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Precious Metals 2013 Forecast

Gold

November 2012

Executive Summary

- Gold's bull market paused between September 2011 and September 2012, but another up leg seems to be getting underway again. Given the concern over EU and US debt and the ongoing quantitative easing, we remain bullish for Gold.
- We expect Gold prices to rise as quantitative easing debases the value of paper money and investors' demand for safety further monetarises Gold.
- Policymakers seem intent on finding the least painful solutions to the debt problems. This is likely to involve reducing the debt burden by devaluing it. Creditors are likely to react by further diversifying away from fiat assets.

Introduction

Gold prices rallied strongly after the initial risk reduction sell-off that followed the 2008 financial crisis. The extent to which Gold prices have climbed highlights how much Gold has been monetarised, not by government decree, but by investors whose faith in the fiat monetary system has weakened. Given we saw further broad based quantitative easing (QE) in September and that no solution has been found to either the EU debt problem, or the US budget deficit, we feel that there will be more QE ahead as policymakers continue to buy time. As money is created at will to keep the economic plates spinning we can not help but feel the value of paper money is being debased. As QE is happening in differing forms in the US, Europe, Japan, Switzerland and UK, the currency debasement is difficult to spot as the currencies of the economies doing QE are weakening in parallel. Given the situation the world's financial system is in, we feel there is still a strong reason to continue holding Gold. The other noticeable development in the latest rounds of QE was that they were unlimited – although this may provide confidence to the market and may dissuade traders from betting against the central banks, it suggests the practice could gather momentum. The debt problems are now so big that the only entity capable of paying off the debt is the global pool of wealth. One way or another, we feel the value of the debt will be reduced by devaluing the currencies the debt is priced in. As such, investors and creditors are likely to continue to diversify away from fiat currencies and that is likely to see further monetarisation of Gold as investors seek to preserve wealth.

The Big Picture

Unfortunately, the big picture has not improved since our last forecast in November 2011. The monetary system in the West is still straining to cope with the mass of debt that some countries have allowed to build up and policymakers still seem at a loss as to how to solve the structural problems. The crisis has migrated from a banking crisis in 2008 that individual governments addressed, by bailing out their banks, to a European crisis in 2011/12 where governments are now struggling to service, roll forward and increase their debt, to the extent that they are now being bailed out by the likes of the ECB and IMF. The worry is that whereas the banks had governments above them to bail them out and EU governments have the ECB - who will be there to bail out the ECB and IMF? The answer is likely to be 'nobody', so solutions will now have to be found.

All the way through the crisis the measures taken have tended to buy time, but each measure has made the problem even bigger. It is now questionable whether all the layers of debt and toxic collateral could be written off without causing unbearable contagion. For example, if a country were to default, all the holders of that country's government bonds would have to take massive write downs and in turn that would likely bring about another financial crisis as a domino effect takes down one financial institution after another. Unlike in 2008, when governments stepped in as circuit breakers, we fear they would now be virtually powerless and certainly without the funds, to come to the rescue. The net result would be massive wealth destruction as all stakeholders behind the debt, would have to take haircuts.

At present the US is managing to keep the recovery going, but the fact it has had to provide a third tranche of quantitative easing (QE3) highlights that the Fed was concerned that growth was flagging. The problem is that as QE1 and QE2 have not led to a self-perpetual recovery, will QE3? All the measures taken over the past five years have led to an explosion in public debt that now stands at $16 trillion and has been growing at over a trillion dollars a year during the past four years. The budget deficit this year is likely to reach $1.25 trillion.

US politicians are at odds about how to cut the budget deficit and this runs the risk of having automatic budget cuts triggered if they can not agree on a plan by the end of the year. This, so called 'fiscal cliff', could be a major stumbling block for the US recovery next year and for market sentiment in general. Given the state of the US finances you have to ask whether the US will follow the EU into a debt crisis - albeit at a later date. This raises the question whether international investors will start to question whether the US is such a bastion of safety.

Over the past decade, the global economy has got used to strong growth in China and for that matter in the other emerging markets too, but this era now seems to have passed, at least for now and that is something developed markets will have to get accustomed to. Growth in China is slowing and the economy is suffering a double whammy in that the recession in Europe has seen demand for its exports drop. Also government's efforts to deflate the private sector property bubble have created credit tightness throughout the domestic market. The slowdown in the economy is a worry for global growth, as slower demand for imports in China has a worldwide impact on other countries' exports.

