THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

Contents

Contact Details

Email:

troy.schwensen@bigpond.com

Internet Address:

www.globalspeculator.com.au

INTRODUCTION

The month of September 07 finally saw the much anticipated move higher in the precious metals sector and a break of the 16 month consolidation. The Federal Reserve cut rates 50 basis points sending the US dollar into a predictable tail spin. At this juncture there has been a flood of bearish articles on the precious metals sector. The reasons have ranged from the sector being technically overbought, to the large commercial short position that has been building in recent COT reports. Whilst a simple look at RSI levels for Gold and the XAU make it pretty difficult to disagree with the overbought appraisal (at least on a short term basis), it's the bearish COT line of reasoning I want to spend a little time on. The chart below is a look at a weekly gold chart mapped with COT data looking at just the commercial side of trade. There is a very common view that it is the commercials that dictate the overall movement in precious metals markets. Whilst this may be true on any given day(s), in the overall scheme of things it is the speculative side of the market that drives prices both sharply higher as well as lower. The bottom section of this chart shows the total **Commercial Open Interest** (COI). The middle section shows the **Net Short Commercial** position as a proportion of the COI.

Looking at this chart we can see that the major movements in the gold price (Red Circled areas) have corresponded with relatively high levels of commercial net short positions (generally over 55% of COI). For every commercial short there is obviously a corresponding long which will be on the speculative side. It is these spikes in speculative interest that drives the gold price higher. The recent COT report released last Friday showed a record in COI. In terms of the **Net Commercial Short** position as a proportion of COI you can see on the chart that we are not setting any records despite being at high levels. The point I want to make here is that to use the COT data to support a selling decision can be a very dicey game, especially when the Gold price has broken out from a lengthy consolidation and the fundamentals are strong. In 2005/06 we saw many participants in the market try to play this COT game cute and were left flat footed as the record net commercial short position was maintained and the gold price surged higher regardless. As you can see in the chart above, the COT data can provide a very useful entry point when the commercials are covering their shorts into speculative selling of longs (Green vertical lines). As a selling indicator when net commercial shorts peak with speculative buying of longs, one has to be very careful.

The other point I want to touch on in this issue is the US dollar. The fundamentals for the US dollar are incredibly poor right now despite the US dollar being technically oversold. Everyone knows the US runs a huge Current Account Deficit (CAD) but what does this actually mean for the US dollar? This means you have more US dollars paying for imports than you have foreign currency paying for US exports, not to mention the net transfer of income and expenses tied to foreign owned assets and debt. This in itself is not a problem as long as the US economy appears to be running well and the interest rates being offered compensates foreigners for the risk of investing these excess US dollars back into US assets. Australia is a good example of a country that runs a CAD almost comparable with that of the US. It is fair to say that monetary inflation here in Australia is more excessive than it is in the US. The Aussie dollar unlike the US dollar is setting record highs against the currencies of its trading partners, despite these negative factors. What's the difference? The difference is in the foreign perception of how well the Aussie economy is traveling. The Reserve Bank of Australia (RBA) unlike the Federal Reserve is raising interest rates. Foreigners therefore are being rewarded for the risk of investing in Australian assets. In other words there is a demand for this surplus in Australian dollars (courtesy of the CAD) that is flooding international foreign exchange markets. As long as foreign investors are not spooked by an international market event (The Sub prime woes, Yen Carry Trade Unwinding etc) and the Australian economy appears strong, there is no problem. When we look at the US economy right now we see things are not as stable, hence the recent cutting of interest rates. Now foreigners holding US dollars realize the US economy is a riskier proposition than it was 6-12 months ago and the interest rates on offer are not compensating them for this additional risk. Thus they are looking for more attractive alternatives (Europe, Canada, Australia etc) despite the universal monetary inflation that is presently occurring globally (Not just in the US). The ease at which the US dollar broke the USD Index level of 80 has caught many by surprise. Yes the US dollar could rally in the short term but in my opinion the fundamentals do not favor an extended rally for the reasons I have stated. If conditions stabilize in the US like many believe they have already started doing (Falsely in my opinion), then this could of course change. Apart from the Dow Jones index running back up towards 14,000, I have not read nor heard anything that convinces me that the recent rate cuts will be the last we will see in the foreseeable future.

