May 20, 2020 – The Way Things Work

Donâ??t worry â?? Iâ??m not about to launch into a discussion of how everything works in the world, as what I donâ??t know or havenâ??t figured out yet (like women) would be worth neither your time nor my effort. So I thought Iâ??d take a crack at how I believe a few things work â?? some old and new.

Starting with the old, Iâ??d like to take a closer look at the issue I admit to being most preoccupied with â?? the concentrated short position in COMEX gold and silver futures. Over the past year, the concentrated short position in gold has brought the 8 largest shorts the most financial damage for the simple reason that over that time gold prices have surged, while silver prices have been contained. As a result, most of the financial damage in the form of growing open losses has come on the gold side (although that may be starting to change).

As of Fridayâ??s close (Iâ??ll update the figures when I send this out later), the 8 big shorts in COMEX gold and silver were out $7.8 billion, the worst weekly closing level ever. (At the same time, JPMorgan held net open profits of more than $12.5 billion on its 25 million oz holdings of physical gold and 1 billion oz of physical silver). A quick calculation indicates that the average loss for the 8 big shorts at Fridayâ??s close came to close to $1 billion per trader.

Bear with me for a moment as I provide the following â??dryâ?• data first before getting into what the data may mean. In terms of numbers of contracts, we know that the 246,383 gold contracts held by the largest 8 short traders comes to an average of 30,800 contracts (3.08 million oz) per trader. In silver, the 74,385 contracts held short by the 8 largest traders comes to just under 9300 contracts (46.5 million oz) each. (All amounts as of May 12).

But since we also know that there is a wide difference between the numbers of contracts held, for instance, by the largest and smallest of the 8 big shorts, looking at average holdings and open losses is not sufficient. Fortunately, the same concentration data provided in the weekly COT report gives a more granular picture, because data for the 4 largest traders are also provided.

In gold, the 4 largest shorts held 174,355 contracts short or 43,589 contracts (4.36 million oz) each. The 5 thru 8 next largest shorts held roughly 72,000 contracts or 18,000 contracts (1.8 million oz) each. Thus, the 4 largest shorts held approximately 2.4 times as large a short position as the next 4 largest shorts. Thatâ??s a more definitive breakdown than is the 30,800 contracts held on average by the 8 largest shorts.

In silver, the 4 largest shorts hold 52,219 contracts or just over 13,000 contracts (65 million oz) each. The next 4 largest traders hold just over 22,000 contracts short or 5500 contracts (27.5 million oz) each. As was the case in gold, the 4 largest silver traders hold a short position roughly 2.4 times as large as the next 4 largest traders. What can we conclude from these data?

First, since we know that the 4 largest shorts in COMEX gold and silver hold a position 2.4 times larger than the next 4 largest shorts and that the position has been fairly static over the past year (except for JPM beating it out of town), we can conclude that the 4 largest shortsâ?? share of the total open losses (roughly $8 billion) is 2.4 times larger than the share of losses held by the 5 thru 8 shorts. In percentage and dollar terms, it means that the 4 largest shorts in gold and silver hold 70% of the total open losses or $5.6 billion, while the 5 thru 8 largest shorts hold 30% or $2.4 billion of the total $8 billion open loss.

So itâ??s more accurate to say, instead of the 8 big shorts holding open losses averaging close to a billion dollars each, that the 4 largest shorts are holding positions with an average loss of $1.4 billion each, while the next 4 largest shorts are holding positions with an average loss of $600 million each. And surely, the largest of the 4 largest shorts hold a disproportionately larger position and loss than the smallest of the 4 largest shorts. Itâ??s just the way things work.

What it means is that itâ??s more accurate to think in terms of the proportionate losses to each of the 8 largest traders, rather than in average terms. While it may mean that the largest of the big shorts may be in greater jeopardy, as was the case with Bear Stearns in 2008, the open losses of the smaller of the 8 largest traders are now large enough (also the largest in history) that it could turn out that they panic and rush to cover first. Itâ??s important to remember that these are unprecedented massive open losses, with â??unprecedentedâ?• meaning never before experienced and, therefore, impossible to plot exactly what happens next.

The last time the 8 largest traders held open losses anywhere near as large as they do currently was back in the summer of 2016, when the total open losses on gold and silver came close to $4 billion, about half of current losses. But one big difference was that JPMorgan was firmly entrenched on the short side, as the largest short seller back then. At least as far as last weekâ??s COT report, JPMorgan held no short position in gold or silver. I am prepared for JPM to have added shorts in the reporting week that ended yesterday, but it would be impossible for it to have become as short as it was back in 2016 just yet.

