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Alchemist

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One of the winning entries in the Swarnanjali Awards, an Indian jewellery design competition.

Jacob Kurian of Tanishq Industries takes a look at the state of the Indian jewellery industry – page 10



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Gold medal performance.



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China's Gold Exchange

The Dawn of a New Era

John Reade, Precious Metals Analyst, UBS Warburg

The official opening of the Shanghai Gold Exchange – the SGE – on 30 October 2002 heralded the start of a new era in the gold market in China, and is further evidence of the intention of the Chinese government to deregulate the precious metals market.

Based on the reports of the early months of trade together with statements from the exchange, trading in gold has got off to a good start and the SGE appears to be fully functional as a physical marketplace. The exchange operates in the following manner:

- Trading is limited to physically settled spot transactions, executed between member firms either on the exchange floor or on an electronic trading platform. Trading is limited to standardised quantities of designated fineness designed around the needs of the physical rather than the speculative or investment market

- There are 108 members, all of whom are Chinese, including banks, producers, manufacturers and refineries. Each company has had to pass stringent credit and probity requirements before becoming eligible for membership

- Prior to trading, the buying member must deposit cash in an exchange-specified account and the seller must deposit gold in one of the 42 designated warehouses across 32 cities in China. Members can deposit or withdraw gold from any of these locations and the SGE is responsible for ensuring that liquidity exists where required.



The floor of the Shanghai Gold Exchange

Increasing SGE Turnover

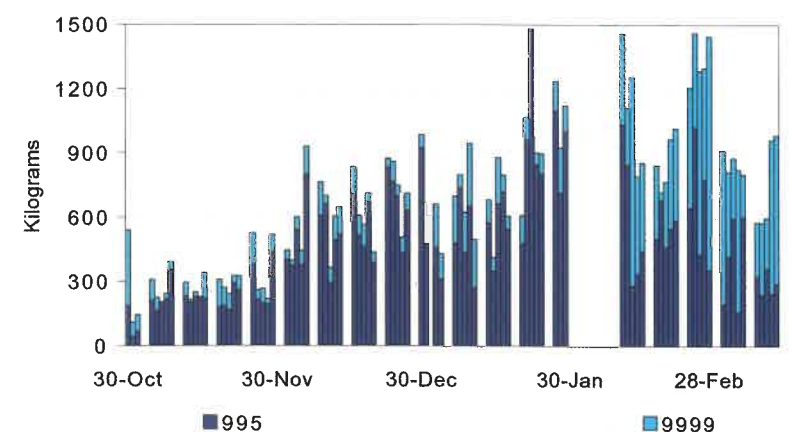
Volumes traded on the SGE grew steadily from the start of trading, as shown in the chart below.

After an initial flurry of activity, trading settled down to a tentative 300kg per day in November, before beginning to steadily increase through December and January. Volumes steadied around the one tonne per day level once the market reopened after the

New Year celebrations before slowing in March, probably related to the slowdown in turnover that has hit the rest of the bullion market.

SGE Chairman Shen Xiangrong described the early months of trading as having "achieved the goal of trading gold as a commodity, satisfying the need of business supply and demand and ensuring safe and steady operation of spot trade."

Volumes traded on Shanghai Gold Exchange: 2002-03



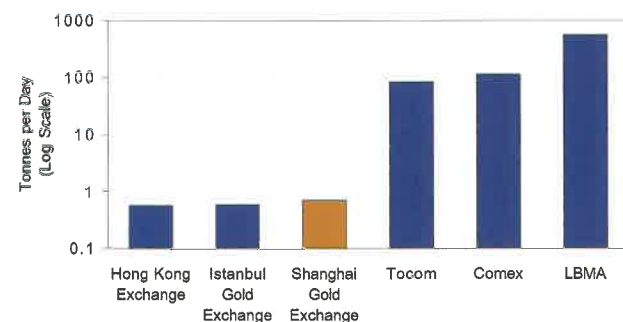
Due to booming jewellery demand, over the past few years China has become the single largest consumer of platinum. The SGE see platinum as a natural complement to gold trading, and is reportedly looking to begin trading in spot platinum in the second half of 2003.

At a rate of roughly one tonne of gold per day, SGE volumes are already equivalent to the 220 tonnes per annum of net Chinese gold demand reported by Gold Fields Mineral Services and the World Gold Council. It is not clear that all of the SGE's transactions are associated with the physical bullion trade – as some members could use the SGE for speculation in gold. But with the People's Bank of China (PBOC) reportedly out of (or at least with a much diminished role in) the physical gold market, all of this trade will soon gravitate to the SGE and will probably lead to incremental growth in turnover.

The position of the SGE is best illustrated in the graph below, which shows UBS Warburg's estimates of turnover in the major gold markets around the world.

Volumes on the SGE have already surpassed those of the Hong Kong Gold and Silver Exchange and (just) the Istanbul Gold Exchange. Compared to the large markets of TOCOM in Japan, COMEX in New York and the over-the-counter clearing volumes recorded by the London Bullion Market Association, the challenge for the SGE is rather daunting. In order to compete on a global scale, turnover needs to grow between 100 and 1000 fold (note that the graph has a logarithmic scale).

Gold Exchange Turnover: International Comparisons



A Plan for a Place at the Top

In order for the SGE to increase its turnover by more than just increments, structural changes to both the SGE and the Chinese gold market are required. SGE Chairman Shen recognised this in a recent speech, which outlined some of the steps that the exchange has identified as part of a development roadmap for both the exchange, and for China's gold market as a whole.

- Step One: Open up the gold market to investment by offering a deferred delivery service
- Step Two: Attract individual investors by offering new products
- Step Three: Integrate the exchange into the international gold market and transform the SGE into a financial market focussed on financial investment business.

These developments will be important milestones if the SGE is to take its place at the top table of gold exchanges. We believe that the most pressing issue facing the SGE is its

interconnection with the international market. Although four large domestic banks were granted approval to import and export gold back in 2002, they have not yet started these cross-border activities, and the PBOC remains the only true connection with the international bullion market. Towards the end of January and in the run-up to the Chinese New Year, very strong gold demand on the exchange led to newswire reports that the PBOC was actively selling gold to prevent the SGE price from moving far out of line with the international price.

The authorisation of four domestic banks to import and export gold will be a step in the right direction, but eventually this permission should be granted to a much wider group of market participants. Ultimately we believe that membership of the SGE should be opened up to international companies or their Chinese subsidiaries, although this may require a fully convertible currency regime.

An Exchange Like the Others. But Different.

The other major trading forums, COMEX, TOCOM and indeed the London bullion market, allow investors, speculators, gold producers, physical consumers and the bullion banking community to transact a variety of financial products that are not limited to spot physical sales. Therefore the SGE will itself need to offer a wider range of products than are currently on offer.

Products and international access are not the only factors behind gold market liquidity, as is evident from the small volumes trading on the Istanbul Gold Exchange. Since liquidity begets liquidity, growth in domestic trading volumes is a precursor to attracting higher volumes. We believe that the most likely source of this growth in liquidity will come from domestic investment and speculative demand. At around one trillion dollars, Chinese savings are vast – and growing at double-digit rates. If even a small portion of this remarkable pool of savings were to be directed towards gold trading, this would certainly lift market volumes.

The SGE has quickly turned into a successful domestic exchange for gold. We believe that the developments outlined by Chairman Shen will lay the foundations for a larger and more important marketplace for precious metals. Whether the exchange can become a genuine source of global liquidity will probably depend upon an ignition in both Chinese investment and speculative demand for metals.



John Reade is UBS Warburg's London-based precious metals analyst, working with the precious metals advisory and trading teams. Prior to taking up this post in July 1999, he spent three years as a gold equity analyst with the bank in Johannesburg. A 1999 Financial Mail survey rated him one of the top analysts in the field.

Before joining UBS Warburg, John was a gold equity analyst with Barnard Jacobs Mellet in Johannesburg, and earlier he spent eight years as a mining engineer and production manager for the third-largest gold producer in South Africa.

John graduated from Imperial College London in 1986 with an honours degree in mining engineering. He is a regular speaker at gold industry conferences, recent examples being the Global Gold, Diamonds and Precious Metals Forum in Frankfurt in November 2002 and the Financial Times World Gold Conference in Rome in February 2001.

From Bazaar to Exchange

Examining the Prospects for the Indian Bullion Market

By Susanne M Capano

'The size of the Indian markets for gold and silver has certainly been one factor in our decision to organise the meeting here...there is no doubt that Indians retain a faith in gold and silver as a security for their futures that is unmatched anywhere else on the planet.'

Opening remarks by Simon Weeks of the Bank of Nova Scotia - ScotiaMocatta at the LBMA Indian Bullion Market Development Forum in Delhi, 30-31 January



From left to right: Kamal Naqvi, Stewart Murray, Simon Weeks, Rajan Venkatesh and Bhargava Vaidya

Acknowledging the importance of India to global precious metals trading markets – as well as its need for a clear and logical plan of action to follow in its liberalisation process – LBMA Chairman Simon Weeks set the tone for the Association's first event in Asia.

Attracting some 150 participants, the two-day event thoroughly examined the practical issues facing the growth of an open market in the world's largest consumer of gold and silver. Presentations and discussions focussed on four primary objectives:

- Establish what domestic market participants need in order to move forward by identifying the barriers that exist as well as the means for removing them
- Consider the experiences that other markets have gone through in their development and liberalisation processes
- Determine which elements of other trading systems – such as standards, consumer protection and taxation – could be applied in India
- Look ahead at how the market might develop in the coming years.

S.S. Tarapore, an economist who retired as Deputy Governor from the Reserve Bank of India in 1996, gave the keynote speech, presenting his views on the key steps the



Dr Sneh Bhatla of the Bureau of Indian Standards

Forum Recommendations

The Indian bullion trade should have one voice

A national bullion trade association should be formed to represent all the elements of the Indian market – banks, private traders, jewellery exporters, domestic jewellers and manufacturers. This body would be the contact point with authorities and regulators and could set industry standards.

A mechanism for the formation of prices should be developed

A bullion exchange should be set up, which could begin by offering trading in spot gold and silver, setting a local benchmark. Trading should eventually be expanded to include futures, forwards and options.

The infrastructure should be developed

Significant improvements need to be made in the areas of refining, assaying, hallmarking, storage facilities, transportation and insurance. In order to have a truly liquid market, it is important that refining capacity be upgraded, though this is not an easy goal to achieve.

Both physical and financial markets would benefit from regulatory reforms

The legal definitions of gold and silver bars should be changed from 'commodity' to 'currency' in order to reduce current limitations on bullion trading. Import duties and local/state taxes on bullion bars should

be standardised or eliminated, which would facilitate both imports and exports of bullion. Domestic borrowing and lending of gold should be permitted and clear regulatory responsibility for both spot and forward trading should be established.

