

Bullion Weekly

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Bullish

- The trend continues to new highs
- Dollar weakness continues
- Central bank buying

Bearish

- Market looks short term overbought
- Short dollar trade overcrowded
- Potential for more profit-taking across the markets

Outlook

Short Term	Build a base	\$1,070/1,090
Medium Term	Move up to	\$1,250
Long Term	Target	\$1,500

Last Week:

- Gold outperformed commodities that were lukewarm on the whole last week, pushing deeper into uncharted territory. The yellow metal conquered option-related resistance around \$1,100, peaking just above \$1,123 per ounce on Thursday. Risk appetite was boosted further when finance ministers around the globe reaffirmed their commitment to keep interest rates low and maintain their stimulus policies. And numerous economic data releases, particularly from Asia, also buoyed markets - Japanese Machine Orders and Chinese Industrial Production both beat economists' forecasts.
- But silver struggled to erode overhead resistance, topping out at \$17.78 per ounce on Monday and Thursday. The AU/AG ratio consequently gained 1.7 percent over the week.
- The Dow gained 2.4 percent across the week on increasing risk appetite while the dollar lost further ground to its stronger-yielding counterparts following the Fed's pledge to maintain record low rates saw. The Dollar Index hit a 19-month low, stopping just short of key chart support at 74.75.
- Numerous bullish forecasts were released last week at RBC Capital Markets' annual Gold Conference. The suggestion was made there that "peak" production had been reached in the gold market and that more mature markets such as South Africa and Australia will continue to struggle against falling ore grades, rising costs and tighter safety legislation.
- Despite the surge in gold prices, the net fund long position in gold dropped 3,259 contracts, while the net long fund silver position dropped 1,844 contracts - this is in contrast to the ETFs, which continued to see net gains last week of 7.2 tonnes in gold and 239 tonnes in silver.

The Week in Numbers NYSE-Liffe						
Gold Dec	Mon 09	Tue 10	Wed 11	Thu 12	Fri 13	Week*
High	1111.90	1109.50	1119.00	1123.50	1119.50	1123.50
Low	1096.80	1097.40	1106.10	1102.80	1101.40	1096.80
Close	1101.10	1102.40	1114.60	1107.00	1116.70	20.90
Silver Dec						
High	17.804	17.635	17.718	17.735	17.430	17.804
Low	17.433	17.167	17.371	17.200	17.031	17.031
Close	17.478	17.223	17.537	17.270	17.376	0.000
* week's high, week's low & change on week						

The Week Ahead:

Risk appetite is rising on the bullish Japanese third-quarter GDP numbers and the APEC pledge to maintain stimulus efforts until there is "durable growth". This news and data have set the foundation for another bullish week.

The market's focus should be on US data (see table opposite). The release of US TIC data will offer some insight into the level of foreign demand for US Treasuries. This could become an important theme for precious metals - the cost to hedge against rising yields on Treasuries, which is measured by the skew in the options on interest rate swaps, is at a record high and is 40 times higher than pre-crisis levels.

This raises the possibility that higher rates may be on the cards despite a low medium-term inflation outlook: investors demand higher yields to counter the risk of buying Treasuries in a weak dollar environment. Overall, there is further potential for gains in precious metals but much will depend on the weak dollar remaining week and the absence of a broader market correction.

Date	Economic Agenda	Expected	Previous
Tuesday 17th Nov	US PPI	0.6%	-0.6%
	US TIC Long Term Purchases	27.3B	28.6B
	US Capacity Utilisation	70.9%	70.5%
Wednesday 18th Nov	US CPI	0.2%	0.2%
	US Housing Starts	0.61M	0.59M
Thursday 19th Nov	Initial Jobless claims	503K	502K
	Philly Fed Manufacturing Index	12.5	11.5
	CB Leading Indicators	0.5%	1.0%
Friday 20th Nov	BoJ Press Conference		
	Buba President Weber Speaks		
	ECB president Trichet Speaks		

Focus – What the options suggest

Gold's stature in the investment community has risen over the past few years which we believe is due to several different factors.

First, investors tend to favour markets with a reliable track record, which gold has proven over the past decade – it was one of only a handful of assets to rally last year. Second, the metal's anti-inflationary qualities have also become more prevalent recently due to the expected impact of Quantitative Easing. Third, strong fundamentals have bolstered the market as also central banks look set to replace producers as net buyers now the majority of hedge commitments have been unwound.

