Alchemist

LBMA

LONDON BULLION MARKET ASSOCIATION

ISSUE 11

April 1998

Rise & Shine

Editorial Comment by Susanne M. Capano

Spot silver quoted with a 10 cent spread between buying and selling rates! Forward prices in a steep backwardation with 20% spreads! The resulting commotion was enough to rouse silver bulls, dormant since the early 1980s.

After a period of steady trading and tightening forward spreads at the beginning of 1998, the spot silver price spiked up sharply on 3rd February following a news announcement from Omaha, Nebraska: Warren Buffett had accumulated a substantial long position in silver and intended to take delivery of the metal. His rationale for purchasing silver was the fundamental imbalance between supply and demand, and his long-term investment strategy is well known. Such is Mr. Buffett's reputation that the silver price actually rallied almost a further 20% in active trading during the three days after the announcement, reaching a high of around $7.90 per ounce.

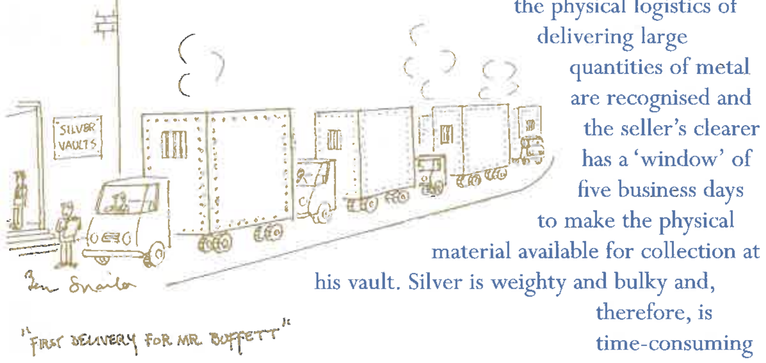
It transpired that Mr. Buffett had placed his buying orders on a Loco London basis. Pressure on London silver stocks increased significantly as he continued to take physical delivery of his forward positions during February. Many analysts had already pointed out the diminution of global physical silver stocks under pressure from solid demand and declining production over several years. The need for 129 million ounces of physical material in London drove the market into a severe backwardation – quoted as high as 60% in the one-month period. Producers wishing to take advantage of the higher prices by either selling forward or undertaking derivative hedging strategies exacerbated this tightness. The dealers executing these transactions needed to sell spot silver and borrow (or buy and sell) that metal to the forward maturity date(s), thereby increasing pressure on liquidity and on silver lease rates.

In an OTC environment, such as the London Bullion Market, clients who decide to sell must either be in a position to provide physical metal or must borrow it in order to satisfy their obligation. Short selling of any commodity is always a potentially dangerous undertaking and arguably should only be considered by professionals who understand and have the financial capacity to cover the risks. Those market participants

In this issue:

who had Loco London short silver positions coming to maturity during January and February faced a sharp increase in the cost of rolling them forward. In commodity markets, locational and time liquidities are just as much markets of demand and supply as the outright price, and Loco London silver was certainly in demand at the time! The amount of gold and silver in the vaults of London clearers reflects metal held on customers' unallocated accounts – and, early on, this metal was sold or lent at attractive rates. Subsequently, as the premium for London silver for spot delivery increased, physical metal began to flood into London from overseas vaults.

Under usual circumstances, clients buying gold or silver Loco London are entitled to request immediate physical allocation. Such allocation is evidenced by a weightlist of bars detailing individual weights, finenesses and brands. In practice, particularly in silver, the physical logistics of delivering large quantities of metal are recognised and the seller's clearer has a 'window' of five business days to make the physical material available for collection at his vault. Silver is weighty and bulky and, therefore, is time-consuming to move. Transporting the 129 million ounces in question requires over 190 articulated truck (in American parlance, 'semi') loads. Every one of the 129,000 bars concerned must be physically weighed in and out of the vaults of market members. Incidentally, London vault staff had no need for gym workouts during this busy period!



A meeting of the Management Committee of the LBMA was called on 5th February in order to address the difficulties in handling the logjam of silver bars within the usual five-day window. It was decided that, as long as sellers produced weightlists of material to satisfy buyers, delivery in London could be extended to 15 business days. This initiative was well received by the market and, in conjunction with Mr. Buffett 's expressed willingness to "…defer delivery for a reasonable period upon payment of a modest fee", took some of the intensity out of the market. The higher prices subsequently effected some producer selling and profit-taking. Within three weeks, the spot price had fallen back to the $6.00 level from which it had sprung. Some "Buffeteers", as market professionals dubbed the speculative copycat buyers, were disappointed by the very short-term performance. However, the long-term picture remains unchanged and the fundamental imbalance continues to argue for higher prices, according to most analysts.

On 22nd April, just before this issue went to print, the Management Committee announced that with effect from 22 May 1998, the five-day window would once again apply. Therefore the 8th May 1998 will be the last day on which the 15-day window can apply, with each working day reducing the delivery period by one day, until the five-day norm is reached on 22nd May.

The London Bullion Market Association is pleased that Mr. Buffett effected his business and requested the delivery of his metal Loco London. We consider that his buying exercise was professionally undertaken on the basis of some apparently compelling fundamental research and we respect the long-term nature of his investment. We wish him well! ■

Postscript

Sell the Rumour, Buy the News?

Those in the gold market know: Belgians sell more than chocolate

The news on18th March that the Belgian central bank had sold 299 tonnes of gold could hardly be described as a shock. The market had been buzzing for months with rumours of European central banks selling off gold reserves ahead of EMU. Of eight previous central bank sales, four had been by Belgium. After the announcement, gold immediately fell over $5 per ounce. All the previous announcements had resulted in continued low prices during the short term.

Not this time.

Shortly after the announcement, the price soon bounced back to close only slightly lower than it had been (roughly $290 per ounce). By the end of March, it had recovered to the $300 level again.

Why?

A combination of reasons:

- Due to cash requirements, several producer interests were involved in buying back short positions or unwinding hedges around the time of the announcement.
- The price steadiness in turn inspired fund short covering.
- In a more general sense, the gold market factors in a certain amount of central bank gold lending and sales, without which a gap would exist between production, scrap and fabrication demand.

Any deeper meaning will have to wait. Our crystal ball can only assure us that this time, there were more buyers than sellers (really must order that new digital crystal ball with the 25-inch screen). ■

A New Market Standard

ISDA-based Documentation for Precious Metals

by Martin Stokes, Vice President, Commodities, Morgan Guaranty Trust Company of New York

Creating standard documentation for use in the over-the-counter bullion market has been an on-going part of the responsibilities of the LBMA's Management Committee, thereby providing participants with greater protection. Having such documentation in place removes a substantial amount of bilateral negotiation and reduces expensive lawyer time. Most importantly, standardised documentation helps establish consistent market practice and conformity of approach, reducing the risks of misunderstandings or disputes.

The initial document produced in 1994, the International Bullion Master Agreement (IBMA), has proved of immeasurable benefit to the market but does have some limitations. Its weak points are the compartmentalisation of bullion exposure and its focus upon purely physical business. In a closeout situation, IBMA effectively allows the netting down of all gold and silver spot and forward trades and options exposures to one single obligation. However, where counterparties have exposures across different market areas, there is an increasing trend toward documenting all types of products under a single master agreement. This gives a non-defaulting party as a contractual matter the ability to net off an in-the-money position in gold and silver with an out-of-the-money position in another business area (such as Foreign Exchange).

Many of our readers will be aware that a working party, established on an LBMA initiative and led by ISDA (International Swaps and Derivatives Association, Inc.) has been toiling for over a year to create a standard Definitions Booklet for bullion transactions governed by such agreements as the 1992 ISDA Master Agreement, including platinum and palladium. This document was finally released on 5th March 1998, and the Management Committee of the LBMA would like to express its sincere thanks to all involved in this exercise. Additionally, we welcome the closer ties with the London Platinum and Palladium Market.

The ISDA Definitions Booklet has been published in two forms, 1997 ISDA Bullion Definitions, and an abbreviated version, 1997 ISDA Short Form Bullion Definitions. Both publications are intended for use in confirmations of individual gold, silver, platinum and palladium transactions governed by such agreements as the 1992 ISDA Master Agreement. The long version, 1997 ISDA Bullion Definitions, provides documentation for spot and forward trades and options, and for cash-settled swaps, caps, collars, floors and swaptions that are either cash settled or physically settled on an unallocated basis. It is important to understand that the word 'swap' in this context has the meaning of an outright trade settled for cash against a benchmark such as a fixing. A swaption is an option to enter into such a swap.

The short form, 1997 ISDA Short Form Bullion Definitions, is an extraction of the long form. It responds to the desire of some market participants for a short-form set of definitions covering only bullion spot and forward trades and options that are physically-settled on an unallocated basis.

The ISDA-based publications can be ordered by fax on an ISDA Publication Order Form that can be downloaded from the Association's website, www.isda.org, or obtained from the New York (212-332 1200) or London (44 171 330 3550) office. ISDA Bullion Definitions costs $50 for members, $100 for non-members; ISDA Short Form Bullion Definitions $25 for members, $50 for non-members. The minimum order of either is three.

