June 8, 2022 – Eyes Wide Shut

Paul Krugman, the economist whose work you either love or hate, had a compelling editorial this week in the NY Times, titled, â??From the Big Short to the Big Scamâ?•, in which he compared the real estate bubble of 2006 and subsequent crash to cryptocurrencies today. Because the article was behind a subscription paywall, Iâ??ll not link it here, and my purpose today is not to agree nor disagree with Krugmanâ??s connection of the real estate bubble/bust to cryptoâ??s, but to bring out a most astute observation he made.

Krugman made the compelling case that what enabled a relative handful of market participants to recognize and act upon the extreme mispricing of real estate into the 2006 bubble peak and sell short subprime mortgage derivatives contracts was the belief among the majority of market participants that real estate would not collapse. His term to describe the widespread belief at the time that real estate prices would continue to climb was the â??incredulity factorâ?• and to use Krugmanâ??s own words, therein was the problem, namely, â??

â??â?¦the sheer scale of the mispricing that the skeptics claimed to see. Even though there was clear evidence that housing prices were out of line, it was hard to believe they were *that* far out of line â?? that $6 trillion in real estate wealth would evaporate, that investors in mortgage-backed securities would lose around $1 trillion. It just didnâ??t seem plausible that markets, and the conventional wisdom saying that markets were OK, could be that wrong. But they were.â?•

If you get a chance to read the entire article, Iâ??ll leave it up to you to decide if Krugman made the case between the real estate boom/bust of 2006 and cryptoâ??s today. Instead, the lightbulb that went off in my head when reading his piece concerned â?? what else â?? silver. I was particularly taken with Krugmanâ??s use of the term â??incredulity factorâ?• to describe what blinded the majorityâ??s opinion about real estate back then and cryptoâ??s today was the broad and innate belief that then-current market prices couldnâ??t be *that* far off from whatever levels they were trading at â?? when the history of markets strongly suggests that yes, indeed, there are times when markets can be extremely mispriced.

While itâ??s true that Krugman was using two examples of markets that were or were perceived to be extremely over-priced, that doesnâ??t automatically exclude the presence of the incredulity factor in an extremely underpriced asset like silver. Simply put, silverâ??s extremely low price over the past few decades has told, in no uncertain terms, the vast majority of the worldâ??s investors to just move along â?? that there is nothing to see here. It would defy credulity for the majority not to think that the persistent low price of silver wasnâ??t due to ample or oversupplied market fundamentals. Thatâ??s just normal collective investor behavior.

But even a slightly more in-depth look at silver would result in the realization that the actual supply/demand fundamentals in silver are nowhere near as negative as the low price would suggest. An even deeper review would raise more substantive questions concerning why, of all commodities, silver is still more than half of its non-inflation adjusted price highs of both 42 and 11 years ago. Adjusted for inflation, silverâ??s low price is downright shocking.

A reasonable person, when presented with silverâ??s extreme undervaluation compared to its actual fundamentals would conclude something is wrong â?? but, according to the incredulity factor (referenced by Krugman) therein lies the problem, namely, the vast majority of reasonable people are not even looking, due to the deeply-imbedded collective sense that current market prices canâ??t be *that* far off from where they should be. Iâ??ve been asked more times than I could possibly recall why someone big hasnâ??t bought silver (apart from JPMorgan). The answer is elementary â?? because the persistent low price has signaled itâ??s not worth the time to investigate.

Complicating the issue in silver is that the reason most eyes and minds are closed when it comes to questioning the possibility that the persistent low price is *that* far off from where it should be, is that the answer is particularly hard to accept. After living and breathing the intricacies of silver for close to 40 years, thereâ??s not the slightest doubt in my mind that the low price is a result of an ongoing manipulation by certain large traders on the COMEX, as Iâ??ve tried to document all along. Iâ??ve come to accept most will never go that deep, but broad acceptance of my take is not required.

