



School's Back

Few are convinced they can read a direction for the broader markets. China is applying breaks to its loose debt conditions, but it may take a few months before that impact is seen. The one market where caution seems to be abating is that for precious metals.

Gold continued its sideways move through August, but has broken new ground quickly in September which is usually its best month. Q2 figures from GFMS (<http://www.gfms.co.uk/>) indicate that Indian demand continues to be weak (down 38% y/y), but that demand continues to strengthen in China and the USA. Middle East purchase was up from the previous quarter though still down on a year/year basis. Central Banks were also net buyers of the yellow metal for the first time in many years, and miners continue to reduce their forward sales on an orderly basis.

This is a market primed for gains against declines for the US\$. Most consider that a matter of time. Just now few want to be too precise on timing anything, but most expect an uptick for the yellow metal. That may be all it needs, and the "when" may be at hand.

Speculative gold stories bringing strong results to market are doing well, and lower tier mergers are picking up. Valuation on defined ounces is also gaining ground again. In short, buying of the sector as an asset class is underway. Though silver has been charting its own course this year we now view it in a similar light.

Base metal prices continued to gain through August in spite of resumed builds in market stockpiles. The combined gains for copper stockpiles in London and Shanghai are now over 100,000 tonnes above recent lows. Nickel stocks have been only marginally reduced by the continued lack of output from Canadian mines. Zinc stocks have continued a near relentless gain that has generated a 300% increase from their lows in 2007's hot market.

Metal price gains reflect speculation on near term demand gains from a bottoming of western recessions. Most base metal equities are acting toppish, indicating concerns about the stockpile builds. We have been looking for copper price consolidation that normally brings excess stocks to market. Instead the price ran to over \$2.95/lb (\$6500/t), which is above many hedge books' pricing.

Number crunching on the costs of replacing existing hedges aside, cash flows for most base metal miners should be improving much more quickly than the market is currently indicating. While we are with the market in looking for metal prices to pull back, a move back into the space could follow quickly on the heels of a bottom forming. And with that will come a greater interest in asset plays.

Xstrata announced it won't immediately re-open its Kidd Creek copper smelter in Timmins Ontario after a summer break; the usual flow of copper cons from the Sudbury nickel mines is still unavailable for it. That smelter can produce 300Kt a year, or roughly the current LME 6-day stockpile. Capacity elsewhere can make this up for the time being, but it's worth noting Xstrata prefers to maintain staff on standby rather than operate at inefficient capacity levels.

Lead smelters in Shaanxi province have been shut down due to high lead concentrations in local children. There may be more closures as the overall extent of the problem is uncovered. We expect a general theme of closing polluting facilities in China to grow. Pollution has been an unhealthy byproduct of most growth spurts, and as we have said before this is an issue China's government has to get on top of. Lead's price and stocks have risen in a pattern akin to zinc with which it is usually a co-product; price gains for lead may hold due to the health hazard in China.

Zen's New Flower?

Japan has just changed its government for the first time since before World War II. How much change actually comes of this is an open question, but for this fatalist culture the act of change is of itself news. And news of a sort that could become important to the planet's shifting economic sands.

Of wealthy nations, Japan has by far the largest government debt to GDP ratio at an outlandish 180%, and the highest rate of personal savings. Its aging population has the highest dependency rate, the lowest unemployment base, and lowest workforce participation rate for women in the industrialized world. Population decline is tough on Japan's comparative stats, so its per capita growth can go unseen.

The new government came in on promises of shaking up the system of bureaucratic golden parachutes (into state funded enterprises) in order to pay for increased funding for child care and related issues. These sorts of changes can create an atmosphere in sympathy with unleashing some of Japan's trillions in low-interest savings. That, potentially, could represent a massive addition to Asian investment while generating revenues useful to paying down government debt.

Regardless of what change will bring in Japan it is worth watching for. Japan seems to us a place that, once it reaches a new consensus, is able to turn on a dime and begin acting on it. And Japan is the poster child for both developed economies' and China's nascent demographic shifts.

Japan's lack of immigration has put it ahead of the west on the demographic curve. Now relative wealth creation is moving away from the industrialized west, and poorer areas are gaining access to markets through a communications revolution. Wealth is not the only reason for migration, but it's an important aspect of it. It is time to begin thinking about growth net of population change, before it becomes a bigger issue than it needs to be. That, hopefully, will govern the shifts Japan seems to be preparing for.

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