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GLOBAL BANKING AND MARKETS

ScotiaMocatta
Precious Metals 2015 Forecast
Gold

December 2014

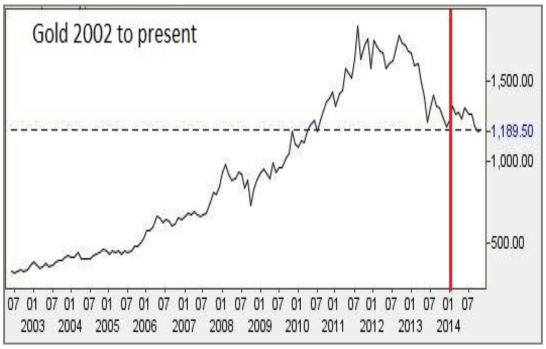
Executive Summary

The steep sell-off in Gold prices started in October 2012 and led to a low of $1,180/oz in June 2013; it then consolidated until October this year, before selling off again to $1,131.60/oz. The danger is that the 2013-2014 consolidation is a continuation pattern.

Sentiment in the Gold market is decidedly bearish as other markets offer better investment opportunities.

We expect lower prices to see physical demand recover; when that happens there is also likely to be a strong short-covering rally that leads to a higher sideways trading range either side of $1,250/oz in 2015.

Introduction



Gold started 2014 with a new lease of life as prices ended 2013 retesting the June 2013 low at $1,180/oz – as it happened, the low on 31st December was 1,182.50/oz. Prices closed that day at $1,205.30/oz and the rebound continued into the New Year and kept on going until peaking at $1,388.70/oz on 17th March. The extent of the rebound caught the market by surprise and seems to have been driven largely by fund activity with bargain hunting and short-covering driving prices higher until mid-March. Exchange Traded Fund (ETF) investors continued to cut their holdings until mid-February and only became tentative buyers for about five weeks, before turning net sellers again. Indian imports remained depressed by import restrictions and Chinese imports slowed dramatically into the price rise. After peaking in March, prices went on to oscillate sideways-to-lower during the second quarter - setting a low around $1,240/oz in early June, before rebounding to $1,345/oz in early July, after which they dropped back to retest the lows around $1,180/oz in October – the low being $1,183.20/oz on 6th October. So, with a triple bottom in place with the troughs seen in June 2013, December 2013 and October 2014, the market once again attempted a rebound but it ran out of steam at around $1,255/oz. Prices went on to slip to a low of $1,131.60/oz.

Gold has been affected by a number of headwinds in 2014. Firstly, investor interest in Gold has been subdued as a booming equity market has seen many indices set record highs has meant the opportunity cost of holding Gold has been high. Secondly, physical demand has been weak, notably in India and China. Thirdly, investors' confidence in the financial/monetary system seems to have been restored sufficiently, after much uncertainty in recent years, to the extent that investors are prepared to hold financial instruments with safe-haven attributes rather than Gold. In a nutshell, Gold has fallen out of favour, but we expect that to change.

The Big Picture

There has been a fairly synchronised phase since the financial crisis when global monetary policy has been extremely accommodative and major economies have been engaged in various forms of quantitative easing (QE). Up until 2013, this had been bullish for Gold, but the first talk that QE was likely to be reined in started to see money move out of Gold, because if QE was to end it suggested the Fed was confident that the economic outlook was improving. This, combined with a low interest rate environment, would provide a bullish climate for equities. We are now at the stage where QE in the US has ended and global monetary policy is likely to diverge, with tighter monetary policy in the US and UK, while it remains weak in Europe, Japan and China. With the focus on the US, the ending of QE and likelihood of firmer interest rates are a double negative for Gold, at least from a US investors' point of view. That said, the legacy of all the QE in the US, the continuing QE in Japan and the possibility of QE starting in Europe could still raise concerns about the value of paper money in other major economies that have a large pool of investor money.

In 2014, the spread in geopolitical tensions initially provided some support for Gold as concerns rose, but as a stalemate has descended on these areas of conflict and as the markets were not overly shaken by events, investors have become more complacent that tensions will not prompt a broad based market correction. Indeed, the fact that oil prices have fallen to around $75 a barrel highlights the lack of concern.

One of the fears about QE was that it would lead to inflation once growth returned and that would debase paper money, but this has so far not happened. In the US, where the recovery has been strongest, inflation remains below the Fed's two percent target. With inflation in China falling and with the European markets more concerned about deflation, it may be that concerns about global inflation were either ill-founded, or premature. That is not to say that inflation could not still become an issue down the road.

