LBMA

Alchemist

The London Bullion Market Association ISSUE 56 October 2009

In this issue

Fireworks over Edinburgh – Gold prices skyrocket as the bullion market heads to Edinburgh for the 10th Annual LBMA Precious Metals Conference (page 10).

all the metals – all the angles – for all the time

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The European Central Bank Gold Agreement Part 3

The Washington Agreement Trilogy

By Matthew Keen, Director, Deutsche Bank

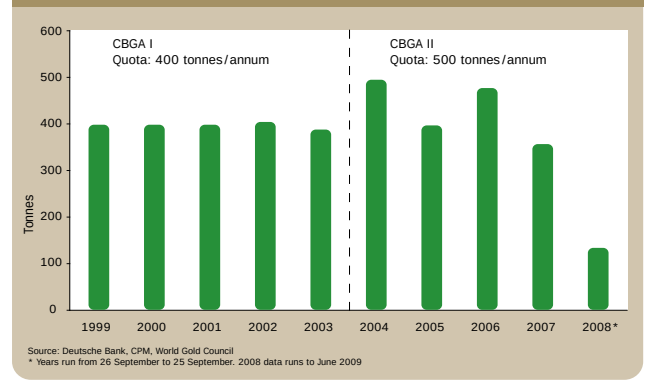
On 7th August 2009, the European Central Bank (ECB) announced the extension of the Central Bank Gold Agreement (CBGA) for another 5 years. The signatories for the CBGA3 were the same as the second agreement and they along with the ECB agreed to cap their combined annual sale at 400 tonnes per annum.

No one will deny that the original European Central Bank Gold Agreement (ECBGA) forged in Washington prior to the IMF meetings in September 1999 was an inspired strategy and of significant importance to just about all sectors of the gold market at the time. Now, ten years on, I suppose the question being asked is what relevance (if any) does ECBGA have in today's climate.

It is a question that has been asked by central banks, bullion dealers, and even the producer community for some time now, and judging by the very late announcement of ECBGA part 3, it may have been touch and go right up to the last minute. Bottom line of course is that on August 7th 2009, a total of 18 European countries have signed up to a third agreement to run until September 2014. However, it has not stopped market participants questioning its relevance, even now.

Looking at the rationale for ECBGA in the first place, the real overriding benefit was the provision of a transparent mechanism for wholesale official transactions to take place. Following 18 years of a bear market, it is fair to say that at the end of the last decade, central banks were making a fair amount of noise about the relevance of their ever depreciating asset. Whilst the actual tonnage of sales in the late 1990s was not overly important, the tarnished reputation of gold was weighing heavy on prices and there was a feeling that central banks were literally queuing up to get their sell orders into the market. As you can see from the chart opposite, the establishment of the agreement did allow for a flood of activity which saw almost 100 million ounces of gold come into the market in the seven years that followed. This rate of selling had not been seen since the mid 1960s when the US liquidated a couple of thousand tonnes.

Annual Central Bank Gold Sales under the Central bank Gold Agreement



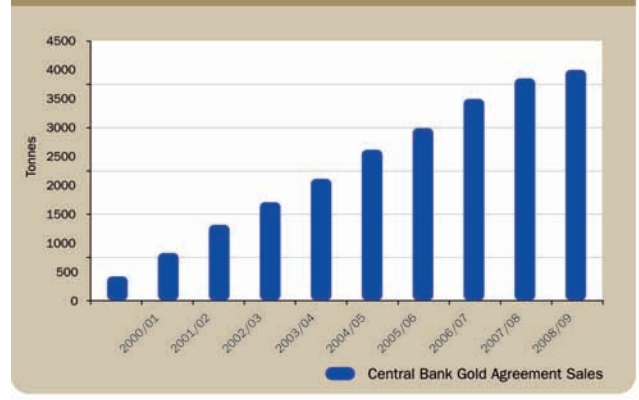
Source: Deutsche Bank, CPM, World Gold Council
* Years run from 26 September to 25 September. 2008 data runs to June 2009

The irony is that the period between 1999 and 2005, which saw more official sector gold sales than at any other time in history, also marked the start of the bull run which is still going strong ten years on. People close to the gold market will know that whilst the ECBGA was a demonstration of "intervention" of a sort, it had a knock-on effect that was to let the industry know that a sea-change was required for the long term health of the market and the valuations of the gold portion of their reserve portfolios. Unfortunately Gordon Brown did not get it and the UK Treasury offered up the majority of its gold at the inception of the agreement. The chain of events that followed the signing of the agreement led to the major producers pledging to cease their hedging activity, a pact which was later "upgraded" to an active hedge reduction policy that is still being followed today.

Like most good trilogies, you have to wait until the final episode before you can piece together some of the strands from earlier episodes. In this case the answer to the question "why was the ECB Gold Agreement dubbed the "Washington Agreement" in the first place"? Well, most people who have been around the market for a couple of decades (or more) will know that every second IMF gathering is held in Washington and that generally, way down the list of agenda items was the subject of gold.

Without wanting to go off on too much of a tangent, the main reason, as far as I am aware, for gold to be on the agenda at every IMF gathering was that the IMF itself wanted to modernise gold's role in monetary policy. And frankly, the only way to get traction on the subject was to have the issue of gold discussed amongst the major gold holding members at one of its annual summits. The IMF had attempted to write gold out of the system on several occasions during the last 50 years, which led to two amendments to its constitution, in 1969 and again in 1978. The first of which introduced the SDR (Special

Cumulative Central Bank sales since Gold Agreement inception



Drawing Right) with 1 SDR being equal to 0.888671 gram of fine gold, which was the par value of the US dollar of 1st July 1944. The second amendment was to make the SDR the principle reserve asset in the international monetary system, paving the way to remove gold as the ultimate reserve asset. So in short, the IMF had been desperate to get the item of gold on the table. Then, in 1999, a core of gold holding countries from Europe actually met in Washington, prior to the official IMF meetings to discuss what could be done about gold's spiralling fortunes and the rest, as they say, is history. The irony is that the IMF was certainly not involved in the pact that was formulated, hence the Washington Agreement was purely a reference to location whereas moving in to ECBGA part 3, we are looking at Washington having a very different role to play.

ECBGA 1 will go down in history as a crucial agreement which lay the foundation for gold to end a 20-year bear market and start a massive bull run which has led to a quadrupling of the price. As I write this article, the gold price is sitting comfortably above $1,000 per ounce. The second agreement was important as a mechanism for transparency, but here we are in Q4 2009 asking the question, "who benefits from ECBGA part 3"?

Well there are no clear winners this time around in the way there were ten years ago. Adding support to the gold price is clearly not a priority for the gold holding central banks around the world today and lease rates, which were also linked to the rationale for trying to fix the market a decade ago, are also rather a non-event. This agreement in fact appears to be rather looser than the first two in as much as lendings are not referenced at all this time around.

The amount of lending by the official sector was flagged as part of the problem with the first agreement, the rationale being that if the official sector stopped providing liquidity to the market, the cost of borrowing could naturally rise to a level that might make forward selling less attractive to the hedgers. Whilst that statement is perfectly logical, the combination of de-hedging and a massive increase in investor long positions have meant that supply far exceeds the demand at the moment and that is not about to change any time soon. For that reason, all restrictions on gold lendings have been removed from ECBGA 3.

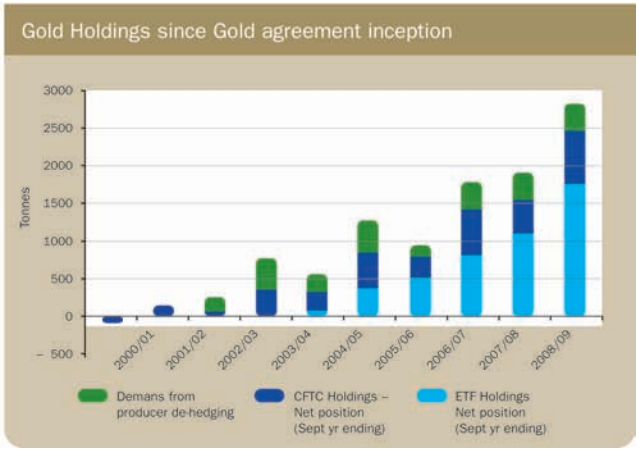
Traditionally most central bank activity in gold is limited to deposit or swap business and following the credit crunch of 2007, it is fair to say that this element of a bullion bank's business is completely dead and buried deeper than most South African primary ore, and short of a resurgence of hedging from the majors, it's difficult to see what will change this current oversupply dynamic. For the first time in history, gold deposit rates are actually in negative territory. I do not just mean that the swap versus USD rates imply a negative gold deposit rate, I mean that with insurance costs higher, credit charges higher and vault space becoming a real concern, there is an argument to say that there are now real costs associated with holding a gold position and that cost has to be borne by the client. Traditionally, bullion banks have been happy to pay a nominal fee to have client deposits on their books but not any more!

ECBGA1 will go down in history as a crucial agreement which lay the foundation for gold to end a 20 year bear market and start a massive bull run which has led to a quadrupling of the price. As I write this article, the gold price is sitting comfortably above $1,000 per ounce. The second agreement was important as a mechanism for transparency, but here we are in Q4 2009 asking the question, "who benefits from ECBGA part 3"?

