

Bullion Weekly

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Bullish

- The big picture for the dollar
- Potential for an equity market correction
- Bargain hunters

Bearish

- Short-covering in the dollar
- Margin calls if equities sell-off

Outlook

| | | |
|--------------------|----------------------------|----------|
| Short Term | Pull back to support | \$920/15 |
| Medium Term | Move up to tackle highs at | \$1,006 |
| Long Term | Set new highs above | \$1,050 |

Last Week:

- Commodities as a whole continued to push higher last week due to increased demand expectation as economic indicators improved, as did investor appetite for tangible assets. The Reuters-Jefferies CRB Index posted a weekly gain of 1.7%, reaching its best level since November on Friday at 266.17. Individual commodities also hit multi-month highs last week. Crude oil traded to its best since October 21 above \$73/barrel, copper hit a 7½ month high above \$5,350/tonne while soybeans traded to their highest since September.
- In contrast gold and silver both closed lower last week as stronger dollar sentiment and slowing ETF investment demand triggered liquidation from heavily leveraged fund longs. Gold spent the early part of the week in a relatively narrow range as two-way trade dominated. Buying interest below \$950 absorbed much of the selling pressure while profit taking above \$960 limited rallies with gold posting a high of \$960.65 midweek. Dollar strength on Friday led gold and silver lower as upbeat Consumer Sentiment data added to generally strong economic data across the week. Both metals broke lower from their recent ranges posting respective lows of \$936.30 and \$14.80 which equates to declines of 2% and 3.4% respectively.

The Week in Numbers NYSE-Liffe

| Gold Aug | Mon 08 | Tue 09 | Wed 10 | Thu 11 | Fri 12 | Week* |
|------------|---------|---------|---------|---------|---------|---------|
| High | 960.5 | 964.1 | 966.8 | 963.1 | 958.5 | 966.8 |
| Low | 943.8 | 949.0 | 947.8 | 943.3 | 936.4 | 936.4 |
| Close | 951.8 | 954.6 | 954.1 | 961.4 | 940.6 | -11.2 |
| Silver Jul | | | | | | |
| High | 15.4460 | 15.3450 | 15.4890 | 15.5450 | 15.4290 | 15.5450 |
| Low | 14.7400 | 14.7920 | 15.0400 | 14.9290 | 14.7650 | 14.7400 |
| Close | 14.9630 | 15.1350 | 15.2250 | 15.4690 | 14.8800 | -0.0830 |

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

The Week Ahead:

This week could be an important week for bullion as we see the dollar as the key driver and it is showing signs of changing direction. We will be watching two factors in particular: foreign investor sentiment towards the dollar and inflationary expectations.

Monday's TIC data showed long-term purchases of US treasuries dropped to \$11.2 billion in April from the previous reading of \$55.8 billion. This shows a marked decrease in foreign appetite for US investments. Will quantitative easing bring more of the same? - We think it will. However, the BRIC's heads of state meeting in Russia this week, could give the dollar a respite, particularly after Russia's Finance Minister Kudrin made a positive statement in favour of the dollar over the weekend. Further positive statements from Russia and China, could signal the end to their verbal assault on the dollar and this could give some lift to the dollar.

This week there is a considerable amount of US data being released; much of the data will have a direct influence on US inflation expectations. If the data indicates an increased probability of inflationary pressure in the US in the next 12-18 months, then we would expect to see gold prices push higher again.

| Date | Economic Agenda | Expected | Previous |
|--------------------------------|--------------------------------|----------|----------|
| Tuesday 16th June | EU Zew Economic Sentiment | 34.1 | 28.5 |
| | US Building Permits | 0.5M | 0.5M |
| | US PPI | 0.60% | 0.30% |
| | US Industrial production | -0.7% | -0.5% |
| Wednesday 17th June | US CPI | 0.30% | 0.00% |
| | US current Account | -85B | -133B |
| | Crude Oil Inventories | na | -4.4M |
| Thursday 18th June | Initial Jobless Claims | 610K | 601K |
| | Philly Fed Manufacturing Index | -17.8 | -22.6 |
| | CB Leading index | 0.80% | 1.00% |

