Gold update 17.4.2013

Market activity in the course of the last few days has been dramatic for the precious metals and commodities as a whole with the main focus being on gold and silver amid falls not seen for over thirty years. We are therefore writing this update to explain what we think has happened and what this implies for the sector in the medium and longer term.

The Background to the Moves

Mainstream commentators and the media focussed on a series of news stories that have served to unnerve the wider investment population about the short-term prospects for commodities and precious metals. With each additional negative news item, weak hands in the sector have been spooked into selling. The stories that have come along include the following:

- the FOMC minutes triggered concerns that the US Fed may reduce quantitative easing soon.
- the Cypriot central bank (and therefore other European central banks) might sell its gold. Mario Draghi suggested that the sale of 400 million euros worth of Cypriot gold reserves would be used to cover any losses the European Central Bank may sustain from emergency loans to Cyprus's commercial banks (this was denied by the head of the central bank in Cyprus as no talks on this matter had been conducted).
- swings in the price of Japanese bond prices meant that money had to be raised to meet losses and margin calls on these positions.
- a report from Goldman Sachs (and other investment banks) downgraded the outlook for the gold price.

Having witnessed many precious metal price take-downs or manipulations over the years, this has all the hallmarks of another deliberate price smash to discredit one of the few remaining havens to harbour wealth and purchasing power for the long term. Those in control of the fiat money system must not allow a viable alternative to paper money to develop and every means possible has been and will be used to maintain the US dollar as the reserve currency of the world. What this ignores in the medium and longer term is that paper money is not fulfilling its proper duty in that it performs only the simple role as a medium of exchange. However, real money has to also provide an effective store of value, a measure and store of built-up labour and the current actions of central banks undermine this important function with many of the policies they are pursuing. In our own history debasing the currency through the act of coin clipping was such a heinous crime that it was punishable by death and yet now it is incorporated as official central bank policy!

Rometsch & Moor Ltd. Lloyd's Building One Lime Street London EC3M 7HA
Tel +44 (0)20 7626 3077/Fax +44 (0)20 7626 3088/www.rometschandmoor.com/info@rometschandmoor.com

Bear Raid

Coming on top of the bearish stories mentioned above, bullion prices were subjected to a sophisticated bear raid in order to provoke the maximum amount of selling. It is important to note that the price activity has taken place via paper gold and via the Comex futures market – the trades are not conducted with real physical gold as this scale of activity would not be possible. It is another example of the danger inherent in derivative markets that enable this sort of trade to take place.

On Friday 12th April and Monday the 15th April selling of paper contracts on Comex came to 1 million contracts an amount that exceeds global annual gold production by approximately 12%. If this were a legitimate sale order then this size of transaction would be conducted over a very long period of time so as not to disrupt the price and therefore achieve the best exit price. This transaction on the other hand was placed in order to break the market below perceived strong support levels (in the US$1,525 area) and once this was achieved stop-loss orders and panic liquidation set in. This is exactly what the seller wanted to achieve.

The price drop is a market shift in the paper markets for gold and silver that were perhaps necessary to underpin the next move higher yet the reasons why gold has risen over 12 years are all still in place and problems in the world are accelerating not dissipating.

All the pre-conditions that brought gold to this point are therefore still intact. The bond market is still showing negative interest rates (after inflation is taken into account – a form of financial repression) and Japan and the United States on their own intend to flood the world with an additional flow of money of almost US$2 trillion dollars over the next 12 months! Let us look at some of the key factors for gold:

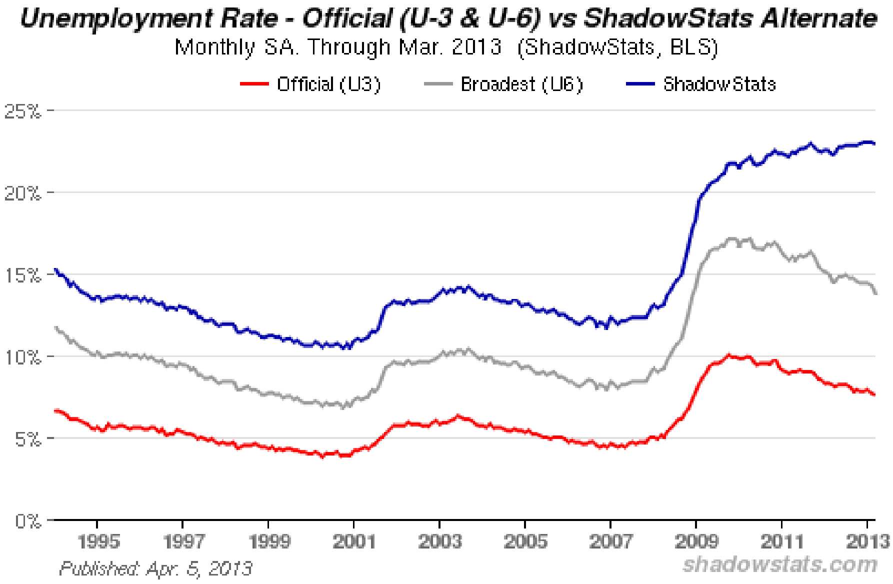
- The Federal Reserve is still increasing the money supply by US$85 billion every month, further debasing the dollar by transforming debt into currency – debt monetisation.

  A useful definition of debt monetisation is provided by Pictet:

  "Debt monetisation: Governments typically have debt, and can either repay this debt with current income (e.g. from taxation), or by issuing new bonds. A government can either issue new bonds to the public directly or to the central bank. If it sells bonds to the central bank, the central bank will create the needed money to purchase the bonds by increasing the monetary base. Thus, debt monetisation is a two-step process whereby the government issues debt to finance its spending, and the central bank purchases the debt by 'printing' money.
  Debt monetisation can lead to inflation because of the increase in the money supply. See inflation, quantitative easing." http://perspectives.pictet.com/glossary/debt-monetisation/

- Has the level of unemployment fallen to a level that suggests the economy in the US is gaining strength?

Rather than rely on just the official statistics provided by the government we show a chart produced by John Williams of www.shadowstats.com as follows:

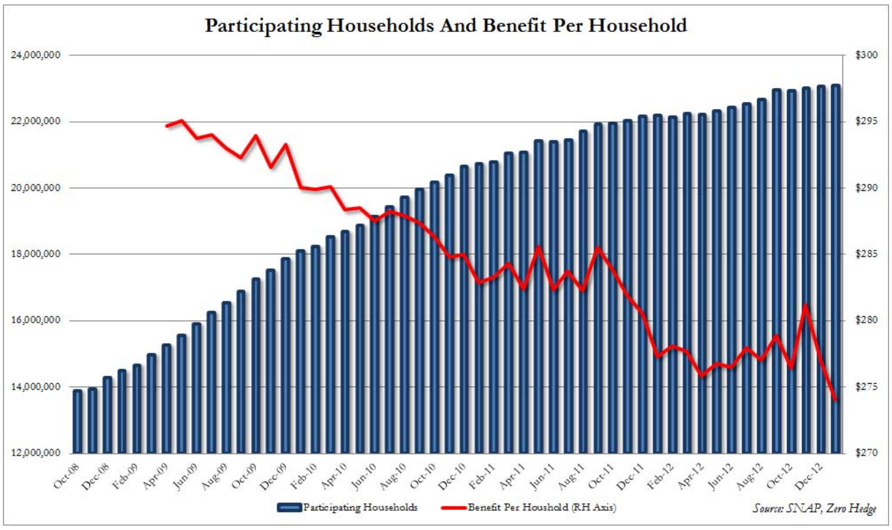


http://www.shadowstats.com/alternate_data/unemployment-charts

The data is explained in the following description:

"The seasonally-adjusted SGS Alternate Unemployment Rate reflects current unemployment reporting methodology adjusted for SGS-estimated long-term discouraged workers, who were defined out of official existence in 1994. That estimate is added to the BLS estimate of U-6 unemployment, which includes short-term discouraged workers.
The U-3 unemployment rate is the monthly headline number. The U-6 unemployment rate is the Bureau of Labor Statistics' (BLS) broadest unemployment measure, including short-term discouraged and other marginally-attached workers as well as those forced to work part-time because they cannot find full-time employment."