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

XAU

XAU GOLD RATIO

Key Dates	XAU/Gold	XAU	XAU Performance	Gold Price	Gold Performance	Net Position
19/11/2001	0.18	49.46		272.90		
28/05/2002	0.27	88.65	79.24%	325.50	19.27%	59.96%
26/07/2002	0.18	55.73	-37.13%	303.30	-6.82%	-30.31%
08/12/2003	0.28	112.21	101.35%	406.60	34.06%	67.29%
13/05/2005	0.19	78.99	-29.61%	420.70	3.47%	-33.07%
31/01/2006	0.27	154.19	95.20%	570.70	35.65%	59.55%
16/08/2007	0.19	125.99	-18.29%	662.25	16.04%	-34.33%
Current (03/10/07)	**0.23**	**165.36**	**31.25%**	**729.40**	**10.14%**	**21.11%**

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

A look at the chart of the XAU for the month of September 07 shows the XAU definitively breaking resistance at 145 and rallying strongly up to as high as 173 (A new high) before consolidating back down towards 165. The XAU/Gold ratio has rallied up to breach 0.23 where it has run into some stiff resistance consistent with previous rallies. A look at the RSI (Top section) shows the precious metals shares had become particularly overbought. All in all things have pretty much panned out as we would have expected them to. Since the low for the XAU/Gold ratio was put in on the 16th August, the XAU has rallied 31.25% and the Gold price just over 10%. We are seeing the typical 3-1 leverage in the Gold shares over the metal which is consistent with a **sustainable** rally.

OUTLOOK

The two short term scenarios as I see it over the coming weeks and months:

Scenario 1: The precious metals shares have pulled back off their recent highs and will spend the next few days/ weeks consolidating. This could see quite a lot of volatility. The US dollar despite its poor fundamentals has been technically oversold and **may** experience somewhat of a rally from here which could put some selling pressure on gold and the precious metals stocks. This will be a fairly short term consolidation followed by a continuation in the rally of both the XAU and gold. I am leaning towards this scenario.

Scenario 2: The precious metals sector again gets caught up in a broad commodity sell off and/or a panic sell off in the equity market, resulting in the XAU falling all the way down to support at 145. This would more than likely be the scenario if the rate cuts fail to alleviate market fears and the markets come under more selling pressure as the credit squeeze tightens its grip again. The gold price theoretically should perform well under this scenario but as we saw in August quite often the baby gets thrown out with the bath water (at least in the short term).

Intermediate Term Outlook:

We have realized our first intermediate target of 165-170 (Close to the previous high). After a brief consolidation at this level, we could then see a more extensive rally that takes us to 200-230 over the next 3-6 months.

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

NORTH AMERICAN SILVER INDEX (NASI)

The Silver index like the XAU rallied in September 07 and whilst it managed to breach the 150 day MA at 7,400, it failed to break the tough resistance at 7,800 and has since fallen away. The relative strength comparative is still managing to hold support but has only marginally rallied since August's low. Silver has clearly underperformed the gold price over the past month and we have seen this reflected in the silver shares with the index failing to replicate the new highs made by the XAU.

OUTLOOK

The two short term scenarios as I see it over the coming weeks:

Scenario 1: The Silver index will continue to consolidate in its trading range of 6,600 – 7,800. If a rally occurs during the month the important resistance level remains the 7,800 – 8,000 range which should eventually be broken. I am presently leaning towards this scenario.

Scenario 2: If the gold and silver price were to get caught up in the sharp fall of the other commodity prices and/or a sharp panic sell off in the equity markets, we could see a worse case scenario of a breakdown of the next support line

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

at 6,600 and move down towards longer term support at around 4,500. Whilst this remains a possibility given the present climate of uncertainty, I don't support this scenario at the present time.

Intermediate Term Outlook:

Over the longer term my next target for the NASI is around the 11,000 mark towards the first half of 2008.

THE TSX GOLD INDEX

The TSX Gold Index rallied during September 07 all the way to resistance at 312 but has since retraced back down to 296.75 or close to its 150 day MA. The TSX Gold index like the Silver index failed to make a new high during the month and looks to be in a similar holding pattern.