The range of bullion products should be expanded

With the implementation of the above-mentioned reforms, a wider range of products should be made available to both the trade (long-term lending, interest rate swaps, options, flexible margin payments) and the retail investment markets (gold deposit schemes, gold accumulation plans, gold-linked funds).

market needed to follow in order to realise its potential. (Excerpts from his speech follow on page 7.)

The next session included a cross-section of presentations from various sectors of the local market – commercial banks, traders and jewellery exporters – in which participants described the challenges facing them.

The final session on the first day focussed on experiences from other parts of the world – both developing and mature bullion markets – in China, Dubai, Japan, Turkey and London.

On the second day, the importance of having an appropriate regulatory framework for the market and ways to ensure the quality of products for consumers were discussed, followed by a look at changes to both the investment and jewellery side of the business. Jacob Kurian of Tanishq, one of the country's largest jewellery companies, challenged the jewellery industry to revitalise itself in order to compete in global markets. An article based on his speech follows on page 10.

Throughout the meeting, a panel consisting of the LBMA Chairman and Chief Executive and

the four session chairmen reviewed the presentations then, during the final session, put forward for discussion a series of recommendations for future action (see box on previous page).

Post-Forum Developments

There were important developments in the Indian market in the weeks immediately following the forum. Early in the month, the government announced the introduction of a uniform one percent VAT on gold across all states.

Then, on 21 February, the government lifted the ban on domestic futures trading in a number of commodities, including gold and silver, thus opening the door to the development of a futures exchange.

There was more to come for the market in the release of the budget one week later. In his speech, Finance Minister Jaswant Singh announced the reduction of customs duty from Rs250 to Rs100 per 10 grams, "but only when it is bought in the form of serially numbered bars, or in the form of gold coins, not as tola bars."

The reduction of duty was expected to lead to a decrease in smuggling, but perhaps even more significantly it signalled the government's desire to aid the development of a transparent trading market in India. The finance minister continued, "It is my hope and expectation that this will become the first step in enabling India to shortly emerge as the gold-trading capital of the world."

If India is indeed to be numbered among the world's leading bullion markets one day, there is still much work to be done. As Mr Tarapore mentioned in his keynote speech "... what remains are the more intricate measures, which need details attention and a lot of hard work." In consultation with Forum participants, the LBMA will develop the recommendations into a detailed report for submission to the government later this year. ■

The Changing Needs of India's Gold Policy

S.S. Tarapore

This article is based on the keynote speech originally given at the LBMA Indian Bullion Market Forum.

The past decade has seen a sea change in Indian gold policy and operations. While the reforms which have been already implemented are the more glamorous and sensational measures, what remains are the more intricate measures which need detailed attention and a lot of hard work.

In developing an efficient and well functioning gold market, we in India do not need to reinvent the wheel. But while absorbing the experience of other markets, we do need to take into account the ground realities in India.

Toward an Efficient and Well Regulated Gold Market

The gold trade in India today is the result of decades of a policy of total prohibition. Prohibition at the supply source, viz. imports, did not curb demand – it only served to make the supply channels illicit, and the trade was devoid of any regulatory standards and codes. With major changes in the official policy on imports during the past decade, the situation is now favourable for the development of a transparent, well regulated and efficiently functioning gold market. There is a distinct role for both regulation by the authorities and self-regulation by the gold trade and industry.

The sources of supply are imports and recycled gold. Gresham's Law states that if two sources have variable standards and quality, the system will inevitably veer towards the lower ones. There is a need for appropriate import of technology and for attracting foreign investment in gold. Issues of assaying and hallmarking standards have to be faced up front. We must be realistic and accept that hallmarking has failed to take off and standards of gold remain uncertain at best and at worst totally unacceptable. It is not enough for imports to be of international standards – the entire range of the

trade down to the retail outlets should bear the hallmark of acceptable standards. However, this is easier said than done.

The authorities do have a role on a number of issues. There is a need for a transparent Gold Regulatory Authority, which would lay down the broad framework and deal with regulatory infringements. It is necessary that the regulatory authority does not stifle the gold industry and trade with a plethora of regulatory knots. Equally, the authorities should not hesitate to punish regulatory violations or to allow total free trade in gold. It must be recognised that forward trading and a futures market do not alter demand for gold; what they do is provide an element of certainty to the user, which is essential for an orderly and well functioning market.

Gold itself is a hybrid between a commodity and a financial asset, and in the context of recent initiatives towards capital account convertibility, it is necessary to rethink the issue of the customs duty of 250 rupees per 10 grammes. Inevitably, gold has to be treated like a currency and not like copper and zinc. If we are reluctant to institute a Tobin tax (i.e., a tax on foreign exchange transactions), the authorities should dispense with the customs duty on gold.

The opening up of gold imports by banks has had a major impact on bringing imports into the official market and virtually eliminating the unofficial market. In the inexorable march towards capital account convertibility, it must be recognised that a total freeing of the gold import-export trade – with an abolition of the import duty on gold – is a necessary concomitant of meaningful capital account convertibility.

The October 2002 RBI measure to merge forex and gold-open positions is a step in the right

direction. There is an urgent need to put bullion banks and non-bank entities trading in gold onto a level playing field – vital in developing the retail gold trade of banks by offering gold accumulation plans and gold certificates.

The gold deposit schemes of banks do have the problems of the indifferent quality of the gold submitted and depositor dissatisfaction with the gold jewellery content. It would be best if there were facilities for conversion of jewellery into standard gold by a centralised organisation with branches that would authenticate the gold after proper assaying.

Establishing a Regulated Bullion Exchange

A freeing up of the gold trade does not mean that there should be a free for all where proper regulation and standards are given the go by. On the contrary, there should be a transparent regulatory system with a strong bias towards attaining exacting standards. It is in this context that the authorities should encourage the establishment of a Bullion Exchange.

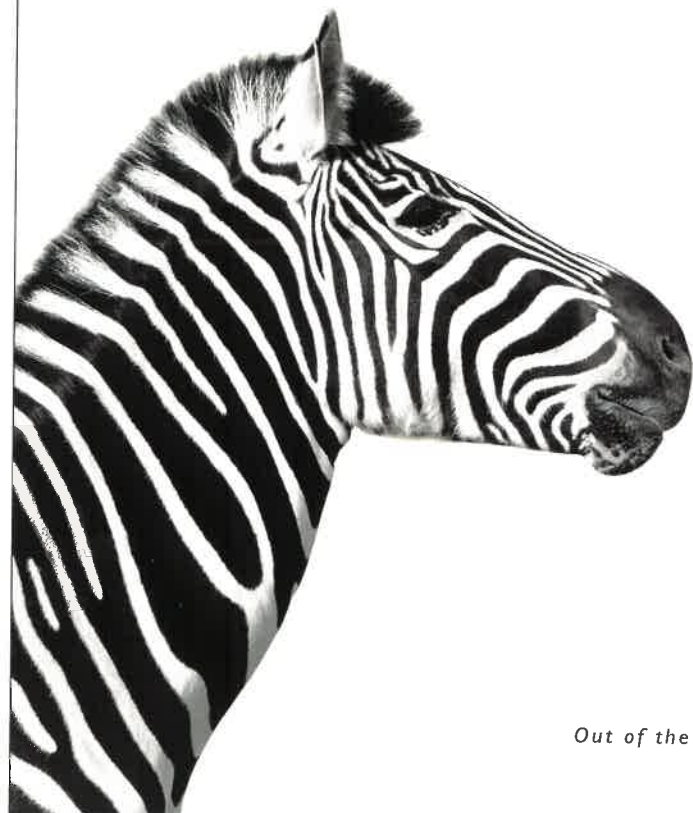
The Bullion Exchange would be open to banks dealing in gold and to other organisations, like the Minerals and Metals Trading Corporation and the State Trading Corporation. It should also be open to the gold trade. Only members of the exchange would have the right to undertake import and export of gold, and imports by members would be totally free from import duty. Members of the exchange would be allowed to participate not only in spot trade, but forward trade and futures.

As a corollary, gold importation by individual non-resident Indians would need to be discontinued (this would also be supportive of anti-money laundering measures). Gold as part of the baggage of returning Indians could be subject to customs duty on par with other goods.

There would no doubt be an attraction to join the exchange. It is here that the exchange can be really effective in ensuring exacting standards of assaying and hallmarking. The exchange

Inevitably, gold has to be treated like a currency and not like copper and zinc.

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must have a transparent code of conduct and strong adverse action should be taken in the case of erring members. The exchange can, if deemed feasible, use the infrastructure of the National Stock Exchange. The Bureau of Indian Standards should have an integral association with the exchange in ensuring exacting standards.

It is estimated that final consumers of gold lose an average of Rs.8,000 crore per annum by virtue of questionable quality (one crore equals ten million). The problem of poor quality is so acute that there is also a need to establish an office of a Gold Ombudsman to which consumer complaints can be directed. The decision of the ombudsman should, as a practice, be treated as final as far as the seller of gold is concerned, though a consumer should always have the right of legal redress. The reference to questionable practices is not to cast aspersions on the entire gold trade but merely to isolate errant traders using sharp practices from that part of the trade that follows the regulatory framework and is law abiding. In fact a strong regulatory framework with the possibility of recourse to a Gold Ombudsman would be a boon to the trade as well as the consumer.

There should be an optimal mix between self-regulation and regulation by the authorities – and of course, the stronger the self-regulation, the less the need for detailed regulation by the authorities. We in India have a lot to learn from the operations of the bullion exchanges in major financial centres, as well as in emerging markets, and the opening of a gold exchange in China in October 2002 was a wake-up call for India.

Official Gold Reserves

With the advent of the euro, there are now only four reserve currencies: the dollar, the euro, yen and sterling; periodically, each of these is wobbly. Gold does not suffer from the weakness of other reserve currencies, as it is no one's liability and, in a sense, is the ultimate settlement currency. More importantly, gold prices move anti-cyclically to reserve currencies, and gold is as liquid as any other financial instrument.

For the leading industrial countries, the share of gold in total reserves is substantial: US (58%), France (51%), Italy (48%), Germany (38%) and Switzerland (37%). The European Central Bank has an explicit stipulation that at least 15% of its reserves have to be held in gold. In the case of India, gold holdings amount to 360 tonnes, accounting for less than 5% of total reserves. The RBI needs to arrive at an optimum proportion of gold in its total reserves, which would surely be significantly higher than this.

A substantial part of the RBI's gold is held in a form that is not of international standards. Even with a passive gold policy, the quality of RBI's gold assets would be enhanced if it were used in a locational swap, which would at least render it into an earning asset. The minting of gold coins also needs to be considered.

With a static holding of the RBI's gold reserves and a continuing rise in total reserves, the share of gold will keep coming down, as purchasing gold in the international markets is strictly prohibited. A rhetorical question: would the Indian authorities consider selling gold? The answer, again: no.

