



Karvy Comtrade Ltd

Precious Metals' Outlook

Q2, 2011 (April-June)

RECOMMENDATIONS

COMEX Gold(\$/Oz) Buy at \$1380 - 1360 TP \$1470/1530 SL \$1300

MCX Gold(₹/10 gm) Buy at ₹20280-20080 TP ₹21400/21700 SL ₹19500

COMEX Silver (\$/Oz) Buy at \$34.5-35.30 TP \$39 then 41 SL \$32

MCX Silver(₹/Kg) Buy at ₹ 53000-53500 TP ₹60000 SL ₹51800

NOTE: CALLS MENTIONED ABOVE CARRY A LONG TERM VIEW AND WE WOULD INSIST TO HOLD ONTO THE ACTUAL TECHNICAL LEVELS FOR INITIATION. MAJORLY THESE ARE TENTATIVE FIGURES WHICH GIVE AN INDICATION OF BROAD TREND.

Economic Backdrop

The first quarter of the year has been marked by geo-political unrest in the Middle East and North Africa and has been tumultuous one by the most recent devastating earthquake and tsunami in Japan. Of course this has stemmed into extreme volatility, may it be in equities or commodities or in any other asset classes amid a rush to avoid risk. Japan is digging their efforts to contain the nuclear disaster which was caused by earthquake and tsunami. But it is quite uncertain that they will rebuild and come back from the devastation very soon. The Yen rose dramatically against most currencies in the face of a major catastrophe and it surged to a new all time low against the dollar. Japan being an export driven country the Yen appreciation in a quick succession after the calamity led the Bank of Japan to act swiftly and decisively to flood the market with Yen. Then of course there is Libya where protests seeking stepping down of autocratic ruler Mr. Muammar Quadaffi has turned into civil war. A disrupted stability has given supply shock to the crude, which transmitted into record surge in oil prices. The prospect of this ongoing and perhaps widening instability in the region is most likely to keep the oil underpinned for some more time to come.

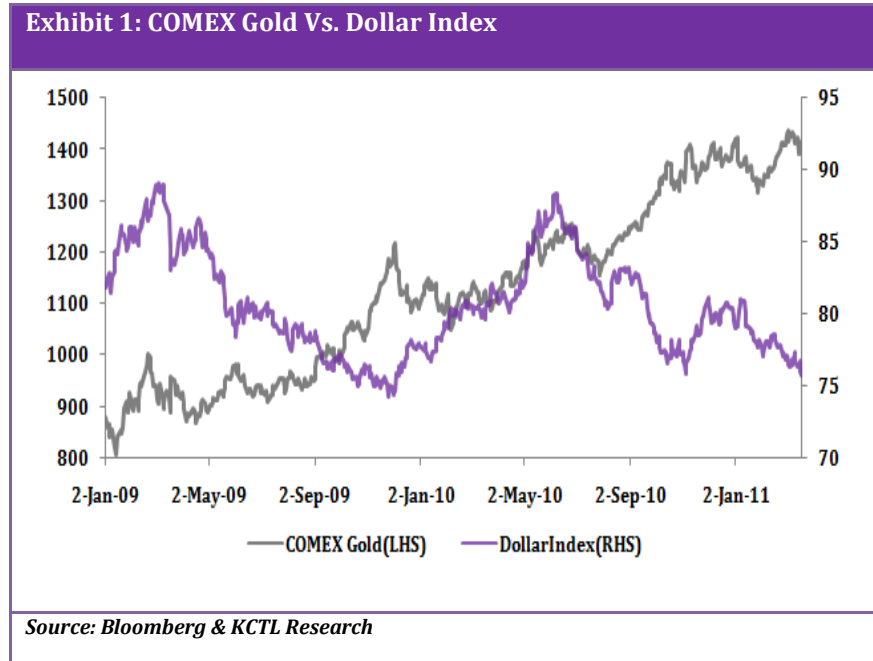
On the other hand, the US Fed officials expect their budget deficit should toll to a near one and half trillion. Widening trade deficit has really faded the outlook although the Fed chairman Ben Bernanke is continuously residing on a firmer footing side of the economy. It is really questionable how the economy will be covering up this deficit with a slumping housing sector and a near zero interest rate combined with a continued monetary easing.

Europe's struggle with their sovereign debt crisis and Portugal's likeliness to file the bailout request is mounting cloud over the economy's growth prospect. The Standard & Poor's down-gradation of credit worthiness of Greece loomed the picture of recovery in a downturn. Debt woes emanated from Greece crept into Portugal, Spain and Ireland. Although these sovereign risks were seen in the last year, heightened in this year and sovereign rating down gradation resulted in bottoming investors' confidence.

With the rising global food and commodities price Asian economies including China and India trapped under the global inflation and resorted to increase the reserve ratio and reverse repo rate to check the currency circulation. The better than estimated Q4FY10 US GDP although has thrown a glimpse of recovery, might not reduce the volatility in financial markets as global outlook is subjected to downside risk amid current happenings in the MENA region and an escalating debt concern of Europe.

Gold: Price Movement

After the yellow metal has ticked its last year high of \$1421.40 on the last day of 2010, it rallied to create record high of \$1437.70/oz in March. Before resuming a rally, the yellow metal discharged some worth in January and February 2011 after reaching peak in December 2010. However, in the subsequent months it has restored back. In the month of March 2011, it has made new high to regain the yellow metal's worth. During the quarter, COMEX Gold futures traded at an average rate of \$1381.98, while the range remained bit wider, from a minimum of \$1313.93 to the maximum of \$1434.5.



Gold's rally was mainly furnished by some economic disruptions, geo-political tensions and a debasing Dollar Index. While the overseas agitations fuelled Gold's safe haven appeal, the depressing Dollar Index intoxicated Gold's alternative demand. The Dollar Index shattered 4.31% during the quarter where as Spot Gold advanced 0.49% till March 18, 2011.

Apart from lowering the Dollar Index, strong investment demand was another reason which took Gold to breach previous highs in the quarter. Investment demand is mainly led by the ETF demand. Although the SPDR, the world's largest gold ETF holder could not add much to its vault, it has experienced run of outflows at a much faster rate from 2005.

Demand

The global gold demand reached a decade high in tonnage counting to 4311.5 tons. The continuous rise in demand for the last three years is basically imparted by jewelers, fabrication, bar hoarding and net investment demand. The jewellery sectors enjoyed a strong recovery in 2010 with annual demand rising by 17% Y/Y. Despite surging bullion prices traditional jewellery demand remained robust with consumption of Asian consumers who drove jeweler demand, particularly in China and in India. Chinese demand is expected to continue to increase rapidly during 2011 as economic growth in China remains strong.