Key Distinctions Between the Application of IBMA and the ISDA-Based Documentation

- *IBMA only covers physically settled spot and forward trades and options in gold and silver.*
- *IBMA's overall jurisdiction is limited to gold and silver exposures only.*
- *In the long form of the ISDA Bullion Definitions, the product coverage is much wider than that in the IBMA, incorporating exposures in a variety of cash-settled and derivative transactions.*
- *ISDA covers platinum and palladium in addition to gold and silver.*
- *The ISDA Bullion Definitions envisages physical trades being settled on an unallocated basis, although there is a provision within the documentation for allocated delivery. This latter, however, would require additional provisions in the individual confirmation.*
- *The ISDA Bullion Definitions are designed to be incorporated by reference in transactions governed by such agreements as the 1992 ISDA Master Agreement. The advantage of documenting bullion transactions under the same Master Agreement is that it promotes netting of exposures across all market areas.*

The LBMA Management Committee is pleased that this initiative has been completed and commends the ISDA-based documentation to its members where appropriate. ■

Martin Stokes began working in precious metals for Johnson Matthey Bankers Ltd. in 1972. He became their chief gold trader in London from 1976 to 1980, after which he transferred to New York, where he worked until 1985 as a Director of Johnson Matthey Commodities Inc. He subsequently joined JP Morgan in London, and is currently co-head of its world-wide metals trading. A member of the LBMA Management Committee since 1989, Martin has been the organisation's Vice Chairman for the past three years. He was instrumental in the development of the IBMA documentation in 1994, as well as the new ISDA Definitions Booklet.

ORACLE

"...The unwillingness [of Europe's central banks] to announce a clear strategy has undermined the market and damaged the mining industry...We should not ignore the effect [this] strategy has had on Europe's own citizens, it's own taxpayers. The reserves, which they themselves have helped create, have been devalued. Following a decision on the actual size of the ECB's gold reserves, the ECB should announce that if in future a member national central bank wishes to sell a proportion of its remaining reserves it must do so through a series of auctions to be managed by the ECB itself." Robert Guy, NM Rothschild & Sons, *Australian Gold Conference*

"...The ECB and its National Banks should give their backing to the launch of a Gold Euro. Europe should take serious note of the 200% increase in the quantity of gold used in producing the American Eagle and the Canadian Maple last year. The coincidence of the new Millennium and the start of European Monetary Union provide a unique double marketing opportunity. This opportunity will be even bigger if the proposal to exempt legal tender coins from VAT is accepted." Robert Guy, NM Rothschild & Sons, *Gold and Silver Institutes Conference, Naples, Florida*

" Perhaps there'll be a spike to $7.50, maybe $7.75 an ounce, but above $7 there are already signs that [silver] is struggling." Wall Street Journal Europe, 5 February 1998. Colin Griffith, Standard Bank London Ltd, *"Silver Soars on Berkshire's Buying"*

" Of the 50-bil ECU that the ECB is likely to hold as foreign exchange reserves, we think that 70% will be held in dollars, another 15% in yen, and another 15% in gold... The ECB won't have much choice [for reserve tools] outside the dollar and the yen." Peter Fava, HSBC Midland *Platt's News Service, 9 April 1998*

Upcoming Engagements

Doing Business in Kyrgyzstan, 14-15 May, London
Hedging Gold in an Emerging Producing Country,
Martin Fraenkel, Chase Manhattan Bank

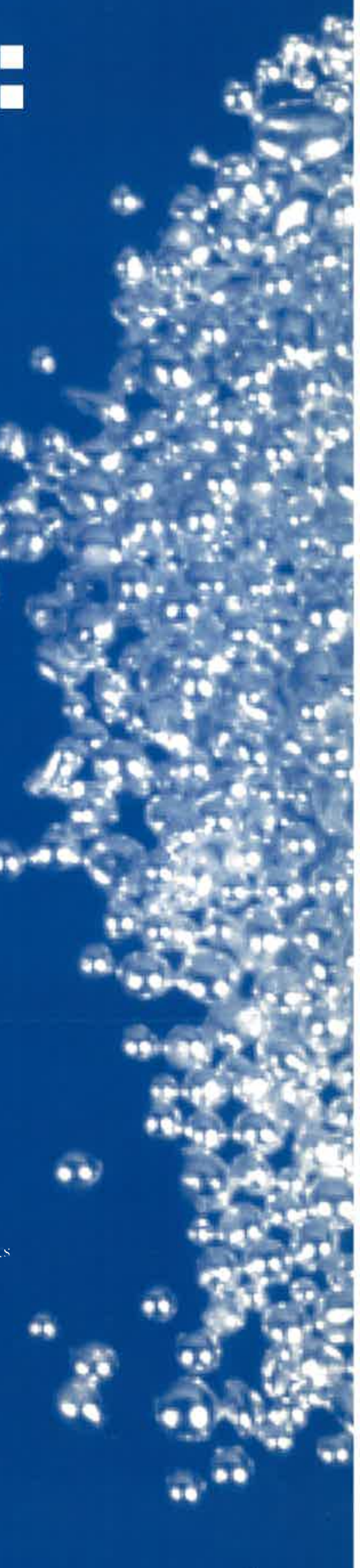
FT World Gold Conference: The London Market, 22-23 June, Barcelona, *Peter Fava, HSBC Midland*

LONDON BULLION MARKET ASSOCIATION

From Silver Bulls to Sacred Cows:

The Outlook for Silver

by Stewart Murray, Chief Executive, Gold Fields Mineral Services



There will be little doubt as to the identity of the silver bull in the title: Warren Buffett who, in February, admitted that he would shortly be sitting on a hoard of 129 million ounces of silver – perhaps we should call him Sitting Bull instead? The more important question is–what has driven the thinking of the investors (or, if you prefer, speculators) who decided that the silver market was ready for a change in direction last year? We would suggest that the silver market's healthy fundamentals and the steady fall in bullion stocks since 1990 were the keys to their decision making. Obviously, the future actions of Mr Buffett and his cohorts are likely to be just as important in determining the future of the silver price as they already have been in the past year.

The second half of the title has nothing to do with the mad cow disease that has afflicted the UK for the past decade even if, for some observers, the silver market has had a whiff of madness about it in recent months. The sacred cow refers instead to India, where it is revered by Hindus as a munificent mother figure. But there is another meaning for the term 'sacred cow' – namely an idea enshrined in myth or tradition which is so deeply rooted as to be unchallengable, even if it is no longer valid.

India today plays a leading role in the silver market due to the sheer size of its offtake: 129 million ounces, nearly 16% of world fabrication demand in 1996, coincidentally (or not?) the same quantity bought by Mr Buffett in the past year.

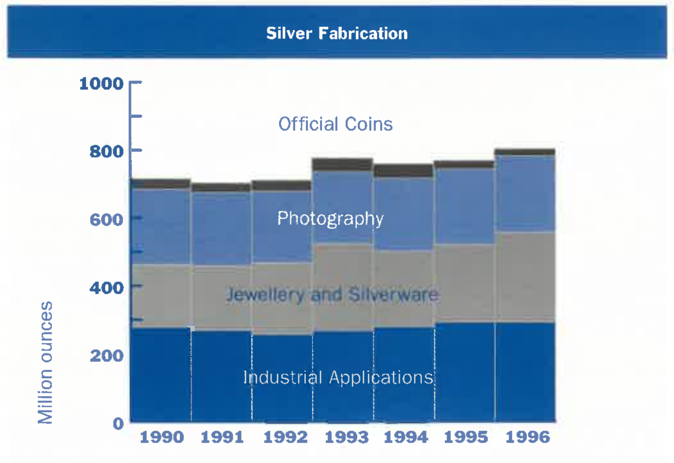
Like any other large economy, India now uses a substantial quantity of silver for purely industrial purposes. But, unlike many more industrialised countries, what sets India apart is the other part of the demand, which includes household utensils and jewellery, nearly all of which are bought with some investment motive underlying the purchase. At present, this investment demand for silver is in some ways a mirror image of speculative North American demand. In India, jewellery and silverware demand largely represents investment by the poorest people – including peasant farmers and tribal men as well as women. It is price-sensitive in a normal way – the lower the price, the more is purchased (and vice versa). North American investment, however, can show inverse elasticity, in which a rising price encourages other investors to buy, thus forcing the price higher still.

Since the price of silver started its rapid rise in the middle of last year, Indian silver bullion imports have declined sharply. The key question is whether this collapse in imports represents a temporary pause (as purchasers wait for the price to stabilise before returning to the market), or a protracted unwillingness for Indian buyers to invest in silver at prices above $6?