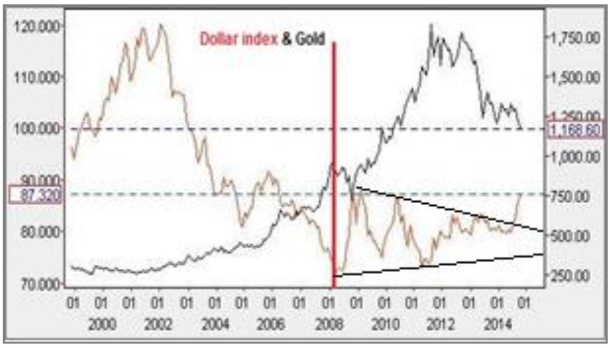
Governments' debts remains high and continuing budget deficits will see those grow; this could still undermine confidence in sovereign debt, but there is no sign of this being the case yet. Going forward we still see the legacy of the build-up of massive amounts of debt as potentially bullish for Gold. Creditors of this debt, mainly in Asia and the Middle East, are at some stage likely to want to swap out of debt that is denominated in fiat currencies.

For now, with equities still near record highs and with dips just attracting fresh buying, it looks as though the opportunity cost of holding Gold is going to remain high, but a correction could be around the corner and when that happens there may well be a case that Gold becomes a relatively cheap safe-haven compared with an already stronger dollar and high priced treasury markets. This is especially the case if a broad based market correction causes issues for governments whose financial armouries to tackle distress are empty.

While the need to monetise Gold seems to have waned as confidence in the financial system has recovered, it seems that the bullish case for Gold will rely more on physical demand for Gold and here we feel the upwardly mobile Chinese and Asian populations will become an important factor in consuming more retail Gold.

FACTORS DRIVING GOLD PRICES

The dollar



The dollar is climbing again with the dollar index recently breaking out of a large triangle formation on the chart. After a long drawn out period of dollar weakness between 2001 and 2008, which was followed by a sideways, rangebound market during the financial crisis, it now looks as though the dollar has embarked on an uptrend. The prospects of no more QE and tighter US monetary policy, while other countries keep monetary policy loose, are dollar supportive and it looks as though the market has been anticipating this in recent months.

For Gold the bull-run started in 2001, so there was a strong inverse correlation between a weaker dollar and a stronger Gold price; the low in the dollar index was seen during the financial crisis as shown by the vertical red line on the chart. After that point it seems as though other factors became the dominant drivers for Gold. Initially it benefited from safe-haven buying and portfolio diversification and then the potential for QE to debase currencies prompted more demand for Gold, which ran apace until the end of 2012, when there was the first signal from the Fed that QE might be reined in. This came from the FOMC Meeting Minutes that were made public on 3rd January 2013. In a way, we would say the weakness in Gold prices in 2013 was partially due to the market starting to discount the ending of QE; the fact it is doing so again now that QE has ended suggests the market may be overdoing it.

Interestingly, whereas the widely held view is that the Fed's programme of QE has weakened the dollar, in reality the dollar reached a low before QE started. This implies that all the money printing that the Fed has been doing since late 2008, which has seen its balance sheet rise from less than one trillion dollars to almost 4.5 trillion dollars, has not weakened the dollar. Perhaps because the Fed's action supported the US treasury market, treasuries were seen as the ultimate safe-haven and foreign buying of US bonds underpinned the dollar as a result. There could now be a delayed reaction.

Looking forward, if QE has in a roundabout way supported the dollar by making US treasuries a desirable safe-haven for foreign investors, then will an end of QE make treasuries less 'safe'? Not only will the Fed no longer be the biggest buyer of treasuries, but as monetary policy is set to tighten, then higher interest rates will no doubt see the price of treasuries fall. If that is the case there is a risk that foreign investors step to the side lines and that leads to less foreign demand for dollars. Given the fact that all the money printing and build-up of debt will have debased the value of the dollar (even if it has not shown up in the price of the dollar yet), we feel there is a danger that although the ending of QE signals a halting of the printing presses, the market may start to reflect the scale of currency debasement that has occurred. It is possible that if there is less need for safe-havens then foreign holders of treasuries may reduce their exposure to them before the dollar starts to reflect the debasement that has happened. At some stage it seems inevitable that reality will catch up with the US and that the economy will suffer a delayed reaction to the currency debasement and all the debt that has built up and this may well show up in a weaker dollar. So for now Gold may be suffering because the opportunity cost of holding Gold is high, as equities have been moving from record high to record high and the market feels less need for a safe-haven as the financial system is no longer seen as jittery. However, it may be too early to say Gold is no longer a useful hedge against financial turmoil.

