



# Quarterly Report

September 2009

Precious Metal

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## **Executive Summary**

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*Gold, a symbol of wealth, has been traditionally considered as a hedge against inflation, mostly moving in tandem with rising inflation and inversely with the dollar. Gold bullion has been maintaining an upward trend with a phenomenal CAGR of more than 15 percent since 2001. It has gained for eight consecutive years as the decline in the dollar and increasing financial volatility boosted demand for the yellow metal.*

*The precious metal continued to glitter in the year 2009 with more than 18 percent surge in gold prices till-date. Dollar weakness and seasonal buying spurred up the demand for this yellow metal and resulting in, the bullion settled the quarter with 8.8 percent jump in the prices. This was the highest since the three month ended March 31, 2008. The dollar index, a measure of greenback against the world's six-major, remained the driving force for gold prices. The gauge dropped 3.74 percent during this quarter, completing 7.24 percent decline till-September in the year 2009.*

*In regard to investment demand, assets held by exchange-traded funds backed by gold bullion jumped 55 percent in 2009 as the financial turmoil and inflation concerns boosted the metal's appeal as an alternative investment. Holdings at the SPDR gold ETF have increased by 41 percent this year and climbed to a record-high in June.*

*Moreover, prices have shot up sharply in the last couple of months because key producers have been implementing a major de-hedging exercise. De-hedging involves a company buying back such "hedged" gold in expectation of price rises. With Barrick Gold Corp, the world's largest gold producer, at the forefront of the move, the indication is that producers are accelerating the process of buying back hedges to get full exposure to the metal, in anticipation that prices will rise further.*

## Headlines

- ✓ On 7<sup>th</sup> Oct 2009, gold prices made a record high of \$1,049 levels during intra-day sessions.
- ✓ On Sep 23, dollar index fell to 75.89 levels, close to one-year low.
- ✓ The recently concluded G-20 Nations Summit acknowledged the recovery remains dependent on emergency government measures. The group of 20 will also avoid any premature withdrawals of stimulus which will further encourage investors to take on more risk. The G-20 leaders also paved the way to overhaul the banking industry. Going forward, the broader G-20 will supplant the Group of 8, a club of the most highly developed nations plus Russia.
- ✓ The recent FOMC meet has concluded with keeping its benchmark interest rate intact at 0.25 percent.
- ✓ IMF approved to sell 403.3 metric tons gold via market. China has shown its interest to buy gold from IMF as the country is increasingly investing in gold reserves to diversify its forex reserves.
- ✓ Zimbabwe, once the third-largest gold producer in Africa, has also re-opened many of its gold-mines which could result in more than a quarter increases in its total production to 4.5 MT against 3.5 MT last year.
- ✓ The G-20 nations won't stop infusing liquidity into the system in the immediate future. They may call for reduction in international trade imbalances and help other currencies to rise.
- ✓ The world's largest gold producer, Barrick Gold Corp plans to record \$5.6 billion in Q3 costs to eliminate fix-price contracts as the company bets that prices for the previous metal will climb.
- ✓ The US president Barack Obama revised its trade deficit forecasts to \$9.1 trillion between 2010 and 2019, in comparison with \$7.108 trillion forecast earlier this year. In this response, the US plans to borrow an unprecedented \$6.78 trillion to finance its burgeoning trade deficit.
- ✓ Many countries are planning to reduce their reliance on dollar and diversify their foreign currency reserves. In this context, Russia and Brazil have already planned to buy \$20 billion of bonds from the IMF, hence cutting their investments in US treasuries. Russia stands 3<sup>rd</sup> in terms of forex reserves with a whopping \$413 billion, as on July 2009. The investments in dollar itself are valued at \$140 billion. China plans to buy \$50 billion and India may also announce similar funding.

## Major economic events

**GDP:** The US GDP posted QoQ (annualized) negative growth of 1 percent in Q2. Euro zone GDP declined by 0.10 percent for the Q2 against the same fell by 2.5 percent in Q1.

**Interest Rates:** Federal Reserve Bank in the US kept its benchmark interest rates as low as to 0.25 percent in its August meet. European Central Bank (ECB) also didn't prefer to increase the benchmark interest rate and kept it at 1 percent in the Q3'09. India also maintained its REPO and reverse REPO rate at 4.75 percent and 3.25 percent, respectively.

**Inflation (CPI MoM):** The US inflation measure CPI grew by 0.40 percent in August as compared to no price growth in July and 0.70 percent in June. Euro zone posted inflation of 0.30 percent in August, after a decline in prices was observed in the month of July.

**Current Account Balance:** The US saw a current account deficit of \$98.8 billion for the June-ended quarter. Euro zone experienced the same to emerge as surplus of €6.6 billion in July as compared to a deficit of €5.3 billion in June.

