The SA Bullion Gold Report

Second Quarter 2009

Analyst: Hilton Davies
Email: Hilton.davies@sabullion.co.za

Performance Second Quarter 2009

	31 March 2009	30 June 2009	Change in %
Gold in USD/oz	916.50	935.50	2.1%
ZAR/USD rate	9.49	7.81	17.7%
Gold in ZAR/oz	8,695.29	7,305.13	-16.0%

The key aspects we look to are gold fundamentals and sentiment, US Dollar direction and South African Rand direction. A composite picture of these aspects gives us a view on gold for the South African investor.

US Dollar Direction

In my *Investment Case for Gold*, published on 21 September 2007 and still featuring unchanged on our website, I wrote "The US government and the Federal Reserve will not protect the dollar. Safeguarding the currency would imply significantly raising interest rates and tax rates. Were such a course to be followed the US could anticipate a Japanese-style deflation. America's unspoken mantra must be "inflate or die". We're in the early stage of witnessing precisely this monetary inflation process. The US budget deficit is anticipated to reach a staggering 13.6% of GDP this year due to the Obama stimulus. Over the next five years the escalation of national debt will beggar belief. This while de-leveraging sees the economic might of the US fracture and contract. Currently the Bureau of Labour Statistics reports unemployment at 26-year highs of 9.5%. If statistical manipulations are reversed one finds that US unemployment is at levels around 17% and deteriorating.

The economic forces propelling the US economy ensure that reflation (monetary inflation) must continue unabated and at unprecedented rates. What I've said above indicates trouble for the US but the real story lies in the bond market. US debt raising presents real challenges and the bond market is starting to cuff government around the ears. The Fed thought that it would manipulate long term interest rates down to cheaper levels, only to be roughed-up while the bond market drove long term rates higher. This means that in the future the US government is going to be borrowing ever greater amounts from a reluctant private sector at higher and higher rates of interest.

The story above indicates that the future for the US dollar is not attractive. But the other major currencies are not sitting pretty either, and the G8 meeting at L'Aquila in Italy has confirmed that the big-8 countries will not compete with currency depreciation. This means they will go down together. Currency debasement is the story of the next 15 years.

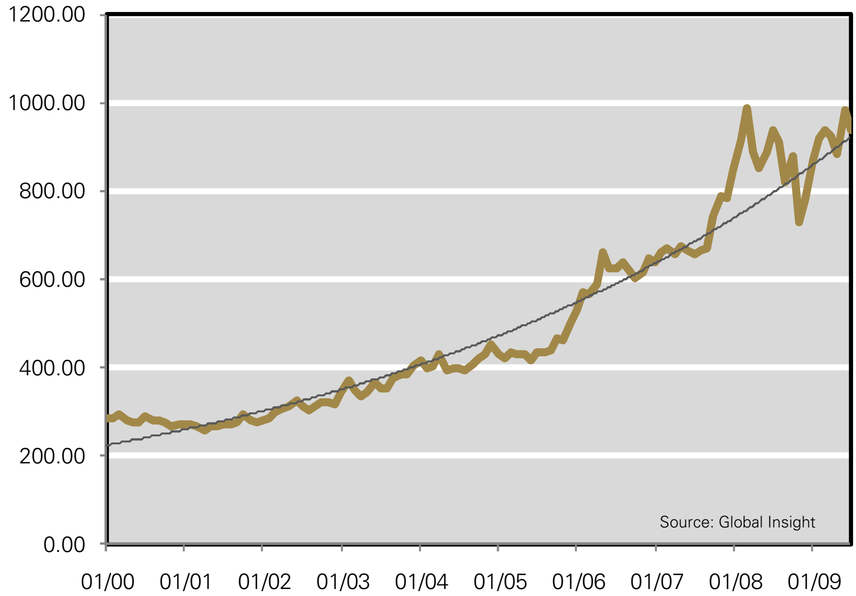
Gold Fundamentals and Sentiment

Gold in US Dollar has been treading water for the last 15 months and has recently entered the seasonal low period of July and August.