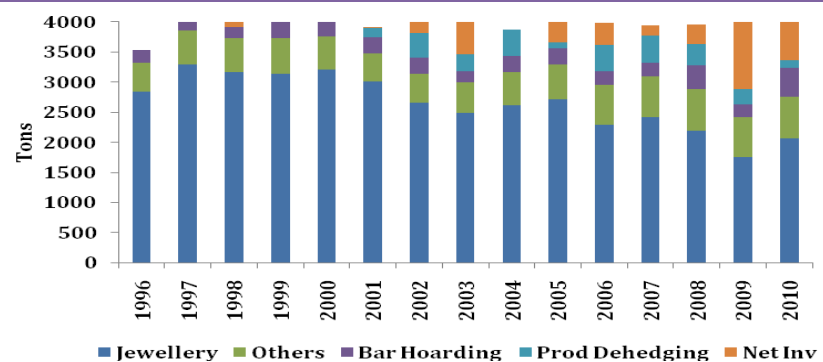
2010 was significant for the fact that Central Banks became modest net buyer of Gold. Investment demand for Gold as a foundation asset for portfolio, protecting against risk and inflation is likely to remain strong. It will be fuelled by

ongoing economic uncertainties surrounding global economic recovery and fiscal imbalances, as well as an impending inflationary pressure and currency tension. Notably, European investments demand appears to have made a sustained shift on the back of lingering fears over the credit worthiness of sovereign debt throughout the region.

Supply

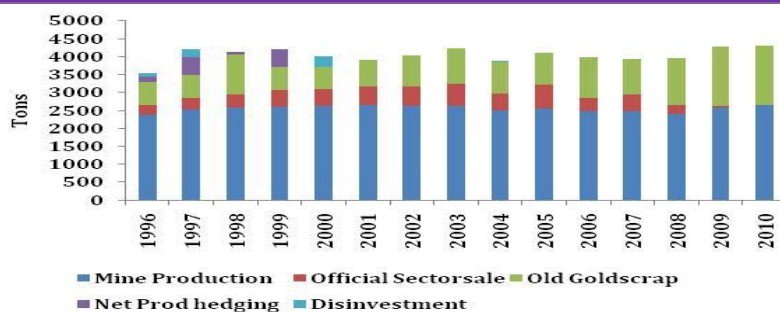
Supply although remained a constraint for the robust growth in jewellery demand. In the year 2010, while jewelry demand growth was 17%, mine production has increased a mere 2.88%. Thus, the demand supply gap is widening. Total supply of Gold in the last year totaled 4311.5 tons, up of 0.59% Y/Y. The scrap selling has also come down last year. This reduction in supply was also attributed to a huge fall from the official sector sale, which is near about 87.17%.

Exhibit 2: Gold Demand



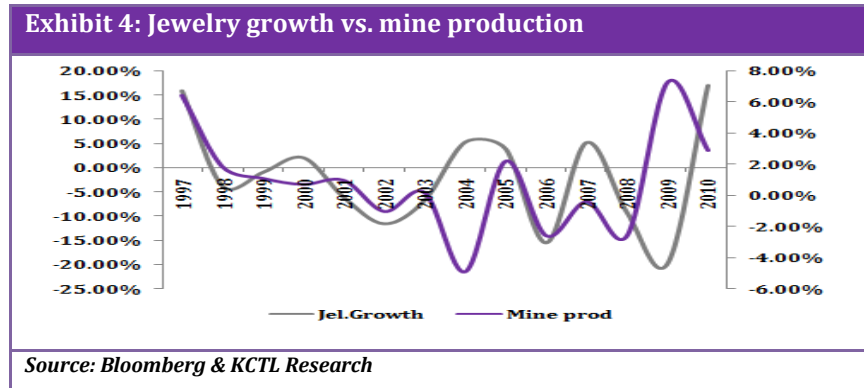
Source: Bloomberg & KCTL Research

Exhibit 3: Gold Supply



Source: Bloomberg & KCTL Research

The demand supply disparity has created an excess demand situation amid global uncertainties and geopolitical tensions as a haven. Also an alarming inflation concern due to crude price surge is abating the demand to surpass supply at a larger extent.



Gold in different currencies

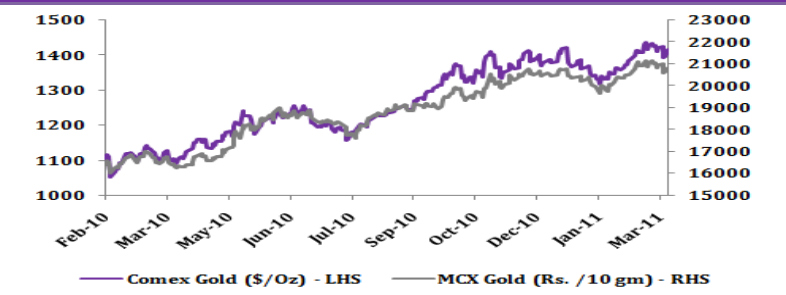
Strong gold prices were seen sustaining their gains across key currencies. Gold prices remained pretty volatile in the last quarter although historical returns were handsome. In between the quarter, Gold has ticked its life time high and has made bit corrections also. The three main components that make up the U.S. Dollar Index; Euro (57.6%), Yen (13.9%) and Pound (11.9%) are important to look at, as these collectively make up 92.5% of the U.S. Dollar Index.

Till March 18, 2011 actually the yellow metal has lost 0.48% in USD while in terms of Indian Rupee it has gained 0.16%. In the six elementary currencies Gold fell, as it normally moves inversely to the currency appreciation. During the quarter, sometimes Gold has witnessed a considerable appreciation along with Dollar as both of them were demanded as safe haven amid political unrest. Later the constituent currencies of the Dollar Index strengthened against the Dollar which led the bullion price to take some corrections in these currencies. The composites of the Dollar Index, namely EURO, GBP, JPY, CAD, SEK and CHF all have appreciated against the Dollar and Gold has moved inversely to all of those currencies. However, the greenback lost 4.31%. Gold and the Dollar Index usually share an inverse relationship, but the last quarter has seen this relation to be broken. Mostly this is because both were demanded as a store of value whenever geopolitical disruptions were aggravated.

CURRENCIES	Movement against Dollar(App-Appreciation/Dep-Deprication)	Gold Price movement in respective currencies till date
EURUSD	2.553(App)	-6.24
GBPUSD	0.570(App)	-5.04
USDJPY	-0.947(App)	-1.89
USDCAD	-0.636(App)	-1.43
USDSEK	-1.528(App)	-6.84
USDCHF	-3.678(App)	-3.93

When Japan faced a devastating Tsunami and earthquake, it saw the Yen take a quick dive (numerically against Dollar, meaning Appreciating) due to a panic selling. Japanese Government stepped in immediately with \$183 Billion of liquidity. Japan being a net exporter, some times down the line their exports will be hampered and hence Yen supposedly will not be able to maintain its strength.

