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Metal Matters

July 2018

Precious metals prices have sold-off as the opportunity cost of holding them has increased as other safe-havens offer a yield. Platinum prices have slumped to levels last seen in 2008.

- Raised tensions over trade with the US have undermined investor and business confidence, which has led to price corrections across many markets.

- Gold has failed to attract safe-haven buying as US treasuries pay a yield – overseas buying of bonds has also lifted the dollar, creating another headwind for Gold.

- Physical demand for Gold remains weak, with first quarter demand the weakest since 2008.

- Investors and funds have also been reducing exposure in Gold.

Silver prices underwent a short-covering rally, but the rally was reversed once the broad-based sell-off got underway.

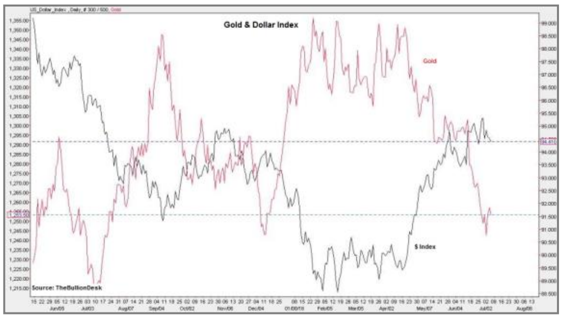
- The sell-off might have further to run as the funds still have a large long position, but prices are unlikely to stay down for long.

Platinum's demand profile is suffering mainly because diesel cars are losing market share – the funds have turned net short. Low prices are expected to lead to production cuts.

- Palladium prices have pulled back in line with the broad base correction in markets, but being in a deficit, prices are unlikely to stay down for long.

Gold prices give back 99% of the December – January gains

Gold prices have dropped to within $1.4/oz of the lows seen on 12^{th} December 2017. After rallying in January to a high of $1,366.15/oz, prices oscillated sideways until mid-April, before starting their decline. The second half of June and early-July was a particularly weak period for Gold prices as they dropped to $1,237.95/oz from $1,309.40/oz. The weakness has been caused by the combination of a rise in the opportunity cost of holding Gold, a stronger dollar, deleveraging in a broad base of markets and weak physical demand from India.

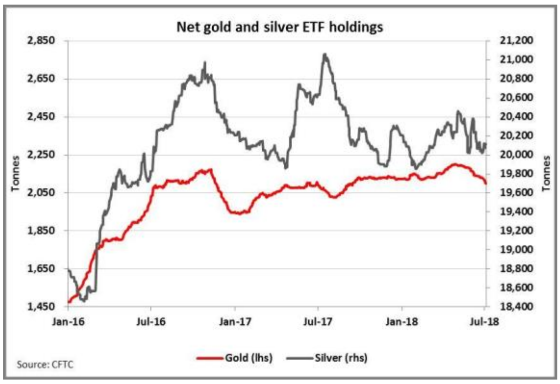


Higher opportunity cost

Given the rise in geopolitical and economic tensions over US trade policies that have turned equity and commodity markets lower (with the exception of oil), it is surprising that Gold has not become more sought after as a safe-haven. The fact it has not means that investors are favouring US and German government debt as safe-havens, especially the former, as at times its yield has been over three percent. The increased popularity of US treasuries has lifted the dollar and the buying pressure for treasuries has even brought the yield lower. Having been as high as 3.128 percent on 17^{th} May, the yield has dropped back to 2.858 percent. The dollar has also been strong, as seen by the dollar index's rise to 95.54 on 21^{st} June from a low of 88.25 on 16^{th} February. That said, with the yield now slipping, the dollar's rally has halted and if it starts to pull back further then that could begin to support Gold prices again. The fact oil prices have also been rising could turn out to be a bullish factor for Gold prices as higher oil prices would be seen as inflationary. Even if Saudi Arabia/OPEC raises oil production to counter the falling supply from Venezuela and Libya, the market may well stay bullish as, from November; supply is likely to fall further as the US has threatened to reintroduce sanctions against Iran.

