

July 4, 2018 – Independence Day

Many countries celebrate a particular day as marking their independence as a nation and for the US, it's the Fourth of July. That's the day, in 1776 when the Continental Congress formally adopted the Declaration of Independence, written largely by Thomas Jefferson, severing obedience to Great Britain. Such occasions naturally call for a measure of general reflection by its citizens for any nation's history and as an American, I'm no different.

My thoughts, formed since childhood with lessons about the early Revolutionary days, particularly the Boston Tea Party, revolve around the inherent unfairness of taxation without representation and citizens being excluded from matters pertaining to their own governance. Admittedly, these are somewhat lofty musings, but what better day on which to contemplate them? My thoughts on this day celebrating American Independence have to do with an inherent unfairness of a different kind – regulation without representation.

Specifically, I'm referring to the lack of legitimate representation by those directly affected by US regulation of gold and silver. In no other commodity is there the near complete level of exclusion of interested parties by the federal regulator, the US Commodity Futures Trading Commission (CFTC), as there is in gold and silver. I'm well aware that big moneyed interests dictate how all commodities are regulated, but none to the extreme seen in precious metals.

Even in agricultural commodities, which have come to be dominated by mega corporate and financial interests, some lip service is regularly given to farmers and ranchers by the CFTC. But when is the last time you heard the CFTC utter concern for the interests of gold or silver miners or precious metals investors? My point is that while the CFTC has come to be controlled by large special interests in all markets, it doesn't even pretend to offer regulatory representation to anyone in gold or silver apart from the relative handful of large banks and hedge funds that have come to control prices and trading.

Think I'm exaggerating about the absence of representation? Then try to explain why the agency won't comment on the most serious of regulatory matters, such as JPMorgan being the largest silver and gold paper COMEX short seller while simultaneously being the largest physical long holder for much of the past decade? Let's face it – the CFTC hasn't even displayed the courtesy of a reply to any public or private inquiry on silver and gold regulation in years and the agency has admitted to receiving more such inquiries on silver and gold than on any other commodity.

I know why the CFTC doesn't respond – it can't respond. It can't allow itself to open a can of worms by addressing the issues in a forthright manner. Same with JPMorgan and the CME Group which let serious allegations of criminal behavior roll off their backs as if such allegations are commonplace. And as much as I hold all of them in utmost contempt (they all are fellow Americans I'm sad to say), I understand that none can offer any defense for their actions or lack thereof.

The problem is that the silver and gold manipulation, unlike the foreign oppression in pre-revolutionary colonial times, is not widely understood or felt, like taxation without representation. That's just the way it is, as the silver and gold manipulation affects such a narrow slice of society that it will never be a general pocketbook issue or cause for broad uprising. I see strong signs the manipulation is coming to

an end (none stronger than the recent double cross by JPMorgan), but I don't envision any rising up of the masses. It's just not that kind of broad issue. I just wanted to share some thoughts on a special day.

I'd be lying if I said that every new price low didn't feel like the final price low, before an explosive move higher. And I'm not just speaking of silver, my primary interest, but of gold, copper, platinum and palladium as well for the very same reason. That reason of course, is the great common denominator affecting all these metals - managed money positioning on the COMEX/NYMEX. The price declines across the board have had everything to do with managed money selling of futures contracts.

I read a pretty graphic description of what's going on in the metals the other day (the author was anonymous) using a tsunami as an analogy. This price flush to the downside, exclusively the result of continued managed money selling, is just like the water being sucked out and retreating from shore before the tsunami then rolls in with great force. And just like the retreating water adding more force to the tsunami when it rolls in, the selling by the managed money traders will only add more force to the near-certain price advance to come.

It is a simple matter of cause and effect. The cause for the uniformity of new price lows in metals is the selling and short selling of paper futures contracts on the COMEX/NYMEX by managed money traders - nothing else. Prices will stop falling when the managed money traders are done selling. As such, the trick is to guess when the managed money traders have exhausted their selling capacity, as that will mark the bottom. Admittedly, this is easier said than done and has been compared to catching a falling knife.

What makes the guessing difficult is that sometimes the managed money traders sell quantities of paper contracts that are less than, equal to, or greater than the historical quantities they have sold in the past before significant price rallies occur. Therefore, it's always real easy to mark important price bottoms after prices turn upward and noting that whatever the level of managed money selling occurred at the price bottom that was the maximum for that move. While easy, such an approach will yield little to no profits because little buying is done at the price lows.

Thus, one needs to employ a degree of subjectivity in guessing when the managed money traders may have exhausted their selling capacity in any particular down move. This recent collective move lower in the metals, particularly over the past month or so, has been marked by especially strong managed money selling. Record historical managed money selling and short selling may not be present in all five metals individually, but the selling has been quite notable on a collective basis.

Certainly, there can be no question that the cause of the price decline in all five metals has been concerted managed money selling (all at the prompting of the commercials). The only question is if the concerted and collective selling has taken the managed money traders to the practical limit of their selling capacity. I think it has and that's why every recent new price low (salami slice) feels like the final price low. However, if there is still managed money selling capacity remaining, the new price lows can be extended. That's why they call it a guess. What's not a guess is what causes the price declines.

