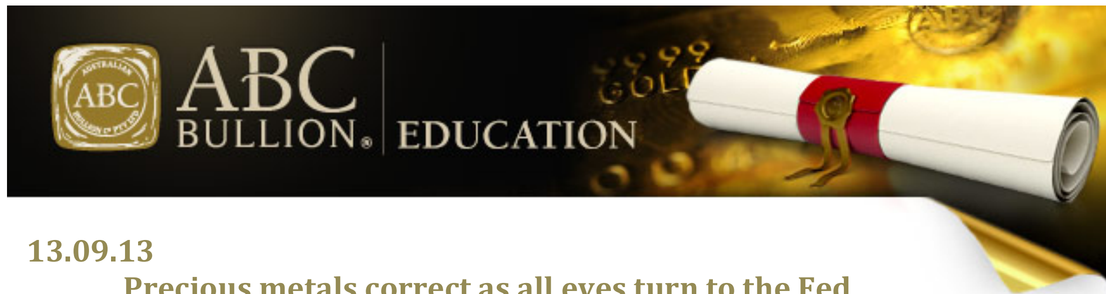

13.09.13

Precious metals correct as all eyes turn to the Fed

It's been an eventful week for precious metal investors, with prices jumping around significantly over the past few trading days.

Markets originally sold off late last week as a stronger than expected non-manufacturing report from the Institute of Supply Management (ISM) suggested renewed strength in the US economy, which inevitably led markets to more fully 'price-in' a tapering of quantitative easing (QE) by the Federal Reserve (the Fed).

The report, which also came out on the same day as a continued fall in initial jobless claims in the US and a lift in non-farm productivity, saw gold sold down to below the USD $1370 level, with silver suffering as well.

All this led to a very nervous market for gold investors last Friday; had the ISM number been followed up by a strong US non-farm payrolls report (widely perceived by the market to be the best gauge on the overall strength of the US labor market), then we may have seen gold sell off aggressively.

This wasn't to be though, as the report released was a huge miss to market expectations (which had risen to over 200k jobs in the wake of the ISM print), and saw a sharp spike back in the USD spot price for both gold and silver, which closed out the week at USD $1387 and USD $23.05 respectively.

This meant that investors suffered losses of -0.56% for gold investors and -2.5% across the course of last week.

It capped an interesting fortnight for precious metals too, which had originally seen gold prices head above USD $1420, with a corresponding move by silver into the US $25 region at one point, before largely reversing these gains, and settling back around levels they were first seen at around the 23rd August.

It has also led to a lot of internet chatter and analysis as to whether the recent rally in precious metals prices is now over, and we are about to resume the cyclical bear market, or whether the recent pull back is just a well deserved breather before prices head north in the months to come.

Market movements over the last few days would tend to indicate that those in the more bearish camp are correct (at least in the short term), as the last few days have seen continued weakness, with falling over USD $30 overnight, currently trading around USD $1330, with silver also falling, currently sitting at USD $22.33

With corrections like this, it's clear that it's too early to be 100% certain that the cyclical bear market in precious metal prices is over. There's clearly some chance we could see gold head down into the USD $1200 range again.

That's not to say that those who are adamant that the June low was indeed the end of this corrective cycle are wrong, and uncertainty around the short-term direction most certainly doesn't mean I'm selling my precious metals (in fact I've been adding to positions throughout the last few months), but it is just an observation that sentiment is still largely negative. There is a huge question over what the Federal Reserve will do next week with regard to quantitative easing, and a sell-off in the metals wouldn't be entirely surprising in this context.

The hope for a "peaceful" resolution to the Syria crisis has also contributed to the weakness in metals the past few days.

Of course, if we do end up with an escalation to the crisis there, and end up in a 'shooting war', it would obviously be bullish for metals prices, as unfortunate as the underlying reason would be.

How about that US Jobs Report?

Whilst next week will be all about the Fed and QE tapering, it's worth looking in some detail at the last US jobs report, to help assess the underlying of the US economy.

Let's start with the headline. According to official reports, the United States added 169,000 jobs in the month of August. This was not a terrible headline number, but it was short of market expectations, which were closer to 180,000 and had crept up in the previous 24 hours.

What was disappointing were the revisions to the reports from July and August (the numbers are always revised a couple of months back), which showed that across these two months, some 74,000 fewer jobs were created vs. what was originally reported.

Furthermore, whilst the headline 169,000 job number wasn't bad, the quality (in terms of the level of remuneration) of the jobs created was disappointing, with 144,000 thousand of them in lower-paying industries like retail trade, leisure and hospitality, temp help services etc.

At the same time, the official US unemployment rate fell to 7.3%, down from 7.4% the month previously, but even this was a misleading print, as the reduction was purely due to a significant reduction in the labour force, which saw over half a million Americans leave the labour force in the past month alone. This recent reading now puts the labour force at levels last seen in 1978, a truly alarming statistic.

Finally, in another disturbing development, household food stamp usage hit a new record high in the last month, with a record 23.12 million households (and

47.8 million individuals) now needing assistance just to put food on the table in the USA.

For some further reading on the unemployment reports, including some fantastic charts that really put the employment challenge into perspective, see here.

As a final article of note for the week in relation to the US, I thought that readers might enjoy this chart available over at Business Insider, which shows the incredible pieces of legislation enacted in order to 'save the economy' during the period 2007-2010.

TARP, TALF, HAMP, Fannie Mae and Freddie Mac conservatorship, liquidity facilities – you name it, they've tried it, and six years later we're trillions further in debt with no economic recovery on the horizon.

Time to look at your super fund?

With the election out of the way, Australians can now get back to their daily lives without being bombarded by the daily circus that was the recent campaign. No doubt we'll get a lift in consumer and business confidence, which is typical in any post-election period, but it won't change the underlying problems that the Australian economy faces, namely seeing unemployment rise, inflation continue to threaten and businesses struggle to maintain profitability.

With that in mind, the following article is worthy of readers' attention, especially in light of the incredible returns typical superannuation funds achieved last year. The bottom line is that Australians would do well **not** to expect this kind of thing to be repeated, as the rise in equity markets (which dominate the exposure of traditional superannuation funds) was not related to an improved economic outlook or corporate profitability.

As David Murray, former Future Fund Chairman and ex-CEO of the Commonwealth Bank stated: "*we are only five or six years into the post-crisis period, which isn't very long*", as well as the fact that "*the investment returns in the period from 1985 to 2007 were unusually high*".

Whilst it's been great to see these funds do what they've done in the last 12 months, I'm still more than happy with my decision to set-up and run my own self-managed super fund, which gives me full control over how my retirement savings are invested, and allows me to invest in physical gold and silver.

Until next week,

Jordan Eliseo
CHIEF ECONOMIST

ABC Bullion

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