

September 17, 2014 – Third Time a Charm?

Third Time a Charm?

Recently, I have indicated that the run in silver prices to nearly \$50 in 2011 looked like just a tune-up for the price run yet to occur. I base my thinking on the fact that the conditions that existed in 2011 are not that much different from conditions that exist in silver today. All that's needed for another epic silver price run is a pickup in investment demand which has been relatively subdued over the past three and a half years. That's hardly an impossible obstacle and more an almost inevitable outcome given total world investment buying power and silver's extreme undervaluation.

But in thinking further about my tune-up analogy, it occurred to me that there were two separate warm up games in which silver ran to \$50; in April 2011 and thirty years before that in 1980, when the Hunt Brothers were found to have manipulated the price of silver higher. In fact, the long term chart of silver is defined by the two sharp surges to \$50 on those two occasions, amid years of flat or declining prices, not dissimilar to the past three and a half years. To my knowledge, few other commodities have that unusual double spike in price that exists in silver.

More remarkable is that each silver price run to \$50 came from extremely low price levels existing in the years before the two price spikes. In other words, when silver does run, history indicates that it runs like it is on fire; racking up the biggest percentage gains of all. Those two facts alone – that silver ran to \$50 twice and the gains far exceeded the historic gains of any commodity (or market) – should be enough to attract investors at current depressed prices. After all, no one can deny that silver can't go to \$50 again, seeing how it's been there twice already. And if it does run again, the percentage gains will likely exceed any other commodity or market (stock, bonds, real estate, etc.).

Most exciting of all is that not only can silver run to \$50, as it has done on two prior occasions, it should far exceed that level in the real price run to come. That looks clear to me when I study the circumstances of the first two historic silver price runs, including how each price spike ended. When I look at the previous and current circumstances in silver, not only do I see a rerun dead ahead in terms of an historic rally, but I also see an ending different than what occurred in 1980 and 2011. In fact, it is the perceived different ending that suggests to me that the ultimate silver price run ahead will far exceed \$50.

Everyone knows that silver ran to \$50 in 1980 because a group of investors, led by the Hunt Brothers from Texas, bought massive quantities of both physical and silver futures contracts, causing the price to jump seven-fold in a year. Actually, Bunker Hunt started buying silver some eight years earlier, around the \$2 level and prices had jumped to \$6 in the mid-1970's, in a tune-up for the tune-up to come in 1980. At the peak, the Hunts were said to have amassed close to 100 million oz of physical silver, as well as another 100 million oz in paper futures contracts.

Unfortunately for the Hunts, their silver holdings were highly leveraged (including the physical portion) and the sharp fall from \$50 in March 1980, quickly forced the Hunts to indiscriminately dump their holdings due to margin calls. As would be repeated in May 2011, regulator and insider collusion on the COMEX was responsible for the rule changes, margin changes and intentional price-fixing to the downside that led to sharp declines in price from the \$50 peaks. It is somewhat remarkable that both prior silver price ramps to \$50 ended due to similar COMEX interference and shenanigans.

Less appreciated is the simplest explanation for why silver ran to \$50 twice before. In both cases, in 1980 and 2011, more silver was bought in physical form than the market could provide. From what I've read, I believe the Hunts manipulated silver prices higher because their intent was that their purchases would drive prices higher. But that's separate from the fact that in 1980, there was an insufficient amount of silver available to satisfy the Hunts buying, forcing prices sharply higher.

Almost eerily, the exact same cause (insufficient physical supply) resulted in the silver price run to \$50 in 2011. Unlike what occurred in 1980, there was no coordinated manipulative buying in the price run in 2011; only broad-based investor buying, particularly in the publicly traded silver Exchange Traded Funds (ETFs), like SLV. If the crooks at the CFTC and CME had been able to pin the 2011 silver run to futures speculators manipulating the price upward, they would have taken that action by now. The reality is that there was no Hunt-like culprit to blame for the 2011 price run, so the actions taken by the regulators to cause prices to crash were strictly to bail out silver short sellers, particularly JPMorgan; just like occurred in 1980.

Thus, the two prior silver runs to \$50 were caused by the same underlying circumstance (insufficient physical supply) and were ended the same way - overt official interference on the COMEX. Let's compare to current circumstances in silver.

