January 7, 2012 – Weekly Review

Weekly Review

For the first week of 2012, the price of both gold and silver rose, although silver was sloppy towards the end of the week. Gold gained $50 (3.2%) for the week, while silver rose 90 cents (also 3.2%). As a result, the gold/silver ratio remained unchanged, at a bit over 56 to 1. While unchanged, the ratio is at the upper end of where it traded for during 2011. This still appears to me to be an opportunity to switch from gold to silver and to deploy fresh funds to silver. However, in no way am I suggesting that the set up for gold, particularly from a COT structure analysis, is negative.

Changes in the visible stocks of silver have garnered attention this week and over the past month or so. COMEX silver warehouse stocks have surged higher while there have been some notable withdrawals from the big silver ETF, SLV. Whether there is a direct connection for silver moving from the SLV to the COMEX warehouses is hard to say, but I suppose it's possible. As I indicated recently, there are always many possibilities for why silver would come into or out from the COMEX warehouses and it is usually near impossible to know for sure. I also wrote recently that it would not surprise me to see COMEX silver inventories rise by 10 or 20 million ounces and we are now more than half way to the upper level of that range. Even if the COMEX silver inflow is not directly related to the decline in SLV holdings, my main point is that any increase in COMEX totals should not automatically be interpreted as representing a surplus and being bearish on price. That's because there are so many possible explanations.

As always we need to put things in perspective. The world mines a bit over two million ounces of silver each day from, quite literally, the far reaches of the globe. Even accounting for an additional few hundred thousand ounces a day from recycling, almost all of that silver is consumed every day as well, leaving maybe 10% of daily total world silver production available for investment purposes. Therefore, when COMEX silver inventories increase by 4 or 5 million ounces in a week, we know that increase did not come from any excess of silver produced in the world, not even considering that silver produced in China, Russia, Australia, etc. is not being shipped daily to the COMEX. By elimination, we know that any such sizable increase in COMEX stocks must be a transfer from existing inventories (either visible or invisible) and not from daily mine production.

I've long held that there is about one billion ounces of silver bullion in the world (although I may soon have to increase that amount by 10% or 20%. Ditto for gold). Of the billion ounces of silver bullion, a little over 70% is recorded and visible, mostly in ETFs and the COMEX. That leaves close to 300 million ounces of silver that is held in unrecorded or invisible inventories. It's not hard to imagine a transfer of 5% or 10% from the 300 million oz in unrecorded inventories to recorded inventories, for any number of reasons. I believe that inventory transfers are what are behind the surge in COMEX inventories, either from SLV or unrecorded inventories or some combination. Such transfers are not related to a sudden excess of silver production, although it sure feels that way at times. I still believe the turnover is more important and that seems to be continuing, although clouded by the overall big COMEX overall increase. Perhaps supporting this line of thought is that the withdrawals from SLV are coming at a time when there is no reason to expect that investors are liquidating shares of SLV, based upon price and volume data.

Sales of Silver Eagles appear to have caught investors' favor again, based upon strong sales from the US Mint for the New Year. Obviously, it's too soon to reach definite conclusions about the state of silver retail demand, so the situation must be monitored. A new report confirmed a recent observation of mine that sales of Silver Eagles for 2011 accounted for the entire US mine production for the year. This is quite shocking when you think about it, as the US is the world's seventh largest silver producing country. (The report also confirmed that Canada's entire silver mine production was consumed by the sale of Silver Maple Leafs last year.) The US is considered to be the largest silver consumer in the world (although I think China may now be larger). Since all the silver produced by US mines was consumed by the sale of Silver Eagles that means the US' import reliance on foreign supplies of silver has never been greater, even greater than for petroleum. That might be something to keep in mind when thoughts of silver oversupply crop up on increasing COMEX warehouse totals.

This week's Commitment of Traders (COT) for gold and silver indicated a mixed bag and maybe a slight disappointment that there wasn't more of an improvement. The monthly Bank Participation Report came in close to my expectations for both silver and gold.