OUTLOOK

The two short term scenarios as I see it over the coming weeks:

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

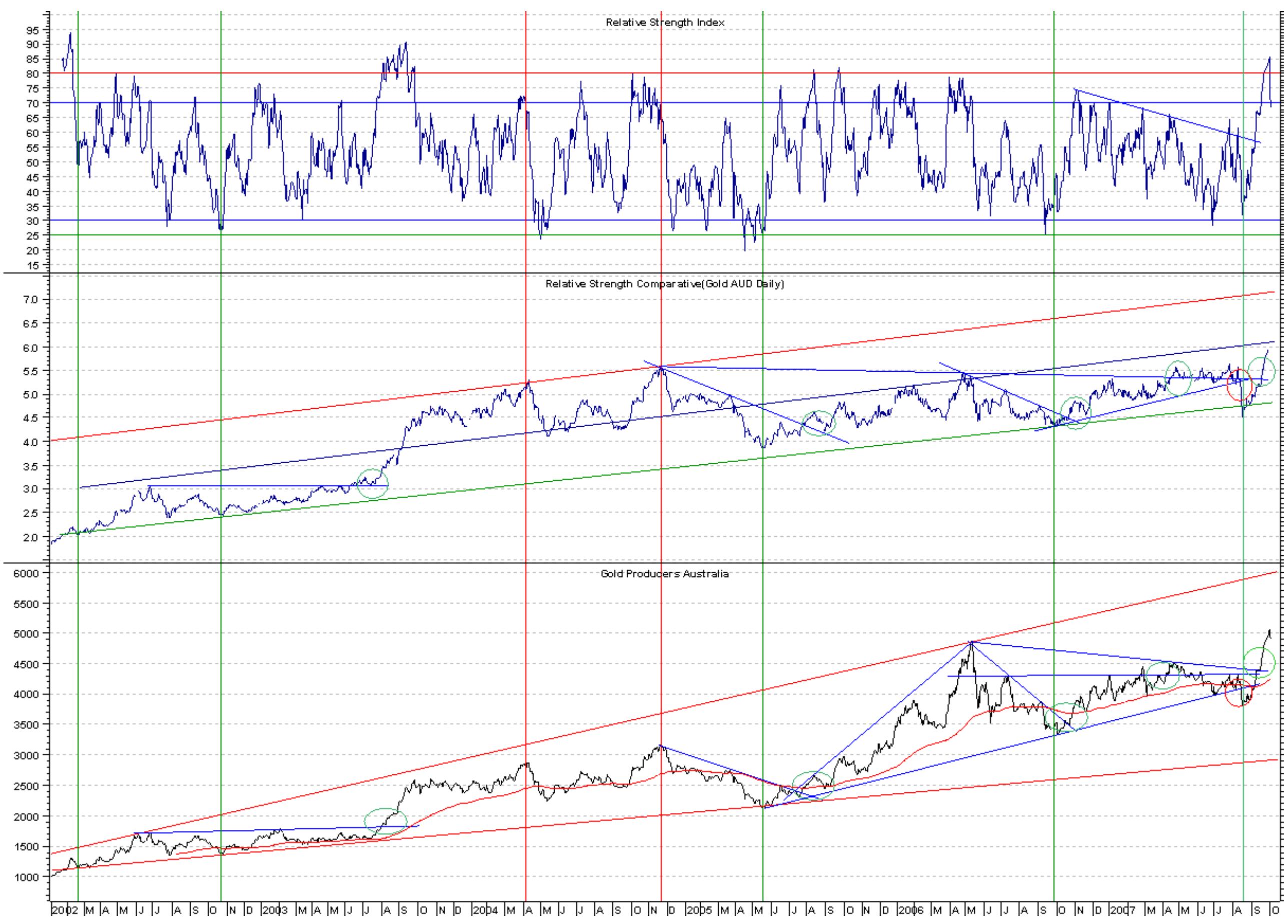
Scenario 1: The TSX Gold Index will continue to consolidate in a range between 265 and 315 in preparation for a breakout either later in 2007 or early in 2008. If the rally in the precious metals sector resumes fairly quickly expect the resistance at 315 and 330 to be taken out. I support this scenario.

Scenario 2: If the Gold and Silver prices get caught up in a sharp fall with the other commodity prices or a panic sell off in the stock market, we could see a worse case scenario of a break of support at 265 and a pull back of the index towards the next support line at 245-250. Can't be ruled out in the present environment but I do not support this scenario at the present time.