Opportunity cost

QE has boosted liquidity and, over the years, that has flowed through various asset classes. Commodities benefited when investors wanted tangible assets because they were concerned about the stability of the financial system and its paper instruments, but as confidence in the financial system returned and commodity price had risen so high that it was causing a supply reaction, attention turned to equities. As the bull market unfolded and record highs were set, the opportunity cost of holding Gold increased, so some investors switched away from Gold. This largely remains the case as seen by the continued redemptions in Gold ETFs. At some stage, however, the opportunity cost of holding Gold is likely to be considered low again when compared to elevated equity and bond prices that could correct. In addition, should investors feel the need for a safe-haven again, they may see Gold as offering more potential to rally than an already strong dollar.

Inflation and Deflation

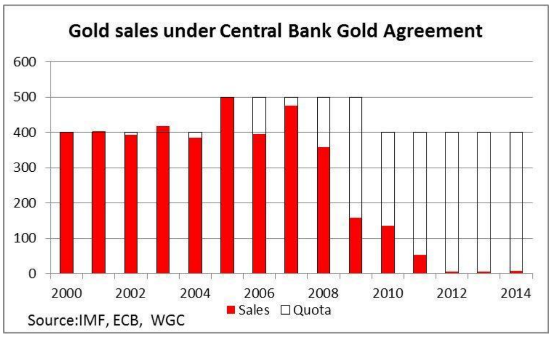
One of the fears about QE was that it will lead to inflation, but that has not been the case. The US has used QE to stave off deflation, but even with a generally healthy recovery there is no sign of inflation picking up. China has in recent years been trying to cool inflation and that has now been achieved by deflating its housing bubble, but in doing so it is now suffering slower growth. Less concern about inflation in China and other Asian countries may well be a negative for Gold, as households feel less need to buy Gold as a way to protect them from inflation. Japan’s QE has seen the economy switch from deflation to inflation and with Europe on the verge of deflation there is a good chance that the ECB goes down the road of QE too. So, for now, inflation does not seem an issue. If the ECB engages QE then we would expect that to be bullish for Gold, especially in Germany, where there is an ardent fear of money-printing dating back to the Weimar Republic and the hyper-inflation it experienced in the early 1920s. Generally, in deflationary periods you would expect government treasuries to do well as even a small yield is good in such an environment, but we would argue Gold would also do well. If faced with deflation, we would expect the governments to do more QE and in turn that would likely debase currencies further, whereas although Gold would not pay a yield, it would stand a good chance of holding its value against currencies that are being debased.

De-hedging / hedging

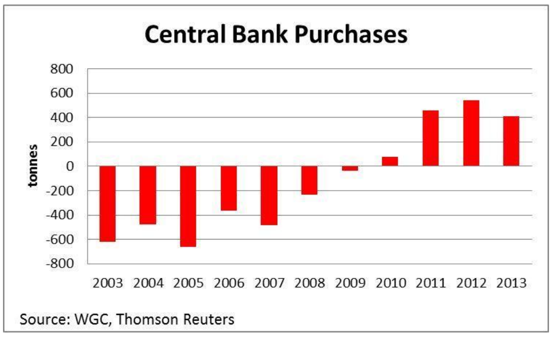
At the start of the bull market for Gold in late 2001, which roughly coincided with the start of de-hedging, the total hedge book stood at 3,107 tonnes (99.9Moz). At the end Q2’14, the hedge book stood at 129 tonnes, up from 77 tonnes at the end of 2013, according to the Thomson Reuters GFMS. In recent years, as the hedge book shrunk, the level of de-hedging slowed and as it did it meant less support for Gold prices. In 2014, the hedge book has increased by 52 tonnes, which means the market has switched from de-hedging back to a light hedging. As the switch has really come about on the action of one producer, it does not signal a broad base shift in producers’ attitude towards hedging, which still tends to be anti-hedging. Given the relentless fall in prices we are surprised producers have not been more active in hedging, but shareholders still tend to be against the idea.

Central Bank Official Activity

For many years, central banks were net sellers of Gold and in order to sell in an orderly manner and not to spook the market a Central Bank Gold Agreement (CBGA) was put into force to limit sales over



a five year period. The first CBGA started on 27th September 1999 and ran for five years; it allowed for 2,000 tonnes to be sold and all of it was sold. The second agreement (CBGA-II) allowed for 2,500 tonnes to be sold and during that period 1,884 tonnes was disposed of; CBGA-III allowed for 2,000 tonnes, but only 207 tonnes was sold and the bulk of that was from the IMF. Given how little of the quota was filled under CBGA-III, the market was surprised that a fourth CBGA was signed, but it was and is now in effect.



