Wg | Weekly Gold Commentary | 2013

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MAIN TOPICS

- Gold prices plummet due to massive sell-off on futures markets.
- Gold up in other currencies.
- Higher interest rates should be good for gold.

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Gold prices plummeted to five-year lows on Monday, weighed down by the dollar's relentless gains as the prospect of the first U.S. interest-rate increase in more than nine years looms.

Gold prices get hammered last week.

After the sell-off which took place on Monday, the price of spot gold fell again on Friday to trade at a fresh five-year low of $1077 an ounce before rebounding later in the session. Nevertheless, the price failed to break back above the $1100 an ounce level.

While many market commentators believe that Monday's decline in gold began during Asian trading, in actual fact the first wave of selling took place when the equivalent of 24 tons of gold were dumped onto the Globex electronic trading exchange in New York in less than 2 minutes. Data revealed that the volume traded in one minute was 7,164 contracts, which at 100 ounces a contract is about 22 tons.

The selling began on the COMEX in the August futures contract on the CME Group's Comex futures in New York a tenth of a second after 9:29 a.m. in Shanghai. Japanese markets were closed ensuring a minimal amount of liquidity and potential buyers to support the price. Then, an additional 33 tons of paper contracts flooded the Shanghai Gold Exchange.

While there appears to be some discrepancy in the figures reported by different analysts and media, the selling knocked the price almost $20 to $1,100 per ounce during those four seconds. It marked the first leg of a dramatic 60-second sell-off that saw prices sink more than 4% to five-year lows.

One thing that I am sure about is that the price action didn't appear to be driven by fundamentals. The nature and timing of the selling suggests that this was not traders responding to a slight strengthening in the US dollar, but was a very well-orchestrated bear raid. Whoever did the selling, the party concerned chose the time when the market had minimum thus being able to slice through the bids in a clear attempt to smash prices and confidence in gold.

In the immediate aftermath of gold's massive price slam, media was quick to attribute the selling to Chinese traders.

In an article published by Reuters, **"**traders from Hong Kong to New York are pointing the finger at others for being behind the move while struggling to unmask the mystery sellers**."**

Singapore-based futures brokerage Phillip Futures declared "indiscriminate selling by Asian hedge funds at the stroke of the market's open in Shanghai" as the chief cause of the price fall in a letter to clients.

But the most well-known Chinese funds denied involvement, and as futures trading is anonymous, dealers may never know who was buying and selling during those crucial seconds.
In a report issued by the World Gold Council (WGC) the organisation stated. *On Monday 20th July 2015, the gold price fell sharply during Asian trading hours. The price declined from a closing price of US$1,134.14/oz. on Friday, to an intra-day low of US$1,086.18/oz., a 4.3% fall. It quickly rebounded to stabilise a little above US$1,100/oz. This fall was precipitated by significant trades on the Globex platform on COMEX and the Shanghai Gold Exchange (SGE). Trading data reveals that 4.7 tonnes (t) was off-loaded on the SGE at 2.29am BST – this is an exceptionally large amount in a short space of time. Normally little more than 40t trades in a day. At around the same time volumes*

spiked on COMEX. Both trades were made during periods of low market liquidity. Sell orders in China and US triggered the price fall.
The price has seen further, less dramatic, declines since Monday. With trading volumes thin, and market sentiment for gold at low levels, the price has now fallen below the US$1,100/oz. level. This is the lowest price level since Q1 2010.

The recent price fall, in common with similar price action in the past few years, was triggered by isolated trades. These trades are not representative of the broader supply and demand dynamics. In thin trading conditions, these actions have a significant impact beyond the relative scale/volume of any corresponding net flows; they are often reflective of and can amplify capital market sentiment in the west. But although these traders provide a depth of liquidity in the market, they are not the key buyers of gold. They do not shape demand over the longer term. These types of large gold trades have been a characteristic of COMEX in the past, but they are less typical on the SGE, where trading volumes are lower, albeit increasing quickly. There has been some speculation as to who made the trade on the SGE. The Financial Times drew parallels with similar trades in other metals in China recently, such as nickel and copper. Nevertheless, short-term speculative transactions, divorced from physical delivery and amplified by leverage, are likely to remain centred on COMEX, rather than on exchanges that have been developed to facilitate wider access to physical gold, such as the SGE.

In the end it seems as if the real culprit was a US-based entity masquerading as a Chinese trader.

While the price recovered somewhat throughout the remainder of the week, prices fell again on Friday but then later in the day, they recovered to end up on the day.

Gold prices remain higher in many other fiat currencies

Even though the gold price has dropped below $1,100 per ounce, it is important to note that in many other currencies gold has fared relatively well. In euros, it is now around 1,000 euros per ounce which is still slightly higher than it was a year ago.

If you are a European living in Europe and saving in euros, you would have been better off investing in gold one year ago than keeping your money in the bank. And with interest rates near zero and even negative at times in parts of Europe, your euros would not have made any interest of any significance.

This current negativity is unwarranted given the reasonable performance of gold this year in currencies other than the dollar. Even following the smash gold is up 4.4% in euros this year. It is also up in Australian and Canadian dollars – not to mention in Latin American currencies which are again under pressure.

During the last twelve months, gold in Japanese yen, it is slightly higher than a year ago. It is up by 8.43% in Australian dollars, up by 26% in Brazilian reals, up 1.46% in Canadian dollars, up 5.66% in Mexican pesos, up a whopping 39.8% in Russian rubles and up by 1% in South African Rand.

At the same time, it is down by 10% in Indian rupees, down 8% in sterling, down 15.71% in Chinese Yuan and down by 10.56% in Swiss Francs.

As I have mentioned on numerous occasions, the notion that gold is set to decline further as the Fed raises rates is not correct. The historical record shows that gold tends to rise with nominal interest rate rises – as was seen from 2004 to 2008 and in the 1970s – and the Fed is unlikely to raise rates in any meaningful way while deflationary forces persist.

According to the WGC although higher interest rates would make the dollar more attractive to investors looking for higher-yielding assets, the current narrative that this scenario would be bearish for gold is incorrect.

It is true that higher real interest rates raise the opportunity cost for investors holding gold. But our analysis of the gold price and previous rate conditions found gold may perform reasonably well in a positive rate environment. Our analysis indicates that gold is only negatively affected when real rates nudge higher than 4%. The current outlook suggests the US rate increases will be moderate and real rates will be below 4% for some time.

In addition, markets are forward-looking and the forthcoming rate rise has been well flagged. It would be surprising if expectations of US rate rise were not already factored into the gold price.

While, I think the current negative sentiment towards gold is unjustified, and set to continue. However, as far as I am concerned, the investment case for gold remains intact. The long-term investment case for gold is not based on short-term price movements. I believe every investor should own some physical gold and have it stored out of the banking system. And, if you have not yet included gold in your portfolio this is probably a great time to buy. It may go down lower, but you will almost never find the bottom.

Physical gold will protect your wealth in the event of a banking crisis, or a financial collapse which I believe is imminent.

TECHNICAL ANALYSIS

Gold prices tested the support level of $1180/oz. last week. While, there was much pressure on the downside, prices have managed to hold above this level. Prices also appear grossly oversold.

About the author: David Levenstein is an independent precious metals market commentator with more than 30 years' experience.

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