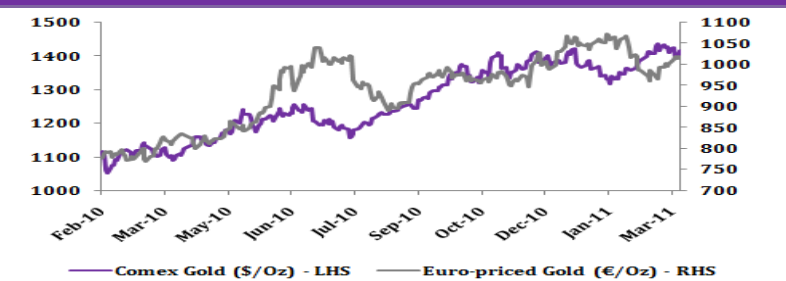
Exhibit 5: Gold price in USD and INR



Source: Bloomberg & KCTL Research

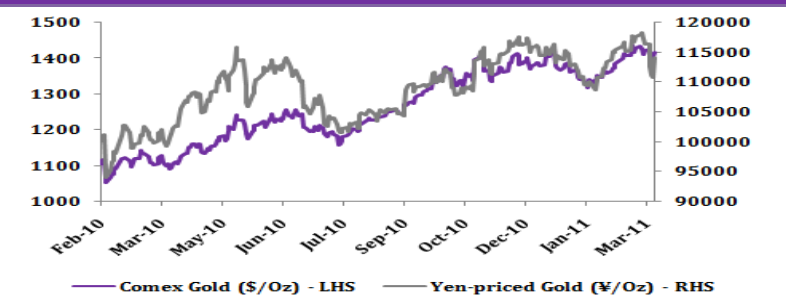
The Euro zone leaders increased the lending power of the bailout fund and revealed it can be used to buy bonds directly from Governments. The Euro despite of all its problems with the PIIGS (Portugal, Ireland, Italy, Greece and Spain) has actually bounced off of its YTD low of 1.2907 to 1.4182 (1Euro = 1.4182 Dollar) as of 18th March 2011. Gold in terms of USD has lost 0.48% till 18th March 2011 while the last year it has fetched 27.10% return. As compared to Indian Rupee, Gold has advanced a mere 0.16% since the Rupee has depreciated by 0.584% this year. The recent Reverse Repo rate hike by the RBI may impact upon the metal as the inflation concern is likely to tame by the step. Circulation of the money will be coming down and hence Indian Rupee may gain strength over the period. The Euro has appreciated by 2.553% against the Dollar led Gold to shatter 6.24%. The same has been observed in the Yen and Pound priced Gold.

Exhibit 6: Gold price in USD and EUR



Source: Bloomberg & KCTL Research

Exhibit 7: Gold price in USD and YEN



Source: Bloomberg & KCTL Research

Volatility & Co-relation

With uncertainty all over the globe, volatility and inflation being at the forefront, the yellow metal appears to be the protector of wealth.

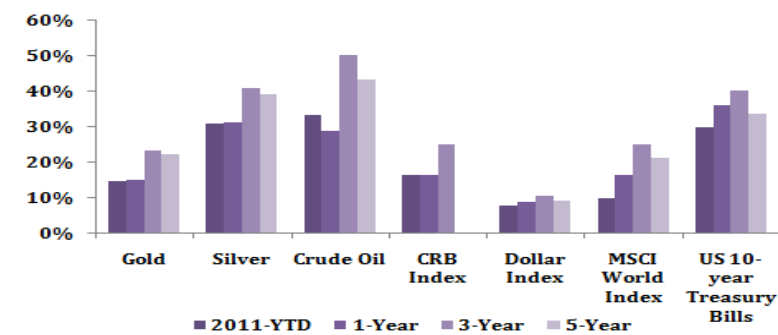
Historically Gold has proved to be less volatile with respect to the other asset classes, mainly equities. In the last year, the volatility for the MSCI World index for stocks has been nearly 16.45% while Gold remained 14.88% volatile. The US Treasuries which are known as safer investments, witnessed

near 30% volatility this year 18th March 2011. The volatility of Gold has been lower than that of Oil, other precious metals (Silver), CRB commodity index in the past. This volatility in Gold is mainly attributed to the ongoing geo-political tensions which is quite unpredictable on a day to day basis.

Gold also has negative correlation with some major asset classes which makes this precious metal to move independently. Over the past five years, Gold moved inversely to the US 10-year Treasuries yield. In recent past and in this year the correlation numbers, however, deviated from their historical pattern. The CRB commodity index and the MSCI World index

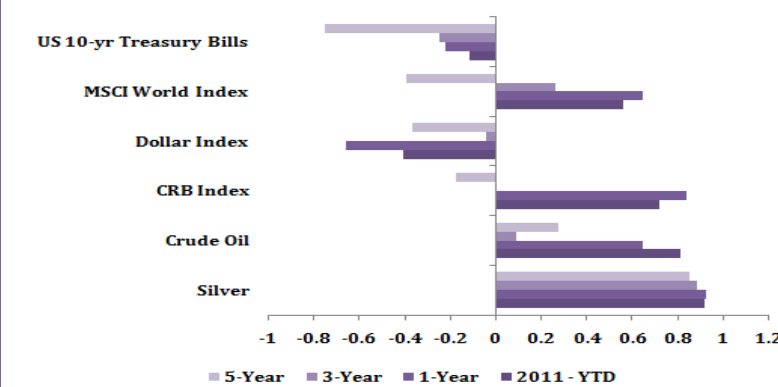
with which Gold normally shares a negative correlation, has now shifted to a positive correlation. With Dollar Index the negative relation remained firm while with Crude Oil also the positive relation kept intact

Exhibit 8: Volatility



Source: Bloomberg & KCTL Research

Exhibit 9: Correlation

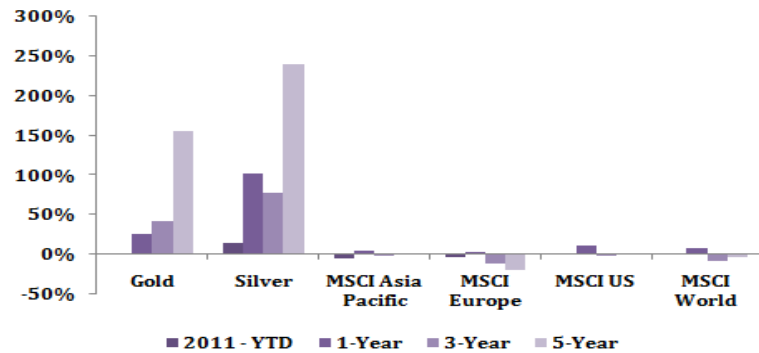


Source: Bloomberg & KCTL Research

Gold & Equity Markets

Global economic uncertainties lowered the appeal of equities as stock markets didn't do fairly well amid such doubtful economic conditions. The poor performance of the equity markets since 2006 has driven many investors to look beyond traditional assets. Gold's strong performance, during this period, has stirred up their interests. Since 2006, the yellow metal has risen nearly 156% against negative returns of equities across regions. However, this year till date Gold remained pretty volatile while global equities also retreated a lot.