While sales under the CBGAs have dried up, other central banks have been buying. The financial crisis turned the trend in official sector activity from being a net seller to being a net buyer – see chart. Interestingly, the main buyers have been emerging markets, which suggests these countries have been swapping some of the proceeds of their trade surpluses out of international currencies and into Gold. More recently, geopolitical tension and unrest has also played a part in increasing central banks' buying of Gold. This has been seen in 2014, with Russia and Iraq both buying around 60 tonnes of Gold in the first half of the year and other CIS countries following suit with Kazakhstan buying 12 tonnes and Tajikistan buying three tonnes. Given the fact that the countries that have the major international currencies - dollar, euro and yen - are all swamped in debt, we may well see other creditor countries continue to want to hold more Gold in their reserves.

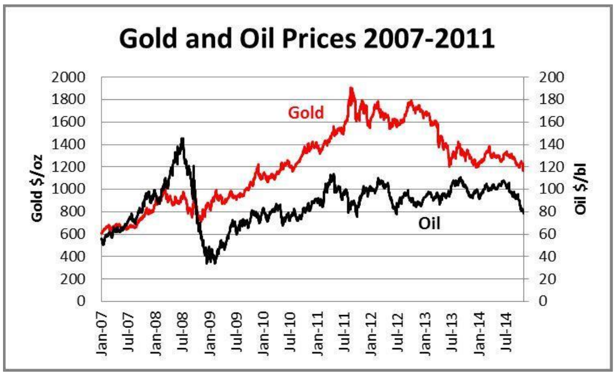
China's Official Gold Holdings

As fewer major currencies can now be called non-fiat, the attractiveness of Gold as a reserve asset has increased. In addition to the countries mentioned above, China is thought to be building up its Gold reserves. It has long been argued that even if China wanted to diversify its $4 trillion of reserves, it could not diversify into Gold without disrupting the Gold market. In recent years, with prices falling and with the country's Gold imports rising, it may well be that it has been able to accumulate Gold without disrupting the market, but unless an official announcement is made we will be none the wiser. That said, there are strong arguments for China to increase its Gold holdings – firstly, it has huge exposure to the US dollar and there must be some concern about how much debt is denominated in the dollar and how that could cause the dollar problems at some stage. Secondly, if China's ambitions are to let its currency become freely traded on the international markets, then it may want to boost its Gold reserves. Compared with other countries its official, published, holdings are low with just one percent of its reserves in Gold (see table).

Gold Reserves	Tonnes	% of Reserves
US	8,134	71.6%
Germany	3,384	67.0%
IMF	2,814	
Italy	2,452	65.9%
France	2,435	65.3%
Russia	1,150	9.9%
China	1,054	1.0%
Switzerland	1,040	7.5%
Japan	765	2.4%
Netherlands	613	54.1%
India	558	6.8%
Turkey6)	524	15.5%
ECB	503	27.1%
Source: IMF November 2014		

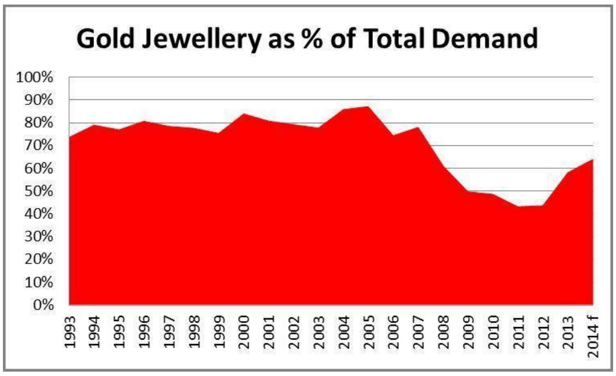
Oil and Gold

Oil and Gold prices have tended to be positively correlated for most of the recovery off the early 2009 lows. However, the correlation broke down in April 2011, which is around the time industrial commodities started to correct lower as concerns about economic growth materialised again. They remained uncorrelated during Gold's price correction from $1,800/oz but became more correlated again since mid-2013 as the market anticipated the start of tapering. Geopolitical tensions in Syria, Iraq and Russia have at times underpinned both oil and Gold prices, but not for long. More recently Gold prices have fallen sharply in line with the steep pull-back in oil prices as lower fuel prices further reduce the risk of inflation. Any rebound in oil may well help turn sentiment less bearish for Gold.

