Bullion Weekly

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31st August 2010

Bullish

- Tests of support hold
- Economic outlook remains vulnerable
- Funds and investors continue to buy

Bearish

- Another bout of risk aversion could initially weaken bullion prices
- The dollar may strengthen further
- Overhead supply need absorbing

Outlook

Short Term	Establish a base above	$1,218
Medium Term	Erode supply up to	$1,265
Long Term	Set sights on	$1,300

Last Week:

- Bullion prices shrugged off initial weakness to turn higher last week on a mix of solid fundamental data (see *Focus* section below), technical breakouts and risk aversion on growing speculation that the pace of the US economic recovery was slowing. Both gold and silver slipped lower on Monday and hit respective lows on Tuesday at $1,210.40 and $17.75 per ounce respectively before rallying sharply after data showed a significant 27-percent drop in existing home sales in July. Both gained more ground on Wednesday when durable goods and new home sales readings missed market expectations – gold rose to its highest in eight weeks of $1,244.30 on Thursday while silver reached $19.33 on Friday. Gold closed the week with a modest 0.55-percent gain while silver was up 5.6 percent, with the AU/AG ratio dipping to its lowest since August 3.
- The reduction in risk appetite led the Dow and S&P500 to decline 0.6 percent over the week. The dollar index dropped 0.2 percent while the euro finished down a similar degree against the yen.
- The Bombay Bullion Association reported a 50-percent drop in gold imports during August – just 16-18 tonnes were imported due to high prices. US investors pared their exposure in the SPDR ETF last week by just less than one tonne of gold to 1,298.56 tonnes but iShare holdings rose 0.5 tonnes to a record 94.49 tonnes. Coin demand remains lacklustre, however, with sales of US Mint Eagles totalling only 41,500 ounces in the months to date, around half the demand of last August.

The Week in Numbers NYSE Liffe US

Gold Oct	Mon 23	Tue 24	Wed 25	Thu 26	Fri 27	Week*
High	1230.30	1234.00	1241.00	1244.00	1242.20	1244.00
Low	1223.90	1213.20	1231.60	1234.30	1234.30	1213.20
Close	1227.30	1232.20	1240.10	1236.60	1233.40	5.70
Silver Sep						
High	18.060	18.451	18.965	19.120	19.250	19.250
Low	17.898	17.756	18.380	18.901	18.905	17.756
Close	17.992	18.376	19.030	18.980	19.029	1.038

* week's high, week's low & change on week

The Week Ahead:

Markets have become quite choppy but bullion prices are generally holding up well, which suggests good demand for safe-haven assets – this is why the dollar and the yen are also strong.

But equities have become volatile as have industrial commodities. As such, the market is nervous about recent poor data.

With a host of data out this week including PMI and especially Friday's all-important US employment report, the markets are likely to be on tenterhooks throughout the week. Nervous trading would come as no surprise, which probably means risk reduction in this environment.

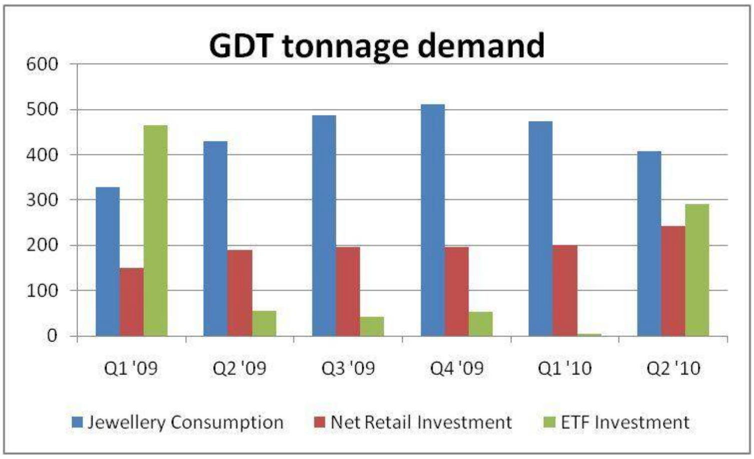
Should equities start to drop, we would not be surprised initially if bullion follows, although we would expect some of the money that comes out of equities to make its way into gold again at some stage.