Of great interest is the action in the hugely important gold derivative market of the US. From the Commitment of Traders Report dated 6 July 2009 we see that bullish speculators are on the decline.

This represents, conversely to what you may expect, improving sentiment for gold. Speculative contracts are down by 25,000 since early-June. A few thousand more and one would think that the 15-month consolidation phase has been completed and that gold is ready for the next leg up.

Gold US Dollar per ounce



There are of course always risks and we would have to say that the physical jewellery offtake in Asia is likely to remain weak until September and more importantly, oil technicals look poor and a declining oil price could exert a drag on gold due to the inflation hedge investment attractions of the two.

It is commonplace these days to hear of the risks presented to gold by a deflation scenario. Furthermore, there is much ado about the likelihood of deflation taking hold. Our view is that firstly, disinflation in the US has been almost entirely due to the drop in oil prices from previous record highs and not because of more widespread factors, and second, that gold is a good inflation-hedge but an excellent deflation-hedge.

As a last point on this subject, while subtle, it is appropriate to view the key gold price driver as anticipated currency debasement, not inflation as measured by a single index.

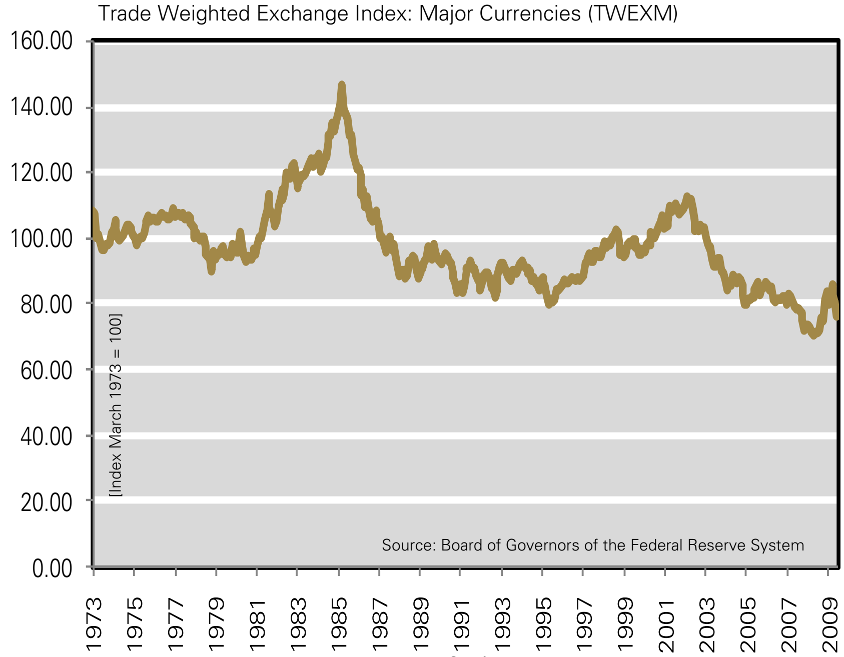
South African Rand Direction

Whilst the US Dollar has been in decline for most of this century, the current financial crisis and recession has caused a massive flight to safety for US capital – this means that as we predicted there was a synthetic short on the US Dollar and this translated into such great demand for the greenback that it strengthened dramatically.

The Rand weakened in comparison over the last year and a half and this translated into good Rand-returns for South African investors.

However, in the last three months the Rand has strengthened dramatically while the US Dollar has weakened. This has translated into significant currency-related losses for South African gold holders.

See diagram of the US Dollar Index since 1973



So where to for the Rand? The Rand strength has been on the back of regained Emerging Market risk appetite and positive sentiment for commodities and commodity producers. We would say that on a balance of probabilities the Rand-strengthening run is at or near its end and that we should expect our currency to be stable to weaker as the gloss on EMs, risk and commodities starts to tarnish.

Outlook

Our best-guess composite picture for gold is:

- A fairly stable range (+/- 5%) for July and August in US Dollar and South African Rand
- Attractive in last few months of 2009 in US Dollar and South African Rand
- In 2010 in a range from, at the least good, to potentially explosive, in all currencies
- Long term very appealing relative to any form of cash in the bank.