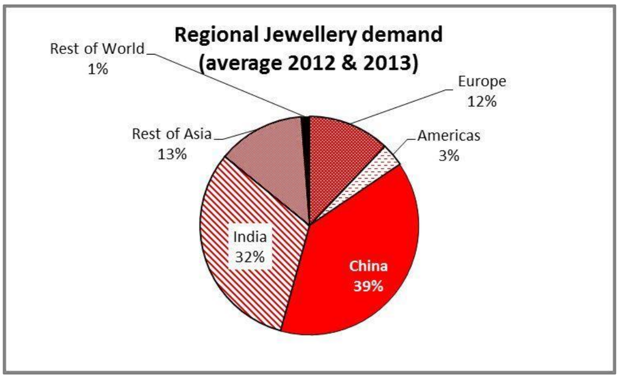


Jewellery demand

Jewellery accounts for the majority of global Gold use and historically accounts for around 80 percent of Gold demand. Demand for jewellery held up relatively well in the first half of the 2000s considering the price rise, but the combination of economic hardship as the financial crisis unfolded and the fast run up in Gold prices that coincided with that, led to a fall in jewellery demand. Interest instead turned to investment demand via ETFs and investment bars and coins - that is until last year. The accelerated price fall in April 2013 that saw prices drop to around $1,325/oz from around $1,600/oz sparked bargain hunting in Asia, especially in China, but also in the Middle East. The combination of a fall in investor interest as redemptions were made in ETFs and a pick-up in demand for jewellery has seen jewellery regain its dominance as the main consumer of Gold.



In 2103, global demand for jewellery climbed 18 percent to around 2,361 tonnes according to the World Gold Council (WGC). The number was skewed by a surge in demand from China, where jewellery demand jumped 48 percent in the first half of 2013, compared with an average increase of 16 percent in the same periods between 2008 and 2012. Although jewellery is still gaining market share it is doing so by default as other areas of demand have suffered more. Actual global demand for jewellery in tonnage terms has suffered this year and is down around 7.4 percent in the first three quarters, compared with the same period in 2013. The main reasons for this are lower demand from China and India, the former as the market destocked after the rush of buying last year and the latter as the market adjusted to the



aftermath of import restrictions, high domestic premiums and uncertainty about whether the new government would reduce the restrictions. The lower price, combined with the Indian market getting accustomed to the higher import tariffs have, however, led to a strong recovery in Q3 demand and there may well be considerable pent-up demand in the country. A combined rebound in demand in China and India may be just what the Gold market needs to stop the downward spiral in prices. Collectively China and India account for some 67 percent of global net jewellery demand.

Given the extreme increase in demand in China in 2013, a more accurate picture of the breakdown of regional demand may be gained by averaging regional consumption for 2012 and 2013. This shows China accounting for 39 percent of global jewellery fabrication demand, India 32 percent, the rest of Asia 13 percent and Europe 12 percent (see chart above). Generally we see the trends in the rest of Asia as following those in China; we expect demand for Gold jewellery in the region to pick-up from organic growth, as the workforce becomes more upwardly mobile, and to benefit from lower Gold prices.

Indian jewellery demand from official channels has suffered due to the import restrictions that lifted local premiums as availability was restricted. The combination of high premiums, that were expected to fall, and falling international prices also deterred buying as there was an expectation that domestic 'all-in' prices would fall. On factor that did help local prices fall in the fourth quarter last year and first half of this year was the rebound in the rupee, but since May this year the rupee has started to weaken again. The market has generally had a volatile time since July 2013 as there have been numerous cross-currents flowing through it with volatile premiums, fluctuating supply, some relaxation of the restrictions that allowed trading houses to import again and uncertainty as to whether the restrictions would be repealed after the mid-May election. All in all, in the twelve months to the end of the second quarter 2014, consumer demand for jewellery has fallen eleven percent, while total demand for Gold in India fell 28 percent with bar and coins demand falling 52 percent. As mentioned above, a recovery in jewellery demand got underway in the third quarter, while investor demand remained weak.

In Europe, lower Gold prices are expected to see higher carat jewellery manufactured, but high youth unemployment, economic hardship and changing fashion trends are pushing consumers more towards using costume jewellery. Jewellery is also facing competition from other consumer goods such as mobile phones, electronic devices and high cost branded fashion items.

Globally, given the significant price weakness, we expect demand from the jewellery industry will have picked-up in the second half and we would expect stronger growth for 2015 too. Not only do we feel demand will take advantage of the price weakness, but we also expect the destocking in China to have run its course; that will prompt a pick-up in buying and possibly restocking too. Generally, we remain bullish for Chinese jewellery demand as we expect strong organic growth as the workforce becomes upwardly mobile.

Investment demand

Investment demand comprises ETF holdings and demand for coins and investment bars. In 2013, these sectors were on diverging paths with demand for bars and coins (including medals) rising 31 percent to 1,766 tonnes, from 1,347 tonnes in 2012, while ETF holdings dropped 880 tonnes (some 33 percent) to 1,757 tonnes. ETF redemptions act as supply and are a negative in

the demand equation. In 2013 as a whole, investment demand fell to 886 tonnes, from 1,626 tonnes in 2012.

