Nov. 6, 2009 – More Q & A

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I've had some very good feedback on the question and answer piece I ran last week, so I'd like to address some new questions that I have been asked since then. Today, I'll attempt to answer questions about short-selling and my expectations for what CFTC Chairman Gensler might do about the short silver concentration/manipulation and JPMorgan's role in all this. Please let me hear from you if you have new questions or if I neglected answering any previous question you may have asked. I won't edit the questions at all, unless I specify otherwise.

Question one Â?

Dear Mr. Butler:

I find it difficult to understand why you think there is something fraudulent about short sales of SLV. The prospectus explicitly says that that the shares can be held in margin accounts, and brokers often require investors with margin accounts to loan shares in those accounts to the broker or the broker's clients in order to affect short sales. If someone sells IBM short, the transaction does not create additional shares in IBM and in no way dilutes the ownership of IBM represented by its outstanding shares, whose number has not been increased by the short sale. So, too, with a short sale of SLV: the short sale has not increased the number of SLV shares outstanding, and each share of SLV represents the exact same amount of physical silver after the short sale as it did before. The ownership rights of someone who buys shares of IBM or SLV from a short seller are identical to the ownership rights of someone who purchases those shares from someone who is not engaging in a short sale. Where's the fraud?

Cordially,

Carlton

Carlton,

Thanks for your note. What we have here is a clear disagreement. The short sale of any stock, whether it has been borrowed first, or has been sold short naked (not borrowed first) does, in fact, effectively increase the float, or the amount of shares outstanding.

As you say, the ownership rights of someone who buys shares from a short seller is the same as the ownership rights of someone who purchases from someone not engaged in a short sale. That someone would include an owner whose shares have been lent to a short seller. The party whose shares have been lent still owns his shares, with the same shares now also owned by the new buyer who purchased those same shares from the short seller. IBM or SLV hasn't issued new shares, but the short seller has created multiple ownership of the same shares.

My personal feeling is that this does constitute fraud, as dual or multiple ownership of the same real property is certainly considered fraudulent in every other property exchange. Can you imagine us having this conversation if someone borrowed a house and sold it to a third party? Admittedly, this is not considered fraud in the area of securities, but I think it should be. I don't think people have really stopped to contemplate what transpires in a short sale.

More to the point, however, is how it relates specifically to SLV. The prospectus is clear that that a buyer should expect that one ounce of silver stands behind every share. But in the case of shares purchased from a short seller (borrowed or naked) there is no deposit of silver into the Trust. The short seller has created phantom shares. Maybe he's good for the silver, maybe not. But how is a buyer to know for sure that one ounce of silver backs up every share he owns, if even one share is sold short?

I have written about this more extensively in these articles from last year Â?

http://www.investmentrarities.com/ted_butler_comentary/07-21-08.html

http://www.investmentrarities.com/ted_butler_comentary/06-16-08.html

Ted Butler

Question two Â?

Ted…To me, the obvious question is… In this day and environment for banks, do we really believe that "JPM" could possibly be that short or that "at risk" without a plan or covered elsewhere ? Could CEO J.D. really not know ? We know that he would show the responsible party(s) "their heart(s)" ! And if the public read that JPM lost $ 3-4 BILLION speculating on silver, the CEO would lose his job ! Bear Stearns yes, JPM ? You answer ? Sorry, as I have been in since $8-10 and believe me when I say Thank-You ! and I love your work and passion ! I want you to be right ! T.S.

Tom,

Whether JPMorgan is really Â?at riskÂ? is something we can't know. But they are short, according to public data. I have speculated that they may have covered their COMEX short position in the OTC market (meaning someone else is Â?at risk.Â? But that also means the short position still exists). Or maybe the government has guaranteed them against loss. The Bank Participation Report shows one or two US banks as having a documented short position in COMEX silver and gold futures. So yes, in this day and environment for banks, we have incontrovertible proof that banks are short obscene amounts of silver (and gold). It's not called the Bank Participation Report for nothing.

Without getting into it too deeply, my analysis shows it to be one bank. While the names of the banks aren't published, separate correspondence from the CFTC to senators and congressmen indicates it is JPMorgan, as a result of their takeover of Bear Stearns. It is not possible that the CEO of JPMorgan is not aware of this position. For one thing, I have emailed him on recent occasions about this, and I know others have as well. He has never responded, but neither have the emails been returned. Here's his email address if you would care to try for yourself Â? jamie.dimon@jpmchase.com I hope you know I am not Â?getting in your faceÂ? or challenging you in any way; I'm just trying to demonstrate that Mr. Dimon must be aware of this issue. Besides, he has a reputation for being a very details oriented and hands on CEO.

I can't speculate as to his job security (it's not something that particularly concerns me), but you make a point is very important. This silver short position business is a big damn deal. If it weren't such a big deal, the CFTC, JPM, CME/COMEX, et al, would be answering my simple questions without delay. They wouldn't take a year to investigate. They would probably be stepping on me like a cockroach, as well. As it is, I think they are afraid to even talk to me because they don't have good answers. That's because the issues are clear and go to the heart of commodity law and are verified by their own data. How it plays out will only be known in time, but I can't go any higher the heads of the CFTC and JPMorgan or raise more specific questions on this very important issue. We're already at the top of the food chain, so to speak. This is good, because that's where the issue belongs.