Overall the EU is in a mess and will remain a threat to global financial stability for the foreseeable future. Given the enormity of the debt problem the situation seems likely to get worse before a workable solution is found. The US is doing relatively well, but could change quickly if it mishandles its budget deficit and the 'fiscal cliff'. Given the hurdles the EU and US face and the elevated level of their stock markets, the financial markets are expected to

correct further and that is likely to make investors increasingly nervous. The chart of the Dow shows that equities are still holding up well, they are almost back at the pre-crisis level, but we would say the risk lies to the downside.

The situation in Asia needs careful monitoring as any deterioration in China's economy is likely to spook global markets and that might well boost demand for safe-haven investments.

Overall, it is hard to have much confidence in the economic outlook and in governments' ability to get to grips with all the interlinked problems. As faith in policymakers wanes with their handling of the crises, we expect investors will not want all their wealth backed by paper assets and therefore will continue to look to spread their risk by holding Gold and other hard assets. Greater monetarisation of Gold is likely to be bullish for prices.

FACTORS DRIVING GOLD PRICES

The Dollar

The dollar's long term down trend seems to have halted and the dollar has been oscillating sideways since early 2008. As the dollar index chart shows, the latest medium term trend has been to the upside with the index recovering to 84.10 from 72.70, although in the past three months the index has pulled back. Given the concerns over the financial situation in Europe and the relative strength of the US economy, it is not surprising that the dollar has been stronger. Interestingly, the run up in the dollar also coincided with the consolidation in Gold prices that was seen between September 2011 and September this year. Likewise the recent weakness in the dollar has coincided with the latest up leg in Gold. This suggests that the inverse relationship between the dollar and Gold is functioning. That said, given the seriousness of the crisis in Europe, it has been hard to understand why Gold was being ignored as a safe-haven for as much as it was. Our observation has been that up until recently, the main safe-havens have been the dollar, the yen, US treasuries and the German bund. As already mentioned in the section above, we feel there is a risk that the dollar could weaken in the medium term as the US struggles to tackle the budget deficit. Given the inverse relationship between the dollar and Gold, we feel the dollar may well be a positive factor for Gold in the medium term; but if the US recovery continues into 2013 then a stronger dollar could become a headwind for Gold. In addition, we feel the other safe havens mentioned above are all looking overbought, which again could be bullish for Gold.

Gold Strong on the Crosses

What is interesting is that even though dollar Gold prices are relatively strong – it is 10% below its record high, Gold in other currencies is even stronger and this we feel supports the

view that Gold is a good store of value in these uncertain times. Gold in a host of currencies has reached record highs in 2012, including: the Euro, Swiss francs, Brazilian real, Indian rupee, Indonesian rupiah and the South African rand to name a few. What is interesting is that this represents a mixture of developed and emerging economies, which highlights the broad based appeal of Gold as an alternative currency. Even though countries that have not seen record high Gold prices this year, such as Japan, the UK, Australia, Canada still have Gold prices near record levels. Indeed, Norway, which is seen as having one of the strongest currencies has a local Gold price just 6% below the peak.

Inflation, Stagflation and Deflation

This time last year, the global economy faced both inflation and deflation, with emerging markets, especially those in Asia, experiencing and fighting inflation, while developed economies were treading a fine line between stagflation and deflation. Inflation in Asia has now calmed down and continued use of QE by Western governments, in an effort to lessen the burden of debt and to provide a low interest environment to encourage economic growth, have so far avoided economies from experiencing too much deflation. QE has not, however, produced sustainable economic growth. Japan continues to suffer deflation and an 18 month rally in JGBs, yielding just 0.5% in the third quarter of 2012, attests to that. Given all the QE, which in theory debases the value of money, we feel there is a high risk that developed markets move towards stagflation, where raw material prices rise as the value of the currency they are priced in devalues. The latest announcements of QE in September lifted metal prices considerably and despite weak economic growth, fuel prices remain high. In addition, there are various side effects of QE that are also helping to keep commodity prices elevated. The low interest rate environment and abundant liquidity available to banks and trading houses are facilitating such things as cash-and-carry deals that are keeping surplus commodities, especially base metals, off market that in turn creates artificial tightness in supply and higher prices. All of which boosts PPI even though demand is weak. Demand-pull inflation may become an issue once the Western world starts to recover from its debt spiral, but there seems little chance of this in the year ahead. The Fed's comment that they would not tighten monetary policy too soon after growth returns, also raises the prospects for inflation and this might become an issue if the US economy manages to see sustainable growth – this is something that will need careful monitoring in the months ahead. Overall, we feel the debt burden will suffocate growth in Europe and the region is likely to follow Japan's lead where deflation and low growth dominate the market as debt is paid off.