If any market is extremely mispriced, as I contend that silver is to the downside, then itâ??s only a matter of time before the mispricing must come to an end. Just like housingâ??s extreme overvaluation was rectified starting in 2006, so too will silverâ??s extreme undervaluation be rectified ahead. The really important point here is that just like only a relative handful of market participants profited greatly from the housing bust by going against the majority who didnâ??t comprehend the extent of the inevitable housing collapse, a similar circumstance is likely to be experienced in silver â?? with a special twist.

Those that profited mightily in the housing bust did so by dealing in highly-esoteric and complex mortgage derivatives securities way beyond the capacity of the regular investor to understand or have access to. To truly profit from the housing/mortgage bust one would have had to deal in derivatives contracts well-beyond the reach of the average man in the street. In contrast, the beauty of capturing the coming radical upward adjustment in the price of silver is about as easy as falling off a log. In fact, there are almost too many really simple and good ways of buying silver to mention â?? no need to have to resort to anything complicated or esoteric. A bigger plus factor and advantage would be hard to find.

As was vividly portrayed in the movie and book, â??The Big Shortâ?•, before real estate prices began their descent after 2006 and derivatives bets against housing began to pay off, many holders of the short derivatives bets were pressed up against the wall, struggling to maintain their short bets and having to meet increasing margin calls to hold on to the positions. I know many silver investors, after so many years of waiting for the actual fundamentals to kick in and bring about the inevitable higher prices to come, must hold similar feelings as faced by the margined holders of what turned out to be the spectacularly profitable results of those that bet on a housing collapse.

But hereâ??s the real beauty of buying and holding silver, as opposed to betting against housing in 2006 â?? there is no margin or leverage required. Sure, there are opportunities galore for those who choose to â??up the anteâ?• by going on margin and deploying leverage when buying silver, but that is not required by those looking to take advantage of what I feel is the single best investment opportunity available. In fact, knowing the stresses associated with borrowing and utilizing leverage to mostpeople, I strongly advise against buying silver on anything but a cash on the barrel basis. Silver isgoing to explode in price to such an extreme extent that leverage is not required. All that is required isan open mind and eyes.

Turning to other developments, one story that caught my attention was the lawsuit filed by the large hedge fund operator, Elliot Associates, against the LME for what was claimed to be losses of close to a half billion dollars in the recent nickel debacle. Previously, the large quantitative hedge fund, AQR, had intimated that it would be suing the LME for losses on nickel, due to the measures taken by the LME (what I believe were) to protect the short sellers at the expense of those long.

The upshot of these suits is beneficial to silver investors for the simple reason that I believe it will discourage the CME Group from enacting similar measures should the big COMEX silver shorts get into trouble. That said, now that the big concentrated commercial silver short sellers are holding a greatly reduced short position from times past, it would appear the only way the big shorts would require a rescue is if they add aggressively to short positions, which as I think you know, is also the key to whether the coming rally in silver is run-of-the-mill or the big one.

There was also a flurry of activity in the solar panel stocks given proposed changes in tariffs. Since silverâ??s use in solar panels is perhaps its biggest single component for industrial usage, itâ??s always wise to keep tabs on this sector. However, considering the current and prospective levels of fossil fuel prices, itâ??s hard to come up with a better long-term incentive for alternative and cleaner sources of energy than solar.

As far as what to expect in Fridayâ??s new Commitments of Traders (COT) report, I would imagine there was not much in terms of significant positioning changes, so specific predictions would be impossible. There was an ever-so-slight upward bias to silver and gold prices thru yesterdayâ??s cutoff and given the (well-deserved) skittishness of the managed money shorts in silver, I suppose some may have covered, but hopefully, not too many. Trading volumes have been low and even though total gold open interest did drop by close to 20,000 contracts over the reporting week, there were heavy deliveries, which automatically reduce open interest.