So back to the crux of what is left in the agreement and who it benefits.

The IMF benefit for starters. In their very thorough presentation to the senate, they needed to deliver not only their rationale, but also their plan for execution and the ECBGA structure does go a long way towards ticking that box. The other thing that we would be wise to remember is the issue of disruptive rhetoric that plagued the market in the late 1990s. Without wanting to name names, gold has had a bit of a role as a political football and it is not unusual for a government and its central bank to have slightly inconsistent strategies when it comes to utilising the asset in question. If that country has signed up to the ECBGA then we can take random headlines that appear on the newswires from time to time with a pinch of salt. The presence of the agreement nips most harebrained ideas in the bud, but even in a case where politicians do throw a strategy out involving their country's gold we can be slightly more relaxed that if it does go further than the concept stage, it will fall within the transparent structure of ECBGA.

Ten years ago, the four biggest gold holding countries in Europe were Germany, France, Switzerland and Italy, collectively holding more than 11,500 tonnes between them, being around a third of all official sector gold. The consequence of any one of those countries unloading gold was simply unthinkable ten years ago and yet, under the auspice of ECBGA part 1 and 2, the Swiss were able to unload almost two-thirds of their gold and the French have sold almost a quarter of their stock without the market falling apart. Germany and Italy are two countries that have adopted a passive stance yet hold a combined total of almost 6,000 tonnes. Any policy shift by either of those two countries could bring us back to the bad old days of the late 1990s. So, in conclusion, it is clear to see that several European countries who were active in the



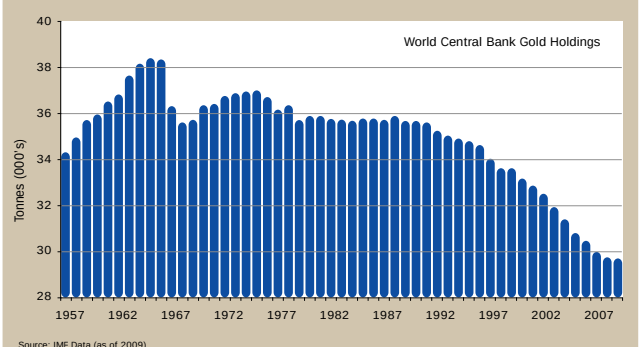
(Gold as a percentage of total reserves)***

Country	Q1 2000	Q1 2009	Tonnages
Germany	33.3	70.2	3,412
France	41.1	74.2	2,452
Italy	46.1	66.9	2,451
Switzerland	43.3	38.0	1,040
Netherlands	45.0	62.0	612
ECB	14.0	23.2	537
Portugal	38.6	90.3	382
Spain	12.2	39.8	282
Austria	19.5	56.0	280
Belgium	18.1	41.3	227
Sweden	9.9	14.2	134
Greece	6.7	92.1	112

Tonnes	Year 1 2004-05	Year 2 2005-06	Year 3 2006-07	Year 4 2007-08	Year 5 2008-09
Eurozone to September 11, 2009	352.2	385.8	352.8	211	136
of which:					
European Central Bank to end July, 2009	47.0	57.0	60.0	72.0	35.5
Austria to end July 09	15.0	13.7	8.7	0.0	0.0
Belgium to end July 09	30.0	0.0	0.0	0.0	0.0
France to end July 09	115.0	134.8	115.1	115	82.5
Germany to end July 09	5.4	5.3	5.1	4.8	4.3
Netherlands to end July 09	55.0	67.5	14.0	19.5	9.0
Portugal to end July 09	54.8	44.9	0.0	0.0	0.0
Spain to end July 09	30.0	62.5	149.3	0.0	0.0
Country not yet known			0.5		4.3
Sweden to September 7, 2009	15.0	10.0	10.0	10.0	13.5
Switzerland to date	130.0	0.0	113.0	137.0	0.0
Total reported or estimated selling	497.2	395.8	475.8	358	149

Source: World Gold Council

The Long Term Decline in Central Bank Gold Holdings



Source: IMF Data (as of 2009)

past have simply reached a point where they do not feel any urgency to sell. After all, since the birth of ECBGA ten years ago, gold will have undoubtedly been the best performer in a reserve portfolio, but it could be argued that so much of the positives that ECBGA brought to the market could be unwound if the agreement was simply mothballed at this point. I think that of all the "agreements" that have been created over the decades, this one is quite an easy one to maintain with most of the member countries happy to.

Looking at the last five years, it is clear to see that several countries who were active in the past have simply reached a point where they don't feel any urgency to sell. After all, since the birth of ECBGA ten years ago, gold will have undoubtedly been the best performer in a reserve portfolio. So, in conclusion, the extension of the ECB Gold Agreement for a third term is helpful to the market as a whole, but on the flip side, it does take away any spontaneity that central banks might have enjoyed in the past. Mind you, giving up the ability to make a "snap decision" is probably something that most central banks will not miss.■

Matthew Keen *started his career at Johnson Matthey Bankers in 1982, moving to Engelhard in 1987 where he started specialising in PGMs. He set up JPMorgan's PGM business in 1991, where he remained until the Chase merger ten years later. He is currently a director at Deutsche Bank with global sales responsibility for Central Banks and the official sector. He also has responsibility for the bank's Platinum Group Metal business and the develpoment of various Rare Metals businesses.*

A Day in the Life of a Refiner

By Grant Angwin, General Manager, Johnson Matthey

07:30

There are those that say the start of a day for a refiner is a round of golf! In my case, it is a good cup of tea. Everything for a refinery begins with what comes in the front door. So for the first 30 to 45 minutes, I pore over my PC looking at reports that detail what was delivered yesterday and, as important, what was produced during the past 24 hours.

08:30

It is now time to get another cuppa, return to my computer, and check the Bullion Desk for prices and news on the market. Whilst prices are not so critical to a refiner in his day-to-day business, they are obviously important to our customers – both product and refining. So a brief review of what is happening in London and the world is necessary. Operating out in the Western USA means that we have a seven-hour time difference with the UK, so the next 30 minutes is spent on the phone with our UK head office. Then, it is time to delete all the unwanted emails and respond to the few that actually do require a reply.

09:30

Having cleared out the emails and checked the market, the day starts in earnest with a 30-minute walk around the refinery. This is an ideal time to talk to the guys, and see and hear what is going well, and hear about any issues. It also sets up the day, as much of the next few hours will be spent with various managers.

10:00

Now that I am in the refinery and have cleared the various security obstacles, my next port of call is with our Operations Manager. We spend the next 30 to 45 minutes reviewing intake and output numbers, staffing levels and discussing plans for the remainder of the month. We are getting close to starting our budget process so this meeting runs on and takes the best part of an hour. I leave him feeling slightly dazed after we have discussed headcount and operating costs – he wants more and I want less!

11:00

Next for a visit is our Employee Health & Safety Manager. Our refinery uses the Miller chlorine process to recover gold and various side processes, which use acids and various reactive chemicals. Whilst a refinery uses many chemicals in its processes, the most sensitive is chlorine. We review our chlorine system on a very regular basis – any escape of chlorine is very dangerous. Today, we walk through the whole process from delivery to use. Molten metal is everywhere in a refinery and is another of the biggest safety issues a refinery faces. We discuss ways in which we can reduce employee exposure to these hazards.

12:00

After all these peregrinations around the refinery, it is time for a break. Another cup of tea and a spot of lunch consisting of a marmite sarnie! This is also another opportunity to catch up on the news and read the *FT*.

12:30

Now, it is time to turn to the two remaining functions. First up is the financial area. A refinery may handle many millions of ounces of gold, but at the end of the day, it is the actual ounces that count or have to be counted. We spend some time discussing where the metal is within the various processes and ensuring that it is in the right part of the refinery. The refining business is somewhat different to most businesses in that we have to concern ourselves with money and metal, which is also money but treated differently in terms of accounting. In effect, our financial area has to do its job twice – count the money and then the metal. Having left our financial chap in the same dazed state as the operational one, it is time again to review some of the reports that indicate how the business is performing.

14:30

Last but not least on daily review is our Business Development area. We spend some time discussing what the recent rally in prices means for our business today and in the future; unfortunately, this time we don't come up with any conclusions!

15:30

The UK and the East coast of the US have closed for the day, and the remainder of the day is spent catching up on emails. One final thing that has to be done is to return to the refinery and review the developments with our sustainability programme on wood recycling.

16:30

By now, the steady stream of lorries arriving on site has all but dried up. It is amazing to think that so much of it starts in the Nevada desert with a mine moving over 7,000 tons of ore, and after we have done our bit, that 7,000 tons ends up producing one 400 oz (12.5 kilos) London Good Delivery gold bar! Tomorrow will be another day, and it will be a very different one, but for now, we can go to the golf course! ■

Grant Angwin *has worked for Johnson Matthey for over 25 years. The first 20 years he was based in the UK and held various positions within the refining business prior to being appointed Head of Sales at the Royston refinery. Five years ago, he relocated to Salt Lake City as Sales and Marketing Director and shortly after that he took the position of General Manager.*

Electronic Weighing of Gold in London

By Douglas Beadle, Consultant, LBMA

As regular readers of the *Alchemist* will be aware, the Physical Committee has, for several years now, been looking at the possibility of permitting gold to be weighed on electronic scales in the London market, in addition to the traditional beam balance weighing of gold.