How Gold will behave in a deflationary environment is debateable. In theory, you would expect government treasuries to do well as even a small yield is good in such an environment, but we would argue Gold would also do well. If faced with deflation, we would expect the governments to do more QE and in turn that would likely debase currencies further, whereas although Gold would not pay a yield, it would stand a good chance of holding its value against currencies that are being debased. If we were to see deflation in the US, then given the different sizes of the market, even a small move out of treasuries and into Gold by foreign investors could have a meaningful impact on Gold prices.

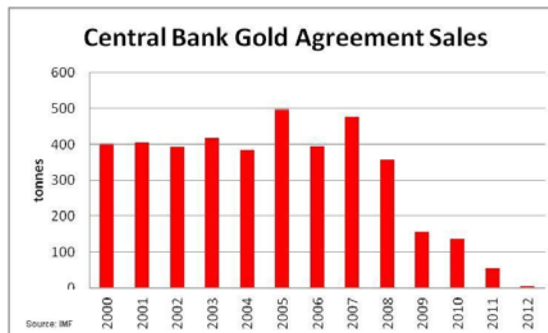
De-hedging

At the start of the bull market for Gold in late 2001, which roughly coincided with the start of de-hedging, the total hedge book stood at 3,107 tonnes (99.9Moz). At the end Q2'12, the hedge book stood at 152 tonnes (4.9Moz), according to the Thomson Reuters GFMS. As the hedge book shrinks, the level of de-hedging has slowed: in 2009 the hedge book was cut by 249 tonnes, in 2010 it fell 96 tonnes, in 2011 it bucked the trend by climbing 6 tonnes, but has

resumed the down trend this year by falling 14 tonnes in the first half. The end of the 'de-hedging era' removes one of the bullish drivers in the market as producers are no longer buying back Gold on the open market to close out their hedges. The question now is will producers start to forward hedge again once the bull market shows signs of ending? At present, the attitude towards hedging has not changed and new hedges only seem to be put on when bankers/financiers demand it for new projects. However, at some stage Gold's bull market will end and even though the current wishes of shareholders of mining companies is for no, or limited hedging, their attitude is likely to change when the prospect for economic recovery improve, the need for safe-havens recedes and investors start to reduce their exposure to Gold. For the moment, the mood amongst producers is, in the majority, still bullish for the Gold price and the attitude of shareholders still seems to be anti-hedging – but we think that will start to change over the next few years. It was interesting that in the first half of 2011 the hedge book dropped 19 tonnes, but by the end of the year it had climbed by 6 tonnes, suggesting 25 tonnes of hedges were put on in the second half when prices started to correct – this, we think, supports our view that hedging will become a negative factor once it looks like the bull market in Gold is over.

Central Bank Official Sales

For many years, central banks have been net sellers of Gold, but that changed in 2010, when the sector became a net buyer. In the first year of the third Central Bank Gold Agreement (CBGA-III), which ended in September 2010, disposals totalled 136.2 tonnes. (The agreement allows for sales of 400 tonnes of Gold per annum.) In the second year to 26th September 2011, sales from CBGA signatories were just 1.1 tonne, but in addition to that the IMF sold 52.2 tonnes. Sales in the third year to 26th September 2012, were just 5.9 tonnes - 5.4 tonnes of which were made by the Bundesbank to make commemorative coins. As the chart shows, as soon as the financial crisis started to unfold, sales started to fall as governments realised they needed Gold to shore up their reserves.



The lack of uptake of the CBGA quota does leave room for European central banks to make further sales if they need to - that is if they are allowed to. Although the general feeling is that central banks will be very reluctant to make outright sales, it may be feasible that some central banks could put their Gold to use in a way to help alleviate their debt situation. There is precedence for this as in 2010 Gold swaps, amounting to 346 tonnes of Gold, were arranged where money was lent to commercial banks and Gold was taken as collateral. The table opposite shows the amount and value (basis a Gold price of $1,785/oz) of Gold various European central banks hold.

Gold Reserves	Tonnes	$ Billion
Germany	3,395.50	194.86
IMF	2,814.00	161.49
Italy	2,451.80	140.70
France	2,435.40	139.76
Switzerland	1,040.10	59.69
Netherlands	612.50	35.15
ECB	502.10	28.81
Portugal	382.50	21.95
UK	310.30	17.81
Spain	281.60	16.16
Austria	280.00	16.07
Belgium	227.50	13.06
Greece	111.80	6.42
Ireland	6.00	0.34

Source: IMF September 2012

Central Bank Buying

The financial crisis and governments' use of QE has turned the trend in official sector activity from being a net seller, to being a net buyer. The demise of CBGA and IMF selling in 2011, that in previous years had more than countered official purchases, now sees official buying as the dominant trend. In 2011, the official sector bought an estimated net 430 tonnes, according to Thomson Reuters GFMS data. The buyers now tend to be emerging market economies that have trade surpluses so instead of building up just foreign exchange reserves they are adding Gold to their reserves too. Mexico bought 100 tonnes of Gold in 2011, Russia added 87 tonnes, South Korea added 40 tonnes and the trend continues, with central banks buying a further 254 tonnes in the first half of 2012, compared with 203 tonnes in the same period in 2011, according to the World Gold Council (WGC). Other buyers include: Kazakhstan who has stated it will buy its country's entire domestic Gold production over the next two to three years, the Philippines, Ukraine, Thailand, Bolivia and numerous other countries are also increasing their holdings by small amounts - most likely as they try to keep a fixed proportion of their reserves in Gold.

