THE HIGHTOWER REPORT

Futures Analysis & Forecasting

SPECIAL REPORT

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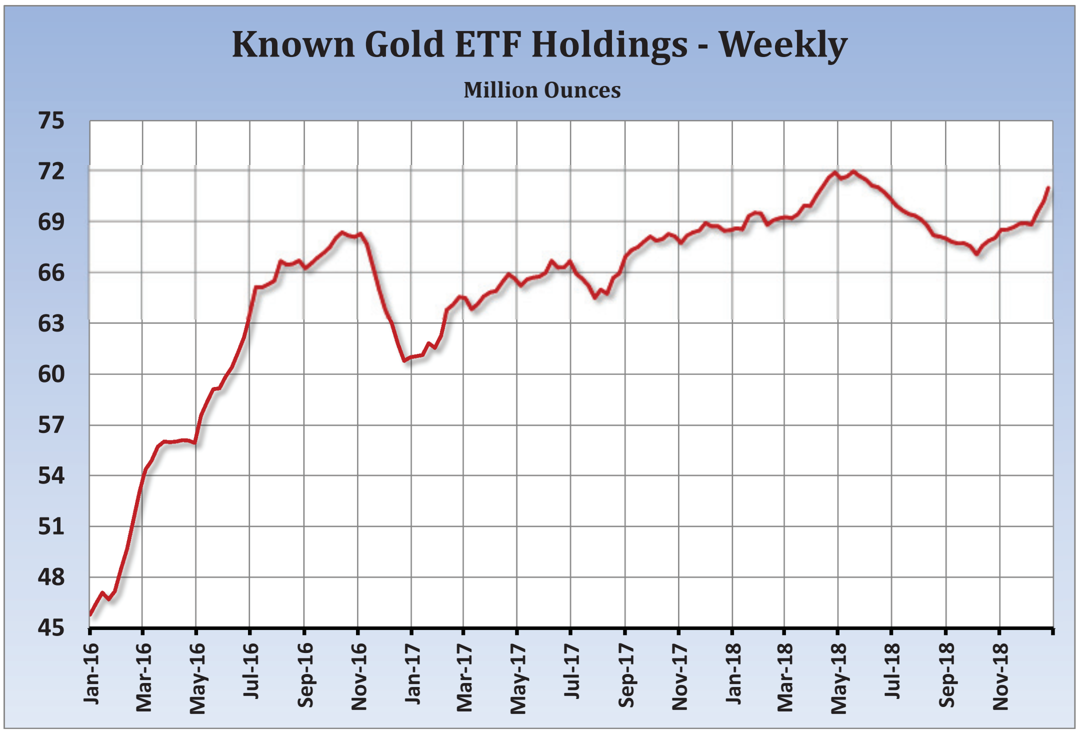
Metals Market Update

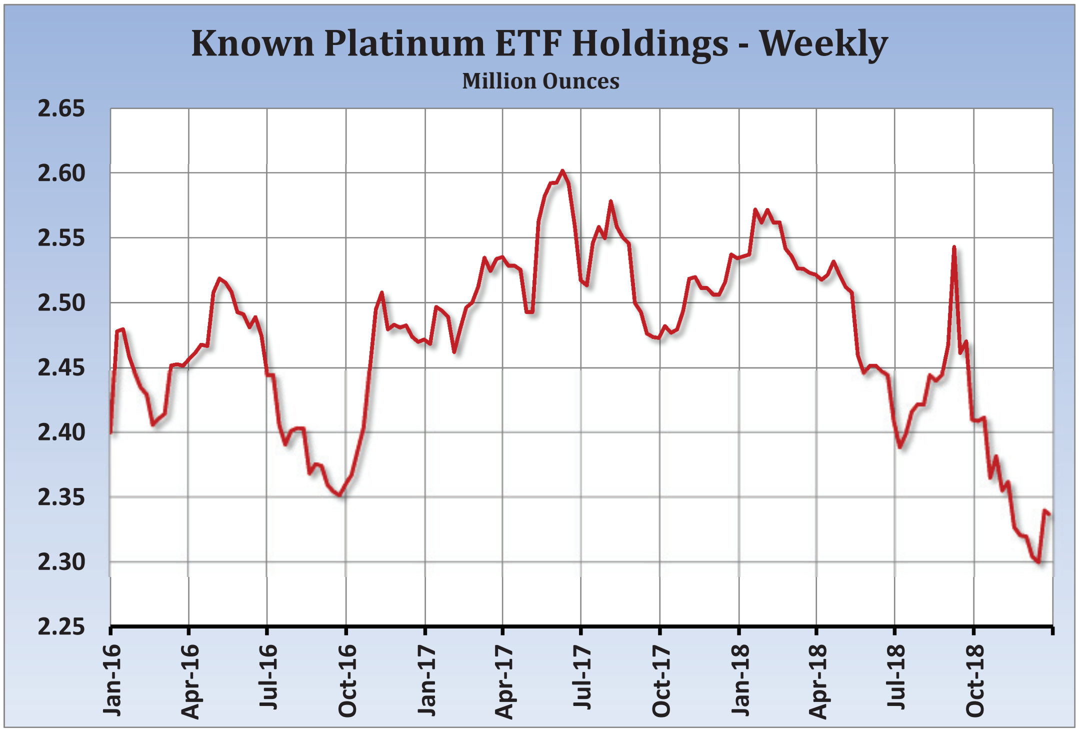
Signs Point to a Return of a Bullish Environment!