Silver was in the middle of a long term physical consumption deficit in 1980 that wouldn't end until 2005, so there are at least 2 billion oz less silver in world inventories in both 2011 and today, than existed in 1980. Since world population and GDP have grown by more than 50% since 1980 and world investment buying power is many times higher, the fact is that the mismatch between buying power and available metal was much more extreme in 2011 and is today than it was in 1980. If the Hunt Brothers caused the silver price to explode in 1980, it would take much less relative buying today, just like was the case in 2011. In other words, the facts point out that it's easier for silver to climb to \$50 and higher than ever before.

But the case for much higher than \$50 for silver in the real move is seen most clearly in how the prior runs ended. There can be little doubt that government officials and COMEX insiders played the key role in causing silver prices to be smashed both in 1980 and 2011. In 1980, these officials and exchange insiders were able to blame it on the Hunts, but had no such opportunity in 2011. Similarly, there will likely be no such opportunity to blame manipulative speculators in the next price run for the simple reason there is not enough silver available that big speculators could buy amounts considered to be manipulative. Simply put, no one investor could buy 100 or 200 million oz of silver without causing prices to explode past \$50.

This was the real lesson of the 2011 price run — unlike 1980, silver ran to \$50 without a big buyer, just as it will likely be on the next big move up. The actions taken in 2011 to smash the price — two \$15 declines in a week or less — because they were so in your face, will be hard to replicate in light of how accepted the manipulation premise has become. So many more observers are aware of the silver manipulation today that the actions of 2011 will not be easily replicated. But if you think such outrageous efforts to smash the price will succeed, then the solution is simple — sell at \$50.

I don't think corrupt government and exchange officials will turn back silver at \$50 the next time it gets there; leaving only one resolution, namely, that the price must burn itself out to the upside. Here's how the price of silver will truly explode — with no artificial exchange interference, all the buying from both investors and industrial users must be satisfied by actual selling or because the price gets too high to consider buying. In that case, almost by definition, the price must go a lot higher than \$50.

It is the different ending to what happens the next time silver hits \$50 that will make the third time the charm and the previous two \$50 runs just warm ups for the big move. The best thing is that the opportunity is open to everyone, whether you participated in the first two silver runs or not. From everything I see, you don't want to miss the next silver run.

A Timely Question

Here's a question I received from Dan, a subscriber.

Dear Mr. Butler

There is a lot of talk about the high open interest of silver and how to translate it. Usually it will be translated to an imminent price smash and so far it worked.

Would you please open in your next letter more about it? Is it always negative? Is it negative now? How does it correlates with the COT division? Etc.

Thanks

Dan

Let me first define total open interest. It is the total number of contracts held open (and not closed out) both long and short in any futures market, like the COMEX. One contract means one open long position and one open short position. Futures contracts are derivatives contracts and all derivatives contracts are formed by a long and a short.

I first discovered the silver manipulation in the mid 1980's by observing that total open interest in COMEX silver was head and shoulders above any other regulated futures market when compared to annual world production and consumption. In other words, there was a much bigger combined long and short position in COMEX silver futures than in any other commodity market when measured against real world production and consumption.

When I dug further, I could see that the long side of the COMEX silver market was widely held (non-concentrated) and representative of the collective public opinion that silver was cheap (around \$5) and the short side was concentrated and held mostly by big New York banks. It didn't take long for me to conclude this configuration was manipulation in its purest form and fully explained the low silver price despite the existence of a structural deficit consumption pattern; the most bullish circumstance possible in any commodity. (And I was finally able to answer Izzy Friedman's challenge to explain why silver prices were so low).

Remarkably, nearly 30 years later, the total open interest in COMEX silver is still head and shoulders above the open interest of any other commodity when compared to the respective world annual production or consumption of each commodity. For example, current total open interest in COMEX silver futures is over 170,000 contracts or the equivalent of 850 million oz (one COMEX silver contract covers 5000 troy oz). That's larger than annual world production of around 800 million oz.

Of course, that statement doesn't mean much to the average observer by itself; it is only when you compare silver's open interest/production profile to other commodities does the profile stand out. The total open interest in COMEX gold futures is around 385,000 contracts, or the equivalent of 38.5 million oz, or less than 40% of the world's annual gold mine production of 100 million oz. I know that gold's open interest is at multi-year lows, while silver's is at a high, but the comparison changes only a little when you employ historical open interest figures. COMEX copper futures' total open interest equates to only 10% of world copper production.

