

Precious Metals Forecast 2010

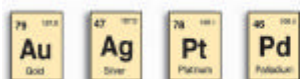
Silver

Executive Summary

- Prices continue to out perform Gold on both the upside and the downside. In 2010, Silver is expected to range between \$13/oz and \$25/oz
- Investment demand is expected to remain strong in 2010, but a rebound in fabrication demand should see buying pressure increase.
- After the slump into recession in 2008, the recovery has been fast, but we doubt it is sustainable and therefore expect further distress to be seen in the months ahead.
- The dollar may be oversold in the short term, but structural problems suggest further dollar weakness is likely and that could lead to a dollar crisis.
- With the supply overhang, investors are going to have to continue buying Silver, but given their current interest and the big picture outlook, this is likely to happen.

Introduction

Since moving above \$10/oz in March 2006, Silver prices have been on a roller-coaster ride with some fast and long rallies interspersed with steep and aggressive sell-offs; none more so than the drop from \$21.36/oz to \$8.50/oz between March and October 2008. However, the strong rebound after last year's sell-off does indicate ongoing steady interest. Silver has benefitted from being both an industrial metal and a cheap precious metal, as industrial metals have rallied strongly in anticipation of an economic recovery and as a cheap precious metal, it has won market share from Gold jewellery. Also as a precious metal it has been sought after as a hedge against dollar weakness and financial distress. Given the diverse nature of Silver demand, prices are expected to perform well as even if weakness is seen in one area of demand, the other areas should hold up and indeed could see demand accelerate. Silver also does not have the threat of IMF sales overhanging it. Generally for these reasons we feel there is still good upside potential for Silver and with prices (basis \$17.50/oz) still 18% below last years' highs and arguably still 185% below the 1980 highs, the outlook remains bullish. However, given Silver's supply/demand situation the outlook for Silver can only be bullish while investors remain as committed to buying Silver as they have been in recent years. Over the past five years fabricated demand has on average been around 2,000 tonnes lower than supply. While investors are prepared to buy this surplus then higher prices can be seen, but should investors' interest wane then Silver prices could tumble. Overall, we remain bullish for Silver as it is likely to follow in Gold's footsteps and at times outperform it. In last year's Forecast report we were looking for the bulk of trading in 2009 to be between \$11/oz and \$18/oz; the low in January 2009 was \$10.33/oz and the high has so far been \$17.93/oz. In 2010, we feel Silver will trade within a \$13/oz to \$25/oz range as we expect more turbulence in the financial markets



Fabrication Demand

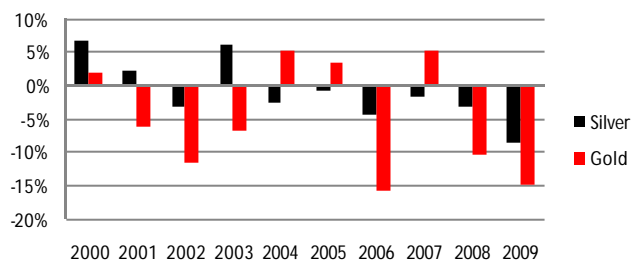
Fabrication demand covers Silver's use in industry, photography, jewellery manufacturing and in the making of coins. So far in 2009, all these sectors, with the exception of coins, have seen demand hit hard. Despite weaker prices, which in the first eight months of the year averaged \$13.34/oz compared with \$17.16/oz in the same period last year, demand has fallen as the impact of recession has taken its toll. Demand from photography remains in steady decline and that is expected to continue, but the recession has knocked industrial demand down by an estimated 21% as actual demand has fallen and destocking will have made apparent demand fall even more. Silver jewellery and Silverware have fared better with an estimated 8.5% drop in demand. Fabrication of coins and medals grew strongly in 2008 and did so in the first half of 2009 as retail investors looked to buy precious metals that they could physically hold as means to protect themselves against bank closures and financial turmoil. The rapid fall in Silver prices during the second half of 2008 does suggest aggressive destocking, however, with total fabrication demand only falling around 1% last year, the data suggests holders of Silver were not prepared to sell into the sell-off. However, consumers do seem to be running down stocks this year as demand has fallen heavily. In 2009 as a whole, fabrication demand is expected to drop 12% to 22,650 tonnes, down from the recent peak in 2005 of 26,350 tonnes. In 2010, demand is expected to recover as industrial demand anticipates a recovery and starts to restock.

