October 15, 2014 – Oil Catches the Silver Disease

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All eyes (except those looking at Ebola) are on the price of crude oil and its dramatic recent decline. Since mid-June, the price of the world's most important commodity has plunged by 25%, with more than half the decline coming over the past two weeks. The plunge has resulted in non-stop commentary as to its cause and predictions for what lies ahead. Reasons ranging from overproduction, weak demand and even an organized conspiracy by Saudi Arabia and the US to undermine Russia's financial condition are just a few given to explain the sudden drop in price.

Alas, I fear that most of the commentary is wide of the mark. However, I have been struck by a common theme offered by those commentators who, in my opinion, seem to be the most informed on actual petroleum matters. That common theme is that they see nothing that has changed radically in the world physical oil markets to account for the sharp decline. None of the most informed petroleum commentators have come out and said it explicitly, but what they are saying implicitly is that the oil price plunge has been caused by derivatives trading. I will try to make a pretty complicated circumstance as simple as I can, but please get back to me if you have any questions.

We trade crude oil and every other world commodity in two forms Â? actual and derivative Â? so it has to be one or the other behind the oil plunge. I would define derivate as a legal contract based upon the actual commodity, such as regulated futures contracts. By process of elimination if there isn't verifiable evidence of drastic changes in the physical oil markets, attention should be focused on the only alternative explanation Â? derivatives trading, particularly the trading on the world's largest oil derivatives oil trading platform, the NYMEX (owned and run by the CME Group). And as it turns out, there is compelling evidence that proves derivatives trading is behind the oil price plunge.

For one thing, a number of the single biggest daily plunges have occurred as the regular trading session has been ending on the NYMEX (and ICE) and other world markets are closed, which points to the NYMEX as being at the core of the plunge. More importantly, government data in the COT reports have indicated massive net selling by traders in the managed money category (technical funds) since the decline started in June. The roughly 150,000 net contracts sold by these speculators is, by far, the largest selling in any trader category on the NYMEX. The biggest buyers on the oil price plunge since June have been US and foreign banks (who hold the biggest short positions).

One can look at that documented evidence and conclude that the concerted selling by the technical funds and counterparty buying by banks (swap dealers in this case) had something to do with the price plunge or was merely coincidental. Since there seems to be a lack of compelling evidence emanating from the physical oil markets to explain the plunge, let's look at the COT data more closely, following some basic background on oil.

Roughly 90 million barrels of oil are produced and consumed each day in the world, worth $7.5 billion (at $84/bbl.) On an annual basis, total crude oil production and consumption is worth almost $3 trillion. Compared to crude oil, other commodities pale in valuation matchups; the value of annual gold mine production comes to $125 billion and silver only registers less than $15 billion. Two days of world oil production exceeds annual silver mine production. In dollar terms and in its impact on the world economy, oil is in a class by itself.

Because oil taken from the ground must be consumed quickly or stored in special and expensive tank farms and other facilities (including ships), there is a fairly balanced ratio between daily production and consumption, rarely outside a million barrel a day overage or underage. In other words, when production exceeds consumption by a million barrels a day (or about 1%) or so, a surplus develops fairly quickly or tightness in the event of a million barrel a day shortfall. Most importantly, such surpluses or deficits are quickly recognized. No such over or under production has been noted recently.

But the CFTC has reported that the traders in the managed money category have sold roughly 150,000 contracts of NYMEX crude oil futures contracts (apart from selling in other energy contracts) since June. Since each futures contract covers 1000 barrels of crude oil that means the technical funds have sold the equivalent of 150 million barrels of oil since June. I know that actual crude oil is different than a futures contract equivalent, but I also know that 150 million barrels of equivalent selling is a massive amount compared to the one million barrels that would put oil in a daily surplus or deficit. In other words, how could the selling of the equivalent of 150 million barrels of oil not cause the price to plunge?

In a very real sense, the crude oil market, along with all COMEX/NYMEX metals has contracted the silver disease Â? or the sickness of having the price of vital commodities manipulated by a relative handful of speculators Â? of having the tail of derivatives wagging the dog of the actual market. I have nothing against speculators (as I am one), but I have everything against letting speculators determine the price of anything. I know that the markets need speculators to provide liquidity to legitimate hedgers and that stands at the core of economic justification for futures trading. But that is not occurring in crude oil or silver or the other metals. Instead, we have speculators (technical funds) trading with other speculators (mostly US and foreign banks) in a private betting game. For allowing this to develop, full blame and everlasting shame must be placed on the regulators, the CFTC and the CME.

The consequences of the crude oil price plunge at the hands of speculators on the NYMEX and other derivatives exchanges are enormous and mostly extremely negative. I am an energy consumer, as is most everyone in the world, and further, I hold no positions in energy and, therefore, I should be welcoming the plunge with open arms. But I am not because of the manipulated nature of this decline. I have been a participant and student of energy trading since futures trading was introduced several decades ago. In the early 1970's, I lived through the Mid-East embargos and crises and gas lines and, perhaps, I have a different perspective as a result.

Crude oil is a unique market in that there must be some control to production and price. Throughout history, oil production (and price) was controlled in some way, from the Standard Oil of Rockefeller, to the Texas Railroad Commission, to OPEC. I'm not saying that the production control at the wellhead is a perfect system, but compared to the system we have evolved into, namely, a speculative free-for-all on the NYMEX, the old days look much better. For one thing, having oil prices determined by speculators introduces a level of disorderliness which I fear will come to haunt us, particularly since tensions in the financial market are running high away from oil.