But with prices at current levels, has gold pushed too high or does it have further to rise?

The physical market would certainly argue that gold is too expensive – imports into many of the key hubs are tumbling and demand is being satisfied by scrap flows from domestic sources. Indeed, scrap sales for the second half of the year will be on a par with, if not greater than, the 900 tonnes in the first half, we believe.

Despite the recent \$75/oz price gain, lease rates are virtually unchanged and, given the scale of metal held at institutional levels, there is little chance of rates being squeezed by supply shortages.

So what about the option market? Although granting out-the-money calls was seen as an easy money maker, the recent price surge has triggered above-market stop-orders. As shown in the accompanying chart, there is potentially another vacuum lurking above due to the increase in holdings around the \$1,200 strike.

While we believe the market is looking a little strained, we think there may be more to come on the upside.

Other observations

- Indian scrap jewellery supply rises as prices hit record highs

Technical Analysis – Gold

Gold extended its gains last week and opened on a small upside gap this week, which is positive but could also indicate the start of a topping formation. The stochastics and RSI both look very bullish, which suggests short-term gains ahead. But we expect gold to consolidate and/or retrace over the next three or four weeks.

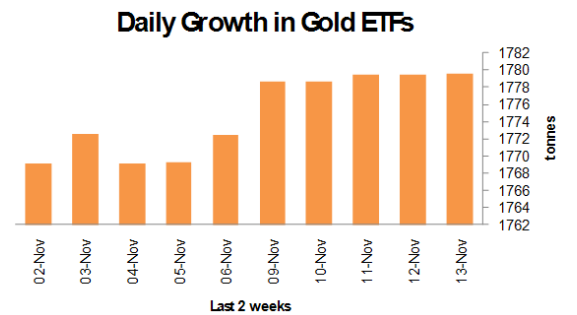
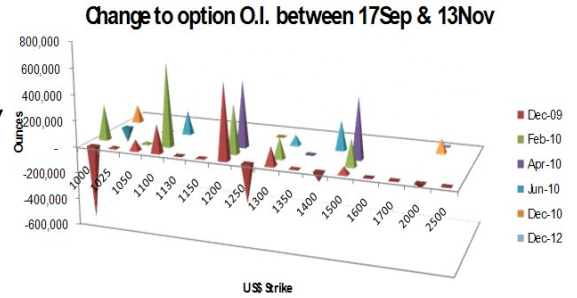
The yellow metal has support at \$1,123 (prior triangle formation target), \$1,112, \$1,101, \$1,097 and \$1,080 (prior pennant formation target). Resistance is seen from psychological numbers at \$1,140, \$1,150, \$1,175, \$1,200 and \$1,250 (our medium-term target). Overall, gold should continue to post gains this week, we think. Our primary targets are \$1,140 and \$1,150.

Technical Analysis – Silver

Silver closed negatively last week but prices have broken out of the symmetrical triangle formation today. If the breakout holds, silver will have a medium-to-long term upside target of \$20.73. The stochastics and RSI both look bullish but not as bullish as gold, which indicates that there is some room for silver to appreciate faster than gold.

Resistance is seen at \$18.75, \$18.34 (the 76.6% Fibon level - Mar 2008 high-Oct 2008 low), \$18.11 and \$17.96. Support is seen at \$17.69, \$17.20, \$16.58 and \$16.44 (61.8% Fibon level). Silver has an opportunity to post some solid gains but the bulls' priority should be a close above the symmetrical triangle breakout at \$17.69.

Conclusion – Although gold continues to set new highs in this rally and pullbacks to date have been limited, we remain wary that central bankers may try to halt the slide in the dollar even though the dollar's fundamentals are bearish, which could trigger a broad correction. Such a correction may well turn out to be bullish for gold as investors seek safety in bullion but the initial reaction may well be to drag precious metals lower first. Until such developments, however, the path of least resistance is to the upside.



Trader Talk:

"The current international monetary system, despite its problems, is still working reasonably well. I expect the dollar to remain the principal reserve currency for some time" - IMF managing director Dominique Strauss-Kahn

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