In hindsight, I believe the reason JPMorgan, almost single-handedly, added enough new shorts in the summer of 2016 and prevented gold and, especially silver from embarking on a much higher price journey was because it wasnâ??t finished accumulating all the physical gold and silver it believed it was capable of acquiring. It would appear that JPMâ??s calculations were prescient, as I would estimate it was able to nearly double its physical holdings of gold and silver over the past 4 years. Looking out at the next four years, particularly considering the attention that JPMorgan has attracted to itself in matters gold and silver, I doubt very much that JPM could replicate the physical accumulation it achieved previously â?? although one never should underestimate what these crooks are capable of.

Back in 2016, JPMorgan was short as many as 35,000 silver contracts and more than 60,000 gold contracts, making it integrally entwined with the fate of the 8 largest shorts. Even if JPM added aggressively to shorts in the just ended reporting week, it wouldnâ??t approach those numbers currently. While I would never rule out the chances for a sharp selloff at any time, in addition to JPMorgan still being in prime position to double cross the 8 big shorts compared to 2016, the managed money gross and net long positions in gold and silver are so much lower today than they were back then that even if we experience a sharp selloff, the likelihood that the 8 big shorts can buy back great numbers of short positions or come close to breaking even seems farfetched.

Always eager to hear some type of rebuttal or disagreement with my contention that the concentrated short position of the 8 largest traders is the central issue I claim it to be, about the only arguments Iâ??ve been able to uncover is that the losses arenâ??t so large as to imperil the banks holding the short positions and that the losses donâ??t really exist because the positions are hedged.

As to whether the open losses are large enough to jeopardize any of the short holders, only time will tell, but the losses are now larger by more than double the previous largest loss in 2016 and the big shorts are not backstopped by JPM, as they were back then. Plus, Bear Stearns went out of business, back in 2008, with losses very much in line with current open losses.

As far as the short positions being fully hedged, meaning the open losses I calculate donâ??t really represent actual losses because the shorts hold some type of offsetting position, like holding physical metal against the short positions â?? letâ??s examine that. After all, since the 8 big shorts are most certainly commercial traders, some contend that means they must be hedged. Thatâ??s not the case, since the designation of commercial has to do with trader category by the CFTC and not whether a commercial trader is hedging or speculating.

In order to understand how the concentrated short position that I claim the 8 big shorts are stuck with now came into being, itâ??s necessary to understand how the COMEX futures market functioned over the past few decades. As regular readers know, COMEX futures positioning has been largely a contest between the managed money traders and the commercials, with the commercials mostly duping the managed money traders into buying and selling. Over the past 35+ years, the commercials have proved so skillful and controlling that that they never once collectively took a realized loss â?? always managing to either take collective profits or breaking even. That is, up until this past year.

I donâ??t doubt that the banks largely making up the bulk of the 8 big shorts may own some physical gold (although I doubt they own much, if any physical silver apart from JPM). Then again, Iâ??m not certain the big banks which are short do own gold. My point is that whether they do or donâ??t own physical gold, is unrelated to their COMEX trading against the managed money traders over the past few decades. The big commercial traders on the COMEX took futures positions opposed to the managed money traders irrespective of whatever physical gold holdings they may have held. These big commercial traders were out to make a buck against the managed money traders, just as they did for 35 years running.

A year ago, as gold started moving higher, the big commercials (including JPMorgan) started selling short against the managed money traders which bought the price breakout. By $1350 to $1400 in gold in June, both the 8 big commercial shorts and the managed money longs were â??full upâ?• in terms of positioning. Based upon how they operated for decades, the big commercial shorts were looking to then rig prices lower, with the hope and expectation to garner perhaps $300 to $500 million collectively from their massive short positions in realized gains.

Instead, the big shorts are out close to $8 billion, completely disproportionate to the expected potential profits and are still involved very much in an open position that could easily move against them from here. Who risks $8 billion or more in order to make perhaps 5% of that amount? Interestingly, the 8 big shorts are now out all their total realized profits over the past decade and more. How can this not be called a major miscalculation on the part of the 8 big shorts? And whether they have the physical gold or not, they still had to have put up the $8 billion in margin calls to the exchange clearing house. Themâ??s the rules and everyone, including the big shorts, are bound by them.

The big commercials had performed this operation (skinning the managed money traders) at least two or three times a year for many years and over the past ten years at least, had reaped $5 to $10 billion in collective realized profits at the expense of the managed money traders. The sole reason the big commercials shorted so heavily into last June had absolutely nothing to do with hedging any physical gold (or silver) they may have owned â?? their only motivation was to skin the managed money traders yet again. Period. So for anyone to claim the big commercial shorts are merely hedging in being massively short COMEX futures simply reveals a misunderstanding of how things work.