**TIC Flows:** Total TIC flows have been found declining in the Q3 as it saw withdraw of \$97.5 billion in July against the prior of \$31.2 billion in June. However, net long term TIC flows stood at \$15.3 billion in July and a whopping of \$90.7 billion in June.

**Industrial Production:** The US industrial production rose for two straight months in July and August by 0.50 percent and 0.80 percent, respectively. Euro zone also saw a phenomenal increase of 3.10 percent in its industrial production for the month of June after a negative growth previously. India's industrial production declined to 6.80 percent (YoY) in July against 7.80 percent in June.

**Housing Data:** Both housing starts and building permits in the US have grown to 598,000 and 579,000, respectively in the month of August.

**Advance Retail Sales:** Advance retail sales in the US have grown by 2.70 percent in the month of August, against the same grew by 0.6 percent in June.

**Consumer Confidence:** The US Consumer confidence rose to 54.1 in August, against 46.6 in month of July. Consumer confidence in Euro zone is on the way to being restored as this stood at -25 in June and rose to -22 in August.

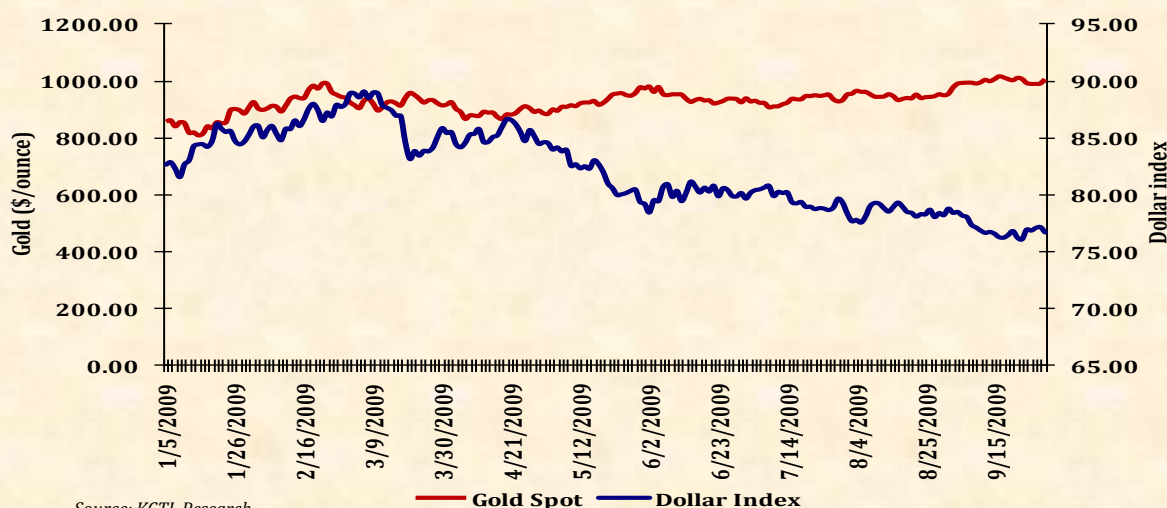
**Unemployment Rate:** The US unemployment rate approached 9.7 percent in August, the highest since 1981. Initial jobless claims and continuing claims have come down to 545,000 and 6,230,000, respectively for the week ended Sep 17, 2009. The same stood at 614,000 and 6,702,000, respectively in the beginning of July. Euro zone unemployment rate also headed to 9.5 percent in the month of July as compared to the same positioned at 9.40 percent in June.

***Above mentioned were few considerable economic events occurred during the quarter and left notable impressions on the overall markets.***

## The Bullion & the Greenback: Q3 Performance

Gold and dollar index shared a negative co-relation during the quarter as the former gave a return of 7.11 percent and the latter closed the quarter with the negative return of 3.74 percent. Gold has been trading in four-digit number since the beginning of September month. Moreover, gold prices touched an intra-day high of \$1,024 levels on Sep 17 on the back of weakening dollar and other fundamental cues. These levels were last seen in March 2008. At the same time, dollar index also broke the 76 levels and traded at 75.89, close to one-year low. Dollar is continuously falling on account of burgeoning US trade deficit and resultant inflationary pressures.

**Gold Spot & Dollar Index**



Source: KCTL Research

## Returns, Volatility and Correlation Metrics

The below mentioned table depicts the correlation of gold with the various asset classes. Correlation between gold and silver rose to the extent of 0.87 against 0.76 in 2008. Till Sep this year, dollar index and gold were negatively correlated to the extent of 0.2212 while the same was -0.5291 last year.

