



Telling the Tale for Metals and Resource Stocks

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India's central bank taking 200 tonnes (6.4 million oz) of **gold** from the IMF in an off market trade has certainly lit a fire under the yellow metal. While a trade of that nature was anticipated, India, which is about the savviest of commercial gold players, was not atop the expected buyers' list. Given the greenback was steady and that gold's chart went near vertical when the overnight rumor became official, it is likely that the big long position that came into the market forced some covering on the short side. Is this more than a spike?

We think India's move could be, in part, a signal it should have a bigger chair at economic tables, which we agree with. Since Indians are the biggest gold buyers on the planet, lifting a perceived overhang from its market has the side benefit of protecting an existing wealth pool of its citizens. And the near US \$7 billion price tag is not large against India's \$260 billion foreign reserve holdings.

However, it does have a bigger impact on gold's market (about \$115 billion annually, now) and that got noticed. Also, it will further establish the notion of a currency basket that includes gold as a global trading medium, and conversely a weaker greenback. That should continue the move of capital into gold as \$ hedge.

In saying that, we realize that it would be tough for gold to replace the oil market as a home for dollar hedge trades simply because of the oil markets much larger scale. But oil can not continue to gain without causing major problems for the near term economy, nor can oil rise if other energy components are not doing the same. Scale aside; gold makes sense as a place to place anti-dollar bets, and especially for players worried about longer term wealth preservation. But so too do other metals.

If **copper** does truly have a PhD in economics (not that that title has quite the allure of a few years ago), our take has to be that the Doctor is mulling over an extended lunch. The red metal's price continues to bounce against the \$3/lb (\$6600/t) level even while available stockpiles have grown. There has been a slight decline of stockpiles in the past few days, but that was after having recouped 60% of the drawn down earlier in the year.

Clearly, new metrics are at work. We and others have already pointed at Dollar roulette as one. In fact that is a big part of the whole market these days, and it's an issue that will grow in the telling. There has also been a build up of small supply disruptions in copper, such as the shut down of most output from BHP's Olympic Dam mine in South Australia. The mine's capacity is less than 1% of global copper supply (but a big chunk of uranium output), but this isn't the only mine at reduced capacity.

The psychology of relatively minor supply disruptions when new mine development is still limited may be adding some price support. The other base metals are similarly in a neutral pose these days. Rumbblings about a better market are most prominent around **zinc**, as are concerns about maintaining concentrate streams to smelters outside of China. That would be next year's story, but it is worth noting. For the past century or so mines were dictated to by smelters, but now smelters are worried about keeping their market shares and the balance of power has been shifting.

As with most things in this changing market landscape, it is tough to make assumptions about the next six months. That simple truism is driving things right now, if being in neutral could be called "driving". Producers' share prices are shifting down with the market, but still finding support. It may well be the balance of the year will mostly be about ensuring gains after a strong uptick, and making cash for future events.

There has been more weakness due to profits taking in some of the early exploration gainers. Conversely, former laggards have been able to pick up steam by showing project advancement. There is a general sense of rotation out of strength and into future potential, at least in our part of the playground. That is meaningful.

As broader stock market gains began to peel away, we have been struck by a consistent lift in one measure. While other North American equity markets saw share turn over slide along with prices, the TSX Venture exchange has actually seen daily volumes as strong as they have ever been. This is not dollar-volume, and some of it can be accounted for by share issuances that are bloated by historic standards. It does however indicate that there are still punters out there.

While we think of the Venture exchange as a proxy of the junior resource sector, other sectors are obviously part of it. Funding for the Tech space is reviving a decade after that bubble burst, and green energy concepts are growing in number. However, on checking volume leaders most days the lists are at least nominally composed primarily of resource deals.

Bears might argue this is desperate averaging down ahead of the next major down shift in the market. It doesn't look to us like the random buying during the bounce of a bear market rally. That type of buying typically comes in spurts, and focused on companies based on their previous market strength. Nor frankly do we think such buying is very likely after last year's market drubbing.

This is a sustained turn over that relates to broader markets only in terms of showing patience on weak days. It is focused on companies that do have underlying assets, regardless of how well they made markets in the past. We see a concerted effort to own resource assets in juniors while they are still in the bargain bin. And we believe this is being done by folks who have been around the sector long enough to recognize that US\$ roll over and supply constraints are still near and mid term factors.

To anyone who thinks we are drinking our own bathwater we can only say, you're right. We are not suggesting that simply because "the usual suspects" are coming to the venture side of mining that prices will go up. Nor does this buying mean they all expect immediate gratification. However, there is a mood building for significant gains for the sector this coming year. Even market watchers with large concerns about the broader economy are recognizing that the resource sector has good fundamental potential. Both supply-demand against Asian growth and the shifting currencies market favour it.

We do expect the balance of the year to have a significant cash generating ethic. After the roller coaster ride we have had that kind of prudence is to be expected. Despite base metal prices holding up, that kind of thinking is evident by consolidation amongst the producers in that space. Gold producers have been doing better, and for the time being we continue to expect this to be the preferred subsector in the metals market.

There may be some frustration with explorers who seem not to be living up to their results, relative to peers, after putting in strong performances. Taking gains along the way will continue to be important, but we also expect rebalancing that will include stronger recognition for undervalued assets. That is usually a question of moving through volume, and the market shifts that take place through year end.

Barring an "event" of some magnitude, it will take an accumulation of stats indicating how well economies are doing as their government stimuli slow down to shift the market too far off its current groove. That is will be next year's story, and we think it's too soon to make assumptions on the outcome

For the time being we will remain on volume watch, both in terms of metals directly and the equities that deal with them. We continue to favour speculations that can generate drilling success, while accumulating those that are still waiting for a mood shift in the market that will lead traders to recognize their already established values. Ω

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