

Commodities

Precious Metals

Gold market poised for a rally as US real rates head lower

The recent sell-off has left speculative long positions in gold oversold relative to US real interest rates, which we believe has set the stage for a rally to our 6-month gold price target of \$1,300/toz.

Gold prices have sold off on lower speculative positioning ...

After rallying to a record high in June, gold prices have declined on a sell-off in speculative futures positions and gold-ETF holdings. Although the sell-off in speculative positions might not be surprising given the rise to a record-high price and decreased concerns over European sovereign debt, it stands in sharp contrast to the movements in US real interest rates, which have fallen to near-decade lows.

... however significantly lower US real rates point to higher prices

Under our gold framework, COMEX gold market positioning tends to reflect US real interest rates, with low US rates driving a high level of net speculative length in gold futures. Consequently, the recent decline in gold net speculative length, even as 10-year US TIPS yields fall below 1.00%, suggests that the gold market is now oversold, and we expect increasing speculative long positions to carry gold prices back toward our 6-month COMEX gold price forecast of \$1,300/toz.

Renewed quantitative easing measures by the US Fed would be an effective catalyst to drive gold prices higher

We expect the current low real interest rate environment to continue as our US economics team recently lowered their US growth outlook for 2011, with the implication that the US Federal Reserve will likely keep short-term US interest rates low through 2011. This should provide further upside support to gold prices and raise the upside risk to our current gold price forecasts. In addition, our US economics team also expects that the US Federal Reserve will return to quantitative easing measures in late 2010 or early 2011. We believe that a return to quantitative easing could act as a strong catalyst to carry gold prices to higher levels.

David Greely

(212) 902-2850 david.greely@gs.com
Goldman Sachs & Co.

Damien Courvalin

(212) 902-3307 damien.courvalin@gs.com
Goldman Sachs & Co.

The Goldman Sachs Group, Inc. does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. For important disclosures, see the text preceding the disclosures or go to www.gs.com/research/hedge.html.

Hedging and trading recommendations

Hedging recommendations

Consumers: We expect gold prices to continue to rise from current levels as real interest rates are expected to remain low on a continuation of accommodative US monetary policy. Longer term, however, we continue to see considerable downside risk, should the US Federal Reserve tighten monetary policy earlier than expected. Consequently, we would recommend near-dated consumer hedges in gold, but more so in platinum where recovering global automobile demand will likely continue to put upward pressure on auto-catalyst demand and therefore on platinum and palladium prices.

Producers: While we expect gold prices to increase in 2010 and 2011, the rising risk of declining gold prices once the US Federal Reserve begins tightening monetary policy suggests this is a good time for gold producers to begin scaled up hedging of forward production, particularly for calendar 2012 and beyond.

Trading recommendations

Long Platinum: Buy October 2010 NYMEX Platinum (Current value at \$1,537.0/toz; first suggested at \$1,595.5/toz; \$367.6/toz gain including rolls).

We continue to expect that low real rates and the economic recovery will lend further support to platinum prices. First initiated in July 2009 (see our July 15, 2009, *Commodity Watch*), this trade has since been rolled with a combined gain of \$367.6/toz.

Current trading recommendations

Current trades	First recommended	Initial value	Current Value	Current profit/(loss) ¹
Long Platinum				
Buy October 2010 NYMEX Platinum	July 15, 2009 - <i>Commodity Watch</i> Rolled on June 20, 2010 from a Buy July 2010 NYMEX Platinum for a \$426.1/toz gain	\$1,595.5/toz	\$1,537.0/toz	\$367.6/toz
Long WTI				
Buy December 2010 NYMEX WTI	February 5, 2010 - <i>Commodity Watch</i>	\$77.75/bbl	\$81.96/bbl	\$4.21/bbl
Long Copper				
Buy December 2010 Copper	May 18, 2010 - <i>Metals</i>	\$6,508/mt	\$7,308/mt	\$800/mt

¹As of close on August 10, 2010. Inclusive of all previous rolling profits/losses.

Source: Goldman Sachs Global ECS Research.