2009*	Returns	S.D	US generic govt 10 year yield %	Oil (WTI)	Reuters CRB Index	S&P 500 Index	Dollar Index	EUR-USD	Silver	Gold
US generic govt 10 year yield %	3.28%	0.42%	1.0000							
Oil (WTI)	52.37%	3.84%	0.0501	1.0000						
Reuters CRB Index	10.89%	1.75%	0.0872	0.8295	1.0000					
S&P 500 Index	13.44%	1.89%	0.1047	0.4473	0.5747	1.0000				
Dollar Index	-6.34%	0.71%	-0.0729	-0.3206	-0.4428	-0.4357	1.0000			
EUR-USD	4.24%	0.82%	0.0868	0.3238	0.4179	0.4890	-0.9138	1.0000		
Silver	44.98%	2.49%	-0.0255	0.2129	0.3790	0.1083	-0.3026	0.2613	1.0000	
Gold	14.61%	1.48%	-0.0293	0.1532	0.2709	-0.0329	-0.2212	0.1818	0.8665	1.0000

Source: KCTL Research

\* Till September 2009

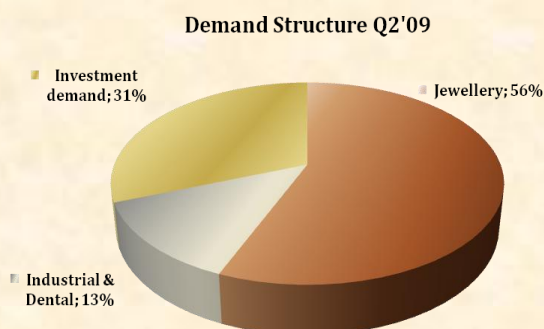
## Demand – Supply Dynamics

The yellow metal has its demand spread across the world and 55 percent of total gold demand across the globe is attributable to just five countries – India, Italy, Turkey, USA and China, though not in particular order. India is the highest consumer of gold mainly because of its religious factors and traditional fascination towards this yellow metal. The consumption is leading higher imports of gold as India doesn't produce as per its requirement. India needs a huge investment in gold mining sector as it mines only 0.4 percent of its total demand despite having 8 percent of total world gold reserves under its land masses. On the other side, China is increasingly making its presence felt in this area and all set to surpass India in terms of gold demand. Though, it may surpass in terms of consumption but not in terms of imports because China is also among the top gold producing countries. In 2007, China became the world's largest gold producer, overtaking South Africa, which held the title as top gold producer for over 100 years. China boosted gold output to 282 tonnes in 2008 and the same may be elevated to 290 tonnes in the current year.

According to World Gold Council data, which cited statistics from GFMS Limited, China consumed nearly 400 tonnes of gold in 2008, while demand in India was more than 650 tonnes. Despite heavy demand for yellow metal, India imported only 403 tons gold in 2008 and the same is expected to fall to 250 tons by this year end, due to higher prices.

## Demand Structure

The demand for gold is mainly segmented into Jewelry, investment and industrial. Jewelry historically accounts for more than 65 percent of the total gold demand following with the investment demand of around 20 percent and rest is taken up by the industrial usage. But, the recent surge in gold prices has brought down the jewelry demand which now accounts for only 56 percent of total bullion demand while investment demand has grown conversely to the 31 percent against the historical figure of 20 percent.



*Source: World Gold Council*

## Jewelry Demand

Jewelry has consistently been accounting for more than 75 percent of total gold demand but, losing its share in the recent past due to higher prices. This segment is also regarded as one of the world's largest categories of consumer goods. Jewelry demand fell to 404.1 tons in the Q2'09 against 517.8 tons in the Q2'08.

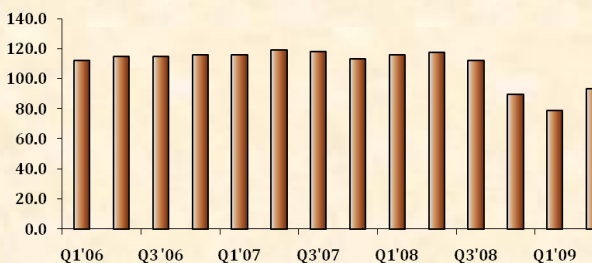


*Source: World Gold Council*

### Investment Demand

Identifiable investment demand has grown considerably in the recent past and ETFs occupy the major chunk of the same. Assets in exchange-traded-funds backed by bullion have grown by 55 percent this year and holdings in SPDR alone, the world’s largest gold ETF, have increased by 41 percent so far this year. Investment demand has grown to 222.3 tons in Q2’09 as compared to 151.9 tons in the same quarter in the previous year.

