



The Debt Ceiling Paralysis makes a welcome change. Finally, raising the limit is likely to impact adversely for a shorter instance; while, a spending cut will be sprinkling as boon in near term for precious metals...

Strategy...

The investors those who are holding buying positions are recommended to hold it for the target of \$1670 with stop loss of \$1577.

In Indian market investors those who are holding buying positions are recommended to hold it for the target of Rs.24000- 24200 with the stop loss of 23120.

Recap

Gold future scaled pick to a new record high of \$1628.80 this month on 27th July following the ongoing controversy in the US while the dollar steadied as investors piled into bullion over fears of a possible debt default as the debt ceiling talks in Washington stalled. Clocks are ticking toward **August 2** deadline for US deficit talks, while President Barack Obama and Congressional leaders struggled to break the stalemate. Silver also detained the impetus from \$33.70 to \$41.47.

Economic Overview:

Last month it was the period which was dominated mostly by the economic news and the lingering debt concerns over the US and European nations. To start the month, it was the EU leaders who took the endeavor to conquer the Greek debt. Germany forwarded their hands to welcome the proposals from the French lenders on a voluntary participation in a rollover of debt by Greece where lawmakers prepared to vote for a budget cut needed to avoid default. However, amid street protests, Greek prime minister was able to clinch enough votes for implementing austerity measures and asset sales which were required to keep aid following. However, Comments from the Standard & Poor that Greece would likely be in a default if it follows a debt rollover plan pushed by French banks increased lingering concern over the stability of Euro zone. The Euro area then approved its share of a 12 billion Euro aid payment for Greece and the finance minister agreed to disburse 8.7 billion Euros of loans under last year's 110 billion Euros bailout by July 15. The ECB has taken progressive decision to anchor the inflation thinking that the Greek default has subsided and raised their benchmark rate by 25bps to 1.50%. Trichet however drew a line on Greece's matter to prop up the nation after which it showed impatience with the political leaders.

Signs of instability over the Euro zone increased at the middle when the Greek contagion was being felt to spread over Italy as policy makers remained split to structure aid for Greece. The ECB was seeking to expand a fund for Italy following a coordinated rescue for Greece by the EU and IMF. European finance ministers revived the prospect of bond buybacks to ease Greece's plight and declined to rule out a temporary default as they struggled to contain the debt crisis that has now spread to Italy who prepared to sell one year bills and as much as 5 billion Euros of bonds on 14th July. ***Fitch has cut Greece's credit grades to its lowest for any country in the world. The move from "B+" to "CCC" reflected the absence of a new fully funded and credible program by the IMF and the EU which intensified a real possibility of default.*** Europe's debt crisis worsened as the EU leaders were ready to hold a special summit after eight of the region's banks failed stress tests and ECB president reiterated that it won't accept as collateral bonds from a nation that defaults. Delay in finding a solution combined with discord among policy makers on whether bondholders should share the burden if Greece defaults had unnerved financial markets. As a result, European banks might have to raise as much as 80B Euros of additional capital to allay investors concern about a Greek default and governments' ability to bail out their lenders. Euro chiefs lastly announced 159B Euros in

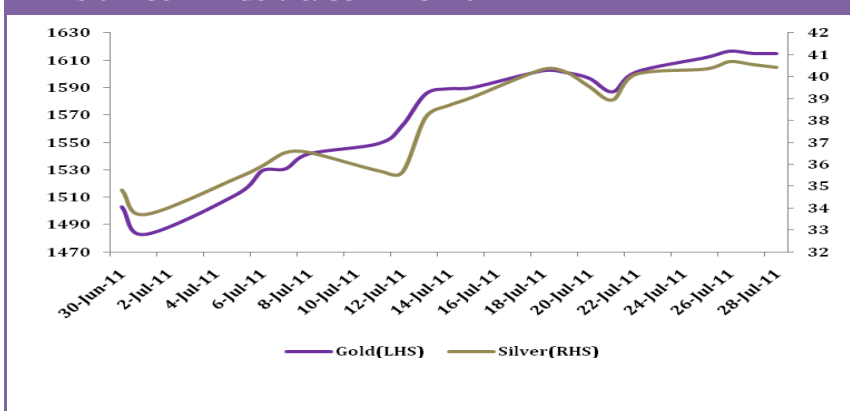
new aid for Greece and persuaded bond holders into footing part of the bill. They also empowered their 440B Euro rescue fund to buy debt across stressed nations, namely Spain and Italy to stave the temporary default.