Price actions, volatilities and forecasts

	Prices and monthly changes ¹			Volatilities (%) and monthly changes ²				Historical Prices						Price Forecasts ³		
	units	10 Aug	Change	Implied ²	Change	Realized ²	Change	4Q 08	1Q 09	2Q 09	3Q 09	4Q 09	1Q 10	3m	6m	12m
Energy																
WTI Crude Oil	\$/bbl	80.25	↑ 4.16	32.7	-2.34	25.2	-5.6	59.08	43.31	59.79	68.24	76.13	78.88	90.00	91.00	107.00
Brent Crude Oil	\$/bbl	79.60	↑ 4.18	32.0	-2.15	26.4	-0.8	57.49	45.72	59.90	68.87	75.54	77.37	88.50	88.50	105.50
RBOB Gasoline	\$/gal	2.09	↑ 0.02	34.7	-1.74	26.3	-3.0	1.34	1.25	1.71	1.86	1.94	2.11	2.20	2.24	2.73
USGC Heating Oil	\$/gal	2.09	↑ 0.12	32.4	-2.25	27.7	-5.2	1.78	1.28	1.51	1.73	1.94	2.01	2.40	2.46	2.74
NYMEX Nat. Gas	\$/mmBtu	4.30	↓ -0.11	51.2	-3.83	40.0	-8.6	6.40	4.47	3.81	3.44	4.93	4.99	4.75	5.00	5.25
UK NBP Nat. Gas	p/th	41.07	↓ -8.62	54.3	1.66	53.6	5.1	65.59	45.30	27.57	23.48	31.83	33.35	35.00	34.10	35.10
Industrial Metals⁴																
LME Aluminum	\$/mt	2170	↑ 166	30.1	-2.57	21.8	-4.8	1885	1401	1530	1836	2037	2199	2050	2160	2210
LME Copper	\$/mt	7300	↑ 540	35.9	-3.45	26.3	-7.1	3948	3494	4708	5856	6677	7274	7167	7925	8050
LME Nickel	\$/mt	22200	↑ 2700	45.9	-3.74	30.5	-13.6	11118	10625	13147	17576	17593	20163	21333	21667	20000
LME Zinc	\$/mt	2085	↑ 181	42.1	-2.59	35.4	-7.3	1219	1208	1509	1780	2241	2307	2033	2121	2225
Precious Metals																
London Gold	\$/troy oz	1196	↓ -14	18.5	-2.55	13.5	-4.0	796	910	923	962	1099	1110	1260	1300	1365
London Silver	\$/troy oz	18.1	↑ 0.2	29.1	-3.14	24.2	-7.6	10.2	12.6	13.8	14.7	17.6	16.9	21.0	21.7	22.8
Agriculture																
CBOT Wheat	cent/bu	695	↑ 171	33.8	5.49	61.7	28.9	547	548	564	485	522	496	650	650	650
CBOT Soybean	cent/bu	1036	↑ 11	23.1	-1.06	16.2	0.9	896	942	1128	1049	1002	955	975	950	950
CBOT Corn	cent/bu	394	↑ 18	30.5	1.70	34.0	-4.6	384	377	406	327	386	370	415	450	450
NYBOT Cotton	cent/lb	84	↑ 6	n/a	n/a	18.1	4.4	47	46	54	60	71	76	70	70	70
NYBOT Coffee	cent/lb	170	↑ 8	n/a	n/a	30.9	-12.1	112	113	124	125	139	134	140	140	140
NYBOT Cocoa	\$/mt	2906	↓ -57	n/a	n/a	36.4	10.3	2252	2553	2499	2867	3259	3070	3100	2700	2700
NYBOT Sugar	cent/lb	18.6	↑ 2.0	34.5	0.20	40.2	-8.6	11.6	12.7	14.7	20.6	23.6	24.4	15.0	15.0	12.0
CME Live Cattle	cent/lb	93.4	↑ 3.2	n/a	n/a	10.4	0.0	88.7	83.8	83.0	85.4	83.6	90.5	93.0	95.0	95.0
CME Lean Hog	cent/lb	81.7	↑ 1.7	n/a	n/a	24.2	-1.8	59.1	60.1	63.2	53.7	57.8	69.7	78.0	80.0	85.0

¹ Monthly change is difference of close on last business day and close a month ago.

² Monthly volatility change is difference of average volatility over the past month and that of the prior month (3-mo ATM implied volatility, 1-mo realized volatility).

³ Price forecasts refer to prompt contract price forecasts in 3-, 6-, and 12-months time.