For anyone who is sceptical about these figures then we should point out that 23,087,886 US households according to the USDA were on food stamps in January and at a new all-time high. Not a sign that all is well.



Source: http://www.zerohedge.com/news/2013-04-15/us-households-foodstamps-hit-record-high

- Currency wars are in full swing despite the official protestations to the contrary and the Euro remains in crisis mode given the weak balance sheets of many banks and of course the chaos in peripheral countries such as Cyprus. Cyprus is unresolved and Portugal is showing signs of rebelling against the hand that feeds it as they recognise that their debts can never be repaid. The highly-respected Portuguese politician Mário Alberto Nobre Lopes Soares served as Prime Minister of Portugal from 1976 to 1978 and from 1983 to 1985. He was then the President of the Republic from 1986 to 1996. He has issued a rallying cry to all of the opposition parties in Portugal to *"bring down"* the government.

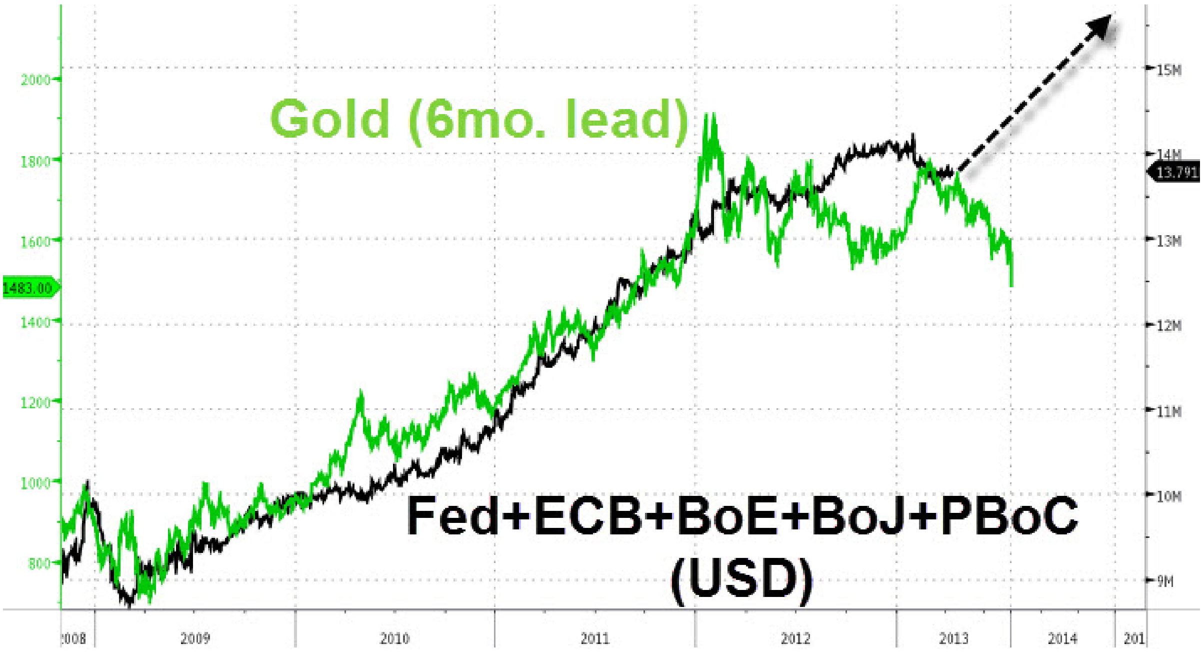
  "In its eagerness to do the bidding of Senhora Merkel, they have sold everything and ruined this country. In two years this government has destroyed Portugal. We absolutely have to end this austerity. Portugal will never be able to pay its debts however much it impoverishes itself. If you can't pay, the only solution is not to pay."