Jewellery - Changing trends

Volatile prices and economic recession have seen jewellery demand fall, which is to be expected as spending on luxury items is bound to suffer in times of hardship. Indeed even significant price falls are not going to entice buyers back into the market if there are other higher profile issues such as rising unemployment and concern over the economic outlook. In addition, this year has also seen drought conditions in India, which is making a bad situation

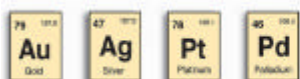
worse as the rural community will have less to spend. However, relative to Gold, Silver jewellery has fared better, Gold jewellery demand was off 25% in the first half of the year, which suggests that jewellery buyers have shied away from buying expensive jewellery, but have felt less extravagant buying cheaper Silver jewellery. Over the past decade, Silver jewellery demand has suffered less than Gold jewellery, as whether high bullion prices, or economic hardship has hit demand, Gold jewellery tends to suffer more, see chart. With Silver prices also well below 2008's peak, while Gold is near record highs, there is a bigger profit margin in Silver jewellery than in Gold, or Platinum jewellery. Overall we expect an 8.5% drop in Silver jewellery and Silverware demand in 2009, followed by a 2% pick-up in 2010 as more sustainable growth unfolds later in the year. In addition, the higher Gold prices go, the more consumers will trade-down to Silver jewellery, especially if Silver prices rise and Silver is seen as becoming a more expensive precious metal.

Changes in Annual Jewellery Demand



Industrial Demand

Industrial demand accounts for 43% of total Silver end-use demand and is of paramount importance to the Silver market. In recent years global growth has been expanding at a fast



pace, but this slowed to 1.4% in 2008 and is off significantly so far in 2009. Indeed industrial demand is expected to drop some 12% this year, but is expected to recover next year as a more broad based recovery is likely. The IMF forecast for World economic growth is 3% in 2010, after a 1% drop in global GDP in 2009. With industrial applications accounting for 54% of fabrication demand, which is up from 38% ten years ago and with India, China and the US, accounting for 70% of this rise in industrial usage and with Silver now being used in a wide spread of new applications, demand is expected to recover faster than GDP growth. As such, we expect Silver's industrial demand to grow around 7% in 2010.

In addition to growth picking up more than global GDP, after the destocking seen over the past year, we expect restocking to see apparent demand rise even faster than actual demand. Therefore the combination of restocking, a pick-up in actual demand and ongoing investment buying, could certainly see Silver prices continue to rise strongly.

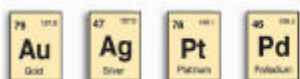
Photographic demand

Use of Silver in the photographic industry peaked in 1999 at around 7,000 tonnes and in recent years has been falling at around 10% a year. However, the combination of the technological shift to digital photography and the recession saw demand for Silver from the photographic industry fall a larger 16% in 2008, to 3,500 tonnes. Silver's use in film is expected to continue to decline, while its use in X-rays systems is holding steady. Although developed countries are rapidly transferring to digital X-rays machines, demand for traditional X-ray technology is still growing in developing countries, especially in China and India, where healthcare is expanding. All in all, photographic demand is likely to continue falling and even a pick-up in economic activity next year is unlikely to see a rebound in demand from photography. After last year's faster drop in demand, demand this year and next are expected to continue declining at around 10 percent per year, which should free-up some 300 tonnes of Silver next year.

New applications

There are a host of new uses for Silver in the health, electronics and renewable energy industries, but many of these new applications use nano-technology with each unit using a tiny amount of Silver. So until the applications have widespread use their impact on Silver demand is likely to take time to be felt. However, some applications, such as Silver's use in consumer electronics, for example in plasma TV / display screens and in solder used in a host of electronic gadgets, do use meaningful amounts of Silver and demand from these products will have been hit hard by the recession. As such, once economic recovery gathers pace demand from these applications should pick-up.