Such a paralysis on gold reserve policy is hazardous. First, the inactive gold policy incurs very large losses, as it does not benefit from fluctuations in gold prices. If the RBI is able to adroitly shuffle its currency portfolio, there is no reason to believe that it cannot periodically increase and decrease its gold holdings to its advantage. It is insensate to stipulate, as is implicitly done in the present legislation, that while currency swaps are a permitted activity for the RBI, gold leasing, swaps and deposits are not. Secondly, only a very small segment of the RBI's gold is interest earning. Had the entire RBI gold stock been deployed actively over the last 50 years at an average modest return of 1% per annum, India's gold reserves would be 60% higher.

Over the past year gold prices have seen an increase of about 25% in dollars, 14% in yen, 13% in sterling, 9% in euros and 7% in Swiss francs. When the gold price goes down, the passive policy of the RBI on gold reserves inflicts heavy losses.

It would be totally unfair to blame the RBI for the extremely risky passive policy on gold. The polity has to bear the responsibility. It should be persuaded to alter its views, and it is here that a discussion paper by the RBI's Development Research Group would be timely, enabling the government to formally place before Parliament a statement of intent on revising the present policy. Attempts to persuade the RBI to – on its own – to alter the policy of paralysis would be totally otiose.

Establishing a Gold Bank

With the major changes in gold policy and operations, the time has come to revisit the proposal for a gold bank. Given the way the RBI is hamstrung by the polity, it may be best that the RBI and the government do not take the lead in setting up such an institution.

However, it is essential that they should not be averse to the idea and, ideally, should encourage it.

The outlines could inter alia cover the following:

- A Gold Bank could be set up by select public- and private-sector banks, foreign banks, foreign investors and other institutions concerned with the gold trade. The initial paid-up capital of Rs.50 crore can be quickly increased as the bank's operations pick up. Since the ownership would be wide, the initial exposure of any single institution would be small. If, however, a few institutions are keen to take up a larger share, there should be no objections

- The bank would not try to mimic the operations of the present banks and institutions active in the import of gold and the operation of the Gold Deposit Scheme
- The bank could, inter alia, operate as a sort of refinancing agency for banks that may face very temporary asset liability mismatches
- It should be empowered to foster the development of new gold-linked instruments including paper gold products – like gold accumulation plans and gold certificates
- The bank should be permitted to operate in international markets and there should be no restriction on it holding gold abroad, buying and selling gold in spot, forward and future markets (with strong prudential norms) and leasing and deposit/lending activity should be permitted
- It should be permitted to offer various products like gold for gold, gold for rupees and gold for foreign exchange, both in India and in international markets
- To the extent the present legislative/regulatory restrictions inhibit the operations of the bank, early attention should be given to easing of these restrictions
- As part of the policy/attitudinal changes necessary for the setting up of a Gold Bank, it would be highly desirable to allow the establishment of gold mutual funds. Such mutual funds have a great potential, and the RBI and SEBI should no longer hesitate to permit the establishment of such schemes by mutual funds. The bank could have an integral link with the gold mutual funds.

If an institution meets a perceived need it would, over time, be able to grow. I am emboldened to say that a Gold Bank would be able to earn its keep from day one and would need no subvention. In fact, over time, initial investors would be the cynosure of those who do not get on the bandwagon. For the idea of a Gold Bank to fructify, all that is required is adherence to the dictum expressed by General George S. Patton: "Either lead, follow or get out of the way." Is the Indian polity listening? ■

S.S. Tarapore, an economist, retired as Deputy Governor from the Reserve Bank of India in 1996. He joined the bank in 1961, and was on deputation with the International Monetary Fund from 1971 to 1979.

Since his retirement, he has been associated with a number of official committees, including the Committee on Capital Account Convertibility and the Committee on Banking Sector Reforms. He has been a weekly financial columnist since 1997 and presently writes for the Financial Express.



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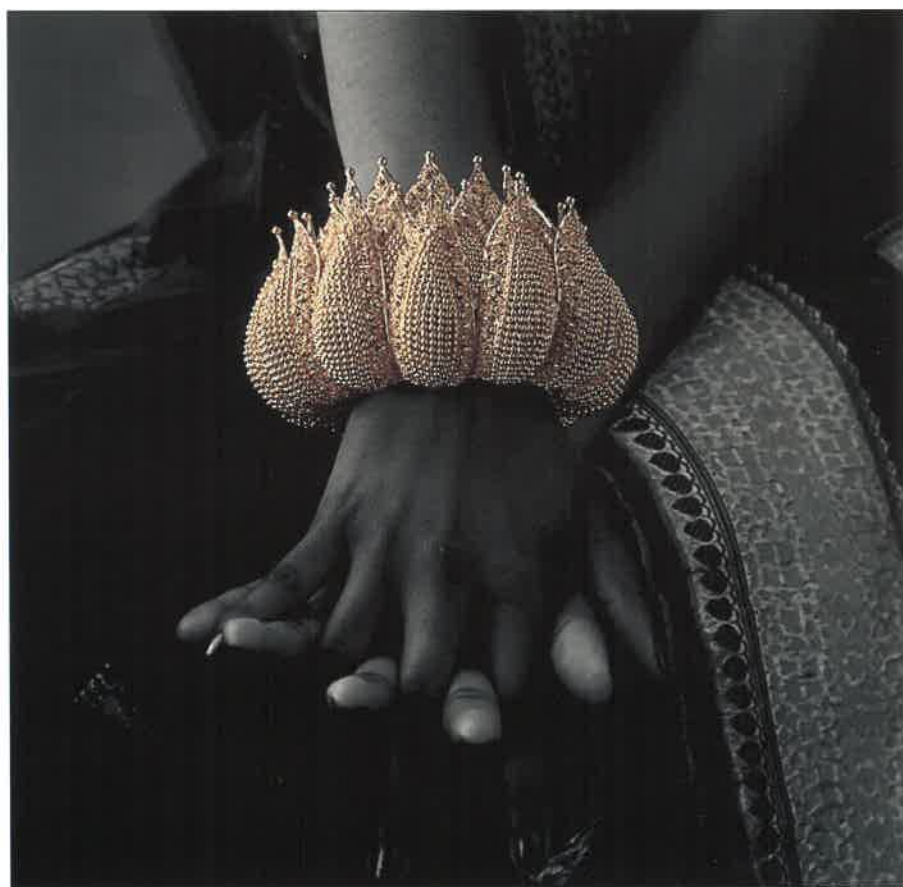
Slaying the Golden Dinosaur

Remaking India's Jewellery Industry for the 21st Century

Jacob Kurian, Chief Operating Officer, Jewellery Division, Tanishq

While the size of the Indian jewellery market in absolute terms is frequently debated, the market's size in relative terms is often overlooked. Other sectors, such as telecoms and cars, receive more attention from the government, the business press and the financial arena than the jewellery sector. The powers that be seem to overlook the fact that jewellery is one of the largest and most broad-based of India's consumer markets. While the importance of some sectors of the economy to Indian consumers can be overrated, jewellery is, in aggregate terms, perhaps the one product category that spans rural India all the way to the top of the economic pile.

Not only has the Indian jewellery business been around for a very long time, it has also had the privilege of operating in a tightly protected market. As a consequence, there are strong territorial franchises – which may bring a certain security to those in the business – but, unsurprisingly, this has led to little innovation and very little differentiation. And the competitive intensity that is a feature of most other markets is lacking.



Photos in this article are based on entries in the Swarnanjali contest, sponsored in India by the World Gold Council. Photos courtesy AngloGold/The World Gold Council

For example, if the names of jewellery stores were removed, it would be difficult to tell one from the other, both in terms of products or store design, and this lack of differentiation generates little excitement among consumers. As many will be aware, India is a market that is slowly opening up to a flurry of economic liberalisation and Indians are increasingly gaining access to a variety of goods and products that consumers in other parts of the world take for granted.

Despite the size of the Indian jewellery market, it is remarkably unregulated. No matter what spotlight has been put on the issue of hallmarking and the progress of the hallmarking system, the reality is that only a fraction all jewellery items are hallmarked. It is perhaps inevitable that opaque practices remain in place and little effort is made to

build any kind of differentiation or branding. Unfortunately, a cost-plus approach to pricing is widely practised – arguably the most transparent pricing mechanism in existence in any consumer market in the world. The comforting idea that jewellery in India will remain an investment-oriented purchase has led to a market notable for a lack of any differentiation and innovation, a certain commoditisation and an inevitable squeeze on margins in the gold jewellery business. It has also led to widespread undercarriage.

A Golden Dinosaur?

Despite the size of India's jewellery sector and the large number of jewellers, it receives no recognition from industry or trade bodies – it was only two years ago that the SII finally decided to invite Tanishq to participate in its retailing committee. The jewellery industry's

lack of recognition was also evident when the international management-consulting firm, Mackenzie, produced a comprehensive report on the Indian retail sector and omitted the 300,000 or 45,000 crore-retail market that constitutes the jewellery business.

There continues to be a belief among many people in both business and finance that the jewellery sector cannot be organised and that current business practices will prevail. But the market's current characteristics need to change in order for it to avoid becoming a dinosaur.

Growth has been flat not only because of the lack of differentiation, but due to the fact that the majority of jewellers compete on price. What is evident from financial data is that the kind of inventory and investments required by retail stores cannot be viable with the level of margins being made by retailers. And yet jewellery retailing is seen as a business in which easy money can be made, and every day more jewellery stores are being opened.

This inevitably results in market fragmentation and a lack of economies of scale. In addition, the single-store concept does not attract professional talent, making it difficult to compete against other professionally

promoted products. As a consequence, consumer attention is shifted to other product categories, and the subsequent lowering of the relevance of gold jewellery to the emerging youth segment is very disconcerting. The amount of gold sold by a large jewellery store can be staggering, but the way the product is merchandised means that it is treated as little more than a commodity.

Product, Branding, Design – and Pricing

Tanishq believes that its role is to bring a new sense of innovation to India's jewellery market and that there is a dire need for the jewellery industry to continue to grow and compete for



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market share. The experience of Tanishq is that being innovative and generating excitement is possible, even in the jewellery business.

It is not just product, it is not just branding, it is not just the way we look at the store or the way we present our designs: it is also about pricing. Tanishq also believes that an educated customer is the best customer, and we can expect future generations to be a lot smarter, a lot more aware and a lot more demanding than the current generation. Therefore more transparency will be required going forward and consumers must understand that sales taxes, low as they are, must be paid.

To provide the best jewellery brands for Indian women, the gold jewellery business has to be transformed, despite being large and successful today. To become viable the business must be consumer-led, vibrant, respected, create more brands and, most importantly, set prices that legitimately reflect the value that is being delivered.

For Tanishq, such innovation is working. Today, the company is the largest and the fastest growing jeweller in India, operating in 44 towns, with at least six stores under development. For the last ten quarters, Tanishq has considerably outperformed the market – and not just by opening new stores: same-store sales growth has been equally impressive.