For the US, at the very beginning of the month IMF has warned to raise the debt ceiling and cautioned about risk of a downgrade as the due date Aug.2 is nearing. Basel Committee argued for a hike in the capital adequacy requirements for the world's biggest lenders and amid concern that the US economy is faltering. Job growth came to a near halt in June according to surprisingly grim new data that raise doubt that the economy will bounce back from its descent labor sector growth soon. Unemployment rate rose to 9.2% as the US adds only 18K jobs. US president felt the exigency of reaching an agreement of raising the debt limit and urged to the Republican leaders to compromise on their opposition to tax increase and achieve the largest possible deal to cut the Federal budget deficit. However, the Fed policy makers disagreed on whether additional monetary stimulus will be needed, even if the outlook for economic growth remain weak, minutes of their meeting (June) showed. Some members noted that the committee might need to consider further stimulus, while others voiced concern about an increased inflation risk that might warrant tighter monetary policy. However, no clear solution was being made in regards of raising the debt limit and hence, S&P joined the Moody's and warned the US to lose its debt rating. While the economy was in a hurry in negotiating an agreement to cut the fiscal deficit, the Republicans were not ready to accept any tax increase while Mr. Obama was pushing for a deal that will combine closing tax loopholes with cuts in government expenditures. Obama's administration however has signaled that it may accept a short term increase in the US debt limit if lawmakers need a few days to finish the work on a broader agreement to cut the deficit. However, the democrats countered crossly that the White House is cutting a deal with the Republicans to boost the US debt ceiling and reduce the deficits by about \$3 trillion over ten years without immediate increase in revenues. So, on the brink of uncertainty, advance in US leading index signals recovery which might have supported the dollar to revive.

Debt debate driving Gold to Record

Both gold and silver were extravagant for the last month. Gold paused for a certain time at the very beginning to touch the \$1482 level after which it did not stare back and made a continuous rally till \$1624. For the last month the metals has given a handsome return of 8.90%. The same has been observed in silver. To start the month silver also had a jerk after which it rallied till \$40.122 and thereby fetching the return of a whopping 16.01% within a month. There are several reasons which made the precious metals to rally.

Exhibit 1: COMEX Gold & COMEX Silver



Rationale to Price mount

This price rise of Gold and Silver was not due to the speculation but from the fundamental front it has its own reason for this spike. To have a brief, below mentioned points would have triggered prices:

- ❖ Sign of instability over the Euro peripheral nations and suspicion of spreading the contagion to Italy
- ❖ Preparation of second Greek bail out amid national protest against austerity measures and budget cuts for smoothing the flow of international aid- led the Euro to weak against the majors, investors sought for safety
- ❖ Controversy over raising the US debt ceiling limit between the Republicans and Democrats made people to have a feeling of sinking ship- investors rushed for precious metals for shielding their wealth
- ❖ **Investment demand** also increased from the last month for both the metals as investors sought for haven amid economic doldrums
- ❖ High rate of US unemployment of 9.2% made people shaky to foresee the labor sector growth along with housing sector collapse
- ❖ S&P joined Moody's credit rating to warn the US of cutting its long term debt rating from "AAA" to "AA" even if they raise the ceiling and if the plan is not backed by well equipped accommodative stance
- ❖ US made an auction to sell \$99 billion treasuries starting with \$35 billion two years notes in the last week of July- led the treasuries to pare gains
- ❖ The dollar index plunged to the two months lowest of 73.474 as the S&P threatens US to downgrade their credit rating facilitated the growth of precious metal price