The problem has been finding a scale that weighs to the exacting standards of the London market, with repeatability being a major problem with scales that were investigated previously. During the past year, the London vaults have been conducting extensive trials of a prototype scale produced by Sartorius and the results have proved extremely encouraging. Some further testing by the vaults in London still needs to be undertaken, but on the results obtained thus far, it seems likely that the Sartorius scale will satisfy the requirements of the London market. Meanwhile, Sartorius is in the process of seeking Type Approval for the scale in Germany.

Subject to the successful completion of the further testing and the Type Approval being obtained, it is hoped that within the first half of 2010, the Physical Committee will be in a position to recommend to the LBMA Management Committee that it should approve the weighing of gold on electronic scales in the London market. At that time, the LBMA will make a further announcement setting out its procedural recommendations and the technical specifications that will need to be complied with. ■

LBMA Certified Reference Materials

Gold and Silver CRMs Available from the London Bullion Market Association

The London Bullion Market Association (LBMA) promotes quality and good practice in the area of gold and silver refining and trade. The production and sale of Gold and Silver Certified Reference Materials represent part of this effort.

The LBMA Gold Certified Reference Materials (CRMs) were produced by Tanaka Kikinzoku Kogyo K.K. on behalf of the LBMA, are now available for purchase. Silver CRMs, manufactured by Krastsvetment will be available by the end of 2009. The project reflects an international collaboration to meet the requirements of laboratories involved in the analysis of high-purity gold and silver. Figure 1. lists the elements in the gold CRMs for which certified values have been established. The values shown in Figure 1 were calculated on the basis of the analyses carried out by ten laboratories in seven countries. For silver, the list of elements is slightly different from the gold CRMs. Cadmium is included and calcium and titanium are excluded..

Figure 1.

	Element Concentrations, mg/kg	
	AuRM1	**AuRM2**
Ag	20.0 ± 0.8	99.6 ± 5.6
Al	9.6 ± 0.8	28.3 ± 1.8
As	14.5 ± 1.0	47.1 ± 2.8
Bi	30.4 ± 1.5	9.7 ± 0.8
Ca	9.6 ± 1.1	28.0 ± 2.6
Cr	9.4 ± 0.6	27.7 ± 2.2
Cu	13.5 ± 2.7	31.6 ± 2.4
Fe	10.6 ± 1.1	30.1 ± 2.2
Mg	30.1 ± 1.9	9.9 ± 0.9
Mn	9.7 ± 0.4	28.2 ± 1.5
Ni	9.8 ± 1.0	29.2 ± 2.6
Pb	9.8 ± 1.8	28.9 ± 2.4
Pd	9.7 ± 0.6	29.2 ± 1.3
Pt	10.3 ± 1.1	30.2 ± 2.1
Rh	7.3 ± 0.6	39.6 ± 2.4
Sb	35.7 ± 1.6	11.3 ± 1.6
Se	11.8 ± 2.9	37.4 ± 2.8
Si	9.4 ± 1.6	28.0 ± 3.8
Sn	9.7 ± 1.1	29.4 ± 1.8
Te	40.7 ± 2.6	12.0 ± 3.2
Ti	10.5 ± 0.9	31.6 ± 1.3
Zn	10.3 ± 1.2	31.4 ± 2.3

Homogeneity

For the gold CRMs, samples were cut from the rolled ingot according to a grid pattern. Fifteen pieces were selected systematically from the grid pattern, which encompassed three samples from each of five evenly spaced rows of cut pieces. The samples were chosen to cover the edges and the middle of the rolled ingot. Samples were analysed at the top, bottom, and at a 3mm depth for each of the elements in a random order. Concentration data were obtained by two different laboratories: using spark ablation ICP-OES and using spark optical emission spectrometry. Results from these tests were evaluated using ANOVA and found to be satisfactory. A similar approach was used for the silver CRMs.

Format of the CRMs

The Gold CRMs consist of a set of two rectangular blocks – 21 x 21 x 6mm and weighing approximately 51 grams each. The silver CRMs are slightly longer (26x26x7mm) and weigh 50g each.

Ordering LBMA Gold CRMs

The cost for these materials is in two parts: firstly, a fixed cost and secondly, a variable part which includes the cost of supply and, in the case of the gold CRMs, the value of the gold content (based on current gold price).

Fixed cost per set (one unit of each RM) LBMA Good Delivery Refiners. USD 3, 750. Other purchasers: USD 4, 450. Further details are available on our website.

LBMA

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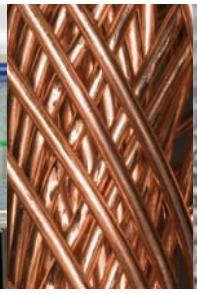
The total metals marketplace.



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LBMA Conference Preview

By Edel Tully, Chairperson, LBMA Public Affairs Committee

The LBMA Conference has arrived and the time has come for the bullion community to once again make its annual pilgrimage. For 2009, the show takes place in Edinburgh, Scotland. The historic Balmoral Hotel provides the impressive backdrop for this year's event from 1-3 November.

The Loch Ness monster is unlikely to reveal itself in the City of Edinburgh, but ghosts and goblins are liable to be out and about on the 31 October amongst those keen delegates, particularly the London contingent, who travel over the weekend to experience Halloween Scottish style.

The 2009 LBMA Conference was an unwitting victim of global financial circumstances and our initial conference location of Peru was deemed by many market members to be a stretch too far this year. After much consultation and debate, Edinburgh became our home and we are delighted to report that conference delegates have been as supportive of this annual event as in previous years. Due to such strong demand, we were forced to close registration on the 30 September and a waiting list was opened.

Unlike venues for past conferences, Edinburgh is not a dominant location in the precious metals industry map. Accepting that Scotland does not straight away stand out as a likely setting, it may surprise you to learn that the LBMA's flock to Edinburgh will not be the first gold rush the region has experienced. No, that happened back in 1869. As an analyst, I fully appreciate Google's abilities to unearth many interesting and largely unknown pieces of information!

So the summer clothes that would have been packed for Peru should suitably be replaced with umbrellas, raincoats, wellies and, in some cases, a hip flask. Yes, Edinburgh is calling and the LBMA conference once again promises to provide an apt forum for market participants to network and discuss the front-line issues in our market.

The LBMA executive has been busy planning and organising to ensure the 2009 event compares favourably with those of previous years. The Public Affairs Committee is charged with the task of putting together the Conference programme and many man-hours have been invested to ensure a quality line up of topics and speakers.

The World Gold Council-sponsored Welcome Reception will signify the formal start to the 2009 proceedings on the 1 November.

The opening session on Monday marks the first formal address by the Association's new Chairman, Kevin Crisp of Mitsubishi Corporation. The keynote speech this year will be delivered by Paul Mercier of the European Central Bank and will be followed by Michael Cross of the Bank of England in what will no doubt prove to be an intense, but informative kick start to proceedings.

The impact of the financial crisis on the precious metal's industry takes centre stage thereafter and chairing of this session lies in the capable hands of Steve Lowe, Bank of Nova Scotia-Scotia Mocatta. From the producer sector, to jewellery, to refineries and fabricators, the fallout across world markets and its journey into our precious metals world will be analysed and dissected by the chosen speakers from AngloGold Ashanti, the WGC and PAMP.

The topic of the afternoon session – Precious Metals Investment – will no doubt draw a large crowd. With James Cross in the Chair, David McWilliams, an Ireland-based economist with an international perspective, will set the scene for this gathering, with a macroeconomic and financial outlook for world economies and currencies. Stephen Mueller of Bank Julius Baer and Co. Ltd and Larry Hathaway of UBS will focus the lens more closely on the metals market through their respective analyses of the ETF investment vehicles and gold's role as a portfolio diversifier – two topics that have dominated market headlines and commentary over the past year.

Session 4 after lunch on Monday brings the PGM complex under the spotlight. At last year's conference in Kyoto, this session proved to be one of the most popular. Therefore, with Edel Tully (yes, that's your author) in the Chair directing the discussion, the future use of PGMs in the auto market from the view point of Johnson Matthey, the overview of the Chinese platinum market delivered by GFMS, and the perspective of the PGM investor arena provided by Redkite Capital Management LLP will, I hope, ensure another successful session for the PGM sector.

Ample networking opportunities will be available at the evening cocktail party, sponsored by the Silver Institute and LPPM, and of course, the Conference dinner. A piper will welcome delegates to the dinner venue and enforce the Scottish theme.

Silver is the early morning topic on Tuesday, led by Michael DiRienzo of the Silver Institute. Jessica Cross, James Steel and Roque Benavides will tackle the prospects for supply and demand, London's role in the silver market, and mining in Peru.

While the topical issues *du jour* will be dissected over the course of the two-day event, the real showdown will take place on Tuesday afternoon as the panel discussion chaired by Stephen Branton-Speak has the onerous task of debating the future of the London Precious Metals Market. This is your opportunity to ask the difficult but relevant questions so do make full use of the available technology and pose your questions to the speakers. Good luck to Phil Clewes-Garner, Raymond Key, and Kamal Naqvi!