As a result, the extremely bullish market structures in COMEX gold and silver would appear to be intact. I confess to expecting a price liftoff to begin just about every single day, although I also know gold and silver prices remain in â??no manâ??s landâ?• as far as hitting price levels that would motivate the managed money technical funds to take aggressive action.

Considering the historically low levels of technical fund long positions in each market and the still-high level of managed money technical fund short positions in silver, any upward penetration of the key moving averages would prompt much more aggressive managed money buying, than would new lows set off additional selling. Simply put, as far as the greater price influence given the current market structures, the upside has much greater potential than the downside.

One thought that has occurred to me that I may not have fully-discussed is the potentially extremely profitable position of the silver raptors at this time. As you know, â??raptorâ?• is the term I coined many years ago to describe the COMEX commercial traders apart from the 4 and 8 big COMEX commercials which had previously dominated and controlled silver prices for decades. Over the past few years, the silver raptors have played an ever-increasing role in supplanting the formerly dominant big commercials, particularly since JPMorgan abandoned the short side on the COMEX in early 2020.

As way of a brief review, the raptors, both in silver and gold have always been profitable, in stark contrast to the 8 big shorts, which have been stuck with varying degrees of losses on the short side since 2019. But itâ??s not just that the silver raptors have always been consistently profitable in their counterparty dealings with the managed money traders, itâ??s something more than that presently. As a reminder, the silver raptors (unlike the gold raptors) rarely ever get net short, itâ??s much more a case of the silver raptors building up long positions on declining prices and then liquidating those longs on higher prices â?? an approach thatâ??s hard to argue with.

From COT report data, there are only about 25 silver raptors or less (about the same number as in gold) and while I still maintain their actions are so uniform so as to be considered collusive in substance, let me save that discussion for another day. The new thought Iâ??ve had is the hard-to-believe potentially profitable position the silver raptors find themselves in.

By my calculations, the silver raptors, as of the most recent COT report, are net long around 38,000 to 40,000 COMEX silver contracts (200 million oz) at a cost basis of $23 (or less). At current prices (around $22), that means they are in the hole for $200 million in terms of open and unrealized losses, which while that amount isnâ??t exactly chopped liver, it is a lot better than the more than $450 million they were out at the recent silver price lows, as Iâ??ve recently discussed.

But what I havenâ??t mentioned is that this is the best potential position the raptors have been in ever, or at least in my memory. I donâ??t ever recall the raptors amassing such a large silver long position this much lower than the moving averages, which when eventually penetrated to the upside (which must occur at some point), will generate significant managed money buying (both short-covering and new buying).

My first question is whether the silver raptors fully-recognize the highly-advantaged position they find themselves in or if their current circumstance is just a random result of what they do on a regular basis? If the answer to that question is that the current configuration reflects a highly-deliberate effort by the raptors to ring the cash register like never before, then thatâ??s one vote for the coming silver move being the big one. Â And it doesnâ??t necessarily require all the silver raptors to be knowingly-in on this special set up, because if only a few raptors are clued in on this and donâ??t sell fairly quickly on the coming silver rally, that could be enough to ensure an explosive rally.

The biggest factor of all, of course, to whether the big silver rally unfolds or not, is still the future behavior of the 4 and 8 largest commercial shorts and whether they add aggressively to short positions â?? same as it ever was. But I will say that if some of the raptors hold back and donâ??t sell out long positions quickly, the requirement of the big 4 and 8 to add new shorts to cap and contain the rally becomes even more critical.

The slightly higher prices since Fridayâ??s close adds $100 million the 8 big COMEX gold and silver shorts total loss, which sits at $8.2 billion.

Ted Butler

June 8, 2022

Silver – $22.06Â Â Â Â (200 day ma – $23.54, 50 day ma – $23.25, 100 day ma – $23.77)

Gold – $1857Â Â Â Â Â Â Â (200 day ma – $1842, 50 day ma -$1891, 100 day ma – $1889)

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