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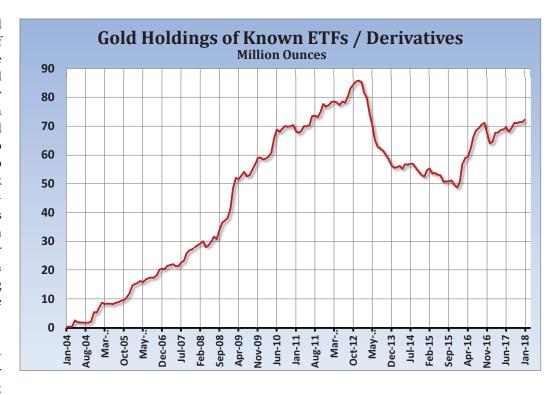
January 29, 2018

Metals Market Update Gold - A Bullish Stance on Classic Fundamentals

It was surprising to see the gold market rally last year in the face of a strong rally in US equities. The lack of safe haven interest in gold was more than countervailed by weakness in the US dollar, which made gold, which is denominated in the US currency, attractive to the world. But it also seemed to suggest that the US central bank would be very careful about raising interest rates. Price measures have continued to be lukewarm in early 2018, but it does appear that synchronized global growth stands a good chance of lifting classic physical demand for the metals complex.

Clearly a shift toward higher interest rates will be a limiting force for gold and silver in 2018, but we get

the sense that the central bankers are poised to err on the side of caution. It would also appear that investors have turn more positive toward gold with total gold derivative holdings in the first month of 2018 reaching their highest level since May 2013.



From another perspective, we see classic physical demand on the mend in 2018 but not at a level that is historically impressive. Changes in Indian gold practices and regulations over the past 18 months have restrained the upside action in gold. The Indian gov-

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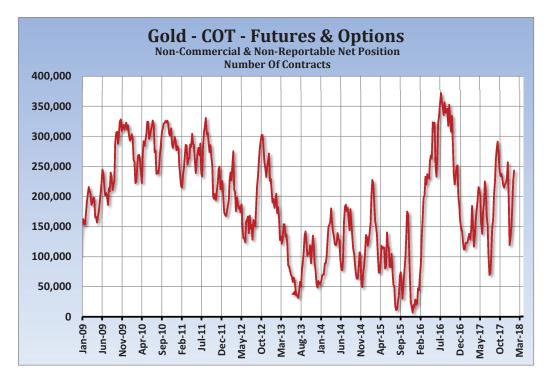
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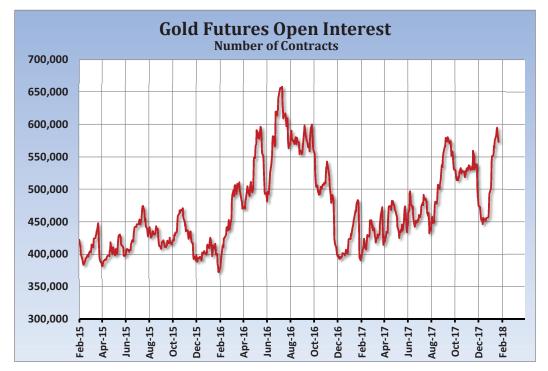
ernment implemented rules to discourage retail ownership of gold at the same time that they attempted to discourage gold imports. Not surprisingly, the reduction in Indian gold demand resulted lower global demand readings from the World Gold Council in 2017.

Chinese gold demand has become a much more significant influence in the market, with their demand for gold bars and coins expanding rapidly last year to reach their highest level since the 3rd quarter of 2013.

From a technical perspective the gold market ended the first month of 2018 with a spec and fund net long of roughly 242,000 contracts. But a look at the COT positioning chart suggests that the market doesn't become significant overbought until it reaches the vicinity of 320,000 contracts. On the other side of the coin, we would suggest that gold will become "mostly liquidated" within a bull market condition when a spec and fund position (including options) falls to 150,000 contracts net long.

The gold market appears to put in temporary peaks when open interest climbs above 570,000, while long entry opportunities could emerge when open interest falls to 527,000. However, in a true bull market it is also possible that open interest could continue to climb higher until sentiment becomes excessive. For reference, record territory for gold open interest is around 616,130 contracts.





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A certain amount of reflation/currency support combined with a return of investor interest should see nearby gold respect the \$1,300 level for at least a couple of quarters, with the market capable of grinding its way up to the September 2017 highs above \$1,365 and perhaps to the psychologically important \$1,400 level. Gold will out-distance our upside targets if significant turmoil is seen in current hotspots like Nigeria, Iran, Venezuela, or North Korea.

While it is difficult to predict the ultimate direction of the dollar in 2018, the trend remains down as of this writing, and the trade seems to think that rate hikes in the US will be slower than elsewhere. Others think that Washington political battling will leave the US dollar out of favor.

Suggested Trading Strategies

- 1) Buy June Gold at \$1,317 with an objective of \$1,389. Risk the trade to \$1,289.
- 2) Buy a June Gold \$1,325 call and sell a June gold \$1,385 call for a met cost of \$18.00. Use an objective of \$37.00 on the trade, and risk it to a loss of \$10.00.

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