have to rely on common sense. If all the houses available for sale on a particular street were priced similarly, say at \$300,000, except one that was offered for sale at \$150,000, wouldn't the immediate thought of what's wrong with that house pop into your mind? If you were in the market to buy a house on that particular street, wouldn't you then seek out the reason why this one house was priced at such a discount? Maybe you would uncover some very serious problems with the foundation, or a termite infestation, or the plumbing or electrical system justifying its severe discount or maybe you would uncover that the problems weren't so serious and created a genuine bargain.

It's this way with just about everything in the world of finance and investment. If a stock or bond were priced at an extreme discount to others in its peer group, the prudent investor would seek to uncover the reason for the discount. To do any less would be irresponsible. The first responsibility of any prudent investor interested in an asset considered to be priced at a discount is to uncover the reason for the discount. Hence, my first simple question about silver is why is it priced so cheaply relative to gold and just about everything else?

Since I am asking the question, I'll answer, but that's not to say others might respond differently. My answer is not as simple as the question, but is, essentially, the same answer I uncovered 35 years ago, namely, the price of silver is in the gutter because of the excessive and concentrated short selling of a handful of large traders on the COMEX. Data published by the CFTC, the federal commodities regulator, states quite clearly that 8 large traders in COMEX silver futures were net short 108,978 contracts, as of Jan 21, 2020, the equivalent of 545 million ounces of silver. That's the equivalent of 65% of world annual mine production, the most for any commodity. Without the concentrated short position of the 8 largest traders, there would be no net commercial short position in COMEX silver. Stated somewhat differently, the short position of the 8 largest commercial traders exceeds the entire total commercial net short position.

Considering the documented and incontrovertible evidence of what is the largest concentrated short position in the world of commodities, is it any wonder that silver is priced so cheaply? If there is a better answer than what I just provided, I'd love to hear it. Yes, it is pure price manipulation and on its face

is illegal, but the regulators refuse to acknowledge this. It also leads to a second simple question – why are 8 large traders so heavily short silver? (A similar question can be asked in gold, but it can be said that gold is dirt cheap on a relative basis compared to silver).

So why would 8 large traders hold such a large short position in COMEX silver futures so as to have caused the price to be so cheap? I don't want to sound dismissive of many of the excuses suggested to legitimately explain away the existence of the extremely large concentrated short position, but it's hard not to be dismissive. Each of the 8 largest traders hold a short position of 68 million ounces on average. With the largest silver producing company in the world, Fresnillo, producing 58 million oz a year and the second largest company, Glencore, producing 35 million oz (2018 data), it wouldn't appear possible that legitimate hedging from producers explained the concentrated short position on the COMEX. Nor is there any public evidence of short selling by mining companies, except in imagination.

<https://www.silverinstitute.org/mine-production/>

And since the COMEX is the largest silver derivatives exchange in the world, suggestions that the big COMEX shorts have somehow hedged their massive concentrated short position by going long on another exchange are, well, downright silly. The simple truth is that in order for the big COMEX shorts to buy offsetting long positions on another exchange, such as on the LBMA or OTC, would require other entities to go short to the big COMEX shorts and that thought is preposterous and without foundation.

It is true that one of the 8 big COMEX shorts, JPMorgan, has more than sufficient physical metal to justify its roughly 80 million oz paper COMEX short position by a factor of ten or more, but to call JPM's COMEX short position a legitimate hedge is nonsense because it only acquired its 900 million oz physical silver position AFTER its paper short position was established. To call JPMorgan a legitimate silver hedger now is akin to calling the guy who killed his parents a legitimate orphan.

So if nothing innocent or legitimate explains the concentrated COMEX short position of 554 million oz, then why are these 8 big traders so heavily short? My answer is fairly straightforward, namely, because the big shorts have never lost collectively when going short COMEX silver futures over the past 35 years, they had no fear of going short big this time around. I'm not saying that the big shorts never had silver (or gold) prices rise after they started to add shorts, as that has been a regular occurrence.

What I am saying is that these big shorts never chickened out and bought back short positions as a group and converted open unrealized losses into closed-out realized losses. Never. As a group the big shorts simply added more and more new shorts until the longs spent all their buying power. After the longs bought all they could, it was just a matter of time before the longs then turned sellers as prices moved lower, which the big shorts capitalized on by further rigging prices lower and only buying back at the lowest prices possible. Sometimes the big shorts only broke even after sustaining very large open losses (like in 2016), but never to the point of booking large realized losses. It was a pretty good racket; sometimes breaking even and other times realizing profits, but never ever booking realized losses.

