

# Metals Outlook: Are The Best Years Past?

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Last year was a one-way street for metals. While [grains](#) and [crude oil](#) saw gains, no sector enjoyed higher gains or as much media attention than metals, especially [gold and silver](#).

While there was a brief sell-off earlier this year, precious metals have resumed their upward climb, moving past old records and approaching historic valuations. Now, the question is how much higher can they go?

"Looking at commodities in general, last year we had a very good recovery in global GDP growth. That's why most commodities have done so well recently," says Tom Winmill, portfolio manager at Midas Funds. "Some people are looking over their shoulders at 2006-2008 and wondering if we're at the high end."

Moving forward, analysts expect precious and base metals to look to different factors and even different parts of the world to guide them through the rest of 2011. Unlike many other sectors, metals face different fundamentals with gold in particular acting as a currency.

## Currency metals

It is easy to tell how much "gold fever" has gripped the nation; just look at the increase in the number of "Cash for Gold" advertisements you see. The latest gold frenzy is easy to understand considering [gold's recent top over \\$1,500](#) an ounce compared to its historical average.

"If you look at annualized prices, even during the crisis period, there was an average gold price of \$759. Even in 2009, the annual average gold price was only \$972," says Jon Nadler, senior analyst at Kitco Metals Inc., North America. "The window in which we've had four-digit gold prices has only been a year plus a few months. Take the entire decade of the bull market and the annualized price of gold was only \$540."

Gold opened 2010 at \$1,099 an ounce and closed the year at \$1,421, nearly a 30% gain. It is no surprise that some of the top performing managed funds last year were those that allocated to gold, such as the Superfund Gold Series B-1, up 53.53%, managed by Superfund Capital Management. That fund is a testament to the popularity of gold as it offers access to a traditional diversified trend-following program priced in gold.

Not surprisingly, gold scrap supplies helped flood the market last year, too. Nadler

says gold scrap was up 27% in 2009 and it was up another 22.5% year-on-year in the second half of 2010. "Scrap [gold] supply is very elastic. The higher prices go, the more scrap comes back into the market," Winmill says. "Demand for jewelry production also is very elastic, meaning as gold price goes up, people decide they don't need that gold bracelet."

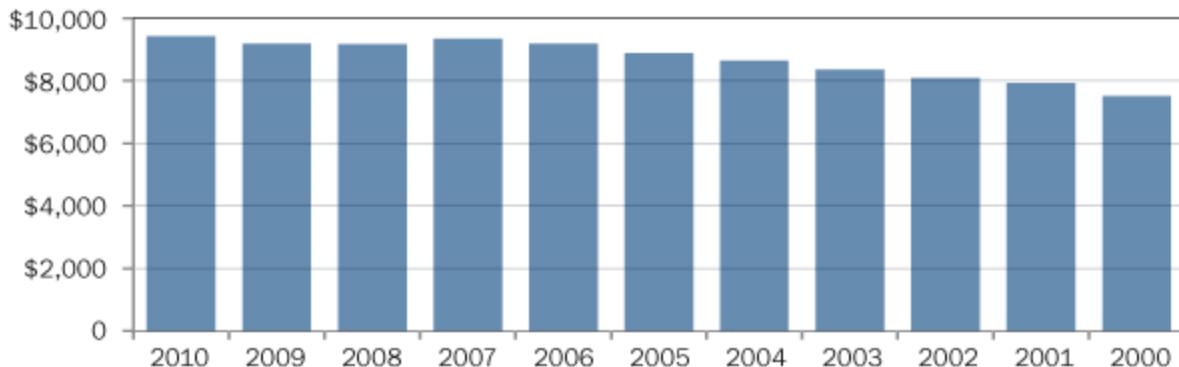
But supply and demand factors based on gold as a commodity aren't moving the markets as much as gold's traditional role as money. "It's really the money flows created by the fiscal and monetary policies of the United States," Winmill says.

## ANOTHER INFLATION GAUGE

While the Consumer Price Index is the most common inflation gauge, the Fed often watches the Personal Consumption Index for a more accurate, or convenient, reading.

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### PCE Index (2010-2000)



Source: [www.data360.org](http://www.data360.org)

Winmill doesn't expect a change by year-end and is forecasting \$1,600 gold prices by then. If things really start to improve and the Fed raises rates, he says gold could drop to \$800. Streible is even more bullish for gold with a year-end target of \$1,650. Even if the Fed begins to tighten, he expects a short-term correction but then a resumption of the upward trend.

