ANZ RESEARCH

COMMODITY STRATEGY
GOLD MARKET REPORT

16 MAY 2014

INSIDE

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EVENTUAL RANGE-BREAK IN GOLD WILL LIKELY BE TO THE DOWNSIDE

The theme of "little conviction" in gold has continued and the market is clearly waiting for an event that will see prices break out of the USD1,270-1,320/oz range of the past 6 weeks. China will be a key market to watch as a mild retracement in USD/CNY over the past fortnight (from a high of 6.26 to 6.23) has helped to improve the Shanghai-London gold premium. However, at less than USD3.0/oz, this is not enough to stoke a response that would be supportive of prices in our view. India remains at the forefront, with hopes high that the expected incoming government will relax import restrictions on gold. On the downside, further ETF selling continues to pressure gold as holdings have declined by 48 metric tonnes (mt) since March, more than unwinding the gain of 34mt that had been made this year. In this environment, it is difficult to see gold sustaining any significant gains and our bias is that the eventual break-out of the range will be to the downside.

Positioning in Comex gold has seen speculative gross shorts unchanged for three weeks and longs are quick to take profit on rallies. Implied volatility in the options market remains near 12-month lows, but likely to spike when the awaited range-break occurs. The ANZ Physical Demand Barometer for China has reached a level in-line with the trough over the past 12 months, and could be in store for a rebound, but not while the Shanghai-London premium remains depressed. Meanwhile, the continuing tensions between Russia and Ukraine warrant monitoring, but the market reaction to new headlines is waning.

IN FOCUS – SILVER PRICES AND THE GOLD/SILVER RATIO

Silver prices have underperformed gold this year by almost 8.0ppts. But looking back over the past 14 years, silver's underperformance to gold from month-to-month is really nothing out of the ordinary. However, the increase in the gold/silver ratio over the past three years, to a 4-year high of 67, may be a tentative sign that silver's fortunes will soon reverse.

KEY MARKET INDICATORS

We are now *neutral* on gold, from *slightly bearish* in our last Gold Market Report.

	BEARISH — BULLISH	COMMENTS
PHYSICAL DEMAND	○ ● ○	The ANZ Physical Demand Barometer declined in the first two weeks of May
LOCAL MARKETS	○ ● ○	Shanghai gold has improved but is likely to provide little support to global prices
MOMENTUM	● ○ ○	Technical risk of a retracement to USD1,277/oz which should trigger a slide to USD1,235/oz
MARKET SENTIMENT	○ ● ○	Positioning in gold shows that the market has little conviction on price direction
OVERALL	○ ○ ● ○ ○	

IN FOCUS

SILVER PRICES AND THE GOLD/SILVER RATIO: SIGNS OF CORRECTION

- **Silver has underperformed gold so far this year with price unchanged while gold has risen 7.8%**
- **The Gold/Silver ratio reached a four-year high of 67 in April, within the 90th percentile of prices over the past decade**
- **The ratio between gold and silver suggests the latter may be bottoming, and likely to outperform gold if the ratio corrects lower**

The price of spot gold was USD1,200/oz at the beginning of the year. Though having done little more than trade a broad USD1,270-1,320/oz range in recent weeks, gold has managed to hold gains of almost 8% year-to-date. Silver has not matched gold's performance, unchanged so far this year. This has raised the question of whether silver is undervalued relative to gold. But while this divergent price behaviour is not the norm, it is also not totally uncommon.

Considering the monthly performance of gold and silver prices since year 2000 (171 months), our analysis shows that 75% of the time, the two metals will trade in the same direction. Additionally, silver will typically exhibit higher volatility than gold (both rising by more and declining by more than gold). Months where gold has risen and silver has declined, account for 15% of the observations, and months where gold has declined and silver rose made up the other 10%.

In this light, silver's recent underperformance seems nothing out of the ordinary, as historically, the metals have moved in opposite directions 25% of the time.

FIGURE 1. GOLD AND SILVER PERFORMANCE

MONTH	GOLD (EOM)	CHANGE	SILVER (EOM)	CHANGE	RATIO
Dec 13	1,202	-	19.5	-	61.7
Jan 14	1,245	3.6%	19.2	-1.4%	64.9
Feb 14	1,326	6.6%	21.2	10.6%	62.5
Mar 14	1,284	-3.2%	19.8	-6.8%	65.0
Apr 14	1,291	0.6%	19.2	-2.9%	67.3
May 14 (to-date)	1,296	0.4%	19.5	0.0%	66.5
2014 (ytd)	**-**	**7.8%**	**-**	**0%**	-

Source: Bloomberg, ANZ Research

The magnitude by which silver has moved relative to gold this year is also within normal ranges.