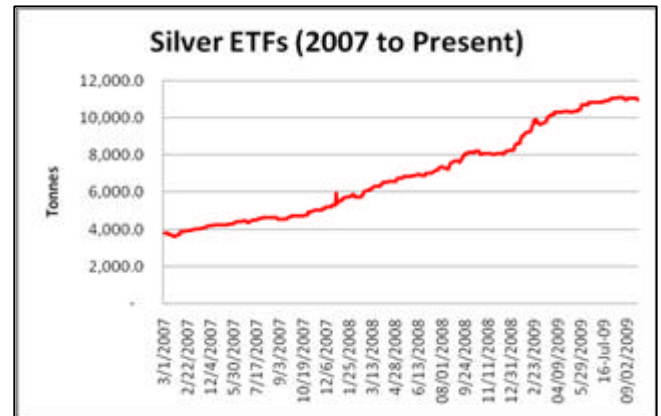
Out of the host of non-consumer new applications Silver's use in thermo photovoltaic (TPV) cells, which convert light into electricity, is growing fast and is likely to continue to do so as governments encourage alternative means to generate energy. The TPV industry's use of Silver reached 420 tonnes in 2008 and as more money flows into this technology, its consumption of Silver is expected to grow strongly. The same is true as other new applications take-off in the years ahead. These include smart tags (RFIDs) and products that are being developed to utilise Silver's antibacterial properties which will be used in medicines, bandages, soaps, clothing, and chemical compounds added to door handles, photocopier buttons, paper, air conditioning units, all of which help stop the spread of bacteria in the home, office and in public places, such as hospitals, public transport, restaurants etc. Although only minute amounts of Silver are used per item, the mass of applications will see demand for Silver from these areas grow. It is estimated that collectively these new applications could account for up to 1,000 tonnes of



demand within the next ten years which could provide a significant boost for demand in the years ahead, which may keep investors' interest high.

Investment demand

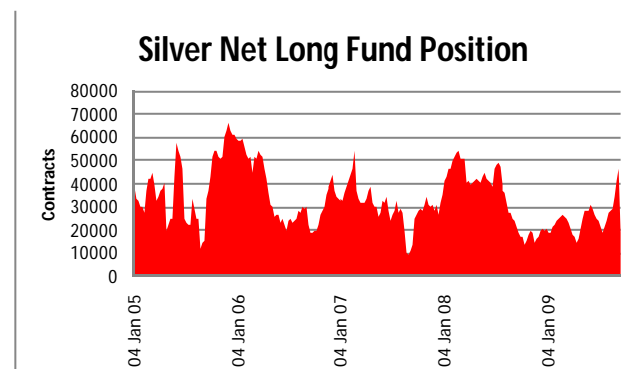
With Silver supply outpacing fabrication demand in recent years, investors' off-take has been critical in driving the overall bull market and the emergence of Exchange Traded Funds (ETFs) have been central in facilitating this growth in investment demand. When the first ETF was launched in April 2006, it started with 653 tonnes of Silver, the peak holding to date was 11,112 tonnes, seen in August this year. As the chart opposite shows growth has been strong and steady; there have been periods of light redemptions along the way, but the trend is firmly up. At the end of September 2009, the combined holdings stood at 10,958 tonnes, which is 1.4% below the peak, but still 32% up since the start of the year. In 2008, the combined holdings grew 2,326 tonnes; in the nine months to the end of September 2009, the ETFs have grown by 2,702 tonnes. The fact that redemptions up until now have been light, suggests that long term investors are still buying into Silver's safe-haven purposes.



The presence of this above ground Silver stockpile is a potential threat to prices if mass liquidation were to unfold, especially as the total combined holdings is equivalent to roughly half a year's mine supply. However, in the current environment of financial uncertainty and dollar weakness we would be surprised if investors were ready to sell the protection Silver offers them. This is especially so as prices are still well below the peak seen in 2008 at \$21.36/oz. However, there is no denying the fact that the Silver in the ETF's is potentially very liquid and therefore trends in the ETFs' holdings need to be monitored carefully.