A hedge involves a loss on one side of a trade combined with an offsetting profit on the other side of the same trade â?? all deliberate and intentional, so as to avoid risk and forgo profit. Hedging oneâ??s bets as it were. The 8 big shorts werenâ??t setting out to hedge anything a year ago when they shorted so heavily against managed money buying â?? the big shorts were intending to profit on their short positions. The simple truth is that the big shorts miscalculated and have not been able to buy back their massive short positions to this day â?? again, for the first time in history. To call their big short positions legitimate hedges is insulting to the concept of hedging.

The way things are supposed to work in free markets that are adequately regulated to safeguard against manipulation is for the regulators to be alert to signs of undue concentration on either the long or short side. The only reason, therefore, that the CFTC monitors and publishes concentration data in every commodity market is to guard against undue concentration.

The CFTC is certainly adept at monitoring and publishing concentration data, but as far as guarding against or doing anything about manipulative concentration â?? not so much. Not to make light of it, because this is hardly a laughing matter, but this is akin to that Seinfeld segment when he learns there is no rental car reserved for him even though he has a confirmed reservation. The CFTC knows how to monitor concentration, just not do anything about it when it exists to extreme and dangerous levels â?? so why does this agency even exist?

I promised something new in terms of how things work and this does not seem directly related to gold and silver â?? at least not yet, but may be getting there. As you know, the stock market seems to many to be disconnected from the real economy, at least according to those with quite a good number of years of successful investment experience, like Stan Druckenmiller and David Tepper, who have both termed the stock market as being extremely overvalued relative to actual economic conditions. I donâ??t have a dog in the stock market fight, so please take what Iâ??m about to offer as simply a possible explanation for the disconnect.

The current coronavirus pandemic has kept many at home and even before that, according to published statistics, there has been a surge in the opening of new online trading accounts, particularly by younger traders, who never invested before. Such traders are reported to be primarily interested in day trading, attracted to buying whatâ??s moving now and not the least turned off by buying after major selloffs. There is a growing feeling this multitude of young new traders are responsible for stock market strength.

In addition (and Iâ??m not joking), there have been other reports indicating that because there are no sporting events, there has been no betting on such sporting events; wagering which has run to many billions of dollars annually. It is being reported that former sporting event betters are now wagering in the stock market instead. If there is such a connection between both new investors and former sports betting enthusiasts speculating in the stock market, it is not unreasonable to conclude that some of that new buying power might find its way into precious metals or perhaps has already started. After all,there is a wide variety of stock market precious metals vehicles for investors to buy, including ETFs.Just what the 8 big shorts donâ??t need â?? a new wave of potential buyers.

Finally, the key question at this point is how much deterioration has occurred in the market structures in COMEX gold and silver over the past reporting week ended yesterday. Gold prices rallied as much as $70 at the highs and ended the reporting week nearly $40 higher. Silver prices rallied as much as $2.20 over the reporting week and ended nearly that much higher. Trading volumes werenâ??t that much greater in gold than recently, but silver trading volumes were higher than recently, but somewhat less than what I would have expected. The total open interest increased sharply in both, gold by nearly 32,000 contracts and silver by nearly 16,000 contracts.

Therefore, it would be a (bullish) surprise if there wasnâ??t big managed money and other speculative buying and commercial selling. My sense (and hope) that the commercial selling was somewhat less than the increase in total open interest in gold, say, closer to 20 to 25,000 contracts, although commercial selling could come close to the increase in total open increase in silver, but hopefully not too much more. But even if we see the expected deterioration in Fridayâ??s new COT report, weâ??ll still be miles below the extremely bearish readings of not that long ago. Iâ??ll be extremely interested in what JPMorgan may have done (in terms of selling) and, of course, what the 8 big shorts did.

As far as the financial standing of the 8 big shorts, at publication time today, their combined open losses increased by around $300 million, putting total open losses slightly above the $8 billion mark at $8.1 billion. This week, at least so far, the increased open losses have come on the silver, not gold side. Trying to handicap the day to day price movements is not my game or forte, so Iâ??ll not even attempt to do so. Tell me what the 8 big shorts will or wonâ??t do and I might have a chance. Iâ??m still playing it like it wonâ??t turn out too well for them in the end.

Ted Butler

May 20, 2020

Silver – $18Â Â Â Â Â Â Â Â (200 day ma – $16.97, 50 day ma – $15.06)

Gold – $1751Â Â Â Â Â Â (200 day ma – $1562, 50 day ma – $1670)

Date Created
2020/05/20