Awareness of Tanishq among consumers is high, with over one million high-spending customers visiting the stores. Perhaps the biggest testament to Tanishq's success is the fact that our jewellery can be exchanged for full value with most other jewellers, is a premium brand that is regarded as aspirational and is seen by the younger customer as "my kind of brand".

Inspiration from the IT Industry

So where we are going in terms of the future of jewellery as a business in India? Inevitably those of us in India know that operating in a large captive market can lead to complacency and mediocrity. The jewellery business will need to compete, not just for discretionary income, but with imports, which will no longer be artificially inhibited from entering India. The Indian jewellery industry will need to compete with international products just like its peers in other sectors. Furthermore, customers and regulation will both increase pressure on the way the Indian jewellery business operates. If it does not change, its very survival will be threatened.



While some companies in the jewellery business have been around for 100 years, longevity is no guarantee of future success. It is highly likely that those companies that will survive long-term will follow the Tanishq business formula. That success is now bringing new investors into this market, and there are at least three large funds seeking an opportunity to invest in our company. But if they are denied that opportunity, they will go elsewhere.

Will India always continue to be a domestic consumer of gold? Even though there has been some encouraging growth, the disparity between gold imported for exports and that used in the domestic market is very large. But there are several reasons to believe that India can be competitive in the future.

Inspiration can be drawn from the fact that the Indian software industry, which does not have a very large domestic base, has still been able to build a people- and skill-intensive business. But there are some critical differences – the desire to compete, for example. A recent Deutsche Bank study noted that Indians in India were more pessimistic about the country's ability to compete internationally than people outside this country.

The software business has been fortunate to have flag bearers of impeccable integrity. The jewellery business should have the ability to think big – that one day Indian jewellery can be viewed in the same light as Italian jewellery, rather than always competing on the basis of having the lowest price. As the Turkish jewellery industry has succeeded, so too can India's.

Perhaps the greatest challenge for Indian jewellers therefore is the one that exists in their minds, and it is the reason why they are so resistant to change. If Indian jewellers can overcome their doubts and fears, then a much bigger opportunity is waiting, both in India and in the world at large. ■

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The Fundamentals of Technical Analysis *Patterns and Predictions*

By Jordan Kotick, Vice President, JP Morgan Chase

This article will discuss the mindset and key tools of the technical analyst. It will serve as a building block for subsequent pieces that will deal with primary technical applications and their use in real time.

Market timing, charting, behavioural finance and quantitative analysis are all pseudonyms for the oldest form of security analysis currently in existence: technical analysis. Be they active or passive many, if not the majority, of market participants are not aware that this is a methodology with a history. In fact, it dates back to the 1600s where it was originally used by Japanese rice farmers to monitor and forecast crop prices.

It gained momentum in the West during the early part of the twentieth century when internal data and information on companies was not publicly available. It has been reported that Charles Dow, first editor of the Wall Street Journal and founder of the Dow Jones Company, would approach companies to ask about their business in order to carry out market research and forecasting. The general response was purported to have been: "our business is none of yours." He thus began to study price action instead, eventually creating the Dow Jones Industrial Average and the Dow Jones Rail Average (now called the Transportation Average).

Tracking, hypothesising and synthesising theories on or about price movements led to an acceleration of successful market forecasting in the West. Technical analysis bloomed, growing throughout the 20th century and continuing into the 21st. Clearly the existence, effectiveness and growth of this market methodology supports the adage that there is something to be said for that which has stood the test of time.

Technical analysis is primarily a timing tool that is particularly helpful at minimising risk. While the fundamental side of the financial equation addresses the what and why of market dynamics, the technical side is primarily concerned with the when and where. In other words, the technician, while having a tepid interest in the cause, is much more focused on the effect.

The foundation of technical analysis is the belief that market psychology is the key driving force behind all market moves and, further, that it is the porthole into ascertaining where the market sits in relation to the supply/demand equation. What is a market if not a place where people agree on price but disagree on value? Further,

since value fluctuates over time and is subjective in essence, the Aristotelian First Cause of these fluctuations must be the ebb and flow of market participants namely: psychology.

Primary Tenets of Technical Analysis

The first key component of technical analysis is the belief that the market discounts everything (price is the final arbiter). This suggests that prices reflect every possible influence, including politics, economics, news

and mass psychology. Studying price movements is therefore both necessary and arguably sufficient from an analytical viewpoint.

The second key element to the technician is the importance of trend analysis. Indeed most, if not all, would argue that the most important question to be addressed for any market participant is "what is the degree of the Primary Trend?" Once a trend is clear, the probability of that trend continuing is high. This applies to all timeframes, the essence of which is the Newtonian presumption that a trend remains in play until the evidence emerges suggesting that it is no longer in play. Market participants who keep this in mind are often able to stay in a trend longer than most, while minimising whipsaw, until clear signs of a trend change emerge.

The third key is that history/psychology repeats itself. Human psychology does not change. Emotions cycle from greed to fear and optimism to pessimism during peaks and troughs. Or, to think of it syllogistically, if you accept that history repeats itself (a Non-Random Walk down Wall Street) and if you can visually show history (which is what a chart is), it must be the case that patterns/cycles/repetitive behaviour occurs.

Key Misnomer

Too many are under the illusion that technical and fundamental analyses are mutually exclusive, leading to an overabundance of antagonism between advocates and analysts on either side. However, both market approaches have a proven track record and there is no reason they cannot be used in conjunction. Though I may be in the minority, I believe that the clash between fundamentalists and technicians is as fallacious in principle as it is unprofitable in practice. Making money in the markets is difficult enough – why discard any methodology that can be of use?

The technician may be anticipating specific moves for which the catalyst is often an economic release or piece of news. There is never an excuse for not knowing what development can affect one's chosen market, even if the result is only a 15-minute, intraday knee-jerk reaction – which may be enough to

run stops. At a minimum, being aware of fundamentals may help with timing. For example, instead of buying or selling US Treasuries at 8:15 am on the first Friday of the month, why not wait half an hour until the US employment numbers are out of the way? Secondly, since the technician believes that the market's reaction to news/data is more important than the release itself, how can the reaction be judged if one does not understand the essence of the data?

On the other side of this coin, it is a mistake for fundamentalists to ignore technicals. Too many have voiced concern and confusion when a market does not rally on ostensibly good news/data (stocks over the last couple of years) or does not fall on ostensibly bad news/data (stocks during the years before that). The bewilderment is based on the lack of understanding of the Primary Trend, which ultimately can help the open-minded decide if the market is likely to buy dips on bearish news/data (bullish trend) or sell strength on good news/data (bearish trend).

Further, a cardinal rule of trading is to always have a stop. A stop cannot be a data point or news event; it must be a price point. To find a price point, you have to look at a chart. Since all points on a chart are not created equal, why not at least understand some rudimentary ideas about charts and technicals in order to ascertain and differentiate valid stops?

Principal Types of Charts

After reviewing some of the operative precepts of technical analysis, I will now turn towards the rudimentary tool of the technician, the building block of all our work: the chart. While there are numerous types of charts, the most common forms are bar charts, candlestick charts and line charts.

The Bar Chart

This is the most common and widely used type of chart in the West. It is a vertical line on a page (thus its name) that shows the open, high, low and close for the specified period, ranging from intraday to as long as weekly or quarterly. The mark to the left side of the bar is the opening price and that on the right side, the closing price. The high and low of the bar represent the high and low of the period, respectively. Thus each bar contains much more information that might initially meet the eye.

The Candlestick Chart

Used predominantly by Eastern chartists, this form of chart continues to gain popularity in the West. These charts are more visually friendly than bar charts and are therefore a valuable adjunct to traditional bar charts and/or a useful stand alone charting

The Bar Chart



The Candlestick Chart



Left — a traditional bar chart of Gold Futures and an expanded diagram of a single bar.

Centre — the same chart in Candlestick version with expanded diagrams of two candlesticks.

Bottom — a line chart version.

The Line Chart



colour. If the close is below the open, the box is dark (usually black or red). If the open is above the close, the real body is given a lighter colour (usually white or green). Aside from being easier on the eyes (one can quickly discern if the close was above the open by the colour of the body as opposed to having to peer closely at a

bar chart), specific patterns – continuation or reversal – emerge when certain candles appear side by side.

The Line Chart

The line chart is a simplified chart that takes one data point (almost always the close) and connects the subsequent points. Since most technicians feel the close is the most valuable

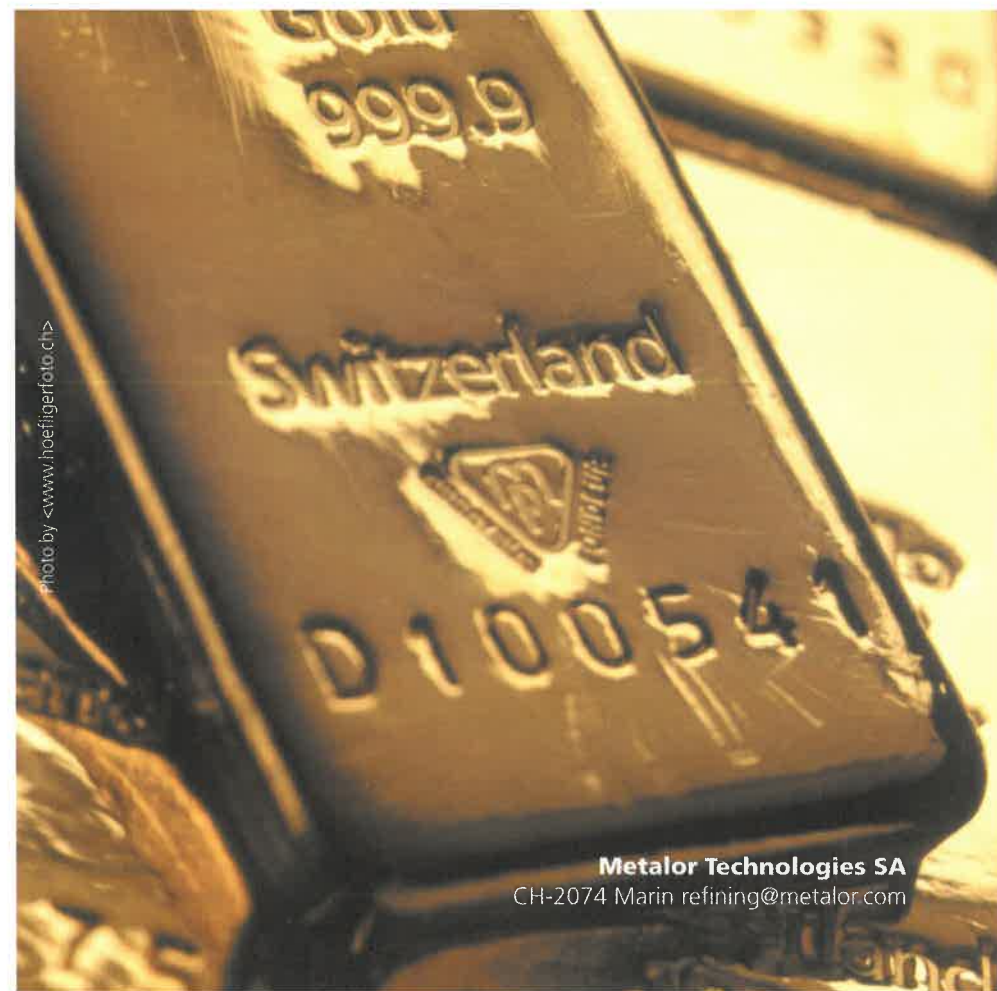
piece of information from among the choices of open, high, low and close, this type of chart is often viewed as a strong gauge of overall price trend. The line chart reduces much of the "noise" of bar or candlestick charts. However, the price paid is that much information is lost. In essence, line charts are excellent at seeing the proverbial trending forest through the trees, but risky if used in isolation for trading purposes.