More room for speculators

The net Fund Silver position pulled back heavily during last year's second half sell-off, but the position is climbing again and remains well below the peaks seen in 2006, 2007 and 2008. With the net long position last at 47,410 contracts, it is still 12.4% below the peak in 2008 and 29.2% below the high in 2006. So with Silver prices also 23% below their 2008 peak, there seems good potential for prices to rise if the situation remains bullish. Indeed, in this respect, Silver looks better placed than Gold to extend gains as the net long Fund position in Gold is already at record levels. As such, it does look as though Silver will continue to outperform Gold on the upside.



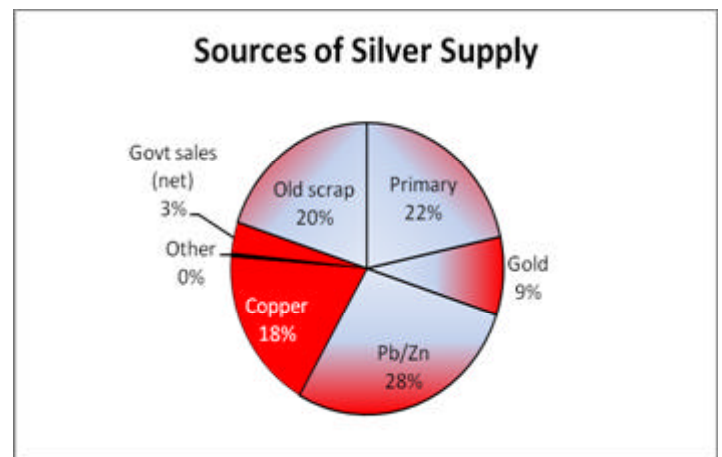
Supply

Mine output rose 2.5% in 2008 to a new record of 21,179 tonnes. This was the sixth year that mine production rose, with output in Latin America, especially Bolivia, and Russia rising strongly as new production came on stream. The sell-off in Silver prices in late 2008 did threaten some mine projects and some mine output was lost as base metal production was cut. However, investments in new projects made earlier in the decade led to increases in primary mine output as new mines came into production. Canadian mine output dropped 19% in 2008, while US output dropped 11% on the combination of cutbacks at lead/zinc operations and as some primary mines closed as ore reserves were depleted. Output also dropped in Poland, Sweden, Chile and Kazakhstan, all areas associated with base metals production.

However significant increases were seen in Bolivia, Peru, Mexico, Russia, Australia, Turkey and China, as new mines stepped up production. Big increases came from Bolivia where a full year of production at San Cristobal saw output rise by 430 tonnes, with the start-up of San Bartolome helping too. In Russia, production increased on the combination of new production, higher ore grades and with a pick-up in processing of by-product material. In China, output looked set to be hit as base metal production was initially cut back, but government incentives to keep mining and smelters in operation has seen ongoing growth in 2009, building on the gains seen in 2008.

Looking forward with base metals price rises now prompting the reactivation of idle mine production we would expect Silver mine output to increase again in 2009 and 2010. This year output is expected to rise by 500 tonnes, with a further 470 tonnes likely to be added in 2010. However, further forward the impact of the credit crunch is likely to have slowed the start-up of numerous projects and that might mean slower mine growth down the road. This year and next should, however, see primary output increases in Argentina and Mexico.

Given the sell-off and subsequent recovery in base metal prices, it is interesting to see the breakdown of where total Silver supply comes from, see chart opposite. With 46% produced as a by-product of base metal production, the rebound in base metals prices should see a steady recovery in output. Cash costs of production for primary producers are thought to lie around \$5/oz with high cost producers around \$10/oz, so it seems likely that primary production will continue to expand. With Gold prices near record highs the incentive to boost Gold output is high, while a recovery in economic activity is likely to see scrap supply increase, see below. Interestingly government sales are now small, only 3%, so again whereas Gold has the threat of IMF sales, Silver does not.



Scrap supply has been fairly stable in recent years, but it did drop 3% in 2007 and 2008, mainly on the back of lower levels of scrap from the photographic industry. Old Silver scrap supply from other sources has been relatively steady and has not surged as it has with Gold. In 2009, we expect scrap to fall 2%, but to rebound 6% in 2010. However, should prices start to spike

higher, supply from old scrap, jewellery, silverware etc, could pick-up markedly as it did in 1980 when Silver spiked up towards \$50/oz.