Having never experienced taking realized losses collectively for decades, it would appear likely that the big shorts were eager to extend the racket indefinitely and didn't hesitate to add aggressively to COMEX silver and gold short positions early in the rally that began last June. But instead of being able

to then turn prices lower and getting the longs to sell, the big shorts have been unable to get the required long liquidation to this point, more than six months later. The continued price increases, mostly in gold prices, have created the largest open losses to the big shorts in history on a combined gold and silver basis.

The open losses matter little to JPMorgan as it holds massive quantities of physical silver and gold, some 900 million silver oz and 25 million gold oz. But the remaining 7 big shorts hold no such physical positions, so the open losses are more of a concern. The most desirable option available to the 7 remaining big shorts is to rig a giant selloff in which the longs sell aggressively into. We saw a clear attempt at that yesterday, when silver was clocked for 3.5% in price for no obvious reason. But not only must the big shorts rig prices sharply lower, they must succeed in inducing massive selling by those currently long. Barring that, the big shorts's only other choice is to buy back shorts on higher prices and big realized losses, something they are trying desperately to avoid.

To be sure, considering that no one would deliberately put themselves into a position where ruinous losses of the magnitude (\$5 billion) held by the 7 big shorts were likely, it must be assumed that the 7 big shorts miscalculated badly this time around – adding shorts too quickly or at too low a price. Had the 7 big shorts waited longer to add shorts at much higher prices than they sold short at, they would not be in the position they find themselves in presently. This can't be lost on them.

So, the answers to the first two simple questions – why is silver so cheap and why have the big shorts sold so much so as to make silver so cheap – have been answered. This leaves only one last simple question – how long can this short selling racket continue? Since this last question involves timing and something yet to occur, it lies in the realm of speculation and can't be answered with the same degree of certainty as the first two answers. But since there are also some obvious facts associated with the above discussion, the speculation becomes more reasonable than less so.

One glaring fact is that the data clearly show that the 7 big shorts in COMEX gold and silver have sustained the largest open and unrealized losses in history. While this is not widely known, these historic losses are certainly known to those sustaining them. Additionally, these traders must regret being in this position and are not likely to replicate the obvious miscalculation in the future. What this means is that if the big shorts do manage to lower the boom on gold and silver prices and get the current longs to sell and go short (a very big if), the big shorts are not likely to rush to go short big on the next rally (as we've contended all along).

But what happens if the big shorts fail not only to rig the sharply lower prices needed to get back as close to even, but also get the required amount of selling from the longs to be able to buy back the big concentrated short position? What happens if the big shorts begin to throw in the towel and rush to buy back short positions to the upside – something that has never occurred? Such a rush to cover to the upside, should it occur, is the precise formula for a price explosion. You can't have what has been the prime reason for why silver is priced as low as it is suddenly cease to exist and get converted to the prime reason for why price must go higher without a price explosion. Should the big traders move to buy back shorts on higher prices it would be impossible for prices not to explode.

Right now we must continue to await the resolution of which it will be — either the big shorts prevail in the end and succeed in crushing the price and getting the current longs to sell or the big shorts get overrun and panic to the upside. Or some variation of that, including a partial cleanout to the downside that runs out of steam and abruptly turns higher.

Yesterday's blatant silver price smash to the downside looked like the start of the long-expected clean out to the downside, but didn't seem to attract much selling in gold and that's telling because gold is where the vast majority of the big shorts' money problems reside. On yesterday's close, silver ended roughly 60 cents lower from where it closed on Friday, bring around \$300 million in relief to the 7 big shorts. But even though gold was down yesterday, it was mostly unchanged from Friday's close, meaning the combined total open loss to the 7 big shorts was the \$300 million improvement in silver, which brought Friday's combined \$5.2 billion open loss down to \$4.9 billion — hardly a reason for celebration by the big shorts. I'll be sure to update the combined open loss when I send this article out later.

This Friday's Commitments of Traders (COT) report will (or should) include yesterday's positioning and what I will be looking for primarily, as always, is any hints as to what JPMorgan may have been up to. No doubt there was managed money (and other speculative) selling and commercial buying in silver yesterday, but there was likely speculative buying and commercial selling over the first four trading days of the reporting week.

For the reporting week as a whole, I would imagine there was commercial buying in silver, given the violence and high trading volume in yesterday's selloff and I'm hoping that JPMorgan took particular advantage of yesterday's selloff to buy back a disproportionate amount of its short positions. Importantly, silver's 50 day moving average was hit and slightly penetrated to the downside for the first time in more than a month, undoubtedly causing some of the late managed money and other speculative buyers to sell — the more the better. Silver did finish around 35 cents lower over the reporting week.

