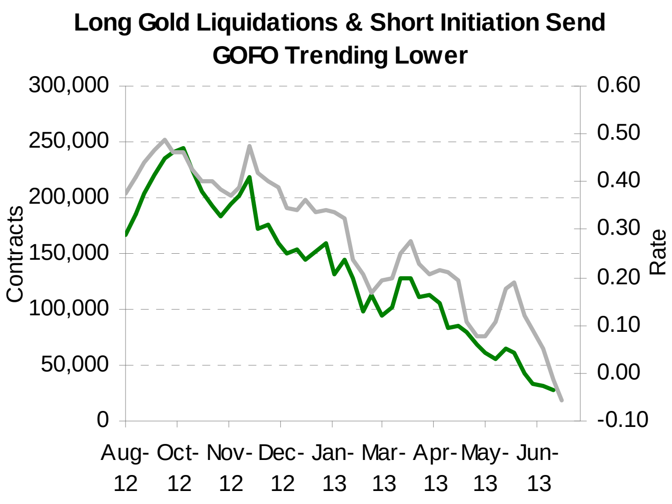
TD Securities

Commodities Chart Logic

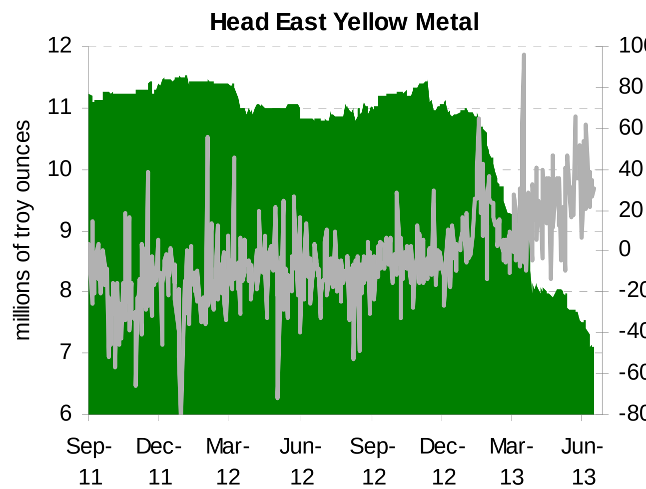
Rates, FX and Commodities Research

18 July 2013 | **TD Securities** | **Toronto**

Negative Gold GOFO Rates & Trend of Rising Shanghai-COMEX Premium May Show a Modest Reversal



Source: Bloomberg, TD Securities



Source: Bloomberg, TD Securities

Starting as early as late-2012 and accelerating in the first half of this year, gold investors started to get nervous about an eventual deceleration in the Fed's extremely accommodative monetary policy. The thinking was that less accommodation would mean a stronger US dollar and higher yields, which would drive up the opportunity cost of holding a zero-yielding asset like gold. At the same time, many speculated that the improving US economy would also likely generate strong equity market performance, as corporate revenues grew alongside aggregate demand and due to flows of funds from bonds and other asset classes.

With these expectations getting rooted in the market's psychology, specs aggressively liquidated longs and grew their short positions. This sent gold prices sharply lower through most of this year. The dropping gold prices, rising yields, a strong dollar, a surging equity market and aggressive short positioning fed off each other to create a vicious cycle that took gold lower than dictated by the fundamentals. With that, the gold 1-3-month offered forward rate (GOFO) rate turned negative for the first time since late-1999—long liquidations along with the formation of shorts causing downside pressure in the forwards. Despite receiving negative yields for swapping gold for cash, positive returns elsewhere prompted investors to get out of gold.

Meanwhile, the Shanghai-COMEX spreads moved convincingly positive and gold started moving from the west to the east of the world, as the Chinese currency strengthened and gold looked like a bargain after the sharp drop. Given that gold is expected to hover in the upper limit of its $1,200-1,325 trading range into the summer, we judge that the GOFO rate may turn positive again and that the Shanghai-COMEX spreads will narrow through this time period as well.

All the factors that have served to send the gold GOFO negative and served as catalysts to widen the Shanghai-COMEX spreads are much less robust now. This is why: the introduction of policy ambiguity by the Fed's Ben Bernanke in recent weeks has partially, albeit temporarily, reversed the rise in bond yields and should also keep the greenback from making new highs. This has already boosted gold prices and may bring us higher throughout the summer, as economic data is unlikely to be stellar and the Fed will remain coy.