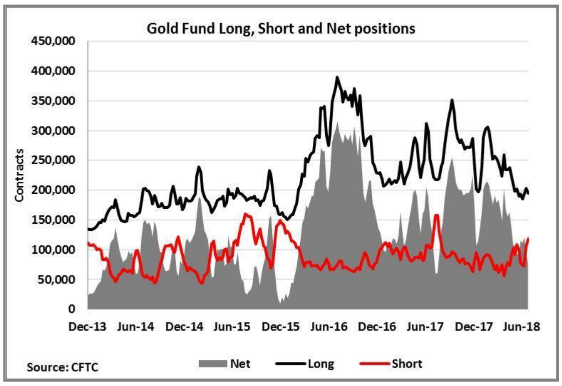
Physical demand weak

Gold demand in the first quarter of the year was 973.5 tonnes and that was the lowest first quarter since 2008, according to the World Gold Council (WGC). Investment demand for coins and ETFs were two of the main causes of the weakness along with a 12 percent drop in jewellery demand from India. Although total jewellery demand of 491.6 tonnes in Q1'18 was up from 487.7 tonnes in Q1'17, the total was low compared with the 556.3 tonne ten-year average for first quarters. The market in India still seems to be adjusting to all the regulations and tax changes that have affected the Gold market in recent years. In addition, the country has seen the rupee weaken to 68.83 from 63.25 in January, which would have increased local prices relative to international prices on the way up and cushioned the price fall on the way down. Indeed, local prices rose 12% compared to a 10.5% rise in dollar Gold, and local prices have retreated 4.7% compared with a 9% drop in dollar prices.



ETF holdings continue to fall

Appetite for Gold ETFs has started to wane, as shown by the red line in the ETF chart. The amount of Gold held in the ETFs we follow has fallen to 2,102 tonnes, down from 2,176 tonnes at the end of May and a peak of 2,201 tonnes seen in late April. This is the lowest holdings have been since mid-September last year.



Net long fund position falls

The net long fund position (NLFP) has fallen to 76,672 contracts; this is the lowest it has been since mid-July 2017, when it set a low of 60,138 contracts. As the chart above shows, the longs have been reducing exposure and hold less now than in December 2016, when spot prices dropped to $1,122/oz. The shorts have been increasing exposure; they hold 118,446 short contracts, again the highest since late-July 2017. While the gross long position is in low ground compared with recent years, the gross short position has been as high as 157,377 contracts in the last twelve months. Given that the peaks in the gross short position tend not to last, it does look as if the market is setting itself up for a period of short-covering again, although the short position may still have further to climb before it peaks. The low level of the gross long position would also mean there is plenty of room for fresh buying too.

Technical – Gold prices have fallen to a low of $1,237.95/oz and just held above the 12th December low at $1,236.55/oz, which suggests former support is still effective. In addition, on the weekly chart the recent low held above the uptrend line off the 2015 low and the 38.2% Fibonacci retracement line of the 2015-2016 bull run is at $1,249/oz and the 50% Fibonacci retracement line off the late-2016 to January 2018 rally is at $1,244/oz. So, although both those Fibonacci levels have been breached, there does seem to be a concentration of potential support in the $1,236-$1,249/oz area that may now provide support. In addition, the stochastic indicators have fallen back to low ground and are in the process of attempting to climb higher.

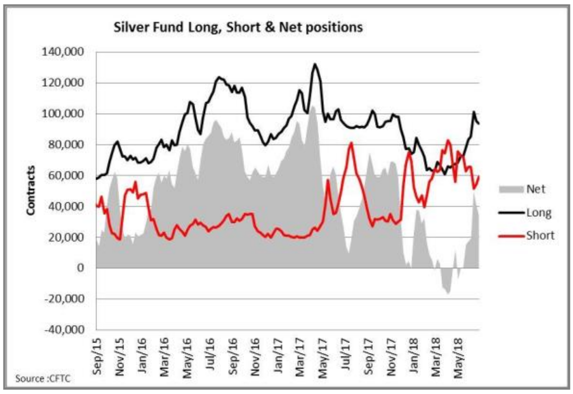
Summary – The sell-off in Gold feels quite severe and it has been driven by logical reasons – those being rising US treasury yields, a stronger dollar and weak physical demand. That said, a look at the weekly chart above shows prices are still well up from the 2015 lows and are holding above the numerous lows seen in 2017. The pullback has also run in parallel with corrections in other industrial metals and equities. Gold prices have dropped 9.4 percent from this year's high, the Dow has fallen 10 percent and the LME Index has fallen 11.7 percent - so the weakness is not just a Gold issue. As such, we do not think this is the start of a bear market for Gold prices, but just another downward move within the sideways trading that has dominated the market since prices peaked in 2016. With the dollar's rise halted for now and with the US on the brink of a trade war that could see foreign owners of US treasuries liquidate, Gold may once again fit the bill as a good safe-haven.