Government stocks getting low

Government stocks of Silver are thought to have fallen to 961 tonnes in 2008 down from 1,314 tonnes in 2007, but this decline in sales seems more to do with rapidly depleted stockpiles, rather than a change in policy. It is now estimated that government stocks had fallen to 2,240 tonnes at the start of the year. Although accurate data on government holdings are hard to come by, if the figure now stands at just above the 2,000 tonne level, then the large burden of 23,000 tonnes that was overhanging the market in 1997 has been severely depleted and is likely to limit sales going forward. For 2009, we expect sales to drop to 400 tonnes, dropping to 200 tonnes in 2010.

Balance

The Silver market swung from a supply deficit to a surplus in 2003 and has remained in one since. Given this, it is somewhat surprising that prices have performed the way they have. However, the pick up in investment demand has soaked up the surpluses. In recent years, the high level of ETF buying has managed to absorb the surplus supply over fabrication demand, even when fabrication demand has fallen. However, the outlook is for another surplus in 2010. Mine output is expected to grow by some 470 tonnes, scrap supply is expected to edge higher as economic activity recovers and as higher prices attract more scrap, while government sales are expected to be lower at around 200 tonnes in 2010. Fabrication demand is forecast to recover by 3% to 23,320 tonnes, while supply is forecast to grow to 27,473 tonnes, leaving a surplus of some 4,153 tonnes.

Technical

Following the rapid sell-off in the second half of 2008, Silver prices have been trending higher again in an upward channel. Prices recently tackled the band of overhead supply seen between March and July last year between \$16.20-\$19.00/oz, but resistance was encountered around \$17.65/oz and prices have now pulled back to consolidate. With the stochastic indicators also crossing lower Silver prices may now pull back towards the bottom of the channel which is around the \$14/oz level, which is also where the 30 week (150 day) moving average is. However if the up channel continues to push prices higher then prices are likely to gradually overcome the overhead band of supply - the top of which is at \$19.47/oz, which would then open up the way for a rechallenge of the highs at \$21.36/oz.



Conclusion and Forecast

The situation in Silver is very interesting, even before the recession the market was running a supply surplus and this was made worse by the drop in demand, even though supply was cut

too. However, the distress in the markets and concern over how this financial mess and the global imbalances are going to be corrected has increased demand for safe-haven assets, such as the precious metals. In the medium term, while the supply surplus is present, Silver will be vulnerable if investors' commitment to Silver wanes. If investment interest fails to soak up the annual surplus prices are likely to fall, indeed falling prices would then no doubt trigger liquidation of existing positions that would add to the downside pressure on prices. However, we do not think such a scenario will unfold between now and the end of 2010, although there is no harm in having a contingency plan for when such a time arrives.

Investor interest as seen by the steady climb in the ETFs' holdings shows ongoing strong demand and with ETFs increasing their size by some 2,700 tonnes in the first nine months of 2009, it does look as though this will more than absorb the market's surplus. With ongoing concern about the dollar and US creditors vocally warning about dollar devaluation, not to mention the risk of a double-dipped recession, there seems plenty of reasons for investors and investment institutions to look to safe-guard their wealth and to diversify their dollar exposure, all of which should underpin demand for precious metals.

In the near term, prices are expected to consolidate, but there is also a risk of a deeper correction in equities and industrial metals, that could drag Silver prices lower initially. However, we think dips in Silver prices will be seen as a buying opportunity, by investors and fabricators alike. In addition, we expect fabrication demand to recover later in 2010 and with that is likely to come industrial restocking. So Silver could, for a time, see strong demand from all areas of demand. In addition, we feel Silver is likely to follow in Gold's footsteps and as such we expect prices to spend the bulk of 2010 within a \$13-\$25/oz trading range. Should central bankers and politicians manage to find workable solutions to the bigger issues troubling the financial markets then demand for safe-haven products could suffer and then some fast corrections would likely follow, but we think there is little chance of this happening any time soon and therefore we remain bullish for Silver.

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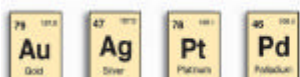
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