Intermediate Term Outlook:

Over the longer term my next target for the TSX Gold index is around the 500 mark some time in the first half of 2008.

AUSTRALIAN PRODUCERS INDEX (API)



During the month of September 07, the Australian Gold Producers index did in fact break out and make a new record high at 5,070 before settling back. The Relative Strength Comparative with Gold also broke long term resistance in a bullish fashion. The RSI (Top section) hit extremely overbought levels early October 07 which signals a short term correction and consolidation is probably on the cards.

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

OUTLOOK

The two short term scenarios as I see it over the coming weeks:

Scenario 1: The API like the XAU will pull back and consolidate over the next few days/weeks before continuing its rally higher. I presently support this scenario.

Scenario 2: If the gold and silver prices get caught up in a sharp fall with the other commodity prices or a sharp sell off in the stock market, we could see a repeat of the recent bearish breakdown and a move of the index back towards the 4,200 mark. Whilst a valid risk, I do not support this scenario at the present stage.

Intermediate Term Outlook:

I have a longer term target of 6,500 towards the first half of 2008.

AUSTRALIAN THEORETICAL PRICE OF GOLD UPDATE

Date	10 Year BB Interest Rates	Official CPI	M3 Aggregate Money Supply	Rate of Australian M3 Change	Gold Production Av Annual Increase (1.73%)	Australian Theoretical Gold Price	Actual Australian Gold Price	Actual as a % of Theoretical
Jun-07	6.26	2.10	867.9	3.3460%	0.14%	2,760.86	766.64	27.77%
Jul-07	6.03		874.6	0.7720%	0.14%	2,778.20	774.60	27.88%
Aug-07	5.54		897.0	2.5612%	0.14%	2,845.35	826.01	29.03%

The month of August 07 has seen M3 increase an impressive 2.56% (30.72% if annualized) which has seen the **Theoretical Price of Gold** rise to AUD$2,845 or AUD$67.15 for the month. The price of Gold in Australian dollars continued to strengthen in August 07 and rose to AUD$826 an ounce or 29.03% of the theoretical value. As I type this the price of gold in Australian dollars has slipped to AUD$816 on Aussie dollar strength. I have mentioned the strong Aussie dollar earlier in my commentary. Whilst the economy here in Australia is strong and favorable interest rate differentials are maintained, we are likely to continue seeing the Aussie dollar perform strongly. I actually see this as a bonus for Aussies investing in gold as it allows us to continue accumulating Gold at a substantial discount to its fair value (As demonstrated above). I don't foresee strong economic conditions lasting forever and we have already had a prelude into how the Australian dollar performs in uncertain market conditions last August when it fell from well over US$0.85 back down to US$0.76 in the space of just a couple of weeks. Official inflation numbers in my humble opinion are being effectively masked by a sufficient weighting towards cheap international imports. When I pay my rent, do the grocery shopping and fill up my car with petrol, I see anything but a tame inflation environment. Unfortunately, my weekly shopping doesn't consist of picking up a DVD player, buying a new computer and then rounding off the list with a brand new plasma TV and/or a new car! The point I am trying to make is the ill effects of extensive monetary inflation are going to become increasingly more difficult to conceal as time goes on. A weaker currency at some point will only serve to exacerbate this problem as I am sure we are going to see demonstrated in the US over the coming months. Once it becomes obvious to the general public that CPI numbers do not reflect reality, look for the gap between the theoretical and actual gold price to close in a very short space of time. A policy you may want to consider employing is taking the profits you make on your gold shares and using them to accumulate your position in physical gold.