**Industrial Demand**

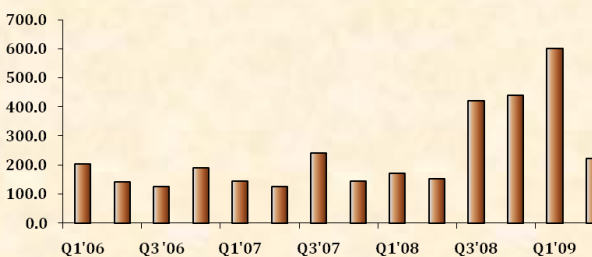


Source: World Gold Council

### Industrial Demand

Industrial and dental uses accounts for nearly 13 percent of total gold demand. The precious metal has its usage in a variety of industrial developments, namely biomedical, catalysis, decorative, dental, environmental, fuel cells, electronics, nanotechnology, photography, property and space. The industrial demand stood at 93.1 tons in Q2’09 against 78.8 tons in Q1’09 and 117.6 tons in the second-quarter of the previous year.

**Investment demand**



Source: World Gold Council

**Total demand** for gold has fallen to 926 tons in the Q2’09 as compared to 1,197 tons in the previous quarter, due to higher prices. The demand has, however, risen in comparison with the corresponding quarter in the previous year.

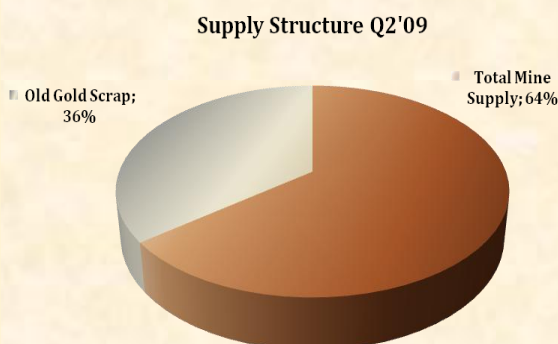
**Total Demand**



Source: World Gold Council

## Supply Structure

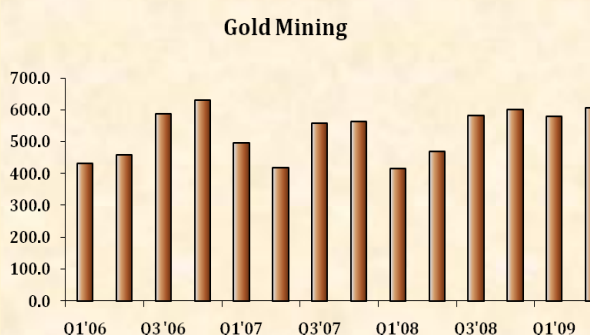
Total gold supply is fragmented into mining supply, scrap sales and central bank sales. Mine production contributes nearly 60 percent to the overall supply side while scrap accounts for 26 percent with the rest 14 percent is sold by the central banks. The total gold supply in Q2'09 was taken up by mining and scrap sales as central banks refrained from selling gold in the market, resulting in scrap sales extended its share to 36 percent of total gold supply and gold mining contributed 64 percent to the overall supply.



Source: World Gold Council

## Gold Mining

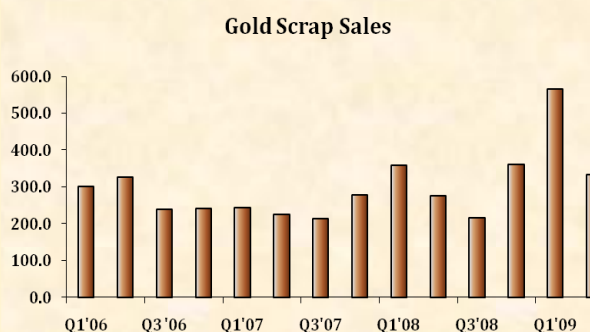
According to world gold council, there are more than 400 gold mines operating in the world. Gold mining is relatively inelastic and hence, the overall level of global mine production has been relatively stable, averaging approximately 2481 tons per year since 2005. This means there has not been any significant expansion in the global supply. However, gold mines are expected to increase production in order to take an advantage of recent surge in gold prices. In this context, Zimbabwe, once the third-largest gold producer in Africa, has re-opened many of its gold-mines which could result in more than a quarter increases in its total production to 4.5 MT against 3.5 MT last year.



Source: World Gold Council

## Gold Scrap Sales

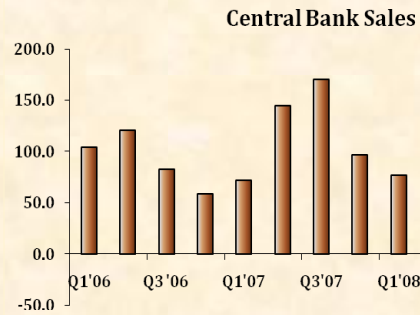
Gold scrap sales or recycled gold ensures the readily available supply when needed and hence, helps to stabilize gold prices. Recycled gold contributed nearly 35 percent to the overall gold supply in second-quarter. Scrap sales has risen to 334 tons in Q2'09 in comparison with 276 tons in the corresponding quarter of the last year. Gold scrap sales saw a phenomenal rise of more than 26 percent in 2008 as it increased to 1,212 tons against 958 tons in 2007. The same is expected to go up by 22 percent in the current year, according to GFMS chairman.



