

# Precious metals: 2010 market outlook

December 2009

## Gold and precious metals march on: shiny prospects in 2010 and beyond

- Economic recovery will lead to increased industrial demand for silver and platinum
- Low interest rates support the ongoing gold bull market
- Emerging nations continue to diversify reserves away from US dollar and into gold
- Increasing demand in BRIC nations for autos supports platinum prices
- Mine production still being hampered by power supply issues

The current gold bull market can be traced as far back as at least 2001 when a confluence of supply and demand factors drove prices to new notional highs, and we believe we have not seen the end of this run quite yet. Accommodative US monetary policy, unrelenting strong investment demand and reduced central bank sales of physical gold reserves are all supportive of higher gold prices and we expect these trends to continue over the next 12-18 months. Silver and platinum prices will benefit from the same trends, while also benefitting from improving industrial demand as the economic recovery grinds on.

### Low interest rates expected to remain

Expectations are that the US Fed is likely to keep short-term interest rates low throughout 2010 and into 2011. While clear signs of economic recovery in the United States are evident it is also apparent that the recovery is slowly building steam rather than launching rocket-like from the economic crisis. It is also clear that while inflation is starting to tick up and will likely increase moving forward, for the time being it is well contained. In this scenario, not only is the Fed encouraged to maintain low rates in order to spur economic activity, they are not pressured to raise them to contain inflation. This low interest rate environment is very supportive of gold prices; while a key risk to this factor is the Fed raising rates earlier than expected, we view this as unlikely.

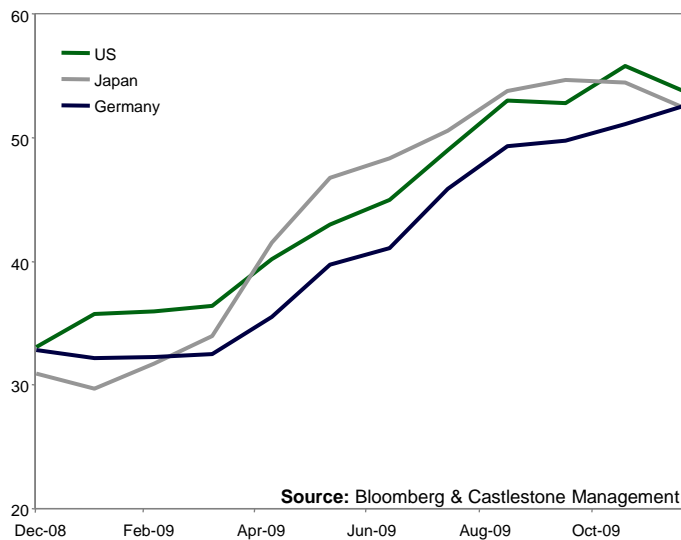
### Supply constrained from both flat mine production and central bank sales

Gold is largely considered a financial asset due to its importance to global finance, but it is still a commodity and thus reacts to physical supply changes. New gold production from mines was largely flat from 1996 through 2008, range bound between 2,450 tons and 2,550 tons. While rising prices have spurred increases in scrap supply, it is telling that mine supply has been unable to increase even as prices have been soaring. It is important to remember the power problems facing South Africa that drove prices of both gold and platinum higher before the financial crisis. Those problems have not gone away; they have merely been hiding behind the financial crisis, and in the case of platinum, reduced auto demand. They will come back to the fore as economic stability increases and, again for platinum, the auto industry continues to rebound.

Central bank selling has traditionally been a major source of physical gold supply; we have seen this decrease dramatically over the last several years as developed nations maintained gold reserve levels and emerging market countries increased them. In particular China, India and Russia have all been diversifying reserves away from the US dollar and into gold. Net gold sales have decreased from 593 tons in 2005 to merely 18 tons in 2009, including the 403.3 ton sale from the International Monetary Fund (IMF).

We expect this to continue as emerging markets continue to diversify, and we see significant room for demand growth in this area: European reserves are currently over 50% in gold, while China is at less than 2% and Russia at less than 5% in gold. They have been increasing their mixtures quickly however, and we believe they are not done diversifying away from the US dollar.

### Industrial production rebounds



### Investment demand continues to boom

Even if central banks remain net sellers of gold, investment demand has been skyrocketing and we expect it to continue to outweigh central bank selling and any mine or scrap supply growth through 2010 at least. This increased demand is caused by several primary factors as investors seek currency hedges, a negatively correlated alternative to the major asset classes, as well as a safe-haven hedge against coming inflation. Gold continues to appeal to a broad range of investors as well, from individuals of varying net worth and from pension funds to hedge funds on the institutional side.

Investment demand has grown from 12% of total demand in 1999 to over 44% of total demand in 2009. January through April of 2009 saw ETF demand equivalent of 13 million troy ounces of gold; only 8 million troy ounces were bought in 2008 as a whole! While some slowdown can be expected we believe investment demand will remain strong throughout 2010 and will only be reduced significantly when the Fed begins a tightening cycle.

## Silver and platinum

As precious metals, silver and platinum benefit from many of the same market drivers as gold. While not typically a major reserve of central banks, investment demand has been increasing for many of the same reasons as for gold. But as metals with greater industrial usage, they are more highly leveraged to the improving economy. Platinum, which is primarily used in catalytic converters, will benefit from improving auto sales as Goldman Sachs expects strong demand in BRIC nations and a rebound in US auto sales in 2010. Silver is highly leveraged to the electronics sector and rebounding industrial production in 2010 will push prices higher.

## Supply versus demand

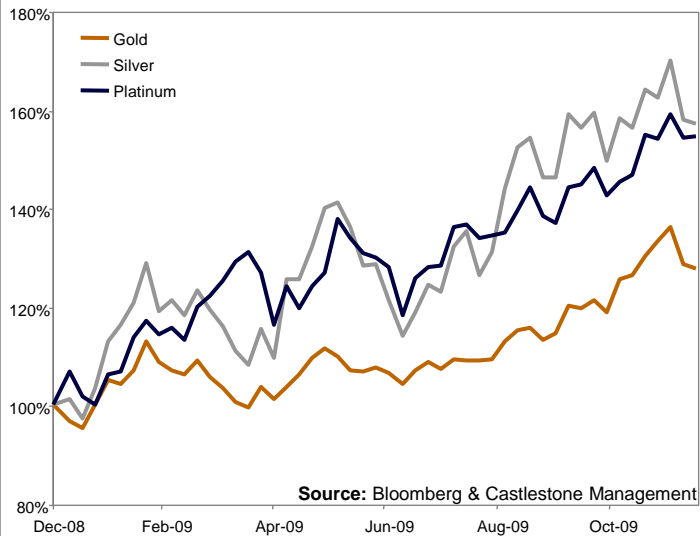
What has been outlined here is the typical situation of demand exceeding available supply pushing prices higher, and our expectations are that this will continue for the next 12-18 months. Continued low interest rate policy in the United States, significantly reduced central bank selling of gold and booming investment demand will continue to drive prices higher.

World Supply (Tons)	2008	2009
Mine Production	2414	2502
Official Sector Net Sales	236	16
Old Gold Scrap	1209	1485
<b>Total Physical Supply</b>	<b>3859</b>	<b>4003</b>

World Usage (Tons)	2008	2009
Jewelry	2191	1770
Other	693	650
Bar Hoarding	392	165
Net Prod. Dehedging	351	78
Net Investment	232	1340
<b>Total Usage</b>	<b>3859</b>	<b>4003</b>

Source: Bloomberg & Castlestone Management

## Gold, silver and platinum 2009 price gains



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