THE HIGHTOWER REPORT
Futures Analysis & Forecasting
SPECIAL REPORT
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Metals Market Update
A Pause that Refreshes

We continue to think that gold and silver have forged very significant bottoms, but the recoveries of the last 2 ½ months are susceptible to corrective setbacks. Certainly the prospect of safe-haven buying from worsening trade relations remains on the market's radar, but bearish forces like another wave higher in the US dollar and a rising chorus of global slowing forecasts are likely to throw prices back toward the consolidation lows below $1200 in December Gold and to the $14.10 level in December Silver. The dollar appears to be widely accepted as the safest harbor against trade-generated headwinds, but it also appears to be catching notable buying as emerging market currencies lose favor. Renewed strength in the dollar relative to the Indian and Chinese currencies has rekindled fears of reduced demand from two largest global consumers of gold as their purchasing power erodes.

On a positive long-term note, total gold derivative holdings in October recovered to their highest levels since August, with an inflow of slightly less than 1 million ounces from the October low to the October high. By the end of October, holdings had reached 53.6

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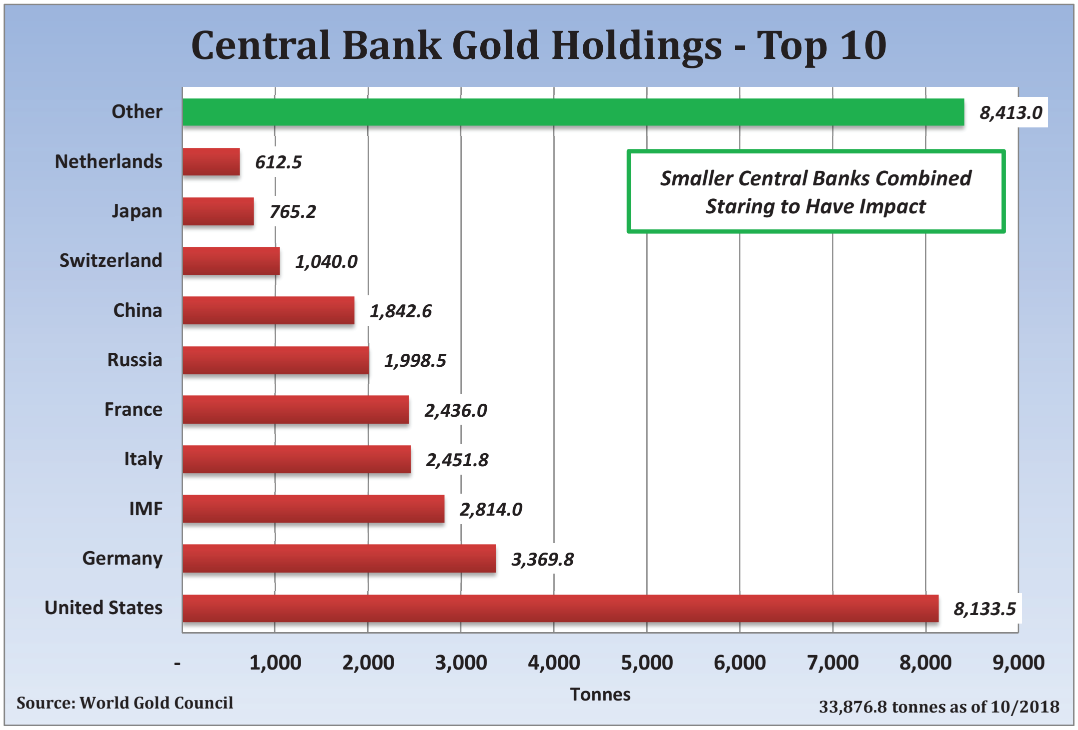


million ounces, but this was still well below the 2018 high of 58 million. The modest inflow of investment capital toward gold confirms our suspicion that prices have found a level of value at the same time that the allure of equities has been tarnished.

In contrast, silver derivative holdings have continued to fall from their 2018 high of 640 million ounces, slipping to 631 million ounces by the end of October. This action highlights silver's lack of sensitivity to the bottoming forces in gold. However there has been a long upward trend in silver holdings; they have effectively doubled in the last eight years. And while they currently sit some 20 million ounces below their record highs from last year, they have increased 10 million ounces since the end of September. This suggests that a recovery in silver futures could quickly prompt a new record for silver investment holdings.

Another issue that should continue to underpin prices is central bank gold holdings, as there are indications that these banks are stepping up their purchases. The IMF recently noted a resumption of purchases by banks that have either not historically held gold or have been out of the buying mode for some time. Poland's central bank recently made its biggest gold purchase since 1998. Russia has purchased 383.3 tonnes of gold since the beginning of 2017. Kazakhstan's bank was the third-largest buyer, adding 68.4 tons since early 2017. The troubles in Turkey have inspired the central bank there to step up its gold purchases. Turkish gold holdings as a percentage of total reserves have risen from 13.1% in the fourth quarter of 2016 to 23.1% in the second quarter of 2018 (the most recent data).