Gold Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	May-18	Jun-18
London Prices (US$/oz)								
AM fix	1266.34	1162.49	1248.16	1257.85	1276.51	1330.72	1303.61	1282.13
Pm fix	1266.20	1161.30	1248.34	1257.13	1274.35	1329.29	1302.91	1281.57
Average	1266.27	1161.89	1248.25	1257.49	1275.43	1330.00	1303.26	1281.85
Parity prices								
Australian - A$/oz	1,403	1,544	1678.88	1645.14	1,659	1,638	1,732	1,710
South Africa Rand/kg	440,562	474,410	589,051	537,559	558,876	510,684	524,426	546,753
Japan Y/g	4,146	4,355	4,203	4,370	4,463	4,464	4,432	4,372
India Rupee/oz	77,077	74,310	83,721	81,767	82,499	85,492	87,897	86,737
COMEX - futures contracts								
Stocks ('000oz)	8,203	7,422	8,962	8,860	8,970	9,151	9,017	8,565
Vol (million contracts)	40.52	41.76	51.84	72.80	20.47	14.11	8.68	5.74
OI ('000 contracts)	380	418	550.71	479.85	511	518	508	494
CFTC (futures only data)								
Net Spec position Long (Short)	98,265	88,022	201,250	163,493	166,887	198,919	90,957	76,672
TOCOM								
Stocks ('000oz)	146	127	120	73	60	57	74	62
Volume ('000 contracts)	8,744	7,928	8,540	5,750	1,524	1,544	600	699
OI ('000 contracts)	88	94	88	87	98	101	95	112
Other Indicators								
FT Au Mines Index	1,409	1,061	1,579	1,521	1,472	1470	1,439	1,448
Dow Jones Index	16,837	17,524	18,062	21,990	24,113	25,094	24,457	24,332
US$ Index	83.0	96.7	97.1	96.0	93.3	89.9	94.1	94.4
Gold Bullion Imports, tonnes (exports)								
Dubai	136	118	920	946				
China	1297	1610	1,316	1,091				
India	776	949	511	880				
Italy	103	~	~	~				
Japan	-80	-107	~	~				
Singapore	284	~	~	~				
South Korea	24 ~		~	~				
Taiwan	22	30	28	~				
Turkey	102	49	106	360				

Data: Financial Times; Bombay Bullion Association; LBMA; TOCOM; COMEX; CFTC, REUTERS
Figures are period averages unless marked by *, indicating the period end. OI= Open Interest on the exchange
~ = data not available yet, *italics* = estimates

Silver prices followed Gold and industrial metals prices lower

Silver prices have had a volatile year so far with three upward spikes seen in January, April and June, and now a lunge to the downside that took prices within around one percent of the December 2017 low. The low in early July was $15.77/oz, while the low in December was $15.62/oz. The weakness has been broad based across markets and seems to have been driven by investors reducing exposure ahead of a potential US trade war. During the second quarter, Silver prices were holding up better than Gold prices (as shown by the Gold/Silver ratio falling towards 75 in mid-June from 82.50 in early-April) but the recent sell-off has seen Silver's increased volatility return, seeing the ratio rise back to 78.40. The overall trend in the ratio is downward sloping now, so any rebound in precious metals prices may well see Silver outperform Gold again.

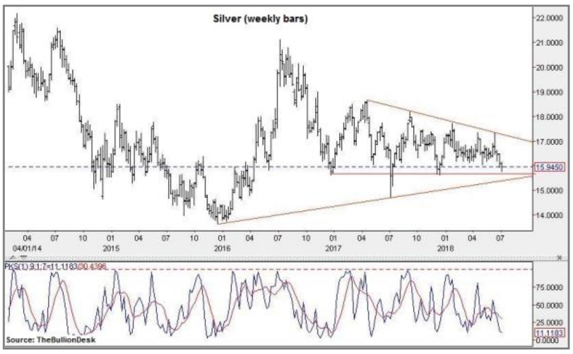


Short-covering rally ran out of steam

In the June Metal Matters report, we warned of a short-covering rally, which played out with the net long fund position rising to a peak of 49,730 contracts from 17,453 contracts in late May. During this time, spot prices rallied to $17.32/oz from $16.40/oz. The rug was pulled from under the rally by developments in the wider markets and now prices are lower ($15.94/oz) than when the fund position was net short 16,965 contracts, as it was in early-April, when prices were around $16.30/oz. With the gross long fund position still quite high, there is a danger of long liquidation that could weigh on prices further.