Nadler is much more bearish. "Even if you just stall on investment demand, we could see \$200 in losses in just a couple of months. If there is a little bit of liquidation, we could lose as much as \$350," he says. While he pegs support levels at \$1,400, \$1,380 and \$1,150, he expects a pull-back to materialize later this year that could see gold fall to \$900. "Ned Schmidt, another industry veteran, says to buy gold 1) On an intermediate buy-signal, 2) when gold is under \$1,000 or 3) if the year-on-year change is 0% or less, depending on what your base currency is," Nadler says.

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### Silver shines

While gold made record highs in 2010, silver posted even more impressive returns with an 82% increase by year-end (see "Silver spoon fed"). "Silver is basically gold on steroids," Nadler says. "In a recent webinar I hosted, it was almost unanimous that everyone on the panel felt that the 'specs' had invaded the silver space, and they are quite possibly going to offer some 'surprises' for small investors." (See "[Gold & silver: Always a good option](#)").

## SILVER SPOON FED

While gold was busy making headlines last year, silver recorded an impressive 82% gain for the year.

Silver weekly (continuous)



Source: eSignal

The result has been silver donning its precious metal hat more so than its industrial hat. "Silver is still a combination of both, but more of the precious metal has been a driver of it because we've seen more days where gold and silver work together as opposed to silver and platinum/palladium," Streible says. "Although we're at the higher end, \$37 is still much easier for a person to part with than \$1,400 for an ounce of gold."

If silver were mostly playing an industrial role right now, Winmill and Nadler both say price would be under \$20 an ounce. This has led some to suspect manipulation.

While no formal inquiry has been reported, some analysts say that what appears to be manipulation can be explained by other factors. "Silver is a relatively small market of about \$25 billion, so it's basically like the whole world wondering what's going to happen to a medium-cap stock," Winmill says. "It's kind of divorced of its fundamentals, and price largely is being driven by speculative activity. That is pushing this relatively small market even more than other commodities."

Further, while prices are approaching the 30-year record high set in 1980 when the Hunt brothers definitely were trying to corner the market, Winmill reminds that prices today would have to be around \$100 to be on a comparable scale, taking inflation into account (See "Jarecki's law").

Looking forward, analysts warn that silver could be more volatile in 2011. "Silver is the single riskiest asset you can own. It's something that easily can outperform nearly everything else, but the risk factor is at least twice that of holding gold or most other asset classes," Nadler says.

Streible puts support at \$32.50 and \$26.50 with resistance at the Hunt brother top of \$42. "If we take that out, it'll go at least to \$50," he says.

Winmill expects \$30 an ounce by year-end, but price could be anywhere between \$28 and \$40 for much of the year. "Ultimately, speculative fever tends to wash out. It could get to \$45 or \$50, but it will probably spike up and spike back down," he says.

Nadler expects the same pullback in silver as he envisions in gold, with silver prices dropping to near \$20.

### New industrials

The Japanese earthquake on March 11 set off a string of losing days for platinum and palladium as car manufacturing slowed in Japan. "When you're talking platinum, palladium and copper, all three are used heavily in the automotive sector. Platinum and palladium are used in catalytic converters, not to mention 50-60 pounds of