Like any market approach – or profession for that matter – technical analysis is neither an art nor a science. It is a skill that, honed over time, will help users make money or avoid losing money, whichever the desired outcome may be. Whether used in isolation or in conjunction with its fundamental counterparts, technical analysis is a critical tool for any analyst, trader or investor interested in minimising risk and maximising gains. Given the current market environment, I cannot help but think that we are entering a golden age for technical analysis, a time when market timing will continue to grow in both stature and utility. ■



Jordan Kotick, a Chartered Market Technician, is vice president, technical market strategist at JPMorgan Chase in New York. Prior to this, he worked for three years at Elliott Wave International as a senior interest rate analyst and was employed at CIBC World Markets in Toronto as a technical analyst on the research, strategy and trading desk and was a government bond trader. Jordan is a contributing author to the textbook for the technical analysis course offered by the Canadian Securities Institute and is a featured author in the recently released book, Market Analysis for the New Millennium.

He is the past president of the Canadian Society of Technical Analysts and is currently the international (IFTA) liaison for the Market Technicians Association in New York. Jordan holds an honours BA with a double major in Philosophy and Economics and an MA in Philosophy.



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Charles Dow's Six Secrets to Market Success

Applying the Dow Theory to Today's Markets

Martin Scott, Royal Bank of Scotland Financial Markets

The world of Charles Dow, of Dow

Jones and Wall Street Journal

fame, was very – and quite

understandably – different to

today's technology-driven world.

When Dow died in 1902, the

charting packages that we now

take for granted did not exist,

calculators would not be mass

marketed for another 75 years

and the high-speed information

flows that we enjoy today were

beyond investors' wildest dreams.

DOW'S SIX MAIN TENETS

- 1 The Averages discount everything**
- 2 The market has three trends**
- 3 Major trends have three phases**
- 4 The Averages must confirm each other**
- 5 Volume must confirm the trend**
- 6 A trend is assumed to be in effect until it gives definite signals that it has been reversed.**

state of the economy, interest rate movements and political considerations – plus future expectations of all three. If these factors were all that made up supply and demand (and therefore market price), technical analysts would simply be looking at the same variables as economists. However, there are more components, and these are what differentiate the two disciplines.

All financial markets have one common denominator – they are traded by people, and human psychology and behaviour play a huge part in price movement. As well as the economic fundamentals, prices reflect the hopes, fears, expectations, errors and speculation of market participants. By analysing price, technical analysts are focussing on all known, or expected, influences on supply and demand. To quote from Technical Analysis of the Futures Markets, by John J Murphy, "The chartist knows that there are reasons why markets go up or down, he or she just doesn't believe that knowing what those reasons are is necessary in the forecasting process."

Dow's Sixth Meets Newton's First

Dow's other tenets are intertwined, and relate to trends within the market. Firstly, he splits trends into three different time perspectives: long term (major), medium term (secondary or corrective), and short term. The major trend is where profits are readily available, as it is a trend that generally dominates for a year or more.

Dips in a major bull trend offer buying opportunities, while recovery attempts in a bear trend offer selling opportunities. These dips or recovery attempts are known as the secondary trend and are smaller waves that flow against the dominant (major) tide. They can be traded successfully, but it must always be remembered that the market will generally return to its major trend.

This introduces another of Dow's tenets: a trend is assumed to be in effect until it gives definite signals that it has been reversed. Dow

However, with help from William Hamilton, S.A Nelson and Robert Rhea, Dow made a number of observations that are as relevant now as they were in the late nineteenth century. Though these observations have become known as the Dow Theory, perhaps Dow guidelines or principles would be a better description. They are not in truth mathematical or economic expressions that can be applied to derive an exact answer; financial markets simply do not work that way. Instead, they are a set of six common-sense guidelines that investors and traders should treat as the unseen foundations of their decision-making process.

The Dow Theory, by the Numbers

The first of these tenets, the Averages discount everything, is deeply woven into the philosophy of technical analysis. Dow's research was based on the Dow Jones Industrial, Transport and Utility Averages. If the words market price were substituted for

averages, we are left with the observation that "market price discounts everything." This premise needs to be fully understood before we can move on. By focussing on price action, technical analysts are simply cutting to the chase, believing that anything that can affect the market price of a financial instrument is already reflected in its price.

This is such an uncomfortable concept to grasp that it is as far as many newcomers to technical analysis get before falling back to the safety net of economics and the financial press. However, the claim is neither as preposterous nor as presumptuous as it first appears. Consider a scenario where the FTSE-100 is temporarily frozen at a price of 3750. At that specific moment in time, the price reflects the net supply and demand of all the factors that affect the FTSE-100.

What are those variables? Firstly, there are the traditional 'fundamental' factors such as the

may have gained inspiration from Isaac Newton's law, expressed in Principia Mathematica, that argues that "a body in motion will continue in the same direction until it shows signs of reversing or slowing." I personally prefer an analogy from the courtroom, in that the major trend is innocent until proven guilty.

This begs the question: when does a secondary trend become so strong that it negates the major trend and becomes a new major trend itself? Trading or analysing the white water created by two clashing tides is arguably the most difficult part of technical analysis, and there are whole books dedicated to it. During a secondary or corrective trend, the analyst constantly monitors price patterns, retracement levels, moving averages, trendlines, volume, and momentum oscillators. Together, these tools are used to determine the critical point at which a major trend will reverse. By identifying this threshold, risks become controllable, therefore minimising losses from an incorrect decision. Often this sacrifice then becomes a loss leader. On breaking beyond a critical support or resistance, the market is generally signalling that a new trend is beginning, allowing a trader to quickly reverse exposure.

Phased Analysis

Identification of the current trading environment is essential when looking at any financial instrument, as tactics will differ between ranging and trending markets. By identifying three different phases within a major trend, Dow went deeper than this. This may appear a little academic at first; after all, if a market is rising, the obvious strategy is to continue buying until a definite reversal signal has been given. However, as investors who bought technology stocks as the bull trend in the NASDAQ matured will testify, forewarned is forearmed!

A new major bull trend actually begins before the preceding bear trend has ended. At this point, economic news and data is still bearish, but importantly this has already been priced in and discounted by the market. It is at this stage that the smart money begins to buy, creating a secondary wave higher. Sellers still believe that they possess overall control, but subsequent dips fail to reach a new low and a basing pattern develops. This is called the accumulation phase.

The second phase of a major bull trend is the strongest and longest. The basing pattern is completed and sellers, realising their mistake, are forced to cover or reverse their short positions. It is at this point that Dow would enter the market on the long side, sacrificing the uncertainty of the turning point for (lower risk) longer-term gains.

For the third and final phase, the market continues to rise as increasingly optimistic news stories are priced in. As with the final phase of the NASDAQ bull trend, everybody wants a piece of the action and the public begin to participate. However, during this climactic final phase, the smart money is already beginning to lock in profits by selling. At this point all the good news is priced in, fresh buying is merely based on speculation, the market is heavily overvalued and subsequent price rises are built on sandy foundations. The only way is down!

A Return to the Law of Averages

Dow's final two tenets provide an early warning system for this final 'distribution' phase. Firstly, volume must confirm the trend. If the major trend is bullish, volume should increase as prices head higher. Volume should also lighten during secondary corrective waves. If volume steadily declines during a bull trend, it should set alarm bells ringing, as there is a genuine risk that the rally is running out of steam.

Finally, Dow suggested that, "the Averages should confirm each other." He was looking at the Industrial, Utility and Transport Averages in the US, and believed that all three had to be moving in the same direction to give ultimate confidence in the longer-term direction of the market. If all three were making new lows, the market was inherently bearish and was likely to move lower still. If they gave conflicting signals, it suggested that investors should stay on the sidelines until they re-aligned. This is still a useful practise in the modern world. If the Dow Jones hits a new low, what is happening to the S&P500 and the NASDAQ? If EUR/USD reaches a new high, is the rally supported by evidence from USD/CHF, GBP/USD and the USD Trade-Weighted Index?

Charles Dow's Theory was not designed to pick out tops and bottoms as they develop. Instead, its goal was to identify a major trend reversal, and ride the subsequent wave higher

until confirmation was given that it had ended. In isolation, knowledge of Dow Theory is not enough to trade the world's financial markets. However, when combined with the trading and analytical tools of technical analysis, his observations certainly help market participants to enjoy significant profits, while limiting losses. ■



Martin Scott joined the technical strategy team at the Royal Bank of Scotland in September 2000 after spending three years at MCM, where he managed the highly regarded CurrencyWatch. At RBS he works closely with the bank's FM clients, traders and sales people, developing technical strategies across a wide spectrum of financial markets. Martin began his career at UK stockbrokers James Capel & Co., where he was an FX trader for four years. He then obtained an economics degree in banking and finance at Cardiff University before re-entering the City as a technical analyst at MMS International Standard and Poors in 1994.

Not Just Another War Story

By Kamal Naqvi, Precious Metals Analyst, Macquarie Bank

Gold had a remarkable start to 2003, as prices surged to a peak of \$388.50 per ounce in early February, a level not seen since August 1996. The rally was fuelled by a heady cocktail of concerns about an imminent war with Iraq, a weakening US dollar, stock market losses and a very positive technical picture, a combination that spurred multiyear record levels of speculative buying in New York and Tokyo.

But the onset of military activities and confidence that the war would be short and successful resulted in a wave of long liquidation in gold. Since then, the constant reports regarding military developments in Iraq have become the major driver of global financial markets and, therefore, gold prices. Despite the huge uncertainty about post-war Iraq and a deluge of poor economic data, for the moment, war is everything to the markets – the 'movie-ready' rescue of GI Jessica had a bigger impact than the disturbingly pessimistic purchasing manager surveys!

What Happened in 1991?

The current conflict sparked an inevitable comparison with gold's performance before, during and after the 1991 Gulf War, and now raises questions as to whether historical context gives any indication for what it could experience after the 2003 sequel.