ETF investors ride out the storm

Holdings in the ETFs we follow have been quite choppy since May, oscillating between 20,000 and 20,460 tonnes and not necessarily following the day-to-day price moves; see ETF chart in Gold section. Indeed, holdings have been quite rangebound since last September. We wait to see if the recent steep price drop attracts further bargain hunting or prompts redemptions.



Technical – Silver prices have broken below the lows seen earlier in the year, but they have held up above last December's low. They are also finding support along the horizontal support line that underlies all but one of the lows since December 2016. The uptrend line joining the 2015 low and the July 2017 low has also not been approached yet. The down trend line highlights there is overhead supply, so we should now get a feel for how strong underlying demand is by seeing whether prices turn higher again before testing support levels.

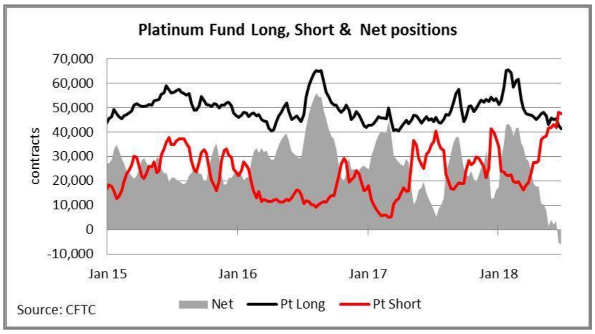
Summary – Prices remain rangebound within the 2017-2018 range; the recent sell-off has seen prices drop back to the lower levels of the range, so we expect support to be found before too long. The past three major dips since late-2016 have tended to be short-lived, so we would be looking for a buying opportunity during July.

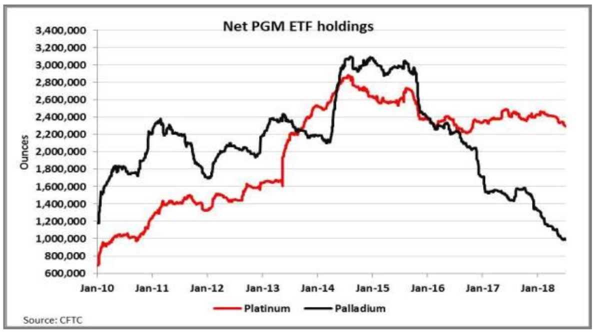
Silver Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	May-18	Jun-18
London Prices (US$/oz)								
Daily Fix	19.08	15.71	17.10	17.05	16.70	16.77	16.47	16.52
Parity (London) prices								
Japan (Y/g)	70.31	58.92	57.46	59.27	58.44	56.29	56.00	58.45
India (Rupee/oz)	1,312.5	1,004.7	1,147.5	1,109.5	1,080.4	1,078	1,110.7	1,118.1
COMEX – futures contracts								
Stocks (Moz)*	178.9	171.6	162.1	210.8	237.4	253.8	270.5	276.7
Vol (million contracts)	13.7	13.5	17.0	23.0	5.8	4.0	1.7	2.5
OI (‘000 contracts)*	155.8	169.6	188.8	191.6	169.9	191.8	194.6	205.6
CFTC (Futures Only Data) non-commercial								
Net Positions *	19,307	31,269	69,366	56,301	33,731	4,639	15,225	34,221
TOCOM								
Stocks (Moz)*	0.2	0.16	0.16	0.18	0.11	0.14	0.14	0.14
Futures Vol (‘000 contracts)	86.1	62.6	61.1	20.6	4.5	4.1	1.4	2.0
Futures OI (‘000 contracts)*	4.5	3.1	3.3	1.8	1.6	1.9	1.5	1.3
Other Indicators								
Gold/Silver ratio*	67.6	74.4	73.0	74.3	76.8	79.5	78.9	78.4
Silver Bullion Imports (tonnes)								
USA	3835	5464	5956	5039				
Japan	1688	1560	1553	1833				
India	5819	7954	2793	5500				
Italy	796	843	540	605				
Hong Kong	948	839	659	1424				
China (exports)	1369	2054	-137	800				

* figures are period averages unless marked; ~ not available yet, *italics* = estimate.