In the silver COT, the headline number, the total commercial net short position, increased by 1800 contracts to a still historically low 15,900 contracts. The silver raptors (the smaller commercials apart from the eight largest traders) sold out 1300 contracts from their net long position, reducing it to 21,400 contracts. The big 4 (read JPMorgan) sold an additional 400+ short contracts, the second straight week of small increases by them.

Any disappointment in silver (and gold) was that the headline number wasn't significantly lower considering the pounding that silver took during the reporting week into the end of 2011. Of course, the reporting week also included the cut-off date of Tuesday, January 3, when silver staged its best one-day rally in years, climbing almost $1.70 (6%). My best guess is that before that Tuesday, the tech funds did go short aggressively accompanied by new raptor buying. Then on Tuesday, the newly short tech funds ran to cover as prices moved against them and the raptors sold to them, ringing the cash register. My guess is that this might have involved 4,000 to 5,000 contracts total, of which only 1800 contracts were visible in the headline number. Since there was ample room for the raptors to clear $1 to $2 profit per ounce on the maneuver, they could have cleared upwards of $30 million or more on what I would consider a manipulative scam on the tech fund shorts. The real question is if the raptors can trick the tech funds into going short on lower prices. I don't have the answer to that question.

In the silver Bank Participation Report, there was virtually no change in net short position of JPMorgan from a month earlier, which I have been calculating recently at 14,000 contracts (maybe now closer to 15,000). Many of you have written to me, suggesting that the commercials and JPMorgan would build up a big net long position by continuing to drive prices lower, given how successful they have been in manipulating the silver market lower since September and in reducing their net short position. Anything is possible, but I'm still not inclined to think they can do so on lower prices. Looking at the still-historic low levels of speculative long positions, it is hard for me to imagine enough speculative selling could be generated to enable the commercials and JPMorgan to get big net long. Although considering how crooked these traders are and the absence of effective regulation, nothing is impossible. I would point out that the commercials have had decades to get net long silver and they have never succeeded.

In the gold COT, there was a slight reduction in the commercial net short position of 2100 contracts. This was somewhat disappointing in that it wasn't larger, but just like in silver I think there was commercial selling on Tuesday, as gold gained strongly that day. The gold raptors sold 3200 contracts, reducing their net long position to 8,400 contracts, while the big 4 bought back around 800 contracts and the 5 thru 8 bought back a notable 4500 contracts of their short position. Unless my eyes or data are deceiving me, the big 8 short position, at 170,157 contracts, is the lowest since January 2009, when gold traded under $850. Likewise, the gold Bank Participation Report showed a notable 30,000 contract net decline from the prior month for all (domestic and foreign) reporting banks.

Bottom line, the silver and gold COT structures are bullish. On a strict historical comparison basis silver is more bullish, but then again, silver is much more manipulated than gold. As always, the brazenness of the silver commercial crooks must always be taken into account. It has never been enough to analyze silver (or gold) on pure fundamentals or facts; the manipulative intent of the commercials must always be considered.

There were two developments this week that I' like to mention. First, the CFTC voted on Tuesday to brush aside demands that their recently approved rule-making on position limits be delayed. As I believe I recently posted, two industry lobbying groups had filed suits to delay the implementation of position limits scheduled to take effect later this year. The Commission voted along party lines (3 Democrat yeas, 2 Republican dissents) not to delay the implementation. http://www.cftc.gov/PressRoom/IntheNews/ni0087-11 Here's another take on the same story http://dealbook.nytimes.com/2012/01/04/regulator-refuses-to-delay-trading-rule/

While I'm glad the Commission rebuffed the lobbyists on the delay, I can't help but be fascinated that of all the different rules under Dodd-Frank in commodities, that industry insiders would mount a legal challenge against the one on which there should be universal acceptance. Legitimate speculative position limits should be in the same league as motherhood, apple pie and the flag. I think any opposition to position limits is deceitful and can only be undertaken in bad faith. That's why I'm glad the Commission stood up to the lobbyists. But I am somewhat disappointed that neither the main stream media nor the Commission itself has been able to simplify and explain the issue of position limits to a wider audience. And it really is very simple.