After the 1991 war, gold prices continued to soften and, by the end of that year, gold was trading at around \$350 per ounce – about the same level as before the Iraqi invasion of Kuwait. The US dollar, which had already been weakening before the Iraqi invasion, continued to depreciate further. And, although it briefly enjoyed a very strong rally on news of the

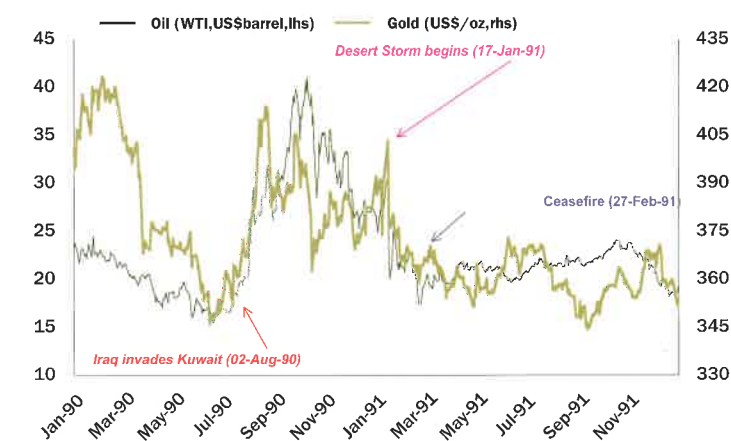
cease-fire, it resumed its slide during the second half of 1991 as the US moved into recession.

US equities followed a pattern similar to the dollar. Already under pressure before the Iraqi invasion, they continued weakening during the conflict, rallied briefly once the war was over, and then stagnated for most of the balance of 1991 – largely due to the weakening US (and global) economy.

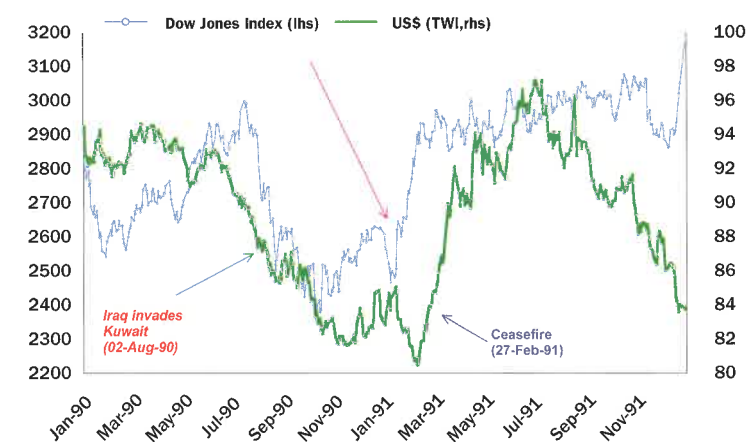
Following the current war, there will likely be a continued relief rally in equity markets and the US dollar. This, in turn, could encourage further downside pressure on gold. But the sustainability of equity market and US dollar gains will be determined by post-war economic reality, with the clear hope being that improved sentiment will feed on itself and thus sustain further gains. However, in the opinion of this writer, a short, fully successful war is not a panacea for the economic, financial and geopolitical issues currently facing the world, and the overall environment remains notably supportive for gold.

Positive Factors

1. Negative news from Gulf War 2
2. Weakening US dollar
3. Equity market losses
4. Producer de-hedging
5. Geopolitical tensions
6. High oil prices



Oil, gold, the DJI and US\$ performances during the first Gulf War

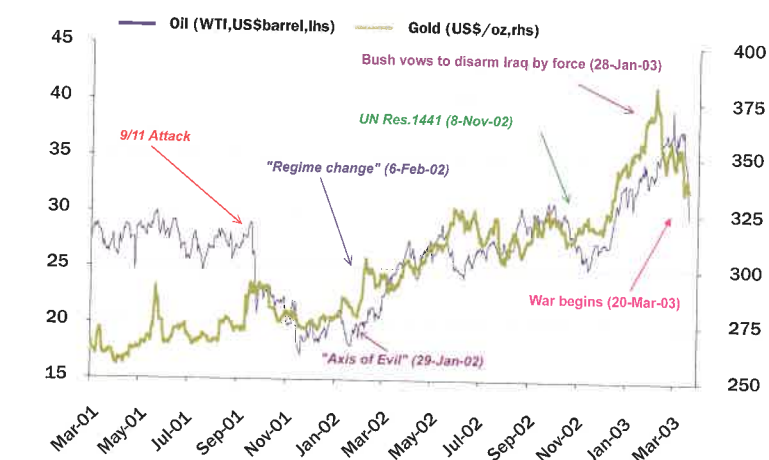


Market Dynamics

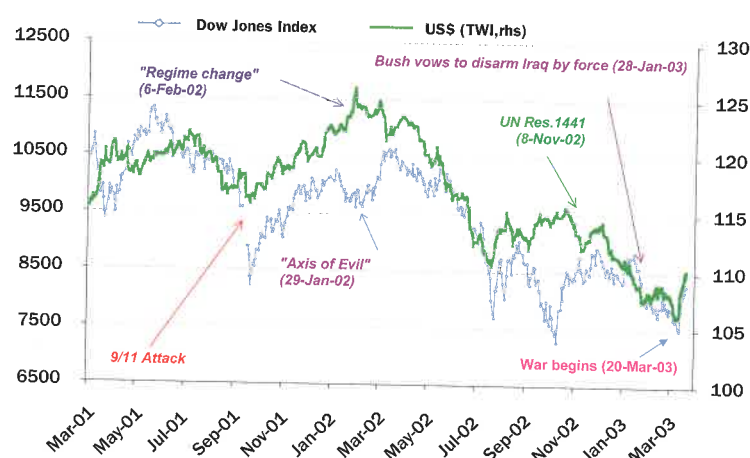
Gold has always been a difficult beast to analyse, as it is virtually a separate asset class – sitting somewhere between a commodity and a currency. One cannot quantify a "war premium" as such since, unlike oil, the "real" price of gold cannot be determined by supply/demand fundamentals. The scorecard below draws together some of the facets impacting the outlook for gold prices.

Negative Factors

1. Positive news from Gulf War 2
2. Disinflation
3. Supply/demand fundamentals
4. Low gold-lease rates
5. Potential for economic recovery



Oil, gold, the DJI and US\$ during Gulf War II



The US dollar has had a mixed history as a driver of gold prices. It was largely irrelevant during the famous 1979-80 gold rally, was the key driver of the one in 1985-87, but was only marginally supportive during the rallies in 1982-83 and 1993-96. So far during the 2001-02 gold rally, the dollar has been clearly supportive, but with legitimate concerns about the Euro Zone and Japanese economies, by how much more will the dollar depreciate?

Inflation has been the missing factor of this rally. Rising (or expectations of) inflation has traditionally been the most dependable macroeconomic variable to support a sustained rally in gold. There is no question that current inflation is at historically low levels and that this does not support gold, but there is now a wide variety of theories and inflation themes – deflation, stagflation, reflation – take your pick!

Producer de-hedging has been the most important gold-specific development since the European Central Bank Gold Agreement in

1999. Since late 2001, many gold producers announced – and followed – plans to deliver into existing hedge positions to reduce and simplify their company's hedge books. There are three principal reasons:

1. – Lower interest rates have reduced the attractiveness of forward selling
2. – The downward trend in gold prices has ended
3. – Shareholder pressure against hedging has risen significantly, partly due to a positive view on gold prices, but also to Enron-generated concerns about transparency and the predictability of earnings related to derivatives.

We estimate that the global producer

hedge book fell by around 400 tonnes in 2002 and, based upon the current trend, appears likely to fall by in excess of 300 tonnes in 2003.

Financial Markets – An Important Secondary Factor

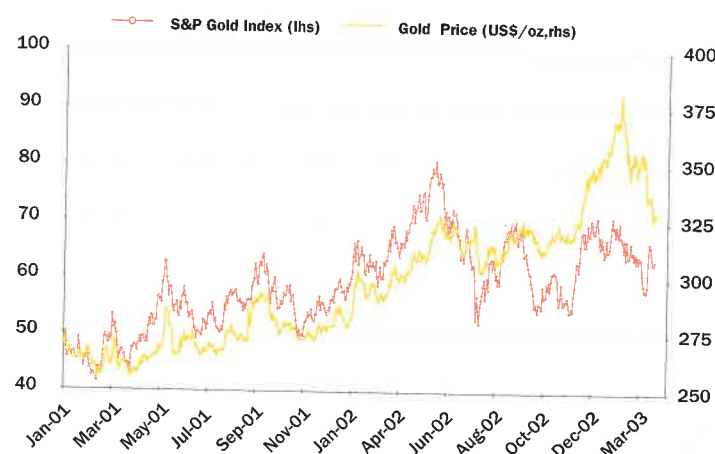
Equity markets have provided second-wave support for gold, and continued losses in the US have also maintained pressure on the dollar. While weak equity markets and firm gold prices have seen gold equities return to some favour, in general, gold equities have been underperforming gold prices for some months now.

Using the S&P Gold Index as a consistent long-dated daily data series, a simple linear regression can be used to estimate the correlation between gold prices and the gold equities relationship from January 1990 to April 2003. The model has a "success rate" (or R squared) of nearly 80%. It is therefore possible to use a formula to assess what the implied S&P Gold Index value should be at current prices, or what gold price the S&P Gold Index is currently factoring in. The calculated regression model is:

$$\text{S\&P Gold Index} = -78.4 + 0.48 * \text{spot gold price (close)}$$

By early April 2003, the gold price had retraced to virtually the same level it was back at its 2002 peak in May, but the S&P Gold Index was 25% lower than at that time. The gold price implied by the S&P Gold Index, at least according to the model, is around \$290 per ounce, which is in marked contrast to May 2002, when the implied gold price was around \$330 per ounce.

As noted earlier, the overall pattern of gold price movement has been reasonably similar to what took place in 1990-91. Gold equities have also followed a similar pattern during both wars – even more markedly than that of



gold prices – initially benefiting during the run-up towards military action, but falling as soon as it became clear that the US would enter the conflict.

Probably even more importantly, in both 1990-91 and in 2002-03, the implied gold price of the S&P Gold Index fell into a significant discount during the entire conflict period. During the previous conflict, this discount held until late 1992.

Buy the War, Sell the Peace?

However, there are two major differences in 2003 – firstly, the discount is now more marked and, secondly, the levels of both the gold price and the S&P Gold Index are significantly lower than they were in 1991. In 1991, gold prices gradually eased lower to hold around \$350 per ounce, while in 2003, the price is already back towards \$320 per ounce. In terms of gold equities, the S&P Gold Index eased lower to trade around 75 in 1991; today the S&P Gold Index is already back around 60.

Even though the two Gulf Wars themselves are very different, gold and gold equities have behaved remarkably similarly in both Gulf Wars. There is, however, a critical difference: back in 1991, gold was already in a notable downtrend, the world was moving into recession and disinflation had taken hold.