John Reade, in his usual hot seat, will deliver the Conference summary which is one of the tougher jobs in the programme. Lunch will wrap up the 2009 Conference before delegates bid each other goodbye for another year.

As Chairperson of the Public Affairs Committee, I am very proud of the hard work invested by my fellow committee members and the LBMA executive. In reality it is some time since the LBMA staged a 'winter' extravaganza, but the weather in Scotland should not dampen spirits at the Conference. Go forth and enjoy, or as the Scots say, *Ceud Mìle Fàilte* – or "a hundred thousand welcomes". ■

Dr Edel Tully *Head of Precious Metals Research at Mitsui and Co. Precious Metals Inc has been a member of the Public Affairs Committee since February 2008 and became its Chairperson in June 2009. Edel has global responsibility at Mitsui for market analysis and forecasting across gold, silver and the platinum group metals. Prior to joining Mitsui, Edel was a researcher and lecturer from 2002 to 2006 whilst earning her doctorate in gold calendar seasonality dynamics at Trinity College, Dublin.*

The LBMA Precious Metals Conference 2009 Programme

1-3 November 2009

The Balmoral Hotel, Edinburgh

Sunday, 1 November

Welcome Reception

Balmoral Hotel, Sir Walter Scott Suite

Sponsored by the World Gold Council

Day One – Monday, 2 November

Opening Session

Welcome – LBMA Chief Executive

Introductory Remarks – LBMA Chairman

Kevin Andrew Crisp, Mitsubishi Corporation UK plc

Keynote Speech

Paul Mercier, Deputy Director General of Market Operations, European Central Bank

The Role of the Bank of England

Michael Cross, Head of Foreign Exchange, Bank of England

Session 2: Impact of the Financial Crisis on Precious Metals Industry

Chairman – Steven Lowe, Managing Director, Bank of Nova Scotia - ScotiaMocatta

Issues Facing Producers

Issues Facing Consumers

Aram Shishmanian, Chief Executive Officer, World Gold Council

Issues Facing Refiners & Fabricators

Mehdi Barkhordar, Managing Director, PAMP

Session 3: Investment – Gold and Other Precious Metals

Chairman – James Cross, Swiss Gold DMCC

David McWilliams, Economist

The ETF Market

Stephen Mueller, Executive Director, Bank Julius Baer & Co. Ltd

James Steel, HSBC

Session 4: PGMs: Looking Forward

Chairman – Edel Tully, Research Analyst, Mitsui Global Precious Metals

The Auto-catalyst Market – The Next Decade

Heraeus Metallhandelgesellschaft GmbH

The Challenges Facing South African Producers

PGMs - The Investor Arena

Michael Sheehen, President, Red Kite Capital Management LLP

Cocktail Reception

Co-sponsored by the Silver Institute and the London Platinum and Paladium Market

Conference Dinner

Prestonfield House

Day Two – Tuesday, 3 November

Session 5: Silver

Chairman – Michael DiRienzo, Executive Director, Silver Institute

Prospects for Silver Supply & Demand

Phillip Klapwijk, GFMS

London's Role in the Silver Market

Mining in Peru

Roque Benavides, Buenaventura, Silver Institute

Session 6: The Future of the London Precious Metals Market

Chairman – Stephen Branton-Speak, Partner, Goldman Sachs

Panel: Philip Clewes-Garner, HSBC and LPPM Chairman

Raymond Key, Global Head of Metals Trading, Deutsche Bank

Kamal Naqvi, Director, Credit Suisse

Session 7: Delegate Feedback & Closing Session

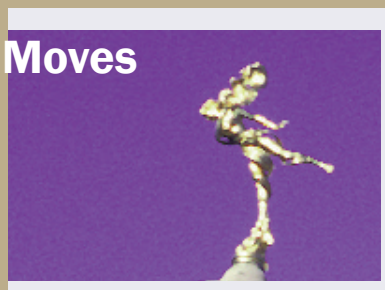
Chairman – Stewart Murray, Chief Executive, LBMA

Conference Summary

John Reade, Precious Metals Strategist, UBS Investment Bank

Prizes Presentation: Best Speaker and Feedback Session Participant

Market Moves



Nicholas Frappell to **Triland Metals** in London to head its precious metals business. Nicholas was born and raised in the Far East. After completing an Economics degree at the City University, London, he joined the precious metals desk at Bank of Boston in London.

He then spent two years working in Tokyo for Sumitomo Corporation, working on TOCOM Arbitrage, and moved back to Sumitomo London, looking after Silver, Islamic financing and latterly Platinum Group metals.

He joined Triland as Head of Precious Metals in August 2009. Nick has served on the Management, the Finance, and the Membership Committees of the LBMA, and also the Market Advisory Committee of the NYMEX.

Tom Coghill to **Standard Chartered Bank**. Tom has been appointed as a Director in Financial Markets where he will head up Corporate Metals Sales in Europe. Tom joins from Deutsche Bank in London, where he was previously responsible for metals sales in both Europe and North America. Prior to Deutsche Bank, Tom worked at Citigroup from 1997, as a salesperson in the Global Commodities group.

The *Commitment of Traders Report* and its usefulness

By Matthew Turner, Commodity Analyst, VM Group

"Speculative fever grips the gold and silver markets" has become a ubiquitous headline, but keeping track of what speculators are doing would be far more difficult than it already is without the weekly Commitment of Traders Report of the Commodities' Futures Trading Commission (CFTC). For decades, this has helped analysts to make some sense of trading dynamics on the Comex futures markets, by splitting the participants up by their reason for trading futures.

As of September this year, the CFTC has enhanced the report to further refine these categories. In theory, this should give us a greater understanding of the market – but does it really?

The Comex division of the Nymex futures exchange remains the most liquid and widely used exchange for trading gold and silver futures. The exchange provides daily information on the amount of futures contracts outstanding, their strike price and date of maturity. This is useful as far as it goes, but as all futures contracts have two sides – a long and short – it tells us little about whether speculators are long or short. This is where the Commitment of Traders (CoT) report is useful because, as of the close of business each Tuesday (although the report itself is released on Friday), it records the long and short positions of three categories of market-user: commercials, non-commercials and non-reportables. Traditionally, as the commercials are seen as entities using the market for hedging business risks (the CFTC describes them as "engaged in business activities hedged by the use of the futures or option markets"), the non-commercials are assumed to represent speculative interest. Most analysts also add in the positions of the 'non-reportables', (which are simply contracts held by users that did not meet the minimum reporting size), as small users of futures markets are more likely to be speculators than hedgers. In gold and perhaps silver this is almost certainly the case, but it is not necessarily so for all commodities. As these entities hold different amounts of long and short positions, one can see whether speculators are collectively net long (own more long contracts than short contracts), and follow the changes on a weekly basis.

The reform of the CoT report has come about because of political concern - largely inspired from within the US - as to the role speculators may have played in pushing up the prices of some agricommodities and energy products, and whether the report was accurately measuring them. So the reform, in a way, has nothing to do with gold or silver; it's more of an attempt to foster greater transparency in those futures markets that are of daily concern to US legislators - crude oil and agricommodities - because last year's soaring prices in the market have attracted the most voter anger.

In particular, it has been argued that the CoT report was understating investment by not accurately recording a relatively new and large user of futures markets, the commodity index funds. This, it is alleged, is because although some commodity index fund buying will be done directly, and so show up in the non-commercial category, much of it is done by swap dealers, who typically are categorised as 'commercials', as they are 'hedging' their exposure to investment funds. So, the theory runs, not only might the report underestimate investment, but if the net long of commercials is rising then, by definition, the net long of non-commercials, what we have called 'speculators', will be falling, which could give a misleading picture of investment trends.

The new report aims to fix this by splitting the two original categories, commercial and non-commercial, into two further segments, making four new categories; commercials thus become the snappily titled "Producer/ Merchant/ Processor/ User" and crucially "swap dealer" categories, while non-commercials become "managed money" and "other reportables". The non-reportables remain the same. The CFTC explains the new categories thus:

Producer/Merchant/Processor/User: A "Producer/Merchant/Processor/User" is an entity that predominantly engages in the production, processing, packing or handling of a physical commodity and uses the futures markets to manage or hedge risks associated with those activities.

Swap Dealer: A "swap dealer" is an entity that deals primarily in swaps for a commodity and uses the futures markets to manage or hedge the risk associated with those swaps transactions. The swap dealer's counter-parties may be speculative traders, like hedge funds, or traditional commercial clients that are managing risk arising from their dealings in the physical commodity.

Money Manager: A "money manager," for the purpose of this report, is a registered commodity-trading advisor (CTA); a registered commodity pool operator (CPO); or an unregistered fund identified by CFTC. These traders are engaged in managing and conducting organised futures' trading on behalf of clients.

Other Reportables: This comprises every other reportable trader that is not placed into one of the other three categories.

The following tables show how the new report compares to the old report for gold and silver as of 29 September, the date of the latest release at time of writing. It is important to remember that the categories 'commercial' and 'non-commercial' are only being disaggregated – they still contain the same number of contracts, and hence the same longs and shorts as before.