Palladium prices follow Gold's lead, while Platinum prices tumble to 2008 levels

Metals prices across the board have been under pressure in the second half of June and early July, but Platinum prices have been particularly hard hit. While the general sell-off is not metal specific, the weakness seen in Platinum is. Platinum prices are suffering as diesel autosales continue to lose market share, not only to petrol vehicles, but electric vehicles too. It would seem that some investor sentiment now sees 'diesel as dead' and hence they are getting out of their Platinum investments; indeed, the funds trading Nymex Platinum have turned net short – although ETF investors still hold 2.3 million ounces – and they seem to be exiting Palladium at an even faster pace; see charts below.





Reduced investor interest in PGMs

While funds have turned net short on Platinum, they have been reducing exposure to Palladium too, with the net long fund position falling to 8,591 contracts, down from a peak of 27,614 contracts in early January. As the ETF chart above also shows, the investors are also cutting their exposure to Palladium. The reduced interest in Palladium is seen as profit-taking and given still strong demand for petrol autosales and supply deficits, we would not be surprised to see investor interest return. This will be especially so if weak Platinum prices start to prompt production cutbacks in South Africa. That said, while dollar-Platinum prices may have been as low as they were in 2008, at 11,400/oz Rand-Platinum prices are well above the lows seen in 2008 (Rand 7,800/oz), albeit well below the highs in 2016 (Rand 16,600/oz). At present, the South African Platinum industry is undergoing some consolidation, which may lead to shaft closures and less production.

Technical & Summary - Platinum prices have fallen hard and are looking oversold. While the demand side of the equation may have lost its lustre, at these price levels there is increased likelihood of production cutbacks, especially as takeovers are underway. In addition, negative sentiment about demand may have run ahead of itself. The price pullback for Palladium looks routine considering the extent of the earlier rally and the weakness seen in other industrial metals prices. Given a supply deficit in Palladium and the possibility of production cuts in the PGM industry in South Africa, we doubt Palladium prices will stay down for long.

PGM Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	May-18	Jun-18
London Prices (US$/oz)								
Platinum	1,390	1,060	976	949	921	978	904	885
Palladium	809	692	611	869	992	1,035	978	986
Rhodium	1,180	953	694	1,101	1,477	1,826	2,134	2,255
Japanese Parity Prices (Y/g)								
Platinum	4,519	3,965	3,278	3,298	3,221	3,283	3,074	3,018
Palladium	2,636	2,587	2,050	3,020	3,472	3,478	3,325	3,362
South African Parity Prices (Rand/kg)								
Platinum	466,074	417,839	444,891	391,696	389,038	362,060	350,754	363,902
NYMEX Stocks ('000oz)								
Platinum	195.8	138.8	205.1	215.0	194.6	183.4	185.3	184.7
Palladium	347.4	134.0	71.1	50.2	49.6	41.8	40.8	40.5
CFTC Futures Only Data Long / (short) non-commercial								
Platinum	35,840	24,585	31,817	24,302	21,430	37,569	1,462	-6,115
Palladium	22,276	12,080	8,765	20,660	23,565	18,564	10,715	8,591
Tocom - Platinum								
Stocks ('000oz)	46.6	53.8	57.1	47.1	54.2	56.3	65.7	49.6
Vol (Million contracts)	4.6	3.9	2.9	2.5	0.6	0.5	0.2	0.2
OI ('000 contracts)	72.6	69.7	52.7	56.8	55.0	50.6	64.5	57.6
Tocom - Palladium								
Stocks ('000oz)	3.2	5.4	11.1	3.6	1.0	0.9	1.8	0.3
Vol ('000 contracts)	77	63	30	32	9.3	7.6	2.2	3.0
OI ('000 contracts)	2.0	1.8	1.1	1.4	1.4	1.4	1.4	1.2
Other Indicators (US$/oz)								
Pt-Au spread	115	-100	-253	-320	-355	-374	-394	-415
Pt-Pd spread	568	245	369	59	-77	-16	-79	-103
Platinum Bullion imports (kg)	2014	2015	2016	2017		2018		
USA	141,413	238,740	201,412	431,277		36,249	(Jan-Apr)	
Japan	32,684	47,283	44,786	42,986		17,159	(Jan-May)	
PalladiumBullion imports (kg)	2014	2015	2016	2017				
USA	92,400	82,500	88,800	86,000		27,510	(Jan-Apr)	
Japan	58,429	57,223	58,860	59,492		24,783	(Jan-May)	

~ = data not available yet, *italics* = estimates

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