⁴ Based on LME three month prices.

Source: Goldman Sachs Global ECS Research.

Gold market poised for a rally as US real rates head lower

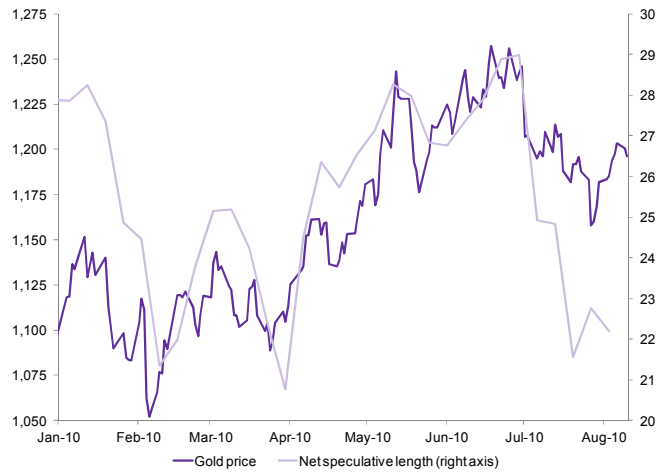
After rallying to a record high of \$1,257/toz on June 18, USD-denominated gold prices fell on the back of a sell-off in speculative futures positions and gold-ETF holdings. Although the sell-off in speculative positions might not be surprising given the rise to a record-high price and decreased concerns over European sovereign debt following the European bank stress tests, it stands in sharp contrast to the movements in US real interest rates, which have fallen to a decade low. As discussed in our June 17, 2010, *Precious Metals Update: Low US rates, high European debt send gold prices to record highs*, COMEX gold market positioning tends to reflect US real interest rates, with low US rates driving a high level of net speculative length in gold futures. Consequently, the recent decline in gold net speculative length, even as 10-year US TIPS yields fell below 1.00%, suggests that the gold market is now oversold, and we expect increasing speculative long positions to carry gold prices back toward our 6-month COMEX gold price forecast of \$1,300/toz. Further, our US economists recently lowered their US growth outlook for 2011, with the implication that the US Federal Reserve is more likely to keep short-term US interest rates low through 2011, providing further upside support to gold prices and raising upside risks to our current gold price forecasts. In addition, our US economics team also expects that the US Federal Reserve will return to quantitative easing measures in late 2010 or early 2011. We believe that a return to quantitative easing could act as a strong catalyst to carry gold prices to higher levels.

Gold prices decline from record high on the back of a sell-off in speculative futures positions and gold-ETF holdings

Gold prices rallied strongly in April-June on the sequential support from net speculative positions and gold-ETF purchases. However, since peaking at a record high of \$1,257/toz on June 18, COMEX gold prices have declined as both supports have waned with a decrease in ETF gold holdings, but more significantly, an unusually large unwind of speculative long positions to close to the lowest level of the year (Exhibits 1 and 2).

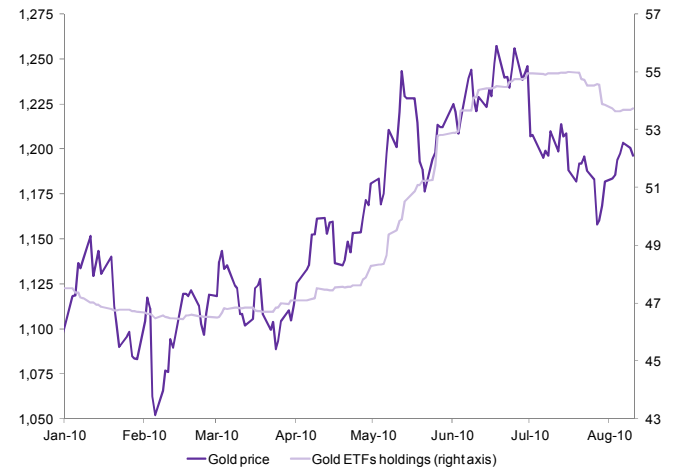
Specifically, ETF gold holdings declined from a high of 55.0 million toz as of mid July to 53.7 million toz currently. The decline in COMEX gold net speculative length, however, has been much larger, dropping from a high of 29.0 million toz at the end of June to 22.2 million toz currently. Our modeling framework for gold prices suggests that a 1 million toz decline in gold positioning, either through gold-ETFs or COMEX futures, translates into a 0.87% near-term decline in gold price (see our report *Commodities: Frameworks: Forecasting gold as a commodity*, March 25, 2009 for details). This implies that the liquidation of 7.4 million toz since prices peaked in mid-June would have lowered COMEX gold prices by 6.5%, to \$1,176/toz, which is consistent with the observed decline in prices to the current \$1,190/toz trading level.

