

## Bullish

- Lack of solution to EU debt woes
- Bargain hunting
- Rise in geopolitical tensions

## Bearish

- \$1,532 support breached
- Potential for more deleveraging
- Dollar strength

## Outlook

Short Term	Find a base	\$1,520-1,560
Medium Term	Regain	\$1,685-1,700
Long Term	Recapture	\$1,800-\$1,900

## Last Week:

- Gold opened the first trading day of the New Year on a positive note, reclaiming \$1,600 per ounce on Tuesday. There was steady buying interest despite thin volumes, with many trading centres still closed for local holidays.
- Despite the gains, sentiment was tempered somewhat later in the day – the minutes of the December 13 FOMC meeting showed that committee members wanted to complete an overhaul of its communications policy before considering additional monetary easing.
- Gold remained supported around \$1,600 by pockets of investment and purchases related to the physical side over the rest of the week but it was capped by technical resistance ahead of its 200-day moving average at \$1,634 and caution ahead of December's jobs data. While the upbeat employment readings lifted the dollar – the DXY reached its best since late November 2010 – broader risk reaction appeared lacklustre, with equities struggling to make significant gains.
- Gold closed the week around \$1,617.50 – a solid 3.3-percent gain – while silver gained 3.7 percent before settling around \$28.85 per ounce.
- Holdings in the largest gold ETF – the NYSE-listed SPDR – were unchanged on the week at 1,254.57 tonnes; redemptions totalling 89 tonnes were made from the iShare silver fund.
- The US Mint has reported strong coin demand – sales of its Eagles have totalled 74,500 ounces so far in January, compared with 65,500 ounces for the whole of December. Silver demand has been equally strong, with sales of just more than 3.5 million ounces in the month to date compared with 2.009 million ounces in December.
- Wholesale wedding season stocking kept physical gold premiums into India at around \$2-3 per ounce last week despite lukewarm retail demand due to high interest rates and low income in rural areas. Robust demand was also seen in China ahead of the Lunar New Year, while premiums into Singapore, Hong Kong and Malaysia held around \$2 amid good demand.
- Turkish demand for gold almost doubled last year to 80 tonnes, import data showed. Silver imports were the highest in four years at 42 tonnes following a pick-up in demand in November and December.

The Week in Numbers NYSE Liffe US (mini contracts)						
Gold Feb	Mon 12	Tue 13	Wed 14	Thu 15	Fri 16	Week*
High	1718.70	1681.40	1645.70	1597.00	1604.30	1718.70
Low	1660.70	1626.40	1566.20	1562.90	1577.70	1562.90
Close	1668.50	1663.30	1587.10	1577.40	1597.90	-118.90
Silver Mar						
High	32.210	32.030	31.050	29.373	29.908	32.210
Low	30.890	30.425	28.532	28.090	29.181	28.090
Close	30.989	31.241	28.909	29.263	29.609	-2.644

\* week's high, week's low & change on week; na = not available

## The Week Ahead:

Three distinct factors in Europe will probably drive the market this week. The first is today's Merkel-Sarkozy summit in Berlin; the second the ECB rate-setting meeting on Thursday (at which we think there is a good chance the bank will cut rates a further 0.25 percentage points to stimulate economic growth given the recent run of poor EU data) and the third is EU data, including IP data for November, German GDP and EU CPI.

Data due for release elsewhere includes Chinese CPI, PPI and trade balance and US retail sales for December and the Fed's latest Beige book.

Given the relative thinness of the economic data calendar this week, markets are likely to focus on announcements from the ECB and BoE rate-setting meetings, political developments in Europe and news from the Middle East for direction.

Date	Economic Agenda	Expected	Previous
Tues 10th Jan	US IBD/TIPP Economic	45.3	42.8
	FOMC Williams Speaks		
	FOMC Pianalto Speaks		
Weds 11th Jan	Japan Leading Indicators	92.9%	92.0%
	EU Final GDP q/q	0.2%	0.2%
	FOMC Lockhart Speaks		
	US Beige Book		
	Japan Current Account	0.44T	0.52T
	China CPI y/y	4.0%	4.2%
Thurs 12th Jan	China PPI y/y	1.6%	2.7%
	Japan Economic Sentiment	46.3	45.0
	German CPI	0.7%	0.7%
	EU Industrial Production	-0.2%	-0.1%
	UK Asset Purchase Facility	275B	275B
	BoE Rate Decision & Statement	0.5%	0.5%
	ECB Rate Decision & Statement	1.0%	1.0%
	US Retail Sales	0.3%	0.2%
	US Initial Jobless Claims	370K	372K
Fri 13th Jan	EU Trade Balance	0.7B	0.3B
	UoM Consumer Sentiment	70.80	69.90
	UoM Inflation Expectations		3.1%

## FOCUS – Gold to benefit while markets expect more pain

Gold maintained its 11-year bull run in 2011 despite the correction below \$1,600 in December, closing the year up a little more than 10 percent and again outperforming many of the other major asset classes.