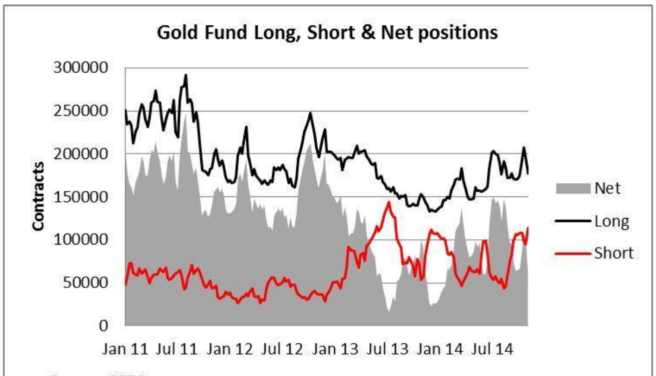
The rise in demand for investment bars and coins in 2013 led to a shift in physical Gold from the West to Asia. As ETF holdings were sold, the large bars were re-refined into smaller bars and coins that are popular in Asia and the Middle East. Out of the increase in global demand for investment bars and coins, 94 percent was seen in Asia. The sell-off in ETF holdings seems to have been driven by a change in sentiment amongst institutional investors who, viewing the end of QE as a sign of confidence, rotated out of the safety of Gold and into the more risky equity markets that were rising and have continued to do so.

In the first three quarters of 2014, overall investment interest in Gold was little changed. Demand for investment bars and coins has fallen 44 percent to 794 tonnes, compared with 1,408 tonnes in the same period in 2013, but whereas in the first three quarters of 2013 ETF redemptions totalled 700 tonnes, in the same period this year they were only 70 tonnes. This means that what demand there has been for investment bars and coins has not been countered to the same extent by ETF redemptions.

So far in the fourth quarter, ETF redemptions have picked-up again and were down 59 tonnes, but countering that it appears that sales of coins have been strong as consumers take advantage of the recent price weakness. Coin dealers and mints around the world are reporting a surge in demand. So for now it appears as though bargain hunting is starting to be seen amongst retail investors, but whether that means institutional investors return to the ETFs remains to be seen. Possibly, if they do, with so much of the physical Gold shifting to small bars, coins and to Asia (all of which are likely to be held in tight hands), it could lead to some tightness if ETFs need to get physical Gold to back ETF purchases.

Our outlook for investment demand remains generally upbeat as we still feel that the financial system, although more robust now, has been propped up by mountains of debt and the legacy of all that may still come back to haunt the market. If the ECB goes down the route of QE then we would not be surprised to see retail demand for investment Gold pick-up as countries like Germany have a somewhat dim view towards money-printing.

The Futures market



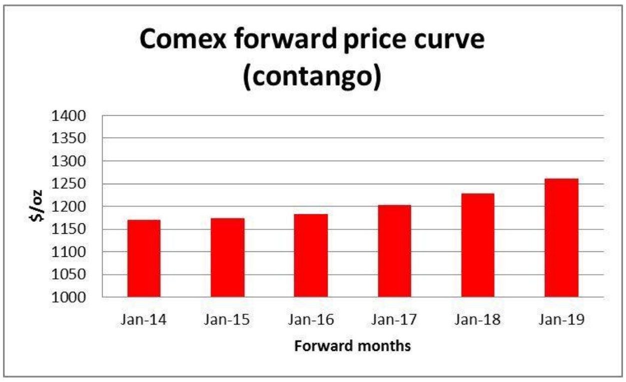
Source: CFTC

The net long fund position (NLFP) has been choppy this year. The rebound in prices at the start of 2014 saw the NLFP climb to 136,814 contracts in mid-March from a low of 38,887 contracts at the start of the year and the move was driven by a combination of short-covering and fresh buying. Since then the NLFP has oscillated aggressively, dropping to 59,151 contracts in early June, climbing to 150,021 contracts in July, dropping to 63,884 contracts in late September and back to 107,984 contracts in October, before falling again to 56,043 contracts. Breaking down the numbers shows the gross long position has oscillated between 139,244 and 207,129 contracts (the low being 32 percent below the high) while the gross short position has oscillated between 43,644 contracts and 121,225 contracts (the low being 64 percent below the high). Judging by the percentage moves in the gross positions, it seems as though changes in short sentiment have been key drivers. As of early November, the gross long position stood at 177,268 contracts and is 14 percent below its recent peak, while the gross short position is at 121,225 contracts which is its high for the year. The combination of weak prices and high gross short position suggests the shorts are confident, but should prices start to rebound then there is room for significant short-covering.

