March 28 – Two Historical Meetings

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This was a big week for silver, in many ways the biggest ever. At least, it was for me. Obviously, this was not in terms of price or in the eyes of the world at large, but in more important ways. There were two meetings this week in Washington, DC, one private and one very public.

As I indicated in my last missive, I met with CFTC senior staff privately at their invitation on Wednesday, the day before the historic public hearing. The meeting lasted an hour and a half and there were not many idle moments. It was me doing most of the talking, but not because I tried to hog the microphone; I was answering a series of intelligent questions I had hoped I would be asked. It was requested that all remarks remain off the record and I intend to abide by that to the extent I am able. But my strong feeling is that the discussion was very productive and has already started to make a difference (more on that in a moment).

Trying to be objective and not to sugar-coat it, I was a bit disappointed in that I thought the staff would have been further along in the process of understanding the silver manipulation. But I will say this Â? I was impressed that all present were dedicated public servants interested in doing the right thing and were eager to learn anything they didn't know. I did not get the impression they were just going through the motions or had closed minds; they were genuinely interested and that was reflected in what they asked. If they weren't further along the learning curve than I would have hoped, it wasn't because of willful negligence or indifference; it was because of the overwhelming demands of too small of an agency trying to regulate too many large markets. This was an awakening for me, as I have written often in the past that they must be incompetent or complicit. I know this is a big switch for me, but they did impress me in their desire to do the right thing. The CFTC does need more resources to do their job properly. Boy, I never thought I would say that.

A personal highlight of the meeting was getting to meet Chairman Gary Gensler, who stopped by to introduce himself. Regular readers know how highly I hold the Chairman for what he has said and done to date, and I can't overstate what an honor meeting him was for me. Considering my decades' long experience with the CFTC, if you told me a year ago I would have written these words, I would have told you that you needed to change your medications. But the fact is that, for the first time in 25 years, I had been invited by the agency to answer questions and present my views to senior staff. That qualifies as historic to me. Hopefully, it won't end there.

The public meeting was historic beyond doubt. The CFTC hasn't held many public hearings until Chairman Gensler arrived on the scene, and certainly this was the first public meeting on precious metals. What made this hearing truly public, of course, was the modern technology that enabled people from around the world to watch and listen for free. This tech stuff is over my head (I still can't comprehend how sound can come through a phone). I may not understand how it all works, but I am grateful that it exists. If you weren't able to watch the hearing live, you can still retrieve it on a recorded basis. Absolutely amazing.
http://www.capitolconnection.net/capcon/cftc/032510/CFTCwebcast.htm#

As far as the public hearing, I'm going to review the meeting from a very broad perspective, and not dwell too much on who said what in minute detail. Plenty of incorrect and misleading comments were made, but I don't know what good would be achieved in identifying all of them. I don't want to sound immodest, but this public hearing would not have occurred were it not for me and you. We are the ones who have raised the issue of position limits and concentration in silver. Many hundreds of you took the time to write to the Commission on multiple occasions over the years and this cumulative effort has directly resulted in this hearing being held. I'm not saying this to heap praise on ourselves, but to make a different point. No one else wanted this meeting; not the exchange, not the big banks, not the miners, not the silver users, not anyone in the silver establishment. The simple fact is that the meeting only took place because of consistent public pressure, presented in a professional and specific manner. No histrionics or wild stories; just level headed reasoning on concentration and position limits presented with data documented by statistics issued from the CFTC itself.

One additional point – there would have been no meeting unless Chairman Gensler also wanted there to be a meeting. Please keep this in mind. That doesn't necessarily mean he or the Commission will eventually take action to reinstate legitimate hard position limits in COMEX silver and crack down on the phony hedge exemptions to those limits, but it does mean they will either do so or not. Like an arrow shot high into the sky, we don't know when and where it will come down, or what it might hit, but we do know the arrow will come down. This is the same here. There will be no Â?never mindÂ? or forgetting about this issue. There will be an eventual yea or nay from the Commission on the specific issue of silver position limits. That's a very good thing.

The other top-down observation is that the hearing officially focused attention on the correct issue. While billed as a hearing on position limits on precious and base metals, most of attention was on COMEX silver and the concentrated short position. This is as it should have been, as this is very much a silver-specific issue. This has created an unprecedented circumstance. Here we now have official and public recognition that there is something potentially wrong in COMEX silver. Nothing that came out of the private or public meetings dissuaded me from my strongly held belief that silver will explode in price suddenly. What these meetings guaranteed is that all parties were put openly on notice. There can be no claims of insufficient warning.

