Weekly Review<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" />

In another week of great turmoil in world financial markets, the price of gold and silver soared. Gold finished at yet another historic high, climbing by $107 (6.1%). Silver, thanks to Friday's large gain, ended the week $3.80 higher (9.7%), but still below the late April high-water mark. These are the largest weekly dollar gains for gold and silver in my memory. As a result of silver's outperformance relative to gold, the gold/silver ratio tightened in by 1.5 points to under 43.5 to 1. The ratio is still within the trading range of the past four months.

Because of the soaring price of gold, silver still □feels□ cheap relative to gold, although that is hardly scientific. If and as gold climbs higher, given the attendant publicity that will garner, more of the world's investors should be attracted to silver as a precious metal alternative. If and as gold suffers a sharp correction in price, the question will become how much silver will reflect that fall. I'll discuss what I think is the main driving force for the price of gold in a moment. One thing is for sure □ the price volatility flag is displaying hurricane force conditions as anticipated.

Conditions in the physical silver market show no indications of a breakaway from the tight circumstances seen all year. COMEX silver warehouse movements are still swirling in and out, highly indicative of a hand to mouth situation in a prime wholesale market. The same for recent deposits into the big silver ETF, SLV. Close attention will be paid to prospective deposits and the upcoming short sale data. The US Mint continues to crank out Silver Eagles at a maximum production capacity rate, with data for the month to date indicating perhaps an increase in that rate. In a word, silver supply continues tight.

Before discussing the data in this week's Commitment of Traders Report (COT), I would remind you that the really big price action this week took place after the report's Tuesday cut-off. Accordingly, the data for the past three trading days won't be available until next Friday's report. For the reporting week ended August 16, gold climbed by a bit over $30 to $1782, after having probed above $1800 earlier in the week. At Friday's high, gold was almost $100 higher than Tuesday's close. Silver climbed by more than $2 in the reporting week, but added another $3 in the three days after the cut-off. Therefore, what took place over the past three trading days, in terms of changes to market structure, is probably more important than the data in this week's report.

In gold, there was virtually no change in the total commercial net short position for the reporting week, as it remained just below 249,000 contracts (24.9 million ounces). Within the commercial category, the big 4 reduced their net short position by 2400 contracts, as did the next largest 5 thru 8 big gold shorts. The gold raptors (the smaller commercial apart from the big 8) increased their net short position by almost 5,000 contracts. While there were similar minor changes in the composition of the reciprocal long side, the bottom line take away from this week's gold COT was that positions were mostly intact, following the big reduction in the commercial net short position the prior week.

In silver, there was a sizable 5300 contract increase in the total net commercial position to 40,700 contracts (203.4 million ounces) on the previously mentioned $2+ increase in price for the reporting week. A big chunk of the weekly increase in the total commercial short position was due to silver raptor selling of long positions of 3700 contracts. The big 4 added 1000 contracts to their short position, with the 5 thru 8 accounting for the balance. Interestingly, the reciprocal buying by speculators was mostly confined to short-covering, rather than new speculative long positions being established. Given the choice, speculative short-covering is better than new long positions being established, as it lessens the likelihood of eventual panic long liquidation at some point. Overall, the silver COT structure is still bullish, while the gold COT structure remains neutral, through the end of the reporting week.

All eyes in the financial world have been focused on the historic gold price action, which is without precedent. Certainly, no silver investor is unaware of what has been happening to the price of gold. Yet, despite the media publicity, I am struck by the lack of mention of what I feel is the most important force behind the gold price surge. To be sure, there are various causes behind the rise of gold. Investors are rattled by economic and financial market turmoil and there has been a natural movement towards safe haven assets. This can be seen in greater demand for gold coins at the retail level and in gold ETF holdings. Yet overall demand for gold does not account for the lift-off in prices over the past two months, according to no less a gold proponent than the World Gold Council. Clearly, there has been no obvious grassroots buying movement to gold that would account for the incredible $375 increase from the price lows of early July. If there hasn't been a worldwide surge of gold buying, then what would account for the surge in price?