  The contagion from Cyprus is obviously spreading and bank depositors in Portugal are on notice that they will be next to receive the “depositor haircut” as the new normal for bank bailouts… We should not be complacent either as this sort of bailout is coming to us all wherever we happen to reside.

- The Japanese are going full ahead with all speed to print money and thus engender inflation and an economic revival. Under this plan the Yen is going to continue to weaken and force the citizenry to seek out alternative wealth preservation strategies…

It is also worth comparing the rising gold price over the last years to the amount of money being added to the world financial system by the main central banks. This shows that gold has been an accurate predictor of increases to the money supply and that the current price for gold diverges significantly from the picture we have now and going forward (this was produced prior to the drop in the gold price so the divergence is even greater now).

INSERT



Source: zerohedge. http://www.zerohedge.com/news/2013-04-14/gold-and-5-years-global-central-bank-temporary-and-emergency-monetary-policy-actions

There is no way to know where or when the liquidation will end, but it will inevitably do so, probably sooner rather than later.

Physical Buying

The reports we have from around the world is that physical buying has picked up significantly as individuals look to be their own central banks. There are already reports of a surge in buying in India where the lower price of the last few days has been jumped on:

http://www.zerohedge.com/news/2013-04-16/indias-response-gold-sell-buying-frenzy

Most importantly central bank gold buying shows no sign of abating and last year saw buying up 17% to 535 t, the highest level in 48 years (World Gold Council). Overall 2012 was the second-highest tonnage year on record. India and China remain the world's gold powerhouses, with yearly demand in those two largest gold markets rising 30% above the average for the past decade.

This physical buying may also be a reason why the market was taken down so rapidly as there have been rumours circulating of a default at the LBMA and there has been a significant drawdown of physical inventory at the Comex warehouses over the 3 months as well. Investors dealing on these markets have, we assume, been going to the exchanges and asking for physical delivery as they have lost faith in the banks charged with looking after their metals. With inventory running out of the door it would seem that not everyone will be settled with physical metals but will rather receive their trades cash settled instead.

http://kingworldnews.com/kingworldnews/KWN_DailyWeb/Entries/2013/4/15_Maguire_-_LBMA_Default_Triggered_Gold_%26_Silver_Takedown.html

Mark O'Byrne commented on the Goldcore website as follows:

"It may again be the case that bullion banks with large concentrated short positions are manipulating the price lower as has long been alleged by the Gold Anti Trust Action Committee (GATA). The motive would be both to profit and also to allow them to close out their significant short positions at more advantageous prices and possibly even go long in anticipation of higher prices in the coming weeks.

Those with concentrated short positions may also have been concerned about the significant decline in COMEX gold inventories.

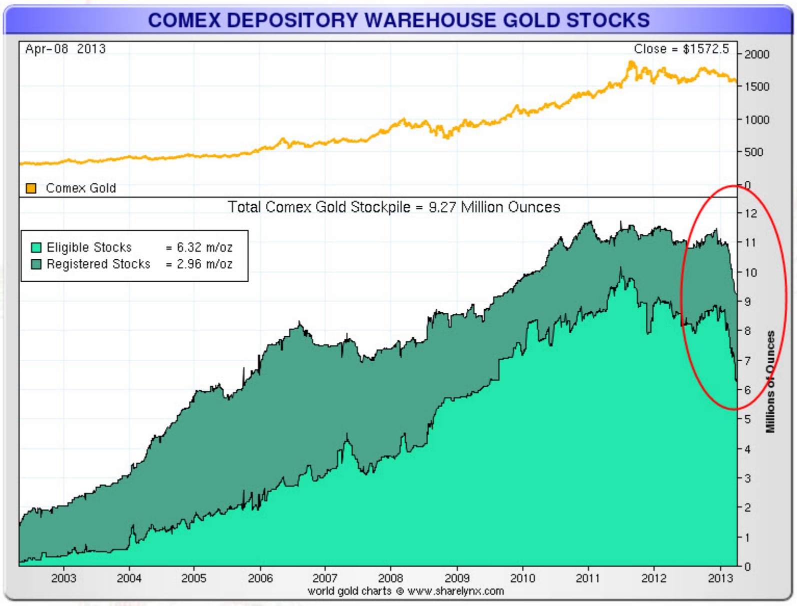
The plunge in New York Comex's gold inventories since February is a reflection of increased demand for the physical metal and concerns about counter party risk with some hedge funds and institutions choosing to own gold in less risky allocated accounts.

