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ANZ Investment Bank

Global Strategy Weekly

Gold key day reversal – watch downside?

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Summary of key views

Fundamentals: Gold prices have been reacting to the usual factors recently, with USD weakness and geopolitical tensions resulting in a solid 6-7 week rally from the early May lows around $372. Producer buybacks continue to provide support at lower levels, however a mixture of suspected CB selling topside and some hedging by producers continues to cap the topside.

Technicals: Gold technicals, which have been positive over the last 4-6 weeks, are turning decidedly bearish after the key day reversals in the metal versus a range of currencies yesterday (USD, CHF, AUD etc) and also in US Gold stocks last night. Daily and weekly momentum is overbought, and has turned bearish, while its possible that the run higher from 381 is over in Elliott wave terms. Expect a $10-15 decline in the coming 1-2 weeks.

Currency Implications: Gold retains its strong correlation with AUD, with the 3 month and 1 year correlations around 0.85/0.90. The outlook above does raise the risk that the AUD - which has experienced a nice 250 point un-interrupted rally over the last 2 weeks - upmove will end, and a correction take hold. While we could still see a new high in AUD around .7050/70, that may be a great place to offload longs ahead of a dip back to .6950/.6900.

Strategies:

Metals – We suggest selling Spot Gold at 400 risking 407 targeting 390/385.

Fundamentals – Gold smack bang in the middle of its 3 month range

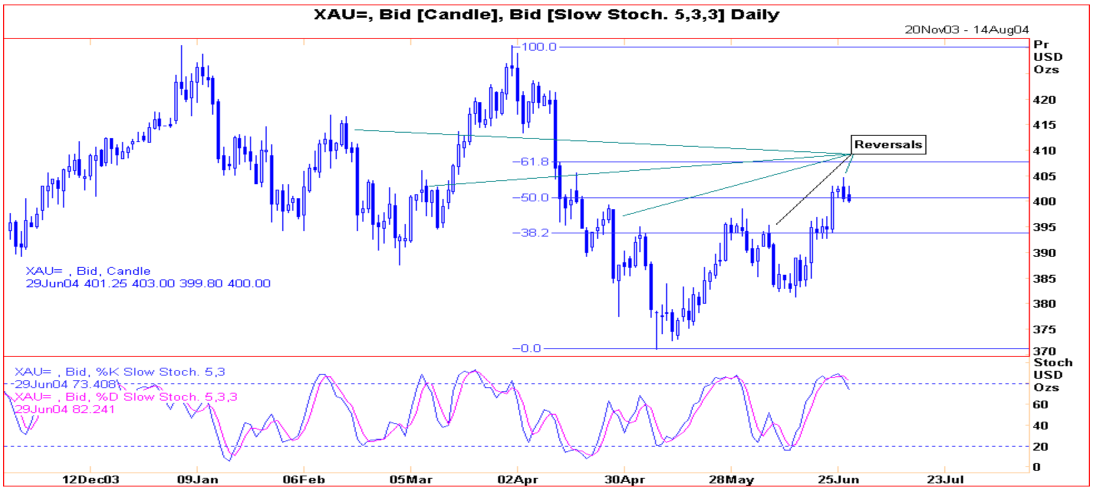
The key short term drivers for Gold remain USD direction and geopolitical factors, against the underlying backdrop of still steady producer buybacks at lower levels, and decent hedging based selling at higher levels above 405. Obviously the key determinant of USD direction in coming days will be the FOMC decision Wednesday afternoon US time, with the market not pricing in anything more than 25 basis points of tightening for this meeting. Longer term, we continue to believe that structural negativities in relation to the US current account and fiscal deficits will continue to undermine the USD, however in the shorter term, the market may still be susceptible to stronger USD news, especially in the early stages of Fed tightening. Indeed looking back over the last 3 Fed tightening cycles, the USD has tended to rally going into the first hike, and potentially for 3 months after the first hike, while structurally weakening from 3-18 months after the first hike. We think this profile will continue to operate this time around, and as such there continues to be short term USD upside risk in coming days and weeks.

Geopolitical factors remain a support for Gold prices, however at times you wonder how much worse the geopolitical landscape can become from current levels. Nevertheless, they remain a threat, although with Gold moving back from its highs above $42, global concerns regarding rising risk appetite may be subsiding somewhat, potentially negatively impacting Gold. Interestingly, Gold stocks in the US have fallen sharply in the last 24 hours, with the AMEX Gold Bugs Index (HUI) and the XAU Indices both trading heavily to the downside. Given the reasonably close correlation between Gold stocks and the metal, this may suggest a larger period of consolidation or downside action for the metal.

However the reality is that Gold is smack bang in the middle of its range, and there appear to be few key fundamental drivers that will push Gold to either extreme of its range at present. Its in exactly this environment that technical drivers become key, as outlined below.

Technicals – Key day reversals abound, beware the downside.

The technical outlook for Gold continues to have a bearish slant, due to the double top formation at 432 and the impulsive nature of the decline from that area to the 372 low. In addition, the rally from that low so far only appears to be corrective or three wave in nature, suggesting that its possible the lower end of the range could be retested. In addition, Gold prices rejected yesterday the 402/408 band of Fibonacci resistance in what appears to be a key day reversal pattern, which coupled with the overbought nature of daily and weekly oscillators, argues for a 1-2 week downwards period to unfold. This outlook is evident against the AUD and CHF, as well as the USD, suggesting that this move lower will be a Gold move rather than necessarily a currency based move.



As mentioned above, US Gold stocks also experienced key day reversals yesterday, suggesting also that a 1-2 week downwards period will be upon us. The ideal outlook for the next 1-2 days in the US would be for a small retracement of yesterday's gains, and then further declines in sympathy with last nights price action. The AMEX Gold Bugs Index (HUI) topped at 198 and could retest as low as 185-180 into next week, while the XAU Index of precious metals stocks topped in front of 90 and should test 82-80 into next week. Usually Gold stocks and the metal trade in tandem, meaning that the coming week should also be a negative period for the metal.

Currency Implications – Gold prices give some downside risk to AUD upon new high.

We've made much in recent months regarding the close correlations between Gold and base metals and the AUD, simply because over time (ie 3-5 years) they consistently provide direction for the currency. If our view on Gold prices is correct (and if the current 0.85 correlation between the metals and currency continue to operate) then the AUD will potentially be vulnerable in the next 48 hours. Our independent analysis of the AUD suggests a new high above .7030 and then a peak around .7050/70, so the possibility of some small non correlation in the next 24 hours between the metal and AUD is present. However we do tend to think new highs are an ideal time to exit short term (ie less than 2 week) longs in the AUD, as not only will it independently be completing its own wave pattern, and be overbought at that level, but we expect the Gold price to start to play an impact on its performance as well.

OPEN TRADES

From January 13 – Bought 1 year 1.20 EUR$ Puts that knock in at 1.34 for 0.39% of USD, reval 0.05%
From January 21 - Bought 1 year 400 Gold puts spot ref 412 ki 455 for $3.05 per oz, reval $0.48.
From January 26 - Bought 1 year .75 cent AUD$ puts spot ref .7690 that knock in at .8100 for 1.05% of USD, reval 0.12% of USD.
June 29 – Buy 395 Friday 2nd July Gold puts for $0.65.

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