



Gold Review

16 February 2007

Gold Report- Will the good times continue?

Below we analyse the recent price action to see whether or not the market is ready for a correction. As always, we hate to pick a top or a bottom, in particular as we have so far this year had such a strong trend. However, as we head into major resistance at 676 (17/07 high) it is worth noting that the environment for change is developing. In this Report we briefly look at the old drivers discussed in previous reports to check the current state of play and see how current they are. We summarise with the view that potential exists for a good correction.

We will re-introduce what we feel have been the main drivers for Gold in the past 12 months and see how relevant they are to the current market:

Current Geopolitical concerns

Iran

We are hearing a lot of talk concerning Iran's testing of short range missiles and their involvement in supplying weapons to Shiite militia groups in Iraq. The US looks to be considering actions against Iran as indicated by a second Aircraft carrier entering the Gulf. The obvious fall out if anything erupted would be a closing of the straits of Hormuz by Iran. So far our reading of this situation suggests that nothing will occur given the negative fall out the US has received over Iraq. Although, we should remain vigilant we can mark down any Middle Eastern premium that may be associated with geopolitical concerns in the region.

North Korea

At last it looks like an agreement for North Korea to suspend and eventually disable its entire nuclear program in exchange for heating oil and aid looks set to be signed off. Although, there appears to be a short time line to conclude the agreement news suggests this threat to global stability will pass and so, should be discounted from the market.

Inflationary concerns

Oil

In our most recent Oil Report where we suggested that Oil will find it difficult to trade through US 60.00 a barrel. Although, the Northern Hemisphere winter has been harsh it has done little to indent the current stocks of Oil. We believe we are still in a consolidation period and expect prices to remain soft. We cannot rule out a move back to US54.00 as the cold months come to close. Inflation, we believe, from this sector will not be forthcoming in the near future unless geopolitical events in the

Middle East and Nigeria restrict supply.

US economy

In Bernanke's recent testimonial he suggested that inflation was under control and the Fed policy towards rates was data driven. Interest rates have not changed since Jun last year (5.25%) and he suggested that the state of play will remain. Given the recent spat of softer economic data it could open the way for more of a neutral to dovish stance on interest rates. Inflation looks to be contained and the need to diversify into Gold as an inflation fight is reduced.

USD weakness

The USD has been trading in a wide range since the beginning of the year. The market is currently testing the downside for the currency having broken through some significant levels. We suspect that the recent move in Gold has in fact been as a consequence of the weak USD and should a weak USD trend re emerge then this will help support the Gold market. Keep a close on the following areas for triggers to suggest that this break lower for USD is false and that we are indeed trading back in the range; USD/CHF 1.2420 a break above, EUR/USD 1.3030 and GBP/USD 1.9370 both a break below.

Demand

ETFs

Demand for publicly listed ETFs for Gold has been increasing in popularity over the last few years. Recent last quarter demand for ETF backed bullion funds increased 0.5% to 84 tons. Demand in the last quarter was more than four times than in the third quarter. We expect demand from this to continue even though we are trading in the high 660s.

Jewelry

As jewelry accounts for close to 72% of demand it is imperative for the price of Gold that consumption trends remain in tact. Fourth quarter data from GFMS reveals that although demand over all was down over the year fourth quarter purchases were up 2.1%. Interesting to note was the fact that demand for Gold by Indian and the Middle East consumers remained strong despite higher prices. This is something we have noted in the past (see Dubai Conference notes) concerning changing demographics of the countries and the increased need for consumption for adornment rather traditional/religious and social reasons. India's consumption used to be highly elastic to price however this trend is changing. Even with higher prices for most of last year India's consumption was up 200% on the previous year.

Supply

Central Banks

Central Banks are now net buyers of the metal. Supply from Central Banks was in fact down approximately 75% from the same quarter last year. We can only expect this trend to continue and as far as supply is concerned Central Bank activity will be confined to the demand side of the equation.

Hedging

Even though prices are high for Gold and the average cash cost for production is between US132-310 hedging is off the agenda for many producers. Accordingly we see little supply coming from this sector.

Mine Production

continues to disappoint with production from South Africa, Australia and Canada continuing to experience falling production rates due to labor and machinery breakdowns. It was announced recently that Gold production in Zimbabwe was down 18.5% in 2006.

Summary

At the beginning of the year we suggested that gold during 2007 would reach 650-660 and 675 then be year end be trading at 700. We continue to support our view that Gold will trade to towards 700. However, at the moment we are suggesting that some of the short term drivers for gold are absent from the market. These drivers are mainly focused around reduced geopolitical concerns in North Korea and the Middle East; reduced inflationary expectations caused by high oil prices and the lack of economic growth in the US. These should reduce the appeal for Gold as a safe haven commodity and as an inflation fighter. These are relatively short term factors and may provide the impetus for a short term correction, however, demand from the ETF and Jewelry sectors, we suggest will continue. Strong physical purchases associated with ETF's and Jewelry tends to put a base line of support for Gold on any pull backs. At the beginning of the year we noticed that good physical purchases helped to pin support at the 600 -610 level. We can now review this higher to 635. In addition, in the absences of supply coming from producers and central banks the up trend for the commodity remains firmly intact.

Given that we cannot break through the 675 resistance level from 17/7/06 high we suggest that we will commence a protracted decline to 635 level before the up trend resumes. Be guided by a break of 662 on a daily basis. We see this as a correction in an overall bull market. We are still on track to realise this years target of 700.

Technically, we are eyeing resistance at 675 and a test of this level cannot be ruled out, an exhaustive move to this level would clear weak shorts from the market and add weight to an expected correction.. As indicated by the Stochastic below a daily close below

the 662 will confirm divergence on a daily basis and conclude that we are ready for a move lower.

Daily Gold Chart



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