Since the cause of the recent collective metals' price decline is managed money selling, what is the ultimate effect? The immediate effect, of course, lower prices, has already been felt; but the ultimate

effect of this selling is very different. That's because all the managed money selling, particularly the new short sales, has been in the form of derivatives contracts. I'm sure no one believes that the managed money traders were selling actual physical metal that they owned, as these traders deal exclusively in paper derivatives contracts, not actual metal. (As an aside, these managed money traders don't deal in shares of mining company stock, which partially explains why the mining shares haven't been as weak on the recent selloff as the metals themselves).

Because derivatives contracts are just that, namely, contracts between a buyer and seller, they are very different in nature than physical metal. Once you sell a physical metal you have owned, the transaction is complete and no further action is required. But derivatives contract transactions are vastly different from physical metal transactions, especially in the case of new short sales which the managed money traders have been very active in selling. These new derivative short sales are open transactions that must, by rigid contract requirement, be closed out at some point. Whereas a physical sale is the practical end of the transaction, a derivatives short sale is the opening or beginning of a transaction that must be completed at some point.

There are only two ways to close out a futures contract short sale on gold, silver or other metal. One way is by delivering the physical metal according to strict contract specifications. The only other way is by buying back the short contract in a closing derivatives futures transaction. The managed money traders which have just gone short enormous quantities of gold, silver and other metals derivatives contracts have absolutely no chance of delivering any physical metals to close out their open short contracts – no chance whatsoever. Therefore, the only way they can close out their short contracts (that must be closed out at some point) is by buying back these contracts at some point.

Since the buying back of open short contracts is required of the managed money traders as the only way for them to close out contracts that must be closed out at some point, this is the ultimate effect of the cause and effect price equation. One would think the managed money traders might recognize the collective potential danger they might be putting themselves into by creating a self-inflicted trap of sorts in which they might all look to rush through a narrow buy door at the same time; but I have pondered this question for decades with no good answer – other than they've been in this same position so many times before and nothing really bad ever happened.

Of particular potential danger to the managed money shorts is the nature of the entities that the managed money traders must buy from at some point to close out their open short sales as required. If there is a group less trustworthy and likely to stab you in the back than the COMEX commercial traders then, I'm hard-pressed to identify them – maybe human traffickers. As it is, I believe JPMorgan has pulled off the double cross of all time and that includes other commercials and managed money traders alike.

Guessing when the last managed money trader contract will be sold is much different than understanding the cause and effect nature of selling. Such selling must result in buying in the same amounts or more (short covering plus new buying) with the price impact determined by how willing the commercials will be in letting the managed money shorts "off the hook". Prices can always go lower in the near term, but, most assuredly, prices will end up much higher than they are currently due the cause and effect nature of what is going on. That's why I prefer the call option approach I'd rather make leveraged bets that prices have bottomed with options that keep expiring worthless than by the alternative, buying on margin.

Yesterday marked the cutoff for the COT report which will be delayed until Monday afternoon. Accordingly, Saturday's weekly review won't contain such analysis and I plan on a separate report late Monday, say around 6 PM EST, analyzing both reports (COT and Bank Participation).

As far as what Monday's COT report might indicate for gold and silver, it's hard to imagine how there won't be further improvement in their market structures; meaning additional managed money selling and commercial buying. After all, prices were lower by \$20 in gold intra-week and made new price lows every single day of the reporting week. Silver prices were off as much as 40 cents during the reporting week, although made new price lows on "only" two days.

Due to today's holiday, final open interest numbers for yesterday are not available (just preliminary), and the total open interest over the reporting week increased by 27,000 contracts in gold, but fell by more than 12,500 contracts in silver. It's hard to reconcile the increase in total gold open interest without a big increase in new managed money selling and I will be surprised if a new record is not reported. As per the discussion above, that's even more managed money shorts that must be bought back.

It's possible the reduction in silver total open interest is related to automatic close outs of futures contracts via deliveries and spread related liquidation, but big increases in managed money shorting are not suggested by the decline in total open interest. I'm still guessing there might have been big managed money long liquidation on last Thursday's price decline and drop in open interest (as mentioned on Saturday) and if that's the case, it should be visible in Monday's report.

Every day looks like we've seen the price bottom, but that can only be known in the fullness of time. But unless the metals world has been turned upside down and the managed money traders are now the new price bosses and the commercials (including JPMorgan) are being snookered instead of doing the snookering, the price bottom will come soon. Not soon enough for me, but soon. I'm still of the mind that feels while the epic price rally has been delayed, it will not disappoint in terms of magnitude.

Ted Butler

July 4, 2018

Silver – \$16.12 (200 day ma – \$16.69, 50 day ma – \$16.49)

Gold – \$1258 (200 day ma – \$1305, 50 day ma – \$1295)

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