Exhibit 2: Investment Demand

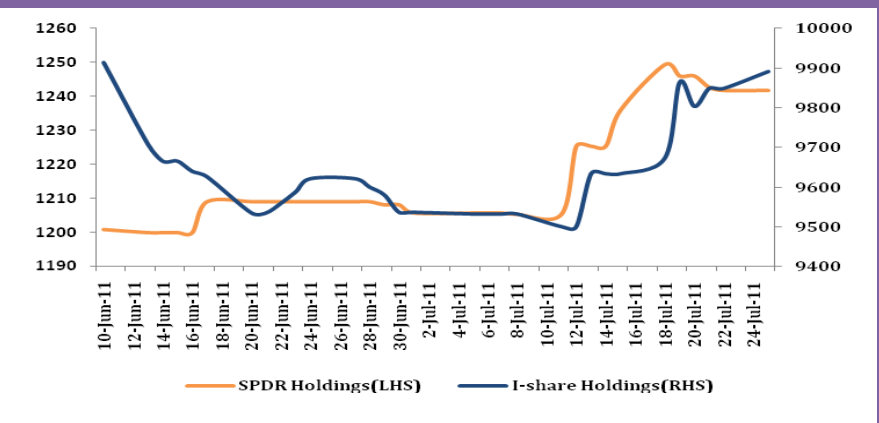


Exhibit 3: US Bond Yield

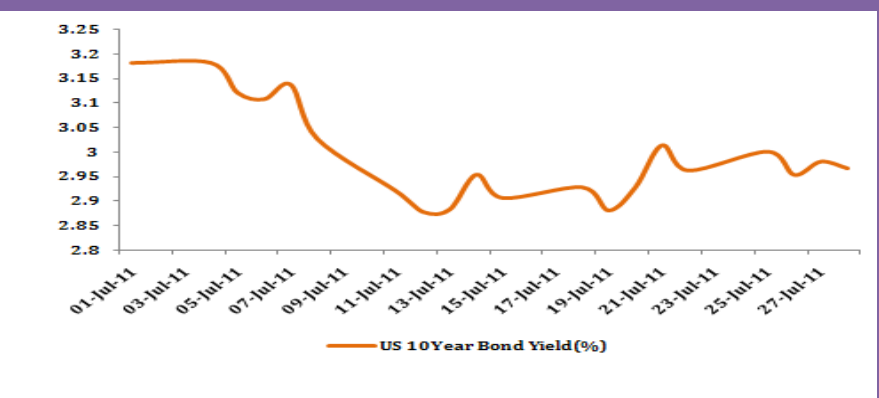
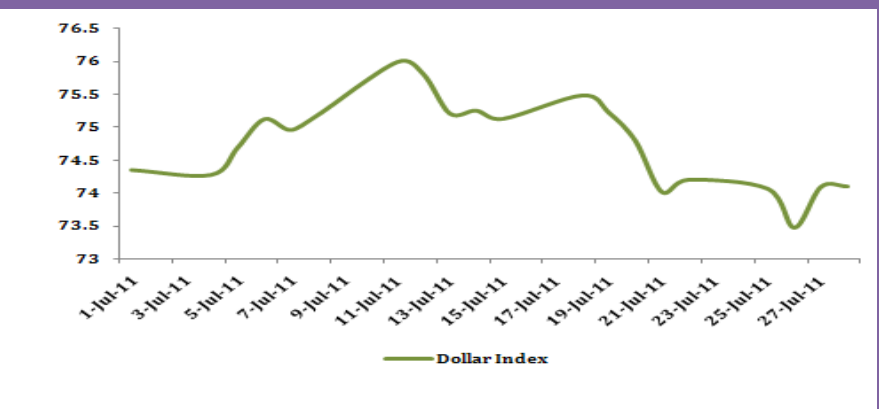


