Alchemist

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Photo courtesy AngloGold Ashanti

Mining at Great Noligwa, one of four AngloGold Ashanti mines located in the original Vaal Reefs mining area of the Witwatersrand Basin in South Africa.

In the run-up to the annual LBMA Conference to be held in Johannesburg on 13-15 November, a series of *Alchemist* articles will focus on South African topics.

To Sell or Not to Buy

Rejection of IMF Gold Sales is not a Cause for Cheer

By Kamal Naqvi, Precious Metals Analyst, Barclays Capital

'Mad gold bulls' have triumphantly cheered each public statement from the US administration that it opposes the proposal by UK Chancellor Gordon Brown that IMF gold reserves should be sold to fund debt relief for Highly-Indebted Poor Countries.

The US administration has maintained this view despite the release of an IMF report that argues strongly in favour of selling 13 to 16 Moz (400 – 500 tonnes) from its 103.4 Moz (3.217 tonnes) of gold reserves.

The US effectively has a veto, as it holds 17% of the IMF voting rights and the proposal requires an 85% majority. Rob Nichols, the chief US Treasury spokesman, has said that since only a small portion of the debt in question is owed to the IMF, "...the US is not convinced that IMF gold sales are necessary."

However, in our view, the gold-related justification most often cited for rejecting the proposal – the negative impact on the gold price – reveals a very sharp double-edge. It starkly highlights the fact that large investors in gold – the IMF is the third largest official holder – become prisoners of their position. Ignoring the hysterical reactions from mad gold bulls to suggestions that gold reserves should ever be sold, the reality is that the gold market has insufficient liquidity to allow selling in large size.

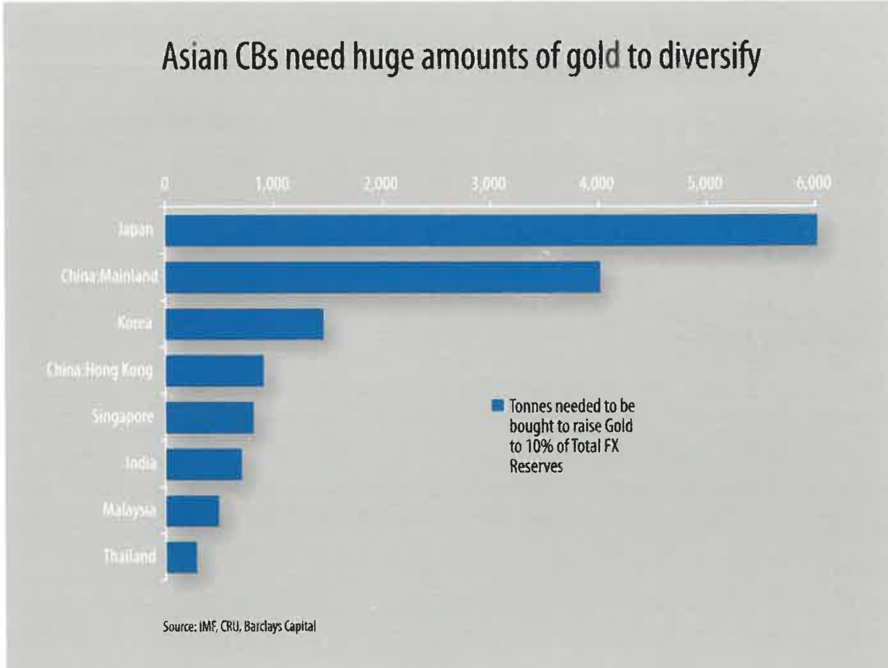
Gordon Brown will be well aware from experience that only a tiny portion of the 103.4Moz (3,217 tonnes), which is worth over $40 billion at current market prices but is valued at less that $9 billion, can be sold in a single year. After all, for the UK's final set of gold auctions in 2002, it was determined that the market could absorb no more than an additional 20 tonnes of gold every two months.

The gold market, of course, is far more buoyant in 2005 and is already absorbing more than 40 tonnes per month in sales from the European central bank Gold Agreement countries. However, for the so-called pro-gold lobby group to argue against IMF gold sales due to its negative impact on gold prices is to accept - in contrast to its own rhetoric – that the buying interest in gold, be it jewellery or investment, is insufficient to absorb a further 20 to 50 tonnes per month. Not exactly a signal of confidence in the gold market or in the strength of the much-espoused but erroneous belief that the market is in deficit.

But surely it should not even come to that. Critically, the lack of confidence in there being a buyer for the IMF gold highlights the absence of that great buying source of the past – central banks. It has been much argued that central banks, particularly in Asia and the Middle East, should and indeed will increase their gold reserves significantly in order to diversify away from their overweight US dollar position. The full 103.4Moz (3,217 tonnes) of IMF gold would represent a one-time opportunity for Japan or China, in particular, to meaningfully increase their gold reserves as a proportion of their FX reserves (see chart).

No Bull
Why this might represent a one-time opportunity for Asian central banks.

- Able to buy a large amount of gold in one purchase
- Avoids an inevitably complicated negotiation with the other mass sellers of gold – the European central banks
- Avoids paying the higher prices that would inevitably result from buying large amounts of gold in the spot market
- Provides moral high ground – helping the world's poor
- Public demonstration of country's global importance
- Demonstrates independence from the US and the US dollar.



However, according to the recently released IMF report supporting the proposal to sell: "Staff does not currently have any indications of official buyers wishing to increase their gold holdings, though a small number of central banks have done so in recent years."

History actually shows that IMF gold sales do not have to be negative for the gold price. Between 1976 and 1980 the IMF sold approximately one-third (50Moz, or 1,555 tonnes) of its gold holdings. Half of this amount was sold in restitution to members at the then-official price of SDR 35/oz; and the other half was auctioned to the market to finance a trust fund that supported concessionary lending by the IMF to low-income countries. Over the same period, gold prices rose from $140.25 at the start of 1976 to $512 by the end of 1980 (although, admittedly, the bulk of the gains occurred towards the end of this period).

In our view, if neither Japan nor China volunteers to buy the full offering of IMF gold, one can confirm that they have little – or probably no – intention of ever significantly increasing their gold reserves. Mad gold bulls have it the wrong way round: it is not the selling of gold that is the problem; it is the lack of buyers! ■

Kamal Naqvi *is a Director and Commodities Analyst with Barclays Capital in London, responsible for cross-commodity research and specialist research across the precious metals complex. He joined Barclays in 2003, after six years as a commodities analyst with Macquarie Bank in London. Educated at the University of Tasmania, Kamal earned degrees in law and in economics (with honours). He is chairman of the LBMA's Public Affairs Committee.*

The Precious Commodity

Gold in the Context of Commodity Index Investments

By Christoph Eibl, Vice President, Dresdner Kleinwort Wasserstein and Markus Mezger, Senior Portfolio Manager, BW Bank

During the nineties, commodities were the underdogs of the investment world: there was little trading activity and few market participants. A product range that might appeal to institutional and/or retail investors was basically nonexistent. But in recent months, that situation has reversed itself, as Christoph Eibl and Markus Mezger explain.

With many commodities trading at multi-year highs, investor interest in a relatively new product – commodity index investments – has been steadily increasing. This world of resources encompasses such diverse products as crude oil, wheat, cattle, cotton and base and precious metals. Together these commodities form their own asset class with superior investment features that cannot be found in other asset categories, such as bonds or equities. While gold generally represents only a tiny share of these indexes, if investor interest continues to expand, it could have a significant impact on gold's supply and demand figures.

Commodity index investments consist exclusively of varying mixes of futures contracts. They have three components of return: a spot return, a collateral yield and a so-called roll yield. The spot return simply represents trading gains against movements in the cash contracts and could be obtained from any number of investment products, whereas the collateral yield and roll yield are features exclusive to the commodity futures world. When buying futures contracts, only the margin needs to be paid, which gives the investor the possibility of applying some collateral against the futures position, for example in the form of treasury bills or money market instruments.

However, the most important component is roll yield. Unlike other financial futures markets, commodity futures markets feature backwardated forward structures from time to time, meaning that near-end contracts trade at higher prices than the later maturing ones (so the cost of carry is negative). When the contract is about to mature, the position is rolled over to the next contract, which is cheaper. During the rollover period, an investor can realise a sale close at a higher price than the purchase open of the next contract. Roll yield represents the differential that is generated by regularly rolling contracts ahead of their maturity, which further enhances total return when added to the spot return and collateral yield.