Source: World Gold Council

### Central Bank Sales

As on 30<sup>th</sup> June 2009, Central banks and IMF hold approximately 26,355 tones of total world gold reserves of 29,697.9 tones dispersed across 103 central banks. On average, respective governments hold around 10 percent of their official reserves as gold, although the proportion varies country-by-country.



Source: World Gold Council

Although a number of central banks have increased their gold reserves in the past decade, the sector as a whole has been a net seller since 1989, contributing an average of 413 tonnes to annual supply flows in 2003-2008. Since 1999, the bulk of these sales have been regulated by the Central Bank Gold Agreement/CBGA (which stabilizes sales from 15 of the world's biggest holders of gold). Net central bank sales amounted to just 470 tonnes in 2007. In Q2'09, central banks have abstained from selling gold as the same are intending to build up to their gold reserves with china moving fast in this regard.

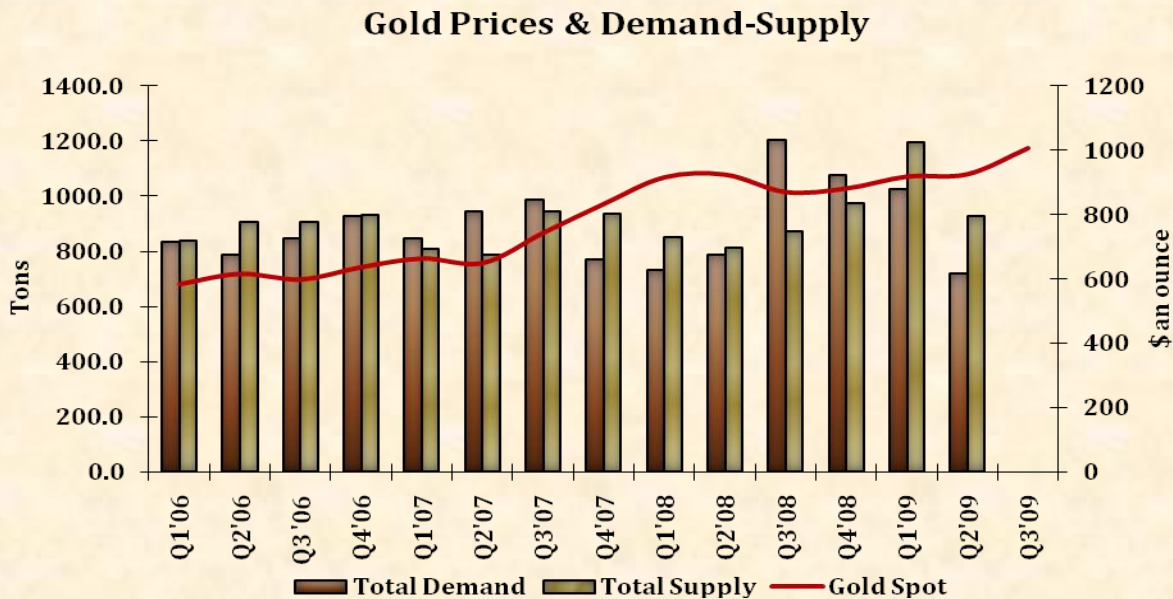
### Total Supply

Total supply of gold has declined for three straight years, starting from 2005. In 2008, supply picked up and reached to 3,514 tons against the demand of 3,804 tons. Demand for gold in 2008 overwhelmed the supply thus, leading the gold prices to advance by more than 5 percent.



Source: World Gold Council

## Gold Prices and Total Demand-Supply



Source: World Gold Council

## Central Banks' Gold Holdings (Q2'09)

Total central bank gold holdings stood at 26,355 tons in the second-quarter of 2009, against the same in the Q1'09. Central banks have not added any new reserves in their portfolio in the Q2'09. United States of America topped the list with the largest gold holdings of 8,134 tons, representing 78.3 percent of its total forex reserves. India's gold holdings stand for meager 4 percent of its total forex reserves.