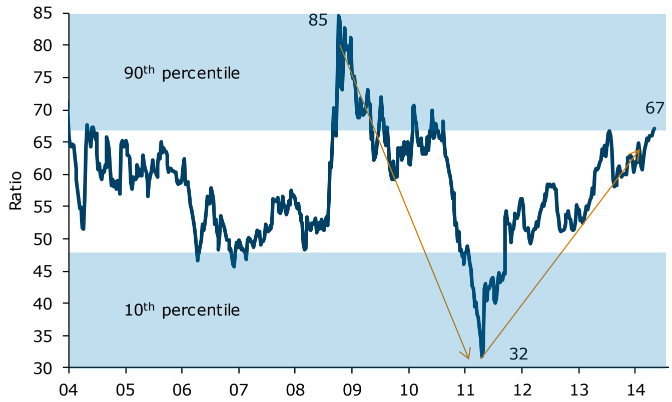
Silver underperformed gold in January, March and April by 5.0ppts, 3.6ppts and 3.5ppts respectively. This is in line with the average silver underperformance of the sample period of 4.5ppts (ie, in the months where silver underperforms gold, it will do so by an average of 4.5ppts). The same is true for the only month where silver has outperformed gold. In February, silver rose by 10.6%, beating gold's rise of 6.6% by 4.0ppts. This is also 'normal', with the data showing the average outperformance of silver is 5.33ppts.

In summary, silver's underperformance to gold in recent months is nothing out of the ordinary as the two metals will move in opposite directions 25% of the time. The magnitude of the notable underperformance of silver is also within historical norms.

THE RATIO SUGGESTS SILVER WILL REBOUND

But while silver's month-to-month performance this year relative to gold is normal (ie. it is not telling us anything new), silver's consistent underperformance for the past three years is notable. The price behaviour in the metals this year is a continuation of the general trend in place for the past three years. This has seen the ratio of gold to silver, a closely-watched relative value indicator, reach a four-year high of 67.2 in April from 61.7 at the beginning of the year.

FIGURE 2. GOLD AND SILVER PERFORMANCE



Source: Bloomberg, ANZ Research

Putting this into context, the gold/silver ratio is within the 90th percentile of the past 10 years and looking stretched by this measure. The ratio has retraced 68% of the decline from the 2008 peak of 85 to the 2011 low of 32. Both gold and silver prices have largely been in decline over this period, with the significant underperformance of silver being the reason for the rise in the ratio (silver down 60% from early-2011 compared to gold down 16%).

IN FOCUS

With the ratio nudging the top of the range that it has traded 90% of the time in the past decade; can we expect the ratio to reverse in the near future?

From Figure 2 above, it can be seen that month-to-month, the ratio declines about as often as it rises. Numerically, the ratio has risen in 90 of 171 months and declined in 81, a typical range-trading market. But with the ratio rising significantly since April 2011 (the ratio moved up in 23 of 37 months or 62% of the time), some "payback" is likely in the near future which should see the ratio correct lower.

With this in mind, the trading opportunity is to buy silver outright, as opposed to selling the gold/silver ratio (buy gold/sell silver) or buying gold outright.

Over the period we looked at, there is a very strong tendency for a decline in the gold/silver ratio to be associated with a rise in silver prices. Figure 3 below outlines the historical frequencies of the three scenarios that can result in a lower gold/silver ratio.

FIGURE 3. HISTORICAL FREQUENCIES GIVEN A DECLINE IN THE GOLD/SILVER RATIO

	GOLD MOVE	SILVER MOVE	% OF SAMPLE	AVG. % MOVE IN SILVER
1.	⇧	⇧ (by more than gold)	63%	11.2%
2.	⇩	⇩ (by less than gold)	16%	-1.7%
3.	⇩	⇧	21%	4.9%

Source: Bloomberg, ANZ Research

Perhaps surprisingly, a declining gold/silver ratio is not usually associated with a declining gold price.