In fact, if you compare the total open interests of other commodities, like grains and meats and energies, the equivalent comparisons to annual world production are miniscule. The obvious question is why is total open interest in COMEX silver at 100% of total world annual production, while all other commodities are much less? That was the question I asked myself 30 years ago and having answered that it is manipulative to price on its face, set me on a journey that exists to this day.

Please accept this as background, as I know I haven't answered Dan's question yet. The question concerns what does current total open interest mean for price direction? The answer is not so much. While I just acknowledged that total open interest was my gateway to the silver manipulation, it is not in the slightest any type of consideration for me in current price expectations. That's because there exists the weekly Commitments of Traders Report (COT) from the CFTC, which provides an exquisitely detailed breakdown of total open interest. If there was no such thing as the COT report, then we would be forced to ponder the meaning of changes in the total open interest. Without the COT reports, we'd be up the analytical creek without any chance of a paddle.

Fortunately, the COT report does exist and we don't have to dwell on total open interest alone to decipher what specific groups of traders are doing and their effect on price. Considering the wealth of information that the report provides, I just about pinch myself when I contemplate how fortunate we are (and me in particular) that the COT is published.

If I had to think of one thing the bad guys (JPMorgan, the CFTC and the CME, et al) would all desire, it would be that the COT report was never created in the first place. Now that it's here and so widely relied upon, it will not likely be abolished. Without a COT report, I would never be able to call JPMorgan the big silver and gold manipulator, the CME Group a criminal enterprise and the CFTC of having progressed from being merely incompetent to criminally complicit, with no rebuttal or denial. It would be a heck of a lot easier for the silver manipulation to continue if all we had to go by was total open interest.

The bottom line is that total open interest sheds little light on the true market structure; sometimes it appears to coincide with expected price moves; other times not. If one wants to drill down to the details, please don't stop at total open interest.

This week's COT report should reflect the continued price weakness in COMEX gold and silver in that technical fund shorts (managed money) should increase. I would have said the same thing about COMEX copper futures, but there was a rip-roaring rally in copper yesterday that was undoubtedly driven by technical fund short covering; perhaps offsetting new technical fund short selling in the days before the Tuesday cut-off. There should be no question that the technical funds are responsible for all COMEX price movements, with actual supply demand factors pushed aside. There also should be no question that the technical funds are the price pawns of the collusive commercials.

Distilled to current basics, COT analysis is in measuring how many contracts the technical funds can be persuaded to buy or sell by the commercials. Most often, that measurement takes on greater meaning when we approach or exceed previous record extremes in technical fund holdings. When we approach or exceed technical fund short position extremes, as was the case in early June and currently, it is reasonable to assume a price decline is ending and a rally should develop. When the technical funds are holding an extreme long position, as was the case by mid-July, the probabilities favor a price decline.

The probabilities proved to be correct both on the one month+ price run up from early June to mid-July and on the subsequent two month price decline in gold and silver. Certainly, in terms of price, the June rally has been completely erased, as both gold and silver gave up all the June gains. However, there is some question as to which COT indicator measures best the extent of the price decline in terms of contracts – the original headline number of the total commercial net short position or the new headline number of managed money?

As of the last COT report, the commercial net short position in gold was still some 35,000 contracts shy of its most bullish (lowest) reading of early June and silver was 20,000 contracts away. But by gross managed money shorts, gold was only 20,000 contracts away, with silver closer still at only missing the technical fund extreme short position by 6000 contracts. And this doesn't include the certain further improvements expected in Friday's report. Given the nature of the price action in the reporting week covered in the new report, we should be at the June technical fund extremes. Otherwise, I wouldn't be "all-in."

Of course, we still could move lower, particularly if the technical funds have more contracts to sell short. And even when this bottom is finally recorded, that doesn't mean prices must turn up quickly. Then again, there is nothing knowable that precludes prices from rising quickly. As a personal matter, if this decline drags out, I intend to add to call option positions on premium decay, as I can't get more all-in on a core holdings basis.

In guessing we are at a bottom, my guess is strictly based upon my estimate of potential additional short sales by the technical funds. I firmly believe that when those sales are maximized, there is no good reason for the commercials to rig prices lower. There have to be a hundred reasons for silver to climb sharply in price, but my bet concerns the sole reason for lower prices – COMEX positioning. When the last technical fund short position is put on, the sole reason for lower prices ceases to exist.

Ted Butler

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Silver – \$18.68

Gold – \$1234

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