Exhibit 1: The recent weakness in gold prices coincided with a sharp decline in net long speculative positions...
USD/toz (left axis); million toz (right axis)



Source: COMEX, CFTC, Goldman Sachs Global ECS Research.

Exhibit 2: ... while gold-ETFs holdings eased from the highs
USD/toz (left axis); million toz (right axis)



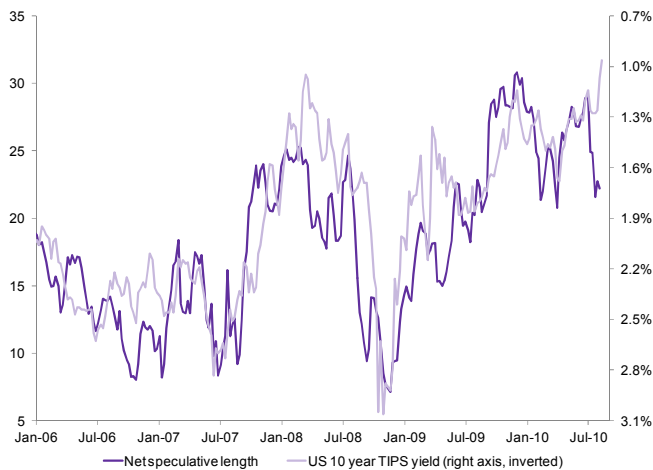
Source: COMEX and Various Gold-ETFs.

The selloff has left gold net speculative length quite low relative to US real interest rates, suggesting the gold market is oversold

While gold-ETF holdings continue to be fairly “sticky” near recent highs, as these investments appear to be more reflective of a longer-term allocation rather than short-term trade, the positioning in gold futures has been remarkably light given the sharp decline in US real rates. Specifically, our gold framework points to lower US real interest rates as the key driver to higher speculative positions in COMEX gold futures, which in turn support gold prices (see Exhibit 3). In the past two months, however, there has been a disconnect between the historically strong net speculative positions and US real rates relationship.

Specifically, net speculative length has declined 6.8 million toz to near year-to-date lows just as US real rates, as measured by the 10-year US TIPS, moved from 1.14% to 0.94%, a near decade low and below 1% for the first time since March 2008 (Exhibit 4). The recent real rate to net speculative positioning relationship would have in turn suggested that net spec positions should increase to 31.5 million toz. This would be a 9.3 million toz increase and would point to an 8.1% rally in gold prices, all else constant, taking current prices to new highs of \$1,293/toz, close to our \$1,300/toz 6-month price forecast.

Exhibit 3: Net speculative long positions have tracked real rates in the United States in recent years ...
million toz (left axis); % yield (right axis, inverted)



Source: US Federal Reserve Board (FRB), CFTC, Goldman Sachs Global ECS Research.

Exhibit 4: ... however positioning has recently diverged from what the recent real rate decline would suggest
million toz (left axis); % yield (right axis, inverted)



Source: FRB, CFTC, Goldman Sachs Global ECS Research.

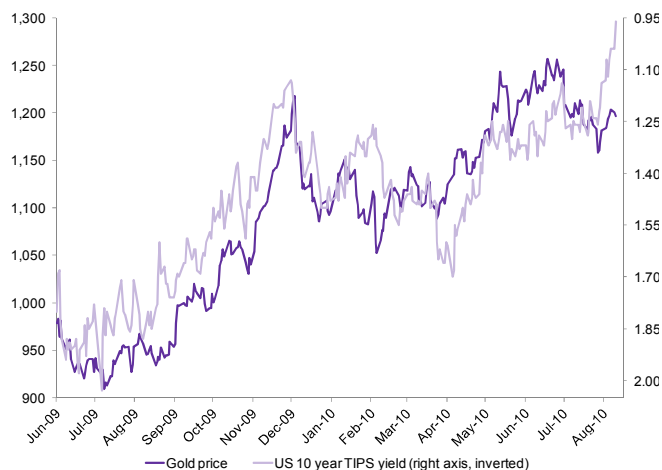
Our US economics team lowered its outlook for US economic growth in 2011, suggesting US real interest rates will stay lower for longer