Exhibit 10: Gold Vs. Equities

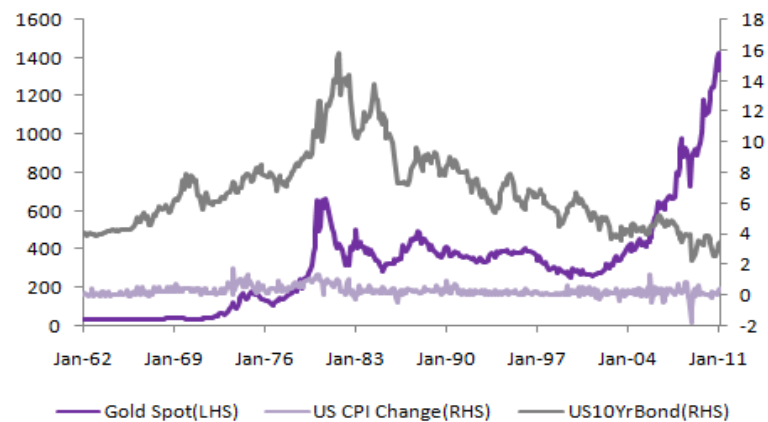


Source: Bloomberg & KCTL Research

Gold & Bond

Inflation vis-à-vis market fluctuation is always a hot topic in precious metal market. Inflation is good for gold, which has a long history of acting as a hedge against it. Gold and Bond is internally related since both of them track one common factor: inflation or the expectation of future inflation. That is why they tend to be around each other. When there is an expectation of higher inflation, investors buy gold as an inflationary hedge and hence gold prices rise and bond yields fall.

Exhibit 11: Gold Vs. Bonds



Source: Bloomberg & KCTL Research

Over the period of time the consumer price inflation change hovering around level zero, sometime negative also. Recently, the Fed is maintaining a near zero interest rate of 0.25 percent although the CPI has accelerated to 2.10% in the month of February leading to a negative real rate of interest. Due to the recent surge in crude and commodities prices, inflationary pressure is being felt all over the globe which will support gold to add more value in near or longer term.

Seasonality Index

The Seasonality Index is an average that can be used to compare an actual observation relative to what it would be if there was no seasonal variation. An index value is attached to each period of the time series within a year. This implies that considering a monthly data from 1993- 2011 till date, there are 12 separate seasonal indices, one for each month. With a base value of 100 percent, a value of 85 (or 0.85) for a particular period would mean that period's price was 15 percent below that year's 12-month

seasonal average price. Concentrating over the graph it has been seen that the first quarter is having an index more than 100 implying gold price has been out performing the seasonal average while from April to October it is prevailing below 100.

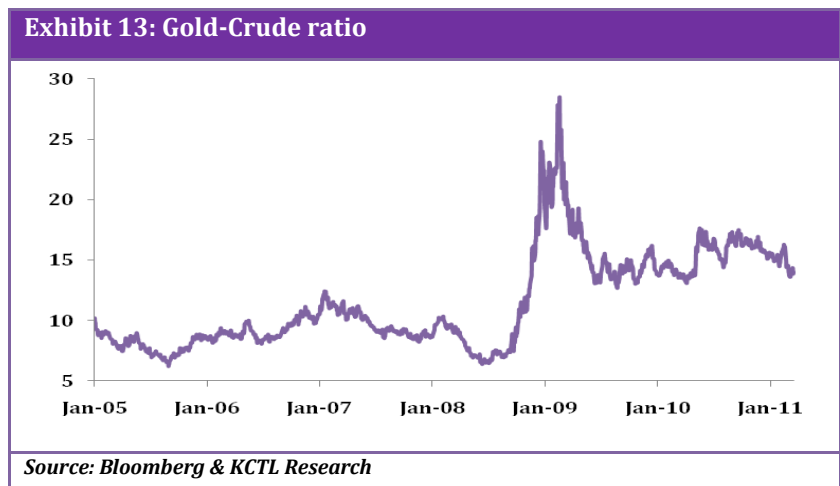


Gold-Crude Ratio

Gold and crude oil price tend to rise and fall in sympathy with one another. Historically oil purchases were paid for gold. Even today, a sizeable percentage of oil revenue ends up invested in gold. As oil price rise, much of the increased revenue is invested as it is surplus to current needs. Besides, a rising crude price place upward pressure on inflation. This again enhances the appeal of gold.

The historical positive correlation between gold and crude oil

remained strong in this quarter. The positivity has substantially improved to more than 81 percent this year till date as compared to last year's 64 percent. The Libyan concern throughout the quarter made uncertainties about the crude supply which made the commodity much more costly than the metal and there by the ratio subdued to 14.03 till date. With crude's surge, inflation concern drove the havens demand for the metal but



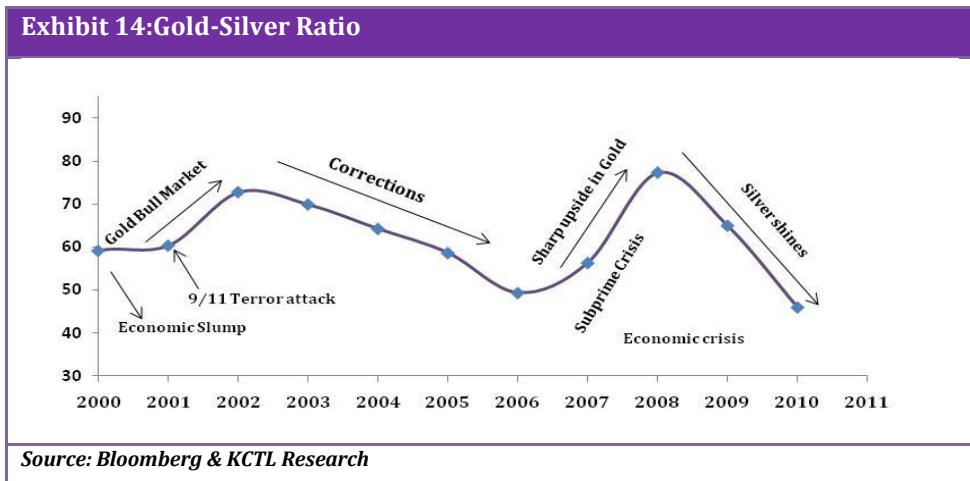
the supply concern made the oil more precious than gold. The anticipation over this led crude to be much more volatile than gold. While geo-political disruptions drove oil to surge by 10 percent till date, gold basically fell 0.47 percent. The average for the year being at 14.92, expecting crude to be traded firm over \$100 for the next quarter, gold price should touch \$1500/ounce.