Lord Keynes on Backwardation

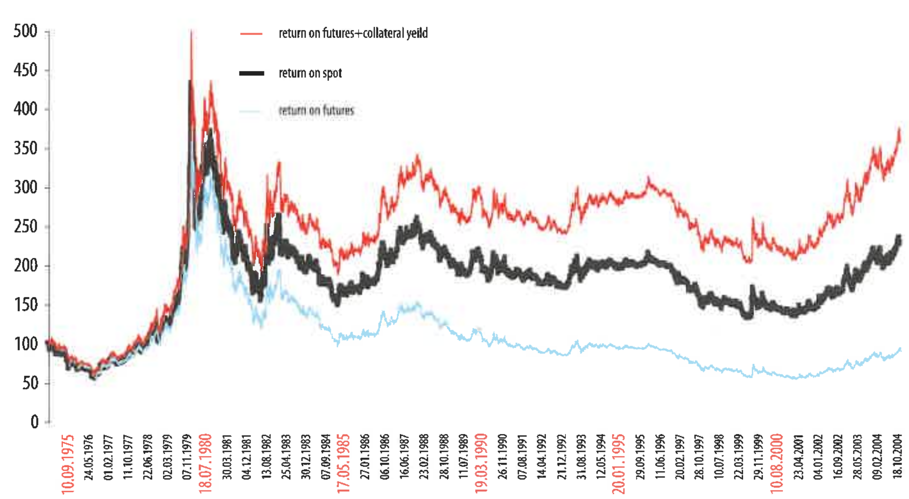
Why does backwardation exist? The classic explanation came from Lord Keynes in the thirties of last century. As an example, a coffee producer in Brazil expects to produce coffee in three months' time, but is meanwhile exposed to price fluctuations. Therefore he intends to sell forward part of his expected production. While he will probably find willing buyers, most often they will need a different quantity of coffee for a different delivery period, leading to a mismatch. Intermediaries like banks or speculators are willing to step in between the two sides and execute the trade, but only in exchange for a risk premium, which results in what Keynes called "normal backwardation".

Another source of backwardation is the market expectation that the price of a commodity must be lower in the future. A good example of this is the oil market, where the one-year price estimates of oil producers and analysts are usually well behind the price of the nearby contract. If market consensus is too low, investors can make money, which has been the case in oil for several years.

Of course, short-term supply disruptions, such as a strike at one of the larger producers, are another reason for backwardated commodity markets. The market assumes that supply will be limited in the near term, but expects the imbalance to redress itself going forward. Consequently, the steepness of the forward curve sharpens. A more serious example is a sharp and long-term increase in demand, as seems to be currently the case in base metals, due to China's rapid industrialisation. When copper, nickel and aluminium markets moved into deficit, the level of stocks became the critical variable. The warehouse data of the London Metal Exchange shows that backwardation in these markets is very highly correlated between stock levels and demand.

Roll yield is only typical for commodities: backwardation seldom happens in other markets. Analysing the returns of individual commodities as well as the overall asset class shows the benefit of investing in futures, even

Comparison of Gold Investment Returns



when considered solely from a return perspective.

The circles show some significant features of commodity investments. Whereas energy in general and copper specifically generate a positive roll yield, gold and precious metals as a group consistently generate a negative roll yield. Why? Because gold is the only commodity with huge stock levels compared to the demand from industrial uses. With some of the bigger gold holders quite willing to sell or lease out their gold stocks in the current price environment, there is no supply shock and no backwardation. In silver and palladium, the current situation in the forward markets reflects the belief that there are large stocks that have not been reported, by the People's Bank of China and Gokhran respectively.

Therefore, the purchase of a later-maturing gold contract is more expensive than buying a near month. But even though the market is trading in contango, there are still reasons to purchase a futures contract instead of spot. From the sole perspective of comparing returns in spot to futures, based on the above argument, the spot purchase would be more efficient.

The chart on the preceding page shows the three different returns for a gold investment indexed on 100 from the starting point of December 1975. The return on a purchase of spot gold would indeed have been better than that generated by buying and rolling the gold futures contract. But, and again this is a feature of commodity index investment, when the yield generated out of the collateral for the margin is added (which would be a fair comparison, as one has to pay the full amount for a spot investment and only the margin for the equivalent future contract), the investment in futures clearly beats that in spot.

Inflation – Positive . . . Dollar – Negative

Gold is traditionally one of the first commodities that investors consider buying, which is why it is one of the most frequently included components of global managed portfolios. In addition to its uses in the jewellery, electronic and other industries, gold has fulfilled the role of a currency for thousands of years. Not only are the characteristics of its pricing similar to FX markets, the fact that gold remains a core investment for nearly all major central banks leaves no doubt that it is still considered a strategic currency reserve and investment.

There might be many reasons why financial authorities and other major market participants invest in gold, but two – its positive correlation to inflation and negative correlation to the US dollar – are certainly key. In the past gold has outperformed other standard assets such as bonds or equities in times of inflation. While inflation was not a concern for some years, given the huge fiscal deficits in the US, Japan and Europe, which are more or less monetised by the central banks, some investors expect inflation to pick up again and that, therefore, real short-term interest rates will remain negative over the medium term.

In the past gold has also proven to be the best hedge against a decline of the US dollar. However there are some signs that the gold price might rise against all of the major paper currencies. While the euro has kept up with gold's rally over the last two years, that situation might change if investors were to start focusing on some fundamental weaknesses in the European Monetary Union (no fiscal discipline, differing economic developments amongst members, the robustness of the European Financial System and the reputation of the central bank).

All this has tended to bolster demand for gold, as proven by the increase in open positions and net long non-commercial positions on COMEX and the interest generated by the launch of gold ETFs. Approximately seven million ounces of gold were held in the GBS products in Australia and the UK and streetTRACKS in the US as of March 2005. At least a share of this investment in gold can be considered to be strategic and long-term, as the investors are seeking insurance against stresses in the financial system.

Gold as an Index-Linked Commodity

Commodities offer investors superior returns, a good risk/return ratio and a slightly negative correlation to stocks and bonds over the longer term. Given these diversification benefits, one might expect further significant long-term investment flows in commodity index-linked products. How might the gold market be affected by such developments?

Gold is included in all major commodity indexes such as the Goldman Sachs, DJ AIG and the Reuters/CRB index. General investment in these index products has increased from around US$10 billion two years ago to more than US$40 billion today. Assuming that the gold share of these indexes is generally between 3 and 5%, around 100 tonnes of gold are already invested in these vehicles today. The net long position of the non-commercials on COMEX – even during significant setbacks in the price – was seldom below 100 tonnes, which represents around 4% of annual gold production.

Going forward, the impact on gold demand might be more dramatic. Given current levels of funds flowing into commodity index investments and the likelihood of increasing demand for these products, total levels of investment could reach $100 billion in the near future, which implies another 100 tonnes of gold demand. The intriguing implication for gold supply and demand figures is that this investment should withdraw stocks from the market over the medium to long term, because much of the interest is coming from institutions seeking long-term diversification against other asset classes.

How much money can commodities absorb without eliminating the backwardation in many markets that makes them so attractive? Yale University in the US is the first faculty to observe commodity index investments. Their analysis estimates that investments of up to a total of $200 to 250 billion would keep backwardation intact. Should those levels ever be reached, the impact on gold would be clear. As the indexes only invest in futures, the more demand there is for such indexes, the more long positions on COMEX will be created. However, the larger questions are how fast will investment in commodity indexes develop, and how will COMEX market participants handle this demand? ■

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Chris holds a degree in economics with a specialisation in corporate banking and a B.A.(Hons) from LOU, London. He is the author of the book Trading the Gold Market in the New Millennium, *published in March 2005.*

Markus Mezger
heads the equity and commodity strategy for BW-Bank in Stuttgart where, in 2000, he introduced commodities as an asset class to the bank's portfolio management.

Since September 2002 he has managed the BW-Bank gold fund, which today oversees about US$150 million. Marcus, who has published several studies about precious metals and currencies, is a speaker much in demand at conferences.

He holds a degree in economics and has specialised in monetary policy and currency theory.

Return on Commodity Index Investments

Future	Exchange	Contract Start	Spot Return	Roll Yield	Collateral	Yield	Total Return
1. GSCI Energy		**1/1/83**	**1.92%**	**4.89%**	**5.82%**	**12.64%**	
WTI Crude Oil	Nymex	30/3/83	1.54%	10.48%	5.63%	17.66%	
Heating Oil	Nymex	4/9/79	2.01%	8.72%	6.76%	17.49%	
Gasoline	Nymex	3/12/84	2.11%	14.91%	5.30%	22.33%	
2. GSCI Industrial Metals		**1/1/77**	**3.15%**	**-1.68%**	**6.64%**	**8.11%**	
Copper	Comex	2/7/59	3.57%	5.27%	6.15%	15.00%	
Aluminium	LME	2/1/80	-0.42%	-4.31%	6.67%	1.94%	
Nickel	LME	23/7/79	3.04%	-3.51%	6.79%	6.32%	
Lead	LME	2/1/79	0.10%	-3.13%	6.87%	3.84%	
Zinc	LME	29/11/88	-2.47%	-2.25%	4.80%	0.08%	
3. GSCI Precious Metals		**1/1/73**	**5.62%**	**-6.48%**	**6.50%**	**5.64%**	
Gold	Comex	2/1/75	3.12%	-3.45%	6.77%	6.43%	
Silver	Comex	2/12/63	4.12%	-5.94%	6.47%	4.65%	
Platinum	Nymex	4/3/68	3.55%	-1.99%	6.73%	8.29%	
Palladium	Nymex	6/1/77	4.79%	-1.72%	6.88%	9.95%	
4. GSCI Agriculture		**1/1/70**	**1.66%**	**-3.02%**	**6.37%**	**5.01%**	
5. GSCI Livestock		**1/1/70**	**2.41%**	**1.77%**	**6.72%**	**10.91%**	

A Fresh Look at Palladium

Will Jewellers – and Consumers – take a Shine to Palladium?

