THE HIGHTOWER REPORT

Futures Analysis & Forecasting

SPECIAL REPORT
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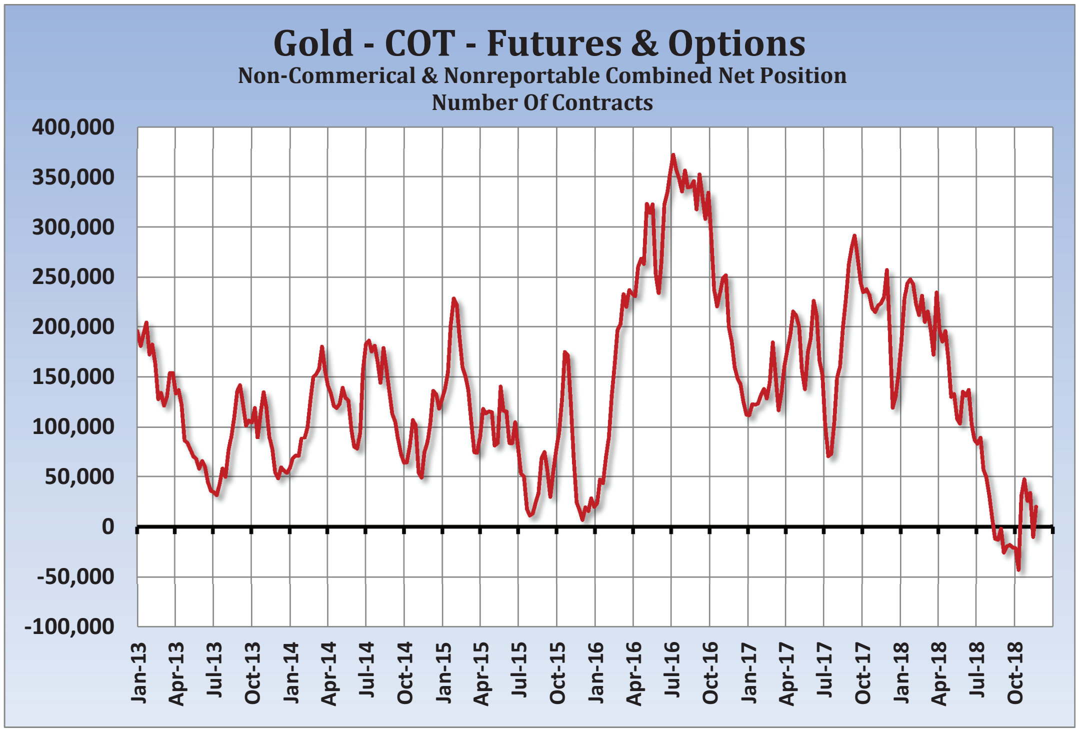
Metals Market Update
Long Gold - A Trade for All Seasons?



Signs of a key bottom in both gold and silver continue to surface, and prices are building impressive consolidation lows. If February Gold falls back below $1,200 and March Silver retreats to $14.00, it is likely that the large and small speculators in both markets will return to net short positions. Fundamental signs are turning up, and the markets appear to have found signs of buying from investors, traders, central banks and jewelers.

However, as we have indicated in a number of previous reports, a strong dollar continues to be the main impediment to sustained upside action in both markets. The gold market was pressured to the tune of $130 by the escalation of the tariff war in June. The trade dispute is thought to slowing the global economy, which will probably slow physical gold and silver demand. If there is a trade solution, we would look for February Gold to recover back to $1300 rather quickly, with March Silver seeing a flash return toward $15.75. But if the threat of 25% tariffs on an even wider range of items comes true, it could result in gold and silver falling to their lowest levels since September.

While we can't rule out a sudden return to a safe haven focus in gold, in the event that trade issues are not settled and the prospects of an escalation of US tariffs in January become prominent, many