Gold-Silver Ratio

While investors in gold have been on a winning spree in the last two years, it is silver that has shot to limelight in the last one year. Recently Gold has ticked its new life time high while Silver also shined. The buying spree in Silver led the white metal price to jump into a decade high of \$36.12 on Mar 9, 2011. This ratio in fact reflects the

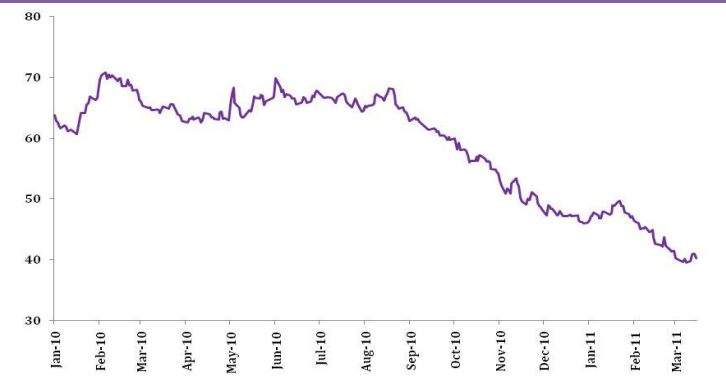
economical and geopolitical factors inhibiting the markets. Moving back to the last ten years, we can see four regimes. The first one is Gold's Bull Rally from 2000 to the middle of 2003 despite Gold reaching its

lowest of \$255.55 per ounce in 2001. For a quick recap, from the year 2000 to 2003, starting with the Economic slump of 2000, the dot com bubble and the Iraq war, investments flooded into Gold. As always iterated, in any economic crux people try to hold on to Gold as a safe haven. As anxiety gripped the market, Gold increased in value relative to Silver and thereby the ratio has increased from 53.46 in 2000 to 82.11 in 2003. The 9/11 terror attacks fuelled the demand for safe investments took Gold up. The wide spread correction took place from mid 2003 till 2006 with a pull back in Gold prices and strengthening of Silver. This was the period of crisis followed by more investments poured into Silver leading to corrections in the ratio. The significance of the period 2006 to 2009 was healthy enough. The subprime crisis led to a market collapse, before which dollar was being dumped by Italy and many other countries slashed their dollar reserves and thereby debasing dollar. Gold witnessed huge upsurge and with the economic crisis in 2008, the ratio peaked its highest level of 84.8. From there it has corrected not because Gold demand was subsiding, but Silver's investment demand was soaring. In the year early 2010 Gold again started rising against silver as a demand for inflation hedge which was anticipated because of the monetary stimulus packages implemented in the recessionary periods. From mid 2010 Silver started gaining. The rebound of industrial activities pushed Silver prices back.



The Gold-Silver ratio nosedived to its lowest 39.46 despite Gold entered into new life high territory. Now, both the precious metals have rallied to their new highs but Silver has already apprehended by 75% within six months. Chronologically it has been observed that Gold considerably dominated Silver in any economic downturn. In the consequence if industries got impacted, Silver lags due to dampened industrial demand, magnifying Gold's demand. Now, slowly when business cycle revives from a crisis to recovery period, Silver outperforms Gold as industry picks up. As the global economy recovers, equity markets are set to role out, risk appetite will return. So, whenever the need for a safe haven recedes, investments will begin to shift away from Gold into higher volatile assets or securities. So, at this economic outset where most of the US releases are handsome for the economy, GDP growth is continuous, manufacturing activities are creeping up, numerous jobs are opening, personal income is increasing, we may expect that a chunk of investments will move away from Gold to Silver. Hence we expect the ratio to come down further.

Exhibit 15: Gold-Silver ratio Jan 2010- Mar 18, 2011



Source: Bloomberg & KCTL Research

Economic Outlook

The quarter ahead is seemed to be a promising one for the yellow metal. The economic outlook seems to be little gloomy as the US is still depending upon the quantitative easing to foster the economic growth. If it fails to do so, automatically the series of easing will be coming up which will be doing nothing but the excess supply of dollar into the economy. The inflation concern is thereby creeping up slowly to weaken the dollar against the majors. The US housing sector slump remained in concern which is dampening the growth prospect. The US budget deficit may hit \$1.48 trillion this year as was expected by the Fed officials which may be counterfeited by a likely increase in tax rate. The lack of stronger economic growth suggests the Federal Reserve Bank will complete its second \$600 billion program of quantitative easing, which began in November and will finish in June. The economy continues to show increasing signs of self-sustaining momentum in the Q1, however, an unexpected jump in oil prices and the potential for further tightening of fiscal policy suggest less economic momentum than previously believed. The recent jump in oil prices and unpredictability of the magnitude and duration of the oil price rise has injected additional uncertainty about the prospects for consumer spending and economic growth for 2011. For example, supposing the US economy roughly consumes seven billion barrels of oil in a year, every dollar increase in the cost of the energy translates into a \$7 billion annual tax on consumers, reducing their disposable income available for spending on other goods

and services. This will again be hinge upon the housing sector as consumer uncertainty continues to stifle demand for housing. The inelastic demand is keeping the housing market on a bumpy road of recovery. This uncertainty coupled with the rise in oil prices, is precipitating reluctance among people to take on large financial obligations such as borrowing money to purchase a home.

Inflation again continues to be concern within the Euro zone, as rising fuel prices helped push annual inflation above the ECB's midterm target of just below 2 percent. Germany also felt the heat. Sovereign debt crisis is still haunting over the economy with anticipation of some bailout packages may harm the investors' sentiments.