### Top 15 Central Banks' Gold Holdings

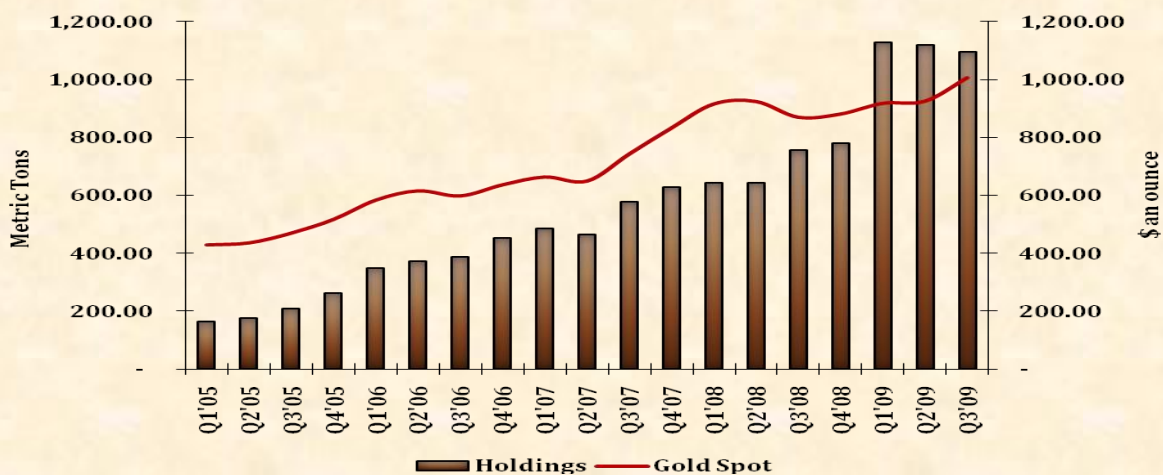


Source: World Gold Council

## SPDR Performance

The world's largest bullion backed exchange traded fund, the SPDR gold trust, has been increasing its gold holdings since 2005. It has surpassed China and Switzerland in terms of gold holdings in June 2009 when its total gold holdings reached 1,077.63 metric tons. The SPDR gold trust now stands sixth in terms of gold reserves held by an organization. An upsurge in gold prices this year can also be attributed to rising investment demand from ETFs' like SPDR. The SPDR has built-up its holdings even in the recent times when prices were soaring, thus giving a clear signal that the fund maintains its long-term bullish outlook on gold prices.

**SPDR Holdings & Gold Prices**



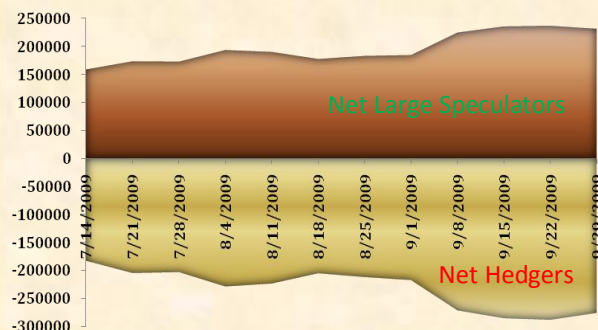
Source: SPDR gold shares and KCTL Research

## CFTC Report

Commodity Futures Trading Commission (CFTC) is a regulatory body for futures trading in the US which enables the futures market to serve the important function of providing a means for price discovery and offsetting price risk.

The quarter saw a jump of more than 40 percent in the net non-commercial long positions which are also regarded as large speculators. Large speculators bet that the prices will rise and took their positions to record level to 236,749 contracts in the week ended Sep 22, 2009.

On the other hand, commercial (hedgers) increased their short positions to the record level of 287,610 contracts in the week ended Sep 22, 2009. Later, hedgers mainly; gold miners, reduced their short positions in order to carry out de-hedge. This further means their bullish outlook on gold prices.



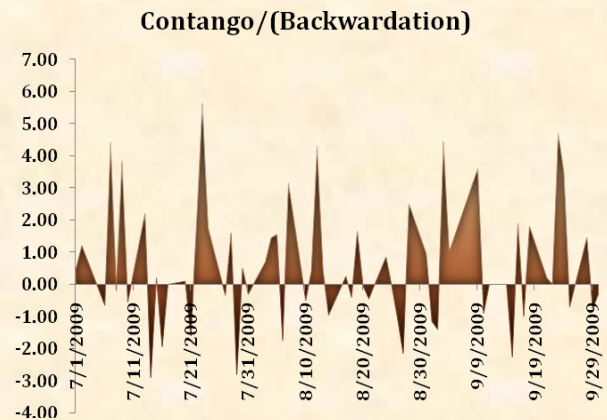
Source: CFTC and KCTL Research

## Market Basis Charts

### Contango / (Backwardation)

The markets lingered mostly in Contango situation where the future contracts' prices exceeded spot prices. Contango is an obvious market condition because of cost-of-carry involved in the futures' prices which will, hence, exceed spot prices.