China Builds Up Its Gold Reserves

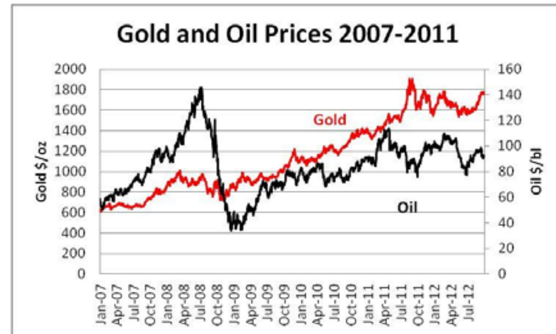
As fewer currencies can now be called non-fiat, the attractiveness of Gold as a reserve asset has increased. In addition to the countries mentioned above, China also seems to be building up its Gold reserves. It has long been argued that even if China wanted to diversify its $3 trillion of reserves, it could not diversify into Gold without disrupting the Gold market. However by stealth, China seems to be doing just this. As well as being an important Gold consumer, China has become the world's largest producer of Gold and is likely to be the largest importer of Gold too, in 2012. In addition, it is buying Gold mining companies around the world. All in all, this suggests China is building up its Gold reserves. The last time China made public its reserves they had doubled to 1,054 tonnes, that was three and a half years ago in April 2009. If they make another update the market should be braced for a significant increase. In 2009, the market reacted bullishly to the news and we would expect a similar reaction if another update were to emerge – that is as long as it did not look as though China had built up enough reserves to slow down its accumulation. This seems unlikely as even if China doubled its holdings again it would still be below that of France, Italy, the IMF, Germany and the US – see table on right. China's official Gold holdings of 1,054 tonnes only account for some two percent of its reserves, whereas Gold held by the US, Germany, Italy and France accounts for around 70 percent of their reserves. We feel central banks' purchases of Gold will continue, driven by the prospect of further currency debasement and higher inflation down the road.

Gold Reserves	Tonnes	$ Billion
US	8,133.50	466.76
Germany	3,395.50	194.86
IMF	2,814.00	161.49
Italy	2,451.80	140.70
France	2,435.40	139.76
China	1,054.10	60.49
Switzerland	1,040.10	59.69
Russia	936.60	53.75
Japan	765.20	43.91
Netherlands	612.50	35.15
India	557.70	32.01
ECB	502.10	28.81

Source: IMF September 2012

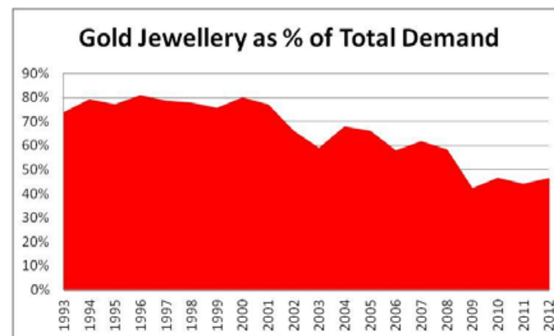
As well as seeking ways to diversify its reserves, China, may also be looking to build up its Gold reserves with the idea that before too long it will want to make the yuan a freely convertible currency.

Oil



Oil and Gold prices have tended to be positively correlated for most of the recovery off the early 2009 lows. However, the correlation broke down in April 2011, which is around the time industrial commodities started to correct lower as concerns about economic growth materialised again. The two prices have become more correlated again in recent months as the market anticipated more QE. However, a pick-up in geopolitical tension with Israel making more noise about attacking Iran, has also been a bullish feature for the oil market and this might become a bigger issue in the months ahead. We have long believed that the US would try to persuade Israel not to make a move until after the US Election, but with that now upon us, the gloves might soon come off. A strike against Iran by Israel is likely to lift oil prices and be bullish for Gold, but how long such a reaction lasts is difficult to say as much will depend on how events unfold after such a development. As we are not bullish for economic activity in the year ahead, we do not expect demand-pull to boost oil prices. That said, prices may remain elevated as the poor harvests in 2012 have led to high food prices so there may be some reduction in supply from bio-fuels as land is used to grow more food crops.