An Interview with Frank McAllister, Chairman and CEO of Stillwater Mining

Until recently, the only place to get a look at some palladium jewellery was on eBay, where vintage pieces from World War II could be found on auction. But once the wartime restrictions had been lifted, jewellers wanting white metal returned to using platinum or white gold. The result was that, with the lion's share of palladium consumption now going into technical applications, it had become an industrial precious metal.

But driven by recently mounting platinum prices, some Chinese manufacturers last year sought an alternative. Of course there was white gold – but consumers there prefer a pure metal rather than a cocktail. Why not try palladium? Its higher profit margins made jewellers happy, but for the experiment to really take off, the consumer had to come onboard, and perhaps not only in China. Frank McAllister, chairman and CEO of Stillwater, the only significant primary producer of palladium in the Western Hemisphere, sees a shining future in jewellery.

Apart from $600, what's the real difference between platinum and palladium?

[Frank McAllister] In terms of appearance, I've heard palladium described as having a greyish tone, which is very annoying. It's actually whiter than platinum. Of course, in China, you don't see either metal when you look at a piece of jewellery. All white jewellery – including white gold – is plated with rhodium to give it a uniform appearance.

But in fact the two metals don't feel the same: palladium does weigh less. To be precise, it's 44% lighter than platinum and 38% lighter than gold. However, that's not a drawback – it's a selling point. It's more comfortable to wear, especially in earrings or larger rings and necklaces, but not so light that it feels like aluminium – it's got enough weight to feel comfortable without being heavy.

And it gives the wearer options. If you buy palladium, it doesn't mean that you'd never wear platinum jewellery again. You might save the platinum jewellery for a special occasion, but you'll wear the palladium jewellery all day, every day.

Palladium doesn't oxidise at room temperature – only when it's annealed. It doesn't need to be polished as often. And it has a double cost advantage: not only is it cheaper than its rivals, but the manufacturer uses less metal in making the piece.

The platinum campaign showed that Chinese consumers preferred a pure, white metal. That gave a logical basis for introducing palladium to that market. How would you say the experiment has worked?

To a certain extent, we did benefit from platinum's marketing campaign. Basically the same principles apply – at a quarter of the price, and that was what opened the door. If manufacturers switched to palladium, they could have margins of 20 to 25%.

Last summer I visited Hong Kong and Shenzhen to meet with a few manufacturers. At that point, perhaps up to 30 had made the change in Shenzhen, depending on who you spoke with. One said he thought it was a 'cheap metal', but later produced three trays of palladium pieces that had come from his platinum supplier. Another took me to visit his factory where palladium pieces were produced. These were destined for the southern Chinese provinces – they wouldn't really appeal to western tastes.

So now it's one year later. How are things going in China?

I've not been able to get there myself so far this year, though someone from our company has gone recently. Since last year's spike in consumption was driven by manufacturers, the next step is to see whether consumers really start to buy. There are some encouraging signs, though palladium jewellery is not yet on offer in the larger stores. We need for that to happen to gain momentum.

But a problem is that there is still a tax on palladium going into the country. Some of the supplies are probably entering by alternative methods rather than official channels. If the SGE were to offer a contract in palladium, that might help towards getting the tax removed.

Perhaps 700,000 ounces went into China last year. If we matched that level this year, it would be a very good sign, but that would only happen if Chinese consumers accept it, want it, ask for it. If consumption levels increased even slightly, then we'd really know that the experiment had worked.

Incidentally, there's further potential for growth in Chinese demand from their automotive market, which is growing by leaps and bounds. Last year they built five million cars; this year it will be six million and by 2010 it's expected to reach ten million. Their emission standards are not as strict as in the West, but ultimately they will want to export, and then they'll have to meet world standards.

Rings courtesy Elichai Fowler

If palladium jewellery is to become accepted and desired, it will need marketing. Where's the marketing force going to come from? And are you only looking at China, or do you see potential in any other markets?

We are taking some steps on a small scale on our own trying to form partnerships with the manufacturers who produce and sell, mostly in China, but also in the US. Japan might represent another interesting opportunity.

One example in the US is Elichai Fowler, who's based in Bozeman, Montana [see "Never a Dull Moment" below]. We've featured some of his work in our annual report.

On a bigger scale, Frederick Goldman Inc, a New York jewellery company, will be introducing the 'Stillwater Collection' of palladium wedding bands, at the Las Vegas JCK jewellery show for the trade in June. They tell us they are already getting a good response from jewellers. We also keep in touch with Mehdi Barkhordar at PAMP, who produced a palladium medallion watch for Stillwater two years ago. Mehdi is advancing his sophisticated marketing concept in promoting a charm, the 'FORS talisman', made from palladium [see photos].

We've also collaborated on a website – www.stillwaterpalladium.com – with information about the various uses of palladium. We hope to eventually offer products for sale, from jewellery to cowboy belt buckles.

Realistically, we can't afford to compete with the multi-millions that have gone into marketing platinum. We're not going to be booking Maggie Chung just yet. But I have got a slogan: It's white. It's light. It's bright. Most importantly, it's a life style.

What has been the response in South Africa and Russia?

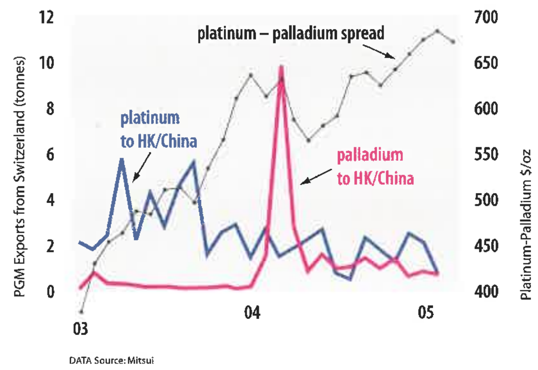
Norilsk is supportive, but hasn't yet made any contributions. We understand that they have independently been pursuing a similar effort. Likewise, we've got general support from the South African producers, but I don't expect them to join in a marketing effort – at least not yet.

Of course, while palladium has benefited from the price differential, platinum has suffered – and two-thirds of the South Africans' production is platinum. They have invested both financially and emotionally into growing the platinum market. So their encouragement is based on the promotion of palladium as an alternative, not a substitute.

Palladium jewellery could really be marketed two ways: as a more affordable alternative to platinum – or as a metal in its own right. What do you think is the best way forward?

In industrial applications, a low price can give one metal a clear advantage. With gold above $400, platinum around $800 and palladium near $200, there is a good environment for some interesting new applications, such as SED televisions, a new technology for large flat-panel displays.

Swiss PGM exports to HK/China and platinum – palladium price spread



Price was the catalyst that got things started for us in jewellery. It *is* a factor. It gave us an opening in China. In fact, it appears it was why QVC offered palladium in the US: get the look for less.

But the real key to jewellery is emotion, not price. If we're going to create a lasting market for palladium, it has to be seen by the consumer as an option that he wants, not a substitute for something he can't afford. ■

Left – Universe, one of a series of FORS talismans developed by PAMP SA in 999.5 palladium. The metal is given a matt finish and inscribed on one side with PAMP's emblem, Fortuna, and on the other side with a motto in nine languages. The range is designed to be worn by men or women and will be lauched in the near future. Why the choice of palladium? The metal's namesake – the palladium of ancient Greek myth – was associated with luck and divine protection.

Right – Palladium watch, courtesy PAMP

Never a Dull Moment: One Jeweller's Experience

When I want to use a white metal, I prefer one that starts out being white. White gold reminds me of adding a lot of milk to a cup of coffee – by the time you've turned it white, you don't have coffee anymore.

About two years ago, I became interested in using palladium, but getting advice on working with it proved very difficult. I even tried contacting the Platinum Guild – my reasoning being that it was, after all, a platinum group metal. They were very discouraging – they said it was very difficult to work with and customers wouldn't want it.

But in my search for information, I had turned up an ad catalogue from the 1940s showing palladium jewellery from 24 manufacturers – among them Tiffany's. There was everything from cast to high-end fabricated pieces.

So I had proof it was usable. I experimented and got some pieces ready for sale within a couple of months. One of the first was an engagement ring for a young couple who had a very active lifestyle – they spent much of their day outdoors, and the woman worked as a bartender at night. They returned a year later, and I couldn't believe what great condition her ring was in.

Appearance-wise, platinum and palladium are very similar, but palladium is actually somewhat whiter. And it's no duller – in fact, it's easier to polish. If you brought in grandma's platinum wedding band to be reshanked, I could use palladium and no one would know – which is not the case with white gold.

I haven't stopped using platinum, but price is a factor. Everyone comes in wanting platinum, but only a quarter of them can actually afford it. If the two metals were the same price, I'd probably choose platinum, except for larger pieces, where the weight becomes impracticable. But as things stand, with platinum you're basically getting half the metal for four times the price. – Elichai Fowler

Good as Gold (and Silver)

Proactive Monitoring Takes Effect – with Good Effect

By Douglas Beadle, Consultant, LBMA

The London Good Delivery List of gold and silver refiners is recognised worldwide as setting a standard of refining and assaying excellence – and the LBMA is very conscious of the need to protect the integrity of the List. Prior to the introduction of Proactive Monitoring, a refiner only had to demonstrate its refining and assaying ability at the time of its application for admission to the List. Ongoing monitoring of those on the List on a regular basis is helping to ensure that the stringent requirements for joining the List continue to be met.