As far as specific issues at the meeting, I wrote in my preview of the meeting early on the morning of March 25, that I would be looking for two issues. One issue was whether the matter of the concentration in silver was adequately addressed. That was answered in spades. The other issue was whether the obvious absurdity over the current identical accountability limits in COMEX gold and silver (6,000 contracts each) despite gold being 4 to 5 times larger than silver in open interest, volume and deliverable stocks would be addressed. This is an issue I have raised often, including in my written submission before the public hearing and in the private meeting on the 24th. This turned out to be a homerun, as Chairman Gensler himself asked this very question of Thomas LaSala of the CME Group at the close of the panel 2 session. LaSala's response was nonsensical (as I predicted in advance to the Commission) when he said it was just Â?historical.Â? Let me translate that for you. It means there is no good reason for it, as the CME/COMEX has done it that way for years and will continue to do so, until they are forced to correct it. That Chairman Gensler asked the right question and the CME's chief regulatory officer answered in such a moronic manner was sweet, as it proved the exchange is clueless or complicit in the silver manipulation.

Another big issue was also something that I mentioned in my March 25 missive, namely, the early press reports that the CME would oppose hard position limits on the grounds it would drive business away from the exchange and dry up liquidity. Surprisingly, this turned out to be the singular reason given by all those at the hearing who were opposed to the CFTC reinstating hard position limits on COMEX silver contracts.   I say surprisingly because it represents such a weak argument against position limits that I am amazed anyone would try to use it. In fact, I am actually quite encouraged to hear this weak excuse advanced, because it raises the immediate question Â? is this the best that they can up with?

Several subscribers emailed me immediately, correctly pointing out that those opposed to position limits were basically choosing liquidity and trading volume over ending an obvious price manipulation. Some sick choice. I certainly agree with that characterization, and I will also try to show why the idea that position limits would damage liquidity and drive business overseas is bogus. In fact, it's exactly the opposite. As always, I will try to present this in the most objective manner; but I must tell you that my personal opinion of those panelists who opposed position limits has been lowered quite a bit by their failure to see the obvious.

Let's define what liquidity means in any market. Maximum liquidity is always synonymous with having the maximum number of traders on either side of the market. In futures trading, as in all derivatives trading, there must be the same number of long positions as there are short positions; a long for every short and vice-versa. While the total number of long positions must equal the total number of short positions, the number of different traders holding those positions doesn't have to be equal. If there are roughly the same number of traders on each side of the market, the market is said to be liquid.

If, however, there are a large number of traders on one side of the market, but only a very few traders on the other side of the market (holding large positions), then the market is said to be concentrated and illiquid. This is the very point that Chairman Gensler made forcefully during questioning at the energy hearings last summer. Liquidity is determined by how many traders exist on either side of a market, not just on how many contracts may trade daily. In COMEX silver futures, because the short side is so concentrated and the majority of the short position is held by so few traders, this market is extremely illiquid, by definition. This is a very important concept. Even if a market trades a large number of contracts, if one side is dominated by just a few traders, that market is not liquid. In such a market, large and sudden price changes would occur if anything caused the few dominant traders to change their positions.

The first observation I would make is that the COMEX silver market, by definition, is not liquid to start with, because it is dominated by a few large traders on the short side. Therefore, it can't lose that which it doesn't already have (liquidity). For example, the most recent COT Report indicates, as have the majority of reports over the past year, that four large commercial traders hold a net short position in COMEX silver futures larger than the entire total commercial net short position. In other words, the short position in COMEX silver is so concentrated that there would not be a net commercial short position at all were it not for the four largest commercial traders. This is a glaring confirmation of illiquidity, not liquidity. How the Â?expertÂ? panelists could warn about the danger of COMEX silver losing its liquidity is absurd.

The truth is that, far from reducing liquidity, the potential exit of the very largest short holders in COMEX silver (principally JPMorgan), would greatly enhance or even establish liquidity in the silver market for the first time. Such an exit would require legitimate free market silver sellers to replace the departing manipulative sellers. This would not be a worry or a cause for concern of what would happen to liquidity; it would be a reason for great celebration that the stigma of manipulation had been removed from COMEX silver and liquidity restored.

There is another great truth that is revealed in the bogus loss of liquidity argument. There is absolutely no substance to the threat that JPMorgan and other large silver short sellers could quickly and voluntarily abandon the COMEX silver market (without causing the price to explode). In fact, they can't leave without setting off the price explosion; they are trapped. Like a spoiled kid threatening to take home his baseball and bat from a sandlot pick-up game not going his way, the threat of JPMorgan or the big shorts being forced by legitimate position limits and them going away to other markets is hollow. Remove JPM's current 150 million ounce net short position from the COMEX and the price will explode. If they could transfer their manipulative COMEX short position to some other market, they would have done so by now. They haven't because they can't.