Focus – The correlation between gold and the dollar

Given the dollar is in focus at the moment it may be appropriate to look at the correlation between gold and the dollar in slightly more depth. The relationship between gold and currencies is a long standing one, dating back to the time of the Gold Standard, although since the adoption of fiat currencies the direct link has become defunct. Gold is still viewed by some as a non-fiat currency, acting as a safe-guard against periods of economic distress and high geopolitical tensions and hence it traditionally has an inverse relationship with the US dollar. In the current climate with quantitative easing threatening to devalue some major currencies, the fact gold is not under any one governments' control means it may well retain its value while other currencies lose theirs. As shown in the accompanying chart, the correlation between gold and EUR/USD was very strong across most of 2008. The relationship broke down at the start of this year with both gold and the dollar acting as safe-havens and moving in tandem, particularly in February. However, since May, the traditional relationship appears to be back in place, but as a result gold could be vulnerable to short-term weakness as the dollar wins support having become oversold as the short-dollar trade has become overcrowded in recent weeks.

Other observations

- ETF holdings increased just 2.6 tonnes last week to 1,618.4t. Average weekly increase has been 19.25t so far this year.
- ATM 3 month gold options volatilities are 26.4%, up from 25.9% a month ago, but down from 41.6% in January.
- India imported 17.8 tonnes of gold in May, down 39% yoy
- Expect scale down physical purchases from jewellery fabricators, especially if prices drop below \$900/oz.

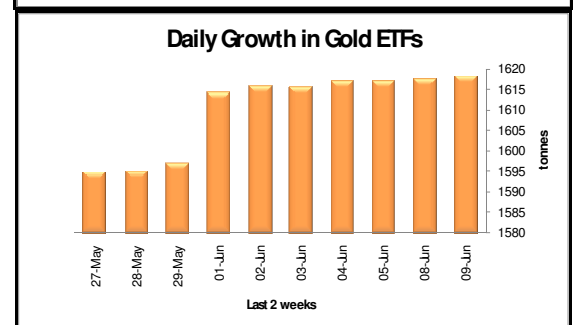
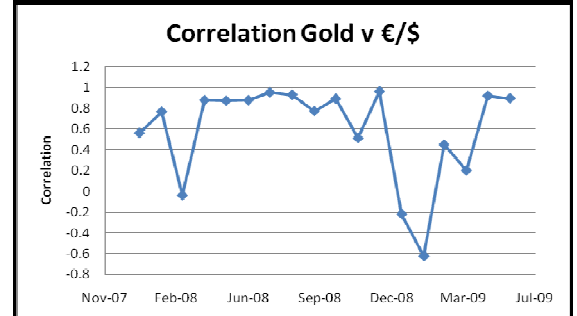
Technical Analysis - Gold

Having now seen two consecutive weeks of bearish closes with long overhead tails, it is easy to see that the metal had strong overhead selling pressure. The metal closed last week under the 38.2% Fibonacci level from the April 09 low to June 09 High and this therefore implies that the metal will look to target the 50% Fibonacci level at \$925 in the near term. The Stochastics have crossed lower with the K% line [yellow line] falling under the D% line. The chart also indicates that the metal has fallen out of the bullish trading range. Presently we still view this move to the downside as a correction and therefore we see the metal rebounding before too long. Support is seen at \$925, \$918 and \$905. Resistance is seen at \$942- \$965 and 975.

Technical Analysis – Silver

Silver, like gold, closed negatively for the second consecutive week. As a result, the metal is now threatening to move back under the July 08 downtrend line, if this occurs it would be very bearish. The metal has also fallen under the May uptrend line which is a short term concern. Silver has also moved under the 38.2% Fibonacci level from the April 09 low to June 09 high. Therefore there is a chance that the metal will move to challenge the 50.0% Fibonacci level at \$14.04. The stochastics are still trending lower so the overall short term outlook is bearish. Expect support at \$14.30, \$14.04, \$13.52, with resistance likely at \$14.56, \$14.84 and \$15.01.

Conclusion – Gold's failure to recapture the \$1,000/oz level has made gold vulnerable to liquidation selling and some dollar strength has been enough to trigger profit taking. In recent weeks the optimism shown in equity markets and for an economic recovery have also increased the opportunity cost of holding gold. However, with equities in retreat and with the big picture far from bullish for the dollar, we think this sell-off in gold is providing a better buying opportunity and if equity markets undergo a deeper correction then we expect safe-haven buying to channel back into gold and silver.



Trader Talk:

"The large part of the worst is not yet behind us." *Dominique Strauss-Kahn; IMF Chief*

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