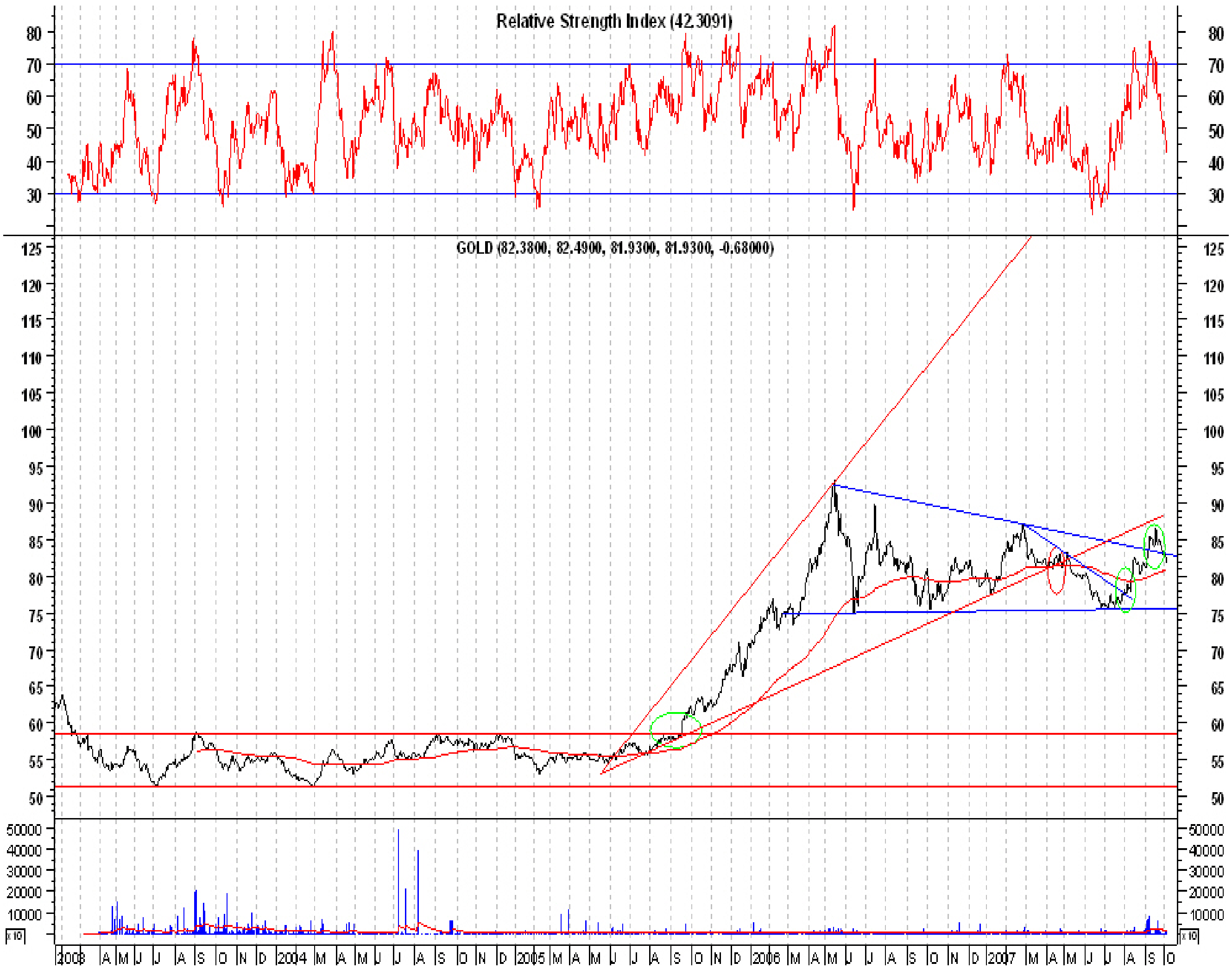
THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

AUSTRALIAN GOLD BULLION

(ASX:GOLD – 1/10 OF AN OUNCE)



CLOSING COMMENTS

The precious metals markets have finally resumed their move higher and commenced the next stage of this bull market. It is at this stage, after a protracted consolidation, that people start to doubt the validity of the move higher and profit take anticipating pull backs and opportunities to cash in now and re-enter at a later stage. In my experience this is great in theory but very difficult to implement in practice. The job is made increasingly harder by the higher levels of volatility that we are presently experiencing. The XAU/Gold ratio, whilst having had a good run, is still significantly below profit taking territory (0.25 - 0.27) at 0.23. This suggests to me that sitting tight and riding the volatility is a sound strategy at this time. It's not sexy and exciting but there's a fair chance it will be rewarding.

Troy Schwensen

THE GLOBAL SPECULATOR

Volume 2, Issue 9, 5 October 2007

www.globalspeculator.com.au

DISCLAIMER

This publication has been prepared from a wide variety of sources which the editor to the best of his knowledge and belief considers accurate. The editor does not warrant the accuracy of the information and forecasts contained in this publication. This information is provided for educational purposes and nothing written should be construed as a solicitation to buy and sell securities.