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**Gold Corporation**  
(trading as The Perth Mint)  
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310 Hay Street, East Perth,  
Western Australia, 6004,  
Australia

A statutory authority under the  
*Gold Corporation Act (1987)* of  
Western Australia

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Founded in 1899, the Perth Mint is an integrated precious metal operation refining circa 10% of world gold production; servicing investors with legal tender bullion coins and bars and the Perth Mint Depository custodial facility; providing collectors with innovative and high quality numismatic coins; supplying mints with precious metal blanks; and operating a leading Perth tourist attraction.

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## BLOG WATCH 2 MAY 2012

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### PREDICTIONS

**Commerzbank:** *“the prices by the end [of the year] are likely to reach new highs. ... You need to look at gold as probably a currency, as a safe haven, as an insurance”*

**Charles “no hair” Oliver:** *“I’ve just lost all my hair, and I’m thinking before I make any new bets I’ll wait until gold actually gets to \$2,000. I’m optimistic that will happen this year, though.”*

### DARK INVENTORY

**FT Alphaville** observes that *“something strange is going on with commodity inventories”* as *“official stocks are rising across numerous commodities, but analysts and traders swear fundamentals remain tight”* with prices not falling, as would normally be expected in such a situation.

The explanation is that much of the inventory is being used *“as collateral for bank loans. With financing for such trades relatively plentiful, traders say that only a fraction of the metal in bonded warehouses is available for sale.”*

They feel that the *“market may be under appreciating the influence of commodity encumbrance ... giving rise to a situation whereby inventory is being withheld from willing buyers, creating something akin to an artificial squeeze”* which will reverse at some point, pushing prices down.

This is news for commodities markets because as discussed yesterday, these markets usually have little in the way of inventory relative to new supply – unlike gold. I would thus characterise the fact that larger amounts of inventory are being withheld from the market means the affected commodities are becoming more “gold like” in terms of their supply/demand dynamics.

Blogger **Chris Cook** made a similar observation last year, concluding that *“most commodity markets have become completely perverted by the entry into the market of a new breed of fund investors ... passive ‘inflation hedger’ participants who are aiming to avoid loss, rather than actively seeking transaction profit.”*

The effect of this **financialisation** *“is that market participants who believe that market prices are actually set by producers and consumers are unaware that financial supply and demand are sending false signals”* and in addition, such inflation hedging investors have to compete with firms who have *“asymmetric knowledge about the Dark Inventory thereby created”* by the financial products these firms operate.



FT Alphaville conclude that *“massive pockets of concentrated wrong-way risk may be appearing as a result. Exactly not what the futures markets were invented for.”*

Chris Cooks' position is that this domination of a futures market by investors who hold massive stocks versus end producer/user volumes will not last, resulting in a price drop.

However, if

- a) the gold market has a 5,000 year history of investor demand dominating industrial uses; and
- b) that this will not change as 170,000t of stock isn't going anywhere; and
- c) futures markets were not invented for this

then the conclusion is we should shut down all gold futures markets? It would certainly make many in the gold blogosphere happy, given the fat gold finger trade story below.

## FAT GOLD FINGER

There has been a lot of coverage on the \$15 price drop in gold on the back of a gold futures transaction of 7500 contracts (750,000 oz) as reported in a [The Wall Street Journal](#) blog. Blogger [The Fundamental View](#) takes exception to the way this was picked up by the gold blogosphere (examples being [Zero Hedge](#) and [Max Keiser](#)). He notes that *“the inference in both these pieces is that the Wall Street Journal covered “gold market manipulation” when in fact it did nothing of the sort but instead pointed out some irregularities in the marketplace ... Not one mention of manipulation is made in the WSJ piece.”*

The other exaggeration that was made by the WSJ blogger was that *“the overall transaction was worth more than \$1.24 billion.”* Certainly a dramatic number, however later in his blog post he does note that *“the collateral required to purchase 7,500 contracts is about \$75.9 million in cash that the trader would have deposited with his broker.”*

If it was actually a \$1.24 billion cash/physical deal then that certainly is a large trade (but the sort of size central banks do). However it is likely the real cash at risk is “only” the \$75.9 million. Nevertheless, if not a “fat finger” error trade, transactions of this size are usually fed into the market rather than being done in one go, which has supported interpretations of market manipulation. If so, it wasn't particularly subtle nor effective, with the price moving upwards over the following hours back to pre-trade levels.

## GOLD SHARES

On the issue of gold mining shares failing to perform relative to gold, Paolo Lostritto, mining equity research analyst with National Bank Financial explains in this [interview](#) that it is because *“we are seeing a transition from a historic premium applied to precious metal companies to one with a more traditional valuation methodology. Precious metal companies are being modeled similar to base metal companies.”*



Charles “no hair” Oliver [agrees](#), giving the example of *“Barrick; it used to have a P/E of 40-50, and now it’s about 7-8. Yet the company has tripled earnings and increased their dividend over the last five years”* and feels that this shift has gone too far. Both analysts agree that a contributing factor has been the creation of gold ETFs.

Charles notes that prior to the ETFs *“the only way for pension funds to participate in the gold market was through the stocks. They couldn’t actually own bullion”* but the ETFs made this possible with the result being that some of the pension fund money is now diverted away from gold stocks into gold ETFs. The high price/earnings ratios also contributed to this, making gold stocks expensive relative to bullion.

However, Charles feels that with gold miner margins having *“gone from a couple hundred bucks an ounce to over a thousand bucks [the] stocks are incredibly attractive, and this will eventually bring those investors back to the equities.”*

## WHEN A TRADE IS OBVIOUS, IT IS OBVIOUSLY WRONG

Blogger [The Short Side of Long](#) sees gold and silver as *“beautifully setup to be a contrarian trade of the year”* on the basis that:

- 1) Continuing outflows from the GLD ETF over the past few months while prices have been moving sideways
- 2) *“Highest consecutive weekly outflows since I began collecting data in 2007”*
- 3) *“Silver’s options ratio still remains bearishly elevated at 0.94 Puts for every 1.00 Call. This is very close to a one year high of 0.98 we saw in late December 2011 bottom at \$26 per ounce”*

He therefore concludes that the market is saying the obvious trade is to short gold and silver, which from his point of view, is a good reason to buy.

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**2 May 2012**

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