Silver broke out to the upside of a large symmetrical triangle last week; we are keen to see whether this turns out to be a false break. If it does, this would tally with our view that there is a danger of a broad-based sell-off that is likely to see bullion prices fall before they rise.

Date	Economic Agenda	Expected	Previous
Tuesday 31st Aug	Japan Manfucturing PMI		52.8
	Japan Retails Sales	0.6%	3.3%
	Richmond Manufacturing Index	14	16
	EU CPI	1.6%	1.7%
	EU Unemployment Rate	10.0%	10.0%
	Chicago PMI	57.9	62.3
	US Consumer Confidence	51.3	50.4
	FOMC Minutes		
Wednesday 1st Sep	China Manufacturing PMI	51.5	51.2
	EU Manufacturing PMI	55.5	55.5
	ADP N/F Employment Change	22K	42K
	ISM Manufacturing PMI	53.6	55.5
	US Total Vehicle Sales	11.6M	11.5M
Thursday 2nd Sep	EU GDP	1.0%	1.0%
	ECB Statement		
	Initial Jobless Claims	479K	473K
	Pending Home Sales	-1.5%	0.2%
Friday 3rd Sep	Japan Capital Spending	-6.7%	-11.5%
	EU Retail Sales	0.3%	0.0%
	Non Farm Employment Change	-103K	-131K
	Unemployment Rate	9.6%	9.5%
	ISM Non Manufacturing PMI	53.6%	54.3%

Researched and Analysed by thebulliondesk.com E-Mail: press@thebulliondesk.com

Focus – Strong demand in Q2 as investors seek safety



The World Gold Council last week published its latest Gold Demand Trends report covering the April-June period, when a surge in safe-haven interest in gold propelled the yellow metal to all-time highs in several currencies including the US dollar, the euro and sterling.

Identified investment demand consequently more than doubled from first-quarter levels to 534.4 tonnes. Interestingly, this is lower than the record of 614.4 tonnes set during the first quarter of last year but the combination of high demand and record prices resulted in a 180-percent surge in US dollar expenditure terms to just more than $20.5 billion.

We also note differing investment tastes between the final quarter of 2009/the first quarter of 2010 and the second quarter of 2010. In the first quarter of last year, ETF demand was far higher than OTC-related purchases – possibly because US investors were reacting at that stage to the collapse of Lehman Brother. In the first quarter of this year, OTC demand was far higher than ETF demand while US markets stabilised; EU debt fears and a slowing US recovery led to a more 50/50 split during the second quarter.

Despite the strong price appreciation and influx of investment interest, jewellery demand remained relatively robust across the second quarter at 408.7 tonnes, five percent lower on the previous quarter and the corresponding quarter of 2009. Turkish jewellery demand slumped 20-percent, with consumption also weak in parts of the Middle East, North America and Europe. But Indian demand proved steady due to purchases related to Akshaya Tritiya while Chinese sales grew steadily – these are expected to fuel demand growth over the longer term as The People's Bank of China develops its domestic market.

Technical Analysis – Gold

Gold has rallied to a high of $1,247.50. Prices are steadily eroding the overhead supply that runs up to the former highs at $1,265 and the inverse head and shoulder target of $1,267. The stochastics have been showing some negative divergence in recent weeks, which remains a concern – we are wary of anticipating expecting new highs before a more pronounced pull-back.

That said, prices have tested their break-up level and support held so perhaps we should not be so cautious. Overall, we expect choppy trading between here and the highs and would not be surprised by spikes lower along the way but we generally expect the dips to be well supported.

Technical Analysis – Silver

Silver has broken higher out of a large symmetrical triangle, which is bullish but also signalled a potential upside move of $2.70. Interestingly, prices have come back to test the break-up level, which has held for now. This lowers the likelihood that the move higher was a false breakout.

In addition, with the stochastics pushing higher, prices may well extend their gains. But we would remain wary of the breakout for a while longer and would not be surprised by more consolidation in the short term.