In comparison, the Dow closed the year up 5.5 percent and the Dollar Index just 1.5 percent; supply concerns helped bolster crude oil, which was up 8.5 percent on 2010, but the CRB Index declined 8.2 percent – industrial metals and agri/soft prices softened amid the weaker economic outlook.

The yellow metal also outperformed the rest of the precious metals, with silver off 9.9 percent, palladium down 18 percent and platinum 21 percent.

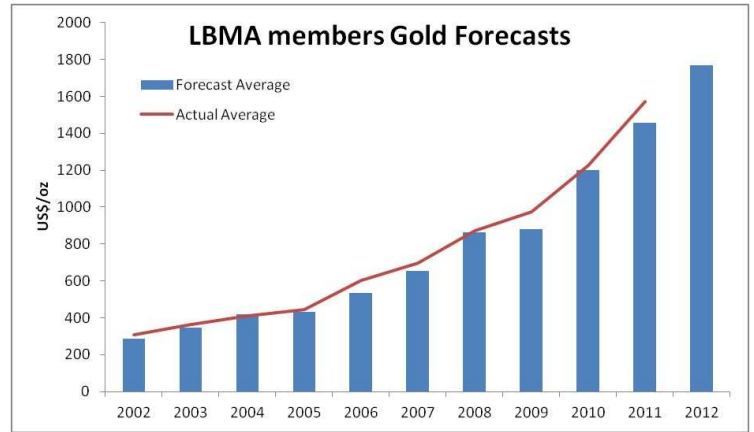
But last year proved a harsh reality check for markets, which felt the true effects of the mass stimulus binge carried out by government following the 2007/08 sub-prime collapse and credit crisis. Many sovereign states, particularly those of a weaker economic stance, struggled under burgeoning debt levels; several were forced resort to fiscal aid from the likes of the IMF to avoid default while others were forced to undertake aggressive austerity measures.

In Europe, politicians are trying to devise ways to manage the debt burden without causing too much pain but all the proposed solutions seem to involve creating even more debt, which merely delays rather than resolves.

Markets may well force US and Japanese politicians to start to tackle their massive debt levels before they become more problematic; Japan's debt-to-GDP exceeds 200 percent and the US' is around 100 percent.

It seems highly likely that the debt/economic situation in Europe will deteriorate further before it improves and there is a high risk of contagion. On this basis, we feel the risk to financial markets lies to the downside.

But in this environment, gold is likely to regain its foothold as major safe haven. Indeed, this is a sentiment echoed by the rest of the market – gold will average \$1,766 this year, according to a poll of market analysts by the LBMA, an increase of 12 percent on its average of \$1,572 in 2011.



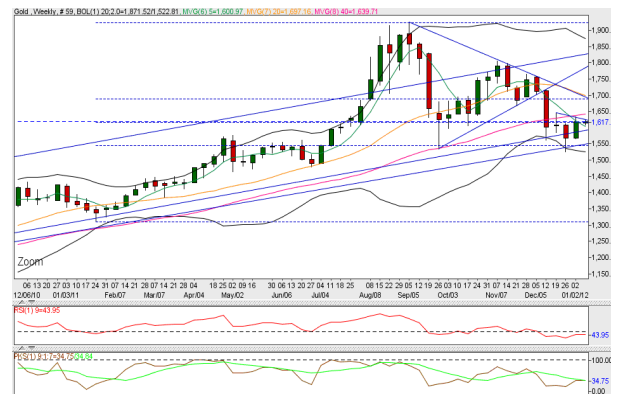
## Technical Analysis – Gold

Gold closed positively last week, forming a strong bullish engulfing pattern. It seemed to be range-trading below trendline resistance at \$1,623 on Monday morning. The stochastics are trying to cross higher while the RSI is neutral. Gold has support from the 5 WMA but this weekly average has crossed below the 40 WMA, we note.

Gold has some support at \$1,522, \$1,545 (UTL), \$1,560, \$1,583 and \$1,600 (5 WMA) and resistance at \$1,623 (DTL), \$1,631, \$1,639 (40 WMA), \$1,642, \$1,666 and \$1,687 (38.2%).