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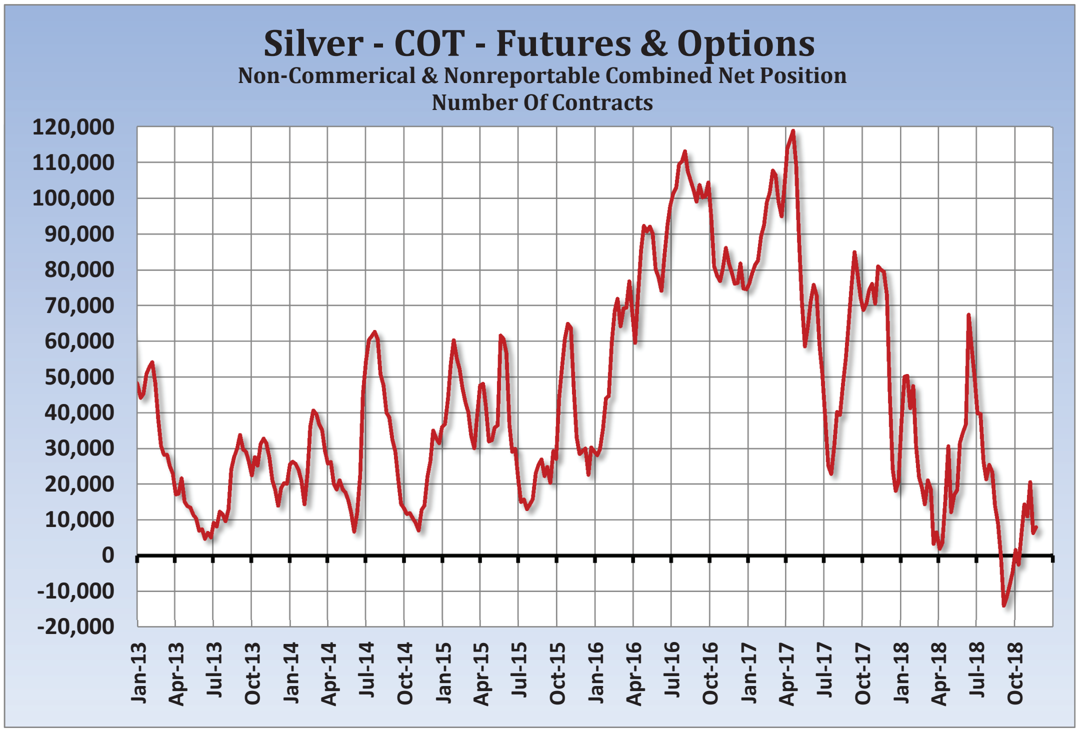


markets are likely to fall back under a fear of a return to deflationary conditions. We think that gold would garner a more sustainable bull trend from a risk on/better growth/weaker dollar environment than rally off safe-haven, panic and anxiety. We would view a rally off flight to quality as less sustainable and much more volatile.

The gold market's focus on classic, physical demand fundamentals seemed to be confirmed again by its sharp rally in the wake of the Federal Reserve Chairman's speech in the last week of November, in which he adopted a more dovish stance. We would also suggest that the gold has exhibited a classic demand focus with its generally positive correlation with global equity markets. Still, we think the single most important leading indicator for gold prices in December will be the direction of the US dollar, which could also be the most credible indicator of the trade situation.

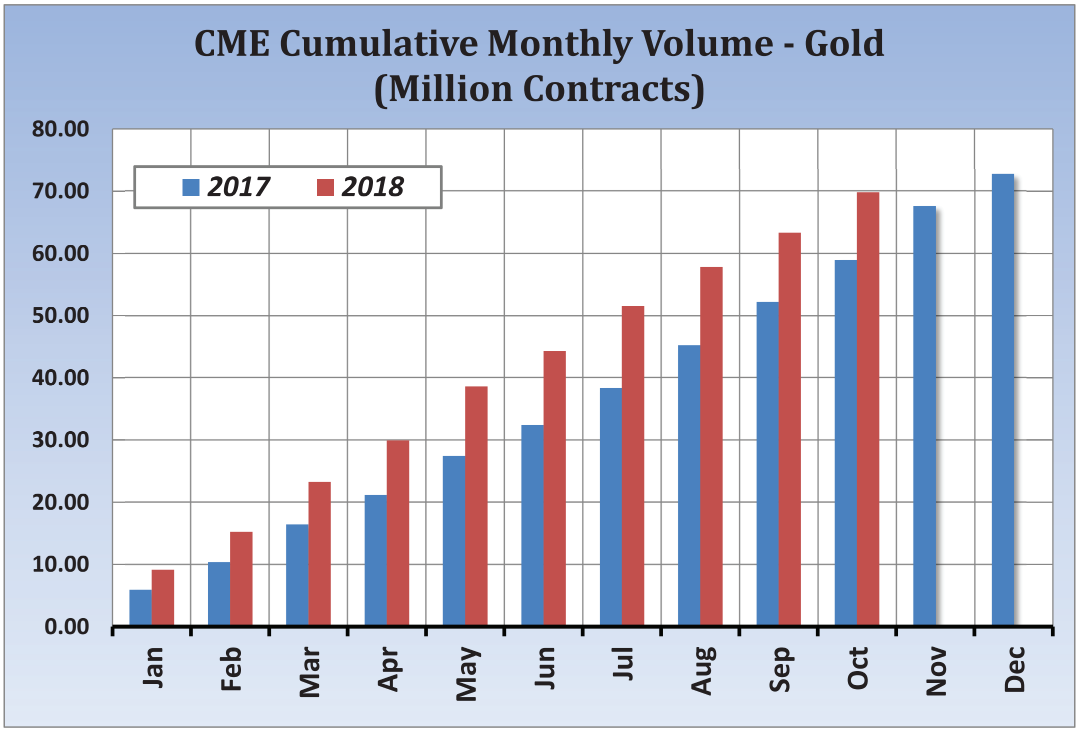
The IMF is projecting central bank gold purchases to increase. The gold trade is also being presented with capital inflows toward derivative instruments and bullish forecasts from large trading firms for 2019. As of October, the IMF showed capital inflows into gold from Europe and North America to be the strongest since May.

