



Capitulation

Gold prices have fallen roughly \$209 or 13.4% in the past two business days, from a settlement price of \$1,564.90 on 11 April to an intraday low of \$1,355.30 on 15 April. By the same measure silver prices have dropped \$4.77 or 17.2%. Platinum, palladium, and other commodities also have declined.

There are a variety of issues behind the declines in these commodities prices. One fact is that there has been some negative economic news out of China, the United States, and other countries and regions, which may have led to what CPM Group would consider an over-sized negative reaction, which contributed to the weakness in oil and base metals prices.

The big declines in gold, silver, and platinum group metals prices has been primarily caused by technically driven selling. There has been a combination of nervous longs liquidating positions and fresh short selling. This liquidation was prompted, to some extent, by recent U.S. unemployment, retail sales, and inflation figures all of which pointed to sustained weakness in future inflation. Several investors have been purchasing gold as a hedge against hyperinflation in the future. Surpluses in labor, real estate, and manufacturing capacity are unlikely to allow inflation to spiral out of control and these recent releases to some extent supported that thinking.

A lot of nervous longs were concerned that bad economic conditions had not devolved into the cataclysmic disaster they had anticipated for years, and were wondering if they should sell. They have been waiting for years for a collapse of the financial structures of Europe and the United States, encouraged by any number of gold marketing groups and internet bloggers who promised them \$2,000, \$3,000, or even \$10,000 gold in a river of hyperinflation. Hyperinflation has yet to appear even on the most distant horizon. Nor has the European Central Bank, the euro, the dollar, or any major bank failed over the past few years. The bad news on which they have based their dreams of ever-higher gold and silver prices has proven just as unrealistic as their price expectations.

Short sellers meanwhile already had grown bolder than they have been in a decade prior to the sell off starting last Friday. As of 26 March already the gross short position of non-commercial investors in Comex gold futures and op-

tions were larger than at any time since 1999, by a wide margin. Gross short positions in silver were far larger than at any time since 2005, when the silver price began to rise sharply. This is a sign that the selling interest already was well in place before the heavy selling of the past two days.

The same has been true with investors in physically backed exchange traded funds. Investors have been net sellers for several weeks having liquidated 8.02 million ounces or 10.2% of their holdings since the beginning of this year. Last week, investors liquidated 934,000 ounces between Monday and Thursday and then reduced their holdings by an additional 721,761 ounces on Friday 12 April.

When gold prices fell below \$1,530 on Friday it triggered a lot of stop loss orders. This triggered fresh short selling as well. These forces pushed gold below \$1,500, where more orders came into the market, pushing prices below \$1,480, etc. The price dropped as each wave of selling hit the market, like floors of a collapsing building pancaking on top of one after the other.

There are all sorts of mis-placed speculations as to what caused this: Goldman short selling, a single Merrill Lynch customer. It all came down to technically driven long liquidation and fresh short selling in a market where the longs had grown extremely nervous about staying long and the shorts had grown progressively bolder. In the end, it was primarily technically driven selling. There was some long liquidation as prices fell due to the increased needs for additional margin if one wanted to maintain one's long position.

At some point prices will stop falling and bargain hunting will appear. In our **Precious Metals Advisory** on 4 April we stated that prices could drop to \$1,430. Below that \$1,380 and then \$1,350 are the next significant support levels. At this point it is too early to say whether prices will hold above \$1,350 before the selling subsides and is replaced by equally technically driven bargain buying. This may well be the bottom.

Gold prices could also get some support from physical demand in India. The recent decline in gold prices coupled with a strengthening Indian rupee against the U.S. dollar and the upcoming wedding season could result in some



bargain buying. This buying could occur after prices stabilize or consolidate at these lower levels, however.

Base Metals

Weaker than expected Chinese GDP figures and technical selling also drove base metals prices sharply lower during the past two trading sessions. Tin prices suffered the greatest decline, falling 10.8% from their intraday high of \$22,986 on 12 April to a low of \$20,500 on 15 April. Copper also faced heavily selling pressure, falling nearly 7% from an intraday high of \$7,606.50 on 12 April to touch \$7,085 on 15 April. Prices of other LME-traded base metals slipped 4% - 5% over this period.

Prices in London have been falling at a swifter rate than in Shanghai, which has widened the arbitrage in copper, aluminum, and zinc. Chinese consumers tend to be price sensitive buyers. The downward trajectory in base metals prices in March and the first half of April has been spurring some bargain buying in China, keeping SHFE prices at a premium to the LME (on a VAT-adjusted basis). Current price levels are very attractive for Chinese importers, which could be the impetus for a rebound in prices.

The prices of several base metals, namely aluminum and nickel, have fallen below operating costs for marginal producers. Other markets like tin and lead are expected to record deficits on an annual basis, while the copper market could be much tighter following the supply disruption at Rio Tinto's Bingham Canyon mine late last week, which could offer fundamental support for a rebound.

Outlook

Gold could stabilize around \$1,350 and, if it does, recover to around \$1,450 in the short-term on bargain hunting once prices stop falling. Given seasonal weakness and investor caution toward gold prices might not rise much more than that on a rebound, and then they could stabilize above \$1,400 over the rest of the second and third quarters.

Silver prices could move a bit lower, toward \$21, \$20, or even slightly lower, in the next few days. However, silver may well stabilize above \$22. Prices could recover to around \$25, or possibly move a bit higher, toward \$26 - \$27.

Platinum prices have dropped to \$1,402 (basis July Nymex). They may find support around this level, and could rebound quickly reflecting investors' views that platinum and palladium are more industrial metals with currently healthy demand and on-going South African supply concerns. In light of this, platinum might be able to stage a more forceful and quicker recovery than gold and silver, possibly recovering to \$1,520 - \$1,560 on the short-term. While platinum could recover, prices will remain vulnerable to weakness in gold prices, and could slip lower with the remainder of the precious metals complex during the second and third quarter of the year.

Palladium prices could find support around \$650, close to present levels. Prices could rebound from this level toward \$720. Prices are expected to move sideways to lower over the summer months, potentially declining back toward present levels.

The broad correction throughout the industrial metals sector has opened up buying opportunities for base metals where momentum-based selling has over-stepped fundamental supports. While technical selling could push prices of some base metals, like nickel and zinc, lower over the next day or so, base metals prices may find support at current levels. Bargain buying from fabricators could trigger a wave of short-covering, taking back much of the losses over the past two days. Further upside might be fairly limited, however. Sober expectations about the current economic environment may keep a cap on prices once bargain buying subsides. If significant production losses are reported at Bingham Canyon, copper prices may be an exception, with supply-side concerns taking prices back above \$8,000. Currently Rio Tinto is accessing the damage from the 12 April land slide.