In 2001, it came to the LBMA's attention that some gold bars being delivered to the market that purported to be 999.9 were in fact assaying between 999.8 and 999.9.

Although such divergences are very small, the LBMA considered that this represented a problem that had to be solved. In response, the Association developed the concept of Proactive Monitoring. After more than two years of intensive work, its introduction was announced in January 2004, though it was not until approximately six months later that the actual programme got underway.

The new system, which involves the regular monitoring of all Good Delivery refiners at least once every three years, necessitated the appointment of Supervisors (to witness the dip-sampling operation that provides samples for testing by the LBMA's Referees). The monitoring operations are carried out in batches of around 10 and on a quarterly basis. So far, two rounds of Proactive Monitoring have been completed, and the third round is well advanced.

Gold refiners that only produce and sell "four-nines" gold may elect to be monitored by assaying a set of reference samples (ranging in fineness from 995 to 999.9) sent to them by the LBMA. These samples have been produced and crosschecked to the highest standards by the expanded panel of Good Delivery Referees, whose appointment was announced at the end of 2003.

If a refiner produces both gold and silver, it is tested for both metals at the same time.

In the first two rounds, eight gold-and-silver refiners and seven silver-only refiners were monitored. Of these, one gold-and-silver refiner and three silver-only refiners elected not to be tested; they were transferred to the Former Melters and Assayers List. One four-nines gold refiner failed the assaying test on the LBMA's reference samples, and is in the process of changing its equipment and techniques before retaking the assaying test. One silver-only refiner failed the assaying test and, following discussions with the LBMA, is currently reviewing its assaying set-up prior to investing in new equipment to allow an increase in the accuracy of its assaying. All the other gold and silver refiners that have been monitored were given clean passes.

As mentioned above, the third round of Proactive Monitoring is currently underway, in which five gold-and-silver refiners, two gold-only refiners and two silver-only refiners are being tested. This round of testing should hopefully be completed by late May.

The LBMA is pleased with the results of the Proactive Monitoring programme to date. In the majority of cases, the results confirm that the high refining and assaying standards required for London Good Delivery List accreditation continue to be met, whilst in the two cases where problems were identified, appropriate remedial action is being taken. ■

The LBMA Assaying Seminar

21 – 22 June 2005
Armourers' Hall, London

This event is designed principally for refiners on the Good Delivery List to discuss technical aspects of the assaying of gold and silver bullion.

Attendance is strictly by invitation and is limited to a maximum of two representatives from each participating company.

For more information, visit www.lbma.org.uk/events.htm.

Double Your Treasure

Two-filter trading strategies use a simple technical screen to point traders in the right direction

By Daniel L Chesler, CMT, CTA

Two-filter trading strategies combine a trend filter for determining price direction with a pattern filter for validating entries and setting natural risk and target levels. While they are not a means for correctly judging every market – whether commodity or stock – they do offer a more objective way for uncovering situations that support directional trading. The two-filter strategies presented in the following article are shorter-term in nature and trading focused. They might be viewed as quantified versions of the traditional chartist's "flag" pattern, which typify a minor pause in an existing trend.

Less Equals More

When constructing a model for analysing and trading a complex entity such as the financial markets, the fewer the parameters used, the greater the model's ability to generalise for unseen cases. This is known as statistical robustness, and represents the ability of a model or a system with a fixed structure to hold up in a constantly changing environment. We simply don't know how the future will unfold. To make the best of this bad situation, the correct approach is to build strategies that attempt to capture the features of the bulk of possible future scenarios, rather than all of them. Strategies that rely upon many layers of rules and exceptions yield less-than-optimal results in a world where the underlying assumptions are constantly changing. The strategies presented herein rely on few parameters, making them not only easy to memorise and implement in the heat of the battle, but also robust.

Not Only Direction

Traders often refer to a "good trade" as one that provides rapid confirmation of their directional biases. Thus, from a trader's perspective, simply being on the right side of a market is not the sum total of a winning trade. Even if price direction has been correctly predicted, your position still needs to appreciate enough to cover your costs (i.e., spreads, commissions and losing trades), and at a rate above the risk-adjusted return of other opportunities. All else being equal, the less time it takes to cover trading costs and exit the trade with a profit, the better. Flat price traders therefore not only want to select market situations that support their directional biases, but that also lead to an increase in short-term volatility. The two-filter strategy attempts to achieve both of these goals.

Entry Filter

Significant price moves – i.e., moves that qualify as more than just "noise" – are usually interrupted by periods of rest before continuing in the direction of the trend. Sometimes these rest periods are deep and protracted, at other times, brief. Traditional chartists use the phrase "flag" or "pennant" to refer to the short-term variety of rest periods that occur in the context of strong moves. Let's take a look at some examples of these classic patterns.

Figure 1 is a chart of the June 1985 gold contract. After declining over $10 per ounce

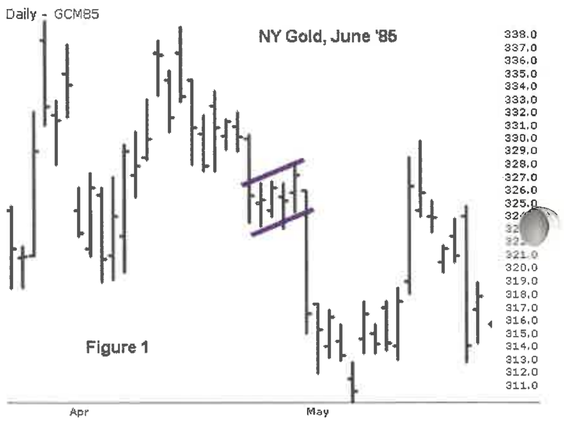


Figure 1

Figure 2

(c) TeleTrader Software AG

from its April high, the market paused for four days before resuming its downward motion. The eventual move below the lower bounds of the pattern was rapid and substantial. Figure 2 is a chart of April 1996 crude oil futures. Following a sustained rise into late February, supply is finally induced, causing the market to halt its advance. But demand is still sufficient to maintain crude oil prices between $19 and $20 per barrel for almost two weeks. Once supply has finally been absorbed, crude oil moves sharply higher into March. These are examples of classic "flag" patterns. However, there is often considerable variation in the length of time it takes each pattern to form, in the angle of the pattern and in other aspects. In fact, we can probably find an infinite variety of patterns fitting the general description of "brief pause."

To arrive at an objective substitute, then, what main components can we distil from the general idea? Two that come immediately to mind are:

1. The concept of prices trading briefly in the opposite direction of the main price trend
2. The concept of a rapid increase in range, i.e., short-term volatility.

To capture the first component, we merely require a single period (i.e., one hour, one day, one week, etc.) where the closing price is below the opening price for a bullish setup, or where the closing price is above the opening price for a bearish setup.

The second component, a rise in short-term volatility, is captured by requiring the market to trigger an entry within two periods (i.e., within two hours, two days, etc.) following the initial setup period. Entries are triggered as follows: following a bullish setup, the market must open below the high of the setup period. For bearish setups, the market must open above the low of the setup period. Trades are entered only if price trades up and through the high of the bullish setup for long entries, or down and through the low of the bearish setup for shorts, and only within the two periods immediately following the setup.

If the market gaps open above the bullish entry point (or gaps down, below the bearish entry point), the setup is discarded. If for any reason no trade is triggered within the two periods allotted following the setup, the setup is abandoned.

By requiring that prices fully retrace the setup period's open-to-close direction within two periods after the setup occurs, we are asking the market to prove - in short order - that all of the previous period's buyers (or sellers) were mistaken. The speed and extent to which prices rise or fall after a trade has been entered help answer the question of whether there is power behind the move, and whether buyers (or sellers) are acting with conviction. Either short-term volatility expands - in the form of prices surging past the entry point - or it does not. The answer should arrive quickly and decisively, or not at all. A schematic of this entry technique can be seen in Figure 3.

The protective stop for long entries is the lowest low of the entire pattern, or the highest high of the pattern for short trades. Stops are moved to break even once open profit equals the initial risk (simply defined as the difference between entry and stop price). Once the stop has been moved to break even, all or part of the position can be exited at multiples of the initial risk taken. In my own testing, I find that among the trades that survive the break-even stop, greater than half of these trades go on to exceed 200% of the initial risk amount.

