

Bullion Weekly

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NYSE Liffe
U.S.

Bullish

- Technicals supportive
- Dips draw fresh buying interest
- Sovereign wealth and central banks believed recent buyers

Bearish

- Market vulnerable due to scale of longs
- Potential for profit-taking

Outlook

| | | |
|--------------------|---------------------|---------------|
| Short Term | Consolidate gains | \$1,045/1,061 |
| Medium Term | Set new highs above | \$1,060 |
| Long Term | Set new highs above | \$1,100 |

Last Week:

- Bullion went from strength to strength last week as investors continued to shun the dollar in favour assets that offer higher returns. After a steady start, gold reclaimed \$1,015 late on Monday and conquered resistance at \$1,025 and the previous record high of \$1,032.50 on Tuesday after reports that several nations were looking to break from dollar-priced oil. Once gold was in uncharted territory, the pace slowed slightly but momentum carried it higher. It touched \$1,043 on Wednesday before hitting the week's peak of \$1,061.60 on the following day. A stronger dollar, bolstered by comments from US economic advisor Lawrence Summers, prompted consolidation around \$1,050 across a busy Friday on which very large flows of metal crossed on an elongated afternoon fix.
- Silver followed gold across the week, breaching the September high of \$17.67 and reaching a new 14-month peak of \$17.93. The volatile nature of silver again meant that it made stronger gains than gold, with the AU/AG ratio closing the week at 59.23 from an opening level of 61.64.
- The correlation between gold and the EUR/USD remained at a very strong 0.99. Rising risk appetite also moved gold in line with equities – the correlation with the S&P 500 stood at 0.88 from -0.40 in the previous week.

The Week in Numbers NYSE-Liffe (mini-sized contracts)

| Gold Dec | Mon 05 | Tue 06 | Wed 07 | Thu 08 | Fri 10 | Week* |
|------------|---------|---------|---------|---------|---------|---------|
| High | 1018.80 | 1044.90 | 1049.50 | 1062.80 | 1054.70 | 1062.80 |
| Low | 1001.90 | 1016.60 | 1038.00 | 1043.80 | 1044.70 | 1001.90 |
| Close | 1018.20 | 1039.60 | 1044.50 | 1056.10 | 1048.60 | 44.20 |
| Silver Dec | | | | | | |
| High | 16.68 | 17.437 | 17.700 | 17.955 | 17.830 | 17.955 |
| Low | 16.14 | 16.632 | 17.315 | 17.525 | 17.565 | 16.137 |
| Close | 16.54 | 17.285 | 17.480 | 17.808 | 17.683 | 0.446 |

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

The Week Ahead:

The dollar will almost exclusively drive gold again this week. The release of IMF data confirms that it is not just investors but also other major central banks that are lowering their exposure to the US currency. The US dollar's share of new central bank reserves has fallen to 37% from an average of 63% since 1999, according to IMF data.

Concern that the US budget deficit will deepen seems to have prompted this move to diversify away from the US dollar. As such, this trend should continue to dominate gold's direction in the near term.

The Federal Reserve's Treasury purchase programme is due to expire at the end of the month. If the gap left by the Federal Reserve, which has bought \$1.75 trillion in treasuries this year, is not filled, it could be another reason for investors to move into gold.

This week's economic data (see table, right) will shed further light on and fuel arguments both for and against inflation as a by-product of unconventional monetary policy, i.e. quantitative easing. With most of this data due towards the end of the week, gold might continue to range-trade below last week's all-time high as investors await a directional signal from the market.

| Date | Economic Agenda | Expected | Previous |
|--------------------|-----------------------------------|----------|----------|
| Tuesday 13th Oct | EU ZEW Economic Sentiment | 60.1 | 59.6 |
| | BOE Inflation letter | | |
| | Fed Budget Bal | -77.3B | -111.4B |
| Wednesday 14th Oct | BOJ Rate | 0.10% | 0.10% |
| | UK Unemployment | 8.0% | 7.9% |
| | US Retail Sales | 0.3% | 1.1% |
| | FOMC Meeting Minutes | | |
| Thursday 15th Oct | EU CPI | -0.3% | -0.3% |
| | RBA, BoJ & ECB Monthly Report | | |
| | US Philly Fed Manufacturing Index | 12.4 | 14.1 |
| Friday 16th Oct | EU Trade Balance | 7.9B | 6.8B |
| | TIC L/T Purchases | 10.9B | 15.3B |
| | UoM Con Sentiment | 73.6 | 73.5 |

Focus - The future for the dollar

Gold's move into new high ground has hit the headlines, with talk focused on why the yellow metal is rallying. This, in turn, is putting the dollar in the spotlight and prompting considerable comment from central bankers from around the World. US Federal Reserve chairman Ben Bernanke's statement that the Fed would be ready to tighten policy when it deems such a move necessary lifted the dollar from its 14-month low from Thursday. Lawrence Summers, President Obama's chief economic adviser, also waded in to restate the US's commitment to a strong dollar policy.