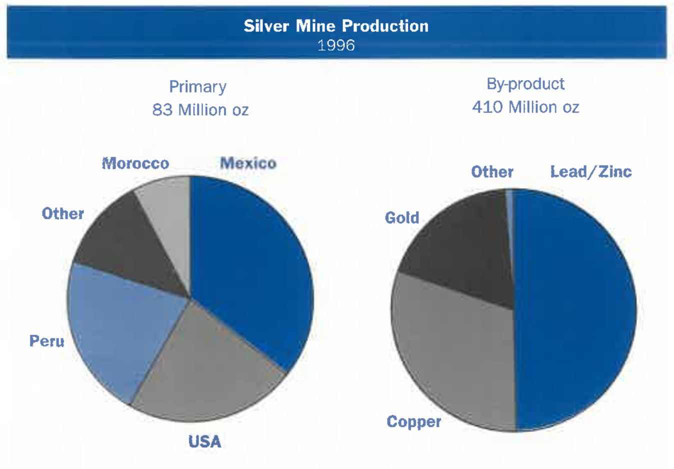
In a sense, then, we have two sacred cows, which appear to be mutually exclusive. The one favoured by silver bulls is that Indian demand is strong enough to recover even if prices maintain higher levels, while that preferred by market bears suggests that India will absorb almost no silver at prices around $7 and will, in fact, dishoard if prices rise much above that. Which sacred cow is more ready for slaughter? That question can only be answered by looking at how the silver price reached the level where it stands today.

Review of Historical Statistics
(1991–1996)

Fabrication
Overall, silver fabrication has grown steadily since 1991, with all main sectors showing trend increases–including photography, despite the digital threat. Apart from the United States, very little growth was attributable to the developed world. The trend in Europe has been sideways while, in Japan, offtake in 1996 had still not recovered to the record 1990 level. Thus, growth has depended mainly on improving demand in the newly industrialising countries of the developing world and, above all, from the surge in the jewellery and silverware sector in India after 1992.



Mine Production
Mine production declined during the first half of the 1990s as producers of primary and by-product silver cut back in the face of falling prices – not just for silver, but also for copper, lead, zinc and gold. With the subsequent recovery in metal prices up to the middle of the decade, mine production of silver has recovered steadily since 1994 and looks to have increased further last year.



Deficit and Stock Reduction
Putting the above figures together with those for scrap reveals a cumulative deficit for the period 1991–1996 inclusive of roughly 800 million ounces, or an average of 130 million ounces per year. This figure fits very well with the decline in identifiable stocks of some 540 million ounces (90 million ounces per year, with the 40 million-ounce difference implying that unreported stocks have fallen by roughly that amount).

This is the picture investors saw in May of last year. Although identifiable stocks were still equivalent to nine months' demand, they were approaching the 'pinch point', namely the level at which the direction of stock movements becomes an important determinant of investor behaviour. The picture shown here was clearly an encouraging one for those with deep pockets and a belief that only higher prices could bring the market to a sustainable equilibrium.

Economic Background
In addition to the role of investment in supporting and latterly raising silver prices, economic developments have also had an impact on the market due to silver's income elasticity:

- When people are wealthy, they buy and use more silver containing products – even if they are unaware of the silver content in the items they purchase (eg, camera film, computers, air-conditioners).

- When companies are doing well, they invest in equipment containing silver (such as transformers, switchgear and machines of all types).

- When countries are doing well, they invest in infrastructure, much of which is related to the generation and transmission of electrical energy – a big market for silver.

The developed world has seen the same kind of trends in the past year as we noted in 1996:

- The United States continued its Goldilocks expansion, which inevitably boosted the demand for silver in a wide range of products, especially those involving electrical and electronic parts.

- In Europe, growth in demand has again been slower than in the United States while, in Japan, the slow growth in industrial activity was insufficient to give a real boost to silver offtake, with the one very positive exception of the electronics sector.

It was, of course, in the developing world where the real income-related changes were seen. The collapse of East Asian currencies has been followed by a period of nervous volatility leaving the longer-term economic impact still a very open question. However, South East Asian economies as a group are much less important to silver consumption than to gold. Furthermore, our understanding is that attempts to mobilise piles of silver chopsticks for refining and export have met with very limited success.

Although economic growth in India has been muted lately, of much more importance here is what we call the 'fertiliser factor', namely the impact of agricultural output on rural spending.

Another good monsoon for the summer crop was positive for precious metals, but an excess of rain means the winter harvest will be relatively poor, especially in the north of the country, a major market for silver.

Silver Supply
Primary silver producers are by no means an endangered species. This sector has shown steady growth in output over the past four years, mainly in Mexico, Peru, the United States and Morocco. However, an overwhelming majority – 83% – of silver production results from by-product output, primarily lead/zinc and copper mining. Even the smaller gold sector is responsible for nearly as much silver production as the world's primary mines. Therefore, any analysis of the prospects for silver mine production must also involve the outlook for the above-mentioned metals.

There has been a lot of talk recently about how the fall in gold, copper and lead prices over the past two years may result in lower mine production and thus of by-product silver. Given normal lags between movements in metal prices and mine production, we would not expect to see that much impact so far. Looking ahead, it does seem likely that a sustained drop in the prices of these metals would likely result in a decrease in mine output of them and, by extension, silver.

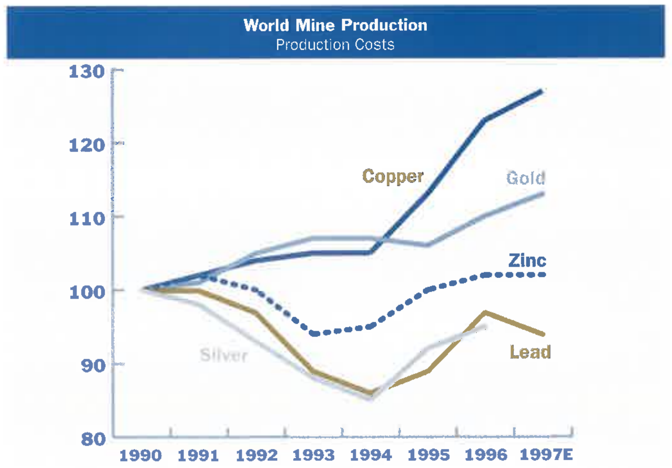
Nevertheless, there are many projects either in the pipeline or which have started up in the past year that will add to future production, mostly as a by-product of gold or lead/zinc.

Impact of Price Rises

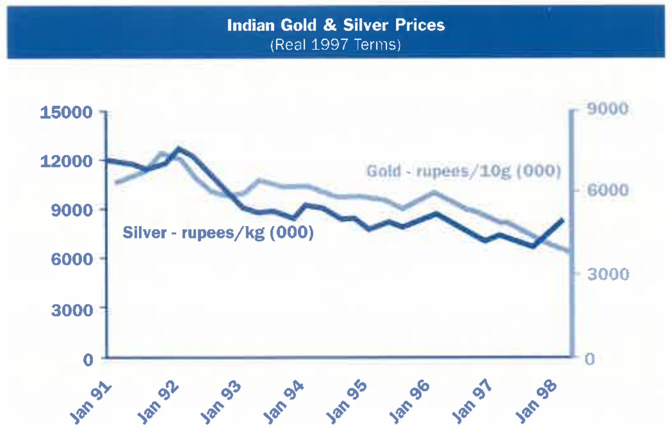
UK Bullion Imports
One of the biggest developments associated with the rise in leasing rates and spot prices in the past half year has been the surge in bullion exports from the United States to the UK.

The United States is both a source of newly refined silver and the location of much of the world's readily available stocks. The UK, on the other hand, is the principal turntable for silver, acting as a storage and distribution centre for the physical markets, either directly or via Switzerland.

Leasing rates for silver have shown two spikes in the past five years, in 1995 and, even more dramatically, in 1997/98. The result of this spike has been to draw silver into London (not just from the United States, as shown here, but even from Europe and Dubai). This certainly explains the jump in imports in the fourth quarter of last year and what will probably be a bigger jump in the first quarter of this year. Over the past three years, there has been a steady excess import of around 10 million ounces per quarter, which corresponds approximately to UK silver fabrication (though the London dealers' role as stockholder complicates the picture).

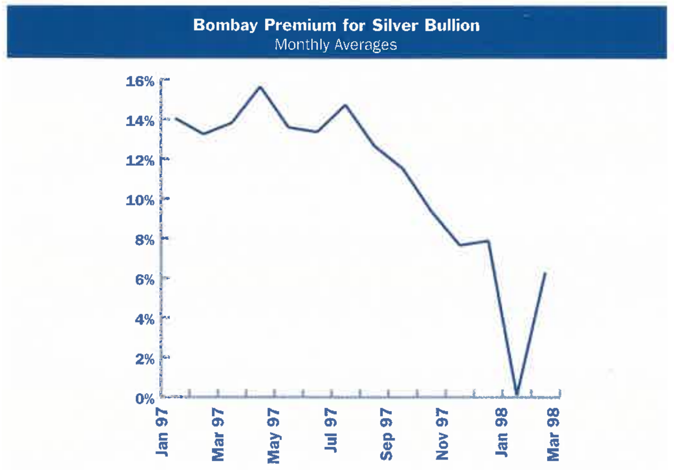


The fourth quarter of 1997 showed a dramatic change: imports leapt while exports collapsed. The jump in imports was presumably Buffett-related, while the fall in exports is the market's knee-jerk reaction to the rising price, reflecting the fall in Indian demand and, to a minor degree, the economic impact of the East Asian crisis. When we look at India itself, last year's story was just as dramatic.