As such, investors are unlikely to dump their gold as enthusiastically as they this over the last few months, with possible growth in long interest. Slower equity market momentum should also help to moderate the exit from gold. We could also see robust short-covering if we reach levels near the upper bound of the current trading range ($1,200-1,325). In China, growth is slower, the currency has moved up from the bottom and at these levels gold may no longer looks like such a fantastic deal, which may moderate the west to east movement.

Over the last several months, long liquidations and short position formation drove GOFO sharply lower as did borrowing to ship metal to Asia. We suspect short-covering could be the trigger to reverse this trend. A lower propensity to build on the record short holdings and a pause in long liquidation due to the Fed's current dovish talk and data choppiness should move prices and GOFO higher. But, this is likely to be temporary as we are still in a gold bear market—the Fed will allow rates to move higher later in the year and lift the opportunity cost of holding the yellow metal. Conversely, there could be some producer hedging which could prevent the deferred part of the gold curve from moving too high, as central banks are unlikely to provide liquidity.

Bart Melek, Toronto

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Commodities Price Forecasts:

Commodity	Spot Price	2013 Q1A	2013 Q2A	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F	2014 Q3F	2014 Q4F	Annual Averages 2013	Annual Averages 2014
Gold *	1,250	1,632	1,417	1,275	1,200	1,175	1,150	1,175	1,250	1,380	1,188
Silver *	19.55	30.10	23.22	19.60	17.90	17.75	17.00	18.00	19.25	22.69	17.98
Platinum *	1,361	1,632	1,467	1,500	1,700	1,750	1,650	1,625	1,700	1,578	1,681
Palladium *	684	742	714	685	825	900	875	850	875	744	874
Copper ** - lbs	3.17	3.60	3.25	3.18	3.35	3.30	3.25	3.20	3.10	3.36	3.21
- tonnes	6,996	7,937	7,165	7,011	7,385	7,275	7,165	7,055	6,834	7,397	7,082
Zinc ** - lbs	0.83	0.92	0.84	0.94	1.02	1.08	1.10	1.10	1.14	0.93	1.11
- tonnes	1,832	2,028	1,852	2,072	2,249	2,381	2,425	2,425	2,513	2,050	2,436
Lead ** - lbs	0.94	1.04	0.93	0.98	1.05	1.12	1.15	1.18	1.20	1.00	1.16
- tonnes	2,070	2,293	2,050	2,161	2,315	2,469	2,540	2,601	2,646	2,205	2,564
Nickel ** - lbs	6.25	7.85	6.79	7.50	8.00	8.00	8.60	8.50	8.20	7.54	8.33
- tonnes	13,780	17,306	14,969	16,535	17,637	17,637	18,960	18,739	18,078	16,612	18,353
Aluminum ** - lbs	0.80	0.91	0.83	0.90	0.96	0.96	0.96	1.00	1.00	0.90	0.98
- tonnes	1,763	2,006	1,830	1,984	2,116	2,116	2,116	2,205	2,205	1,984	2,161
Molybdenum +	10.10	11.39	10.90	12.50	13.25	13.50	15.00	15.00	14.50	12.01	14.50
Iron Ore *+	121	149	126	135	130	135	135	130	130	135	133
Nymex Crude Oil +-	101	94	94	93	95	95	92	95	95	94	95
Brent Crude Oil +-	106	113	103	103	105	107	103	105	105	106	105
Heating Oil -+	2.95	3.04	2.89	2.80	2.85	3.00	2.75	2.80	2.90	2.89	2.85
Gasoline -+	2.84	2.99	2.83	2.75	2.70	2.85	2.70	2.65	2.75	2.83	2.75
Natural Gas --	3.69	3.48	4.02	3.85	4.05	3.90	4.00	3.90	4.25	3.84	4.00
AECO Natural Gas --	2.97	3.13	3.43	3.40	3.65	3.55	3.60	3.40	3.85	3.40	3.60
Uranium ++	39	43	41	45	45	45	45	50	50	43	48
Hard Coking Coal Spot +*	n/a	166	145	155	165	170	175	175	175	158	174
Newcastle Thermal Coal-	78	92	85	100	95	95	95	85	85	93	90

Note: *London PM Fix $/oz., **LME $/lb., +Molybdenum equivalent to moly oxide, FOB USA,
+CFR China, 62% Fe, dry $/tonnes, +- $/bbl, -+ $/gal., -- $/mmbtu, ++pre-2011 Uranium price is Ux Consulting spot price indicator post 2011 is NYMEX, + Japan-Australia Spot, $/tonne FOB, -Japan CIF steam coal marker -Newcastle, $/tonne

F = Forecast, E = Estimate, A = Actual
All forecasts are period averages
Source: Bloomberg, TD Securities

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