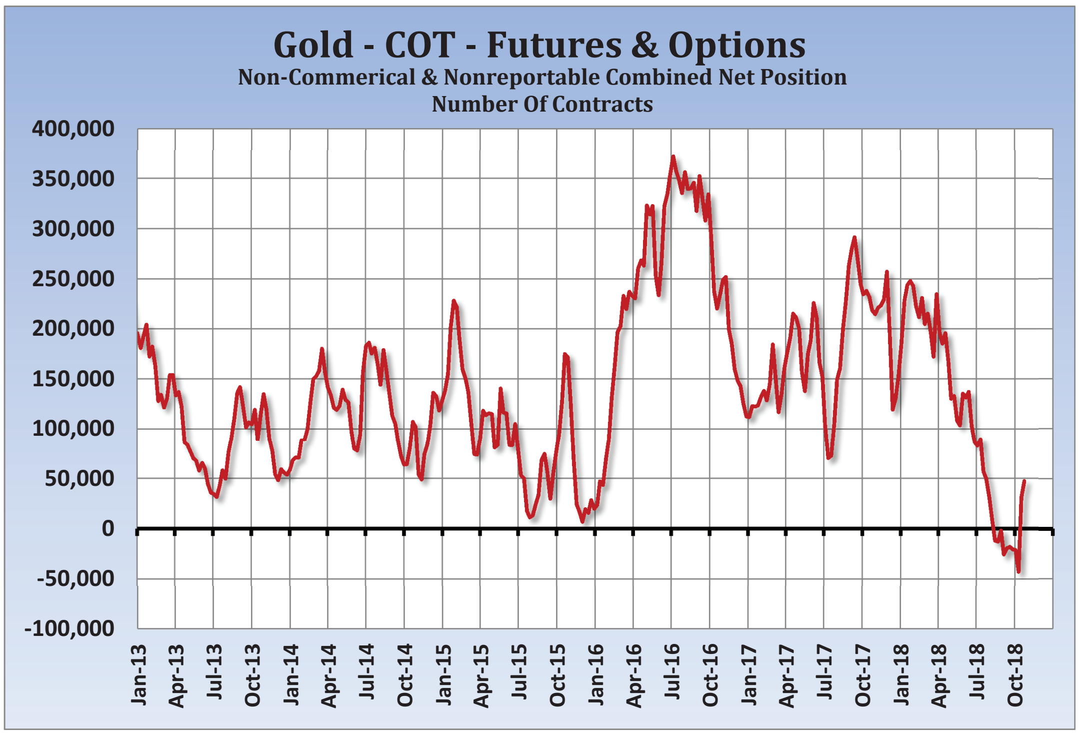
The World Gold Council and the International Monetary Fund report that as of July, central banks had added 193.3 tons of gold to their reserves since the beginning of 2017. We suspect that the fear of global slowing, of a potential financial crisis off unrelenting trade battles and the rapid deterioration in their own currencies against the dollar will result in a continuation of central bank buying into the end the year.

With another sharp escalation in US tariffs on Chinese imports being threatened, diversification among central bank holdings is likely to include gold. Russia has been by far the largest buyer of gold, as they are diversifying away from American investments. Apparently Russia has sold American bonds to purchase gold, and estimates now put Russia's gold holdings above 1,908 tonnes.

Technical Balancing to Offer a Fresh Long Opportunity

While the 2 ½ month, $79 rally in December Gold sent a signal that the 2018 downtrend had ended, that rally saw the spec and fund position go from a net short of 42,000 contracts to a net long of almost 50,000, indicating that the market had reached short-term overbought levels at the $1250 high. The October washout in the equity market did provide some safe haven buying, but the net result appeared to leave the gold market fearful of declining physical demand.

December Gold managed to climb above the 100-day moving average for the first time since April 25th, but then it violated that line with a return to the 14-day consolidation low. We doubt gold will fall back $1200, and we also doubt that the spec and fund positioning will go back to being net short, but a healthy correction could take it back to $1212.30. A similar target in December Silver is seen down at $14.255, but we think the decline could be less significant given its minimal net spec and fund long of only 12,000 contracts in the last week of October.



Short Term Strategy:

SELL December Gold on a bounce to $1,237. Use an objective of $1,212 on the trade, and risk it to a tight stop at $1,246.

Long-Term Trade Strategies:

1) BUY February Gold at $1,215. Use an objective of $1,250, and risk the trade to $1,194.60.

2) BUY 3 March Silver $15.50 calls for $0.20 and then SELL a March Silver futures at the market. Use an objective of $14.19 on the short futures, but plan to exit them and hold only the calls by mid-November. We see an ultimate objective of $0.50 for the $15.50 calls. Risk the combination to a net adversity of $0.24. The plan is to use break back near the 3rd quarter lows to finance a portion of the cost of the calls. As of this writing, the March calls had 118 days until expiration and the delta on the three calls was 0.84 of a futures contract.

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