After the tremendous jump in Indian imports in 1996 (despite the higher price) and a record-breaking first half in 1997, there was a spectacular collapse in the fourth quarter. By contrast, at the end of the third quarter, Indian demand had appeared certain to be heading for a new record, showing just how sensitive that market can be to short-term price movements.

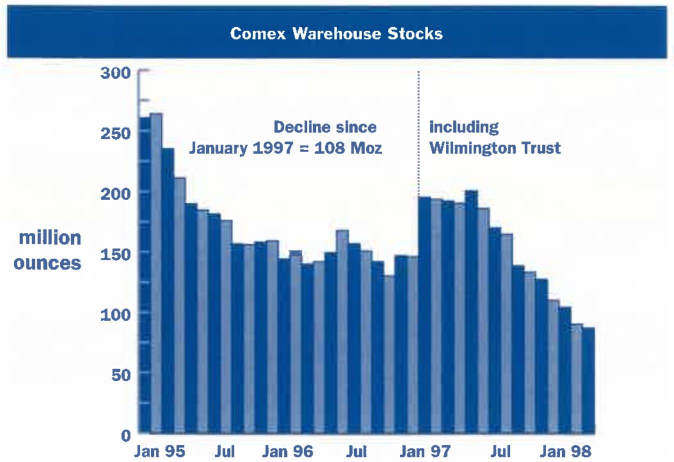
Local prices were influenced by rupee fluctuations as well as the Bombay premium. In spite of pressure from exporters to devalue in order to compete with the wounded tigers to the east, and political uncertainties surrounding recent elections, the rupee showed very little movement over the course of the year, and only dropped just over 10% in the last quarter.



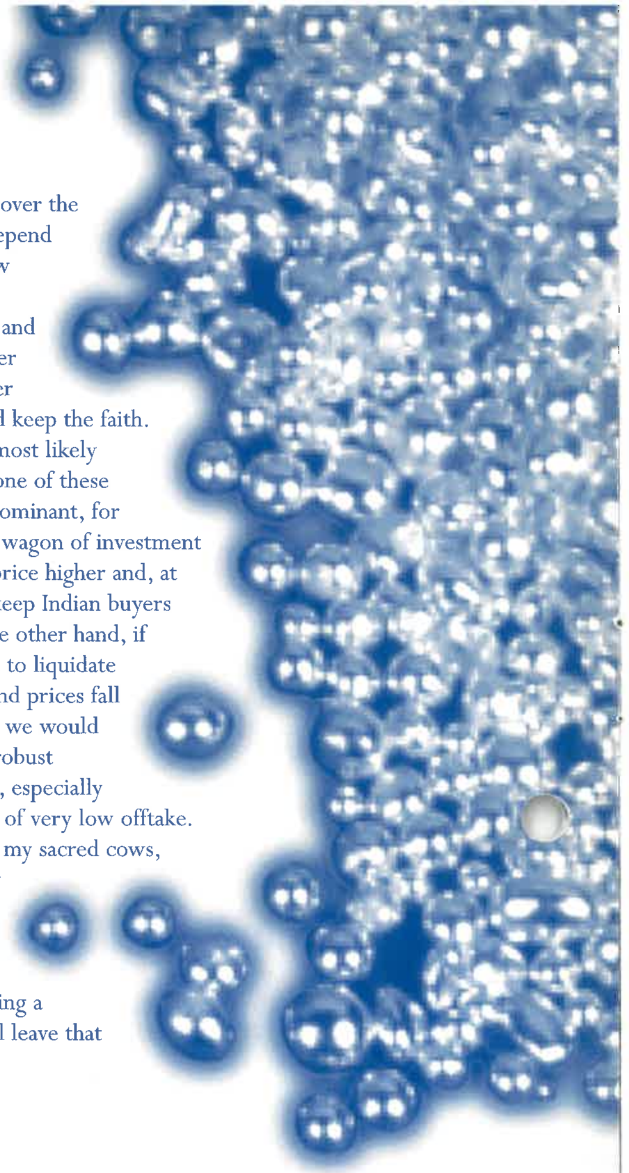
This fall pushed up the silver price in local terms, but the simultaneous drop in the Bombay premium as the government moved towards a more liberalised regime offset the price increase. The combined effect caused local prices to rise by just over a quarter, as opposed to the one-third rise in world prices over the same period. An even more important factor for silver demand in India in the past six months has been the relative changes in the price of gold and silver: the sudden rise in silver contrasted with a fall in gold, leading many purchasers to prefer relatively cheap gold to relatively expensive silver.

Conclusion

The future of investment and speculative demand will depend to a large extent on the trend in stocks, both highly visible exchange stocks and less easily observed dealers stocks in Europe. Comex silver stocks have been falling steadily since November 1992, when the published figure was 280 million ounces (excluding Wilmington Trust stocks, which were not reported until January 1997). The real fall in Comex stocks has been concentrated in two periods: the first half of 1995 and the second half of 1997. We have already indicated that stocks in Europe moved up in 1995, virtually offsetting the fall in Comex that year. With silver flowing into London since the middle of last year, European stocks in total have probably again offset the fall in Comex over that period. Nevertheless, it would be somewhat surprising if changes in European dealer stocks could have compensated for the entire 90 million ounce outflow from Comex during 1997, giving some encouragement to silver bulls.



The price trend over the next year will depend primarily on how quickly Indian demand returns and whether the silver bulls on the other side of the world keep the faith. We believe the most likely scenario is that one of these groups will be dominant, for instance, a band wagon of investment could push the price higher and, at the same time, keep Indian buyers sidelined. On the other hand, if speculators start to liquidate their positions and prices fall much below $6, we would expect to see a robust increase in India, especially after six months of very low offtake. Coming back to my sacred cows, you can see now that I am not prepared to slaughter either one of them. Being a vegetarian, I will leave that task to you. ■



Stewart Murray *After qualifying as a metallurgist from London University, Dr Murray studied for a PhD at Imperial College on the subject of hydriding of titanium alloys. In the decade up to 1984, he worked for the International Wrought Copper Council in London, serving as its Secretary General from 1980 to 1984. He then joined Consolidated Gold Fields (CGF), being responsible for the Group's commodities research, until the company was taken over by Hanson PLC in 1989.*

In that year, Dr Murray set up Gold Fields Mineral Services (GFMS), with the backing of Gold Fields of South Africa. The publications of GFMS include the authoritative annual survey of the gold market, now in its 31st year. Since 1993, this has been supplemented by two annual updates. Since 1994, GFMS has been responsible for the preparation of the annual World Silver Survey *on behalf of the Washington-based Silver Institute.*

Dr Murray continues to play an active role in the World Bureau of Metal Statistics, having been its Chairman from 1989 to 1991.

The Book Value on Gold

The Industry Catalogue of Gold Bars Worldwide

Move over BBC. When it comes to publishing a 'companion volume' to a definitive glitzy production, this book wins the ratings' race. And it's yours for less than the price of an ounce of gold.

As both a comprehensive professional's reference to the gold business, and as an equally thorough guide to the Industry Collection of Gold Bars Worldwide – the current special exhibition at the Bank of England Museum – this book is a must.

The volume is designed for all professionals in the gold market, from the mine entrance to the refinery to the dealing floor. It is the first definitive reference on gold bars grouped by major categories and covers the entire process of gold production.

The world's most important standard bars (400 ounce, 1000 gram and 10 tola) get the ample coverage one would expect, with all bars less than a kilo being shown actual size. In addition, there are other standard bars issued by accredited manufacturers and denominated in gram, ounce, tola, tael, baht, chi and don weights. (All those who know their weight in bahts, go to the head of the class.)

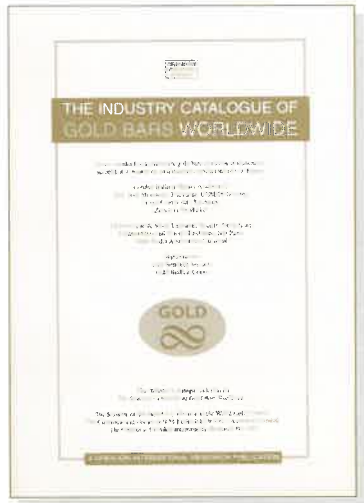
Hologram, kinegram, pendant and gold leaf bars are well represented and displayed, and for those who can't decide which they would prefer under their Christmas tree, there are yin-yang bars.

There is even a photo of someone trying to heft a 400-ounce London Good Delivery Bar. As anyone who has recently tried it at the exhibition will attest–an ounce here, an ounce there, pretty soon you're talking about 28 surprisingly dense pounds. It's enough to make you rethink that career change into gold theft.