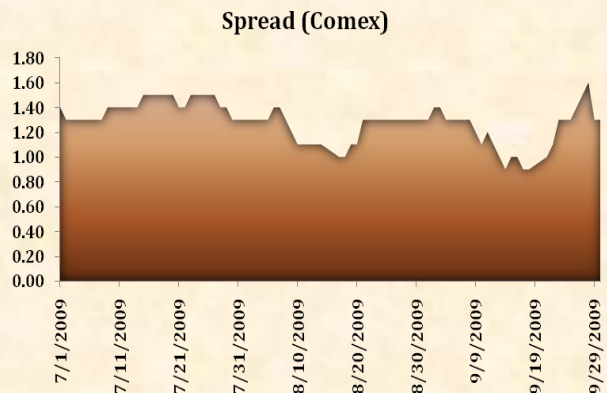
The heavy trading in futures markets kept the gold prices lingering above \$1,000 levels for as many as 9-trading days. CFTC report says that long positions in this precious metal reached to record levels of 265,925 contracts in the week ended on Sep 22, 2009.



Source: KCTL Research

### Spreads (Comex)

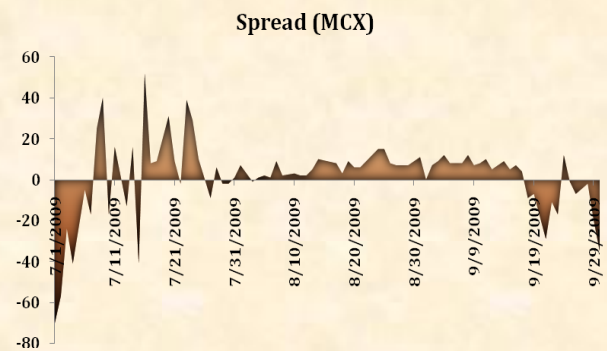
For spread purposes, we have considered October month and December month contracts as near-month-contract and far-month-contract, respectively. The spread between these two contracts at Comex remained in the range of 0.90 - 1.60, with 1.27 being the average spread. Investors held a bullish view on both the near-month and far-month contracts which let them trade with the least spreads.



Source: KCTL Research

### Spreads (MCX)

For spread purposes, we have considered October month and December month contracts as near-month-contract and far-month-contract, respectively. The spread between these two contracts at MCX was very broad with -70 being the lowest and 52 being the highest. The average spread settled at 1.67 for the quarter. Since, both the contracts were actively traded during the period; the spread witnessed considerable volatility.



Source: KCTL Research

## Technical Analysis

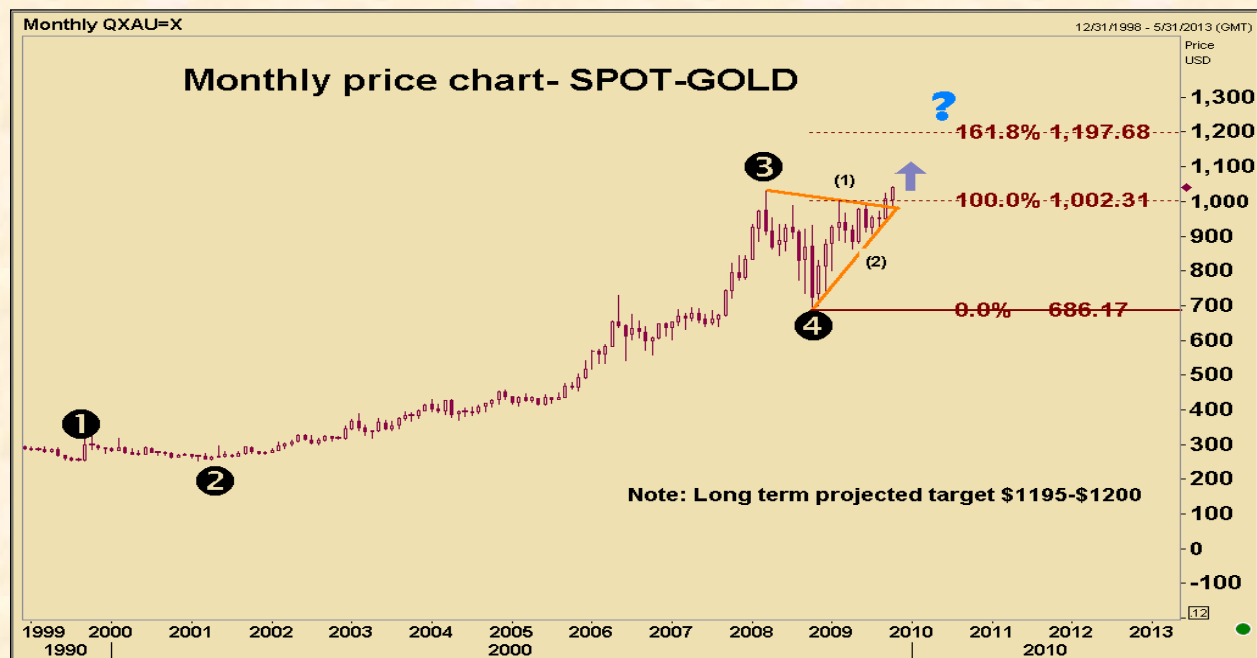
### Review:

Spot Gold prices settled above \$1,000 levels in last quarter and gained \$83. After a price consolidation for nearly 6 quarters, last quarter gold price chart witnessed a symmetrical triangle break out onto the higher side indicating prices may trade further high in near future as market has come out of its consolidation phase.