So, taking gold, we begin with open interest – the total number of outstanding contracts on Comex – which was 454,585 contracts.[1] As futures have a long and short side, this means that there were also 454,585 longs, which in the old report were split into a non-commercial long of 252,994 contracts, non-commercial spreading (which is where an entity has both long and short contracts) of 49,564 contracts, a commercial long of 84,923 contracts and finally 43,848 of non-reportables. The new report splits the non-commercial long and the non-commercial

spreading into two further categories, making four in all – 198,175 contracts of managed money longs, 31,419 managed money spreading, 54,819 other reportable longs and 18,145 'other reportable' spreading. Note that the longs and the spreading contracts still each total the same as in the old report, and therefore collectively they equal the total of the old non-commercial category. This means the residual 'non-reportable' long category also remains the same, at 43,848 contracts.

The disaggregation follows a similar pattern for the commercial category, with longs of 84,923 contracts, but there is a slight difference. Whereas, before, there was no spreading category for commercials and there still isn't one for the Producer/Merchant/Processor/User category (because the spreading category measures the extent of arbitrage trading in the futures markets, and an arbitrage using the futures markets is not a commercial activity), there is one for the other new category, the swap dealer. Thus the commercial long is split into three categories: Producer/Merchant/Processor/User long of 40,629 contracts, a swap dealer long of 34,250 contracts, and a swap dealer spreading of 10,044 contracts. This new spreading category, which by definition has a counterpart on the short side, means that the old report overstated the longs and shorts of the commercial category, although not the net position.

For the short side, exactly the same analysis applies as for the longs, with the same disaggregated categories.

The net position, which is the longs minus the shorts, by definition has no spreading category, as these cancel out, and therefore, it is rather simpler – clearly showing how the two reportable categories in the earlier report are now split into two new categories, with the non-reportables the same.

So have we learnt anything new? On the non-commercial side, not a lot. Where we had non-commercial, we now have 'managed money' and 'other reportables'. Of those, managed money is clearly useful, being obvious speculation/investment demand. Across all 22 commodities in the new report, gold and silver have the highest 'managed money' long, at 44% and 33% of open interest respectively, which intuitively seems right. But of course all of this was previously in the non-commercial category, and as we don't see any reason not to continue adding the category 'other reportables', to get total investment/speculative demand, we in fact still have the non-commercial category as before. In other words, the disaggregation isn't very illuminating – and is unlikely to become so unless as we get more data both in the past (the CFTC has promised to release two years' back data imminently at the time of writing) and, in the future, showing that the two categories reveal very different trends.

But reform of the non-commercial category wasn't the real point of the new report. Instead, it was concern that speculative investment in commodities was being 'hidden' in the commercial category via swap dealers' hedging of index fund investment. The new report separates out swap dealers from those entities that are hedging more obviously commercial activity. Interpreting this category for gold and silver is tricky, as rather than showing a huge undiscovered investment position, in both gold and silver, the swap dealers are net short. In gold, this net short was 92,287 lots as of 29 September (made up of longs, including spreading of 44,294 contracts, and shorts, including spreading of 136,581 contracts), equal to 20% of open interest. For silver, the effect is less pronounced but still there – swap dealers were net short by 2,241 contracts (with longs and spreading of 19,594 contracts offset by shorts and spreading of 21,835 contracts) as of 29 September, about 2% of open interest.

This doesn't tally with what we know about index fund investment in gold and silver, which is that both are substantially net long. The CFTC's Quarterly Investment Report estimates that, at the end of June 2009 (the nearest available date), index fund exposure in gold was 113,000 contracts long and 40,000 contracts short, while in silver it was 38,000 contracts long to 11,000 contracts short. While not all of these will translate into actual futures contracts held on Comex (traders will net off positions held both long and short before using the futures market) we believe most will be.[2]

The CFTC gives two reasons why the net

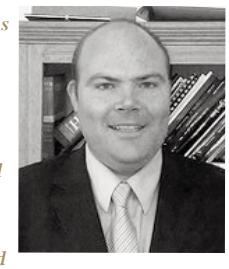
	Open Interest – 454,585							
	Long – 454,585							
OLD	NC long	NC spreading			C long			NR long
	252,994	49,564			84,923			67,104
NEW	MM long	MM spreading	Other long	Other spreading	Producer/merchant long	Swap dealer long	Swap dealer spreading	NR long
	198,175	31,419	54,819	18,145	40,629	34,250	10,044	67,104
	Short – 454,585							
OLD	NC short	NC spreading			C short			NR short
	21,608	49,564			360,157			23,256
NEW	MM short	MM spreading	Other long	Other spreading	Producer/merchant short	Swap dealer short	Swap dealer spreading	NR short
	3,726	31,419	54,819	18,145	223,576	126,537	10,044	23,256

	Net – 0							
OLD	NC net long	NC spreading			C net long			NR net long
	231,386	0			(275,234)			43,848
NEW	MM net long	MM spreading	Other net long	Other spreading	Producer/merchant long	Swap dealer net long	Swap dealer net spreading	43,848
	194,449	0	36,937	0	(182,947)	(92,287)	0	67,104

swap dealer position might not match the index position:[3] a) swap dealers also hedge risks that are not index-fund related (which would mean the swap positions being higher than the expected index positions); and b) there are index fund investors who directly buy futures rather than use swap dealers, and so are in the managed money category (which would mean the swap dealer positions being lower than the expected index position). For gold, and to a lesser extent silver, for the longs it seems (b) must be particularly important.

We can use these figures to say what is the maximum amount of investment in both metals that might be hidden in the swap dealer category. For gold as of 29 September there were swap dealer longs of 44,294 contracts, of which 10,044 were spreading, so also short. It is possible that all 44,294 longs were hedging long index fund positions (although swap dealers clearly have other risks that they hedge), which as 10,044 of those were spreading contracts would also imply in that category were 10,044 index short contracts,[4] meaning a net long index position of about 34,000 contracts. If this was the case, then to fully count investment in gold on Comex we could add to our non-commercial net long of 231,386 contracts and our non-reportable net long of 43,848 contracts another 34,000 more net longs for index investment that were hidden in the commercial category. For silver, doing the same calculations, i.e. assuming the entire swap dealer longs are index investment, we could add another 18,000 longs to the non-commercial net long of 47,410 contracts and non-reportable net long of 16,696 contracts. Neither of these two additions is huge, and not something that invalidates using the non-commercial category to gauge investment trends, but they do represent an eighth more gold investment and 28% more silver investment than we would estimate from looking at the non-commercial and non-reportable categories alone.

There is another consequence, if our numbers are correct. If net 34,000 index fund long contracts in gold and 18,000 contracts in silver are hidden in the swap category, this still means that (using the data from the Quarterly Investment Report as a guide) 39,000 net long index fund contracts in gold, and 9,000 net long index fund contracts in silver are in the non-commercial category (and probably in the managed money sub-section). In many ways, these investments are different to 'traditional' speculation, being less volatile and less directly linked to the specific fortunes of gold and silver (rather than commodity and investment trends as a whole). It's hard to be certain about the numbers, but if the non-commercial net long ever falls below something like 34,000 contracts in gold or 9,000 contracts in silver, be aware that the non-index speculative investor might already be net short. ■



Matthew Turner *has been with VM Group since 2001 and covers precious metals, agricommodities and economic analysis and forecasting. Prior, Matthew was an economist at the World Gold Council and a researcher at The Economist. He holds a BA Hons in PPE from Magdalen College, Oxford University and an MSc in Economics and E-Commerce from Birkbeck College, University of London.*

[1] This is the futures-only report – there is also a futures and options report. Normally the wider report is better, but as index funds typically invest in futures only, we will use that report in this article.

[2] Comparison of the 12 agricommodites where the CFTC publishes a weekly index fund report to the Quarterly Investment Report suggests that there are fewer longs and shorts held on the exchanges than notionally would be needed but the net (long/short) position is much the same.

[3] Although for the 12 agricommodities where the CFTC publishes index fund data on a weekly basis the two categories do normally match up reasonably well.

[4] It is possible, because the CFTC classifies entities not trades, that of the swap dealers' 34,250 spreading contracts all 34,250 held long were hedging index fund exposure, but none of the 34,250 held short were not. But it is rather unlikely.

	Open Interest – 128,695							
	Long – 128,695							
OLD	NC long	NC spreading			C long			NR long
	54,966	19,057			26,732			27,940
NEW	MM long	MM spreading	Other long	Other spreading	Producer/merchant long	Swap dealer long	Swap dealer spreading	NR long
	42,374	11,894	12,592	7,163	7,138	17,874	1,720	27,940
	Short – 128,695							
OLD	NC short	NC spreading			C short			NR short
	7,556	19,057			90,838			11,244
NEW	MM short	MM spreading	Other short	Other spreading	Producer/merchant short	Swap dealer short	Swap dealer spreading	NR short
	2,840	11,894	4,716	7,163	69,003	20,115	1,720	11,244

	Net – 0							
OLD	NC net long	NC spreading			C net long			NR net long
	47,410	0	0	0	(64,106)	0	0	16,696
NEW	MM net long	MM spreading	Other net long	Other spreading	Producer/merchant net long	Swap dealer net long	Swap dealer spreading	
	39,534	0	7,876	0	(61,865)	(2,241)	0	16,696

Jastram's Golden Constant

How is it relevant today?