There appears to be a definitive change in psychology in the precious metals complex. In the past month gold, silver and palladium all managed to make strong gains concurrently, and we view that as a sign of broadening of bullish forces. While the markets still appear to be focused on safe-haven and currency-related action, the fourth quarter washout in equity prices has clearly stirred what appears to be a rotation of investment capital toward gold, silver and palladium, and perhaps more importantly, a return to classic, safe-haven conditions.



Historically, safe-haven interest in metals has started out as a typical rotation, but it can also transition into a flight-to-quality rush, which in turn brings about quick, aggressive price gains. However, with the long absence of investment interest in the metals and the globalization of all markets, a slight change in asset allocations could result in significant upside action.

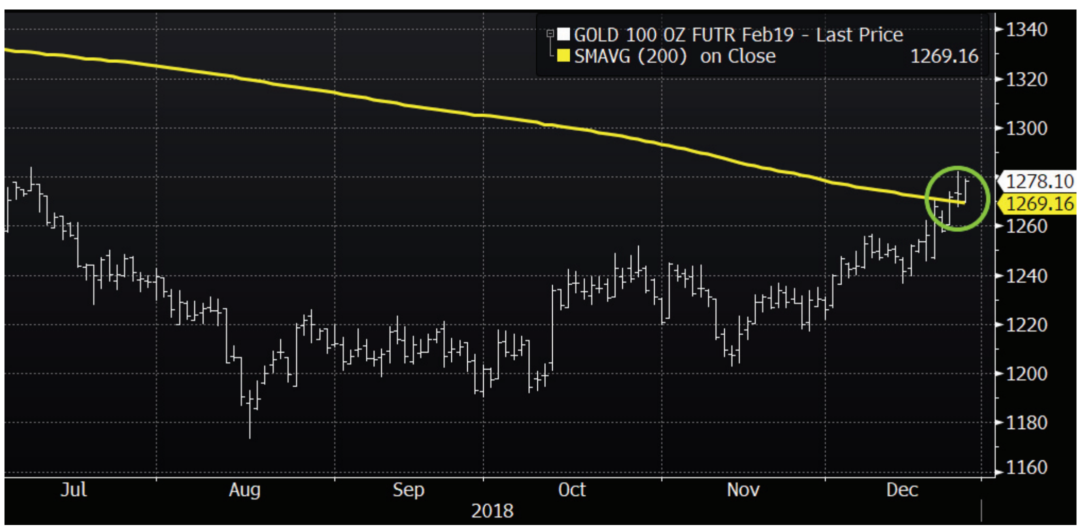
Evidence of improving investment demand for gold was seen from early October into the end of December, with total derivative holdings seeing an influx of nearly 3 million ounces, to stand at 55.5 million. Unfortunately for the silver bulls, total derivative holdings in silver have continued to erode, sitting at only 617 million ounces by the end of December, compared to the all-time record of 651 million from July 2017.



We expect the impressive gains in gold and silver prices into the end of 2018 to result in favorable annual fund rebalancing allocations. In December alone, February gold prices gained nearly 5%. They also managed an August through December rally of 9.5%. That should really get the attention of investors after seeing equity prices decline by 16.4% for the month of December!