Figure 3 shows that when the gold/silver ratio is declining, it is likely that both gold and silver prices are actually both rising (63% of the monthly observations), and silver is simply rising faster than gold. A decline in the ratio that is associated with a falling gold price only occurs 37% of the time.

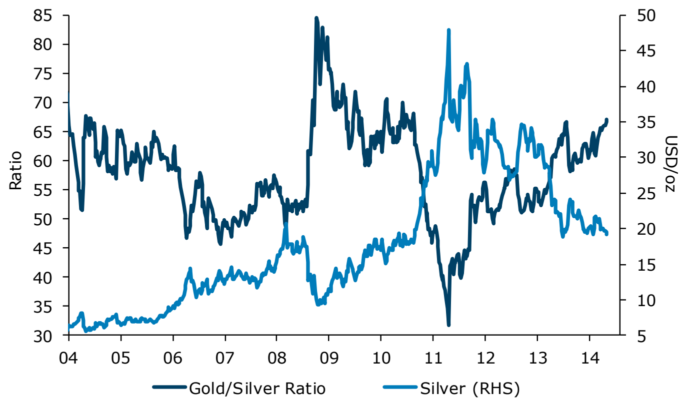
Another observation is that when the ratio is in decline, it is associated with a rising silver price 84% of the time (rows 1 and 3 in Figure 3 above), with respective average monthly silver returns of 11.2% and 4.9%. The gold/silver ratio actually tells us more about silver than it does about gold.

As the gold/silver ratio reaches levels which are starting to look stretched, it is worth monitoring this as an indicator for a bottom in silver prices.

Historically, the ratio has been a good indicator of turning points in silver, and a downward move in the ratio is overwhelmingly associated with a rise in silver prices. Given this strong tendency, we believe that positioning long in silver is the better risk/reward trade when the ratio becomes stretched, and could be signalling a turning point in silver prices.

On a technical basis, there remains the risk and bias that silver prices can move lower. The near-term bias is for a further slide in the silver price towards the 2012 low of USD18.30/oz, representing a 6% pullback from the current spot price (see Short Term Technical Perspective on page 6). This could suggest that the gold/silver ratio has room to move into further "stretched" territory before correcting to more-average levels over time and a potentially better buying opportunity awaits.

FIGURE 4. RATIO AND SILVER PRICE



Source: Bloomberg, ANZ Research

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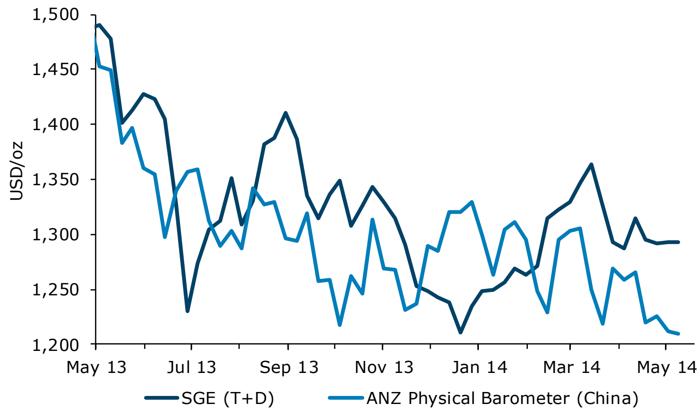
LOCAL MARKETS

PHYSICAL DEMAND

- The ANZ Physical Demand Barometer for China fell through the first two weeks of May and is back to the lowest levels of the past 12 months. This suggests onshore supplies of physical gold remain ample.
- It is likely to take a significant downward correction in prices to elicit a strong physical demand response from China. Gold imports (measured through Hong Kong trade) likely declined in April (after a 24% m/m fall in March), with indications that May will be another relatively soft month.