Bearish Entry--
1. Setup period close is above open
2. Next open (within 2 periods) is above setup low
3. Trade entered at setup period low

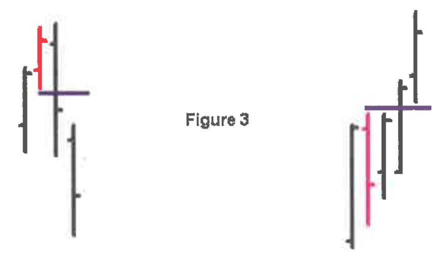


Figure 3

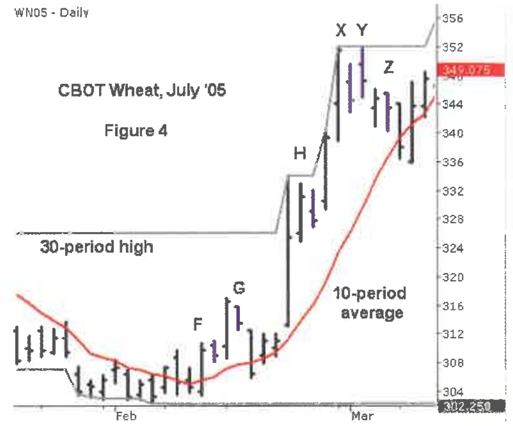
Bullish Entry--
1. Setup period close is below open
2. Next open (within 2 periods) is below setup high
3. Trade entered at setup period high

Trend Filters – The Quick and the Slow

The next step is to combine the entry pattern with a trend filter. Long entries are acted on in "up" trends and short entries are acted on in "down" trends. By definition, trend filters are lagging indicators. Trend filters help answer the question "which way is the market moving," but do not solve the mystery of when one trend is over and another has begun. There is always a trade-off between "too fast" and "too slow." Shorter-term filters produce earlier indications but include many false alarms and aborted trends. Longer-term filters produce later indications but fewer false alarms and more sustained trends. My approach to this, after studying the problem for a number of years, has been to settle on two very simple filters, one quick and one slow.

The faster acting trend filter defines any market that closes above its 10-period simple average as an uptrend, and any market that closes below its 10-period simple average as a downtrend. The slower trend filter designates any market making a recent 30-period high or 30-period low as being in either an uptrend or a downtrend, respectively. Recent simply means within the last five periods.

Let's review some examples. At point F in Figure 4, the close of the July' 05 CBOT wheat contract is below the open. The shorter-term trend's filter is "up," since the price is above its 10-period average. The high of the setup bar (coloured blue) becomes the entry point if taken out within two days. In this example, wheat immediately takes out the previous high. The result of the trade was positive – assuming you moved your stop to break even and exited the position after prices reached a multiple of the initial risk.



(c) TeleTrader Software AG

Another bullish setup occurs at point G, but no trade was taken, as the market did not confirm an entry within two periods after the setup. Setup H yielded a successful long entry, taken in the context of a recent, 30-period high. A losing long trade would have been entered and stopped out for a loss at the low of the setup bar at point X. There was no trade triggered following setup Y. Lastly, a bullish setup occurred at point Z. The market confirmed an entry by trading up and through the high of the setup bar within two periods following the setup.

At point E, near the left side of Figure 5, the close in the June '05 gold contract is below its open and the trend is "up," since prices are above the 10-period moving average. But no trade is taken. No trade is taken at point G either, for the same reason (i.e., the market did not confirm the entry within two periods following the setup). An unsuccessful trade was entered following the setup at point F in the chart, while a profitable trade was entered at point H. H was a bullish setup in the context of a recent 30-day high, and was confirmed on the next period, immediately following the setup.

The two-filter strategy is part science and part formalisation of trader intuition and experience. When it comes to finding trade setups, the best ideas are usually simple rather than complex, do not rely on layers of rules and exceptions and do not require expensive or sophisticated indicators to implement or understand. ■

For further reading

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Trading Systems and Methods, 3rd Ed
Kaufman, Perry J. John Wiley and Sons, New York, 1998.

Daniel L. Chesler, *CMT, CTA, provides strategic technical forecasts for commodity and financial markets to proprietary traders, risk managers and brokers. He is a charter member of the AAPTA, the American Association of Professional Technical Analysts, who has previously worked as a trader and price risk manager for the Louis Dreyfus Group. He is a graduate of Babson College.*

Challenges Facing the South African Gold Mining Industry

By Lebo Mogotsi, Director, Lebone Resources (Pty) Ltd

The mining industry remains a major contributor to the economy of South Africa. According to data from the Department of Minerals and Energy of South Africa, the sector contributed 7.1 % to gross domestic product in 2003, of which gold was a key contributor in value terms.

However, the gold mining sector continues to face a variety of extremely difficult tests – in nearly every aspect of its day-to-day operations: financial, technical, human and policy. If the industry successfully overcomes these tests, it should emerge leaner, fitter, and more efficient. It will also be radically different from the country's gold industry of even a few years ago.

Technical Considerations

The South African gold industry is mainly characterised by deep-level hard-rock mining. The inherent technical constraints and the difficulties of labour-intensive mining working away at persistently declining grades has put a lot of pressure on many companies to increase efficiencies in terms of productivity improvements – such as higher tonnage mined per mineworker and increased production volumes – as well as managing and reducing costs.

Financial Considerations

Deep-level gold mining requires large capital investment and specialised equipment and is associated with long lead times from development to actual production of gold.

Previously, the cost pressure was negated to a large extent by a weakening rand against the US dollar. However, in 2002 the fortunes of the rand convincingly reversed and miners lost the cushion of higher rand gold prices, as shown clearly in Charts 1 and 2.

The effects of the strong rand against the US dollar have also counteracted any positive effects of the steady increase in the dollar-gold price over the past five years.

Human Capital Considerations

Perhaps the greatest concern now facing the gold industry is the degree and rapidity of shrinkage in personnel. Chart 3 reveals that, over a twenty-year period since 1984, the number of unskilled personnel employed by the South African gold mining industry has fallen from 450,000 to 130,000 due to restructuring in the sector. It is estimated that each mining job has between seven and 12 dependents. Thus the wider social and economic damage – not just in South Africa but in neighbouring regions – is substantial.

The struggle to get ore to the surface has been compounded in the last decade by the need to come to terms with the fact that HIV/AIDS has become endemic among South African and migrant mine workers alike. The ongoing implications of this include increased expenditure on medical insurance and disability cover and higher indirect labour costs through reduced productivity, higher absenteeism, and the need to train and replace labour.

According to data from the Chamber of Mines of South Africa, mining companies spend between R200 and R480 per employee per annum on HIV/AIDS programmes in the workplace. The programmes covered by this budget include prevention and awareness campaigns, education and training of employees, voluntary testing and counselling, treatment of sexually transmitted infections, wellness management and home-based care, and community-based intervention programmes. This amount excludes the antiretroviral treatment introduced by some of the mining companies, which is normally allocated from a separate budget.

Therefore, the strong rand (ranging from 6.00 to 6.50 to the US dollar) has put pressure on operating costs at a time when individual mining companies have demonstrated a commitment to good corporate social responsibility, with significant expenditure on a myriad of social welfare programmes, including health care, education, self-help and infrastructural projects within the communities in the vicinity of the mines themselves.

Policy Considerations

In addition to these financial, human and geological challenges, the South African gold mining industry has also been required to embrace various pieces of national legislation, designed to address the inequalities of South Africa's apartheid past.

Chart 1 – Rand per dollar

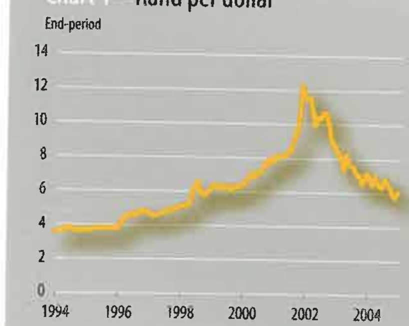
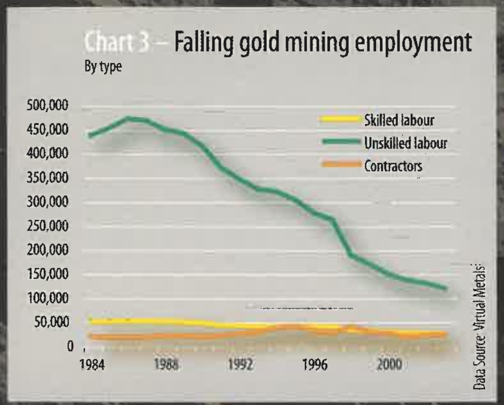


Chart 2 – Rand gold price

Data Source: Virtual Metals



The Mineral and Petroleum Resources Development Act of 2002, which came into effect on 1 May 2004, has direct consequences for the mining industry. This act seeks to facilitate participation in mining ventures by Historically Disadvantaged South Africans (HDSAs) and to ensure that mineral rights are fully exploited by applying a "use it or lose it" principle. To realise these two broad objectives, the right to prospect and mine for all minerals will vest in the state, and applications for those rights must be made directly to the state. This represents a fundamental change, as the right to prospect and mine was previously vested in the owner of the mineral rights.

The act furthermore grants the government some discretionary powers to regulate mineral rights and to promote and support HDSAs in the mining industry.

The broad-based Socio-Economic Empowerment Charter of 2002, which has become known as the Mining Charter, is central to the objective of creating a globally competitive mining industry that draws on the human and financial resources of all South African people and offers them real benefits. The target for HDSA ownership of a business entity has been set at 15% of mining assets in the next five years and 26% within 10 years.

Progress on this front is being monitored via the 'mining scorecard', a formulated standardised mechanism for monitoring the empowerment progress of a company. A mining company's conversion of licences from old order to new order is dependent on compliance with this BEE scorecard. The risk of not converting or of non-compliance is to forfeit the right to mine.

The Mining Charter allows mining companies to offset the levels of beneficiation achieved against HDSA ownership requirements. Critical to this offset is that companies identify their current levels of beneficiation and indicate to what extent they can grow the baseline level of beneficiation.

