

# Bullion Weekly

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14<sup>th</sup> December 2009

## Bullish

- Pick-up in sovereign debt fears
- Weaker prices to attract bargain hunting
- Expect more central bank buying

## Bearish

- Correction is now under way
- Dollar showing signs of rebounding
- After strong gains, the dip could last longer than the market expects

## Outlook

<b>Short Term</b>	Build a base	\$1,070/1,120
<b>Medium Term</b>	Move up to	\$1,250
<b>Long Term</b>	Target	\$1,500

### Last Week:

- Last week proved to be very mixed, with investors flitting between risk-positive and risk-averse in a busy period for newswires. Credit jitters were very much the focus in the first half of the week – concerns of a default by holding company Dubai World were exacerbated by Fitch's downgrading of Greece's credit rating to BBB+, while Standard & Poor's lowered its outlook on Spain's debt after cutting its rating earlier in the year. The second half of the week was more upbeat, however, as the Reserve Bank of New Zealand sparked hopes of a rate increase, Australia's employment increase was far stronger than expected and Chinese Industrial Production beat expectations. US data also offered some positive surprises – the trade gap narrowed while the University of Michigan Consumer Sentiment gauge climbed to 73.4 and retail sales were stronger than expected.
- While the upbeat US data helped return equities to positive territory, it also prompted a further rebound in the dollar, which in turn triggered long liquidation in commodities. The CRB Index finished the week down 1.1 percent and crude oil closed below \$70 per barrel. Gold and silver both slipped to their lowest in a month at \$1,109.50 and \$16.90 per ounce respectively and finished the week significantly lower, down 3 percent and 6.9 percent.
- Data from India showed that investors increased their gold ETF holdings 32.9 percent in November; however, this equates to just 7.4 tonnes of gold. The Bombay Bullion Associated reported reported imports of just 18 tonnes for November, a drop of almost 50 percent on the equivalent period of last year, reflecting the drop in demand and increased scrap recycling volumes of from the domestic market.

The Week in Numbers NYSE Liffe US						
Gold Feb	Mon 07	Tue 08	Wed 09	Thu 10	Fri 11	Week*
High	1166.00	1169.80	1148.90	1136.90	1143.20	1169.80
Low	1136.00	1125.40	1117.20	1122.00	1110.20	1110.20
Close	1164.00	1142.50	1120.80	1125.80	1119.60	-49.90
Silver Mar						
High	18.373	18.365	17.903	17.521	17.626	17.521
Low	17.902	17.563	17.140	17.172	16.927	16.927
Close	18.352	17.803	17.175	17.205	17.097	-1.423

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

### The Week Ahead:

Following last week's dollar rebound, dollar direction is likely to be all-important this week. Should the dollar look to head higher, it may trigger further profit-taking in commodities and equities. Indeed, if a firmer dollar also prompts some unwinding of dollar-based carry trades, the liquidation could turn quite aggressive, which is likely to keep bullion under pressure, at least initially.

US data due this week and Wednesday's FOMC statement might well set the tone for the run-up to the end of the year. If the dollar continues to react positively to good news and if concerns grow about sovereign debt in Europe, the markets could turn quite active as the dollar trend swings to a rebound from a down trend. How long any dollar rebound lasts is debatable – quantitative easing and growing budget deficits seem set to keep the currency's fundamentals bearish.

Date	Economic Agenda	Expected	Previous
Tuesday 15th Dec	ZEW Economic Sentiment	50.90	51.80
	US PPI	0.8%	0.3%
	Empire State Manufacturing	25.1%	23.5%
	US Industrial Production	0.6%	0.1%
	US Capacity Utilisation	71.1%	70.7%
Wednesday 16th Dec	EU Flash Manufacturing PMI	51.50	51.20
	EU CPI	0.6%	0.6%
	US Housing Starts	0.59M	0.53M
	FOMC Rates & Statement	<0.25%	<0.25%
Thursday 17th Dec	Initial Jobless Claims	470K	474K
	Philly Fed Manufacturing Index	16.1	16.7
	US CB Leading Index	0.8%	0.3%
Friday 18th Dec	BoJ Press Conference		
	German Ifo Business Climate	94.6	93.9

## Focus – Concerns of brewing bubbles

Gold fell \$100 from its lofty highs above \$1,220 in just six days – something that reflects the scale of the 'hot money' pumped into the market in recent weeks as investors seek to offset record low interest rates, we believe. But while low rates have helped economies stabilise and gradually claw their way out of the worst economic catastrophe since the Wall Street crash, they are now being seen as a mixed blessing and could be responsible for fuelling asset bubbles.