FIGURE 5. ANZ PHYSICAL DEMAND BAROMETER

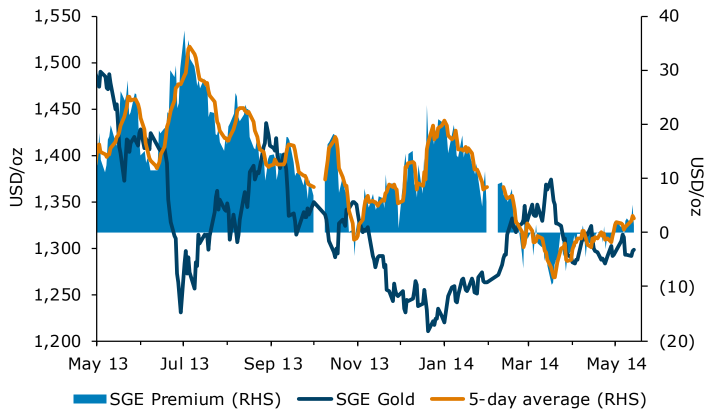


Source: ANZ Bullion, SGE, ANZ Research

CHINA

- The Shanghai Gold Exchange premium to London spot gold improved over the first half of May and has been trading in positive territory over the past week.
- Nevertheless, average Shanghai premiums of less than USD3.0/oz remain a far cry from the average USD10/oz premium in Q4 2013, but a clear improvement from the trough of -USD10/oz seen in March.
- While spot gold remains trading either side of USD1,300/oz, this indicator of Chinese demand remains very sensitive, flitting between discount and premium. The magnitude of either is currently unlikely to influence global prices.

FIGURE 6. CHINA GOLD PRICES

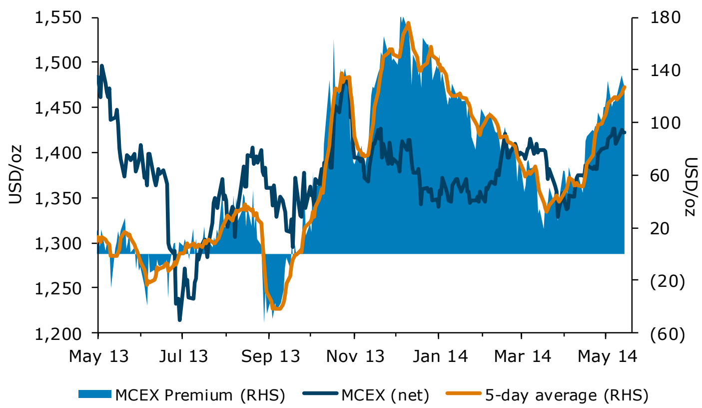


Source: SGE, Bloomberg, ANZ Research

INDIA

- Indian market premiums continued to rise rapidly through May after experiencing sharp gains in April. The domestic price reached a premium of USD130/oz over London spot gold at the beginning of this week, supported by strong gold buying for the Akshaya Tritiya religious festival.
- The month of May represents the peak in the wedding season (13 auspicious wedding days in May this year), and will continue to keep demand robust in the near term.
- Hopes for a relaxation in gold import curbs seem high after the BJP looks very likely to win the election.

FIGURE 7. INDIA GOLD (NET OF IMPORT TAX)



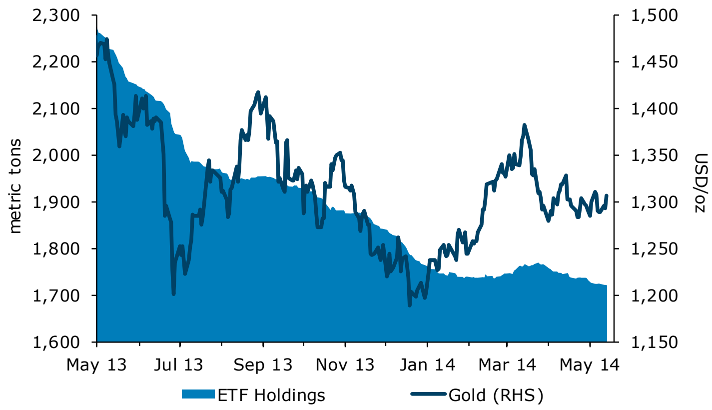
Source: CBEC, MCEX, Bloomberg, ANZ Research

FINANCIAL POSITIONING

EXCHANGE-TRADED FUND POSITIONING

- Global ETF holdings of physical gold declined by 11mt in the first two weeks of May, roughly the same pace of declines seen in April.
- Gold holdings fell to 1,721mt by the middle of the month after reaching 1,770mt in late-March, the highest level since December 2013.
- The largest physically-backed gold ETF, the SPDR Gold Trust, saw outflows of 8mt in the month, reaching 780mt on May 14, accounting for the bulk of the decline.

