

Bullion Weekly

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Bullish

- Continuing dollar weakness
- US creditors continue to diversify away from the dollar
- Stronger oil prices

Bearish

- If equities fall, bullion may initially sell off
- Will central banks intervene in the dollar?

Outlook

Short Term	Consolidate gains	\$1,043/1,071
Medium Term	Move up to tackle highs at	\$1,071
Long Term	Set new highs above	\$1,250

Last Week:

- Investment inflows prompted another strong performance in commodities last week. The CRB Index gained 5.1 percent over the week, with gold, silver, crude oil, coffee, zinc and FCOJ among those setting new 2009 highs. Growing risk appetite and positive earnings results also bolstered US equities but the Dow and S&P 500 could only muster weekly gains of 1.3 percent and 1.5 percent respectively as profit-taking emerged in the second half of the week. Historically low interest rates and deficit concerns kept the US dollar under pressure, with the currency touching new lows for the year against currencies including the euro, the Australian dollar and the Swiss franc. The DXY closed the week down 1.1 percent, having earlier hit its lowest in 18 months.
- Gold extended its recent rally during the first half of the week on initial dollar weakness, setting a new all-time high of \$1,071 per ounce during Wednesday's European session. Similarly, silver hit a 14-month high of \$18.11 per ounce. Despite weak dollar sentiment, fund and technical profit-taking led both metals to consolidate at lower levels across the remainder of the week, with the gold-EUR/USD correlation easing to 0.89 from 0.99 in the previous week. Silver also lost ground to gold, with the AU/AG ratio closing back above 60.
- Although the Hindu festival of Diwali started on October 17, reports so far suggest that jewellery sales were extremely poor due to near-record gold prices and weak monsoon rains affecting agrarian incomes and spending.

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

Gold Dec	Mon 12	Tue 13	Wed 14	Thu 15	Fri 16	Week*
High	1060.40	1069.80	1071.80	1066.60	1057.90	1071.80
Low	1048.10	1052.30	1056.60	1047.10	1043.40	1043.40
Close	1057.80	1064.50	1064.50	1050.60	1051.40	2.80
Silver Dec						
High	17.96	18.066	18.232	17.995	17.580	18.232
Low	17.73	17.567	17.731	17.315	17.205	17.205
Close	17.82	17.830	17.905	17.414	17.424	-0.259

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

The Week Ahead:

The dollar will no doubt remain bullion's main driver again but themes such as public finances and economic data in West will also play a role. Gold has consolidated in a \$1,043-\$1,071 range over the last nine trading days – the market will therefore need a bullish confirmation of its existing fundamentals to resume its uptrend.

With the dollar index at a multi-month low and fundamentals looking bearish for the dollar, the path of least resistance for the US currency is a move lower. The only dollar-positive theme is the overcrowded nature of the short dollar trade; this could produce some short, sporadic moves higher in the dollar index.

The Bank of Canada is due to make its interest rate decision tomorrow and, given the upset caused by its Australian counterpart's unexpected rate rise this month, we think the market will be wary of another surprise. The bullion markets could interpret a rise as a positive signal. Complementing the data, several central bankers are due to make speeches this week. Any support from them for the dollar could prove negative for bullion.

Date	Economic Agenda	Expected	Previous
Tuesday 20th Oct	German PPI	0.0%	0.5%
	US PPI	0.1%	1.7%
	US Housing Starts	0.62M	0.60M
	US PPI	0.0	-0.9%
Wednesday 21st Oct	Crude Oil Inventories		0.4M
	US Beige Book		
Thursday 22nd Oct	China GDP	9%	7.90%
	US Initial Jobless Claims	516K	514K
	US Leading Index	0.9%	0.6%
Friday 23rd Oct	EU Manufacturing	50.2%	49.3%
	Fed Chairman Bernanke Speaks		
	US Existing Home Sales	5.39M	5.10M

Focus- US Treasuries remain in demand

Rumours of the demise of the dollar as the world's reserve currency may be greatly exaggerated. Things appeared to have come to a head earlier this month when reports circulated that some OPEC member were in talks with Russia, China, Japan and France over dropping the US dollar for oil trading. Those stories have since been vehemently denied. But while record debt and historically low interest rates have pressured the US dollar to multi-month lows, it seems that investors have not lost all faith in USA Inc.

