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Yellow metal tipped to shine again

By William MacNamara

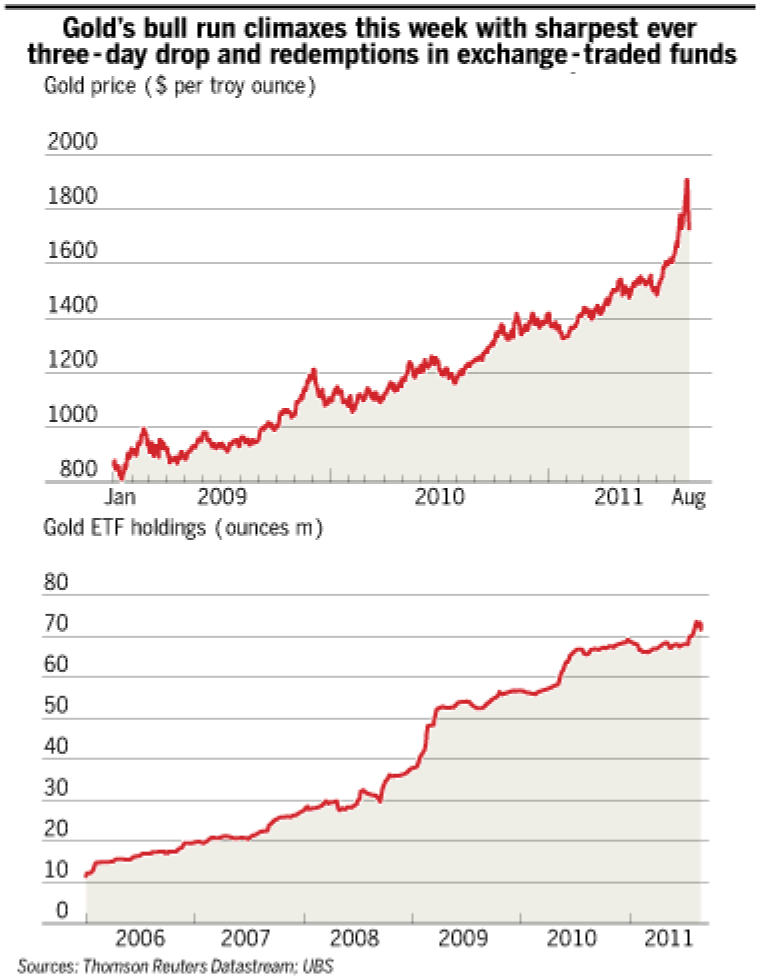
Gold set two opposite records this week. On Monday the yellow metal hit an all-time high of $1,911.46 an ounce. Then, over the following three sessions, it briefly fell more than $200, its sharpest ever three-day absolute drop.

The sudden nature of the falls has got traders and investors asking whether this “haven” asset is losing its structural support.

But, following a prolonged bull run which accelerated through August, most analysts and investors view this week’s sharp fall as a temporary correction that will be overpowered by the forces that have driven gold to record highs.

While froth has undoubtedly come off the price, analysts are still preparing for prices of $2,000 per ounce or more by the end of the year.

“The pace of the rally has been really quite crazy,” says Neil Meader, research director at GFMS Thomson Reuters, the metals consultancy. “If you’re seeing $50 per ounce gaps between the am and the pm fix, you’re in odd territory,” he says, referring to the daily benchmark gold prices. “There are 101 reasons why people are moving into gold, but the pace of gains was unsustainable.”



One reason behind the dramatic falls was this week's move by the Chicago Mercantile Exchange requiring investors to back their gold investments with a larger amount of cash.

The CME's decision – its second margin hike this month – has weighed, says Ben Davies, chief executive of Hinde Capital and manager of Hinde's gold fund. "The increase in margins has had an impact by forcing out the late speculators on a rise in the gold price".

Rupert Robinson, chief executive of Schroders Private Banking, predicts further falls. "A meaningful correction has been overdue, and this is exactly what this is," he says. "How far can the correction go? We believe back to meet the rising 50-day moving average in the $1,600-$1,650 range."

But Mr Davies is positive. "Physical demand is very strong, especially official interest from Asia," he says. "As we move into a bullish seasonal period, the price should take $2,000 by the end of the year."

Suki Cooper, gold analyst at Barclays Capital, agrees, explaining that the physical gold market is in "a seasonally slow period where short-term factors can weigh temporarily." Profit-taking among holders of gold exchange-traded funds (ETFs) is one such factor, she says, and is evident in this week's sell-off.

Investors added 58 tonnes of gold to the top 25 gold ETFs from August 1-19, Ms Cooper says. But, in the week to Wednesday, that reversed, with redemptions reaching 56 tonnes.

"The key," Ms Cooper says, "will be to see whether the Chinese and Indian physical buyers come, with the festival season starting in September. The gold price is dependent on investment demand now, but in the seasonally strong period from September you should see two sets of buyers."

Besides profit-taking, investors may be retreating because of expectations about US monetary policy. In a speech on Friday, Ben Bernanke, chairman of the Federal Reserve, will guide expectations over a possible third round of quantitative easing.

The falling gold market, analysts say, may reflect investor scepticism about another round, which would act to further weaken the US dollar and prop up gold.

Meanwhile equities have made tentative gains this week, in a signal that "risk-on" trades may be returning at the expense of haven asset classes.

If US stimulus spending does stop, weak economies and devalued currencies may still prop up the price of gold. "You would be brave to say that the eurozone crisis is over, that the sovereign debt concerns will not raise eyebrows again," says Mr Meader of GFMS.

Barclays Capital forecasts gold-price averages of $1,725 for the current quarter, $1,875 for the fourth quarter, and $1,930 per ounce for the first quarter of 2012.

"The actual volatility in gold is a symptom of the underlying volatility in currencies," says Mr Davies. As people discard each currency, it's an inverse function and gold has to rally accordingly."

This rally may have already started. By Thursday evening, prices rose over $1,760 per ounce, a marginal improvement on Wednesday's prices.