FIGURE 8. EXCHANGE-TRADED FUNDS



Source: Bloomberg, ANZ Research

COMEX POSITIONING

- In the week to Tuesday 6 May, the net speculative position in Comex gold stood at long 140k contracts, an increase of 16k contracts from the previous week. Despite this apparently increased interest, prices increased by little more than USD10/oz over the period.
- The increase in the net position was driven by higher levels of gross long positions while gross shorts were largely unchanged. Interestingly, shorts have been unchanged for the past three weeks, with shifts in the net position driven mostly by changes in the gross long position. This is keeping gold price gains limited.

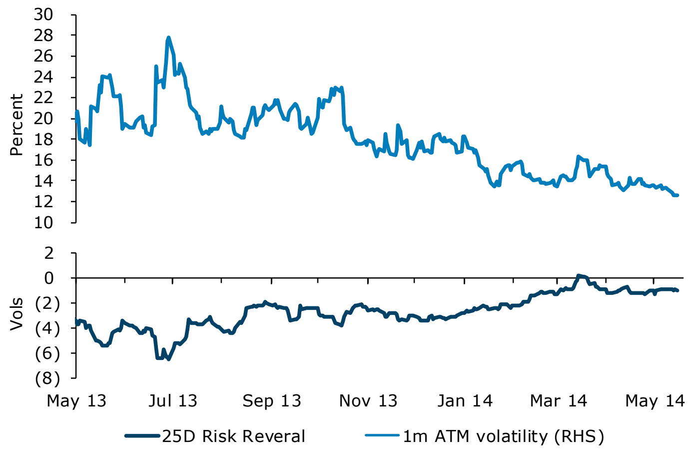
FIGURE 9. CFTC SPECULATIVE POSITION

Source: Comex, CFTC, ANZ Research

OPTION SKEW AND VOLATILITY

- The option market is a clear indication of investor attitudes towards gold at the moment.
- Implied volatility in 1 month ATM spot gold options declined further to near 12%, the lowest in over 12 months.
- The put skew remained stable and virtually unchanged since April, with a very slight bias to the downside. Volatility on a 25-delta put is priced 1ppt above an equivalent call.

FIGURE 10. OPTION MARKET SENTIMENT



Source: Bloomberg, ANZ Research

TECHNICALS AND CALENDAR

SHORT-TERM TECHNICAL PERSPECTIVE: SILVER BOUNCES ARE CORRECTIVE, TREND STILL DOWN

RESISTANCE
22.00/oz
20.63-65/oz
20.20/oz
18.84-85/oz
18.22-23/oz
17.30/oz
SUPPORT

Source: Bloomberg, ANZ Research

- Rebounds off the retest of USD18.84-85/oz appear wholly corrective. Their inability to even test the low end of the USD20.20-65/oz interim retracement zone and declining resistance brings downside risk to the fore.
- Dips ought to remain above USD19.05/oz (ideally above USD19.40/oz) to allow for another attempt to test at least USD20.20/oz, but a close above USD20.65/oz is needed to suggest a turn in trend.
- Given the corrective style of near-term rebounds, silver remains at increasing risk of sliding through USD18.84/oz towards 2012's USD18.30/oz low, if not a deeper move to test USD17.30/oz.

UPCOMING MARKET EVENTS

MACRO	DATE	COUNTRY	PERIOD	PREVIOUS	MARKET
FOMC Minutes	21 May	US	May	-	-
Existing Home Sales	22 May	US	Apr	4.59m	4.67m
Initial Jobless Claims	22 May	US	May 17	-	-
Consumer Confidence Index	27 May	US	May	-	82.3
PRECIOUS METALS MARKET					
IMF Reserve Data	20 May onwards	-	-	-	-
Hong Kong Trade Data	27 May	HK	Apr	-	-
Switzerland Trade Data	27 May	CH	Apr	-	-
Dragon Boat	2 Jun	CN	-	-	-