Gold was different in that it didn't selloff near as much yesterday as silver did and managed to still end higher by about \$10 over the reporting week. As such, I would imagine some managed money and other speculative buying and commercial selling in Friday's report, in contrast to what I expect in silver. Yes, gold's total open interest declined by a whopping 78,000 contracts over the reporting week, but I would be real surprised if that wasn't due to spread liquidation as we approach the first delivery day in the February gold contract later this week. As of the latest COT report, I'd estimate close to 200,000 contracts of gold's total open interest of close to 800,000 contracts was spread related and, accordingly, should be disregarded in terms of net positioning.

I would be negligent if I didn't comment on the severe price declines this past week in a number of commodities, most particularly, crude oil and copper. Over the past six trading days through yesterday, both crude oil and copper fell around 10% in price, truly an enormous move in what is the largest commodity of them all, crude oil, whose total annual production and consumption is equal to more than \$2 trillion. And copper is no slouch as a world commodity, measuring around \$125 billion in annual production and consumption. Silver, by contrast, is a pipsqueak in comparison, amounting to around \$15 billion in total world annual mine production (gold's production comes in at more than \$150 billion).

My first conclusion is that if the price of crude oil and copper can be smacked for more than 10% in little more than a week, how can I complain about silver's 3.5% decline yesterday? At least in crude oil and copper, there was a pretty good background story of expected slowing demand from China due to the coronavirus, but if there was any attempt at a cover story for silver's decline, then I missed it.

The main point I would make is that despite the great disparity in size between crude oil, copper and silver, all three share a commonality in the obvious effect of futures positioning on price. Friday's COT report on crude oil and copper will undoubtedly feature massive managed money selling and commercial buying, as the key 50 and 200 day moving averages were decisively penetrated in both markets. I want to be clear here - the same manipulative effect on prices that outsized paper contract positioning has on silver and gold, is also present in other commodities.

The same artificial impact on price that excessive paper positioning has on silver and gold was also evident in crude oil and copper this week. US and foreign banks weren't net short in copper (and were, in fact, net long), but the banks, particularly just 4 US banks, held an outsized net short position in crude oil. If JPMorgan wasn't the biggest bank short of all in crude oil, I would be genuinely surprised, as these guys seem to have a leading role in everything that isn't on the up and up.

What's really shameful is that the excessive paper speculation, along with its obvious effect on price goes unnoticed or at least unanswered by the CFTC. What do these guys do all day? I've long given up any hope that the regulators will ever do anything constructive in terms of legitimate position limits, which would cure any problem with excessive speculation and excessively large concentrated positions, if those limits were set at legitimate contract levels and administered fairly. To that end, the Chairman of the CFTC, Dr. Heath Tarbert, seems to have resurrected the issue of position limits in a recent speech.

<https://www.cftc.gov/PressRoom/PressReleases/8106-20>

But you'll forgive me if I don't get excited or hopeful, having tried to raise the issue of legitimate speculative position limits with the agency for decades, with no success. Besides, Chairman Tarbert, seemed most concerned with position limits in agricultural commodities, where pretty decent position limits already exist, to my knowledge. He also mentioned energy commodities, but that was before this week's price smash and didn't mention metals at all - where the real problem with excessive speculation and concentration exist and no actual position limits have existed for decades. I just don't have any patience left for lip-service and pandering to certain constituents which completely ignores the real problems in metals, particularly silver. Color me deeply skeptical.

I would note that earlier this week, the new short sale report on stocks indicated pretty big increases in the short positions on SLV and GLD, for positions held as of Jan 15. The short interest in SLV rose by nearly 4 million shares to 13.84 million shares (ounces). While still not alarmingly high, it was the biggest two-week increase in months and would tend to support speculation that last week's unusually large deposit of 6 million oz was related to the increase in short selling. Then again the very high volume price smash yesterday also would provide a prime means of buying back the added shorts. In either event, I would be surprised if the next short report didn't feature a sizable decline in the short position on SLV.

<https://www.wsj.com/market-data/quotes/etf/SLV>

As I get ready to hit the "send" button, I never cease to be amazed at how often we get violent price moves (mostly lower), only to turn around the very next day to low volume and scant price volatility. This just adds to the phoniness of the price discovery process. In terms of how the 7 big shorts fared financially since the close on Friday, the late rally (after the Fed announcement) worsened the big 7's running tally from readings earlier today. At publication time, the big shorts were less than \$200 million better off from where they were on Friday - I'd peg the combined open loss at just over \$5 billion - still more than \$700 million per trader on average.

Ted Butler

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Silver – \$17.55 (200 day ma – \$16.63, 50 day ma – \$17.46)

Gold – \$1575 (200 day ma – \$1445, 50 day ma – \$1508)

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