The *Industry Catalogue of Gold Bars Worldwide* is available for US$ 275 from:

Grendon International Research Pty Ltd., 33 Alexandra Road, East Freemantle, WA 6158 Australia

Tel: 61-8-9319 2171
Fax: 61-8-9319 2154
E-mail: grendon@global.net.au ■



CFTC SURVEILLANCE OF THE SILVER MARKET

by John Mielke, Director, Market Surveillance Section, CFTC

The Commodity Futures Trading Commission (CFTC) is the United States government agency responsible for the regulation of all US futures markets. The CFTC seeks to safeguard the economic utility of futures markets by encouraging their competitiveness and efficiency, ensuring their integrity and protecting market participants against manipulation, abusive trading practices and fraud.

The CFTC's market surveillance program extends to all participants in US futures markets. Occasionally, the inquiries of the CFTC surveillance staff may extend to markets in other countries. Where markets outside the US have contract delivery terms–particularly delivery points–that significantly overlap with the terms of US futures contracts, forces affecting those markets may also affect futures and cash markets in the US. Although silver trading conducted under the rules of the London Bullion Market Association does not have common delivery vaults with the Comex silver futures market in New York, there is a substantial overlap in approved brands, and the time and cost of moving silver between the two markets is small in relation to silver's value.

Thus, for markets like copper and silver, a price manipulation effected in London could significantly affect the cash and futures markets for those commodities in the US. Moreover, the potential exists for a trader or group of traders to use both US and London markets to execute a potentially manipulative scheme. Since the Commodity Exchange Act prohibits the manipulation of "...the market price of any commodity, in interstate commerce, *or* for futures delivery on or subject to the rules of any contract market..." (emphasis added), the CFTC has a regulatory interest in such market situations.

On occasion, and generally in response to the emergence of unusual price movements, price relationships, extraordinarily large trader concentrations in US futures markets or a credible market rumour, the CFTC surveillance staff may find it appropriate to inquire about participants in the corresponding London market. Staff make these inquiries in consultation with the regulatory authorities in the UK. We likely also will request information from US firms that are active in the London market. Information obtained through these inquiries will be shared, as appropriate, with UK authorities, particularly if the information indicates a potential market threat.

In recent years, the CFTC has had an excellent relationship with UK regulators. Following a meeting in May 1995 in Windsor, England, convened by the CFTC and the Securities and Investments Board, our two organisations were among the founding signatories on 15 March 1996 of the Declaration on Co-operation and Supervision of International Futures Exchanges and Clearing Organizations and of subsequent international efforts to define best practices in information sharing, market surveillance and other regulatory issues.

MARKET SURVEILLANCE PRACTICES AND PROCEDURES

The goal of market surveillance is to spot adverse situations in futures markets and to pursue appropriate preventative actions, in co-ordination with the involved exchange, to avoid disruption or manipulation of those markets. The CFTC and the exchanges concentrate their market surveillance analyses most heavily on contracts that are expiring, because it is during contract expirations that the markets are most vulnerable to manipulation through abuse of the delivery process. The delivery mechanism is intended to lead to, and normally results in, convergence of cash and futures prices at expiration. However, if a trader attains a market dominant position, he or she may be able to control the delivery process, dictate the terms of liquidating trades and cause a divergence of futures and cash prices, as well as other price aberrations. The CFTC is alerted to possible disruption through its day-to-day analysis of prices, positions and supply/demand data.

Potential problems are reviewed immediately by the surveillance staff, and are discussed with the Commissioners and senior staff at weekly surveillance briefings or more often, as needed. These briefings keep those individuals abreast of potential problems and significant market developments so they will be prepared to take prompt action when necessary.

When the potential exists for market disruption or manipulation, CFTC's market surveillance team makes verbal contacts with the brokers or traders who are significant participants in the market in question. These contacts may be for the purpose of asking questions, confirming reported positions, alerting the brokers or traders as to CFTC's concern for the situation or warning them to conduct their trading responsibly. These contacts effectively resolve many potential problems at an early stage.

Since market surveillance is not conducted exclusively by the CFTC, if a problem develops it is usually handled jointly by the CFTC and the affected exchange. Relevant surveillance information is shared and, when appropriate, corrective actions are co-ordinated. The CFTC customarily gives the exchange the first opportunity to resolve the problem itself, either informally or through emergency action. If an exchange fails to take actions that the CFTC deems appropriate, the CFTC has emergency powers under which it can order the exchange to take actions specified by the CTFC. The CFTC has rarely needed to use its emergency powers.

INFORMATION GATHERING FOR MARKET SURVEILLANCE

At the heart of the CFTC's market surveillance system is its large-trader reporting system. In order to identify potentially disruptive futures positions, the CFTC staff collects and analyses data on large trader positions in all commodities. Each day, staff economists examine computer listings of large trader positions in actively traded markets to identify positions that could pose the threat of manipulation. Reportable positions, futures positions above specified levels set for reporting purposes, are obtained daily from futures commission merchants (FCMs), clearing members and foreign brokers. Exchanges also provide the daily positions that each clearing member is carrying in each futures and option contract on each underlying commodity.

Since traders frequently carry futures positions through more than one FCM, and since individuals sometimes control, or have a financial interest in more than one account, the CFTC routinely collects information that enables its surveillance staff to aggregate related accounts. FCMs must file a Form 102, which identifies each new account with reportable positions for each futures. In addition, if a trader's position reaches a reportable level, the trader may be required to file a more detailed identification report, a Form 40, to further identify accounts and reveal any relationships that may exist with other accounts or traders.

Surveillance economists may further investigate the positions of large trader by instituting a 'special call.' A special call requires a trader to report their futures and option positions with all brokerage firms, or their cash market or OTC positions.

Another element of the market surveillance program is the monitoring of compliance with the CFTC or exchange speculative limit rules. These rules help prevent speculators from accumulating concentrations of contracts of a size sufficient to possibly disrupt a market. Since bona fide hedgers are exempt from speculative limits, the CFTC and the exchanges administer hedge exemption programs that require commercial traders who need futures or option positions in excess of speculative position limits periodically to submit data justifying the exemption level they seek.

REMEDIAL SURVEILLANCE MEASURES

The CFTC has authority to deal with potential market problems in several different ways. These alternatives range from informal efforts to encourage compliance with the Commodity Exchange Act and the maintenance of orderly markets to formal legal actions to ensure compliance or to prosecute alleged noncompliance.

The CFTC surveillance staff frequently contact traders to determine their intentions regarding their futures trading or positions, to express any concerns the CFTC staff may have regarding such trading or positions and, less frequently, to issue any appropriate warnings, verbally or in writing. Also, the CFTC may make special calls for information from traders, as a means of getting a more complete understanding of the market situation and to be sure the trader knows its activities are being scrutinised.

The CFTC also has statutory tools for addressing violations of the Commodity Exchange Act. These include taking injunctive action to stop an ongoing manipulation. The Commodity Exchange Act authorised the CFTC to bring an action in a US District Court to enjoin a person or a contract market from violating the Commodity Exchange Act. The CFTC also has the authority to investigate and, if appropriate, prosecute alleged violations of the Commodity Exchange Act, by traders or by exchanges that have failed to enforce their rules.

The CFTC has emergency powers to intervene when it determines that a serious market threat exists. These emergency powers are contained in Section 8a (9) of the Commodity Exchange Act. In general terms, the CFTC has the power to take necessary action to maintain and to restore orderly trading when there is a threatened manipulation, or other major market disturbance that would prevent the market from accurately reflecting the forces of supply and demand for such commodity. ■

John Mielke

Mr. Mielke has over 25 years' experience in the regulation of US commodity markets. After receiving an MA in economics from Michigan State University, he started his career as a surveillance economist in the Chicago office of the Commodity Exchange Authority of the US Department of Agriculture, the predecessor agency of the CFTC.

Since 1978, Mr. Mielke has been the director of the CFTC's Market Surveillance program. As such, he supervises a staff of surveillance economists who monitor all actively traded markets on a daily basis and statistical support staff who maintain an extensive data base regarding these markets.

Mr. Mielke briefs the Commission and senior staff each week on significant market developments and potential problems that may require Commission attention. His staff also prepare special studies of unusual markets events and help prepare responses to Congressional inquiries regarding market performance.

SOUTH AFRICA'S GOLD MINING CHALLENGE

A Mining House Response

by Kelvin Williams, Executive Director, Marketing Anglogold Limited

For some years, media reports and market commentary on the South African gold mining industry have focused largely on negative news. Journalists report frequently on the marginality of gold mining operations in South Africa. Speculation on the imminent demise of large portions of our industry has been a stock item in the media since early in this decade. Most recently, attention has been focused on this image by the gold mining summit held in Johannesburg in February of this year to address the crisis in profitability in the South African gold mining industry.

The rise in unit costs of production and the decline in productivity on South African gold mines have certainly provided reason for serious concern, and the past decade has seen the local industry become the highest average cash cost producer of the major gold producing countries in the world. The comparison between the weighted cost per ounce of gold produced in North America and Australia since 1980, and the same cost in South Africa is shown in the graph on page 13. After the massive cost increases between 1985 and 1988, South African producers managed, for a brief period in the early 1990's, to pull down their costs of production towards non-South African levels of costs. However, recent years have seen the cost gap widen again.