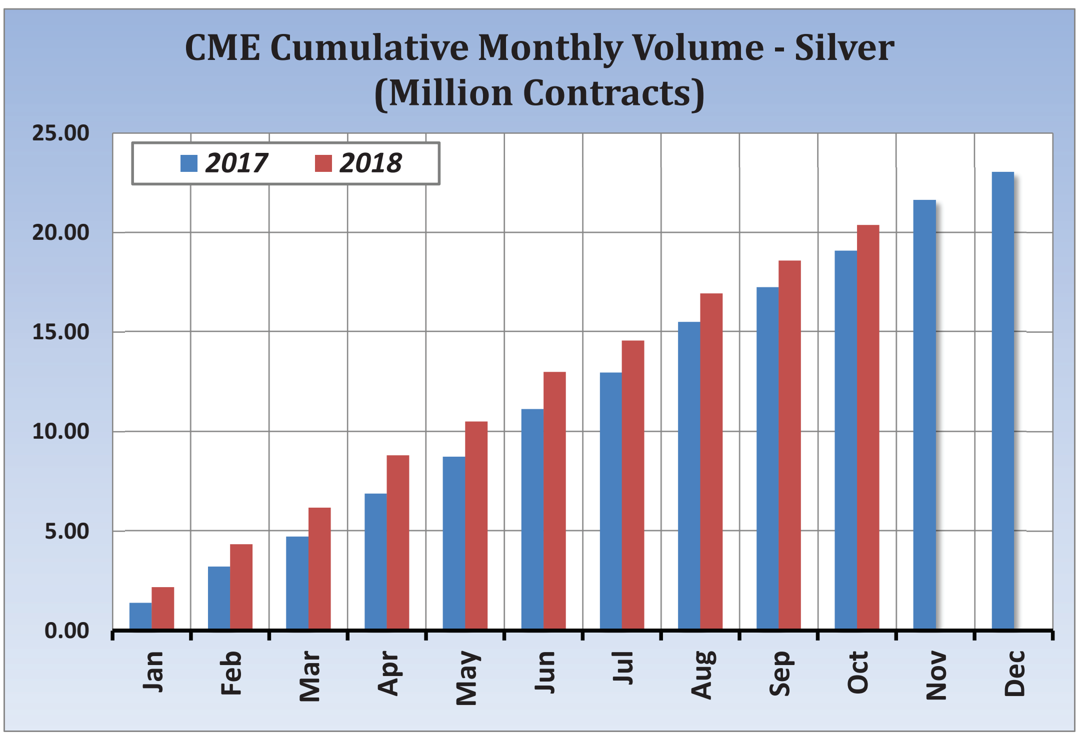
The Peoples Bank of China, China's central bank, may have already started to build its gold reserves as a cushion against the trade conflict with the US, but we also think they will continue to mask their efforts. Their ability to hide a buildup of gold reserves recently increased by the expansion in the number of ports capable of importing gold and by their purchases from non-typical sources. Several years ago the Peoples Bank of China announced their desire to become a global money center bank with the yuan becoming a "reserve" currency like the US dollar. As a way of accomplishing that goal, China seems to have embarked on a program to increase their Central Bank holdings from what was approximately 1,000 tonnes towards the 8,000-plus tonnes the US holds.