We have based our outlook for gold prices on the expectation that US real rates would remain in a 1% to 1.5% range, however recent deterioration in the US economic outlook has carried 10-year TIPS yields to the low end of this range. Our US economist and fixed income strategist outlooks suggest that these levels are sustainable and we expect this to support COMEX gold net spec positions at significantly higher levels and in turn push USD-denominated gold prices significantly higher with upside risk to our gold price forecast as a result.

Specifically, the key driver of the recent sharp decline in US real rates has been the re-pricing lower of US growth expectations as the economic recovery has lost a considerable amount of its momentum in the past two months. Our US economists forecast a significant slowing in US growth in 2H10 that is now expected to extend in 2011 and lowered their 2011 US growth forecast to 1.9% from 2.5% last week (August 6), in large part on heightened congressional resistance to extending various measures of fiscal stimulus. The team also expects the Fed to resume quantitative easing, with the FOMC announcing a "baby step" in this direction yesterday (August 10) when it decided to reinvest principal repayments of agency and mortgage-backed securities. Finally US disinflation is now expected to continue, but at a slower pace than before. As a result of these forecast revisions, our fixed income analysts have lowered their US Treasury yield forecasts and now expect 10-year UST to reach 2.5% in 4Q vs. 3.25% previously.

These forecasts suggest that the current low US real rate environment will persist and in turn support gold price (see Exhibit 5). At current US TIPS yields of 1% and in the absence of net buying or selling from gold-ETFs and central banks, our gold framework points to gold prices reaching \$1,360/toz over the next six months, suggesting upside risk to our 6-month forecast of \$1,300/toz (Exhibit 6).

Exhibit 5: Lower real rates pushed gold prices higher but have outperformed recently
 USD/toz (left axis); % yield (right axis, inverted)



Source: COMEX, US Federal Reserve Board (FRB).

Exhibit 6: Our constructive view on gold has been predicated on our expectation for low US real rates
 Real interest rates are the key determinant of gold prices over the medium term under stable monetary demand

US 10 yr TIPS yield % per annum	Front-month gold price 2008 USD/toz
0.00	1780
0.50	1555
1.00	1358
1.50	1186
2.00	1036
2.50	905
3.00	790
3.50	690
4.00	603

Source: COMEX, FRB, and GS Global ECS Research.

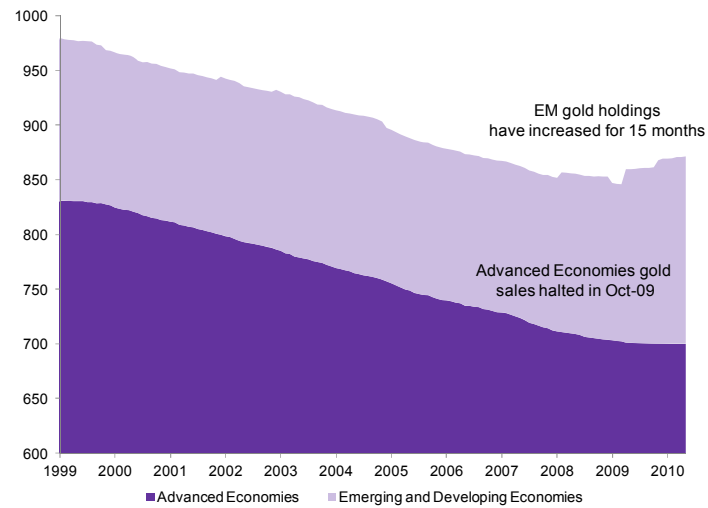
Our US economics team also expects renewed quantitative easing measures by the US Federal Reserve in late 2010/early 2011, which could serve as an effective catalyst to carry gold prices higher

Our US economists view yesterday’s FOMC statement as a "baby step" toward the renewed quantitative easing policy anticipated by late 2010/early 2011. The team expects the Fed to respond to renewed upward pressure on the unemployment rate with another round of unconventional monetary easing with measures involving more asset purchases and/or a more ironclad commitment to low short-term policy rates. We would view such an event as an effective catalyst to take gold prices higher from current levels to our 2011 average gold price forecast of \$1,350/toz.

