The SA Bullion Gold Report

Q3 2014

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Table 1: Gold Performance to 30 September 2014 (% per annum)[1]

	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in US Dollar	-7.5	-8.3	-17.2	-9.1	4.1	11.3
Gold in Rand	-1.7	1.7	3.2	1.7	12.8	17.7
Gold in Euro	0.2	-1.6	-16.3	-7.1	7.2	11.1

[1] Based on LBMA Afternoon Fixes
[2] not annualized for periods of less than 1 year

Table 2: Quarter-End Gold Prices and Exchange Rates[1]

	Gold in US$/oz	R/$ rate	Gold in R/oz	$/€ rate	Gold in €/oz
30 Sep 2004	415.65	6.47	2,691.33	1.24	335.12
30 Sep 2005	473.25	6.36	3,008.78	1.20	393.13
30 Sep 2006	599.25	7.77	4,655.06	1.27	473.15
30 Sep 2007	743.00	6.90	5,124.29	1.42	522.98
30 Sep 2008	884.50	8.28	7,324.23	1.42	624.03
30 Sep 2009	995.75	7.58	7,545.29	1.46	682.62
30 Sep 2010	1,307.00	6.97	9,115.41	1.36	958.35
30 Sep 2011	1,620.00	8.07	13,068.70	1.34	1,204.73
30 Sep 2012	1,776.00	8.26	14,671.89	1.29	1,377.27
30 Sep 2013	1,326.50	10.19	13,519.96	1.35	980.41
30 Sep 2014	1,216.50	11.30	13,749.86	1.26	964.40

Note 1: Gold prices in US$ and € are LBMA Afternoon Fix prices
Note 2: Gold price in Rand from Rand Refinery
Note 3: Gold prices at time of writing—$1,142.00, R12,708.74, €914.99

Table 3: Calendar Year Performance of Gold

	% US Dollar	% ZA Rand	% Euro
2004	4.6	-11.7	-2.9
2005	17.8	32.6	35.7
2006	23.2	37.0	10.2
2007	31.9	27.9	18.9
2008	4.3	41.1	9.7
2009	25.0	-0.4	21.1
2010	29.2	16.1	38.2
2011	8.9	33.0	12.6
2012	8.3	13.6	6.2
2013	-27.3	-11.8	-30.3
2014 year to date	1.0	11.0	10.4

Figure 1: Ten-Year Chart of Gold Price in US Dollar [LBMA PM Fix]