Comex gold bullion inventories have slumped 17% already in 2013, falling to just 286.6 metric tons of actual metal on April 11, the lowest since September 2009.

This means that futures speculators on Friday sold a significant amount of more paper gold, in an hour or two, than the entire COMEX physical gold bullion inventories.

Interestingly, the drop in Comex inventories would be the biggest for a whole year since 2001, when bullion began its secular bull market."

https://www.goldcore.com/goldcore_blog/massive-20-billion-paper-gold-sell-orders-trigger-stop-loss-selling-and-unfounded-pani

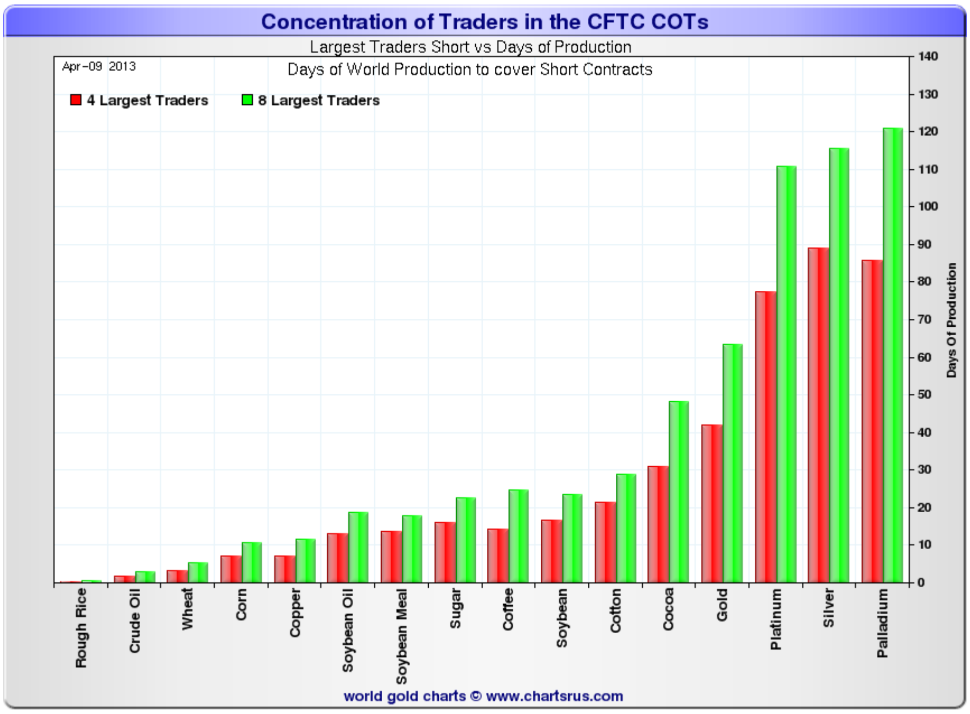


Comex depository warehouse stocks
http://bullmarketthinking.com/comex-gold-inventories-collapse-by-largest-amount-on-record/

What comes next?

Remember that a market also has two sides so with all the selling being undertaken who was on the other side buying?