In 2003, gold has been in an uptrend, the world is already struggling to recover from a recession and disinflation appears to have ended – all reasons why the course for gold and gold equities should see a much more buoyant post-war experience than twelve years ago. ■



Kamal Naqvi is the London-based precious metals analyst for Macquarie Bank, where he is an associate director. He has worked for the bank for the past five years and is part of a dedicated research team that services the equity, bullion

and commodities trading and corporate advisory divisions of the bank with metals and minerals research, strategy and market intelligence.

Prior to joining Macquarie, Kamal was a consultant with CRU International Ltd in London, as part of both the lead/zinc and precious metals teams. Earlier, he was a project manager/economist for the Mining & Mineral Processing Division of the Tasmanian Department for Development and Resources.

Educated at the University of Tasmania, Kamal obtained degrees in economics (with honours) and law. He is a member of the LBMA's Management Committee and is chairman of the Public Affairs Committee.

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A view across Eduardo VII Park looking down the Avenida da Liberdade

The fourth annual LBMA Conference will be held in Lisbon's Four Seasons Hotel on 2 and 3 June 2003. The Conference had originally been scheduled for Shanghai, but mounting concern over the SARS virus necessitated a change of venue.

Outside of the Conference sessions, visitors will find Lisbon a colourful and cultured city steeped in history. The Castelo de São Jorge, overlooking the twisting streets of the mediaeval Alfama district, occupies a site used as a fortress long before the Romans arrived in 205 BC. Perhaps the site was even used by Ulysses, whom legend has it founded the city.



Above, Portuguese tiles; centre, Rossio Square; right, the Tower of Belém

A short distance away lies Belém, whose tower marks the place where Vasco da Gama, Ferdinand Magellan and other explorers set sail for India, Asia and the Americas. The riches that returned in their holds funded the city's Golden Age, witnessed today by sites such as the elaborately decorated Jerónimos Monastery.

For more information on the Conference, visit the LBMA website – www.lbma.org.uk – or contact the LBMA Executive. ■

Lisbon 2003 – Conference Programme

Sunday 1 June 2003

18:00 – 19:30 Welcome Reception –
Sponsored by NYMEX

Monday 2 June 2003

9:00-10:15 Opening Session
Introduction – *Stewart Murray, LBMA Chief Executive*
Remarks – *Simon Weeks, LBMA Chairman*
Welcome to Lisbon –
(speaker to be announced)
Keynote Speech – *José de Matos, Deputy Governor, Bank of Portugal*
The Bullion Market Year in Review –
Kamal Naqvi, Macquarie Bank

10:15 – 10:45 Break

10:45 – 12:15 Session 2 – GOLD INVESTMENT
Chairman: (to be announced)
Investment-led Recovery in the Commodities Markets – *Diego Parrilla, Goldman Sachs*
A Hedge Fund's Perceptions on Precious Metals –
Steve Mathews, Tudor Investment Corporation
The Private Investor – *John Reade, UBS Warburg*

12:15 – 13:30 Lunch

13:30 – 15:15 Session 3 – MINING
Chairman – *Martin Fraenkel, N M Rothschild & Sons.*
Challenges to Mining: Environmental, Safety and Socio-Political – *Anita Roper, International Council on Mining and Metals*
Gold Mining in Russia – *Vaery Rudakov, Norilsk Nickel/Polus Gold Company*
Risk Assessment in Mining – *Bernard Swanepoel, Harmony Gold Mining Co Ltd*
Making Money: The Challenges Facing Global Miners – *Rex McLennan, Placer Dome Inc*

15:15 – 15:45 Coffee Break

15:45 – 17:15 Session 4 – A NEW ERA FOR GOLD?
Chairman: *Martin Stokes, JP Morgan Chase*
New Attitudes to Gold – (Speaker to be announced)
An Overview of the Shanghai Gold Exchange – *Shen Xiang Rong, Shanghai Gold Exchange*
The De-hedging Phenomenon – *Jessica Cross, Virtual Metals Research & Consulting*
Behaviour and Decision Making in the Bullion Market – *Gerald Ashley, Consultant*

Evening Conference Reception and Dinner

Tuesday 3 June 2003

9:00 – 10:15 Session 5 – ABOVE-GROUND STOCKS

Chairman: *Jonathan Spall, Deutsche Bank*
The Role of the Bank of England –
Graham Young, Bank of England
Gold as a Reserve Asset: a Central Asian View –
National Bank of Kazakhstan
(speaker to be confirmed)
Gold's Role in the Official Sector – (Speaker to be announced)
Russian PGM Stocks – *Merlin Marr-Johnson, HSBC Bank USA, London Branch*

10:15 – 10:45 Coffee Break

10:45– 12:00 Session 6 – JEWELLERY
Chairman – *Paul Walker, GFMS*
Marketing PGMS in China, Japan and India –
James Courage, Platinum Guild International
The Marketing of Gold and Gem-Set Jewellery –
Tawhid Abdullah, Damas Jewellery Group
Does Gold Jewellery Need to be Marketed? –
Sarah Da Vanzo, gold® Limited

12:00 – 12:30 Coffee Break

12:30 – 13:30 Session 7 – FUTURE PROSPECTS
(panel discussion)
Panel Chairman – *Simon Weeks*
Medium-Term Outlook for Precious Metals –
Philip Klapwijk, GFMS
Investment – *Kevin Crisp, Dresdner Bank AG London Branch*
Trading – *Roy McPherson, EBS Dealing Resources International Limited*
Official Sector – *Andy Smith, Mitsui & Co Precious Metals*
Promoting Physical Gold – *Bernhard Schnellmann, Argor-Heraeus*

13:30 – 14:45 Lunch Close of Conference



LBMA News

By Stewart Murray, Chief Executive, LBMA

Membership

New Member

Westpac Banking Corporation of Australia became a Member on 1 March 2003.

New Associates

Two new Associates, both from Uzbekistan, were admitted on 1 January 2003:

Almalyk Mining and Metallurgical Complex

Navoi Mining and Metallurgical Combinat.

Resignations

Engelhard-CLAL resigned as a Member with effect from 31 December 2002.

GNI resigned its membership as a result of the sale of its metal trading business to the Man Group, though Man Financial has indicated that it wishes to continue the Membership previously held by GNI.

Change of Address

HSBC Bank USA London Branch relocated in to its new office in the Canary Wharf area:
Level 4
8 Canada Square
London E14 5HQ
T - +44 (0) 20 7791 5953
F - +44 (0) 20 7792 4889.

Good Delivery List

Following the formation of AGR-Matthey in Australia – a joint venture of Johnson Matthey (Australia) and the AGR Joint Venture – the new company's brand marks were approved by the LBMA on 26 January. In future, AGR-Matthey's production of refined gold and silver will take place at its Newburn refinery, located in Perth, Western Australia.

Metalor (USA) registered new marks for its gold and silver Good Delivery bars, which took effect on 18 February.

Committees

Management Committee

In addition to reviewing the work of the subcommittees, the Management Committee has been discussing contingency arrangements for the bullion market in the event of any major disruption in the City of London. Part of this has been within the context of the work being carried out by the financial sector in London under the aegis of the Bank of England, the FSA and the UK Treasury. In addition, the Management Committee has taken steps to ensure that the GOFO benchmark, which is the responsibility of the LBMA, could be published in the event of disruptions affecting either the existing infrastructure or the Members, whose contributions are used to calculate the GOFO means at 11:00 hrs each trading day.

Public Affairs Committee

The first quarter of the year saw the successful culmination of the PAC's work on two events.

The first was the Bullion Market Forum, attended by some 150 delegates in New Delhi at the end of January. This meeting was designed to further the process of reform in the Indian bullion market. Invited speakers from a wide range of market players from India and from precious markets around the world contributed their knowledge and experience to a debate that ultimately allowed the meeting to agree a coherent set of recommendations on the future development of the Indian Market.

The second event was of a very different nature: the annual social function this year was loosely based on a Brazilian Carnival theme, allowing members of staff of member companies to sample Latin American food and then demonstrate their skill (after a demonstration and a few lessons) in salsa dancing.



However, the bulk of the PAC's work recently has consisted of putting together the programme for the annual LBMA Precious Metals Conference, which was due to take place in Shanghai in mid-May. With the speakers' programme virtually complete, it seemed that all that was left to do was fine-tuning of the extramural events, including the entertainment for the Conference dinner. But with mounting concerns about the possible spread of the outbreak of SARS in Hong Kong and southern China, a decision was eventually taken in early April to relocate this year's Conference. As a result, it has since been decided that the Conference will now take place in Lisbon on 2 – 3 June, with essentially the same programme of speakers and with the intention of holding next year's event in Shanghai.



From left to right, Cherry Hart, Cedric Bernadac, Andrea Smith, Susanne Capano, Rick McIntire, Martin Stokes

Physical Committee

The Physical Committee continues to process a number of applications for Good Delivery Listing, which as usual forms the core of its work. It has also been heavily involved in the process of expanding the panel of Good Delivery referees. This is an essential precursor to the introduction of proactive monitoring of companies on the Good Delivery Lists and the exercise of testing the applicants for this status has taken much longer than originally envisaged. This reflects the LBMA's determination that all its referees must be able to demonstrate the very highest standards of sample preparation and assaying of both gold and silver. ■

LBMA GOLF DAY 2003

By John Coley

The 2003 event will take place on Thursday 1st May at Blackmoor Golf Club, Hants. This is a great opportunity to play one of the best courses in the South of England. It is used for Open Championship qualifying and hosts one of the majors of the UK amateur circuit. My enthusiasm is no doubt heightened by the fact it is also my home course – but you will not be disappointed! More details can be found on www.blackmoorgolf.co.uk.

The cost is expected to be less than £40 per head thanks to generous sponsorship. Full catering will be provided. The morning round will be an individual Stableford competition for the Jack Spall Trophy, and the afternoon will be played for the LBMA Team Trophy, donated by Tradition Financial Services.

While an enthusiastic response has already been received, we still have room for more players. This is an excellent opportunity for members to meet in a convivial atmosphere and we urge you to get your applications in to the LBMA as quickly as possible.



Market Moves

Clare Ferguson has rejoined NM Rothschild. She had left Rothschild in 2000, where she started her career in bullion back in 1993, to join Credit Suisse First Boston. In her new position, Clare will focus on the sales and marketing of precious metals.

Martin Turner has joined NM Rothschild as a precious metals trader responsible for gold and silver forwards. He started his career in

bullion with Phibro before moving on to Credit Suisse and then JP Morgan Chase, where he spent eight years as a senior bullion trader.

Ed Jette has joined Stillwater Mining, initially as a consultant. Ed will be responsible for metal sales and marketing, expanding client relationships and overall business development.

David Swinburne has joined Mitsui and Co Precious Metals Inc in London as a trader, having spent the last two years in the NY office on the trading desk.

