

September 4, 2019 – Still Focused on the Shorts

Yesterday morning was like Christmas when I was a child. Silver being up certainly contributed to the good sentiment, but the biggest cheer came from seeing the deadly Hurricane Dorian turn north (as fully predicted by the weather people). My heart goes out to those in the Bahamas and for those still in its path, but the relief of seeing Florida spared can't be overstated.

Actually, silver was only up a bit going into Tuesday morning from Friday's close, but I was relieved it wasn't down a bunch following last week's sharp gains. I was particularly taken aback by the surge in silver and gold prices as the COMEX opened, as it was further clear proof that COMEX futures trading sets the price. It's quite remarkable how to this day that all don't see that.

I know I've gotten quite myopic in my focus on the big shorts in COMEX gold and silver, but as an analyst I don't see any alternative. The concentrated short position on the COMEX has always been a prime focus of mine for more than three decades and goes to the heart of my contention that the price of silver has been manipulated. There can be little doubt that the big COMEX shorts in silver and gold had mastered the game of skinning the managed money technical funds, refusing to ever buckle and rush to cover shorts at a loss even when the market went against them in a big way – like in the summer of 2016.

And the jury is still out as to whether the big shorts have lost their control over prices, despite the current beating they are taking in terms of open and unrealized losses. Yesterday's price surge in gold and silver added \$850 million to the 7 big shorts' combined open losses in COMEX gold and silver, pushing the total open loss to more than \$5.4 billion – an average of nearly \$775 million for each trader. That was as of yesterday's close, I'll update the tally when I hit the "send" button later today.

Remarkably, I see no strong evidence of pronounced short covering as yet, although there were some subtle signs of concentrated commercial short covering in gold in last week's COT report. Yesterday's price surge and volume explosion has resulted in notable increases in COMEX gold and silver futures, not at all indicative of short covering (although there did turn out to be some short covering in gold last week despite a large increase in total open interest). As always, we must await the clear final verdict in future COT data.

One thing to keep in mind is that despite my focus on the 7 big shorts in COMEX gold and silver futures, these are not the only shorts feeling the sting of the price rise. The 7 big shorts are completely responsible for the ongoing manipulation and the great size of their positions warrant the attention I give to them, but they are not the sole shorts. There are other shorts in every category of trader in the COT report and when prices make multi-year highs, as has been the case recently, it means all longs are ahead and all shorts are in the red. These other shorts add to upward price pressure as and when they move to buy back short positions.

One area for shorting that I don't often mention is the short selling that goes on in call options, particularly in silver, both on the COMEX and in SLV, the big silver ETF. Here, I'm not talking about the shorting of futures contracts or in the shares of SLV, but the shorting of call options. As a hopelessly-addicted buyer of kamikaze (cheap, out of the money and not much time remaining) call

options on SLV and formerly on COMEX futures contracts, most (95% to 100%) of these options expire worthless, rendering a complete loss almost always. However, should silver prices pop, as has recently been the case, these dumb as dirt options suddenly don't look so dumb.

My point has nothing to do with the merits of buying such options (get your head examined first), but in the mechanics of the trade. Since options are derivatives contracts, it means there must be a seller for every buyer (and vice versa). For every reckless call option bought that experience dictates will expire worthless on expiration, there has to be a seller — the entity that collects the option premium paid by the buyer and who gets to keep that premium on expiration. In return for getting to keep the premium time after time, nearly always winning, the option seller promises to provide the subject of the option — shares of SLV or futures contracts on silver (or gold) at a specific price (the strike price) for the duration of the options time term. In the unlikely event that silver suddenly jumps sharply in price during the life of the option, the seller of the call is obligated to provide the shares or futures contracts at the agreed upon strike price, even though the current price may be substantially higher.

For example, if a call option is bought and sold at ten cents per share (or ounce) when silver is at \$16 and the strike price is \$18, the option will expire worthless if silver stays below \$18 through expiration and the buyer will lose the ten cents, while the seller gets to keep the same ten cents. But if silver suddenly jumps to \$19 during the time before the option expires, the option will be worth at least one full dollar or ten times the price of the option when first bought and sold. In this case, the option buyer stands to make ten times the cost of the option while the option seller must come up with ten times what was originally received in premium.