By Jill Leyland, Economics Consultant

In his foreword to the new edition of Roy Jastram's "The Golden Constant" Pierre Lassonde[1] wrote: "This book, more than any other, has given me my lifelong passion for understanding the role of gold in our societies."

The Golden Constant was the first statistical proof of gold's property as an inflation hedge over the centuries. For this, and for its masterful examination of the behaviour of gold and its purchasing power against the background of political and economic events, it is rightly considered a seminal study.

However, when published in 1977, it was too soon to assess whether gold's long-term inflation hedging characteristics would persist after the gold price was freed in 1971. The new edition, to which I had the privilege of adding two chapters to Jastram's original work, was able to start doing this. This article will summarise the main findings of the updated version and attempt to draw some conclusions for the present.

The approach adopted by Roy Jastram was in essence very simple (although executing it was certainly not): research (when necessary) and construct an historical index series of the gold price; research (when necessary) and construct an historical index of prices; divide one by the other to compute an index of the real value of gold; and then examine the behaviour of these three series over time against the political and economic developments. His main analysis goes back to 1560 for England/UK and to 1800 for the USA.

What did Jastram find and do his findings still hold after 1971? I suspect that two of his conclusions will surprise some people since they are counter-intuitive and contrary to current experience. He concluded from his research that: Gold is a poor hedge against major inflation and that gold appreciates in operational wealth (purchasing power) in times of deflation. Have a look at Figure 1, which shows the gold price, the price index and the index of the purchasing power of gold for England from 1560 to 1970. This shows how gold prices and wholesale prices broadly kept pace with each other but also how in times of inflation – until 1650, the Napoleonic wars, around World War 1 and then from 1950 onwards – the general price level moved up faster than gold so the purchasing power of gold fell; vice versa in times of deflation.

While at first sight it may seem strange from the perspective of the present day that gold lost value in times of inflation in the past, there is in fact a simple explanation. Gold was either money, or closely related to money, throughout this period. In times of inflation when prices rise the value of money falls. Hence it is entirely logical that gold's purchasing power behaved that way in the past.

But from 1971 the opposite is true and we revert to what we today consider the more normal situation of gold acting as a hedge against inflation, as in the 1970s, or the fear of inflation, as in recent times.

In contrast, Jastram's main conclusion - that despite often substantial fluctuations gold has held its purchasing power over the centuries – still applies. Figure 2, for example, shows how gold and consumer prices have broadly kept pace with one another in the USA from 1800 to the present. Figure 3 shows the purchasing power of gold from 1560 in England/UK and from 1800 in the US. Its purchasing power has fluctuated, sometimes sharply. But in both countries it fluctuates around a roughly horizontal line – a stable level.

Perhaps even more remarkable is the experience of some other countries we look at briefly in the book. France and Germany, shown in Figure 4, suffered more severely from the wars of the 20th century than either the UK or the US. France was defeated and occupied during the course of World War 2 while Germany was defeated and suffered complete economic and political breakdown at its end. Germany also experienced the hyperinflation of the early 1920s. Yet again, while gold's purchasing power fluctuated, and while at times the lack of market exchange rates or the statistical problems associated with hyperinflation impose breaks in the series, the same conclusion holds. A German family owning a certain quantity of gold at the end of the nineteenth century would find, if it still owned it today, that it would still buy approximately the same quantity of goods and services. In contrast any quantity of German currency held at the end of the nineteenth century would today be worthless.

For an economist it is not entirely surprising that if the long-run stability of gold's purchasing power holds in one country it holds in all since in theory exchange rates should over the long term adapt to changes in inflation differentials. Nevertheless the 20th century is an extremely severe test of this.

Figure 1: Gold, Wholesale Prices and the Purchasing Power of Gold, England, 1560 to 1970 (Indices, 1930=100)

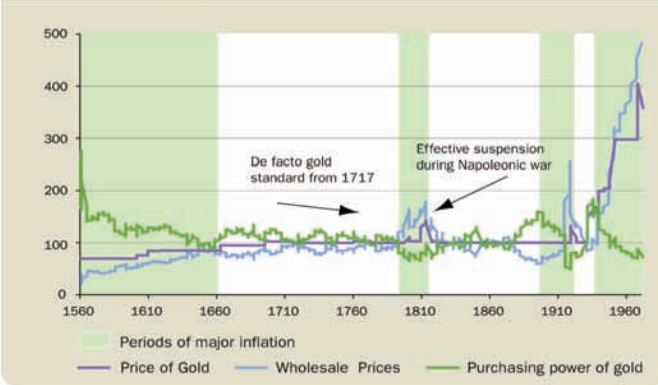
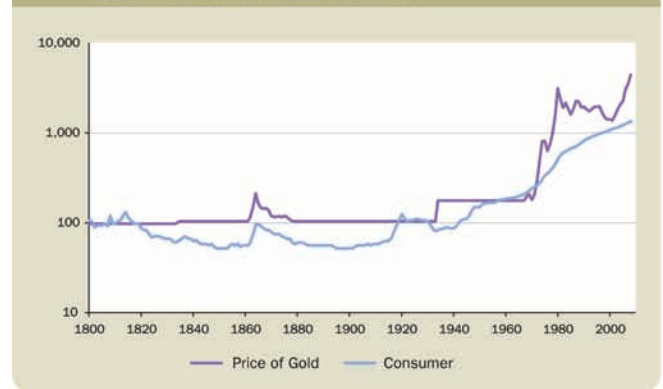
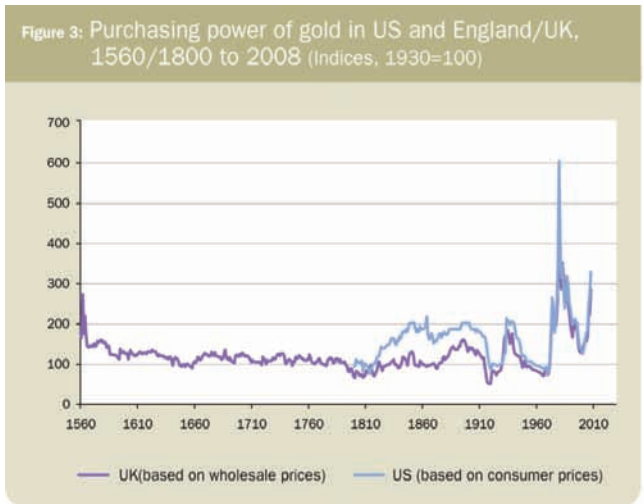


Figure 2: Gold prices and consumer price index in the US, 1800 to 2008 (Indices, 1930=100)





Why does gold have this power of broadly holding its purchasing power over the centuries and what lessons can, or cannot, be drawn for present times?

Clearly the conclusion applicable to the pre-1971 period, that gold's purchasing power fell, almost automatically, in times of inflation and rose, again almost automatically, in times of deflation no longer applies in current circumstances. There are also arguments which can largely explain why during much of the time up to the World War 1 gold held its real value; for example the classical gold standard with a fixed gold/currency parity acted to keep prices stable over the long term thus making gold's long-term purchasing power also stable (the book had more details on this).

But the longer-term constancy of gold's purchasing power and the fact that this still persisted after World War 1 and in particular after 1971 is a different matter. Its constancy over the centuries, through a huge range of economic and political circumstances, through calm and crisis, peace and war, and through immense changes in the gold industry itself, is remarkable.

Two factors are worth mentioning as to why gold's purchasing power has remained broadly constant. First gold's appeal to humans, apart from its relatively limited industrial use, lies in two elements: the human need for security and the desire to own something of beauty. These are human needs that do not change over time. The desire for gold as an object of beauty or adornment goes back for millennia. The book, and the history of the 20th century, amply demonstrates its use in a crisis and thus how it responds to the need for security. Hence there is a constancy of demand for the metal to match the better-known constancy of supply, in that above-ground stocks of the metal change only slowly over time.

The second key point is perhaps the alternating fluctuations shown in the chart and the fact that for the last hundred years gold's purchasing power will rise for a period and then fall back by a comparable, if not always exactly similar, amount. Gold, no one's liability, can be viewed as the alternative to fiat money. Investors turn to it when confidence in fiat money, and particularly in the US dollar as the world's leading fiat money, falls: that is when they perceive that its value is diminishing or might be about to diminish. A fall in the value of currency can come around for two reasons: either due to inflation, which is why gold is seen as an inflation hedge, or through depreciation against other currencies, which is why gold often acts as a dollar hedge. Lack of confidence in the system can also develop through either political or economic concerns, which is why gold is seen as a safe haven.

It seems to be part of human nature that good times and bad times alternate. For a while all is well with the global economy, confidence grows but then can turn to over confidence and problems arise. This can happen to a relatively minor extent, as in the early 1990s, to a serious but geographically limited extent, as in the Asian crisis, to a more serious extent as in the current crisis, or to a really serious and prolonged extent as in the 1930s. And occasionally it happens to a catastrophic extent as in times of war. When people are confident many people do not see the need for a "safe haven". When problems occur, or are foreshadowed, the need becomes more obvious. This alternation contributes to longer-term constancy.