David is a graduate of Bates College in Maine, USA, where he studied Economics and Political Science. ■

DIARY OF EVENTS

April 2003

12 – 13

Montreal Gold & Resource Investment Conference
Montreal, PQ, Canada
Tel: +1 604 687-4151
Fax: +1 604 687-4726
hfitich@cambridgehouse.ca
www.cambridgehouse.ca/montreal/apr2003

26 – 27

Las Vegas Precious Metals Conference 2003
Las Vegas, Nevada
Tel: +1 305 669-1963
Fax: +1 305 669-7350
iiiconf@iiiconf.com
www.iiiconf.com/Conference_LasVegas2003.aspx

29 April – 1 May

2003 New York Mercantile Exchange Derivatives Symposium
New York, NY
Tel: +1 212 299-2359
symposium@nymex.com
www.nymex.com

May 2003

4 – 7

Montreal 2003 - CIM Tradex
Montreal, Quebec, Canada
Tel: +1 514 939-2710
Fax: +1 514 939-2714
jgaydos@cim.org
www.tradex.cim.org

8

World Silver Survey 2003
New York, NY USA
Tel: +44 (0) 20 7539-7820
Fax: +44 (0) 20 7539-7818
laurette.perrard@gfms.co.uk
www.gfms.co.uk

June 2003

2 – 3

The LBMA Precious Metals Conference 2003
Lisbon, Portugal
Tel: +44 (0) 20 7796-3067
Fax: +44 (0) 20 7796-2112
conference@lbma.org.uk
www.lbma.org.uk

8 – 9

World Gold and PGM Investment Conference
Vancouver, BC, Canada
Tel: +1 604 687-4151
Fax: +1 604 687-4726
hfitich@cambridgehouse.ca
www.cambridgehouse.ca/vancouver/gold2003

10 – 13

18th International Congress and Mining Exhibition
Ankara, Turkey
gulhano@metu.edu.tr
www.infomine.com/events/welcome

A New Year for Gold

Editorial Comment By Peter Fava, HSBC Bank USA, London Branch

As a result of its poor performance since the beginning of hostilities in the Middle East, some commentators have been quick to write gold off as an asset class. However, it's worth a closer look at the factors behind the fall in the gold price since the beginning of February and what developments have taken place in precious metals markets around the world since the start of the year.

On 5 February 2003, gold reached its recent high of \$385.00/ounce on the morning fixing. Six weeks later, the price fell to a fixing of \$329.45/ounce on the afternoon of 24 March, as the uncertainty of a pending war was replaced with the reality that war had started. Open interest on NYMEX stood at a high of 12.7 million ounces in early February; but by the end of March, it had fallen to 5.7 million, as the old adage of "buy the rumour, sell the fact" came into play. Over seven million ounces of profit-taking clearly explains the fall in the gold price.

Physical Markets

On the other side of the world, the Indian gold market grew very quiet after 15 December 2002, when the wedding season ended and the market subsequently went on hold pending the budget. The decrease in activity was compounded by the steep price rise at the start of the year – the Indian market has always been price-sensitive. Demand restarted after the price fell back to the \$330 level, boosted not only by the \$55 correction, but by a significant reduction of import duties in the new budget. Duty on metric, numbered bars was reduced by the equivalent of \$9/ounce (for further details see article on the LBMA Forum on page 5).

Refineries that had been all geared up for ten tola bar production were not able to change to metric bars immediately, so the supply of bars into India slowed. Kilo bar production has started, but 100-gram bars are still in short supply. Thus the ability for Indians to buy gold at the lower prices has been hampered by this supply blockage.

In Istanbul, the market has generally seen good demand, with Istanbul Gold Exchange statistics from the Istanbul Gold Exchange showing imports of up to seven tonnes a week. Currency worries and war fears have helped to fuel this market since the beginning of the year. Although the Istanbul gold market is more sensitive to local than international prices, demand did increase as the market fell back to the \$325-\$330 area.

An Asset for Diversification

Contrasting the seven million-ounce sale made to cover short-term NYMEX open positions against physical demand in India and elsewhere, the fall of \$55/ounce seems reasonable under the circumstances. Now that the price is finding a base, underlying economic problems in the world economy, coupled with record low interest rates, leave gold – with much of its war premium removed – as a prime asset for diversification from weakness in bond and equity markets



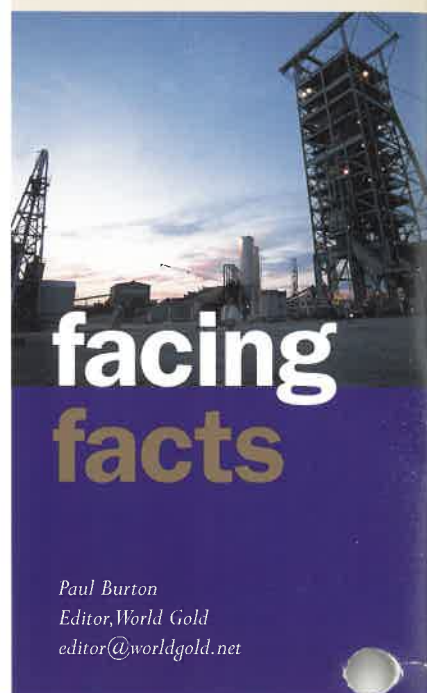
Paul Burton
Editor, World Gold
editor@worldgold.net

There is a strong inverse correlation between gold and the US economy. With the latter still in the doldrums and unlikely to recover anytime soon, the prospects for an increase in the gold price looks good for the remainder of this year and into 2004. Gold remains a significant investment in many countries. The recent securitisation of gold on the Australian Stock Exchange by the World Gold Council will help encourage its wider use as a portfolio diversifier. All told, gold could become an asset that, quite literally, is better than gilt-edged. ■

The Cupboard's Not Bare

Exploring the World's Largest Remaining Gold Deposits

One of the major talking points over the past five years has been the downturn in exploration spending and what it will mean for future global gold production. The combination of a declining international gold price and the fallout from the Bre-X scandal has had a profound effect on exploration spending since 1997.



For each of the last five years the gold mining industry has been spending less and less on finding new gold deposits. In fact it is spending less than half that spent in 1997. This has meant that new production – production from greenfields projects – has declined, and this dearth of spending on exploration has led to the common belief that gold production will decline significantly in future years.

Greenfields Considerations

True, the gold price improvement of the past year has given fresh impetus to greenfields exploration programmes, with many of the majors taking the initiative and increasing their spending. And this is already proving successful, with Barrick Gold's Alto Chicama discovery in Peru last year showing what can be achieved.

But such success is rare and activity, and more importantly money, has yet to filter down to fuel the junior sector, traditionally the most successful at finding gold.

Furthermore, there is a considerable lead time required from drilling that first hole to pouring the first ounce of gold. Historically, a lag time of seven to ten years is not uncommon.

Thus, industry analysts have predicted a decline in world production as the impact of decreased grassroots exploration activity bites into the production pipeline in the latter part of this decade.

But whereas 12 to 15 months ago most people in the industry would have accepted that production must deteriorate, the rise of the international gold price to levels of \$350/oz and above has introduced a new variable – in the form of potential from known, but undeveloped, deposits that may now play a significant role in the dynamics of primary supply.

Of course there are projects out there on mining company shelves ready to be dusted off and brought into the production pipeline. The big question is will there be enough of these projects and will they be of sufficient size to fill the exploration vacuum – and avert any tail off in production profile?

Major Undeveloped Gold Deposits

Well, there is some evidence that suggests that the industry is not in as bad a position as many first thought. In fact, there are some big, undeveloped deposits around the world that do have half a chance of generating more than just fantasy ounces.

In 2000, a thesis completed by South African mining analyst John Handley identified and catalogued gold resources in the ground amounting to around 55,000 tonnes, or roughly 20 years of production, which gives some idea of the overall potential.

Working with data provided by Brook Hunt consultants, in London, and the Beacon Group advisors, in Toronto, as well as World Gold's own research, I have compiled a list of the major undeveloped gold deposits. These deposits are all at a stage where some quantitative work has been done, in fact to resource level, so that we can estimate the size and have some relative measurement to determine the largest.

I have worked from published resource figures aggregated into a total resource figure. This approach makes it easier to make comparisons even if the methodology would not stand up to stock exchange scrutiny.

This approach also implied that I consider more than just the physical abundance of gold mineralisation in a particular deposit. So I have taken into account economic criteria; metallurgical implications; legislative, political and fiscal regimes; and impediments which may invalidate some of the

Resource		Moz
1 – Target North & Sun	Avgold (South Africa)	72
2 – Sukhoi Log	Russian Govt (Russia)	46
3 – Telfer	Newcrest (Australia)	26
4 – Pascua	Barrick (Chile)	24
5 – Donlin Creek	Placer/Novagold(Alaska)	23
6 – Cerro Casale	Placer/Bema (Chile)	23
7 – Boddington Expansion	Newmont, AngloGold, Newcrest (Australia)	20
8 – Turquoise Hill	Ivanhoe Mines (Mongolia)	19
9 – Burnstone	Great Basin Gold (South Africa)	17
10 – Pueblo Viejo	Placer (Dominion Republic)	17
Total		286

geological advantages. Also I have factored in the presence of co-products, which may have a significant say in determining whether or not the gold is actually extracted.

Thus, I have tried, where the companies concerned have not already themselves defined the risk factors and constraints, to impose a degree of objectivity into the assessment of each project to determine the likelihood of it actually coming to fruition.

The list of the top ten, ranked by resource size, is shown above. There are some well-known names there, as well as some surprises. There are also some deposits like Las Cristinas, Valadero and Rosia Montana that do not feature, as they sit just outside the top ten. Durban Deep's Argonaut may soon come into reckoning as technical and economic feasibility are investigated further.

Some General Observations

First, many of the elite deposits were discovered back in the 1970s, and many others are remnants of the 1990s exploration boom. The newest discoveries are Telfer and the Avgold project, discovered in 1998. Even Turquoise Hill has been around for some time.

Second, at a \$270/oz gold price, few of them looked robust enough to add to supply. At levels around \$350/oz they are virtually all likely to show enough of a return to warrant the green light.

Third, unlike greenfields projects, many of them are late-stage, which means that they can impact supply in considerably less time than the seven to ten years I mentioned earlier. The Telfer restart, for instance, is planned for next year.

Fourth, if and when the top ten projects do bear fruit, the market can expect to see some 7-7.5 Moz/y of new gold; that's just under 10% of current world production.

The figures speak for themselves in demonstrating how resilient the industry can be – and that the earth is not totally devoid of sizeable projects that can have an impact on primary supply. ■

The *Alchemist* is published quarterly by the LBMA. For further information please contact
Susanne M Capano, Editor,
LBMA Executive
3rd Floor, 13-14 Basinghall Street
London EC2V 5BQ
Telephone: 020 7796 3067
Fax: 020 7796 2112
Email: alchemist@lbma.org.uk
www.lbma.org.uk

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