Friday's Treasury International Capital data showed foreign purchases totalling \$28.6 billion in August compared with \$15.3 billion in the previous month. Indeed, the depth of liquidity and a combination of low interest rates and the weak dollar are working in favour of international investors, with holdings now totalling a record \$3.45 trillion.

Given the scale of US treasuries held by foreign investors and central banks and the number of currencies pegged to the dollar, the possibility that the US currency will lose its status as the reserve currency of choice in the near term is extremely slim. But there are signs of divergence into other currencies, particularly the euro and the yen and also hard assets such as gold, with both China and Russia increasing their holdings over the past 12 months.

The immediate outlook for US treasuries remains positive as double-dip recession fears linger due to high US unemployment rates. But with the Fed not expected to raise its target rate until the second or third quarter of next year and this week's housing data possibly suggesting the start of economic expansion, demand for treasuries could falter as confidence in financial markets as well as the global economy continues to revive. But given the size of US government debt, it is not surprising that gold remains highly prized.

Other observations

- Combined gold ETF holdings dropped 8.8 tonnes last week
- Combined silver ETF holdings climbed 27.6 tonnes last week
- Fund net long position climbed 14,287 contracts

Technical Analysis - Gold

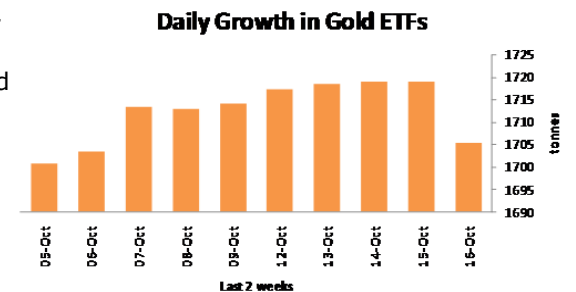
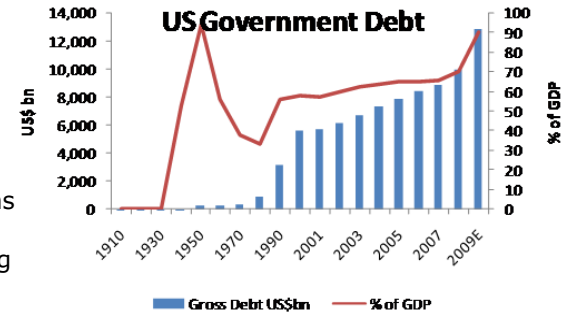
Gold closed neutrally last week, forming a spinning top candle. A negative close this week would complete a three-part bearish evening star reversal. This week, despite the RSI and stochastics looking a little more neutral, they are still holding in the bullish range, which favours the upside overall.

Gold has consolidated within the \$1,043-\$1,071 range since rallying two weeks ago. We are now at a pivotal juncture: a positive close this week could allow the metal to rally higher in the coming weeks but a negative close could send it back towards \$1,026.

Technical Analysis – Silver

Silver closed negatively last week, suggesting that retracement was the primary driver during the week. It started this week on last week's close, indicating that it remains in a consolidation phase. The RSI and stochastics remain neutral-positive, which seems to back up this hypothesis. Silver is trading below the 76.6% Fibonacci level – once it ends this consolidation phase, we think it will look to retarget the 76.6% Fibon again. Thus we remain neutral in the short term but positive in the medium term.

Conclusion – Gold is consolidating after its run-up to new highs, which seems natural. The net fund long position grew again last week but there was some profit-taking in ETFs towards the end of the week. Concern over the dollar remains paramount but we note with interest that foreign investors continue to buy US treasuries, so fears about the US cannot be that great. At some stage, we feel that central banks may well start to talk up the dollar, which could prompt some profit-taking in bullion, but we expect dips generally to be well supported.



Trader Talk:

"The issue is currency devaluation and the worry is that it essentially lowers our credibility in the world"
Office Depot Inc CEO Steve Odland

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