There are two conclusions from the book, therefore, that I think are particularly relevant to today: the fact that gold, despite sometimes severe fluctuations, does hold its real value over the centuries and the fact that it has repeatedly shown its ability to safeguard wealth through crises. Jastram's work, however, provides much more than that to anyone working in the gold market today. Gold has a strong and deep emotional pull on human sentiment. But deep emotion does not always lend itself to rigorous thought. The richness, depth and complexity of gold's long history can make a long and difficult study but historical perspective can be a major influence in individuals' attitudes towards the yellow metal. So the combination of intellectual rigour in Jastram's approach, his historical analysis and the way he wrote in both a scholarly and entertaining fashion (this is not a dry academic tome) is what makes his work so important for the gold industry. ■

[1]Chairman, Franco-Nevada. Formerly President Newmont Mining Corporation 2002-2006 and Chairman, World Gold Council, 2005-2008.

The Golden Constant: The English and American Experience 1560-2007 by Roy W Jastram with updated material by Jill Leyland. Published 2009 by Edward Elgar Publishing Ltd (www.e-elgar.com)

NOVENO SIMPOSIUM INTERNACIONAL DEL ORO

PERÚ:

NINTH INTERNATIONAL GOLD SYMPOSIUM

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Metales preciosos: un desafío para la industria

Precious metals: a challenge for the industry

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The LBMA - Expanding Horizons

Editorial Comment by Stewart Murray, Chief Executive, LBMA

Just over ten years ago, the LBMA Management Committee decided that it was time to expand the Association's horizons and look beyond the shores of the UK for its future development. So a decade later, how has that decision affected the growth, membership and activities of the LBMA?

During the first decade of its existence, membership had been confined to UK companies, albeit that many of them were the UK branches of banks and trading houses whose head offices were located in North America, Asia or elsewhere in Europe. The most fundamental aspect of the changes introduced in 1999 was the decision to allow companies located outside the UK to join the LBMA as Associates, at the same time allowing companies whose activities were relevant to the London gold and silver markets to join. This is in contrast to the basic requirement for Membership (that a company must be actively involved in the loco-London market). Ten years on the result is that the number of Associates is greater than that of the ordinary Members and that the membership now encompasses 20 countries. Total membership now stands at 120 companies.

Another innovation in 1999 which affected me personally was the decision to appoint a full-time Chief Executive who would ex-officio be a member of the Management Committee. That was how I came to present myself for duty in the LBMA's tiny office in Frederick's Place on 1st October 1999.

Looking back at the development of the Association over the next ten years, it seems to me that it has grown from a boisterous teenager, full of energy, into a reasonably mature adult with lots of experience (both good and bad) gained

along the way. The workload has increased enormously. Our office space is comfortable without being showy while our systems and methods have improved immeasurably. Although our staff numbers have in effect doubled since 1999, I still find it almost embarrassing to admit to visiting delegations how few we are.

The biggest challenge in 1999 was undoubtedly to organise the LBMA's first conference which, it had been announced shortly before my arrival, would take place in Dubai in February 2000. We were in effect taking on the *Financial Times* whose Conference Division had been running an immensely successful gold conference for the previous twenty years. And the nearest we had to conference organising experience was the Great Hedging Debate – staged in Johannesburg – in 1997. But we had some real advantages: an enthusiastic Public Affairs Committee (which justified our slogan – "The Conference for the Industry, by the Industry") and a wonderful conference organiser (Maggie Nash, fresh from the events department at JP Morgan). If that first conference had not been a success, it is quite possible that there wouldn't have been a second. But it was and we are now eagerly anticipating our tenth in Edinburgh next month. With one exception, every conference has more than covered the external costs of holding the events and thus offset the considerable office overheads attributable to them.

Another area which has seen huge change over the past decade is our stewardship of the Good Delivery List. In 1999, the involvement of the Executive in the processing of applications for Good Delivery accreditation was minimal. There were only two referees, both UK companies, who bore the brunt of testing of applicants, both in relation to the assay test and the testing of sample bars and who therefore knew the identities of the applicants. The logistics of the application process were managed by the "Vaults", in other words the members of the Physical Committee, who took it in turn to process the applications through the stages of the technical assessment. Today by contrast, we have five referees (located in Japan, South Africa and Switzerland) who carry out their work on a double blind basis (ie, the referee is not aware of who is being tested and the applicant does not know which referee is testing its bars). The management of the process is now completely in the hands of the Executive. And finally proactive monitoring of Good Delivery refiners was introduced in 2004 (involving the regular re-testing of all refiners, including referees, on a three year cycle).

Although not actually part of the Good Delivery system, another activity in recent years has proved very popular with the refiners: the Biennial Assaying and Refining Seminar, first held in June, 2005. A by-product of these meetings was the Reference Materials Project which regular readers of the Alchemist have seen building up to its successful conclusion over the past two years. The success, both technical and financial of the project owes much to the commitment of the project Steering Committee and the expertise of the two manufacturers, Tanaka and Krastsvetmet.

The most recent development and one which is at a very early stage is the idea of commercialising the data on precious metals generated within the market. The genesis of this idea was the need for providers of cleared forwards to have a reliable forward curve, representing actual market conditions at the end of each trading day for the calculation of variation margins.

It is by no means clear where the concept of data commercialisation will lead. Together with some of the projects mentioned above, it does appear that the LBMA is becoming more of a business than the simple trade association of a decade ago. But it seems to me that regardless of the business model, one thing will remain true. The LBMA's main object will be to work for the good of the companies which together constitute the London bullion market and their customers around the globe. ■

LBMA News

By Stewart Murray, Chief Executive, LBMA

MEMBERSHIP

Members
Landesbank Baden Württemberg ("LBBW") was admitted as an ordinary Member on 1 September 2009.

The Royal Bank of Canada ceased making markets in forwards on 3 September 2009. It will continue as a spot Market Maker.

Associates
The Associateship of Baden-Württembergische Bank was terminated at the end of August, 2009 due to it having been merged into LBBW (see above).

GOOD DELIVERY LIST

There have been no changes in the companies on the Good Delivery List during the past quarter.

The LBMA has introduced one significant change to the Good Delivery Rules this year (in August, 2009). This relates to the situation which occurs from time to time where a Good Delivery refiner produces bars in the form of its registered Good Delivery bars that are intended for fabrication by a local customer and which do not meet the requirements of the LBMA (for instance having inferior appearance or in not having the specified bar marks). Such bars must be marked "NGD". The text of the new paragraph in section 7 of the Rules is shown below.

"If bars are produced in the general form of Good Delivery bars, but due to their intended use (for example bars produced for and delivered directly to an industrial customer for use as a raw material) they do not meet the Good Delivery specifications (for example, inferior appearance or sub-standard bar marks) then the Good Delivery refiner must stamp the bars NGD (meaning Non Good Delivery) in close proximity to the LBMA-approved manufacturer's mark."

COMMITTEES

Management
Gerry Schubert resigned from the Committee in early October as a result of his departure from INTL. We send him our thanks for his lively and positive participation in the work of the Committee over the last three years.

Usually, the Management Committee has a break in the summer but this year it met each month between August and October. The first of these meetings focused particularly on the question of the possible commercialisation of the data produced in the precious metals market. As a result, a new sub-committee, the Precious Metals Data Committee was set up under the chairmanship of Steve Branton-Speak. The first task identified by the sub-committee was the production of a forward curve, based on contributions from Market Makers and representing the actual situation in the market at the end of each trading day.

Physical
The Physical Committee met in late August and early October. The Committee was pleased to note that the long-running investigation into the electronic weighing of gold has finally produced a successful conclusion, namely an electronic scale that appears to be able to match the accuracy and reproducibility of the beam balance. See the brief article on this page by Douglas Beadle.

The main activity of the Physical Committee is of course monitoring (and eventually approving) applications for Good Delivery accreditation. At present, six refiners (from four countries) are actively going through the technical assessment procedure. This may be a record and it certainly places a heavy demand on the LBMA Executive. Five out of the six applications are for gold, which is a very different ratio from that of recent years, when most applications have been for silver. In addition, a further ten companies have indicated that they may submit applications in the coming year.

Proactive monitoring is another activity which places significant demands on the Executive's resources, especially when as at present, many of the companies being monitored are in Russia and China. Satisfying the import and export conditions in relation to the despatch of reference samples to these countries might best be described as a "challenge"!

The Physical Committee has always been responsible for the issue of VAT in the bullion market. The Committee has formed a VAT sub-committee to formulate proposals to put before HM Revenue and Customs ("HMRC") with a view to agreeing a uniform and simplified approach to the application of VAT to storage, transfer, handling and similar fees levied in respect of precious metals. It is hoped that it will be possible to reach agreement with HMRC by 1 January 2010, to coincide with the introduction of new EU VAT regulations concerning services and their place of supply.

Reference Materials Project
Following the successful conclusion with the gold part of the project in the summer, it is pleasing to report that great progress has been made with the silver materials. The project Steering Committee has concluded that the materials are homogeneous and essentially, it only remains to determine the concentration levels of the 21 contained elements (by means of a round robin analysis involving 13 assayers). It is hoped that the materials will be ready for shipment before the end of the year.