Jewellery Demand



The pull back in prices after the highs at $1,921/oz in September 2011, surprisingly has not led to a pick-up in jewellery demand. In the first half of 2012, the jewellery industry consumed 906.4 tonnes, compared with 1,042.3 tonnes in the same period in 2011. This represents a drop of 13%. Numerous factors have negatively impacted demand. In India, demand was disrupted by industrial action at jewellers, but the main reason for lower demand in most regions of the world is more to do with less appetite to buy due to economic hardship. Slower GDP growth in both developed and developing economies has meant consumers have had less money to spend on luxury items such as jewellery.

Currency factors have also had an impact, especially in India where a weaker Rupee has pushed local Gold prices to record levels. So far this year the Rupee against the dollar has averaged 53.3 compared with an average of 46.8 last year. Not only has this choked off some demand, but it has also prompted jewellery scrapping, where old jewellery is offset against buying new jewellery. Even jewellery demand in China, which has been the up and coming jewellery consumer in recent years, fell 8% in the second quarter, yoy.

Where jewellery demand has been price elastic, jewellery fabricators have had to reduce the carat of their jewellery in order to keep sales flowing. This has been particularly evident in Asia. While in Europe, tighter credit limits from banks and cash flow issues have also led to a certain amount of destocking with wholesalers and retailers carrying less stock.

Another trend that has hit jewellery demand in recent years is that jewellery has to compete against other consumer desirable items such as electronic gadgets, like mobile phones and high

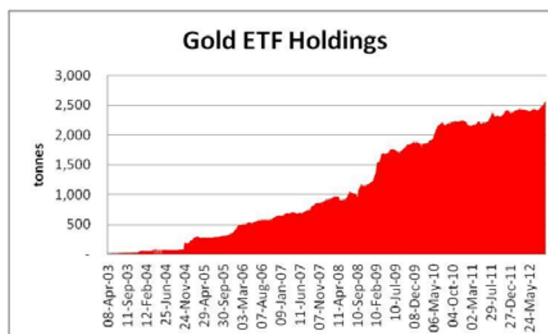
cost brand fashion items. In addition, concerns over the economic climate have led to a pick-up in the popularity of investment bars. In Asia, jewellery has always tended to be seen as both an investment as well as an adornment, but with prices moving much faster these days and becoming more volatile, investment bars have provided a more standard product to trade.

In 2011, global jewellery demand dropped 2.1%, yoy, to around 1,974 tonnes, according to Thompson Reuters GFMS and judging by the decline in the first half of 2012, and the on-going harsh economic climate, we feel demand could fall 10%, to 1,775 tonnes for 2012 as a whole. For 2013, we expect demand for jewellery to be subdued as we expect prices will remain high and the economic climate will stay weak. However, there may be some relative relief as the market is now likely to have destocked and after lacklustre performance this year there may be pent-up demand in India and China next year.

Investment demand

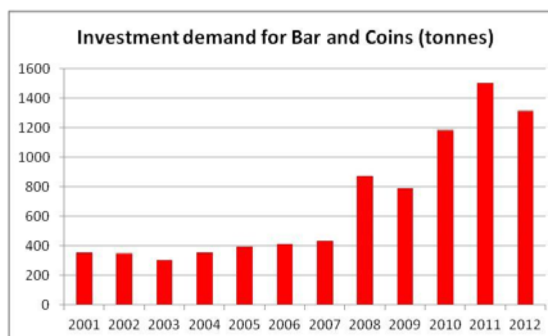
In recent years, as jewellery demand has fallen, production has climbed and scrap sales have surged, investment demand has had to step up to the plate to take up the slack. So far this has not been a problem for the investment sector as exchange traded funds (ETFs), official purchases and the buying of coins and bars have been rising strongly. While this remains the case, then the bull market is likely to continue.

ETFs have become a highly popular investment vehicle as the chart opposite shows. Holdings have been trending higher at a steady pace, although there have been periods that have seen accelerated buying as seen in late 2008. As of late October 2012, the holdings within the ETFs we follow reached a record high of 2,595 tonnes. This was up from 2,371 tonnes at the end of 2011.



Generally ETF investors are thought to be in for the long term. Even after the September 2011 peak in Gold prices, holdings in the ETF only dropped from 2,331 tonnes to 2,308 tonnes and the fall came immediately after the price drop. It was followed by scale down buying and within about a month the holdings were back above the peak seen in September.