More to the point is that the option buyer is limited to losing the entire premium, but no more than that. The option seller, on the other hand, has unlimited liability until he or she decides to buy back the option sold or some related security. Many options sold involve "buy/writes" meaning the option seller already owns the underlying security and the option seller is protected from unlimited liability, but the underlying security can be called away. Other options are sold against option purchases, a spread transaction that generally does not involve unlimited liability.

But there are option sellers who sell options without the protection of owning the underlying security or against purchase of other options. These are naked options that are very much subject to unlimited liability should the underlying security or commodity stage a large rally. While it's hard to quantify just how many such naked call options exist on COMEX silver futures or on shares of SLV, I would estimate the total of truly naked call options to be in the several hundreds of millions of ounces range. After all, there are many fools (besides me) who believe silver will explode in price one day and for all the call options bought, there must be sellers.

So, in addition to the 7 big COMEX shorts and the shorts in other trading categories in COMEX futures contracts, there is a separate and distinct short position existing in call options on COMEX futures and SLV shares. Plus, I'm sure, additional naked short sales in OTC and interbank dealings. Should silver truly ignite to the upside, the bonfire of the shorts trying to cover will surely be a sight to behold.

As for what could ignite a short silver bonfire, the choices are limitless. In fact, the fuse may have already been lit. My wife asked me the other day (she doesn't follow silver closely; thank the Lord) as to what was the news that caused silver to rally, asking if the tariffs had anything to do with it. It was a good question, but the answer has nothing to do with news and everything to do with market structure — which is as easy for someone to understand as nuclear physics. The fact is that silver is

structured to explode in price (due to the massive naked short position) and needs only a spark to set it off.

That's not to say the big shorts still can't engineer one final selloff in which they get the managed money traders to sell on much lower prices and save the big shorts' bacon one last time. These big shorts are harder to kill than Count Dracula, although they are not in good shape currently. The 7 big shorts are up against the wall and until really concrete evidence emerges that they have turned tail and begun to cover shorts, it is unwise to conclude there can't be one final shakeout to the downside.

As I've indicated all along, I'm playing it as if the big shorts will get overrun, but I have created reserves in case we get one last push lower. The reason I believe that if we get a selloff (a big "if") that it will be the final selloff is that I believe the big shorts have had the bejesus scared out of them by this move and if they escape with their hides intact, they will never go short as heavily as they are now. However, I'm more convinced that they won't go heavily short again if given the chance, than I am that they will be given the chance.

As far as what to expect in this week's Commitments of Traders and the monthly Bank Participation reports, yesterday's sharp rally on the cutoff day resulted in a big increase in total open interest for the day in both COMEX gold and silver futures, but not for the week. I'm more inclined to review the COT data than predict it this week, but would note that silver added nearly a dollar for the reporting week while gold was only up by a few dollars, implying managed money buying and commercial selling in silver.

I am still waiting for much more physical silver to be added to the SLV and other silver ETFs, given the price rise and high trading volume. I sense at least 15 million oz is now "owed" to SLV and other silver ETFs and this is, effectively, yet another short position in addition to the various other forms of short positions discussed above.

I first started mentioning the open loss to the big concentrated shorts in an article back on June 19, when gold closed just above \$1350 and silver just above \$15 and I was contemplating re-starting the money scoreboard I maintained during the summer/fall of 2016. While not a prediction, I mentioned in that article that should the price of gold jump by \$100, the 8 big shorts would be out a quick \$2.5 billion (including JPMorgan). Subsequently, as first gold and then silver began to rise, I revised the financial scoreboard to exclude JPMorgan (given its vast holdings of physical gold and silver) and confined the running tally to the 7 other big COMEX gold and silver shorts.

In little more than two and a half months since June 19, the total open and unrealized loss to the 7 big COMEX gold and silver futures shorts (not including options or OTC dealings), as of today's publication deadline, has grown by another \$1.1 billion since Friday's close to \$5.7 billion or more than \$800 million per trader on average. To think that 7 traders (banks) could be underwater that much so quickly is simply astounding.

Ted Butler

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Silver – \$19.55 (200 day ma – \$15.43, 50 day ma – \$16.44)

Gold – \$1562 (200 day ma – \$1334, 50 day ma – \$1462)

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