SUPPLY

Gold supply is made up of mined output, scrap sales, official government sales, producer hedging and starting last year, we have added redemptions from ETFs. In recent years, since 2008, mine supply has been climbing by an average of around four percent per annum. Given the price increases and generally high price of Gold from 2006 to 2012, it is somewhat surprising that more investment was not put into new production, but at the time producers were stretched trying to invest in a broad spectrum of metals while skilled labour was in short supply. With Gold prices now relatively low, mine supply is likely to suffer as mining companies cut back on development-stage projects as they brace for lower profit margins. In 2013, mine production totalled 3,039 tonnes, according to the WGC, while total supply including metal released from ETFs was 5,142 tonnes, meaning mine output accounted for 59 percent of total Gold supply, with scrap accounting for 24 percent and ETF sales, 17 percent. Official Gold sales dried up in 2010 and in recent years producers have tended not to be in favour of hedging, so supply from these activities has been minimal.

Mine supply increased 6.2 percent to 3,039 tonnes in 2013, according to WGC, as new mines and expansions, commissioned when Gold was in a bull market, saw production ramped up. Output in the first half of 2014 increased 58 tonnes (some 4.1 percent) compared with the same period in 2013. This increase has also come about as production increases come on line at a time when the fall in prices has so far not prompted much in the way of production cutbacks. Falling prices have, however, encouraged producers to improve efficiency, which has boosted output too. Going forward, lower prices, possible production cutbacks and a limit to how much can be gained by efficiency drives are all likely to lead to a slight decrease in mine output, which could remain the case for a number of years now given capital expenditure will have been cut. Although mine production is expected to drift lower, supply to the market from producers could increase if they start to do more forward hedging as that would require the borrowing of metal from central banks, which is then sold into the market as part of a hedge. The practice of forward hedging on a large scale ended in 1999; in the seven years before that an average of 280 tonnes, some 10 percent of mine output, was hedged each year. At present there still does not appear much appetite to hedge, but if prices remain low and interest rates rise to the extent that a considerable forward contango presents itself then hedging may become popular again as a way to lock in higher forward prices via the contango. Basis Comex forward contracts, December 2015 prices are $4/oz higher than December 2014 prices and December 2016 are $14/oz above December 2014 levels.



In 2014, we expect mine output to increase around three percent to 3,130 tonnes but to drop back by around 2 percent in 2015.

China's Gold production has taken off in recent years, with output rising to 428 tonnes in 2013, an increase of 6.2 percent according to the China Gold Association (CGA). In the first half of 2014 it reached 211.1 tonnes, up 9.5 percent from the same period in 2013. The country overtook South Africa as the world's largest producer in 2007 and has not looked back since. South Africa was the world's 5th largest producer in 2013, with the US, Russia and Australia now the fourth, third and second largest producers respectively.

Scrap

Gold supply from scrap is all-important as it accounts for a significant proportion of supply, although it does vary depending on Gold prices and economic hardship. Up until recent years, the importance of scrap had increased, as in the early 2000s scrap accounted for around 22% of supply. However, as prices have climbed more old jewellery has been cashed-in. Scrap supplies peaked in 2009 at around 40% of total supply, but have since slipped as there is less old scrap around and as lower prices have reduced the incentive to cash-in old Gold. In 2013, as prices start to fall, scrap supply fell around 22 percent to 1,267 tonnes and in the first half of 2014, it is estimated to have fallen around 7.9 percent to 578 tonnes, according to WGC.

The combination of a prolonged period of high Gold prices that is likely to have drawn a lot of old Gold out of the woodwork and now significantly lower Gold prices is likely to mean supply from scrap remains relatively low for a while now. This is especially the case because whereas in recent years there had been a surge in 'cash-for-Gold' businesses on the high street, many have now gone, which will hamper scrap collection.

Overall, with mine output expected to be falling slightly next year and with scrap supply expected to fall too, Gold supply is likely to drop marginally in 2015. That could change if mining companies start to hedge more, or if redemptions from ETFs gather pace again.