In the minds of many observers, these high costs have come to be associated irrevocably with the deep level underground nature of South African gold mining, compared with production in other major gold producing countries. Outside of South Africa, a significant percentage of gold is produced from low-cost open cast mining operations with fairly simple metallurgical extraction procedures. Where gold is produced from underground operations outside of South Africa, the depths at which this mining takes place, and the seam widths in such operations, are generally more favourable than the typical circumstances of South African gold mining. Commentators have tended to see in these comparative statistics confirmation of the lack of any future for the South African industry.

We believe that these views on the South African gold mining industry are excessively negative, and that fears for its terminal decline are simply wrong. The crisis of costs which has so challenged South African gold mines these past 10 years or more does not arise from any single cause. The major individual problems that the South African industry faces are well understood and there are few producers who do not have initiatives under way to solve these problems.

Multiple causes

One of the problems the country faces is a direct consequence of the time that South Africa has been mining gold. Many of the richest and most accessible areas of our ore bodies have been mined over the past 100 years, and there is an inevitable grade attrition in the remaining gold reserves.

This does not affect all operations equally. Some mines still have large and rich reserves to sustain them through decades of mining. Other mines have only the remnants of a depleted ore body in their lease areas, and have to mine lower grades, often at considerable distances from the mineshaft. Older operations and those mining lower grade ore contribute substantially to the high average cost of production in South Africa.

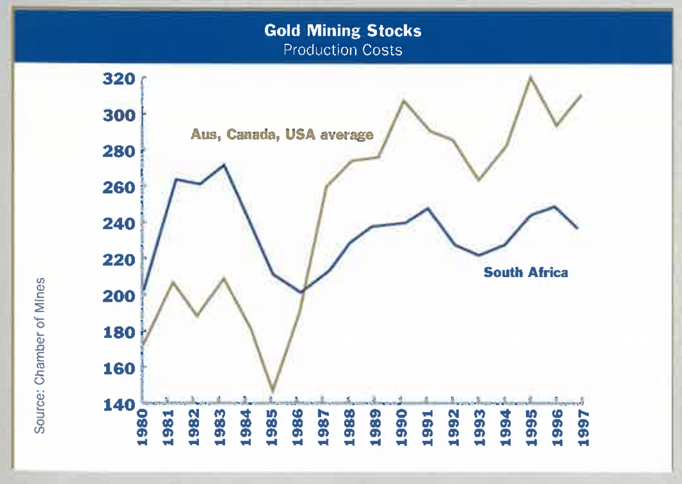
Also central to the problem of unit production costs is the large percentage of downtime on South African gold mines. This problem flows in large part from historical legislation, which forbade mining on Sundays. This heritage has been exacerbated by the promulgation of new public holidays, and by government pressure to reduce total working hours in all industries. The consequence of these circumstances has been that, on the basis of an 11-shift fortnight, many gold mines in South Africa have operated for as few as 275 days in a year.

A further inheritance from the past has been the fact that South African gold mine labour at most mines is neither sufficiently trained nor effectively organised for optimal productivity. Legislation from the apartheid era strictly reserved many jobs and skills for whites only, and actively discriminated against the acquisition of mining and technical skills by black employees. This legacy of the apartheid era has left the industry with a mixture of world class competence in many areas of activity, and great under-utilisation of human talents in others.

On top of these challenges, the international price of gold has triggered a squeeze in profitability on many South African gold mines which has made it difficult for some operations to get to grips with the work needed to solve the problems listed here. This problem is exacerbated by the fact that overall levels of gold price hedging in South Africa are low compared with the levels of price protection undertaken by producers in the other major gold producing countries.

Anglogold is addressing all of these problems, and the results of our operations reflect the success of the initiatives taken.

In respect of the problem of ore depletion, continued exploration within existing lease areas and on properties adjacent or close to existing lease areas have identified new prospective reserves. In addition, we have succeeded in swapping parcels of ore reserves with other producers in exchange for reserves contiguous to our mining operations, which have hitherto been sterilised by different ownership. In Anglogold alone we are involved in three major expansion projects at Freegold, at our Vaal River operations (previously Vaal Reefs) and at Western Deep Levels respectively, in which new shafts will access large gold reserves, often at levels deeper than current. In addition to these new projects, a whole new generation of high grade gold reserves has been delineated between 4,000 metres and 5,000 metres below surface on the far West Rand, adjacent to Western Deep Levels. The first stages of exploration are already under way to prove up and evaluate these reserves. In the area of unit production costs, our initiatives are already bearing fruit. Escalation in labour costs (which equate to some 50% to 55% of total costs in the industry) has played a substantial part in the negative performance since the 1980's. To offset this effect, the wage agreement reached in 1997 provided for fixed increases over two years, and included the undertaking by trade unions to enter into mine level agreements which would generate productivity increases to offset these wage cost increases. In the first instance, these mine level agreements have tackled the problem of downtime in the industry. In Anglogold, the Vaal River operations agreed to a new operating calendar, which adds fully 26 days to the working calendar of mining operations in this area. Similar agreements have been reached at all other Anglogold regions.



On another level, Anglogold has either closed or radically downsized loss-making shafts and business units in order to concentrate productivity effort on maximising the performance of the core and long-life shafts in our company. Using the gold price hedges in place in the company, Anglogold was able to continue to fund restructuring activities throughout 1997.

The problem of inadequate skills and sub-optimal work structures is less amenable to solution by agreements, and requires more time and effort to remedy. Nevertheless, in this area a start has been made. At Elandsrand, all underground production workers have undergone skills retraining and redeployment in teams designed to achieve greater productivity in South African circumstances. Structures of remuneration have been amended appropriately, and the continual improvement in Elandsrand's results over the past two years shows the potential for the South African industry. Similar programmes involving retraining and redeployment are well under way at other Anglogold operations.

To focus attention and effort on productivity, since the beginning of 1997, Anglogold management has published its productivity targets in advance (expressed as volumes of ore broken and gold produced per employee). In 1997, these published targets aimed for average increases of 83% in productivity per employee. Good progress was made during the year and, by the end of the fourth quarter, all of Anglogold's operations were achieving their targets. For 1998, the average target improvement is a further 23,5%. In broader terms, the company has set cash cost targets for all of its core operations of US$250 per ounce. Several of our operations are well below this production cost already; others will reach this target only in the next 18 months. On average, the cash costs for the company for 1998 (excluding retrenchments and extraordinary items) are targeted at US$248 per ounce.

All in all, we believe that Anglogold has gone quite some distance down the road to solving those major problems which have affected underground mining in South Africa so negatively over the past decade. The ongoing management of these problems is now an integral part of the strategic objectives of management on Anglogold operations. Much work remains to be done in certain areas, and retraining, upgrading skills and reorganising of production labour must be regarded as a task which will continue well beyond the immediate present. However, already the cash operating costs reported by Anglogold compare well with many well-rated, quoted mining companies in North America and Australia. With no debt in our company, total production costs are better than all of the highly rated North American and Australian producers. Gold mining in South Africa will always be a challenge, but it is by no means an overwhelming challenge. The changes and initiatives undertaken to date show just how much improvement can be achieved in this industry, and with enormous reserves in South Africa at world competitive grades, Anglogold intends to be in the forefront of gold production in South Africa in the decades ahead. ■

KELVIN WILLIAMS

Kelvin Williams joined Anglo American Corporation as a member of the Industrial Relations Department in 1976. Between 1978 and 1985, he worked in the Coal Division with responsibility for Amcoal's anthracite collieries and, in September 1985, joined the Corporation's Gold and Uranium Division.

Kelvin currently sits on the boards of the Anglo American Corporation of South Africa, and Anglo American Gold Investment Company (Amgold), as well as the boards of all of the Anglogold mining companies, and of several gold mining companies outside of Anglogold.

Kelvin is a member of the Chamber of Mines' Gold Producers Committee; a director of Rand Refinery Limited and Chairman of Radpro. He is also a member of the World Gold Council's Executive Committee and Chairman of the Council's Membership Committee.

Clips and quotes since the previous edition of the *Alchemist*

Silver Spot

London silver market eases, *Financial Times, 16 April 1998*

Buffett may have sold a third of silver hoard, *Financial Times, 6 April 1998*

Silver Buffett sends Britain's deficit ballooning, *Times, 27 March 1998*

Buffett Says Little on Silver Stake, *Wall Street Journal, 16 March 1998*

Silver prices expected to remain buoyant, *Financial Times 24 February 1998*

In This Corner, a Silver Bull. In That Corner, India, *Wall Street Journal Europe, 19 February 1998*

Being a genius investor has its rewards besides making one filthy rich. Chief among them is knowing that hordes of people will follow your every move once you disclose what you have most recently bought.

Buffett's Silver Streak, *Time Magazine, 16 February 1998*

Maybe there is no other message than that Mr Buffett knows a good investment when he sees one.