Position limits do one thing Â? prevent concentration, in turn preventing manipulation. No more, no less. Therefore, anyone opposed to position limits is opposed to preventing manipulation. Of course, the industry groups suing the CFTC to delay position limits openly proclaim that they are all in favor of position limits; just that they are opposed to how the Commission is going about the process, or some such nonsense. It is simply amazing the spin that can be put on any issue for any purpose. I think if the Commission would speak in simple terms that would go a long way towards neutralizing the lobbyists' spin.

The second development this week was the news report that indicated that the Commission might be (finally) looking towards the CME Group for their role in the MG Global debacle. I can only add that it's about time. http://dealbook.nytimes.com/2012/01/05/mf-global-inquiry-turns-to-its-primary-regulator/?partner=yahoofinance

Shortly after MF Global declared bankruptcy, I alleged that the real culprit at the heart of the mess was the CME Group, the primary frontline regulator as MFG's main Self Regulatory Organization (SRO). Please don't misinterpret what I am saying. I'm not for a moment exonerating senior management at MF Global (Jon Corzine) from blame in any way. Obviously, Mr. Corzine badly miscalculated the full ramifications of his big bet on sovereign debt and that resulted in the firm's demise. But what made the mess an unmitigated disaster was the CME, first by failing to fulfill its role as an auditor of MFG and then by abandoning responsibility to MFG's 40,000 customers by failing to fulfill the CME's promise to make customers whole in the event of a clearing member default. http://www.investmentrarities.com/ted_butler_comentary11-14-11.shtml

Instead, the CME Group took the approach of trying to pin all the blame on MF Global and Corzine by making unsubstantiated allegations of illegal transfers of customers' segregated funds. I'm sure that there is plenty of blame to go around in this disaster, but the CME was the SRO responsible for auditing MFG and guaranteeing customer funds. That they failed at both is shameful and I am hopeful more will come to this conclusion. I am also hopeful that the role of JPMorgan in the MF Global disaster is fully examined.

Finally, Commissioner Bart Chilton of the CFTC gave an interview this week with Jim Puplava that should interest you. http://www.financialsense.com/financial-sense-newshour/guest-expert/2012/01/06/bart-chilton/concentrated-positions-have-the-ability-to-manipulate-markets

A number of subscribers asked me if I would comment on what Commissioner Chilton had to say. In commenting, I can't help but try to be as objective as possible. For the record, I commend Chilton for the role he has taken in the important issues, like position limits, concentration and in addressing allegations of manipulation in silver. He is the only commissioner to have done so. I believe there would be no ongoing silver investigation were it not for him. I think he is one of the good guys and I started writing to him about these issues in 2007 http://www.investmentrarities.com/ted_butler_comentary/11-13-07.html

I agree with most of what Commissioner Chilton had to say, particularly about concentration and position limits and manipulation. I'm glad the interview was mostly about potential manipulation in the silver market. I'm going to skip over all the things I agree with Chilton on and confine my remarks to where I disagree with him. Agreement can be boring. Even though the disagreements are few, I believe they go to the heart of the matter.

Chilton pointed out that it is difficult to prove manipulation in a court of law. He indicated that there are three elements necessary to prove manipulation Â? the intent to manipulate, the ability to manipulate and the success in the manipulation. I accept his legal definition. Where I respectfully disagree with him is in the degree of difficulty in establishing all three elements in the silver manipulation. Let's go through the three elements.

Let's forget for a moment that silver has been under investigation by the CFTC's Enforcement Division for almost three and a half years and that countless civil lawsuits have been filed against JPMorgan for allegations of silver manipulation in 2008. Let's just focus on the last year, when silver experienced two separate 35% price declines in a matter of days. Such a decline in a world commodity for no observable supply/demand reason is unprecedented and I would say impossible in a free market. Yet it happened twice in silver within months.