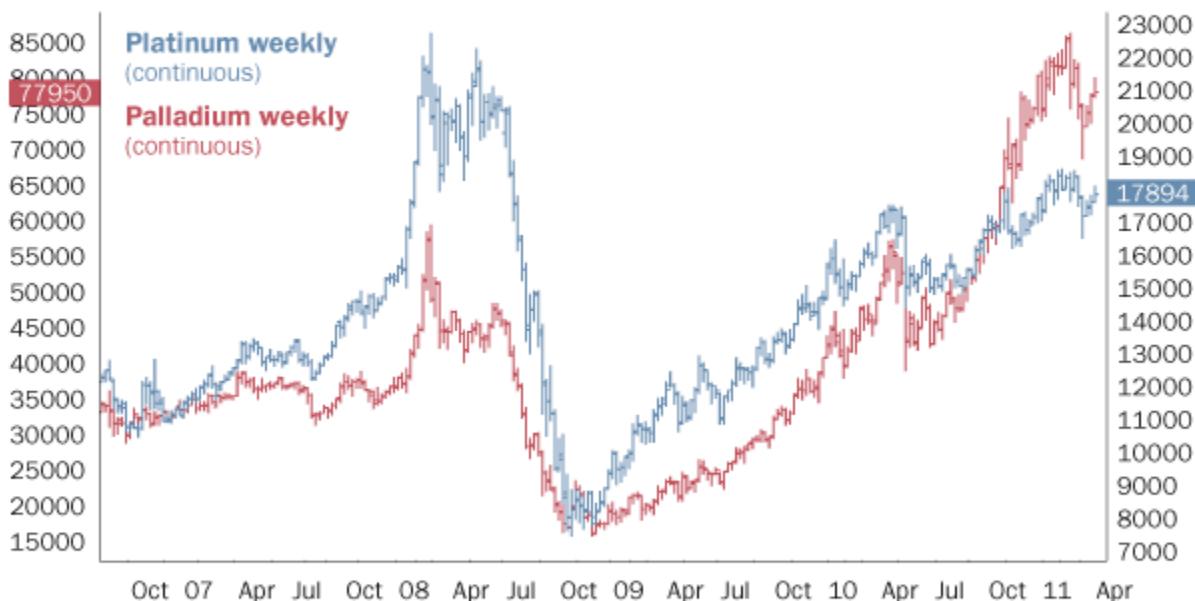
copper go into each car," Streible says. "As long as there is a slow-down on [Japanese] automobile manufacturing, demand is going to slump on those metals significantly."

Industry consultancy IHS Automotive says total Japanese automotive production has been curtailed by 400,000 units since the earthquake struck.

While tragic, analysts don't expect the [Japanese earthquake](#) to have a long-term downward impact on metals. "Going six months to a year out, platinum and palladium prices will be higher as demand ramps back up (see "Climbing back up"). Think about all those automobiles that were destroyed; those eventually will need to be replaced," Streible says.

## CLIMBING BACK UP

Platinum and palladium both were hit hard in 2008. With automobile demand picking back up, palladium is above pre-crash prices and platinum isn't far behind.



Source: eSignal

A wild card factor, Streible adds, is Russia, as they have had palladium supply crunches in the past. He sees \$1,680 holding for platinum with a potential upside to \$1,800. Palladium has support at \$680 and may reach \$800-\$850.

Nadler expects palladium to outperform platinum this year because it has a tighter supply and is equally vital in those applications where manufacturers can't substitute.

Winmill disagrees; he expects platinum to end the year with about a \$50 gain and palladium to have a \$50 loss.

Whereas most of the platinum and palladium attention is focused on Japan, copper's focus is on China. "Copper is a China-based situation. Will China stockpile if prices remain high? Will China tighten and slow economic growth? Will the empty buildings in Shanghai come to mean anything to copper speculators?" Nadler asks. "We ran to records that were obviously overcooked. However, that's become a symptom in the whole complex."

[China](#) has been the bright spot in a world struggling to find signs of economic recovery. Unfortunately, that bright spot became a solar flare as inflation began running rampant, leading to numerous interest rate increases from the People's Bank of China (PBOC) as well as increases to reserve requirements in an effort to stymie inflation.

"Short-term and even medium-term, look for tightening in copper speculation as China continues to try and fight inflation. It's a snowball effect in that if you can't get a loan, you don't build and so you can't speculate on the real estate market," Nadler says.

With high prices, the question has become: Will China continue to buy at these levels? "They're very savvy players; they buy low and sell high," Winmill says. "I could see the Chinese pulling out of the market at these prices to try and bring price lower." He sees copper prices settling down through the rest of the year with a year-end price of \$3.75-\$4.25 a pound.

Streible says to watch manufacturing, rebuilding in Japan and ending stocks in Shanghai and the LME for market tells. He says \$3.85 is proving to be strong support that should not be violated and resistance is at \$4.50 a pound.

Metals had a historic year and many traders are hoping for a repeat. While many analysts are bullish for this year, each metal has taken on its own personality and place in the investor's folder. "In the long-term, five to 10 years, gold is going to have a wonderful place in most portfolios. Medium-term, if you're OK about the economy, I'd look to platinum and palladium," Winmill says. "Short-term, if you like to roll the dice, then go with silver. The metal I'm most bearish about is copper. If there's a hiccup in the economy, copper could go down substantially."