

Bullion Weekly

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25th January 2010

Bullish

- Political moves create uncertainty
- Bargain hunting
- Increased danger of a more meaningful equity correction

Bearish

- Dollar's rebound advances again
- Further risk reduction seems likely
- Room for profit-taking in bullion

Outlook

Short Term	Build a base	\$1,050/1,075
Medium Term	Move up to	\$1,250
Long Term	Target	\$1,500

Last Week:

- Investors continued to lower their exposure last week as EU sovereign debt fears worsened while strong fourth-quarter GDP growth data from China – up 10.7 percent from 9.1 percent – increased speculation officials could soon be forced to raise interest rates to tame the surge in investor borrowing and prevent the formation of asset bubbles. The Obama administration also proposed new financial regulations on Thursday, banning commercial bank from proprietary trading and from owning or investing in hedge funds and private equity funds.
- Despite the shortened week, with US markets shut on Monday for Martin Luther King Day, the resulting drop in risk appetite saw the Dow fall 4.1 percent over the week; the S&P500 fell a similar 3.9 percent. The decline in the CRB Index was more measured; it closed down 2.1 percent. In contrast, safe-haven demand for the dollar and US treasuries picked up, with the dollar index gaining 1.3 percent while the 10-year yield declined 8 basis points.
- Thin trade initially confined gold to a \$10 range of \$1,130-40 per ounce before it corrected lower in midweek. Support emerged at \$1,110/1,100 and \$1,090; however, the yellow metal eventually dipped to a four-week low of \$1,082.25, finishing down 3.8 percent. Silver's correction was more dramatic – it fell 7.8 percent as the AU/AG ratio jumped back above the 62.32 chart level.
- The Central Bank of Russia announced a further build in gold reserve holdings last month, adding 24.9 tonnes. The addition brings total holdings to 637.6 tonnes and sees Russia surpass the Netherlands as the eighth-largest holder, according to available data.

The Week in Numbers NYSE Liffe US						
Gold Feb	Mon 18	Tue 19	Wed 20	Thu 21	Fri 22	Week*
High	Closed	1140.30	1141.80	1117.30	1098.90	1141.80
Low	Closed	1128.70	1107.00	1088.00	1081.90	1081.90
Close	Closed	1140.00	1112.60	1103.10	1089.70	-40.70
Silver Mar						
High	Closed	18.870	18.842	18.034	17.478	17.478
Low	Closed	18.457	17.805	17.350	16.885	16.885
Close	Closed	18.790	17.900	17.538	16.969	-1.470
* week's high, week's low & change on week						

The Week Ahead:

The main focus this week is likely to be the fallout from President Obama's new banking regulations initiative, although a close eye will be kept on monetary policy in China and the debt situation in Greece/Europe.

On Wednesday, market attention will be on the FOMC meeting and the President's State of Nation address, which might have jobs instead of healthcare at its centre. Should this be the case, it could buoy market sentiment, as could the reappointment of Fed Reserve chairman Ben Bernanke, if indeed he is reappointed. Any deviation from these expectations could exacerbate volatility.

All in all, we think this week will be driven by moves in the political sphere, as investors attempt to gauge the Obama administration's priorities.

Date	Economic Agenda	Expected	Previous
Tuesday 26th Jan	US CB Consumer Confidence	53.6	52.9
	Richmond Manufacturing Index	0	-4
Wednesday 27th Jan	US New Home Sales	372K	355K
	FOMC Statement		
Thursday 28th Jan	EU Consumer Confidence	-15	-16
	US Durable Goods Orders	2.1%	0.2%
	Unemployment Claims	451K	482K
	Japan CPI	-1.3%	-1.7%
	Japan Industrial Production	2.5%	2.20%
Friday 29th Jan	EU CPI Flash	1.2%	0.9%
	EU Unemployment Rate	10.1%	10.0%
	US GDP Q4	4.5%	2.2%
	Chicago PMI	57.2	58.7
	UoM Consumer Sentiment	73.2	72.8
	UoM inflation Expectations		2.80%

Focus – It's all about the dollar

The broad rise in investment demand for gold over the past few years has seen it move in line with overall risk appetite – the yellow metal provides a hedge against dollar weakness and is a “safe haven” in uncertain times. Interestingly, whereas gold tends to rally when the dollar weakens, the inverse relationship is not as strong when the dollar strengthens. One clear example of this was in February-March 2009 when gold and the dollar rose in tandem amid the global financial crisis, with Americans seeking safety in gold while the rest of the world sought sanctuary in gold and US Treasuries.