Closely allied to this is the Mineral and Petroleum Royalty Bill, introduced in 2004 by the National Treasury to the Assembly as the Money Bill. If passed, it will become law and be effective from 2009. This bill recognises that South Africa's mineral resources are non-renewable, and stipulates that they belong to the nation, with the State being custodian, much along the same lines as the Act of 2002. The Royalty Bill, however, proposes that all mineral producers (including gold miners) pay a royalty on mineral production. It is proposed that gold producers pay 3% of revenue from output (as opposed to 4% on platinum and 8% on diamond revenues).

The proposed 3% royalty represents a direct cost, although proponents of this tax argue that the bill will merely level the playing field. They point to the fact that most other mining countries already have similar royalty structures in place, and therefore argue that South Africa is simply catching up to international norms.

Royalties will be levied from 2009 in order to dovetail with the company conversion to the new mineral rights as laid out by the Mineral and Petroleum Resources Development Act of 2004, calling for 15 % of South Africa's mines to be owned by HDSAs by 2009 and 26% by May 2014.

The Beneficiation Debate

In South Africa, the concept of beneficiation as technically defined by the Department of Minerals and Energy refers to the various processes that involve upgrading, improving, processing or treating a primary ore by the removal or separation of impurities from the economic minerals.

All photos courtesy AngloGold Ashanti

The issue of adding value to South Africa's minerals before they are exported has been under debate for a number of years. This debate is based on the argument that the South African beneficiation of gold is currently only about 2% of current mine production – and that the country is not exploiting any comparative advantages of its large natural resource base. But the perception of South Africa having comparative advantage due to the location of its mining industry does not in itself render the country competitive in terms of its downstream industries. In South Africa, downstream industries are largely dominated by the gold jewellery manufacturing industry, as it represents over 80% of South African gold consumption.

It is clear that the process of adding value to gold has not taken off to any great extent in South Africa. There are structural reasons why these industries have had stagnant growth. They are very small and hold little potential for the kind of incremental growth expected by the key stakeholders in the next five years. Hence the significance of exports as the focal point for any deliberations that take place on gold beneficiation.

Any strategy that is to have national impact and invigorate the gold beneficiation industry of South Africa must be based on jewellery: quantities of gold used in industrial applications such as electronics are still relatively small. But even within jewellery exports, a distinction has to be made as to where a competitive gap can be found for a South African company to enter. For example, India, the largest consumer of gold jewellery, does not offer itself as an opportunity for South Africa because labour costs are cheap.

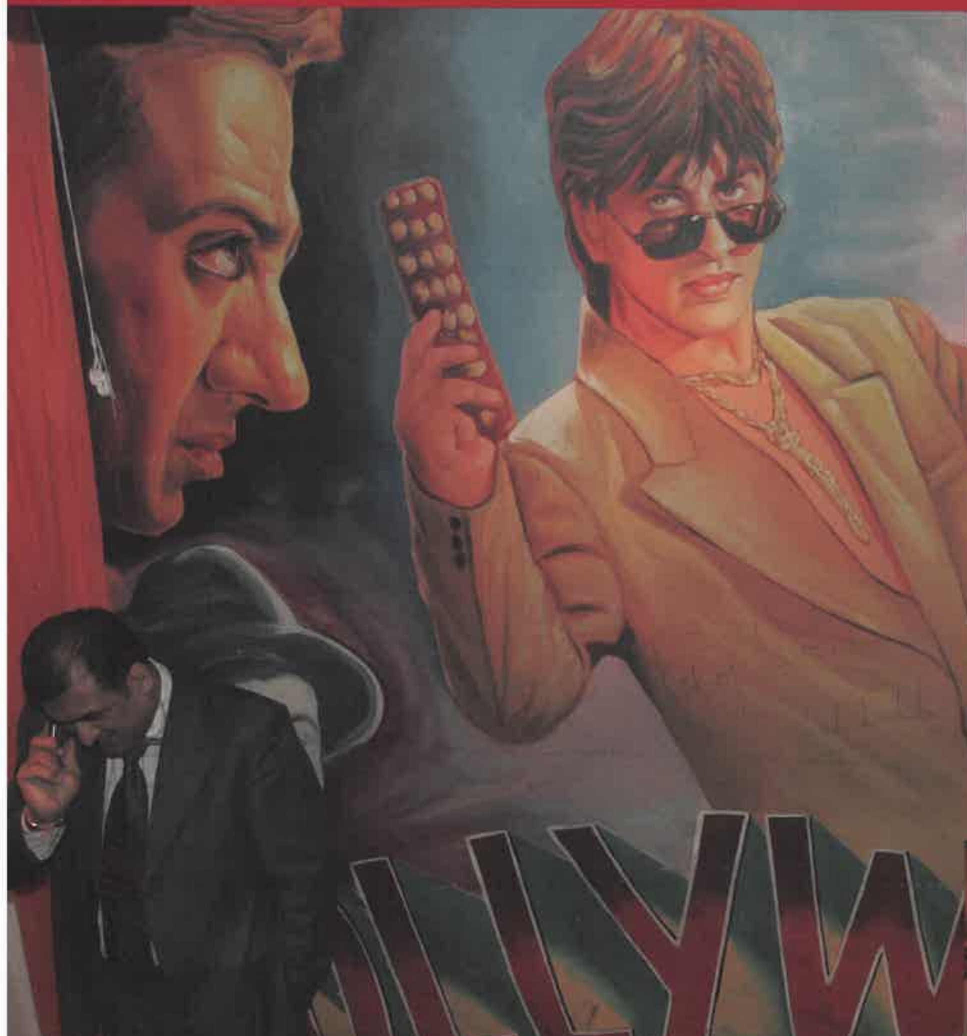
Europe and the US are relatively sophisticated markets that use mechanised industries, and these might be open to exploitation by South African jewellery manufacturers if a conducive environment can be created. But the barriers to gold jewellery manufacturing growth need to be eliminated, and the structural problems of a highly fragmented industry mainly characterised by family-owned businesses do not provide beneficial economies of scale. Conditions have to be right in terms of incentives to support growth, such as the provision of gold loan schemes comparable to those in place for successful downstream industries in the international market.

In South Africa, there is a widely accepted need to redress the past destructions and distortions to individual career paths and education, and to widen access to opportunities both in terms of employment and the country's inherent mineral wealth and entrepreneurial prospects.

Whatever the arguments, the upshot is that the South African gold mining industry is facing a number of very substantial challenges. Fortunately, this is an industry that has overcome many challenges over 100 years and no doubt will rise to address the ones highlighted in this article. ■

Lebo Mogotsi *is a director of Lebone Resources (Pty) Ltd, a women's empowerment mining company focusing on mining, beneficiation and consulting, and is on the boards of a number of JSE-listed mining companies.*

She is a past executive member of the Jewellery Council of South Africa, has spoken at many industry initiatives and is currently working with Virtual Metals Research and Consulting Limited on a gold beneficiation research project in South Africa. She holds a Bachelor of Commerce degree from the University of Cape Town.



Bollywood Boulevard

From Brazil to Scotland – via China and Ireland – the annual LBMA members' party has travelled to the far corners of the world (accessible via the Tube in London) with themes ranging from St Patrick's Day to Chinese New Year. Scheduled in the winter, the event is open to all Members and Associates.

The theme this year was Bollywood Nights, held at the Yatra restaurant in London's West End. The evening featured dinner, drinks and dancing, with entertainment provided by the Bollywood Dancers. Ideas for next year's celebration are welcome. ■

LBMA News

By Stewart Murray, Chief Executive, LBMA

MEMBERSHIP

Members

The Royal Bank of Canada was reclassified as a Market Making Member with effect from 1 March 2005.

Natexis Metals Limited changed its name to Natexis Commodity Markets Limited on 12 January 2005.

The Membership held by Credit Lyonnais Rousse Limited was transferred to Calyon on 11 February 2005.

Associates

The Associateship of Ashanti Goldfields lapsed at the end of 2004 as a result of the merger with AngloGold to form AngloGold Ashanti Limited.

Zinifex Metals Limited was listed as an Associate on 8 February 2005 in place of Pasminco, following the latter's restructuring.

Peekay Intermark Limited of Dubai was accepted as an Associate on 1 April 2005.

Good Delivery List

Zinifex Limited of Australia was listed as the successor of Pasminco on the Silver List.

The LBMA has approved the relocation of Asahi Pretec Silver Refinery to a new location (Saijo, Ehime Prefecture) with effect from 1 April 2005.

EU Retalitory Duties

In late January, the European Union Commission announced the suspension of retaliatory duties that had been imposed on a large number of US products in March 2004 relating to the dispute between the EU and the United States about the US Foreign Sales Corporation Extraterritorial Income legislation. The EU indicated that the suspension of the duties would be retroactive to 1 January 2005. The Commission also indicated that, if it were necessary to re-impose such duties in the future, neither gold nor silver bullion bars would be included. The latter aspect of the decision was a reflection of the complaints that had been made by the LBMA concerning the disruption to the bullion market in London caused by the EU having included the gold and silver bullion in the list of products subject to the retaliatory duties.