Exhibit 4: Dollar Index



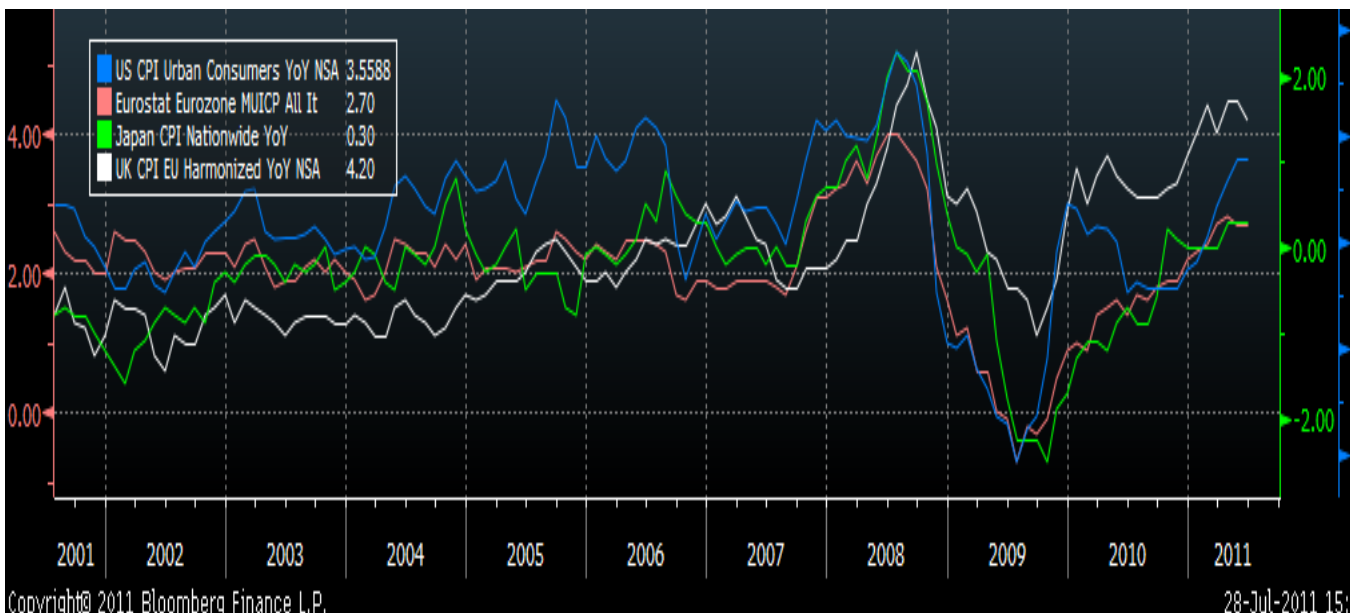
Outlook:

Month of August is going to be crucial as market remains on edge of the world's biggest economy's debt default. Any move of precious metals cannot be evaded. The initial jerk of the policy stance could lead both gold and silver to forfeit a bit, but slowly the underlying economic and political problems are likely to set the motion of the metals.

➤ *Inflation Pressure to support*

Global inflationary pressure creates a major role to provide a spike to the precious metals prices. From the graph shown below, we can see the US, Euro zone, Japan (Asia) and UK consumer prices are increasing since 2009 while the US keeping the benchmark rate constant at 0.25%. For the period of December 2010 till June 2011,

- US : 138% rise in CPI (from 1.04957 to 3.5588)
- Euro zone : 23% rise in CPI
- UK : 14% rise in CPI



Source: Bloomberg

Thus, to tame the price rise, ECB has raised the interest rate. The same has been observed from the Asian countries as well, namely China and India. This step however has already impacted upon the prices but current economic scenario proved to be supportive for precious metal prices to be skyrocketed. We expect the inflation pressure to be continued for some more time and thereby to support prices as haven.

➤ *Interest Rate: A fear factor as well as an affirmative aspect*

Global major countries like Europe, China and most of the major economies have already increased their interest rate to check the price rise.

- ❖ The ECB has raised its rate to 1.50% from 1.25%
- ❖ China has hiked interest rates three times this year. One year lending rate increased to 6.56% while the deposit rate also rose to 3.5%. Despite of that hike Chinese corporate profits have surged by 28% this month, indicating that the economy is at a firmer foot even after such tightened monetary policy.
- ❖ In India also same stance has taken by the central bank on 26th July by raising the Repo and Reverse Repo rate by 50 basis points which came as a surprise to many, who were expecting the regulator to hike rates by 25 bps. The RBI has continued its upward interest rate revision policy of the past one year by yet again hiking the interest rates by 50 basis points. The new Repo rate is 8% and the corresponding Reverse Repo rate is 7%. Over the last one and a half year, the RBI has raised the Cash Reserve Ratio (CRR) by over 100 basis points and the Policy rate by over 275 basis points.

Overall, most of the emerging economies are rather ready to accept slower growth anticipating an US economic slowdown and hence to protect themselves from a sudden financial crisis. After such hikes in rates INR got appreciated and restricted the upside of the price moves. Such scenario therefore is a logical threat to the metals price growth.

Rising interest rates undermines equity markets, housing prices and in turn the overall economy. Therefore, with such low growth rates in the States already we would expect deflation to take place. With energy and food inflation already high, unemployment rates will rise alongside the weakening economy.