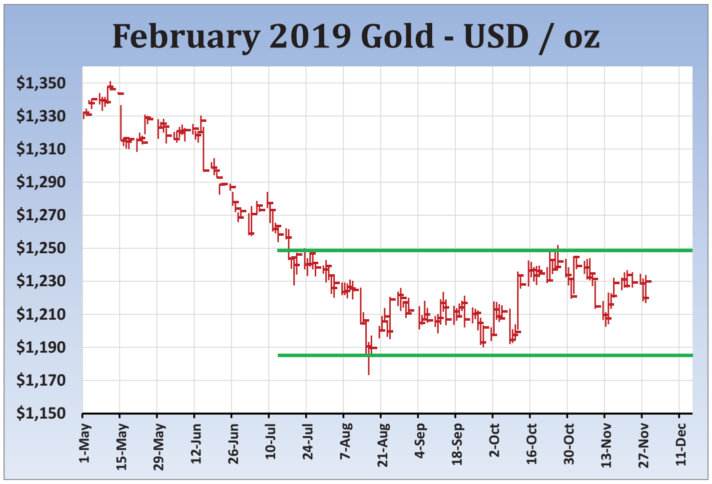
Asia showed significant inflows of gold ahead of the tariffs in May. If the trade situation starts to look like it is blowing up, there might be a temporary influx of flight to quality buying. The developing pattern of declining Chinese investment in US Treasuries could mean that Chinese "cash" would be funneled away from US instruments and toward gold, as an escalation in tariffs could be the straw that breaks the back of the global economy. In other words, we think that investors and traders inside China will flee equities and their own currency in the event "no deal" is found by the second week of December.

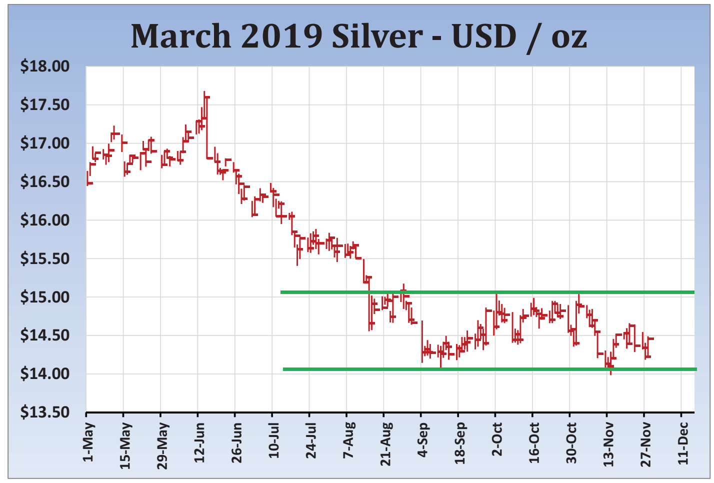
Gold and silver could continue to see capital inflows from small investors. As of the end of November, a single category of gold derivative holdings was showing a year- to-date influx of 419,793 ounces. Silver holdings showed a year to date inflow of 7.4 million ounces. Another measure of silver derivative holdings showed a gain of 131 million ounces since 2015. Gold derivative holdings have seen an influx of 14 million ounces since 2015. January-October 2018 trading volume in CME Gold futures was 69 million contracts above the same period in 2017, a gain of 18%. Volume in CME Silver futures was 20.3 million contracts over the same period in 2017, a 7% gain.

Technical Positioning Signals a Mostly "Sold-Out" Condition
We mentioned above that a return to $1,200 in February Gold and $14.00 in March Silver could put the non-commercial and non-reportable spec positioning back to neutral or even into net short, and for that reason we might not see any aggressive liquidation from a "no-deal" outcome to the US/China trade dispute. Both gold and silver have built significant support on their charts with five months of range-trading. We continue to view breaks to consolidation low support as a long term buying opportunities.









Short-Term Trade Strategies

1) BUY March Silver at $13.99. Use an objective of $15.01 on the trade, and risk it to a close below $13.80.

2) BUY December Gold at $1,211. Use an objective of $1,250 on the trade, and risk it to a close below $1,191.

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