Chief Executive Presentations

In February, the Chief Executive gave presentations on the LBMA and the London bullion market at the Des Jardins Securities Commodities Conference in Toronto and the third Dubai City of Gold Conference.

AGM

The LBMA's Annual General Meeting will take place at the Armourer's Hall, 81 Coleman Street, at 4pm on 22 June 2005. Any members of staff from Member and Associate companies can attend. In addition to the normal business of the AGM, presentations on the work of the LBMA will be given by the Chairmen of the Finance, Membership, Physical and Public Affairs Committees. The annual ballot for the Management Committee will be held at the AGM. The formal papers calling the meeting and announcing the ballot will be distributed one month before the meeting.

Annual Party

The Annual Party was held on 24 February in the Yatra Restaurant in London's West End (see page 18). During the past five years, the annual party has adopted a number of different national themes (Scottish - Burns Night, Chinese New Year, Brazilian - Mardi Gras, Irish - St Patrick's and, this year, Bollywood). All staff, Members and Associates were invited to participate and the event was subsidised by the LBMA. Looking ahead, the Executive would be delighted to receive suggestions for the format for next year's party.

COMMITTEES

Management Committee

The Committee has met twice since the beginning of the year. In addition to reviewing the recommendations put to it by the subcommittees, the Management Committee has agreed that the LBMA should continue to develop a generic consignment agreement that Members might wish to use to facilitate negotiations with clients. At its meeting in March, the Committee also approved the draft annual accounts for submission to the AGM in June.

Following the resignation of Diego Parrilla from the Committee in January, the Committee agreed to co-opt Mr Stephen Branton-Speak of J Aron until the AGM.

Physical Committee

The Good Delivery system remains the core of the Committee's activities. Currently, six applications for listing are in the pipeline and the Committee has also had to deal with various requests concerning changes of ownership or location on the part of listed refineries.

During the past year the Committee has been monitoring a trial of electronic weighing for gold bars that has been carried out by representative vaults in London, including the Bank of England. A final assessment of the results of the trial will be made during the coming months, after which a recommendation may be made to the market about the possible use of such balances in London. The Committee has also held discussions with the Bank of England about the means of communicating bar lists between commercial vaults and the Bank. It should be noted that the possibility of using electronic weighing would not imply any change in the use of the troy ounce as the basis for the trading and holding of gold and silver in the London market.

At present, a substantial part of the processing of Good Delivery applications is carried out by the Members of the Physical Committee and their vaults. In the future, it is expected that the Executive will take on an increasing share of this work, and discussions are underway to allow the changes in methodology to be implemented later this year.

The Committee has overseen the arrangements for the Assaying Seminar that the LBMA is organising in London on 22 June (see page 10).

Public Affairs Committee

The PAC has met twice in the first quarter and the arrangements for the LBMA conference in Johannesburg (to be held on 13-15 November this year) occupied the main part of its discussions. The second of the meetings was of "open" format, allowing a number of analysts and market participants who are not actually members of the Committee to take part in discussions and provide feedback and ideas to the LBMA. The Committee also discussed the possibility of holding a members seminar on the subject of exchange-traded funds. The seminar would take place at the end of the working day at a location in the City and be followed by a reception. As usual, the Committee discussed possible articles for our future editions of the Alchemist and reviewed the plans for upgrading the website.

There have been a number of recent changes in the makeup of the Committee, with Peter Smith and Oliver Beane resigning and David Holmes, Ross Norman and Paul Walker joining the Committee. Our thanks go to Peter and Ollie for their past service on the PAC.

Finance Committee

The Finance Committee met as usual in March to review the draft accounts for submission to the Management Committee and eventually the AGM.

LBMA STAFF

Andrea Smith has recently returned to work following major surgery in mid-January. During the last four months Andrea's work has been undertaken on a temporary basis by Graham Handley, and the LBMA would like to record its thanks to him for the excellent contribution he has made during this period.

Belinda Elliott joined the staff as PA to the Chief Executive in January. ■

The LBMA Annual General Meeting

22 June Armourers' Hall

- Chairman's report
- Presentations from the Finance, Membership, Physical and Public Affairs Committees
- Ballot for the Management Committee

Attendance is open to all Members and Associates.

DIARY OF EVENTS

May 2005

16
Platinum 2005 Release – Johnson Matthey, London
T: +44 (0) 20-7269-8269
F: +44 (0) 20-7269-8155
platinum@matthey.com
www.matthey.com

23 – 24
IICONF – New York Institutional Gold Conference New York
T: +1 305-669-1963
F: +1 305-669-7350
iiconf@iiconf.com
www.iiconf.com

23 – 24
Portfolio Diversification with Commodity Assets London
T: +44 (0) 20-7368-9373
F: +44 (0) 20-7368-9377
team@iqpc.co.uk

24
LBMA ETF Seminar
Membership Only
London
T: +44 (0) 20-7796-3067
F: +44 (0) 20-7796-2112
seminar@lbma.org.uk

25
World Silver Survey 2005
New York

26
Mexico City, Mexico
T: +44 (0) 20-7478-1777
F: +44 (0) 20-7478-1779
laurette.perrard@gfms.co.uk
www.gfms.co.uk

June

2
LBMA Annual Golf Day
Blackmoor Golf Club, Hants.
T: +44 (0) 20-7796-3067
F: +44 (0) 20-7796-2112
andrea.smith@lbma.org.uk

11 – 14
IPMI 29th Annual Precious Metals Conference Florida, USA
T: +1 850-476-1156
F: +1 850-476-1548
mail@ipmi.org
www.ipmi.org

12 – 13
World Gold, PGM and Diamond Investment Conference
Vancouver, Canada
T: +1 604-687-4151
F: +1 604-687-4726
info@cambridgehouse.ca
www.cambridgehouse.ca

14 – 15
2nd Annual Global Commodities Finance Conference London
T: +44 (0) 20-7779-8999
F: + 44 (0) 20-7779-8603
jjohnson@euromoneyplc.com
www.euromoneyplc.com

21 – 22
LBMA Assaying Seminar
Armourers' Hall, London
T: +44 (0) 20-7796-3067
F: +44 (0) 20-7796-2112
seminar@lbma.org.uk
www.lbma.org.uk

21 – 22
San Francisco Gold Forum 2005
San Francisco, California
T: +1 303-625-3368
info@denvergold.org
www.denvergold.org

22
LBMA AGM
Armourers' Hall, London
T: +44 (0) 20-7796-3067
F: +44 (0) 20-7796-2112
mail@lbma.org.uk
www.lbma.org.uk

22 – 24
Commodity Investment World Asia 2005 Hong Kong
T: + 65 63-222-750
F: 65 62-263-264
lydia.sebastian@terrapinn.com
www.terrapinn.com

28 – 29
Securing Transactions in Emerging Commodity Markets
Amsterdam, Netherlands
T: +44 1392 271222
F: +44 1392 275 444
www.dayrobinson.com

August

8 – 10
Diggers & Dealers Mining Forum 2005 Kalgoorlie, Western Australia
T: +61 8-9481-6440
F: +61 8-9481-6446
www.diggersndealers.com.au

September

6
25th Minesite Mining Forum
London
T: +44 (0) 20-7395-1935
F: +44 (0) 20-7395-1931
www.minesite.com

7 – 8
IICONF - Las Vegas Gold Conference
Las Vegas, Nevada
T: +1 305-669-1963
F: +1 305-669-7350
iiconf@iiconf.com
www.iiconf.com

MARKET MOVES

Jordan Kotick to Barclays Capital

Jordan Kotick has joined Barclays Capital as the Global Head of Technical Analysis. He and his global team cover commodity, fixed-income and foreign-exchange markets.

Jordan was previously a vice president and technical strategist for JP MorganChase in New York, where he fulfilled a similar role. He is also currently the President of the Market Technicians Association (MTA) in New York.

Diego Parrilla to Merrill Lynch

Diego Parrilla has joined Merrill Lynch as Managing Director, where he is Head of Commodity Solutions, responsible for sales and structuring of commodity investment products for the EMEA region.

Prior to joining Merrill Lynch, he was an Executive Director of the Fixed Income, Currency and Commodities division at J. Aron (since 2001), and a precious metals derivatives trader at JP Morgan in London (beginning in 1998).

Stephen Pender to Fortis Bank

Stephen Pender has joined Fortis Commodity Derivatives, a division of Fortis Bank S.A./N.V., where he will cover market making in both precious and base metal derivatives. He reports to John King and Gerry Schubert in the bank's London offices.

Prior to joining Fortis, Stephen spent seven years with JP Morgan, working for five years in various back- and middle-office roles in Europe and the US before moving to their London precious metals trading desk.

Loco Logic

Clarifying the Complexity of Loco London

Editorial Comment by Jeremy Charles
Managing Director, HSBC Bank USA, NA, London Branch and Vice Chairman, LBMA

The next time you pick up the phone to purchase ten bars of gold or a lac of silver, take a moment to consider what that actually entails. Behind the simple term 'loco London' lies a complex set of rules and procedures as well as a considerable number of people.

Each gold or silver bar you purchased – now sitting as a simple credit to your loco London account – has in the process involved a range of unnamed people. They may have had to organise air or sea transportation; clear the metal through UK customs; and arrange armoured truck collection, delivery to a secure vault in London, unpacking, weighing on sophisticated scales, storage and accounting.