Many market commentators are predicting gold's demise as an asset class but many of these have been poor predictors of gold in the past and certainly were not buyers back in 2001 when we first started buying. As stated previously, we have seen this sort of activity in these markets before. Each time the 'paper market' for gold has capitulated it has represented a buying opportunity for gold.
In this context it is important to remind ourselves that markets require a seller and a buyer and we must ask ourselves who acted as the buyer in these last days? Given the size of short positions in both gold and silver (and now also platinum and palladium) it had to come a point where the shorts either cover or suffer a short squeeze. The following graph shows how extreme these positions have been:



Source: Casey Research

This fall in price and the volume associated with the drop may have allowed many of these short trades to be covered. If this is the case it would structure the market in a very similar way to what took place in the bull market of the 1970s – more of this in a moment.

Deflationary Danger?

There is a danger with the takedown because it signals deflation is again a possibility, a threat that the entire QE system has been trying to prevent. We look at the gold/ silver ratio as a good indicator of the risk on or off trade with a falling ratio showing that silver prices are rising faster than gold and that this is a risk-on situation and an inflationary picture. Recently the ratio has gone higher and there needs to be a rally to signal that deflation is not gaining the upper hand….

There is a risk that the deflationary genie has escaped from the bottle and will start to wreak its own version of havoc although we do not see this as a likely outcome. With gold as the signal for inflation placed back in the bottle for now it actually gives the green light for more money printing, something that the IMF have urged recently as they see no signs of inflation anywhere! The following item expands on this:

http://www.reuters.com/article/2013/03/08/us-imf-europe-idUSBRE9270IB20130308

http://www.telegraph.co.uk/finance/economics/9981600/Billions-of-pounds-of-QE-unlikely-to-cause-inflation-IMF.html

This provides the price background to enable central banks everywhere to print with impunity!

Déjà vu?

Owning precious metals is part of long-term wealth planning and it is easy to forget that bull markets and precious metal bull markets in particular have their moments of extreme violence designed to shake off weak holders and those who have doubts about the ultimate course that the metals are plotting. Volatility has reached an extreme in the last few days and this engenders both fear and doubt in all participants. However, it is instructive to look back to the most recent map of history for precious metals and the increase in price that took place in the 1970s and mentioned a few paragraphs earlier in this note.

The run actually started in 1968 and peaked in 1980 rising from US$35 per ounce to its eventual peak at US$850. However, the intervening years saw gold first peak in 1974 at US$195 per ounce from where the price then headed all the way back to US$103.50 on 25th August 1976. The fall was also violent as is the case today and the percentage drop was in fact higher then at 43.4%. This led many investors to exit the market in disgust as gold had failed to do what they had been expecting and the 20 month grind of lower prices was too much to bear. Thereafter, gold turned on its heels and rose to its peak leaving many as spectators to the ultimate bull run of 900% from its low.

http://www.24hgold.com/english/news-gold-silver-rusty-old-tin-can-of-gold.aspx?article=4261528804G10020&redirect=false&contributor=Adrian+As

We should remember that the fundamentals for owning both gold and silver are strong and that the big players in the market i.e. central banks are buying what they can to add to their reserves. It will take some time to repair the technical damage caused by the sharp decline and there is likely to be further volatility. However, we see a fiat money system in disarray, currency wars in full swing and financial repression being used as standard policy. This increases the reasons for holding gold and silver and we continue to see very bright prospects ahead.

Please come to us for questions you have about this note and for individual guidance.

We look forward to hearing from you,

With kind regards,

Colin Moor & Toby Rometsch
Rometsch & Moor Ltd

"First they ignore you, then they laugh at you, then they fight you, then you win." Mahatma Gandhi

Rometsch & Moor Ltd. Lloyd's Building One Lime Street London EC3M 7HA
Tel +44 (0)20 7626 3077/Fax +44 (0)20 7626 3088/www.rometschandmoor.com/info@rometschandmoor.com