FORECASTS

COMMODITY PRICE FORECASTS

COMMODITY	Unit	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	2013F	2014F	2015F	2016F	LT
PRECIOUS METALS													
Gold	USD/oz	1,206	1,284	1,350	1,400	1,450	1,470	1,480	1,206	1,450	1,500	1,500	1,450
Platinum	USD/oz	1,369	1,418	1,530	1,540	1,550	1,570	1,590	1,369	1,550	1,630	1,667	1,620
Palladium	USD/oz	716	776	845	850	870	849	837	716	870	819	817	800
Silver	USD/oz	19.5	19.8	21.4	22.4	23.4	23.9	24.7	19.5	23.4	25.0	25.0	24.0
BASE METALS													
Aluminium	USD/lb	0.80	0.79	0.80	0.82	0.83	0.88	0.90	0.80	0.83	0.92	0.98	1.00
Copper	USD/lb	3.35	3.02	3.13	3.22	3.27	3.30	3.35	3.35	3.27	3.35	3.10	2.80
Nickel	USD/lb	6.27	7.19	7.30	7.40	7.70	8.00	8.20	6.27	7.70	8.05	7.70	7.50
Zinc	USD/lb	0.93	0.89	0.90	0.94	0.96	0.99	1.00	0.93	0.96	1.02	1.02	1.00
Lead	USD/lb	0.99	0.93	0.94	0.96	0.98	1.00	1.01	0.99	0.98	1.02	1.02	1.00
ENERGY													
WTI NYMEX	USD/bbl	98	102	103	102	104	107	107	98	104	103	99	90
Dated Brent	USD/bbl	111	107	109	108	110	112	112	111	110	108	104	95
Uranium	USD/lb	36	36	36	38	40	43	46	36	40	48	52	70
BULKS													
Iron ore Spot (CIF China, fines)	USD/t	134	117	112	114	116	114	114	134	116	112	110	95
Coking coal - Premium hard	USD/t	152	143	120	125	135	140	145	152	135	150	152	160
Coking coal - Semi-soft	USD/t	106	104	92	96	106	111	116	106	106	120	119	125
Low Vol PCI coal	USD/t	120	116	100	104	113	117	122	120	113	125	124	130
Newc Thermal Coal (Spot)	USD/t	85	73	75	78	80	81	83	85	80	90	92	95

GOLD REFERENCE PRICES

REFERENCE PRICE	Unit	Close	Change		
			1 Wk	3 Mth	6 Mth
SPOT GOLD					
USD	USD/oz	1,296	0.5%	-1.7%	0.5%
AUD	AUD/oz	1,386	0.9%	-5.1%	0.6%
CNY	CNY/oz	8,078	0.6%	1.0%	2.8%
INR	INR/oz	77,154	-0.1%	-5.4%	-5.2%
CAD	CAD/oz	1,410	0.9%	-2.5%	4.6%
ZAR	ZAR/oz	13,497	1.3%	-5.8%	2.8%
EUR	EUR/oz	946	1.7%	-1.8%	-1.2%
GBP	GBP/oz	772	1.4%	-2.0%	-3.6%
JPY	JPY/oz	131,664	0.5%	-1.9%	1.8%
EXCHANGE MARKETS					
COMEX	USD/oz	1,294	0.5%	-1.9%	0.5%
SHFE - Shanghai	CNY/g	262	0.8%	2.9%	2.9%
SGE - Shanghai	CNY/g	261	0.7%	1.8%	3.1%
MCX - India	INR/10g	#N/A	#N/A	#N/A	#N/A
DGC - Dubai	USD/oz	1,296	0.5%	-1.8%	0.7%
TOCOM - Tokyo	JPY/g	4,255	0.7%	-0.4%	2.6%

REFERENCE PRICE	Unit	Close	Change		
			1 Wk	3 Mth	6 Mth
OTHER PRECIOUS METALS					
Platinum	USD/oz	1,466	2.0%	2.6%	1.7%
Palladium	USD/oz	812	1.0%	10.1%	10.8%
Silver	USD/oz	19.5	1.6%	-9.3%	-6.2%

	Unit	Close	1 Wk	3 Mth	6 Mth
RATIOS					
Gold/Silver ratio	times	66.5	67.2	61.3	62.0
Gold/Platinum ratio	times	0.88	0.90	0.92	0.90
Platinum/Palladium ratio	times	1.80	1.79	1.94	1.97
GOLD FORWARD RATES					
1 month	%	-0.046	-0.066	-0.050	0.057
2 month	%	-0.032	-0.046	-0.030	0.073
3 month	%	-0.018	-0.028	-0.010	0.093
6 month	%	0.028	0.014	0.036	0.117
12 months	%	0.072	0.064	0.118	0.153

close: 15 May 14

Note: Forecast prices are end of period. Historical data are actuals.
Source: Bloomberg, ANZ Research

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