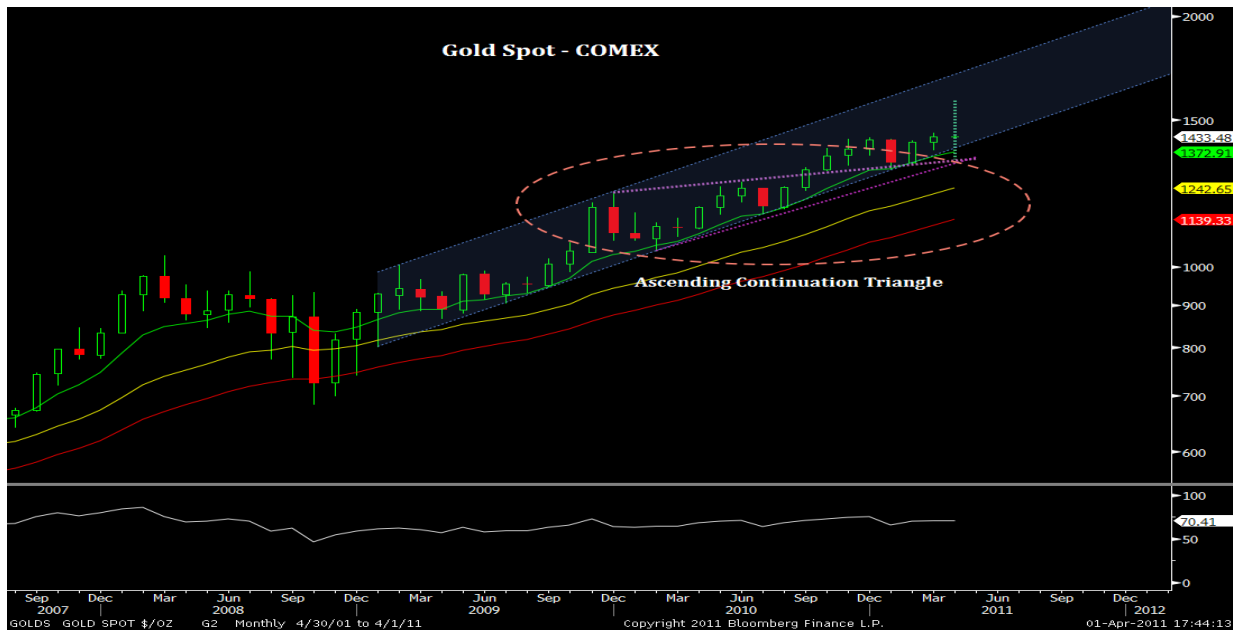
Chinese GDP grew at a faster rate than expected despite Japan's repeated attempts to tap the brakes. This raised the concerns that the authorities will resort to tougher methods in their struggle to contain inflation which could stall the world's main engine of growth. So far, despite rising inflation, the people's bank of China has shied away from raising interest rate because the pain it would cause to lenders. Instead it is relied mainly on raising bank reserve requirements in order to curb the lending volume. Japan with the most recent devastating earthquake followed by Tsunami, is limping. Government has already infused a chunk of national currency to revive the shattered economy. So, it is expected for Japan to need some time to be back on the faster recovery path. G7 had to step in and intervene in the currency market to make sure Japan's Yen does not appreciate. This is another example of governments and central banks controlling and manipulating the value of the paper currencies, bullish for gold as it represents a reliable means for store of wealth.

Gold registered record high with more room to run!!

To put it in a nutshell stagflation is where economies do not grow or fall, while money cheapens persistently, ensuring no protection against wealth attrition. Investors who wish to guard against this have to flee such environments while they still can. In the developed world one sees limp economies, interest rates at such low levels that allow economies to grow very slowly still (raising interest rates would choke off that growth) and rising levels of inflation that are now undermining what little growth there is. Even though these economies are growing, that growth is hormone free and very slack. It does not matter that the inflation rates were low historically, but it does matter that they are reducing economic activity and causing rising resentment. Food and energy inflation are doing the same as raising interest rates would. That kind of global inflation is acting like the imposition of additional taxes, reducing the already low levels of discretionary income. So to the future, it seems that interest rates will not overtake inflation thereby ensuring that bank deposits returns after bank charges will continue to yield negative returns. If interest rates do rise it is likely that the bond markets will collapse, thus making these forms of cash, inadequate investments. Gold will flourish while bond markets collapse and will move up while bank deposits (after bank charges) fail to perform like gold or silver investing.

The **Seasonality Index**, however, is indicating a sluggish pattern for the next quarter. Since seasonal variation is a component of a time series which is defined as the repetitive and predictive movement around the trend line in one year or less, is very crucial for forecasting. So, a slight possibility of a price correction may take place. **Gold-Silver ratio** staying at a crucial level of 40, it is hard to find whether this ratio will correct little more or will recover. Hopefully we expect silver to outperform gold as the industrial demand is likely to pick up. Especially a larger than expected demand may come from the third largest economy Japan to foster their economic recovery at a faster rate after catastrophe hit them largely. This does not mean that gold will retreat but the white metal will be costlier with respect to gold, thereby reducing the ratio. Assuming this ratio to stay at an average rate of 44.65 and silver to become more costly, gold price is likely to hover around \$1428-\$1430 level. Hence, seasonality factor may prove to be right. On the other hand, a victimized global inflated economy, steered by crude price surge will mostly be escorting the Gold-Crude ratio to come down further. In that case assuming the average ratio at 14.62 for this year till 18 March, 2011, gold price may touch an extreme of \$1500 while should oil remain at least at \$100. Overall we expect the precious metal to crawl at a narrow range with the paramount level of \$1500.

Technical Analysis



COMEX Spot Gold prices have been trading continuously in a sky scraping mode since 9 consecutive quarters. For this quarter one of 2011 it made a low \$1308 and settled after a marginal gains at 1439.9; high \$1447.

In the quarterly chart of COMEX Spot gold, it made a high wave candle sticks that signifies indecision in the prices at higher levels. However, there are no any other trend reversal pattern shown in the chart and therefore prices might remain in the higher side for coming quarter also.

In the monthly chart shown above, a bullish trend channel chart pattern is witnessed suggest bullishness is still intact in the market. Crucial support for this quarter is seen at \$1350 that is:

- Lower trend line (680.80-1043.75-1156.90-1308) support of the bullish trend channel
- And also a support level of Short term EMA (8)
- Upper trend line support of the ascending triangle chart pattern witnessed in chart above.

Resistance is seen at \$1510 that is:

- Upper trend line (931-1004.50-1226.10) resistance of the bullish trend channel
- Target prices for the ascending triangle chart pattern
- 76.4 % projection of the range 1156.90 – 1430.95 – 1308 as per fibonacci projection principle.

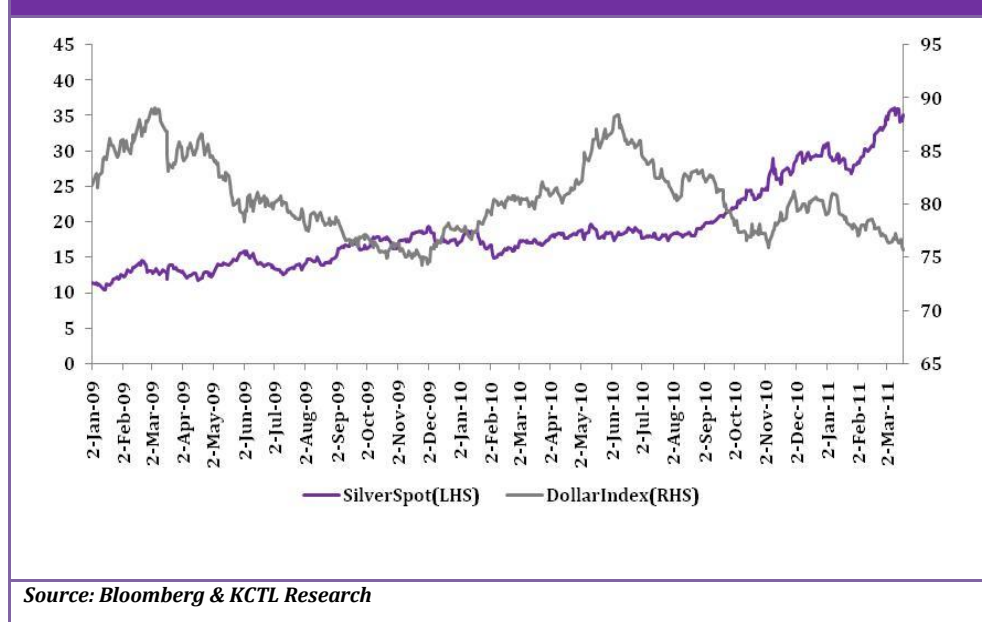
For this quarter we expect that the gold prices may respect the long term trend channel it has been following since the low of \$680.80 and move in the range of 1350-1510.