Maybe they manage to come up with a plausible-sounding explanation for why this big short concentration exists more in silver than in any market in history. Maybe not. But they sure haven't been beating down our door with that explanation. Nor can they deny that JPMorgan is mega-short.

Question three Â?

Hello Ted,

I really appreciate how clear you communicate your views. I was wondering, with all the bank failures happening on a weekly basis, how likely would it be if JPM or a subsidiary of JPM “assigned” with all the silver short positions they hold be allowed to fail or just file for bankruptcy? Was there not some news recently from China that some of their government sponsored companies might default on certain derivatives they have? What’s to stop JPM / JPM subsidiary from defaulting on their silver short positions? Wouldn’t that be an easy way to cover/eliminate their risks?

Yours truly,
Noel S.

Noel,

I don't think there is any real chance that JPMorgan would go bankrupt as a result of their silver short position. They are too big and important to the financial system. But as I answered in the previous question, I think you are raising a very important point, namely, what if there is a COMEX default and the short sellers walk away from their obligations? Or if the regulators could see no way out other than to shut the COMEX down? I admit that this outcome sounds very extreme, but I also believe that this concentrated short position has created such an extreme situation, that such possible outcomes must be considered.

Some things actually favor closing the COMEX silver market. For one, it would eliminate the short position instantly. And it's not an issue with broad political significance, like health care or economic concerns. Most people wouldn't even notice if futures trading was closed in COMEX silver. The number of traders involved in COMEX silver futures, compared to the population as a whole, is such a small percentage that little public outcry would result. There would be no million man march on Washington protesting a closing of silver trading on the COMEX.

In addition, there is actual precedent for such a default and shut down of futures trading.
Over 30 years ago, on the very same exchange affiliated with the COMEX, the NY Mercantile Exchange, a few big short sellers couldn't deliver and defaulted on their Maine Potato futures contracts. All long and short contracts were closed out at an arbitrary price (ten cents a pound, as I recall). It was a very big scandal in the commodities world and the Maine Potato futures contract never traded again. But few people were affected and life went on. As a broker who did some trading in the contract for clients at that time, I don't remember losing any sleep over it, but I wasn't really tuned into the situation. Maine potatoes are still grown and consumed, proving that futures trading is not necessary in order for a commodity to exist. Likewise, silver would certainly still exist, even if there were no trading on the COMEX. I believe such thoughts have been contemplated by the regulators.

On the other hand, a default and closing of COMEX silver trading is the biggest scandal possible. In an instant, it will confirm what has been alleged for years, namely, that the silver market was crooked and manipulated. There were no prior public warnings of a manipulation in Maine Potatoes. My allegations of a manipulation in silver go back 25 years. Maine Potatoes were a small regional commodity; silver is a world commodity. A COMEX silver default will set the commodity world on its head.

Such an outcome will launch the price of silver skyward. Without the futures contract shorting mechanism, the short sellers would instantly lose their main manipulative device. Plus, the buyers of paper COMEX silver futures contracts would be forced to buy real silver, including ETFs and other investment vehicles that deal in physical silver. This would create physical buying demand at precisely the time the short sellers will have withdrawn. This would be the perfect formula for a price explosion.

Finally, a closing of the COMEX silver futures market would send a signal to the world silver producing, consuming and investing community that silver had been artificially undervalued for many years, opening up a Pandora's Box of litigation and other actions. I believe these thoughts have also been contemplated by the regulators. Bottom line Â? this outcome is still a very big deal, and one that will not be as easy as it may first appear.

Question four Â?

Mr. Butler:

I have recently subscribed to your newsletter and am quite pleased with it.

I am curious about one thing, though. I don’t mind waiting one, maybe two years for this problem with the silver shorts to be resolved. But, after waiting for that long, I would probably get impatient and sell my miner stock.   And, I know you don’t know when this problem with the short positions will be resolved. Judging from the data you examine, though, can you discern trends suggesting an acceleration toward resolution of these short positions you have been discussing.

Kind Regards,

Stephen

Stephen,

You're correct. I like to say that I am an analyst, not a prophet, which means precise timing is way above my pay grade. However, everything I see tells me we are on an accelerated trend towards resolution of the concentrated short position. Just look at how many people are discussing it and asking questions about it, like you. Look at the statements coming from the CFTC. Maybe it gets drawn out longer, but I just don't see how it quietly disappears.

I would like to offer another thought. Someday, the short position will be resolved, either by regulatory action or the physical shortage, or some combination of the two. When that comes, the short position will cease to be the bullish prop to prices that it is now. Yes, I know that sounds contradictory. I complain about the manipulative effect that the concentrated short selling has on the silver price, but my complaint is based upon legality and fairness. The flip side to the manipulation is that it creates an undervalued asset, which is a gift to silver investors.

So my suggestion is for you to look at it differently, namely, cherish the time, like now, when the short position is in full force because it is responsible for low prices. Worry instead about when to sell when the concentrated short position no longer exists. Of course, Â?worryÂ? won't be the right term, considering how high prices will be when the concentrated short position is history.

Question five (I get more of these than any other) Â?

Hi,
I have read your articles for years- and I have made a substantial investment in silver based on that information.

However, I fail to understand the optimism you give to Gensler in his current predicament. It has only been a decade since Ms. Born stepped down as Cha

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