Monetary and financial demand for gold continue to provide support to gold prices over the long-term

We expect the level of US real rates to be the primary driver of gold prices over the next 18 months, but fluctuations in monetary demand for gold, notably from gold-ETFs and government central banks will likely continue to exert considerable influence on prices.

Aggregate central bank gold holdings have continued to turnaround, increasing in each of the past 14 months, according to IMF data up to May (see Exhibit 7). Compared to the late 1990s when central banks broadly viewed gold as a low-yielding asset that was sold, putting downward pressure on gold prices, the more recent movement among central banks is to view gold reserves as a source of diversification in reserve holdings. Emerging and developing economies and in particular China, India and the Russian Federation have been the key drivers of this reversal via on- and off-market purchases while advanced economies have halted sales.

Exhibit 7: Gold reserve holdings have continued to increase, driven by EM purchases
 million toz


Source: IMF and Goldman Sachs Global ECS Research.

Given the recent softness in gold-ETF holdings and despite this continued central bank buying, we maintain our outlook for unchanged combined physical demand for gold for the rest of 2010. However, should either central bank or investor demand resume growing at the first half rate, we would expect gold prices to rise to \$1,375/toz by the end of 2010.

Finally, although the market initially took negatively the announcement that the Bank for International Settlements had engaged in gold swap transactions, we think the fact that physical gold is now being used as collateral in large financial transactions makes the news of the BIS gold swaps quite constructive for gold prices. This supports the trend that we have highlighted in the past of governments and central banks increasing the role of gold in reserve holdings.

Reg AC

We, David Greely and Damien Courvalin, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

Disclosures

Global product; distributing entities

The Global Investment Research Division of Goldman Sachs produces and distributes research products for clients of Goldman Sachs, and pursuant to certain contractual arrangements, on a global basis. Analysts based in Goldman Sachs offices around the world produce equity research on industries and companies, and research on macroeconomics, currencies, commodities and portfolio strategy. This research is disseminated in Australia by Goldman Sachs & Partners Australia Pty Ltd (ABN 21 006 797 897) on behalf of Goldman Sachs; in Canada by Goldman Sachs & Co. regarding Canadian equities and by Goldman Sachs & Co. (all other research); in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd.; in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs & Partners New Zealand Limited on behalf of Goldman Sachs; in Russia by OOO Goldman Sachs; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman Sachs & Co. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom and European Union.

European Union: Goldman Sachs International, authorized and regulated by the Financial Services Authority, has approved this research in connection with its distribution in the European Union and United Kingdom; Goldman Sachs & Co. oHG, regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, may also distribute research in Germany.

General disclosures

This research is for our clients only. Other than disclosures relating to Goldman Sachs, this research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgment.

Goldman Sachs conducts a global full-service, integrated investment banking, investment management, and brokerage business. We have investment banking and other business relationships with a substantial percentage of the companies covered by our Global Investment Research Division. Goldman Sachs & Co., the United States broker dealer, is a member of SIPC (<http://www.sipc.org>).

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, our proprietary trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

We and our affiliates, officers, directors, and employees, excluding equity and credit analysts, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives, if any, referred to in this research.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors. Investors should review current options disclosure documents which are available from Goldman Sachs sales representatives or at <http://www.theocc.com/publications/risks/riskchap1.jsp>. Transactions cost may be significant in option strategies calling for multiple purchase and sales of options such as spreads. Supporting documentation will be supplied upon request.

All research reports are disseminated and available to all clients simultaneously through electronic publication to our internal client websites. Not all research content is redistributed to our clients or available to third-party aggregators, nor is Goldman Sachs responsible for the redistribution of our research by third party aggregators. For all research available on a particular stock, please contact your sales representative or go to <http://360.gs.com>.

Disclosure information is also available at <http://www.gs.com/research/hedge.html> or from Research Compliance, 200 West Street, New York, NY 10282.

Copyright 2010 The Goldman Sachs Group, Inc.

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of The Goldman Sachs Group, Inc.