SILVER

Last trading day of 2010- Silver has seen a breach of \$30 mark. After having a flying start with the beginning of New Year, month of January has not gained much rather has lost some value from the white metal. However, from there on it need not look back till date as it gained as much as 12.75 percent to cross \$36 mark. A debasing

dollar index could be attributed to gains in precious metals. Both silver and gold have historically tested as a store of value and a safe haven in times of turmoil. These two have historically moved in same tandem, although silver showed more volatility in either direction. Nowadays,

Exhibit 16: Silver Price and Dollar Index



silver is taking investors' precedence over gold, shown by the popular Gold/Silver Ratio (GSR) which broke downwards. It shows that falling Gold/Silver Ratio means silver has been perhaps more in demand, mainly investment demand. It was primarily because of silver being a cheaper alternative to the yellow metal which benefitted this white metal to take big moves in the recent times as investment demand stood 184% higher than the prior year.

Silver in different currencies

Silver reaped off the benefit of the greenback's weakness against the majors as the metal has added a minimum of 5.54% in Swedish Kroner while the maximum of 12.75% in terms of US dollar.

CURRENCIES	USD	EUR	GBP	YEN	CAD	SEK	CHF
2009	46.72%	42.63%	32.01%	48.63%	28.24%	36.50%	40.47%
2010	77.24%	90.86%	82.61%	55.41%	69.82%	68.71%	60.94%
2011- Till date	12.75%	6.22%	7.57%	11.15%	11.67%	5.54%	8.83%

In each and every other composites of the dollar index, silver has gained modestly. There is no sign of negative return from the metal till 2009 rather there were only numbers of whooping returns. The economic turmoil has boosted the havens demand recently and after the economic slowdown the economic recovery supported the metals industrial demand. Silver being cheaper than the gold stood as the second best alternative to haven.

Co-relation with crude & dollar index

The silver price surge can easily be identified by such a strong correlation with crude. This recent price soar of crude paid off in silver as it has shared an increasing positive relation with the metal. On the other hand the dollar index as conventional; is being negatively correlated, transmitted into silver gain as it shattered more than four percent this year till date and fell near about two percent in the last year.

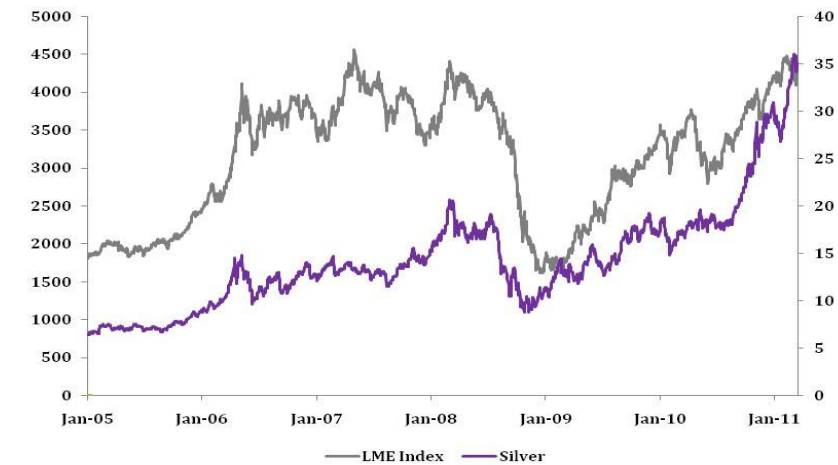
Co-relation	2011-Till date	1 Year	3 Year	5 Year
Crude oil	0.85	0.84	0.37	0.43
Dollar index	-0.66	-0.72	-0.31	-0.44

The economic outlook as discussed in gold's outlook will be supportive for silver also. And since the aftermath of economic slowdown the industries are growing slowly, industrial demand for silver is likely to soar up at a lesser pace but at a continued momentum. To compare with its peer, gold, the correlation with crude is less and hence the crude's continued addition to price will prompt the white metal to be more precious as of now.

Silver & LME Index

Silver also tracks the base metal groups because of its growing usage in industrial application. Out of the total silver demand, the industrial demand occurs more than 43 percent on an average. Sometimes the industry has demanded more than half of the total demand. Silver has performed consistently with the base metals from 2005 till date which has made it an industrial input. Last year the correlation between the two stood at 0.78 and so silver performed at par with the London Metal Exchange. This year till date the correlation has weakened a bit but since silver is closely tied to the economic activity, with base metals demand silver's demand will also be increasing as a by-product or co-product of base metal mining.

Exhibit 17: Silver Vs. LME Index

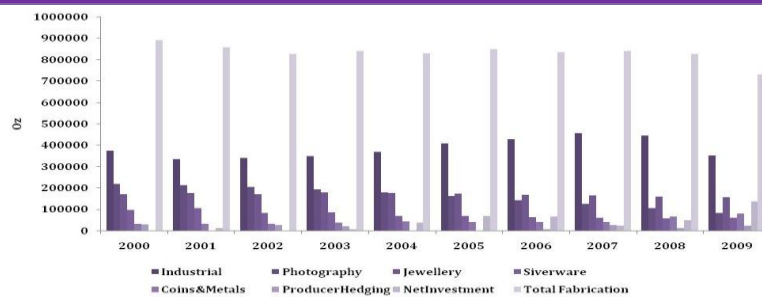


Source: Bloomberg & KCTL Research

Demand

From the demand side, the major driver is the fabrication demand and the net investment demand. Investment demand has shot up by 184% in FY2009 which made up almost 15.5% of the total demand. Producers now-a-day are probably doing hedging at a greater extent so that the demand from their

Exhibit 18: Demand

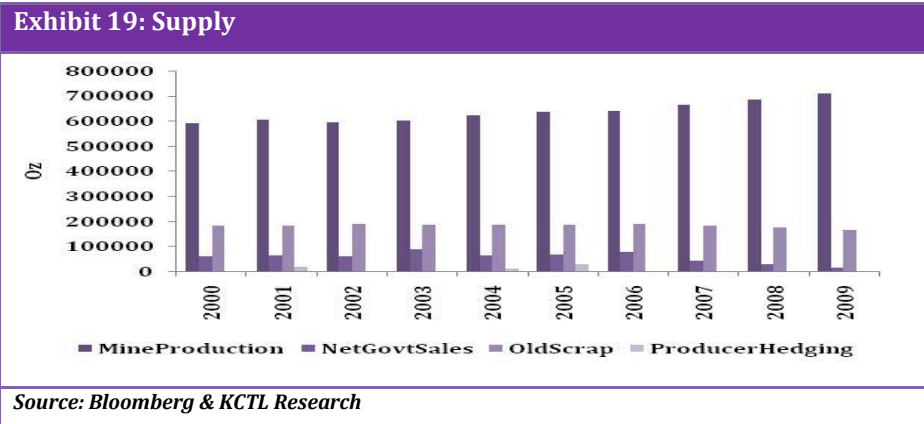


Source: Bloomberg & KCTL Research

perspective is also soaring day by day. In a situation of economic slump or unrest, demand for safe haven generally moves up. Eventually, to produce silverware and coins, the metal was being incredibly demanded for the last three years.

