July 6, 2022 – The Perfect (and Only) Solution

A new article by Reuters concerning this yearâ??s default in nickel on the London Metals Exchange help me to crystalize some new thoughts on the recent Â dramatic collapse in commodity prices of all types, certainly including silver and gold. I would describe my new thoughts as being fully in line with all the major themes Iâ??ve presented over the years, but now with a clarity I hadnâ??t quite anticipated. Please bear with me for a bit, as I try to tie this in with the current quite pronounced melt down in the prices of metals and other commodities.

The Reuters article didnâ??t provide anything really new, except to more clearly quantify the actual losses and margin calls involved when the LME rescinded and busted nickel trades on March 8. Had the trades not been busted and trading in nickel not been suspended, the margin calls due from the big nickel short (and its brokers) would have amounted to close to $20 billion on that date, an astoundingly large sum.

https://www.mining.com/web/explainer-nuts-and-bolts-of-the-lmes-cancelled-nickel-trades-legal-case/

When a customer canâ??t meet a margin call due to an adverse market movement, that customerâ??s brokers are obligated to meet the call to the clearing house from the brokeragesâ?? own funds. If the brokers holding the customerâ??s account canâ??t come up with enough of their own cash to satisfy the margin call, then all the other members of the clearing (guaranteeing) association are called upon to pony up the required cash to meet the call and keep the exchange solvent. It is the association of clearing members on every commodity exchange that guarantees the performance of all derivatives contracts and gives the exchanges their legitimacy. So large were the margin calls in nickel to the big short seller, that the exchange decided to simply cancel the trades and suspend trading, as it became obvious it would drag the LME into overall default; thereby suddenly ending 140 years of LME existence.

In order to avoid having the LME suddenly cease to exist, which would be the worst outcome possible, the exchange chose to cancel the trades and suspend trading, the next worst outcome. While I am not condoning the LMEâ??s actions in any way, I do understand why it took the actions it did take. But nowhere in the Reuters article was it mentioned what the real problem was and how the LME failed to anticipate that problem.

Not to sound like a broken record, but the problem in LME nickel was the existence of a concentrated short position that was so large so as to endanger the entire exchange when the size of the position became obvious to all. The LME never should have allowed the nickel short position to grow as large as it got. No doubt, as the massive short position was established, its large size artificially depressed nickel prices initially, just as it caused prices to soar when it became obvious the short seller was in trouble â?? necessitating the busting of trades and suspension of trading. Had the LME properly performed its regulatory role, it never would have allowed the nickel short position to grow as large and concentrated as it did grow. Ignorance of the short positionâ??s existence is hardly a legitimate defense by the LME.

As the worldâ??s leading base metals exchange, a sudden and complete closure of the LME and the ripple effects that would have had, most likely, would have severely impacted the UK and financial systems elsewhere. On the other hand, since trading on the LME is limited to base metals, any financial system fallout would be a drop in the bucket compared to any similar problems that may arise at the CME Group, which, in addition to trading precious metals and copper, also offers trading in the widest variety of financial products, including stock and bond futures, currencies, energies, foodstuffs and grains. It would be easier to list the products that the CME doesnâ??t trade.

As such, the CME Group is very much a member of a highly select list of financial institutions officially considered to be systemically important, or too big to fail. Banking giants like JPMorgan, Bank of America and others, like giant asset manager BlackRock are also elite members of financial institutions considered to be systemically important. Should any of the financial institutions on this elite list ever fail, no doubt there would be serious implications for the financial system itself, both for the US and the world in general. Therefore, thereâ??s no real comparison between the LME and the CME Group, in terms of what an actual failure of or contract default in each would mean to the financial system. In order of financial system importance, with a higher number being more important, if the LME was a â??1â?•, the CME would be a â??100â?•.

Thatâ??s why, since the inadequate regulation on the LME in the case of not dealing with the concentrated short position in nickel before it was too late was serious, then any such failure by the CME, say in COMEX silver, would be that much more serious. Plus, I donâ??t recall hearing of any prior concerns of a massive concentrated short position in LME nickel before the default, whereas I have been screaming from the roof tops about COMEX silver having the largest concentrated short position of any commodity in real world terms for decades.

Simply put, the concentrated short position in COMEX silver and its resolution, is the most important factor, bar none, as anyone who has read any of my articles would attest. With that preamble, I would like to come full circle and further refine my take on how I see the concentrated short position in COMEX silver (and gold) getting resolved, after further digesting what occurred in LME nickel.

First, I must raise a set of circumstances so coincidental, so as to be nearly impossible to be purely coincidental. The default and busting of trades in LME nickel took place on March 8, 2022. Â On that same day, the price of gold hit its all-time high of $2080, while the price of silver hit $27.50, the highest it had been since June 2021. Since those price highs, gold has fallen more than $350 (17%), while silver has fallen by a much steeper $8.50 (30%).

Also, in the COT report for positions as of that same day, March 8, the concentrated short position of the 4 largest traders indicated a gold short position of 188,358 contracts (18.8 million oz) and a concentrated short position in silver of 54,187 contracts (271 million oz). Â As it turns out, this was the largest concentrated short position for COMEX gold since March 2020 and for silver since June 2021. Interestingly, since March 8, the concentrated short position in gold has fallen by more than 66,000 contracts (35%), while the true commercial-only portion of the concentrated silver short position has fallen by 17,000 contracts (32%), as of the last weekâ??s COT report (and likely even more in this Fridayâ??s new COT report.