While many are quick to reach the conclusion that lower oil prices are unabashedly good without having a clue as to the cause of the lower prices, I am less enthused. If I am correct and the oil price plunge can be laid at the feet of speculators (technical funds and speculating banks alike) on the NYMEX and other exchanges, then the price drop should prove as permanent as speculators changing their minds and positions. When the technical funds are done selling in oil and other energy contracts and begin to buy, prices are likely to rise as fast (or faster) than they fell. What will that do to consumer confidence and finances? Wouldn't all of us been better off without the price volatility brought about by speculative trading?

It would be a mistake, in my opinion, to assume that the world's big oil producing and exporting countries, like Saudi Arabia and Russia, will simply abide by the NYMEX generated price-setting, just as it would be a mistake to assume they are powerless to reverse it. The only thing such oil exporters are missing is the specific cause of the price plunge (as hard as that is to believe considering how obvious it is). Instead, they are bickering with each other because they haven't zeroed in on why oil prices have plunged (if I am correct).

Considering how long it has taken silver producers to recognize and acknowledge the silver manipulation, I suppose it is possible that the big oil producers might continue to remain unaware of my premise. But there is a big difference between oil and silver, as I highlighted above, when it comes to dollar value. Simply put, the budgets of Saudi Arabia and Russia and other oil exporters are dependent on a certain price for their oil exports; that's not the case in silver. What this translates into is that these countries, whether they wake up to the price scam on the CME's NYMEX or not, they must and will take measures to bolster the price. And in time, they will succeed because history has shown that oil producers, not consumers, will set the price in the end or in a crunch. It's been 40 years since I waited on line due to gasoline rationing and I vividly remember the feeling that I would pay any price to fill the tank on my VW bug. Deprived sufficient supply, I expect most would feel the same way in the future in similar circumstances.

But one potential good outcome is if the oil exporters (or any oil producer) came to realize that the speculators on the NYMEX were responsible for the price plunge and moved against this manipulation, could be to shine the light on the silver scam. After all, it's not that great a distance between the CME's NYMEX manipulating oil prices and the CME's COMEX doing the same in silver (and gold). Hey Â? you never know.

Another negative consequence of a recognition that oil prices were artificially manipulated lower could be a loss to general confidence as investors might conclude (and rightly so, in my opinion) that most markets are rigged. Sadly, that is an opinion that I have long held. I am also struck by how many can't see the oil manipulation we've just experienced even though everyone looks at it and talks about it. I can't help but reach the conclusion that just like in silver, where most are unaware of how the price is actually set, the vast majority is unaware of what goes on in other markets, like oil and stocks and bonds.

The easiest takeaway from my oil manipulation premise is that considering how big and important and visible crude oil is to everyone, if that market can be scammed by NYMEX speculators, as I contend, how hard would it be to manipulate COMEX silver? Given how small and off the radar silver is compared to oil, the answer must be not high at all. I mention this as it conforms in every way to my long held convictions that silver has been long manipulated in price.

While both fell about the same percentage over the past few months some important distinctions between oil and silver are that silver is at record extremes of managed money short selling and well below the cost of production for primary producers. Crude oil prices may have fallen enough to reverse upward here or soon, but silver is more advanced on both counts. Plus, there are continued signs that the supply/demand situation is relatively tighter in silver than they are in crude oil.

Lastly, silver is a natural as a safe haven demand in what are increasingly tenuous financial times. Yes, it's true that silver has been underperforming just about everything under the sun for some time, but that has only resulted in it becoming more of an outstanding undervalued asset. Silver investment demand has, can and will turn into a torrent at a moment's notice and if ever there were a time for it to soar that time would appear to at hand.

I'm almost tempted not to mention it so as not to appear sensational and because so many bogus scams have surrounded it, but the fact that silver is an age-old natural biocide and we seem to be confronted with the worst threat of a viral outbreak with the current Ebola crisis, it's hard for me to conceive that silver won't play a role somehow. Silver is already used in clothing and surfaces in hospitals to prevent the spread of viruses and I can see a major push to expand silver's role as easily possible. Try as I might, I can see no downside to silver from the threat of Ebola and only the possibility of upside, if only from the improved perception of the value of this metal.

However, the most important factor in silver for me is still the setup on the COMEX (and the fundamentals). Very recently, silver has continued to underperform gold and just about every other CME metal. I don't think that's accidental as silver's extreme undervaluation stands out too much as does the lack of plausible explanations away from price manipulation. And if you'll pardon my use of the pun, there really is a silver lining to silver's punk performance. I am a bit concerned, for instance, that commercial selling has picked up in COMEX gold because it has traded and closed above its 20 day moving averages for six days straight, while silver has not performed the same way to the time of this writing and has not closed above its 20 day moving average ($17.50) yet. The silver lining is that price action in silver being so punk strongly suggests there has been no big increase in commercial selling.

I would expect that gold might see some increase in commercial selling in this week's COT report since it closed above its 20 day moving average for every day of the reporting week and is much closer to its 50 and 200 day moving averages than is silver. Gold would appear to have a long way to go price wise to the upside but it would have gone farther by now if the commercials hadn't sold as much as I think they have. Perhaps that's an indication that the commercials will sell aggressively in silver on a rally similar to what gold has experienced, but we already knew that was the key question all along. We'll get the answer and probably soon.

Looking at all the markets and trying to take in the changing collective sentiment, as well as the growing sense that things could get disorderly pricewise, I'm left with the strengthening conviction that silver is the very best asset to hold. Sure, the crooks at JPMorgan and the CME Group might be able to engineer further price weakness, but I've long passed the point of even thinking about selling silver. In the meantime, since so many are trying to figure out what the heck's going on in crude oil, there is a better chance than ever that they may find it in the silver disease that has incubated on the NYMEX/COMEX. All they have to do is look.

Ted Butler

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Silver – $17.40

Gold – $1238

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