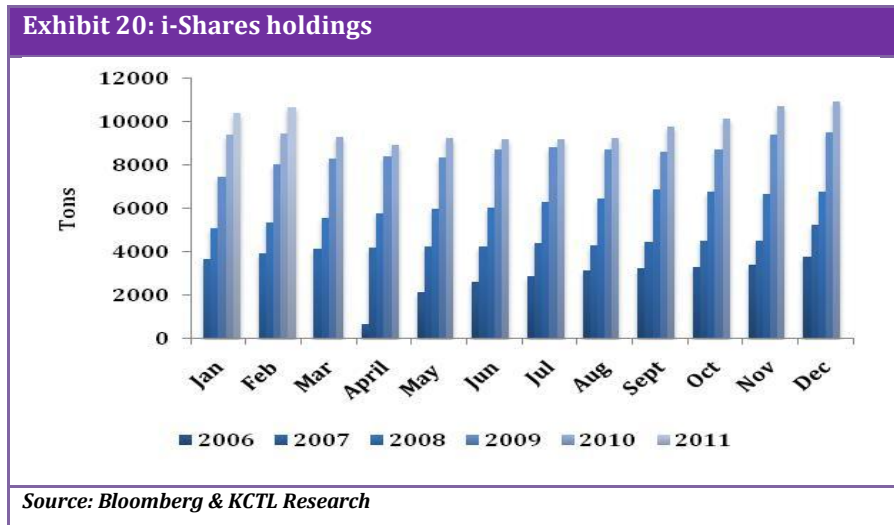
Supply

From the supply side, the mine production has increased by 3.64% in FY2009 over the prior while old scrap selling and net government selling came down. This supply demand gap is still persisting which may lead to a price surge in silver in the next quarter as net investment demand is likely to be continued at the same pace.



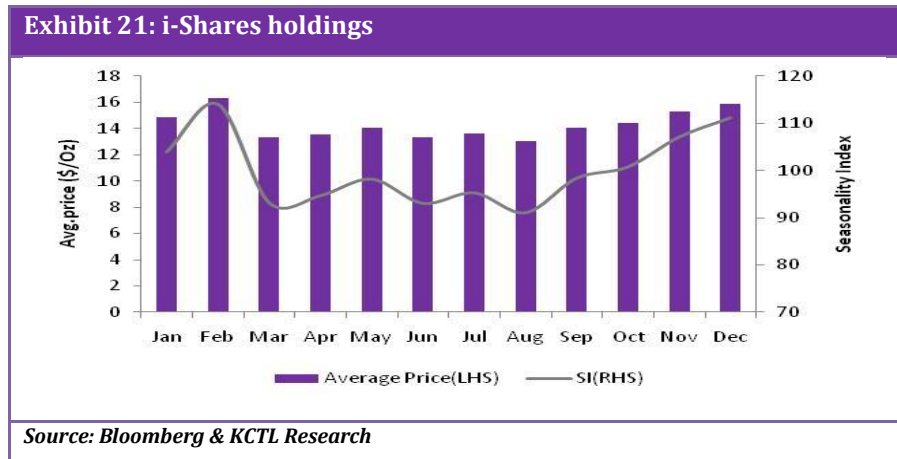
I-Share Holdings

An increased holding in the I-share ETF, the largest ETF holder, is a major reason to boost the investment demand. On a month basis each and every year the holding is seen to be increasing. However, during the first two months of 2011, the holdings came down by 375.18 tons on average. This fall in the early quarter will obviously be hampering the investment demand but it is too early to make a comment that the holdings will be further coming down. Even if the economic outlook is gloomy, silver ETF holdings may increase due to a safer side option.



Seasonality Index

As discussed in the gold's seasonality index, it can be seen that the first two months of the observed period of 2005-2011 silver has surpassed the average price. The second and third quarter index remained below 100 while the fourth quarter again silver has usually traded at above the seasonal average. This year in the first two months silver has traded well above the seasonal average. The month wise closing price



was almost double than the average. Hence it is expected that in the next quarter the price will remain above the mean supported by a high correlation with the crude oil.

Silver to glaze

As we have already reviewed the economic outlook and gold's glory, silver as its counter part will no more be far behind. Rather silver to add more sheen into its kitty. The Gold-silver ratio as we are expecting to come down further, other way round meaning silver to glaze. The poorest among the poor metals may shine on the back of a stronger correlation with soaring crude. Lingering jitters over the financial stability of the euro zone are continuing to unsettle some investors may pour on the metal amid global uncertainties. However, Seasonality index again may disturb or limit the upside gain. Q2 for each year has seen some pull back in price may again be right given the economic unrest over the MENA region eases. Fluctuations are anyhow expected due to the dwindling economical factors but mostly the indicators are showing bullishness.

Technical Analysis



Spot Silver COMEX prices flew high this quarter 1 of 2011 and settled at 37.88; high 38.16. This is for the 9th consecutive quarter silver prices settled upside.

In the monthly chart, 2 long white candle sticks witnessed suggesting a bullish mode to be continued for the coming quarter also. Crucial resistance level to watch for this quarter is \$ 40.00-42.00 that is

Target prices for inverted head and shoulders witnessed at the bottom

- It is 63.75 degree line resistance as per the Gann fan principle as silver prices are trading over and above the 45 degree line so the next resistance line is seen at that level
- \$40.00 is also 100% projection of the range 71.31-31.23-26.04 as per Fibonacci projection principle.

Crucial Support level for this quarter is seen at \$35.00 – 34.00.

- \$34.10 is the pivot point for this quarter and also support level of 45 degree line as per the Gann fan principle.
- \$35.00 is seen 61.8% projection of the given range as per Fibonacci projection principle.

Overall trend in the silver prices for this quarter is looking upside and to move in the range of \$34.50-42.00\$. We recommend buying on the support levels.

Note: We have taken 18th March 2011 as the last quote to prepare this report

Prepared By:

Aurobinda Prasad - Head of Research - aurobinda@karvy.com

Subhrasom De - Fundamental Analyst – subhrasom.de@karvy.com

Nikky Joshi - Technical Analyst – nikky.joshi@karvy.com

To unsubscribe please mail us at commodity@karvy.com

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