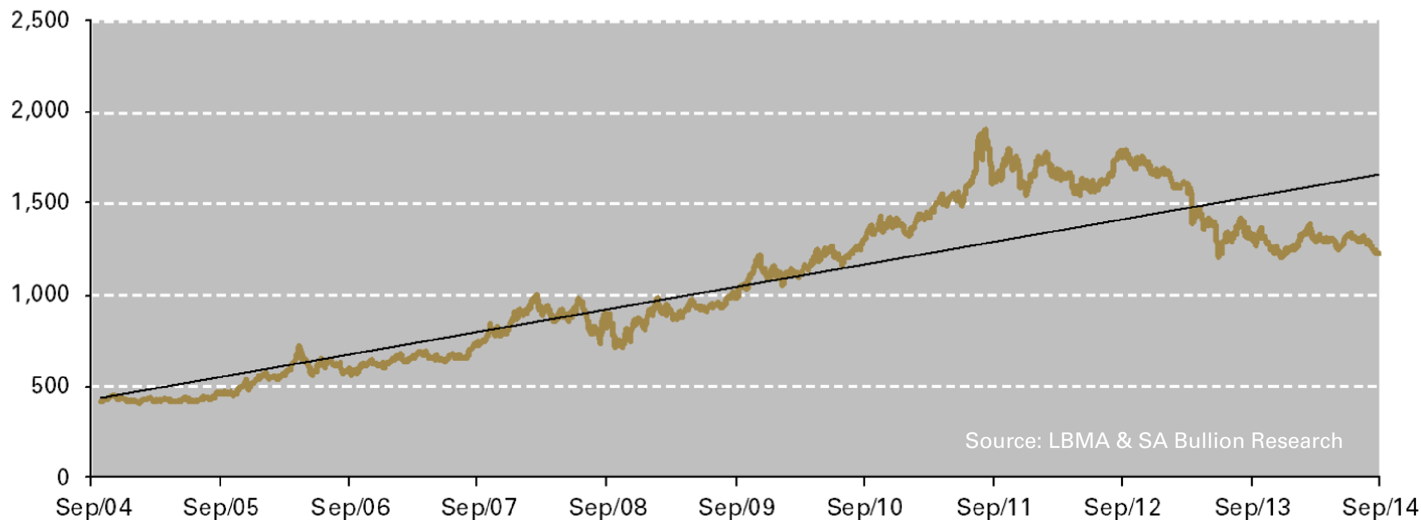
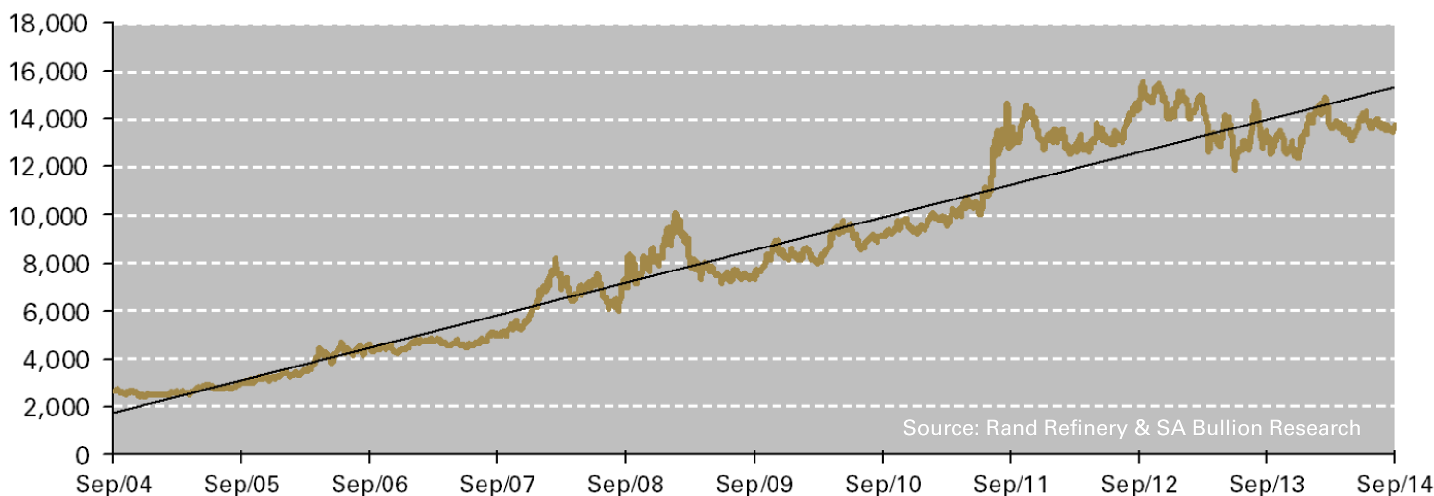


Figure 2: Ten-Year Chart of Gold Price in South African Rand (Rand Refinery first pricing)



Gold Price Action in the Third Quarter

In the third quarter gold in US Dollar declined by a whopping 7.5%. Almost all of the gains in the first half of 2014 were given back in the third quarter. I am sure that I don't have to tell you that gold has had a further slump following the quarter-end.

In this recent quarter the Euro declined 8.0% against the Dollar! This is illustrative of the big picture - what we have witnessed is not, in fact, a big retreat in the gold price but a big advance in the US Dollar.

Long term holders of gold will feel secure in their bullion investments as they have benefitted from decent annualized returns over the longer periods, such as between 11% and 17% per annum over the most recent 10 years (see tables above). On the other hand, short term holders are likely to be experiencing a little unhappiness, if their investment currency is Rand, to considerable misery if their investment currencies are Dollar or Euro. For these investors we offer our sympathies, but also some rational perspectives that should prove profitable in the years ahead.

Technical Perspective

A massive body of data of many different asset prices, and types of asset prices, reveals a common picture of price breakdown. Although by no means universal, it is common in finance to see a long term wave structure (of prices) that break down and retrace 50% of the previous long term price rise. We seem to be witnessing one of these "Fibonacci" retracements in gold prices following the big rise this century of $285 to $1895. A 50% (of price rise) retracement implies a target price of around $1100. This normally becomes the floor price following which prices rise again to new highs.

The obvious technical takeaways are that (1) we could easily see short term prices go lower, to reach $1100 (or thereabouts) and (2) we have reached the floor-zone from which we can expect the next big, long term, upward march.

Recent Past

In a nutshell, global prices and currencies are saying that the global economy is weak and going weaker, that China is cooling down, and that the US is fixed, or at least looking fairly good.