Technical Outlook

In last year's Gold Forecast we had a downside target of between $1,137/oz and $1,100/oz, which was taken from the count off the upper descending triangle and where the uptrend line was at the time. As such, prices have reached our target area, but the break below the triple bottom around

$1,180/oz has now opened the path for further price falls and the $1,000/oz psychological level seems a likely target. This would take prices back into the range they were trading ahead of the financial crisis (see red box). If prices get back into and hold the $1,180-$1,200/oz range then the recent dip below $1,180/oz could be viewed as an overshoot on the downside, but given that the move below $1,180/oz has damaged the chart and signalled the break of another descending triangle - this time with a $255/oz count that would take prices to $925/oz - a drop to the $1,000/oz level or slightly below seems a reasonable expectation. Although the drop to the recent lows feels like the market is oversold, a look at the monthly chart with a prolonged period of sideways trading since mid-2013 suggests otherwise, as support from the second descending triangle has only recently been breached. Short-covering rallies may well see aggressive moves to the upside, but we would expect those to be capped ahead of the top of the triangle, which is around the $1,335/oz level, if not before.

Forecast & Conclusion

The bull-run from 2001 to 2011 is now being corrected, but as the long term charts show prices are still relatively high, indeed prices have only just returned to long term up trend line. The break of support around $1,180/oz may well now signal that prices have further to fall over the medium term; the move below $1,180/oz to $1,131/oz hardly shows up on the chart, which suggests prices could still have considerably further to fall. With investors continuing to reduce their exposure to ETFs and with physical demand from India and China generally low this year, there is not much supporting the market. In addition, sentiment is bearish as investors are more involved in equity and bond markets. With there being less concern about stability in the financial markets and monetary systems, the need for safe-havens has diminished. While these conditions persist there is every possibility that prices may fall further, although down at these prices bargain hunting and restocking may well become more powerful forces.

A stronger outlook may not be that far away as we expect pent-up demand in India and a return to the market, post-destocking, in China to underpin physical demand and once a base is seen to be in place, then more shorts are likely to cover. This in turn could lead to a significant rebound even if it does not last too long. Another possible supporting factor that is expected to emerge at some stage is when the equity markets start to correct; when this happens Gold may be seen as a cheap safe-haven.

On balance, we feel Gold has now lost its safe-haven appeal that supported it in the post-financial crisis period and now physical flows of metal will drive prices more. In this respect we are bullish for demand from China and emerging markets. At some stage we feel there may well be further need to monetise Gold as the legacy of all the debt and QE comes back to haunt the financial markets, but that might still be a few years away. We would expect Gold prices to establish a base over the next few months, after which we expect bargain hunting, short-covering and restocking to lift prices to a higher sideways trading range in the $1,050 to $1,400 range.

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To obtain additional information on our products and services, please contact one of the offices listed below.

CANADA
Toronto
Scotia Plaza
40 King Street West
Box 4085, Station 'A'
Scotia Plaza
Toronto, Ontario
M5W 2X6

Russell Browne
Russell.Browne@scotiabank.com
Tel: 1-416-862-3863
Fax: 1-416-866-6897

UNITED KINGDOM
London
201 Bishopsgate
6th Floor
London
EC2M 3NS

David Wilkinson
David.Wilkinson@scotiabank.com
Tel: 44-20-7826-5931
Fax: 44-20-7826-5948

UNITED STATES
New York
250 Vesey Street
New York, N.Y. 10281

Bimal Das
Bimaldas@scotiabank.com
Tel: 1-212-225-6200
Fax: 1-212-225-6248

INDIA
Mumbai
91, 3rd North Avenue
Maker Maxity
Bandra Kurla Complex
Mumbai 400 051

Rajan Venkatesh
Rajan.Venkatesh@scotiabank.com
Tel: 91-22-6658-6901 (Direct)
Fax: 91-22-6658-6911

New Delhi
Upper Ground Floor
Dr. Gopal Das Bhavan
28 Barakhamba Road
New Delhi 110001

Prem Nath
Prem.Nath@scotiabank.com
Tel: 91-11-2335-8789
Fax: 91-11-2335-9342

Bangalore
25/2 S.N. Towers
M.G. Road
Bangalore 560001

Mahendran Krishnamurthy
Mahendran.Krishnamurthy@scotiabank.com
Tel: 91-80-2532-5325
Fax: 91-80-2558-1435

HONG KONG SAR
21st Floor, Central Tower
28 Queen's Road Central
Central
Hong Kong

Alice Lam
Alice.Lam@scotiabank.com
Tel: 852-2861-4778
Fax: 852-2573-7869

SINGAPORE
1 Raffles Quay
#20-01, North Tower
One Raffles Quay
Singapore, 048583

Swee Kiang Teo
Sweekiang.Teo@scotiabank.com
Tel: 65-6536-3683
Fax: 65-6534-7825

UNITED ARAB EMIRATES
Dubai
302, Precinct Building 03
Dubai International Financial Cent
Dubai
UAE

Pramod Mohan
Pramod.Mohan@scotiabank.com
Tel: 971 4 371 1555
Fax: 971 4 448 4640

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