MARKETS

Gold bugs scatter

BY DANIEL P. COLLINS

In the post-apocalyptic year of 2013, stocks may be replacing gold and the U.S. dollar as the new safe haven, and some more obscure industrial metals may be a better play for those looking for dramatic moves.

Metals, both precious and base, are measures of economic health. Precious metals serve as a store of value and base metals measure economic activity. Gold began an impressive rally at the beginning of this century as the long bull equity market came to an end. Analysts are debating whether or not we are in another secular bull equity market and many turn to gold as a gauge. But gold bulls are liquidating to get into U.S. equities as the Dow Jones set an all-time high in the first quarter of 2013.

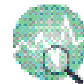
India taxes demand
Palladium, zinc and aluminum, oh my!

Gold peaked in September 2011 at $1920.80 and has been mostly range-bound between $1,525 and $1,800 since then (see "Is it the end of world or end of gold bull?" right). The fear is that there is a wall of inflation awaiting us because of all of the liquidity added and quantitative easing executed across the globe to deal with the financial crisis. But many a fortune has been made and lost in gold on both sides of the market. If gold is the place to be when inflation spikes, many traders have realized that, like the end of the bull equity market predicted throughout the 1990s and eventually arriving in 2000, the market can remain irrational longer than traders can stay solvent.

"Gold is off, S&Ps are up. Fund managers have to move money to performance. There hasn't been any new buying in gold," says George Gero, vice-president of Global Futures RBC Capital Markets and long-time gold trader. He compares what is going on in gold to the mid- and late-1990s when many people correctly understood that the long equity market was coming to an end but lost money by being early. He says traders are in a wait-and-see mode and will wait for a sign of an exit (from QE) before going long again. And he doesn't expect the next leg up in gold to happen for a year, barring some unforeseen geopolitical event.

Steve Platt, senior futures strategist at Archer Financial Services, says the market lost a lot of interest because of the movement in stocks. "It is movement from one asset class to another and stocks have been a favorite after being ignored for so long. Money has moved out of gold because it did have a sizable rally and people have taken profits."

The attention to gold has shifted to other assets. Although gold is consolidating at historically high levels, it



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won't move higher, says Patricia Mohr, vice-president, economics & commodity market specialist for Scotiabank. "The reason gold has leveled out has a lot to do with a shift in investor interest away from gold and into U.S. equities," Mohr says. "The other reason is recognition that the Federal Reserve Board does not need to further step up its quantitative easing to kick-start the U.S. economy."

Edward Meir, senior commodity consultant to INTL FCStone, points out that how retail investors access gold could put on additional selling pressure. "So many retail traders access gold through exchange-traded funds (ETFs) that when they sell there is also a massive outflow from the funds themselves that buy physical gold to back the ETF," he says.

Gero says we just haven't had the inflation many were expecting and that to a certain extent drove the gold rally. "It could be six or 12 months down the road," he says. Gero expects gold to remain range-bound in 2013, but warns that there could be a geopolitical shock that changes things. "I don't see anything yet but something always happens to upend the cart," he adds.

One possibility is what occurred in Cyprus this March when the government decided to go after people's savings. Gero says there could be follow-through if a similar situation occurs in Italy, which appears to be the most vulnerable.

Meir agrees. "Cyprus is [contained], but if it spills over gold could perk up. Italy is a big question; so [are] Spain and Portugal. Basically the continent is not growing."

The inflation picture is unclear, Meir says. Some people believe, "If all this [liquidity and quantitative easing] were going to cause inflation, we would have seen it by now."

On the fundamental front Meir says central bank buying has been restrained and while jewelry demand has been good, the tax increase on gold imports instituted by India, the world's largest user of physical gold, earlier this year could hurt demand .

Meir says the conflicting fundamentals (see "Demand drivers," right) make it difficult to see how gold will perform for the rest of 2013, but adds that U.S. equities may be the big driver. "Basically it depends on U.S. equities — [they are] the new safe haven displacing gold."

He expects gold to take out its 2012 low of $1,530. "We could get down to around $1,480 in 2013," Meir says. "On the top side, I don't think it will go beyond $1,700."

Platt is looking for the gold market to be weaker. "I'm not looking for much lower than $1,500 on the downside. It may be that given the negative sentiment, it is good for the market as it has started to exhaust people," Platt says.

Mohr adds, "One of the factors driving up the price of gold was that there would be further QE that many people [felt] would be inflationary. There is not going to be a [QE4]. We are at the end of the ratcheting up by the Fed. When you have a Fed meeting now, there is a discussion of when the asset purchasing program will begin to be withdrawn. We don't think [it will happen] until 2014, but just the discussion of when is enough to unnerve the gold market."

She also pointed out that Basel III put out its revamped liquidity ratio for banks and did not include gold as one of its assets. "They included equities, albeit with a haircut. To include equities and not gold was surprising," Mohr says.

IS IT THE END OF THE WORLD OR END OF GOLD BULL?