The rebound in the dollar in recent weeks has kept bullion prices under pressure but, interestingly, it seems that gold prices fall only while the dollar is actually rising, while gold prices have tended to rise when the dollar is flat or weakening; this suggests the undercurrent in gold is still to the upside.

As the chart opposite shows, the move in gold prices in percentage terms compared to the gains on euro vs. dollar have been significantly stronger. This suggests that dollar weakness is just one of the driving forces in gold but other factors are at play that account for gold's outperformance.

These factors include safe-haven buying, buying against the devaluation implications of quantitative easing (not just QE in the US but also in other countries too) and retail investment buying of bars, coins and ETFs – investors want to insure themselves against further instability in the banking and financial markets.

Other observations

- The combined gold ETFs position dropped 0.37t last week
- The combined silver ETFs position climbed 3.1t last week
- The net fund long gold position dropped 7,873 contracts
- The net fund long silver positions dropped 227 contracts

Technical Analysis - Gold

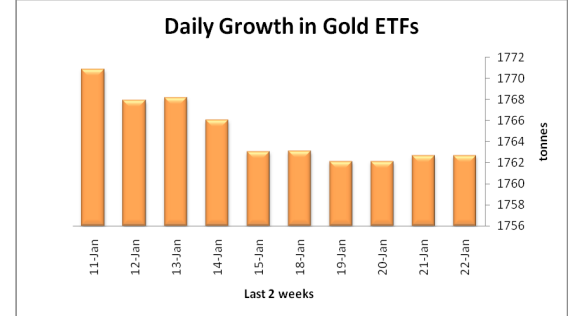
Gold closed negatively last week, reinforcing the idea that it remains in a retracement phase. Gold closed below the 23.6% Fibon level [\$1,098] last week; another negative close below this level could push it down towards the 38.2% Fibon [\$1,018]. Trendline support is seen at \$1,083-\$1,059-\$1,033 and trendline resistance is seen at \$1,142-\$1,162.

With the stochastics looking bearish and the RSI trading water at the midpoint, we think these indicators show that gold is still in a retracement phase. It has support from the 20WMA [\$1,090] and resistance from the 5WMA [\$1,112]. Overall, while there is potential for gold to bottom out at current levels, we will remain neutral-to-negative until further bullish evidence appears.

Technical Analysis – Silver

Since last week's downside correction was a steep one, the chart looks vulnerable. Support is expected at \$16.87-\$16.74-\$16.11- \$15.38 [UTL]. Resistance is seen at \$17.27 [UTL] - \$17.41 [20WMA] - \$18.34 [UTL]. The stochastics and RSI look neutral-to-negative.

Silver found support last week from the 23.6% Fibon [\$16.87] – a break below this level could signal a move towards the 38.2% Fibon [\$15.34]. We would turn bearish on a move and close below \$16.74; conversely, we would be bullish on a close above \$17.41.



Conclusion – The pick-up in the dollar has piled downward pressure on bullion prices. With the greenback looking as if it may have further to rise, we would not be surprised to see gold and silver pull back further. But if a stronger dollar triggers a more meaningful sell-off in equities, we feel it will not be long before investors move out of equities and into gold – leading to another instance where the dollar and gold rise in tandem.

Trader Talk:

"We have huge amounts of money printed throughout the world. It's going to cause currency instability. It's going to cause more inflation. It's going to cause higher interest rates" - Jim Rogers

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