According to the former head of one Asian central bank, asset bubbles are the main threat to financial stability in Asia, a view echoed by financial officials in Japan and China. "Strong capital inflows and the resultant large liquidity overhang in the financial system could potentially lead to rapid credit growth, fuelling asset markets and creating macroeconomic volatility," the IMF has recently suggested.

While we have seen a tentative sign of dollar carry-trade unwinds, we attribute these for now to book-squaring related to the end of the year rather than a larger trend change in both the euro and the US dollar. But central banks are likely to face the tricky balancing act next year of keeping rates low to maintain the pace of economic recovery while staving off the threat of inflation and that posed by asset bubbles.

For now, we expect gold to maintain its correlation with the US dollar. The yellow metal is therefore vulnerable to further pressure in the short term, we believe. But we expect a break from the traditional relationship next year as the Fed begins to raise rates while gold is buoyed by diversification as well as fundamental factors.

## Other observations

- The combined gold ETFs position dropped 20.1t last week
- The combined silver ETFs position climbed 17.7t last week
- The net fund long gold position dropped 4,635 contracts
- The net fund long silver positions dropped 2,663 contracts

## Technical Analysis - Gold

Gold's pullback has been quite aggressive; prices closed the gap at \$1,119 but have found support around \$1,100. The 38.2% Fibonacci level is now at \$1,088 while the up trend line is at \$1,078, which should provide a good area for support.

With the stochastics still pushing lower, further weakness looks likely, although a cross higher in the stochastics might provide some short-term upside jobbing opportunities. But overall, further consolidation is to be expected, possibly at lower numbers.

## Technical Analysis – Silver

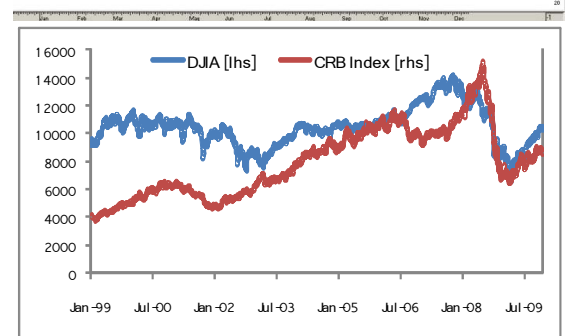
Silver has pulled back to \$16.90. The 38.2% Fibonacci retracement level is at \$16.79, which is also where the up trend line is; this is a probable area of good support. The stochastics have been trending lower but now seem to be moving sideways at low levels, suggesting that selling pressure may be easing.

Look for prices to attempt to build a base around \$16.70-\$16.90. Failure to hold at those levels would then suggest a possible pullback to the October lows around \$16.10. A cross higher in the stochastics may well provide some short-term upside jobbing opportunities.

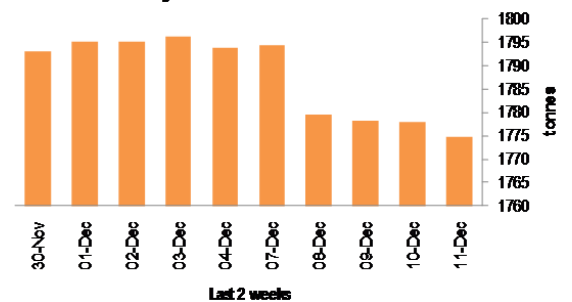
**Conclusion –** Gold and silver have fallen heavily in recent weeks as signs of a turnaround in the dollar have prompted profit-taking. Bullion prices were starting to look overextended, we noted in recent reports. Since they pulled away from their up trend line, the correction comes as little surprise and should help rebalance the market in that it will give consumers an opportunity to restock. But after such strong and drawn-out trends, the correction may be deeper and longer than the market anticipates. That said, we would be on the lookout for buying opportunities once support seems to have been established.

### Trader Talk:

"No doubt the Fed will note the recent improvement in economic data but this is highly unlikely to result in a change in the overall stance towards policy" – Mitui Kotecha, head of global Forex strategy at Calyon



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