We are neutral on gold in the short term but would look to turn positive on a sustainable break above \$1,642 – this would materially raise gold's upside potential. We would only turn negative in the short term on a break back below \$1,589 (UTL).

We are neutral in the medium term and bullish in the long term.



## Technical Analysis – Silver

Silver closed bullishly last week, forming a tweezer bottom formation. It consolidated on Monday morning.

The stochastics are attempting to cross higher while the RSI is neutral. The metal is oscillating around the 7 WMA and has further resistance from the 20 WMA and the 40 WMA.

Silver has support at \$27.70, \$26.17, \$26.06, \$25.05 (DTL) and \$24.64 (UTL) and resistance at \$29.15 (50%), \$29.46 (UTL), \$29.78, \$30.21 and \$30.39 (DTL).

With silver trading in a bearish down channel, we are negative in the medium-to-long term. In the short term, silver could attempt to rally to \$29.78-\$30.34 but failure to break above the top of the down channel could raise the risk of another down leg. With this in mind, we will remain neutral unless it can close above the top of the down channel and will await signs of further weakness.

### Trader Talk:

"No asset is safe now, the only choice to hedge risks is to hold hard currency – gold" – a senior People's Bank of China official

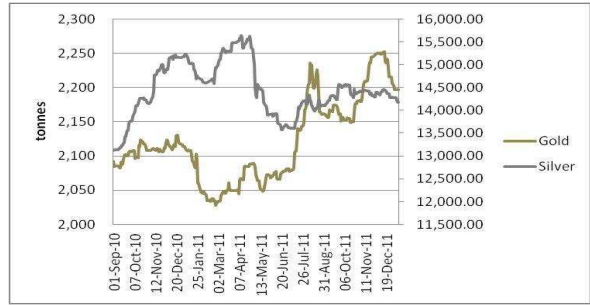
## Market Drivers

### Dollar Index



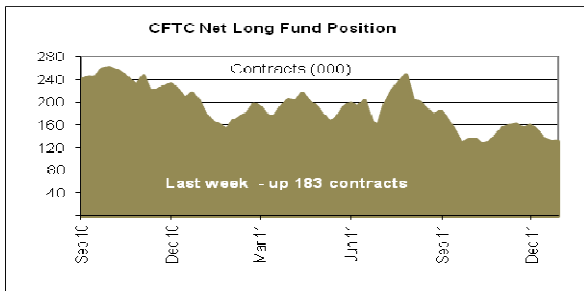
This weekly dollar index chart shows the 50% Fibonacci retracement line has been overcome as have the highs from between November 2010 and January 2011. This suggests the powerful rally in the dollar is set to head higher. Interestingly, bullion prices have managed to rise at the same time as the dollar. We have seen this before but not recently.

### Gold & Silver ETFs



Investor interest in the ETFs continues to wane, with light redemptions in both the gold and silver ETFs. Although the selling has not been heavy, we are surprised that the rebound in prices of late has not attracted more investor buying. A return of ETF buying would give us more confidence in the rebound.

### Funds



The net long fund position (NLFP) in gold climbed just 183 contracts last week but given the holiday period we may have to wait until this week's data to see if sentiment is starting to turn more bullish. Silver's NLFP gained 2,423 contracts – a jump of 40 percent, albeit from a low base. Given the pullback in the NLFP, there is potential for a lot of fund buying and short-covering if a rally in bullion gets going.

### Gold / Silver Ratio



This weekly gold/silver ratio chart shows that silver has suffered considerably more during the pull back that gold has. But if a sustainable rally starts to unfold in bullion, we would not be surprised to see the ratio start to fall again. The trend line on the chart is at 54.70; a move below there, followed by a move below recent lows at 52.35, would suggest sentiment is getting bullish again.

**Conclusion –** The spikes lower late in December damaged the chart pictures – especially that of gold, where the low on December 29 breached the previous major low at \$1,532 in September last year. But both gold and silver have recovered well – prices are now consolidating and we are waiting to see whether there is follow-through buying interest.

Given the distress in Europe over debt, the heightened tensions in the Middle East after last year's spring uprisings and the stand-off between the West and Iran, there are good reasons to remain bullish for gold and silver.

We generally feel that the sell-off in bullion had more to do with financial institutions' need to raise cash rather than a change in sentiment for gold from bullish to bearish.

If the latest phase of deleveraging has now run its course, we would not be surprised if safe-haven buying returns to bullion. Indeed, the fact gold and silver have managed to rally while the dollar has been heading higher suggests that bullion has regained its role as a safe haven – not that we think it ever lost it. The weight of deleveraging was greater than the safe-haven buying, we feel.

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