Warren Silverfinger, *Economist, 7 February 1998*

Rise in silver prompts Indian destocking, *Financial Times, 6 February 1998*

Silver-Supply Shortage Further Bolsters Prices, *Wall Street Journal, 6 February 1998*

Silver Price at highest since 1988, *Times, 6 February 1998*

Silver traders act on backlog, *The Independent, 6 February 1998*

Silver is basking in the glow of Warren Buffett.

Buffett's Silver Gambit Stirs the Market Again, *Wall Street Journal, 5 February 1998*

Farmer takes on traders over jump in silver price, *Financial Times, 3 February 1998*

Gold Quotes

Barrick advances 33% as costs fall. *Financial Times, 22 April 1998*

Anglogold appoints S African mining union chief to board, *Financial Times, 15 April 1998*

Anglogold share ratios revised, *Financial Times, 13 March 1998*

Lonhro faces legal challenge over Impala, *Financial Times, 27 March 1998*

Plans For a Millennium Coin Add a Jingle to the Gold Market, *Wall Street Journal Europe, 27-28 March 1998*

Swiss Banks Set to Work For Nazi-Gold Settlement, *Wall Street Journal Europe, 27-28 March 1998*

Kingdom of Lesotho Tunnels Into Trouble as Gold Prices Dive, *Wall Street Journal Europe, 25 March 1998*

...As sometimes happens on Wall Street, death is not necessarily a permanent condition.

Gold Coffin? *Barron's, 23 March, 1998*

Belgian central bank sold $2.8bn worth of gold, *Financial Times, 19 March 1998*

Buying gold because Warren Buffett bought 129.7 million ounces of silver is like buying Pepsico stock because he owns 200 million shares of Coke.

Why Gold Isn't Silver, *Fortune, 16 March 1998*

JCI to keep top mine after split, *Financial Times, 12 March 1998*

Gold price fails to shine, *The European, 9-15 March 1998*

Desperate times lead to desperate measures.

Just Call It GoldPEC, *Barron's, 9 March 1998*

Wary Investors Begin to See Luster in Gold, *Wall Street Journal Europe, 6-7 March 1998*

Lack of transparency and the unwillingness of Europe's central banks to announce a clear programme for gold disposals concerned many [Australian Gold] conference delegates.

ECB urged to organise gold auctions, *Financial Times, 5 March 1998*

Branded gold bars generate interest. *Financial Times, 2 March 1998*

Homestake sees gold price rise, *Financial Times, 20 February 1998*

Hong Kong's Gold Market Regains its Luster As Smugglers Capitalize on Asia's Economic Woes, Wall Street Journal, 20 February 1998

Two Legendary Figures Bracket Stormy Story of JCI, *Herald Tribune, 6 February 1998*

ECB seen as likely to hold little gold, *Financial Times, 6 February 1998*

Koreans hand in $900m in gold, *Financial Times, 3 February 1998*

Gold Fields moves towards independence, *Financial Times, 2 February 1998*

As Pure as It Gets

.99999 Gold Coin from the Royal Canadian Mint

by Michael Toope, Royal Canadian Mint

The world standard for gold purity is on the rise.

The Royal Canadian Mint has issued its first five nines gold coin, the largest coin with this high level of purity ever issued. Numerous months of extensive testing of several alternative processes for the production of five nines gold by a team of engineers, chemists and refiners were required. One of the challenges faced by the team was the chemical analysis of such high-purity gold. Analytical methods were developed to quantify impurity elements by inductively coupled plasma mass spectrometry (elements are separated and measured based on the mass of ionized atoms) and by inductively coupled plasma emission spectrometry (elements are measured based on the light emitted from the material).

The new coin has a face value of $350. Designed by Canadian artist, Pierre Leduc, it depicts the flowers of the Coat of Arms of Canada: the English Rose, the Scottish Thistle, the Irish Shamrock and the French *Fleur-de-Lis*. The obverse of the coin shows an effigy of Her Majesty Queen Elizabeth II by Dora de Pedery-Hunt surrounded by the inscription "Elizabeth II Canada D.G. Regina Fine Gold 350 Dollars Or Pur," with the year of issue to the left of the Queen and .99999 to the right.

The mintage of this new .99999 coin is limited to 1,998. It is available worldwide through the Royal Canadian Mint network of distributors.

For more information, e-mail the Mint at info@rcmint.ca, or call (613) 993-9999. ■

It's all in the Mine

A Profile of Marion Bush, LBMA 1997-98 Bursary Recipient

Unlike most people, Marion showed a talent for her future career choice at the ripe age of seven.

"We knew she'd be a geologist when she got a pebble stuck in her ear and we had to wait until she fell asleep before we could take it out", her father later recounted.

Nor was she frightened away from her career choice when, visiting a project with her boyfriend during her first year of studies at Curtin's University of Technology in Perth, Western Australia, their truck blew a tire and overturned several times, landing upside down. They escaped relatively unscathed through the gap left by the shattered windscreen and had begun walking back when they were spotted with great relief by the site's geophysicist. Having seen the condition of the truck, he had begun searching for bodies. Marion was unfazed. "I decided that I had made the right career choice. What are the odds of something like that happening again?"

After completing her degree, she began working for Eagle Mining at its Nimary project, near Great Central Mines in Dundee, as a Junior Exploration Geologist, checking for site safety, supervising the drill rig and logging core or chip samples. After working for a brief time in Perth, she returned to the field, this time for Summit Gold, a New Zealand-based company. It was while working for them that she attended the "Diggers and Dealers" Gold Conference in Kalgoorlie during the summer of 1997 and learned about the Mineral Deposits Evaluation degree at Imperial College, London.

"With the gold price dropping, it seemed like an opportune time to resume studying. This program was perfect for me: an MBA for geologists, which I could complete in a year's time". She had to apply quickly to become accepted for the October 1997 beginning. After acceptance, Marian became aware of the LBMA bursary. She applied and was told that she had received the scholarship two weeks before the start of the program.

Marion will complete her course dissertation in mid-September, after which, she is interested in staying on in London for a while, possibly working as a mining analyst. "The best job opportunities for a precious metals career seem to be in London." ■

LONDON BULLION MARKET ASSOCIATION

To Bosnia Herzegovina – and back

By Chris Elston, Chief Executive, LBMA

It's hard to keep a good man down.

Fresh from his five-day cycling exploits on behalf of Oxfam in Israel and Jordan *(Alchemist 8)*, Neil Newitt of J. Aron couldn't rest. So in December, he set off in his intrepid Land Rover (only 100,000 miles on the clock – any offers?) to take vital supplies to Bosnia.

Along the way he was joined by two other vehicles/Land Rovers from a small York-based charity called WATCH, which has made a number of such trips over the last two years. On this trip, their deliveries included computers, school equipment, musical instruments, a washing machine and a record player.

After leaving England, they drove through Holland, Belgium, Germany and Austria before arriving at the Slovenian and Croatian borders. Each border took the better part of a day to clear, forcing Neil to spend the evenings wrapped in a sleeping bag inside the Land Rover.

And how cold did it get? "The first thing I had to do when I woke up was scrape the frost from the *inside* of the windscreen."

Neil vividly described the tragic scene in Paljic Polje, the first stop he and his colleagues made to deliver supplies to a local school.

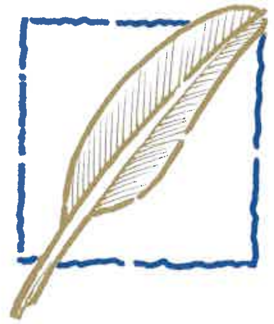
"All the buildings around the school, as everywhere else, had been blown to pieces. The school had escaped only because it was used as a weapons store and as a 'killing room'".

The boxes of supplies were received with wide-eyed gratitude, especially when the record player was rigged up and Vivaldi's Four Seasons was played to a tearful headmaster.

A second destination, Sipovo, in the Serbian part of Bosnia, involved driving up into the mountains via steep, narrow roads and peering through freezing fog and snow in order to avoid collisions with a continuous convoy of Dutch military tank transporters heading the other way.

Sipovo is a town that was completely undamaged by the war but was razed to the ground by retreating Croats and Muslims. Here, Neil and colleagues were welcomed by the King's Own Border Rifles and accommodated at their camp in a badly damaged factory unit. They delivered food, clothing, sewing machines and a complete panel beating kit to the local population.

Yugoslavian hospitality was magnificent, and numerous draughts of Slivovic were downed. Despite the hardships, Neil found the response of the people receiving their aid so moving and heartfelt – and their ongoing needs so great – that he may well go again. ■



Letter to the Editor

It was good to see in issue 10, February 1998, the views of 19 courageous analysts willing to bare all to the world and hang their washing on a communal line. While some have wider spreads than others (probably something to do with lunches consumed for the sake of research) the style seems to suggest that gold is not expected to be the fashion of 1998.

It would be interesting next year to compare 1998 predictions with the eventual range and average for the year, along with predictions for 1999.

Perhaps the LBMA could sponsor an award for the best analyst that would cover the cost of the laundry bill for those reckless enough to participate!

