New York Securities Pty Ltd

Monthly Newsletter – MAY 2013

GOLD BULLS GET SPOOKED

On Friday the 14th April, Gold dropped over 9% from its previous trading session, its largest one day percentage fall in over 31 years. The following day and the price dropped again over 5% to a low of US$1321, crawling its way back to the current level of US$1475. There were many explanations behind the collapse, the most prominent being; Cyprus selling gold to cover debts, inflation numbers remaining subdued, to comments made by the US Federal reserve minutes discussing the possible winding down of massive assets purchases at the end of this year.

Realistically it's more so the latter two but considering these were nothing new to the market, the ferocity of the move has to be questioned. What started the collapse was a short sale of 500 tons of gold equivalent (20% of 2012 global production) of paper gold futures contracts on the COMEX in New York. The trade valued at about $24 billion dollars resulted in the break of the support level of US$1564oz, then all hell broke loose as participants panicked, stop loss selling accelerated and margin calls were triggered. Chart 1 (30 year chart) reflects this sizeable drop.

You would have thought if you were to exit a large position, the rational decision would be to ease out the holding over time to achieve the best price. Doing so ensures you don't "spook" the market, creating a situation where buyers pull their bids and sellers dump their holdings in fear, which only guarantees you a lower selling price. But perhaps this was no ordinary sale. Sales of this nature are done to make a statement and whilst it was a perfect trade for large institutions to capture big profits, the main beneficiary of a collapse in the Gold price would have been the US Federal Reserve. We discuss why restoring confidence in the US dollar helps the US Federal Reserve benefit in more ways than one.

(CHART1, 30 yr chart, Red line =US$500oz, Red Circle = start of 12 year uptrend from 30 June 2001)

Firstly though, manipulation is hard to prove and saying it was orchestrated by the US Federal Reserve is setting yourself up to be classified as a "certified nutter". We don't invest based on conspiracy theories but after the LIBOR scandal and the fact that anything can and will happen its interesting enough to write about.

Gold has always been an effective measure of the management of fiat currency. The Gold price generally increases if the management of currency is poor, and declines if it's managed well and as Chart 1 reflects, a loss in confidence in the US currency and paper currencies in general has been building over time.

And so we theorize in an attempt to re establish confidence in the US dollar as the Global Reserve Currency the price of Gold had to fall. As confidence is re established it is reflected in the bond market, redistributing demand to bonds resulting in higher bond prices and low yields. After all the US has unbelievably large debts to pay, have seemingly no control over the federal debt, are experiencing tepid growth and subsequently what don't need right now are higher yields, otherwise they risk defaulting on their debts and that would be catastrophic.

In recent months yields have been creeping up to higher levels, against the key policy of low interest rates which is holding up the US economy and which Ben Bernanke is hell bent on making work. Shaking out speculators, hedgers and investors from the historical hedge against currency devaluation impacted treasury yields heavily, short, mid and long. In percentage terms, as the Gold price fell, US 10 year and 30 year yields dropped 17% and 11.6% respectively, to finish at 1.7% p.a. and 2.9% p.a.

Late Settlement Fees on Purchases

To avoid late settlement fees on purchases please ensure if you are not set up for direct debit, the funds are available in your trading account the day before settlement. This will ensure the funds are available on time for settlement and to ensure you avoid the hefty fail fee of $100 for each day settlement is delayed

Another benefit to the US Fed that emerges from a collapse in the gold price is to force participants to question the legitimacy of Gold as store of wealth (which we dismiss). People are generally adverse to volatility so after the recent event many people will think twice before allocating savings or investing in gold for the future. Consequently we reviewed the reasons why we should continue to hold Gold and concluded we remain bullish on its long term prospects. Despite inflation yet to rear its head, it's the massive out of control deficits, the ongoing printing of money to fill the sinkholes, the lackluster effect money printing has had to date on global growth prospects and the ongoing "race to debase" between economies that remain a concern to us.

It seems others shared the same conclusion but showed their support in a different form, physical bullion. Consider these headlines for example:

- "US mint runs out of Gold bullion coins"
- "Gold rush in China, biggest in half a century"
- "India Gold demand surges on bargain buying"
- "Perth Mint Sales climb 49% from year earlier, in first quarter"
- "US mint sets record sales of American Silver bullion coins"

The demand remains strong and it's not just retail consumers and investors, Central Banks in particular remain big buyers as they continue to increase their holding of Gold as a percentage of their foreign reserves.