As I have written recently, as a result of the second silver price takedown in September, a tight-knit group of commercials traders bought the equivalent of 165 million ounces in net COMEX futures contracts on the price decline. This is equal to 22% of the world's annual 740 million oz silver mine production. These same traders came close to buying the same amount in the big May silver price decline as well. This is an extraordinary amount of silver futures, much larger than any manipulative long position attributed to the Hunt Bros. in 1980. It is not possible to buy such a large amount of silver by accident. It had to be intentional. There is the element of intent that Commissioner Chilton speaks of.

The next element necessary to prove manipulation is the ability to manipulate by a concentrated position or otherwise (collusion among different traders). It would seem that the ability to manipulate is also self-evident, as it has been done on more than one occasion in silver. This also ties into Commissioner Chilton's third element, namely, success being brought about by intent and the ability to manipulate. It couldn't have been more successful for the COMEX commercial crooks than the results they achieved (at great cost to innocent investors and traders).

I think the problem that Commissioner Chilton and the agency are having is that they have convinced themselves they need proof by wire-taps and emails and other incriminating documentation (like actual confessions) before they can prove manipulation in silver. But the COMEX commercial crooks are not likely to accommodate them. The Commission has something better than that already in hand, namely, the very data that I rely on in analyzing the market. The Commission should stop wishing and waiting for evidence to drop out of the sky and just study the COT and Bank Participation statistics that they produce on a regular basis.

Because it appears so easy for the Commission to prove a silver manipulation on the basis of the three elements outlined by Commissioner Chilton, my guess is that there is something else holding the agency back from ending this scam. They just don't want to end it. Perhaps there is a political motive or the knowledge that JPMorgan and the CME may be too big to sue. It's hard to see how the three elements can't be proved by the public data.

This is all very troubling. Every federal agency and department has a specific public mission. For example, the Federal Aviation Administration's mission is to ensure aviation safety. Having come off the safest decade in aviation history, it would appear the FAA is achieving its primary mission. The Department of Defense would appear to be meeting its primary mission of defending the country from foreign military attack. I'm sure the Federal Drug Administration would quickly deal with an outbreak of tampered drugs harmful to public safety.

Try as I might, I don't see the CFTC as coming close to meeting its primary mission of protecting the public and our markets from fraud, abuse and manipulation. Manipulation is the most serious market crime possible. There have been enough credible allegations of manipulation in silver, based upon data from the Commission itself, that the agency appears involved in a never ending silver investigation. But the investigation is never resolved. The critical point is that if there is a silver manipulation (as I and many believe), then it is an active crime in progress. It would be as if commercial passenger jets were dropping out of the sky every other day and the FAA refused to comment. Or if the US was invaded militarily and the Department of Defense went on vacation. Or if citizens were dying from tainted aspirin and the FDA couldn't be bothered. That would be completely unacceptable and require immediate remedy of the strongest kind.

Because preventing manipulation is the CFTC's number one mission, credible allegations of an active manipulation, particularly one in which the Commission has initiated a formal investigation, must be resolved immediately. The Commission must either terminate such a manipulation or explain why there is no manipulation forthwith. This business of explaining why it's so difficult to prove manipulation is unacceptable, especially when all the elements of manipulation are present in the public record.

When the stock market experienced its infamous flash crash in May 2010, all the regulators, including the CFTC, rushed to make sure it would never happen again. That's good. What's not good is that silver has experienced a continuous and more severe series of flash crashes all along and the same CFTC hasn't lifted a finger to intervene. The laws against manipulation apply to all markets, not just to those randomly selected and deemed by the agency to be important. The rule of law applies to all. That includes silver investors who have been savaged by the COMEX commercial crooks.

The CFTC has many important matters to deal with in Dodd-Frank and in helping to sort out the MF Global mess. But nothing comes close in importance to resolving allegations of an active manipulation in silver, as this is truly a crime in progress. I call on the Commission to immediately end the silver manipulation or explain why there is no manipulation. So should you.

Ted Butler

January 7, 2012

Silver – $28.80

Gold- $1617

ggensler@cftc.gov Chairman Gensler

bchilton@cftc.gov Commissioner Chilto

Date Created
2012/01/07