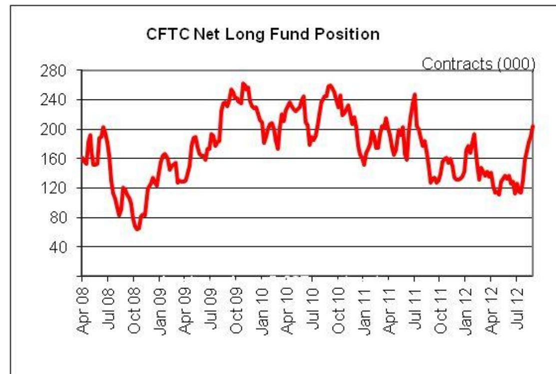
Investors' interest has not just been confined to ETFs, in recent years there have been unprecedented levels of investment in Gold bars and coins, see chart. The buying dipped in 2009, as the economic recovery pushed money back into more traditional investments, but rebounded in 2010 and 2011, as concerns over sovereign debt picked up. At times, the market was even worried about the euro falling apart if countries like Greece exited the euro. Interestingly, annualised data for first half data for 2012, suggests demand for coins and bars will fall short of last year's record. Given risks remain high we assume that the weaker demand may reflect that those who were going to buy coins and bars have already done so. That is not to say that demand will not pick-up again if Draghi's latest rescue plan is seen not to work. Given the extent of the financial mess in Europe, we generally feel demand for Gold as a



safe-haven will remain high and at the retail end of the market, coins and bars are likely to remain popular.

At some stage, once more sustainable economic growth is back on the agenda, we would expect investors to reduce their exposure to Gold in all forms. So not only will demand fall, but bars and coins are also likely to be sold back into the market, thus adding to scrap supply. However, this is unlikely to be an issue in the medium term as risks remain plentiful so the case for owning Gold remains strong.

The Futures market



In the run up to the record high Gold price in September 2011, the net long fund position (NLFP) peaked at around 247,000 contracts, it then fell back sharply as profit-taking took hold. The January to February rally at the start of 2012, saw the funds increase their exposure again, but after that, as Gold prices fell back into a drawn out consolidation phase, fund interest fell back to a low around 110,700 contracts. The NLFP then oscillated sideways until mid-August when interest started to recover. It has since accelerated back up to around 204,000 contacts, overcoming the late February 2012 peak in the process. The chart suggests that the funds have a saturation point between 250,000 and 260,000 contracts. Needless to say the various peaks in the net long fund position (NLFP) have meant the dollar value of Gold held by the funds has increased significantly - due to higher Gold prices - but there does seem to be a cap on the number of contracts the funds are comfortable holding. As the latest round of QE in the US and Draghi's bond buying offer are now unlimited in scope, we would not be surprised if investors get more concerned about fiat money being debased and that may well fuel demand for Gold and see the NLFP climb back up to the highs seen in recent years.

Supply

Gold supply has climbed in recent years as high prices have encouraged a supply response from miners. Whereas in recent years supply has also been boosted by rising levels of scrap, this was not the case in 2011 as scrap supply fell around 3% to 1,665 tonnes according to the WGC and the data for the first half of 2012, shows a decline of around 1.6%. Over the past decade, dehedging by producers has also been a negative factor for supply, but last year hedging once again became a supply factor, albeit a small one with a net 9.7 tonnes of metal hedged. We feel it is worth mentioning this as at some stage when the outlook for Gold is less bullish, we would expect hedging to once again become an important factor of supply.

Mine supply increased three percent to 2,822.4 tonnes in 2011 according to WGC and output in the first half increased 1.5%, compared with the same period in 2011. The increase for 2011 was 83 tonnes and the first half of 2012 was 20 tonnes. These are not large volumes of extra supply for the market to have to absorb, especially when you consider ETF holdings increased 143 tonnes in 2011 and 55 tonnes in the first half of 2012.

Mine output is expected to edge higher in 2012 as new production comes on stream, but this will to some extent be countered by falling production at existing mines as producers have

encountered lower ore grades, adverse weather and production disruptions. Despite ten years of rising prices it has become ever more difficult to bring new mines on stream as it is harder to find new large deposits, the time taken to bring a new project into production has increased considerably due to all the government and environmental legislation - all of which increases the capital and production costs significantly. In 2012, we expect mine output to increase around one percent to 2,855 tonnes, while output is expected to climb around three percent in 2013, to 2,940 tonnes. The 3,000 tonne level may not be seen now until 2014.

In 2011, China retained its position as top Gold producer, with Australia the second largest producer, followed by the US, Russia and in fifth place, South Africa. Going forward, we expect to see steady increases in Gold mine output in China, Russia and central Africa.