The proof of this lies in considering the other side of the market, the long side. There is very little concentration on the long side of COMEX silver. The COMEX silver long holders are many in number (around 10,000 in total by my estimates) and they hold smaller numbers of contracts each, on average, than do the short holders. This means that there would be very little impact on long silver holders should legitimate silver position limits be enacted, even if limits were reduced to the 1500 contract limit that I have long recommended. There are a couple of points I would like to make about this.

Lost in the debate about the fears of disappearing Â?liquidityÂ? in silver is the fact that only 0.1%, of all COMEX long side traders would be impacted by legitimate position limits of 1500 contracts. In addition, very few COMEX short side traders would be affected. In other words, 99.9% of all the long side traders in COMEX silver and no less than 99% of all the short side traders would be unaffected by an imposition of a 1500 contract position limit. Please think about that. In all the huffing and puffing of those worried about the loss of liquidity, they have failed to mention these numbers. How could true liquidity be threatened by restrictions to only a few large traders?

It is important to remember that 99.9% of long COME silver traders would have no reason to transfer to other markets should a 1500 contract position limit be enacted. Instead, these traders and many new ones would be drawn to the COMEX should position limits be installed, encouraged by a new level playing field. As I have written previously, honest traders prefer to trade on honest markets. Crooks look for unfair advantage. A market doesn't lose liquidity when a few dominant traders get kicked out. A market loses liquidity when a few large traders are allowed to dominate. That this point was basically overlooked at the hearings is amazing. You can be sure that I would have made this point had I been allowed to testify at the public hearing.

Another mischaracterization made at the public hearing was how small the COMEX silver market is in the world wide trading of silver. My experience suggests the opposite, namely, that COMEX silver is the dominant price setter for world silver. I base this on the simple observation over many years that the big silver moves are COMEX generated. On every unique US holiday, for example, silver rarely moves in price. If there was such important silver trading overseas, one would expect that trading to set prices, yet it rarely does. But let's leave my personal observation aside. If, in fact, COMEX silver is less important to world silver prices than I suggest, the big traders could care less about the imposition of position limits and would simply move their positions on the mere possibility of such an imposition. They wouldn't be howling in unison about the loss of liquidity.

The fact is that the smaller traders who comprise 99% and more of all traders on the COMEX aren't going anywhere. There is no reason for them to move. Because of this, the big crooked short silver traders are stuck. The threat of them leaving is silly. With the smaller silver traders sitting pat on the COMEX, who would be the counterparties to the short big traders if they did try to take their ball and bat and go overseas? You need a long and a short for each derivatives contract. The longs are staying, who cares what the crooked shorts do? Let them go play with themselves overseas. Good riddance.

I'll have more to say on the hearing in the future, so let me wrap it up here with a few closing comments. The meetings were all that I had hoped they would be, although there were some surprises. The hollowness of the argument against position limits promises to advance their enactment, rather than impede it. The full airing of the issues was of great benefit. The issue of position limits and the concentration on the short side of silver is not going away. No one convinced of a silver price manipulation before the meeting is any less convinced afterward. Maybe the same can be said about those unconvinced, but the liquidity arguments against position limits are laughable.

Although my private meeting with the CFTC was off the record, I would like to share one of the messages I did try to impart to them. Since I have previously written on this point, I don't think this violates any confidentiality. And it was certainly offered in the spirit of constructive suggestion. I tried to warn them to be prepared for a firestorm of criticism when a silver shortage becomes visible. When this shortage becomes apparent, much attention will be placed upon the Commission for not having acted sooner to head it off, despite clear and numerous warnings. Once the silver shortage starts in earnest, no one can stop it; it must burn itself out. The way these things usually work, whoever is on watch gets the blame. It would be a great loss to our country should the blame fall on Gary Gensler, considering how much he has accomplished during his tenure as chairman and how much more he has yet to accomplish. Few recognize his true talents and mission. I implore the Commission to get ahead of the curve and act on the silver manipulation before the silver shortage kicks in, if it's not too late already.

Lastly, there have been recent reports of a whistleblower emerging, in the form of London silver trader. I know the trader well and have discussed with him the allegations for several months. You can never know in advance what specific catalyst will actually set off the silver explosion, but you can know that this market is structured to be set off. It's always been a question of when, not if the silver market will explode. Please position yourself accordingly.

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