PAPER BEATS GOLD

The GOLD future markets, such as COMEX, are huge and are by far the biggest influence on determining the price of gold. The futures markets provide an avenue to "Go Short" that is selling assets you don't own or as a speculator intend to deliver. The aim here is to buy back your position at a lower price, lock in a profit and do so before you're forced to make delivery of an asset, especially one which locks you in to deliver 500 tons of physical Gold bullion! And so because no delivery takes place, someone with enough determination, bank balance and bad intentions can use the system to manipulate the price of Gold for their own benefit. Leverage can be as high as 20:1 on a 5% margin. So for someone wanting to short 500 tons of gold which is worth about $24 billion dollars, the exchange would command $1.2 billion in cash, not 500 tons of Gold. Furthermore as this monstrous trade hit the paper market no equivalent sale of 500 tons of physical Gold took place and so a disconnect exists meaning the movements in the paper markets don't necessarily reflect movements in the physical market, creating a situation where paper beats rock.

BUY/SELL/HOLD GOLD STOCKS - CONSIDER THIS FIRST

If you are currently holding gold stocks, or considering taking a position in Gold companies in light of the recent weakness; consider the following before you sell/buy/continue to hold:

- Cash Costs and Operating Costs per ounce – is the mine still profitable at current prices?
- Mine Life – time remaining to employ capital and generate cash flow
- Development – are exploration programs at risk i.e. development issues
- Gold Hedges in place – does the company have any hedges in place as insurance against unfavorable movement in the gold price?

A good example where we believe sellers have outdone themselves in the short term is a company called Beadell Resources (ASX Code: BDR), located in Brazil.

The company's first gold pour was Mid Dec 2012 and have only just reached commercial production this April. Their cash costs (to be confirmed June quarter) are expected to be around $750 per ounce due to iron ore credits reducing cash costs by $100 per ounce. It has an open pit mine life (current resources) of 12 years and forecasted production of 180,000oz per annum. The company has a forward hedge over 195,000oz over a three year period (40% of target production), where 95,000oz are hedged at US$1600oz and 100,000oz are hedged at BRL$3,124oz (US$1540oz), compared to the current price of US$1475. This coming year the Exploration budget is forecasted at US$6.5 million, with Cash and Gold on Hand totaling $38 million and thus we see no risk to the program being stalled. The stock is currently down 38% from its $1.135 high in December 2012, trading at $0.70. 12 month price targets from independent analysts are around $1.16 per share, which technically is close to the previous resistance point/high of $1.135.

Performance of Key Indices

Equities	***Close***	***Change (M)***	***Change %(M)***
All Ordinaries	**5168.6**	**+188.7**	**+3.8%**
S&P/ASX200	**5191.2**	**+224.7**	**+4.52%**
Dow Jones (US)	**14839.8**	**+266.95**	**+1.83%**
NASDAQ	**3328.79**	**+89.62**	**+2.77%**
S&P500	**1597.57**	**+35.40**	**+2.27%**
FTSE 100 Index	**6430.12**	**+18.38**	**+0.29%**
Nikkei 225 (Japan)	**13860.86**	**+1725.84**	**+14.22%**
10-year bond rate (US)	**1.6736%**	**-0.1595**	**-8.70%**

Upcoming RBA Events

Reserve Bank Board Meeting – 7th May
Statement on Monetary Policy – 10th May
Minutes of the RBA meeting – 21st May

ABS releases March

Building Approvals (March) – 2nd May
Retail Trade (March) – 6th May
Labour Force (April) – 9th May
Housing Finance (March) – 13th May
Lending Finance (March) – 14th May

Upcoming US Economic Releases

ISM Manufacturing Index – 1st May
International Trade (March) – 2nd May
US Employment Situation (April) – 3rd May
Retail Sales – 13th May
Consumer Price Index – 16th May
FOMC Minutes – 22nd May
Durable Goods Orders (April) – 24th May
GDP – 30th May
Jobless Claims – Weekly Basis