Scrap

Gold supply from scrap is all important as it accounts for some 37% of supply. The importance of scrap has increased over the past decade as in the early 2000s, scrap accounted for around 22% of supply. However, as prices have climbed more old jewellery has been cashed-in. Scrap supply peaked in 2009 at around 40% of supply, but has since slipped. In 2012, record high rupee Gold prices saw a rise in Indian scrap supply, but generally in other countries scrap supply has fallen as subdued prices, at least up until September, have reduced the incentive to sell old Gold. We now feel that Gold prices will need to move into new high ground to see scrap supply pick-up again, but even then after so many years of rising prices, a lot of the old jewellery may well have already come out of the woodwork. As such, we would not be surprised to see scrap supply as a percentage of total supply continue to drift lower in the years ahead.

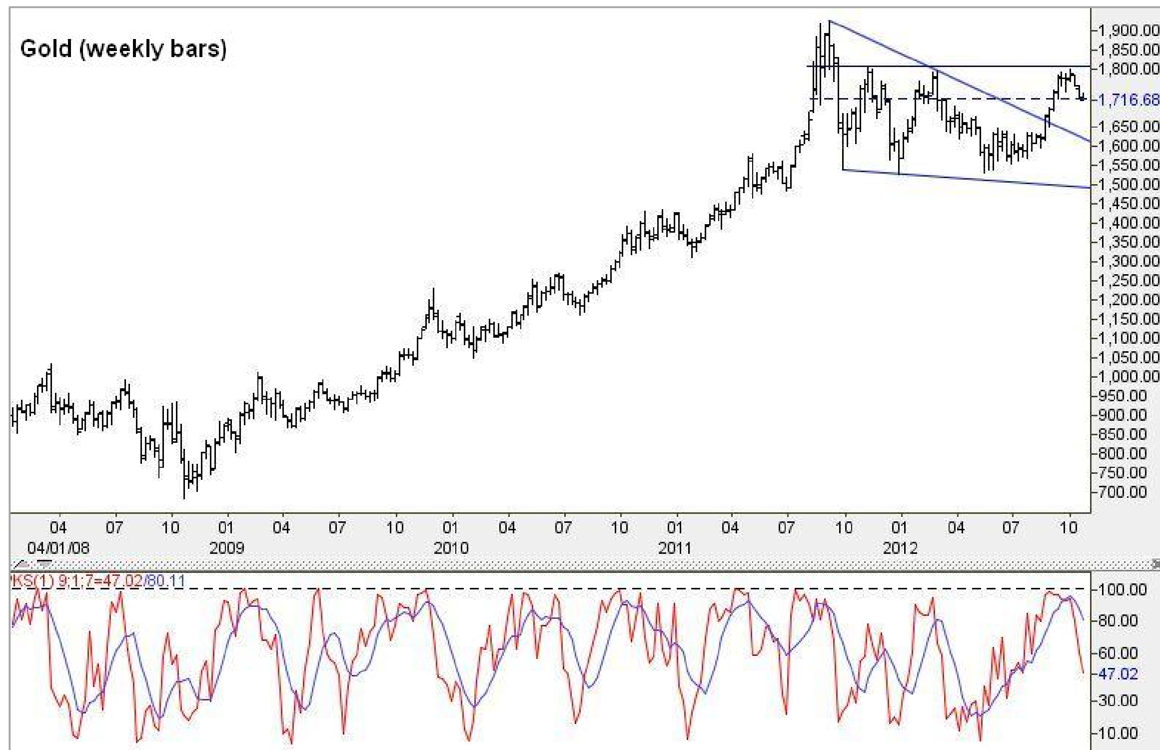
In recent years dehedging has been a number on the demand side of the supply-demand equation, but it reappeared as a small number on the supply side in 2011. In the first half of 2012, some 14 tonnes of dehedging was carried out, so for now hedging is once again not a supply issue, but this may well change in the year ahead once the risk increases that Gold's bull market is over.

The official sector swung from a net seller to a net buyer of Gold in 2010 and that trend has continued. As such, the official sector is no longer a factor of supply.

China Remains the World's Largest Gold Producer

China became the world's largest Gold producer in 2007 and has held that position each year since, with output in 2011 climbing 5.9% to around 361 tonnes, according to the China Gold Association.

Overall with mine output picking up again and with scrap supply expected to drift lower, we think Gold supply will continue to increase at a moderate pace. The rate could speed up should sentiment towards the outlook for Gold start to deteriorate to the extent producers put on forward hedges and redemptions from ETF start to gain momentum - but the earliest we would expect that is late 2013, but more likely nearer 2015.