Public Affairs
There has been one change in the make-up of the PAC, as a result of David Holmes' resignation from the Committee, due to a change in his responsibilities at Commerzbank in the wake of the merger with Dresdner Bank. The resulting vacancy has been filled by Suki Cooper of Barclays. Many thanks to David for his four years of service on the PAC and in particular, for his many insightful and thoughtful suggestions.

The PAC has had something of a fallow period during the past few months following the most intensive period of work in the second quarter when the programme for the Edinburgh conference was developed. The

***The London Gold Marking Fixing Limited** has announced that there will be no afternoon gold Fixings on Christmas Eve, Thursday 24th December, 2009, nor New Year's Eve Thursday 31st December, 2009.*

Committee's meeting in late October represented the first step in planning the programme for the conference to be held in Berlin during the period 26 - 28 September, 2010. Check the website for more details as our plans evolve. And if you have a suggestion for a topic or a speaker, do please let the executive know.

Membership
Following Nick Frappell's resignation from the Committee in June as a result of his departure from Sempra, the vacancy has been filled by Davide Collini of Merrill Lynch. Thanks to Nick for his work on the Committee and best wishes to him in his new position at Triland.

The Committee met in September to review progress with a number of applications for membership and associateship. The Committee has also been asked by the Management Committee to carry out a review of the structure of the LBMA's membership and the requirements that applicants have to meet to be admitted.

REACH
The LBMA has been working to produce a position paper arguing that the large gold bars held in the vaults of the London bullion market should be regarded as articles for the purposes of REACH and that the corresponding imports should be excluded from an importer's REACH registration. The Brussels-based Precious Metals Consortium has assisted in the development of this paper. When completed, the paper will be submitted to the UK Competent Authority (probably in late November). The final phase in the work (at least for the moment) will be the organisation of a seminar, probably in early December, to allow LBMA members to evaluate whether they should join the Consortium or else obtain the necessary registration dossiers by means of a letter of access.

LBMA Staffing
Amy Berman has taken over the role of PR and Media Assistant from Rionne Preuveneers (primarily the editing of the *Alchemist* and managing the website).

Varsha Peiris has been appointed as Office Administrator to support the work of the Executive in a number of areas including office management, membership applications, associate reviews and meetings. ■

DIARY OF EVENTS

NOVEMBER

6-7
International Precious Metals & Commodities Show 2009
Munich
www.edelmetallmesse.com

10-12
Russia & CIS Mining Congress 2009
Moscow
T: +971 (0) 4 709 4500
F: +971 (0) 4 347 3889
www.terrapinn.com

20-22
China Mining Congress and Expo 2009
Tianjin Binhai International Convention and Exhibition Center
T: +86 10 5822 1790
www.chinamining.org

21-22
Hard Assets Investment Conference
San Francisco
T: +1 314 824 5515
www.hardassetssf.com

21-23
2009 China International Silver Conference
Chenzhou, China
T: +86-10-85692818
www.silver2009.antaike.com

DECEMBER

3-4
China Gold & Precious Metals Summit
Shanghai
T: +86 21 5181 5373
www.chinagoldsummit.com

JANUARY

20
Minesite Forum
London
T: +44 207 562 3381
www.minesite.com

FEBRUARY

9-12
Mining Indaba
Cape Town
T: +1 314 824 5515
www.iiconf.com

11-13
CIS Precious Metals Summit
Moscow
T: +44 20 7017 7342
www.adamsmithconferences.com

26
LBMA Annual Party
London
T: +44 20 7796 3067
www.lbma.org.uk

MARCH

23-27
Asian Mining Congress
Singapore
www.terrapin.com
T: +65 6322 2700

MAY

18-20
International Gold Symposium
Peru
mjaramillo@snmpe.org.pe
T: +51-1 460 1600
F: +51-1 460 1616

JUNE

12-15
IPMI Precious Metals Conference
Arizona
www.ipma.org

facing facts

Paul Burton
Managing Director
GFMS World Gold Ltd

Gold Stocks Still Recovering

Just over a year ago, the gold equity markets were hit by the staggering news that Lehman Brothers had collapsed and that Merrill Lynch had been acquired. The news broke just as the annual gathering of the world's top gold companies and the most influential institutional investors was convening in Denver.

Fund managers and mining executives alike at the Denver Gold Group forum were shell-shocked by the extent and depth of the massive sell-off in gold equities. The scramble on the part of investors to be liquid and the need of many hedge funds to

cover redemptions caused the Philadelphia Gold/Silver Index ("XAU") to plunge from 150 to 64, a fall of 57% in less than a month.

This year, however, we have seen a gradual recovery in the market with an initial peak at 161 in June, when the gold price rose to US$980/oz, and then a new year high of 174 as the gold price marched its way to the US$1,000/oz mark in the sharp September rally.

Since the October 2008 low, the XAU has grown by 172% against a 35% increase in the gold price. This impressive performance probably says more about how oversold gold stocks were a year ago than it does about a return of the historical leverage to the gold price that gold stocks displayed in the past. Nonetheless, the mood at this year's Denver Gold forum was buoyant despite the trials of the past year, and interest in gold shares was high, with a record attendance.

One of the most significant and well-attended presentations in Denver was that given by Barrick Gold Corp, the world's biggest gold producer. CEO Aaron Regent's presentation focused on the company's decision to abandon its long-held strategy of hedging its gold production. Mr Regent explained the rationale behind the decision and outlined the mechanics of how this will be achieved in response to some probing questions from investors. Barrick Gold is eliminating all its hedging contracts by neutralising its fixed forwards and buying back a portion of its floating contracts. To finance the move, Barrick has raised a staggering US$4.0 billion through an offering of 109 million shares.

Barrick intends applying US$1.9 billion of the proceeds to eliminate all of its fixed-priced gold contracts (3.0 Moz) within the next 12 months. The company will either purchase gold in the open market, which will add to the demand side, or deliver its own production to settle the hedge contracts. Since the end of June, Barrick has already bought back 2.4 Moz of its gold hedges.
The company will apply some of the remainder of the funds raised to reducing its 'floating contracts' on 6.5 Moz of gold.

There has been a trend amongst producers over the past few years to unwind any hedgebooks as the gold price has increased in order to take full advantage of the rise, but Barrick is one the biggest and last to renounce the strategy.

Barrick has given its reasons for the about face as a combination of an increasingly positive outlook on the gold price, continuing robust gold supply/demand fundamentals, and the adverse impact its continuance of a hedging strategy was having on its appeal to the broader investment community. On this last point, figures from World Gold Analyst certainly show that Barrick has underperformed its contemporaries in the market since last year's downturn.

The table below shows how the top gold producers have fared since the October 2008 lows (figures to September 14th).

Company	% increase since Oct 08 low
AngloGold Ashanti	199%
Randgold	196%
Gold Fields	188%
Newcrest	175%
Agnico-Eagle	153%
Yamana Gold	131%
Kinross Gold	128%
Goldcorp	127%
Newmont	112%
Harmony	83%
Barrick Gold	76%

Meanwhile, in Denver, the gold-producing industry presented a positive picture of organic growth from a well-stocked portfolio of projects. Investors seemed to be encouraged by recent performances and appeared confident that growth plans are realistic.

Certainly, there are indications that the gold industry has reversed, although perhaps only temporarily, a four-year, 2% per annum declining trend, with news from GFMS in its latest assessment pointing to output having expanded by 7% in the first half of 2009. The dramatic improvement in production at one of the largest copper/gold mines in the world, Freeport McMoRan's Grasberg in Indonesia, was responsible alone for almost 1 Moz of the boost. This increase was not due to expansion, but a function of the mine sequencing at Grasberg, which resulted in activities being focused in higher grade pit areas this year.

Thus, the increase in January to July 2009 may be just a blip in the overall declining trend unless record exploration spending over the past few years can produce a few more success stories. However, that likelihood seems remote, because the flight from risk last year that severely hit the major gold producers was even harder on the junior exploration stocks.

The TSX Venture index (used here as a proxy for the exploration sector) more than halved (from 1,608 to 684) from post-Lehman to its nadir on

December 5.
Highlighting the particular problems of a sector that relies on equity risk capital, the recovery of the index has been much more muted than that for the companies that actually produce gold (and are thus receiving high prices for their product). The index has risen 88%, against a gold price rise of 33% since December 5.

As another illustration of how the junior market has changed since the financial crisis of last year are the, comparative statistics issued by the TSX Venture exchange on trading activity. In the eight months to the end August 2009, the value of deals on the exchange fell by 64% compared with the corresponding period of 2008. The total market value of the companies on the exchange declined by 33%. Furthermore, transactions were down 41% and the number of new listings fell by 68% to just 59. Perhaps most telling, however, is the statistic that new equity financing more than halved to C$2.1 billion.

The junior sector has yet to fully recover, with only the most promising projects finding adequate support in the market. Many companies are still cash-strapped and in survival mode. The impact on an industry short of exploration success will be profound, as at least one full season of drilling has been lost in many cases. ■

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