Best regards,

Tony Dobra
March Rich Investment Ltd.

Quick Study...

Will the Gold Range Bet option gain in popularity?

by Hamish Treleaven, Managing Director, Metals and Mining Group, Bankers Trust London

A range bet is one of many forms of bet or digital option that are available in the derivatives markets today. These trades have been very popular among speculators in the global debt and foreign exchange markets over the last two years. In the foreign exchange derivatives market, range bets with payouts of over US$20 million have been reported sold.

As its name implies, it is a bet that a given product will stay in a specified range for a defined period of time.

A typical trade would have the following details:

Initial bet premium:	US$ 175,000
Final bet payout:	US$ 500,000
Bet expiry date:	6 months
Gold trading range:	$275.00 to $320.00

Bet criteria: The bet purchaser would win the 'bet' and therefore receive the $500,000 final payout if the spot price of gold trades inside the nominated range at all times from the time the bet is purchased through to its expiry date. If at any stage during the bet's life, the spot price of gold trades outside the nominated range, then the bet is lost and there is no payout at expiry.

What influences the value of a range bet?

Uncertainty, width of the range and maturity. The greater the volatility in the market, the narrower the defined range and the longer the term to maturity, the greater the bet's payout.

The range bet is essentially a short volatility trade. If you believe that the market's volatility is going to decrease, you should purchase a range bet. Contrary to layman's intuition, range bets are generally not held through to maturity. They are typically sold back when somewhere between 70% to 90% of their life has passed, or they have accrued towards 80% of their maximum payout.

Is such a range bet trade sensible in gold?

With the fall in gold from $370 to $280 during the course of 1997, this style of trade clearly would have been unsuccessful. Speculators were only interested in staying short gold, and successfully so.

However, as we enter the second quarter of 1998, some of the market's concerns regarding the Central Banks' intentions might be dissipated by announcements accompanying the formation of the new European Central Bank.

Therefore, could some of the hedge funds lose interest in gold, leaving it to finish the year in a $270 to $330 range? Remember that gold traded in a $370 to $395 range for 25 consecutive months starting December 1993.

Will the range bet trade prove as successful in 1998 as the short gold trade was in 1997?

Only time will tell.

Disclaimer: The views expressed in this article are those of the author and do not necessarily reflect those of Bankers Trust Co. ■

source: reuters

From Berkshire Hathaway Inc. 1997 Chairman's Letter

Unconventional Commitments

When we can't find our favourite commitment – a well-run and sensibly priced business with fine economics – we usually opt to put new money into very short-term instruments of the highest quality. Sometimes, however, we venture elsewhere....

Our second non-traditional commitment is in silver. Last year, we purchased 111.2 million ounces....In a way, this is a return to the past for me: 30 years ago, I bought silver because I anticipated its demonetisation by the U.S. government. Ever since, I have followed the metal's fundamentals but not owned it. In recent years, bullion inventories have fallen materially and, last summer, Charlie and I concluded that a higher price would be needed to establish equilibrium between supply and demand. Inflation expectations, it should be noted, play no part in our calculation of silver's value.

- Warren Buffett

The LBMA Third Annual Spring Seminar

Thursday 21 May
11:15 for 11:45am

Trinity House, Tower Hill, London EC3

Mr Giles Keating, Credit Suisse First Boston
on "Asia and the World Economy – Can There be a Happy Ending?"

Professor Gordon Gemmill,
City University Business School
on "Buffett Lunch – Congestion, Corners and Squeezes in Metal Markets?"

Cocktails and Buffet Lunch

For more information and tickets please contact LBMA Executive:

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London EC2R 8BT
Tel: 0171 796 3067 Fax: 0171 796 4345
Email: alchemist.lbma@btinternet.com

LBMA News

by Chris Elston, Chief Executive, LBMA

Annual General Meeting

The tenth AGM of the Association is to be held at 4.30pm on Thursday, 4 June 1998 in the Library of Morgan Guaranty Trust Company of New York at 60 Victoria Embankment, London EC4 (the main entrance is in John Carpenter Street). The Notice convening the meeting and accompanying documentation will be issued to Members shortly. All Members are urged to make every effort to attend.

In the meantime, Members are reminded that, in accordance with Article 35 of the Association, all present members of the Committee retire from office at the AGM, but are eligible for re-election. Members are therefore invited to submit nominations for the new Committee. Nomination forms will be included in the documentation for the AGM. If more nominations are received than are required to fill the places on the Committee, an election will be held at the AGM.

Membership

Following the questionnaire to Market-Makers (see *Alchemist* 9), a similar questionnaire has been sent to Ordinary Members and the results will shortly be processed. An up-dated Membership list, with some revised addresses and telephone numbers, will be distributed to Members in early June and quarterly thereafter.

Good Delivery List Changes

Additions:

Gold – DPR of Korea: Central Bank, DPR of Korea
Silver – DPR of Korea: State Refinery, Pyongyang,
both with effect from 25 March 1998.

The North Korean refineries were transferred to the Former Lists for gold and silver on 12 December 1997 when confirmation that they continued to meet the LBMA's criteria for inclusion on the Lists was not forthcoming. The relevant information has now been supplied by the Central Bank of the DPR of Korea and the LBMA is satisfied that the North Korean refiners continue to meet our criteria. They have therefore been reinstated to active status on the Good Delivery Lists.

LBMA News

continued

Committees

Management Committee

A special meeting of the Committee was called on 5 February to discuss conditions in the silver market and to consider action. As a result, a Press Release was issued that day announcing the following decision:

With immediate effect, the period for physical delivery of silver between clearing members of the LBMA is extended from five to 15 working days. Allocation of physical silver will continue to take place on demand. The provision of brand, weight and bar numbers will take place as usual within the normal period of 24 hours.

This move was aimed at easing the log-jam of silver coming into London. It remained in place until 22 April, when the Management Committee announced that with effect from 22 May 1998, the five-day window would once again apply (see Editorial Comment for more details).

Other issues before the Committee over the last quarter have been the EU Draft VAT Directive, which is still under discussion in Brussels, the completion of the ISDA Bullion Definitions (see Article on p 3), and the new regulatory regime under the Financial Services Authority. In this last context, the Association responded to the FSA's invitation to submit its views on the future stance of regulation and the role of practitioners.

Finance Committee

Jack Allen (Deutsche Morgan Grenfell) has joined the Committee to take the place of Brian Reid.

Physical Committee

Apart from the five Russian refineries (all gold and silver), six other applications for inclusion on the Good Delivery lists are currently under consideration (2 gold, 1 gold and silver, 3 silver).

Work on the proposed electronic clearing system continues and has reached the demonstration stage.

A second round of Questionnaires to Refiners is under preparation and the first Questionnaires will be sent out shortly.

Other issues before the Physical Committee include Bullion Delivery Standards (including weighing procedures) and a new topic, but one which must be examined seriously – the so-called Millennium Bomb (or, less colloquially, Preparations for the Year 2000 and implications for the Clearing Market).

Public Affairs Committee

Helen McCaffrey (NM Rothschild & Sons Limited) and Sylvia Williams (Barclays Bank Plc) have joined the Committee to replace Paul Copsey (NM Rothschild) and Susanne Capano, who, of course, is now on the LBMA staff.

Apart from overseeing the production of the *Alchemist* and *Market Statistics* and the organisation of the Biennial Dinner, which takes place on 23 April at about the time that this issue comes out, the PAC is organising a Spring Seminar on Thursday, 21 May (see box on page 19).

Finally, work continues on the construction of our LBMA web-site.

DIARY OF EVENTS

5 May 1998
Derivatives and Risk Management Conference, organised by ISDA and the EBRD, Hotel Bristol, Warsaw.

14 May 1998
LBMA Annual Golf Day, Clandon Regis Golf Club, Surrey.

14 May 1998
Gold Fields Mineral Services Ltd, launch of World Silver Survey 1998, 11:30am, Wax Chandler's Hall, Gresham Street, London EC2.

14-15 May 1998
Doing Business in Kyrgyzstan, The Hyatt Carlton Tower, London, organised by IBC UK Conferences Ltd.

18-19 May 1998
Structured Commodity & Trade Finance in Russia, The Marriott Moscow Grand Hotel, Moscow, sponsored by Rossiyskiy Kredit Bank and Standard Bank London.

19 May 1998
Gold Fields Mineral Services Ltd, launch of World Silver Survey 1998, 3:00pm, Wax Chandler's Hall, Gresham Street, London EC2.

21 May 1998
LBMA Third Annual Spring Seminar, Trinity House, Tower Hill, London EC3. (see box on page 19)

4 June 1998 LBMA Annual General Meeting, in the Library at Morgan Guaranty Trust Company of New York, 60 Victoria Embankment, London EC4 at 4.30pm.

22-23 June 1998
FT World Gold Conference, Hotel Rey Juan Carlos I, Barcelona.

11 September 1998 - London
14 September 1998 - New York
Gold Fields Mineral Services Ltd, Update I to Gold 1998.

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