Spot Gold opened at \$925 initially traded sideways to lower and created a low of \$905 in last quarter. Prices started to trade higher there on posted a high of \$1023 and finally closed at \$1006. Gold was unable to break the all time high of \$1033 in last quarter.

All the trading sessions in last quarter majorly traded sideways to higher keeping momentum on to higher side.

Prices are trading above 20, 50 & 100 3 Month's EMA (\$766, \$578 & \$456) suggesting higher side price moment. Prices are trading above the average line of Bollinger band suggesting the capability of trading higher to test upper band of Bollinger (\$1114) in very near short term. RSI is trading at 0.85 levels in over bought zone. Although, symmetrical triangle break out on to the higher side would push the prices to higher levels. RSI-(14) is trading in over bought zone may limit the higher side price movement and actual price target of the pattern break out.



Source: KCTL Research

## Elliot Wave Analysis

Gold is in bullish trend from the year 2000 to till date and is currently in Intermediate (3) wave of Primary 5<sup>th</sup> wave.

Type of Wave	Starting time of Wave	Ending time of Wave	Starting price	Ending Price
Intermediate Wave 1 of primary wave 5	11/30/2008	2/28/2009	\$736	\$939
Intermediate Wave 2 of primary wave 5	3/31/2009	4/30/2009	\$939	\$885
Currently Market is in intermediate wave 3 of	5/2/2009		\$885	Exp to End near \$1100 levels

Source: KCTL Research

As per the rules of Elliot wave theory Wave 3 should move at least 1.3812 percent of Wave 1. (Since as per the rules of Elliot wave 3<sup>rd</sup> Wave should not be the least wave among 1, 3 & 5 waves) and wave 3 should close above \$1110.

## Technical Outlook for the Quarter Ahead

We expect the prices to trade sideways to higher in this quarter. Market may post a new high of \$1080 & \$1152 on the higher side. A strong support of \$965 is witnessed. However, by any means if prices settle below these levels, we can see downward movement and a possibility of a bullish pattern failure.

	S1	S2	R1	R2
Gold - Comex (per ounce)	\$980	\$965 & \$950	\$1,080	\$1,114 & \$1,152
Gold - MCX (per 10 grams)	Rs. 15,137	Rs. 14,909 & Rs. 14,680	Rs. 15,945	Rs. 17,180 & Rs. 17,759

Source: KCTL Research

## Recommendation:

Gold Dec Comex>> Buy 1<sup>st</sup> lot at \$1032-35, 2<sup>nd</sup> lot at \$ 1010-1015 targeting \$1066 & \$1100 Stop loss below \$960.

## Outlook

Gold prices have been trading above US\$1,000 levels in recent weeks, after a seesaw of few points in both the directions. We believe that investors should acclimatize themselves to the four-digit figure as prices will remain well-supported due to tumbling dollar. The US dollar is expected to lose its sheen amid burgeoning US trade deficit and the country's mind-boggling borrowings to finance the same. In addition, many countries are planning to reduce their reliance on the dollar and diversify their foreign currency reserves. In this context, Russia and Brazil have already planned to buy US\$20 billion of bonds from the IMF, thus cutting their investments in US treasuries. China also plans to buy US\$50 billion and India may also follow suit. There certainly seems to be a trend towards increased diversification of reserve assets away from what is seen as a dollar in decline, with gold probably being a major beneficiary.

Inflation could be another trigger which may intensify as a result of government deficits and loose monetary policies around the world. Inflation has historically been fuelling gold prices as investors seek to safeguard their wealth against rising inflation.

Another factor could be noted is the introduction and growing popularity of ETFs which have changed the market in a very important way. By facilitating gold investments and ownership, ETFs have brought significant numbers of new participants to the market place. These ETFs shall continue to drive the prices higher.

In India, the festive season peaks in October with Diwali followed by the culmination of the marriage season in December. Since this is the peak period, gold demand has been evident in late September despite consumer perception of high price levels. Clearly, some buying is inevitable regardless of price levels as gold jewelry forms an essential part of dowry baskets in Indian marriages. ***Bullion prices are expected to remain volatile, with reconciliation levels of US\$1,100 by this year-end.*** Moreover, there will be significant buying coming in at lower levels—if prices fall to US\$960-980, we could see very heavy buying. Prospective investors should keep a close watch on prices and can considering investing in gold on declines.

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