Technical Outlook

After peaking at $1,921/oz in September 2011, Gold prices retreated before entering a long drawn out period of consolidation within what appears to be a falling wedge. Given the extent of the 2008 to 2011 super-charged rally, the fact prices took a long time consolidating is unsurprising. In mid-August 2012, prices started to rally again and that led to an upside break out of the wedge that saw prices reach $1,796/oz. Prices overcame the February 2012 peak at $1,790.80/oz, but failed to get above the November 2011 peak at $1,803/oz. Prices are now pulling back in search of a support level that holds. The stochastics have also swung lower so further weakness seems likely in the short term. Overall though, we feel prices are pulling back to consolidate before rechallenging resistance at $1,803/oz - clearance of which would then open the gateway that leads to the $1,921/oz highs. We would now wait for prices to find a base and once that is established and the stochastics cross higher again, we would expect another rally to get going. For support, it may be prices pull back to test the break-out level, as seen by the top of the wedge that is around $1,615/oz, although we would also expect support ahead of that between $1,650/oz and $1,680/oz. A move down below $1,580/oz to $1,600/oz would look ominous.

Forecast & Conclusion

There remain a multitude of factors influencing the Gold price, but one of the main reasons we are still bullish is because of the mess the Western world is in. Europe has a debt problem that is proving all but impossible to solve and all efforts to date have revolved around throwing more money at the problem to avoid the monetary system from breaking down. That should be reason enough to be bullish for Gold and we think the latest move higher in Gold prices shows that it is.

The US has its debt problems too, but with the dollar being the world's reserve currency it has not had any trouble financing its debt – so far. However, given the extent to which debt has

grown and is growing, creditors may well start to get worried and then the US could start to find itself in a similar situation to Europe. A big test for the US will be how it handles the budget deficit issues in the remaining months of the year. Overall, we expect the US will remain hooked on QE well into 2013 and possibly beyond. As QE means currency debasement, we expect that to underpin investment demand for Gold.

In Asia, demand growth for Gold jewellery and investment coins has suffered as the region has seen GDP growth fall. Also, as inflation has fallen the need to buy inflation-beating commodities has declined. However, we think this lull will be temporary as there is massive potential for organic growth in the region and we expect the slowdown in buying will lead to pent-up demand in 2013. At the government level, we think Asian central banks, or sovereign wealth funds, will remain strong buyers.

Given the monetary and political strains in Europe, the uncertainty over whether the US will avoid tripping over the 'fiscal cliff' and whether China will avoid a hard landing, we feel there is a near term risk of another market correction, probably led by US equities. In turn, this could trigger risk reduction across the commodities. In such a circumstance, Gold prices would likely fall, at least initially, but we would expect dips to attract good buying interest. Indeed if concern over the US budget deficit is the cause for such a correction, then the dollar might sell-off too, in which case Gold might once again be seen as the safe-haven of choice.

Overall, we do not think we have seen the peak in Gold yet as we think the world's financial problems are far from over. However, the higher the Gold price goes the more volatile trading is likely to become and the more nervous investors and funds are likely to be.

At some stage, the problems facing the global economy (and the West in particular) will be solved and normality will return. When that process begins, safe-haven assets are likely to be sold, producers are likely, once again, to increase hedge selling and a good deal of the stock that has built up in allocated accounts at banks and in ETFs may move back into the market. One can imagine what prices will do under such circumstances. There may well be some scares along the way that the end of the bull market is unfolding – indeed even over the summer when Gold prices were lacklustre there was a pick-up in talk about the bull market ending. As such, we should expect sell-offs along the way. However, until the problems facing the global economy are properly sorted out and a workable plan to revive robust private sector growth is seen, we expect Gold's bull market to continue.

In 2012, the global economy has struggled; momentum after the massive stimulus seen in 2009 and 2010 has worn off and the financial problems have not been solved. This raises the question whether we have been in the eye of the financial storm in 2010 to 2012. If austerity measures in Europe force a country to leave the euro, if the US fails to sort out is budget deficit, or if China suffers a hard landing, then the next part of the storm may well be the one that leads to the end-spike up in Gold prices.

Overall we feel the issues facing the EU, China and the US are so big that policymakers will do whatever is necessary to avoid a meltdown, but the cost of this will be currency debasement where creditors' assets lose value and debt is reduced as the currency the debt is denominated in is devalued. In this scenario, we would expect Gold to become more monetarised.

Having consolidated between September 2011 and September 2012, we feel Gold prices have started another up leg that is likely to lead to new highs during 2013. How high prices go is

difficult to gauge, we would not be surprised to see prices reach $2,200/oz. Should prices undergo another correction in the short term then we would look for good support around $1,600/oz. Eventually, once the bull market has run its course and the there is less need for safe-havens, then we would look for prices to retrace back towards $1,100/1,200oz as investment Gold is liquidated and supply surges, but we certainly do not expect that to happen in the year ahead.

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