The only problem is that the policy in question is not conducive to a strong dollar – quite the opposite, in fact. The US continues to run a massive budget deficit and is boosting money supply by means of quantitative easing, in effect devaluing the dollar. Large US creditors (see graph, right) are in a difficult situation – if they reduce their dollar holdings, they run the very real risk of triggering a dollar or bond crisis but, if they continue to support the US dollar, they are potentially adding to their problems.

With other countries fighting to give their economies the best chances of recovery, they are also worried that the falling dollar is making their exports less competitive, creating a spiral of competitive currency devaluation. It is little wonder therefore that investors have scant faith in fiat currencies and are buying into gold and, to a lesser extent, silver to protect the value of their cash.

Given the widespread problems in the financial markets and the fact that no outright solution has so far been found, it looks as if gold could have considerably further to rally. But there are likely to be corrections along the way, especially when the dollar firms – which might happen if central banks intervene.

Other observations

- Combined gold ETF holding climbed 14.95 tonnes last week
- Combined silver ETF holding declined 20.4 tonnes last week
- The fund net long position in gold increased 50.6 tonnes

Technical Analysis - Gold

Gold closed very bullishly last week, piercing the trendline at \$1,008, and was free to challenge \$1,032, the start of a new up leg. The RSI and the stochastics are bullish but do not indicate that gold is overbought. Weekly moving average support is distant, however - the 5WMA is at \$1,020.

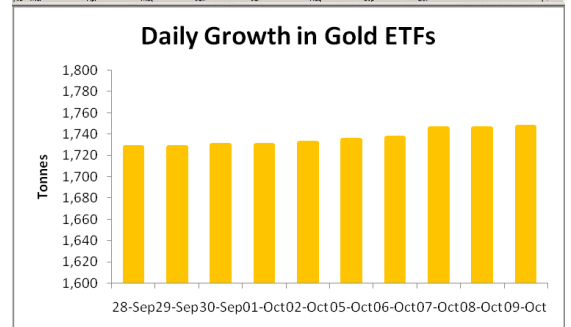
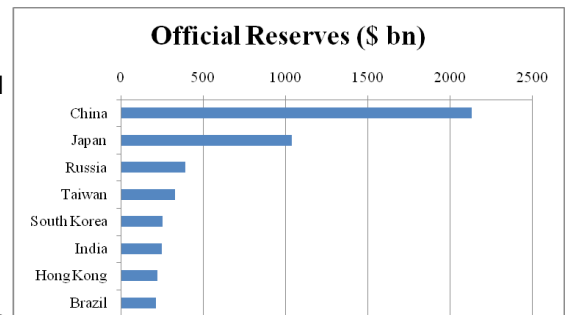
Gold started this week above last week's close, underlining the bullish sentiment. We must therefore be bullish on a weekly basis but also acknowledge the downside risk. A close above \$1,058 would therefore be bullish but a close below it could prompt a sell-off.

Technical Analysis – Silver

Silver closed very bullishly last week, taking out the September high. It met resistance from the newly formed upward weekly trading range [\$18.21] and we expect this upper trendline to become the primary resistance in the near term. The stochastics are verging on overbought while the RSI (the slower indicator) is just turning bullish.

The momentum indicators therefore suggest further gains will be harder this week. Silver has opened at a bullish level this week and we think it will need to close around \$18.00 to close positively – anything below this will leave the metal vulnerable to a sell-off.

Conclusion – The rising scale of longs in both gold and silver – and, for that matter, dollar shorts – is again a cause for concern. We would be reluctant to enter fresh longs at current levels. But with sovereign wealth funds and central banks now rumoured to have joined the fray, we expect dips to be well supported and maintain our bullish stance over the mid- to longer-term as investors continue to seek assets that offer a higher rate of return. And while last week's reports of nations seeking oil priced in non-USD currencies have been denied, it again casts doubt over the US currency's longer-term role.



Trader Talk:

"We have come a long way from where we were last winter but we're in no position to declare victory"
– Lawrence Summers, presidential economic advisor

**To learn more about trading gold and silver on NYSE Liffe US
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