Much has changed since I started in the business 30 years ago. I clearly remember my first day at work after leaving school. I asked the rather imposing HR person at NM Rothschild in Croydon where I would begin my career, and was quite shocked when the reply came back: "The bullying department, Jeremy".

It was Thirty Years Ago Today

Back then in 1975, the market was dominated by speculators who ranged from the 'new' oil money of the Middle East to the 'old' oil money from the US and the occasional private-client money from Switzerland. The products on offer were primarily spot contracts.

Today both the players and the products have changed. The speculators have become investment gurus. Traditional spot contracts compete with a whole new range of products, from ETFs to capital-secured range-trading notes. Industrial applications for precious metals are considerably broader, and the financing and hedging tools offered by market participants have enabled themselves – as well as their clients – to continue to build strong businesses.

The common link throughout this ever-changing environment is still perhaps the least understood or even mentioned: the 'Loco London' clearing contract, which underpins each trade, whether it involves a simple transaction or a more complex derivative product.

Without this fundamental support, the London precious metals market could not exist in anything like the form it does today. Clients ranging from central banks to traders, miners, refiners, investors and fabricators all ultimately rely on one of the five members of the Loco London clearing market.

The LPMCL

These five do, in fact, operate a separate company – and one that few people realise exists: the London Precious Metals Clearing Company Limited (LPMCL).

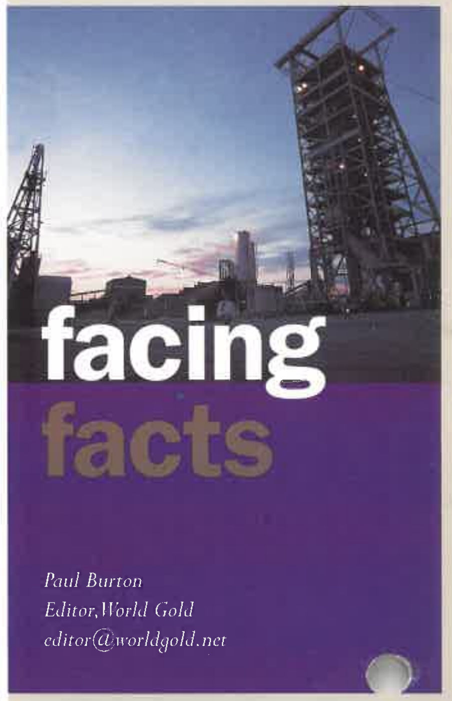
The LPMCL meets on a regular basis with the aim of ensuring the ongoing efficient operation of the London clearing system. This includes policing all metal that enters the system to ensure that the high standards set by the LBMA are maintained.

A recent development was last year's introduction of an electronic matching system to facilitate the smooth transfer of metal between clearing members. This system improves efficiency, enhances controls and should help to facilitate straight-through processing, which is now a high priority throughout the financial services industry.

In an increasingly onerous regulatory environment, the London clearers continually have to deal with the unexpected – the latest example being the type of pallet on which precious metals are stacked. No longer can pallets be hammered together by the vault manager. Today's hi-tech pallet needs to be fungus-free – and with its own certificate of conformity!

Issues on the horizon include the capability of London's vaults to continue to increase capacity to cope with an increasing array of investment products. Even the simple unallocated loco-London contract is underpinned by physical metal. With commodities increasingly in vogue, even a relatively small percentage of the global investment pot going into precious metals may put London's vault capacity under pressure.

As has been the case many times in the past, these issues will receive the necessary expertise, foresight and commitment to be resolved.
My thanks go out to the considerable number of people who work tirelessly behind the scenes to bring you 'loco London'. I was once one of them. ■



facing facts

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Acts – of God, Government and Others

Has the South African gold mining industry reached the beginning of the end?

Already suffering a loss of profitability because of the strength of the rand and the consequent relatively depressed gold price, the last few months have seen 'Acts of God' and labour unrest conspire to jeopardise the viability of a number of operations.

All this drama is being enacted in front of a backdrop of the continuing boardroom battle between the two largest South African producers, Gold Fields and Harmony.

South Africa has been the world's largest gold-producing nation for over a hundred years, but its output – and share of global output – have been shrinking since 1970, when it produced 1,000 tons, equivalent to roughly 70% of world production.

The corporate architecture of the industry was redesigned in the 1990s, allowing the emergence of Gold Fields and AngloGold Ashanti as global majors and prompting the expansion of Harmony and DRDGold from their one-mine roots.

Lower grades, higher costs and lower revenues from gold sales in the last two years have put a severe squeeze on margins, jeopardising the future of many operations. The latest casualty is DRDGold's Buffelsfontein, which has been liquidated and administrators appointed, with the loss of almost half DRDGold's reserve base and something like 6,000 jobs.

Earthquake!

Operations at DRDGold's North West Operations' No. 5 Shaft were suspended following an earthquake on 9 March that caused extensive damage. Then, a week later, DRDGold was forced to suspend operations at its NWO No. 2 Shaft following a further tremor, which knocked out three production panels. (NWO was already undergoing a review after the operation recorded losses of over R270 million in the six months to 31 December 2004.)

It came as little surprise therefore when DRDGold provisionally liquidated Buffelsfontein Gold Mines Ltd, the wholly owned subsidiary that runs NWO, on 22 March.

Amongst all this trauma, DRDGold received an unwanted offer from Simmer and Jack Mines to purchase its Blyvooruitzicht Gold Mining Co Ltd and its interest in Crown Gold Recoveries Ltd. The DRDGold board rejected the offer.

Despite the terminal nature of these developments, DRDGold chief executive Mark Wellesley-Wood was upbeat, describing the times in terms of the Chinese proverb, as 'interesting'. "We are truly living through a transformation and recently we have seen the best of success and achievement and the worst of challenge and obstacle," he told shareholders in a newsletter.

Partial salvation came on 5 April, when the company secured a rescue package, or at least bought some time, with an agreement with London-based Baker Steel Capital Managers to raise R180 million (US$29 million) through an underwritten share sale. Baker Steel will buy a total of 32.8 million shares at an 8% discount to the market price, 15.8 million of which can be 'clawed back' by shareholders at a rate of six shares for every 100 held.

The fund-raising was prompted by the company's auditor, KPMG. "The main purpose of the capital raising is to address KPMG's concerns, and redress the balance between current assets and current liabilities," the company said.

Liquidity and Labour Problems

Even if the company is kept afloat it faces liquidity problems of another sort.

Two NWO mines – Buffelsfontein and Hartebeesfontein – lie updip of AngloGold Ashanti's operations in the Klerksdorp area. If DRDGold closes NWO, and consequently stops pumping, AngloGold could have severe water problems. AngloGold believes, however, that NWO, as the updip operation, is obliged by law to continue pumping underground water even after their mining operations have ceased.

DRDGold is not the only mining company in South Africa to be between a rock and a hard place.

On March 30, the National Union of Miners declared a strike at all of Gold Fields' operations in a dispute over living out allowances. The NUM is demanding a 70% increase in the living out allowance.

The proposed industrial action, which would have affected 28,974 NUM members, was deemed to be unlawful and unprotected by the Labour Court when it granted Gold Fields an interdict preventing the strike action.

Meanwhile, Gold Fields' hostile suitor, Harmony Gold Mining, also had labour problems.

About 21,000 mineworkers went on strike at two mines after mediation efforts with the union over pay and working conditions failed. The NUM was demanding a pay raise, improvements in housing conditions and allowances, and also sought guarantees that miners who die of illness (mostly AIDS) or are killed underground will be replaced by relatives.

The principal reason for the strike was Harmony's implementation of continuous operations (Conops), which increase production by adding shifts (24-7 instead of 11 days in a fortnight).

The parties reached an agreement after a week, and employees at the original Harmony and Freegold operations returned to work. The strike, which lasted eight working days, cost the company approximately 45,000 oz in lost production, equating to approximately US$18 million in lost revenue.

Black Economic Empowerment (BEE)

While operational issues continue to beleaguer the South African producers, they also have to cope with uncertainties in the legislative architecture of the industry introduced last year with the new mining policy law that promotes the philosophy of Black Economic Empowerment (BEE).

The move to give blacks greater involvement in ownership of the industry is the most powerful socio-economic initiative within the mining industry in South Africa.

A key element of the Minerals Development Bill was the change from a system that allows private ownership of mineral rights to one of exclusive state ownership, with exploration and mining activities being licensed by the government.

Under the terms of the Charter, HDSAs (Historically Disadvantaged South Africans) were to participate to a level of ownership of 26% within 10 years, with an interim target of 15% to be achieved within five years. A "scorecard" would be kept by the Department of Minerals and Energy to record progress by each company.

The scorecard was designed to translate the qualitative objectives and targets and spirit of the charter into quantifiable measures so that the minister could adjudge the progress of mining companies as they implement the agreed changes.

As the mining companies go through the transition from 'old style' mining licences to those dictated by the Bill, they face many uncertainties, since the scorecard often provides little guidance for the industry. The clauses are short on concrete details and long on subjectivity, especially as the Minister has discretionary powers.

Therefore it is difficult to be optimistic about the gold industry in South Africa as labour unrest threatens stability and poor margins give the companies little leeway to negotiate with the NUM. ■

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