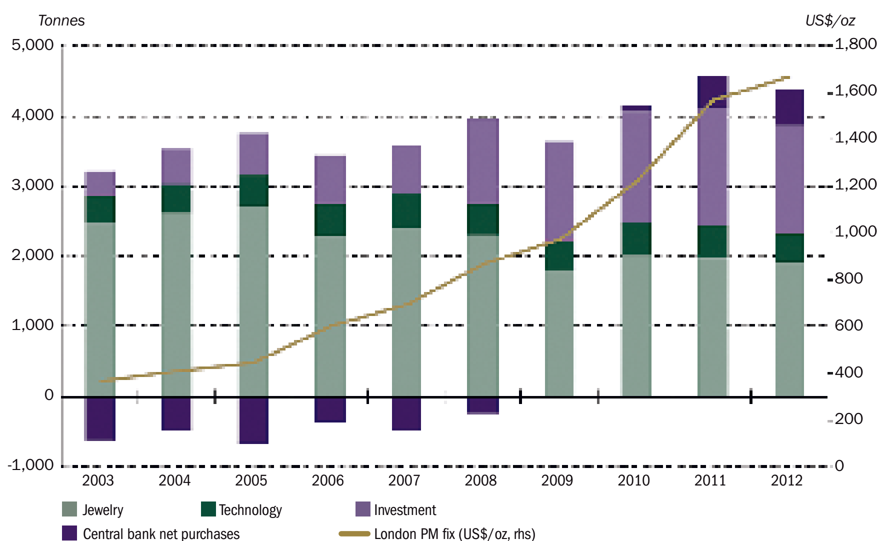
Gold bulls had taken it on faith that the yellow metal's historic run had just begun and would run up past $2,000, $3,000 or much higher, but doubt has crept in and some analysts believe a long-term top is in place.

Source: eSignal

DEMAND DRIVERS

More and more of the demand for gold is as an inflation hedge and central banks have gone from net sellers to buyers during the last decade.

Gold demand by category (tonnes) **and the gold price** (US$/oz)



Source: LBMA, Thomson Reuters GFMS, World Gold Council

Is it over?

Gold has been off its high for the longest period in its current bull move — even longer than the 2008 shock — and it is still nowhere near its peak, leading some to ask whether a long-term high is in. Analysts are mixed.

"Gold had taken off because of all the massive easing. At some point the Fed will pull back its balance sheet," Meir says. "Gold has had its peak for years. I don't see it going back to [all-time highs];

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we are at some point going to start to pull back this quantitative easing."

Mohr expects gold to average $1,650 in 2013. "I don't see a huge decline because there are many people around the world who do view gold as a store of value, and central banks continue to buy gold. So I see it holding up, I just don't see it moving higher."

She adds, "The 2011 high could be a long-term top. It is a peak for this business cycle, is the way I would put it."

Gero is still a long-term bull but is in no hurry to get back in. He says the extent of the rally would be based on how smoothly the Federal Reserve and other central banks execute an exit strategy. Further, with the Fed signaling there will be no exit strategy until 2014, there is no urgency to buy gold.

All that glitters is ...

While she is not particularly bullish on gold or silver, Mohr likes palladium. "Palladium still is considered a precious metal but really is an industrial metal used in auto catalytic converters, [looks strong]," Mohr says. "There are two reasons palladium will perform well: One is [that] the auto market in emerging markets, particularly China and India, probably will be a lot better. The second factor is last year's strikes in South Africa, which supplies 34% of worldwide palladium."

She notes that the supply has dropped because of the labor strife and the Russians' huge stockpile of palladium has depleted. "When that is gone the price of palladium will go higher; it already has performed well this year," Mohr says.

And Mohr is talking the long-term. She expects the price of palladium to average $745 per oz. in 2013, $800 in 2014 and $850 in 2015. It averaged $643 in 2012.

In addition to palladium, Mohr is extremely bullish on zinc. "The story on zinc is that there [are] going to be mines that get depleted in 2013 to 2016. Beginning next year prices are going to move higher," she says. Mohr sees zinc averaging 96¢ this year, $1.10 in 2014 and $1.40 in 2015.

A main driver of Mohr's bullish view on base metals is Scotiabanks's estimates of continued growth in Chinese auto demand. The bank estimates the sector to grow another 6% after a 10% increase in 2012.

Copper short-circuited

While growing demand, especially from China, has analysts bullish industrial metals, the king of industrials, copper, is not expected by many to advance.

It is not that some new exotic metal will replace copper; just that prices have been fat and supply is not expected to be an issue.

"Copper has been the star performer in the entire metals group," Mohr says. "Although pricing in recent weeks has moved down to the $3.30 mark, it remains exceptionally profitable for miners. One of the reasons copper has done so well is the fact that there has been growth in demand in emerging markets, particularly China, but also because new line supply has come on stream slowly. Copper was on a supply deficit."

That void is expected to be filled, according to Mohr. "In the next 18 months, there is going to be a lot of brownfield (existing mines) expansion finally coming on stream," she says.

Another reason for her outlook is that copper, while affected by the global economic tsunami in 2008, rebounded quickly. "Remember China's economy, although it slowed in 2008, never went negative year-over-year," Mohr says. "Copper snapped back very quickly in 2009. Traders realized that China's state reserve was buying. China put together a massive infrastructure spending program on railways and bridges and municipal works to kick-start their economy."

She expects copper to drift lower for the rest of the year and to continue its weakness into 2014, averaging $3.20 per lb.

Platt also is bearish copper. "Copper is still overpriced. I have a hard time seeing copper at these prices. Aluminum might actually be the market that has some potential because of the structural adjustments you are forcing on the producers given the low prices prevailing," Platt says.

He sees copper and aluminum benefiting from increased demand, but prefers aluminum because of its current valuation. It seems with gold fever waning, traders still will find some action and profits to be made, just not in the usual places. F

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