While there are always many reasons to account for the way a market may move, generally there is a prime force, at the margin, that sets the price. All the evidence that I examine tells me that the prime force driving the price of gold has been the market structure on the COMEX. Specifically, the driving force in gold has been commercial short-covering on the COMEX, combined with a lack of increase in commercial shorting as has always occurred in past price rallies. Again, there have been many various influences on the gold price rise over the past two months, but the lead dog pulling this sled has been commercial short-covering on the COMEX. This commercial short covering appears to have commenced in early August and accounts for $230 or so of the gold price surge. Certainly, it has not been new speculative buying on the part of the technical funds that has pushed gold prices higher.

My take on why gold prices have risen also explains why there hasn't been a corresponding surge in the stocks of gold mining companies as gold prices have exploded. Most mining companies don't have the extreme short positions seen in COMEX gold (and silver). (There is, of course, a very large short position in shares of the big gold ETF, GLD). Without a very large short position in the shares, there couldn't have been the type of short covering that was witnessed in COMEX gold contracts.

Explanation for what just happened in gold is not the same as predicting what will happen in the future. Even if I am correct in identifying the prime price driver in gold, that doesn't make predicting what will happen next easy. But an analyst's job is to try to see things as objectively as possible. There is little doubt that gold's price has run very far, very fast; in fact, the farthest and fastest in history. As such, either a sharp correction or a continued upside explosion is possible. Which it will be is dependent on how this commercial short-covering on the COMEX plays out. If the commercial short covering becomes exhausted, either temporarily or otherwise, the gold price could crash. If the commercials have a lot of short covering still ahead of them, gold prices could soar. I don't like speaking from both sides of my mouth, but sometimes I must.

If I can't speak definitively as to what will happen next to price (other than to prepare you for continued volatility), at least I can speak directly to some facts surrounding the status of the commercial short covering in COMEX gold. First, this has been a financial disaster for the commercial shorts in COMEX gold. From the beginning of July, my guess is that the gold commercials are in the hole to the tune of $7 to $8 billion, with as much as $1 billion of that loss already booked and closed out. Since most of the losses are still open, great danger of a sharp sell-off exists for these crooked commercials to recover their open losses. Likewise, the commercials' weakened financial state could just as easily result in a full blown short-covering panic ahead.

I can also state that the gold price move to date confirms almost everything I have alleged about the COMEX setting the price and not being a true price-discovery mechanism as intended by commodity law. We have run hundreds of dollars quickly in the gold price due to crooked trading games gone badly on the COMEX and not due to legitimate changes in the real world of gold supply and demand. This underscores the need for the CFTC to get tough with the CME Group, the criminal enterprise that owns the COMEX. That the CFTC can allow excessive speculation on the part of the COMEX commercials to endanger the public and our market system is beyond shameful.

While my focus so far has been on specific developments in short covering in gold on the COMEX, I am reminded that what we have seen in gold is very close to what my silver mentor, Izzy Friedman, anticipated in his Full Pant's Down theory. According to Izzy, he envisioned a day when the commercials would get caught with a full short position in silver and being unable to rig the normal crooked sell-off, would instead be forced to cover to the upside in a panic. Speaking for Izzy, I'm sure he anticipated it would happen first to silver, instead of gold. But I can tell you that seeing the commercials on the wrong side of gold only increases the chance it will happen in silver as well.

Right now we are witnessing the results of the commercials having overextending themselves on the short side of COMEX gold. This is directly behind the gold price surge and extreme volatility. How this commercial gold short position gets resolved will be seen in the immediate future. But that gold resolution will come with very little likelihood of an actual gold physical shortage or a gold industrial users' inventory buying panic. That's because there is no significant industrial consumption in gold and no industrial users set to panic. In silver, we must add a very high likelihood of a physical shortage and an industrial users' buying panic to any COMEX short covering. The commercial short covering we are witnessing in gold has caused the unprecedented run up in prices. This run up will look like kid stuff when the short covering comes to silver accompanied by a physical shortage. The advice for silver investors remains unchanged. Prepare for great volatility and position yourself for the substantially higher prices to come.

Ted Butler

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Silver – $42.90

Gold – $1853