How do we come to the above world-view? - you may ask. Consider the following:

- Almost all commodity prices are in a bear market. Commodity prices are on the whole, at their lowest since 2008. The commodity index is down 16% since April alone. The commodity price action implies poor global demand, and not even China is keeping demand and prices up.
- The *bad times* for commodities is further reflected in the currencies of Emerging Market countries, and in particular in the currencies of commodity producing countries (such as South Africa, Australia and Russia). Commodity producers have seen their currencies tumble.
- A combination of a roaring stock market (driven by Quantitative Easing) and a well-fudged story of renewed economic prosperity caused the United States to become the *belle of the ball* and this has caused a mighty flow of capital to the US that has served to inflate the value of the Dollar. Virtually all other currencies and hard assets have been on the other end of the see saw – oil prices, EM currencies, the Euro, the Yen, copper, gold…..you name it.
- Gold has clearly reflected a strengthening Dollar with prospects of rising US interest rates and yet very low inflation (partly in thanks to low imported commodity prices).

The upshot of all this is that gold has seen a fall-off in physical demand and a lack of interest in its status as a safe haven asset.

Well-Fudged

The US Federal Reserve (the "Fed") has a number of weapons in its arsenal and it is no secret that the big guns have been deployed in the years since the 2008 financial crisis. The most apparent of the deployed weapons have been interest rate policy (where short term interest rates have been taken to effective zero rates), Operation Twist (where short term instruments have been sold cheaply and the cash redeployed into overpaying for long term instruments) and Quantitative Easing (which has been a combination attack to take long term interest rates to low levels and to take many vulnerable assets out of the financial system).

The US Treasury stood shoulder-to-shoulder with the Fed by providing massive fiscal stimulus through tax breaks, and between them the two agencies were able to goose the system.

The Fed must be wiping its collective brow these days. It is out of ammunition in that it runs serious risks if it were to continue with its asset purchase program of recent years. As for the Treasury, it will have to balance its books one day, and that means raising taxes or cutting expenditure or finding significant new creditors to fill the huge budget deficit.

The report card is mixed, but definitely weak overall. The most important measure, overall aggregate demand; is poor. The US consumer is highly indebted and tapped-out. Employment is poor, even if Unemployment says otherwise. The reason for this is that Unemployment is stated as the Unemployed as a proportion (percentage) of the Workforce. This means that the number the bureaucrats talk about is not the number of unemployed workers, but rather the percentage of unemployed workers *relative to the number of people in the workforce.* And guess what? The size of the workforce has been stated as smaller and smaller so as to reduce the unemployment PERCENTAGE! A case of – if you can't fix the numerator then fudge the denominator.

US new homes sales have been telling us for some time that consumers are not better off. Certainly stocks have been roaring upwards but the vast majority of Americans do not benefit from share price appreciation unless that filters through the Wealth Effect transmission system and translates into business investment and employment. But that has not happened.

Staying with military metaphors, the most important arrow in the Fed's quiver is none other than words – convincing words, words of persuasion and influence. The Fed has done well with words. The Fed has fudged, prevaricated and obfuscated so as to tell a good story and settle the nerves. The Fed has soothingly painted a picture of economic revival (via stock market inflation) and in so doing assisted the development of a massively over-extended stock market. This is rosy with a storm warning. Moreover the US economy is 70% consumer, and ultimately the health of the consumer as measured by final aggregate demand, is the real indicator. In this department the authorities have failed thus far, and the prognosis does not look good.

Looking Forward

US stocks (as addressed in the previous quarterly report) are looking very vulnerable and we expect a huge stock market retrenchment in the not too distant future. The US stock markets have been an incredible tornado sucking in much of the world's investment capital away from alternatives such as gold. This will change.

Gold has experienced a massive bear market and is at a level where many gold miners will go out of business if these prices persist. The technicals and apathy towards gold (a strong contrary indicator!) indicate that gold may still go down a little but that it is at, or close to, the turnaround point. Thereafter the economic fundamentals point to new all-time highs being reached.

The recent quantitative easing actions of the Japanese central bank and its European counterpart indicate the start of a new round of competitive currency devaluations. Currently these actions successfully weaken the Yen and the Euro relative to the Dollar but that pendulum will swing back.

Our Position

We advocate a portfolio position in physical gold. That has been our position since inception and we invite our readers to revisit our Investment Case for Gold which can be found on the SA Bullion website. In times of credit contraction (i.e. the bad times, or the times following a financial crisis), we advocate a policy of diversification. Such a policy is likely to result in some losing *bets* (as has been the case with an investment in gold in the last two years) but hopefully our clients will have a majority of winning *bets*. We are sure (as sure as one can be in the world of investments) that gold will be one of the winning *bets* again following this 50% retracement. And we are certain that a portfolio position in gold as part of a diversified policy for investment makes enormous sense.

Hilton Davies

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