Gold Review

Phone 1300 660 734
www.commoditybroking.com.au

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Gold,

Is the ETF demand enough to see Gold through to US1000 again?

Gold has been trading in a solid range and we can define it as being USD1000 on the topside and US865 on the low side. At the moment we are taking the view that Gold is cheap at US865 and not until we get a break below this level will we question our resolve for Gold to keep on tracking higher. In this report we briefly look at the current supply/ demand picture for the metal and take a focus on the state of the current Exchange Traded Fund (ETF) market for Gold.

So far this year we have seen a mixed picture concerning the demand side of the equation. Demand for investment as a result of the Global Financial Crisis (GFC) has seen an increase in demand for ETFs that specialize in Gold. The SPDR ETF is the world's largest publicly listed Gold trust, although it holdings have recently come off their highs it continues to show signs of investment growth. It is interesting to note that the current holding at the moment in the ETF is 1104 tonnes which is roughly the same size as China's Central Bank reserves, which stand at 1054 tonnes. The growth in the ETF market, although large has to some extent not yet placated traditional demand and this is where we have seen some divergence in price and demand. In the past this has given us a false impression that the overall demand for Gold is strong however in reality it has not been the case.

As an overview the world is supplied with about 3500 tonnes of Gold a year and the same is consumed. The market is relatively even in terms of consumption and production. Of the consumption just over 70% of the demand for Gold comes from the jewelry sector and India is the number one consumer, importing close to 700 tonnes a year. So far this year consumption for jewelry is virtually none existent and imports from India have dried up. The recent Indian festival of Akshaya Tritya was hoped to revive sentiment however, demand this year for the ceremony was down by 8% thereby adding to the already negative sentiment. The market has as a result of traditional weak physical purchases been focusing on the demand for ETFs, and taking this as a broad measure of overall demand for the commodity, which up until recently only represented a small fraction of total demand. As a gauge investment demand for ETFs or similar in 2006 only represented about 5.5% of total demand, this has changed dramatically in 2009. For instance in quarter four 2008 demand for ETFs was 145 tonnes and in the last quarter alone demand reached 469 tonnes an increase of 324 tonnes. This has brought the total amount on investment in ETF funds to about 1658 tonnes. **This is a monumental gain and is now a recognizable sector for demand, however is this ongoing demand sufficient to keep the bull market intact and is there a chance if momentum stalls that we could be in for a far greater decline?**

As it stands investors have been willing to pour money into the ETF markets as it is a convenient way to invest in gold and in an instrument that is understood by many. After all it is just like buying a share, so if you are looking at Gold as a store of value, safe haven or inflation fighter then the ETF is the right product. However, the concern is that these investors also hold the key to the future direction, as effectively they have been the only buyers keeping the market up. If they decide to switch from Gold to more mainstream equity investments then there is a steady stream of sellers in a market where traditional demand is weak. **Does this mean that as we climb out of the recession investors will sell their holdings in ETFs and switch to other investments?** We feel the weighting investors have in Gold is high and can suggest that as we move out of the recession this switch will occur…..however as a store of value it is coming back in vogue and this may placate any major fall in the price in particularly as central banks (CBs) revisit the metal.

The change in attitude by central banks toward Gold is pretty much in the same way investors have been lured to it as a store of value with positive sentiment gaining momentum every year. Recent news from China and Venezuela reiterate this sentiment, their CBs are looking to increase reserves. At the moment China is looking to increase her holdings to around 5000 tonnes. The current holding is 1054tonnes. The announcement to increase the percentage of holding of foreign reserves in Gold is on par to when Russia announced at the LBMA in 2005 that they intended to increase the percentage of foreign reserves in Gold to 10%. The Chinese CB has overtaken Switzerland, Japan and the Netherlands to become the fifth largest holder of gold in the world. However, will this renewed demand by CB actually go to the market…this is where it will be interesting as China is also now the world's largest producer. It can and probably will like Venezuela use domestic production to increase their holdings or rather look for other avenues such as the IMF gold sales to build there reserves. If they did go to the market then it would only be on weakness and when they are looking to exchange USD for Gold. We suggest that in order to increase to their desired level that it will look at all options after all it is a lot of Gold needed and this will take time. However, we do feel that it will help underpin any major falls in the price. **So fundamentally what's the summary for Gold from here?**

At the moment we suggest that positive momentum in the equities markets will draw some investment away from Gold as signs of life in economies in particularly in India and China's suggest holding gold as a result of GFC just may be "old hat". However, the main concern we hold is that of **"inflation".** Inflation is becoming a hot topic amongst economist and there is real cause for concern here. We have mentioned before that the sheer size of the stimuli packages particular in emerging economies where they will stimulate demand. **This could give way to demand pull inflation pressures in particularly, as economies are forced into to reducing capacity whilst the printing press is working overtime.** In addition to this we have had eighteen months of lack luster investment which represents eighteen months of money parked on the sideline waiting to go somewhere. As momentum picks we will probably find ourselves in a situation where more money will be chasing less products. This will only develop over time as the market digests the state of GFC and opportunity in the equities markets evolve. **However, we feel that the bullish fundamental picture which includes demand from ETFs, demand from CBs and the prospects for inflation will keep the trend intact, it just may take time to develop.** What technical is the market saying?

<u>Daily Gold Chart</u>

Technically, the picture is a lot clearer and we have some significant chart points to make use of, from a chartist point of view is doesn't get any easier. As you can see from the chart above Gold is going through a consolidation process the big range is between US1009 and US865. Then as we work our ranges in, the next is between US880 and US920. As we are in the lower of all the range we can suggest that as the consolidation period continues that we can afford to buy on dips. The good point here is that we have a strong exit signal if we are wrong; that being at US875 then US860.

A break of either of these levels risk more downside that could ultimately see Gold at US820. At the moment we are at the lower end of the range. So it makes sense to have long positions on with stops at the suggested levels.

Happy Trading and Gold

Jonathan

Please do not hesitate to call concerning any of the above. I can be reached on direct call 1300 660 734.

Jonathan Barratt

Commodity Broking Services Pty Ltd | **Level 14, 309 Kent St, SYDNEY NSW 2000 Ph: +612 8221 8802 Fax: +612 6847 3676** | **Level 1, 8 Burton St, WARREN NSW 2824 Ph: +612 6847 3302 Fax: +612 6847 3676**

ABN 3211 128 286 **AFSL 280 372** | **FICS 4312**