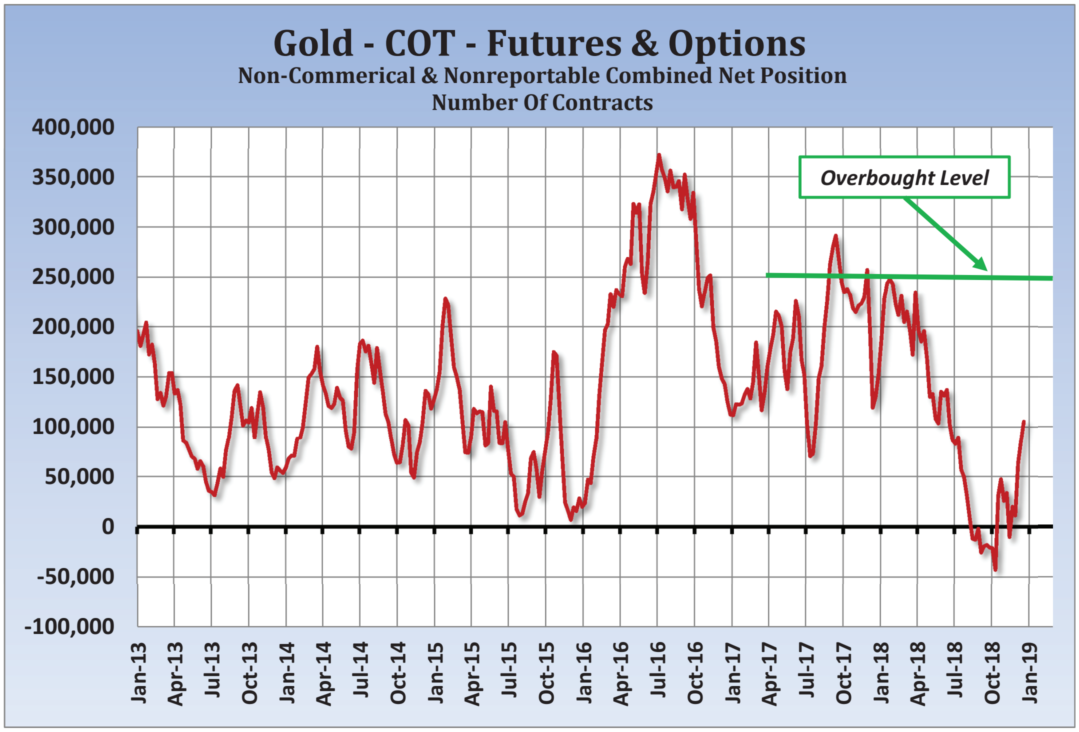
Obviously the markets have also benefited from the idea that the December US rate hike will end the Fed's current tightening cycle. With some economic projections calling for a recession in 2019, there are a number of analysts predicting the Fed may actually have to cut rates. So with the dollar gaining more than 7% from the mid-2018 lows off the idea of three further "dot plot" rate hikes in 2019, it is possible that the bullishness toward the dollar has peaked and that the precious metals could be slated for consistent support from the currency markets in the coming months.

FEBRUARY 2019 CME GOLD



With the gold trading in reverse lock step with the dollar for much of 2018, a downtrend in the dollar could result in gold quickly returning to the levels they were at before the US started putting tariffs on Chinese goods. Using straight line inverse, a return to the late-summer lows in the dollar could equate to gold prices trading up at $1325.

From a technical perspective, the gold market managed very impressive gains in December, directly in the face of adverse outside market action, which suggests a change in market mechanics has taken place. Certainly the gold market had been in an uptrend since the spike low below $1,175 in August, but the market's strength since mid-November has been due to a lack of alternatives, and that has given added credibility to the bullish case. A longer term bullish technical signal was also registered recently when the February gold contract climbed back above the 200-day moving average for the first time since the mid-May.



The December rally has begun to puff up the spec and fund net long positioning, but the gold market might not be considered overbought until the non-commercial and non-reportable combined net long position climbs back to 250,000 contracts. By the end of December, that position was roughly half of that level. The silver market showed a spec and fund net long of roughly 45,000 contracts. We don't consider that market overbought until the net long rises above 75,000.

Both technical and fundamental conditions appear to be changing in favor of the bull camp. For the first time in a long time, this change could be something sustainable and significant. In the weeks ahead the precious metals markets will be monitoring the action in the dollar for signs of a downtrend. The trade will also be watching for evidence of investment rotation toward metals, and that could see gold and silver prices extend the December rallies.

Short-Term Trade Strategies

1) **BUY** March Silver at $14.97. Use an objective of $15.99 on the trade, and risk it to a close below $14.70.

2) **BUY** February Gold at $1,247. Use an objective of $1,325 on the trade, and risk it to a close below $1,230.

3) **BUY** a May Silver $16.25 call and **SELL** a May Silver $17.25 call for a net cost of $0.20. Use an objective of $0.70 on the spread, and risk it to $0.08.

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