➤ *Treasuries Bonds: A Fetid Pick*

With interest rates on 'safe' sovereign debt at or near zero on the short end, and well below the rate of inflation on the long end, safe bonds offer a negative real yield (meaning a yield below the rate of inflation). This is a compounding disaster for everyone but especially for funds with their longer time horizons. Worse, we now know sovereign debt can no longer be considered safe (even the US is facing a downgrade threat) - which means that on a risk-adjusted basis, the returns are even more unattractive than the negative real yields on offer. So, what remain else to protect wealth from attrition? It's undoubtedly- ***Bullions!***

Part of the goal behind ultra-low interest rates was to drive money back into the stock market, which the Fed has been specifically and openly targeting in both word and deed. It is a well known fact that low interest rates are supportive to the stock market and so far that strategy has worked. On the flip side of this success is the fact that a lot more risk has been forced into the system. When prices are artificially distorted to the upside for stocks or bonds, then it is self-

evident that risk becomes mispriced. Having to choose between mispriced risk and negative returns is truly a foul choice indeed.

➤ ***South African Mine strikes- to be felt on supply shock***

South African gold mine workers and the country's main producers were to meet on 29th July, last Friday of the month for wage talks in a bid to end a strike that could halt output worth up to \$25 million a day at a time when the price of bullion is near record highs. The country's annual "strike season" is in full swing with unions demanding 10-15 percent pay rises, well above inflation of five percent. Although South Africa has lost its first position in gold mining in 2007, it is now the fourth largest producer of gold, is likely to impact upon the prices, positively.

➤ ***U.S. Debt Ceiling Impasse: The Odds***

The effect of the debt ceiling impasse had on the gold and Silver Price today had nothing to do with the gold or silver fundamentals, but on the threat to financial stability and the US Dollar. Precious metals act as a counter to the main cash and currency markets; therefore, we have to take a look at the sum total of the influences on the gold and silver prices, not just the short-term speculative ones. These are simple and clear –gold and silver prices have been reflecting the uncertainty and instability of the currency worlds and the undermining of the value of paper currencies.

The massive size of \$14.3 trillion debt has been built up by over the years and has accelerated drastically recently. No one can now think of that this will ever be reduced to zero. Rather, US perhaps go on running deficits of this size or higher for ever as because the gap between spending and income being so enormous. The possibility that if the debt ceiling is not raised that Social Security payments are not made in August is really beginning to bring the financial mess in which the US finds itself into the forefront of debt default.

However, being the world's largest economy, measures to raise the limit is very much likely to happen on **August 2**, at least for the time being. Measures like government spending cut or axe the wealthy people by raising tax may take place. ***Anticipating so, the initial jerk of raising the limit has to be borne by precious metals by retreating a bit. But, effect of other policies and intricacies might be felt at a later point in time which will again be a supportive factor for the metals.***

➤ ***Stalling US economy to spur demand for bullions***

The US economy grew less than forecast in the second quarter and consumers also retrenched their spending. GDP rose at 1.3% annual rate pressurized by slower job and income gains. The faltering economy will probably complicate the debt ceiling negotiation. ***Thus, the transition in to the second half is on rocky footing should support the metals prices.***

*****Note: Data incorporated till July 28, 2011 to make this report***

Technical Outlook



Elliot wave analysis

(Currently gold is in minute wave 5 of minor 3 of intermediate 5 of Primary Wave 5.)

Yellow brick line is on its optimistic path. And people around the world eyeing gold to hit another mile stone.

While, doing a wave count here (as on 02-08-2011), COMEX Spot Gold is trading at \$1637.80. The question arise is whether the minute 5th wave ended here or not. However, as per our calculations minute 5th wave might end at \$1646 which is 1.618 of minute wave 1st to minute wave 3rd or it may extend up to \$1670 which is equal to minute wave 3. And if the minute 5th wave ends at any of the 2 given points, we depict that minor wave 3 may come to an end and gold prices are expected to correct for minor wave 4 thereafter. The immediate support level then is presumed to be \$1577 which is swing high of minute 3 and also 23.6% retracement of minor wave 3. The next support level is coming at \$1532 which is 38.6% (Natural retracement) of the Wave 3.

Long Term View: If gold prices move as per our analysis then it should hold the ultimate support level \$1430 (as per Elliot wave rule that wave 4 should not enter into the territory of wave1).

As per the above analysis the strategy for the coming month can be: The investors those who are holding buying positions are recommended to hold it for the target of \$1670 with stop loss of \$1577.

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