My take on all this is that, while Iâ??m not into deep conspiracies, the events of March 8, which culminated in the LME nickel default by the largest concentrated short seller, sent a powerful message to the concentrated shorts in COMEX gold and silver futures that they had better get their house in order and reduce their short positions pronto. My hundreds or thousands of allegations and complaints of concentrated short selling in COMEX silver and gold may have been brushed aside, but seeing the

LME default due to concentrated short selling woke up the COMEX commercial crooks. Either that, or the events of March 8 were simply some innocent coincidences.

Moreover, what I am now contending, namely, that the big commercial shorts in COMEX gold and silver have put in motion a plan to buy back and cover as many of their concentrated short positions as possible, looks to me to be the perfect and only real solution available to them. And the only way for the big commercial shorts to pull this off successfully would be to rig a market selloff of the ages â?? which is what we have witnessed. Letâ??s face it, had the COMEX silver and gold concentrated short sellers waited too long and tried to buy on higher prices, as did the big short in LME nickel, it was likely there would have been a default on the COMEX â?? with much more negative fallout given the systemic importance of the CME.

In essence, the big commercial shorts on the COMEX have and are offloading their short positions, largely to the brain-dead managed money technical funds. As Iâ??ve been reporting, the managed money technical funds are enjoying their best six months, performance-wise, in decades and, ironically, the money theyâ??ve made has allowed them to take even bigger positions than otherwise. Of course, if it does turn out that the managed money traders do prevail when their current short positions are finally bought back (which assumes the commercials will sell at lower prices), then that will be confirmed in future COT reports. However, to this point, the managed money traders have never collectively made money whenever they have gone heavily short silver or gold.

At times like this in the past, when prices on a wide variety of commodities decline markedly in price due to technical fund selling, I recall suggesting the â??silver diseaseâ?• was spreading to other commodities. Iâ??d define the â??silver diseaseâ?• as the uneconomic selling and selling short of derivatives contracts when there were no corresponding obvious signs of physical oversupply. Nothing I see indicates any sudden physical oversupply of crude oil, or grains or metals â?? yet prices are collapsing, as if there was physical oversupply. Thatâ??s because the managed money traders trade on price momentum, not the commodityâ??s actual fundamentals.

The only plausible explanation for the sudden spate of pronounced price weakness across a broad base of commodities is derivatives selling and short selling by traders motivated by price momentum. The selling is real enough in that it depresses prices, but not in the least bit economically legitimate because itâ??s as far from legitimate hedging as is possible. No silver miner would be looking to lock in the sharply lower prices of late. Instead, this has all the makings of a massive hoodwinking by the large commercial interests which dominate most markets in which the technical and price momentum traders operate.

I would place the blame for allowing speculative traders to massively plow onto the short side on the CFTC, because the selling is extremely large and non-economic in terms of why regulated futures trading exists in the first place (to allow legitimate hedging), but when the inevitable turn for higher prices occurs, the folly of the regulators allowing it will flip to much higher prices as the speculative short sellers rush to buy back what I consider to be their ill-advised short sales. The CFTC, essentially, abandoned the idea of legitimate speculative position limits a couple of years ago and the markets are now dealing with the aftermath of the agencyâ??s failure.

I also canâ??t help but be further convinced, if my musings of the big concentrated COMEX commercial shorts getting a wake-up call as a result of the default in LME nickel are correct, that these big commercial shorts will be quite reluctant to put their heads back into the lionâ??s mouth by heavily shorting again. I know I have said it too many times in the past that the big shorts would stand aside and not short into future price rallies, not to acknowledge that that possibility exists â?? but that doesnâ??t take into account the default in LME nickel and what has transpired with the concentrated short positions in COMEX gold and silver since March 8. Â The good news is that whatever the big COMEX commercial shorts do or donâ??t do in the future will be recorded in future COT reports.

As far as what to expect in Fridayâ??s COT report, the steep near $2 decline in silver and near $60 drop in gold over the 4-day holiday-shortened reporting week would suggest managed money selling and commercial buying, with the only question being how much of each. Certainly, the price decline was epic, which would usually call for epic managed money selling and commercial buying, but there is a limit to how many new managed money shorts may be put on at this point, considering how far we are now below the key moving averages, particularly in silver.

Two reporting weeks ago, the managed money shorts in silver bought back nearly 7000 short contracts on a rally of a dollar or so, which came nowhere close to the moving averages. What this demonstrates to me is that this is a highly-skittish group of shorts, prone to rush to buy back shorts on the slightest rally from the fear of getting hooked for big losses should a silver rally commence. So, while I would expect new managed money shorts to have been added this reporting week in both silver and gold, itâ??s hard for me to put a number on it. My sense is that the big former commercial shorts are not eager to short aggressively on higher prices, so itâ??s going to be interesting to see how this evolves â?? on the one hand, the managed money shorts seem like they will be quick to run on higher prices, while the former big commercial shorts seem less likely to add new shorts.

One thing for sure is that the total loss to the 8 big shorts has been dropping sharply, along with the size of the existing shorts to a level that has surprised me. At todayâ??s close, the 8 big (commercial) COMEX gold and silver shortsâ?? total loss has dropped by more than $1.7 billion from Fridayâ??s close, to $5 billion, another new low going back two years and fully $8 billion less than their loss as of March 31. As surprising and dramatic as the recent reductions in the total loss have been, I canâ??t help but believe that this is yet another reason for me to suspect that the big shorts wonâ??t be aggressively increasing their concentrated short positions on the next rally.

Ted Butler

July 6, 2022

Silver – $19.20Â Â (200 day ma – $23.29, 50 day ma – $21,81, 100 day ma – $23.39)

Gold – $1737Â Â Â Â Â Â (200 day ma – $1844, 50 day ma – $1848, 100 day ma – $1891)

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