Any close back within the triangle would need to be watched closely. But if the break higher holds, the upside target would be around $21.55 – needless to say, this would be a medium-term target but it would mean prices trading up to a multi-year high.

Trader Talk:

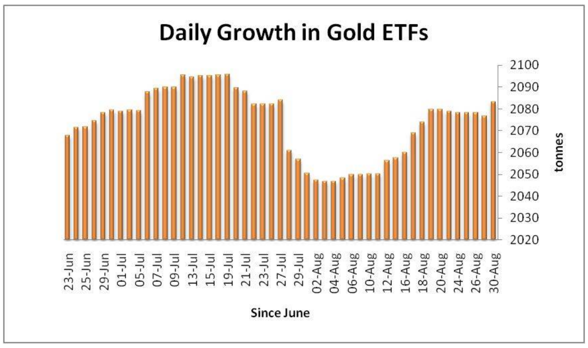
"A busy and potentially negative US economic calendar could trigger a fresh bout of risk aversion at the support of the US dollar and at the expense of metal prices" – ANZ

Market Drivers

Euro

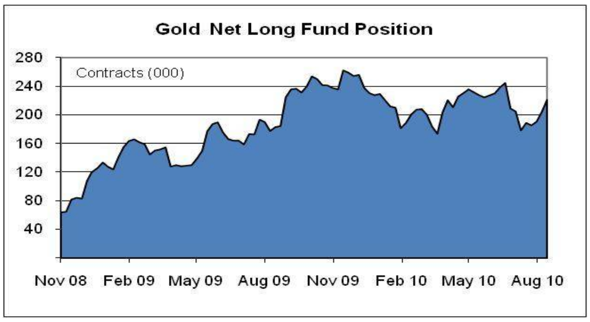
The EUR/USD been consolidating either side (but mainly above) the downtrend line. The inverse relationship between the dollar and gold has been in play in recent days – this is likely to remain the case unless an equity sell-off prompts safe-haven buying.

ETFs



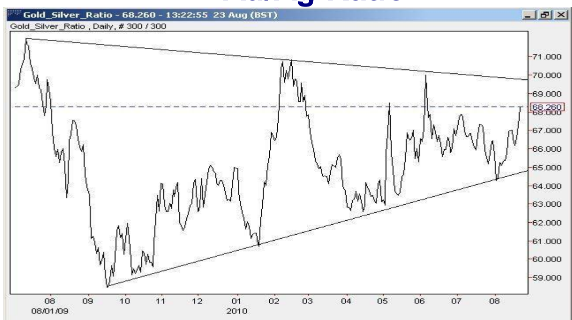
Investors have again been buying into the gold ETFs. Although the amount held in ETFs was flat for most of last week, some 3.52 tonnes were added on Monday. The jump in silver prices also prompted ETF buying, with some 177 tonnes added last week.

Funds



The net gold fund long position continues to climb – it grew a net 16,963 contracts last week. The bulk of this was made up of 15,290 new longs while 1,673 shorts covered. Interestingly, the net fund long silver position dropped 765 contracts as longs took profits and shorts covered. But the reading was taken on Tuesday before prices popped higher.

Au/Ag Ratio



The rising ratio shows that gold prices are climbing as investors, concerned about economic growth, seek safe havens. So gold is up while silver has struggled. At some stage, we would expect silver to start to catch up – when that happens, the ratio is likely to ease again.

Conclusion – Gold and silver continue to push higher and dips have proved short-lived, which shows underlying robustness that may well be enough to extend the rallies.

But the divergence on the gold chart is of concern. Recent poor US data also raises the risk of a more meaningful pullback in equities and industrial commodities, we feel – if such a correction gets underway, gold prices may suffer as well, at least initially.

We remain bullish for gold in the medium term because we feel that central banks will have to keep monetary policy loose and there is a high risk of more quantitative easing measures, which is likely to be bullish for gold.

But we are also wary of more talk of deflation, which might well prompt long liquidation in gold as money moves into treasuries. We would not be surprised if deflation also caused more concern about the financial system, however – this might prompt investors to put more money into gold at a later date.

Overall, we expect choppy trading this week, especially ahead of the US employment report on Friday.

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