THE HIGHTOWER REPORT

Futures Analysis & Forecasting

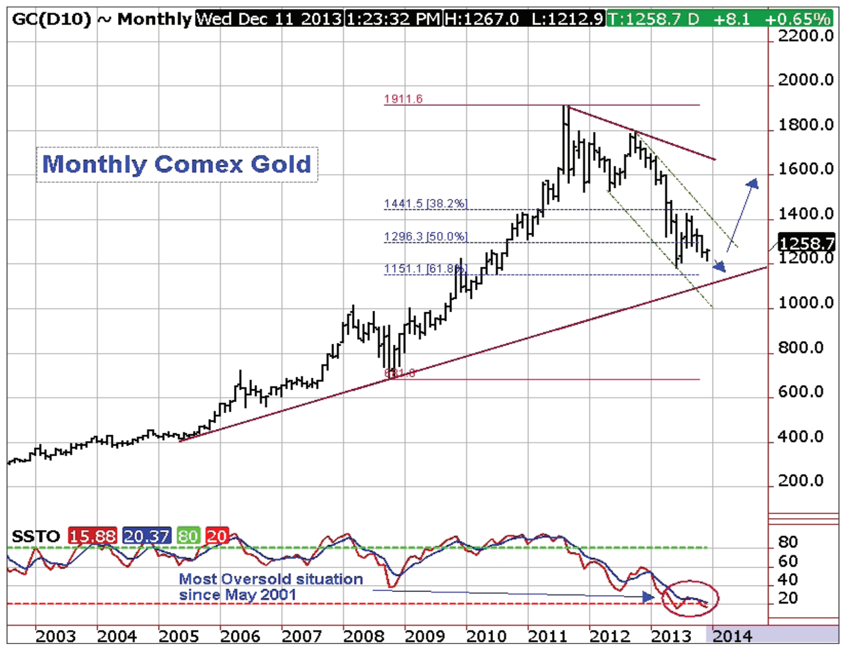
SPECIAL REPORT

HightowerReport.com

December 11, 2013

Long Term Outlook for a Major Low in Gold and Platinum-Group Metals

The last 2 1/2 years have not been good for the gold bulls, as consistent and sometimes violent declines in gold prices have injured sentiment and chased away potential investors. In our opinion, gold is in the midst of a transition from being a safe haven/currency surrogate instrument back into a classic physical commodity with a return to good old-fashioned supply/demand tightness. However, we do not think the transition will be easy or quick. Replacing residual flight-to-quality long interest with physical-related buying could be very difficult at the start of 2014, especially if the markets see the threat of actual tapering from the US Fed. In a nutshell, we think the slow but powerful arm of economics is set to tighten the fundamental situation for gold. Many times in history the market has made fantastic tops and bottoms, and we suspect that the low of 2013/14 will be no exception.



The key argument for a major bottoming in prices is that production in Africa continues to decline. Industry consolidation due to spiraling wage pressures and the financial pressure being forced on mining companies have meant that capital

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expenditures have been slashed in the face of a necessity for deeper and deeper mining activity. The cost of mining ultra-deep deposits is significant, and the risks to mine workers are rising. These issues are likely to pressure mining companies into increasing automation and reducing their workforce. If there is any additional significant downside price action, the markets could be confronted with idled production from both South Africa and Zimbabwe. This could start a bull trend. Already, many South African mining companies are claiming that escalating labor and production costs are forcing them to curtail capital and exploration expenditures, potentially limiting supply growth. In addition, there is a threat of additional strike action in 2014 when more mineworker union contracts come up for renewal.

Escalating Mine Costs

WAGES		
	Mining	Non-Mining
South Africa, % Gain 1978-2013	78%	17%
ENERGY		
	1978	2013
South Africa Electricity Cost	1 c/kwh	50 c/kwh
SHALLOW VS. DEEP MINING		
	Shallow (Pit)	Deep (~3.5km)
Temperature (F)	70	140
Pressure (tons per square meters)	10	9500
Humidity	45%	100%

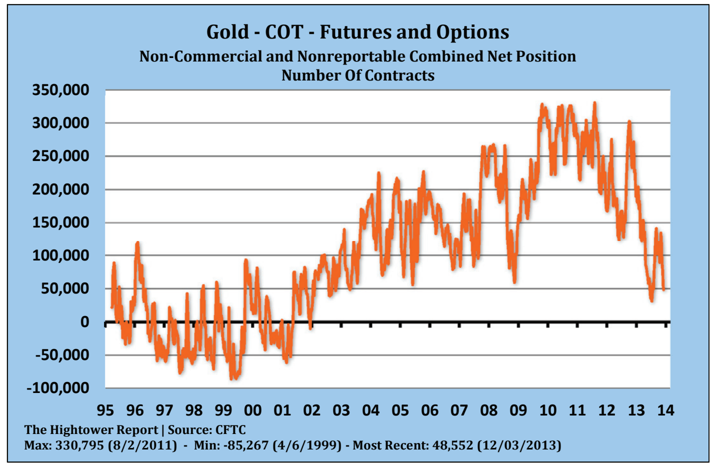
The moral of the story is deep mines are nearly impossible environments to maintain: 140 degrees, 100% humidity, increased rock instability, increased death and higher costs!

The Zimbabwean government has already recognized the need to recapitalize and retool their gold and platinum mining sector, but there are also signs of a possible government takeover. Looking ahead, we should not be surprised to see any of the following: renewed violence, layoffs, government takeover of mining assets, or an increase in mining accidents. We would expect any of these events to lead to a realization that gold prices need to be significantly higher to support the world's precious metals output.

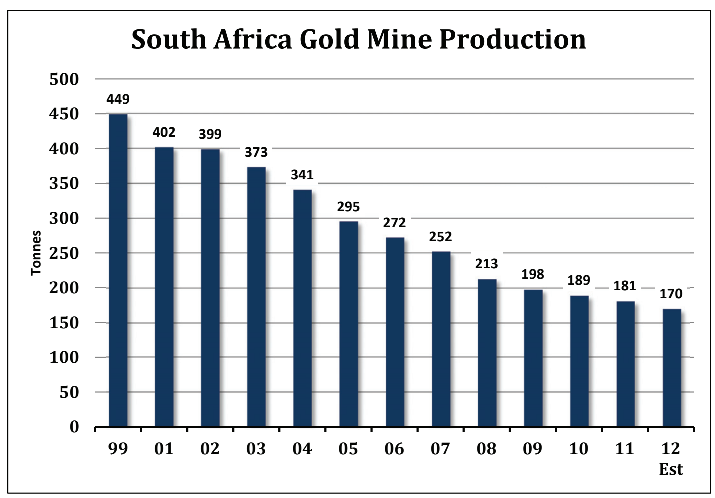
CHANGING TIDES

For the last several months, gold has been undermined by stronger US economic data, as those numbers fostered fears of tightening by the Federal Reserve. In the face of a better than expected November Non-Farm Payroll result on December 6th and talk of a US budget deal, gold managed to rally.

Since speculators have remained long gold (according to weekly Commitment of Traders positioning reports) it does not appear that the recent gains in gold were from "short covering", or buying by those that were short futures to cover those positions.



News this week that South Africa showed another monthly decline in their September gold production (down 3.7%), is another sign that gold is not only paying attention to classic supply-side developments; it could rise even in the face of a series of hawkish Fed statements.



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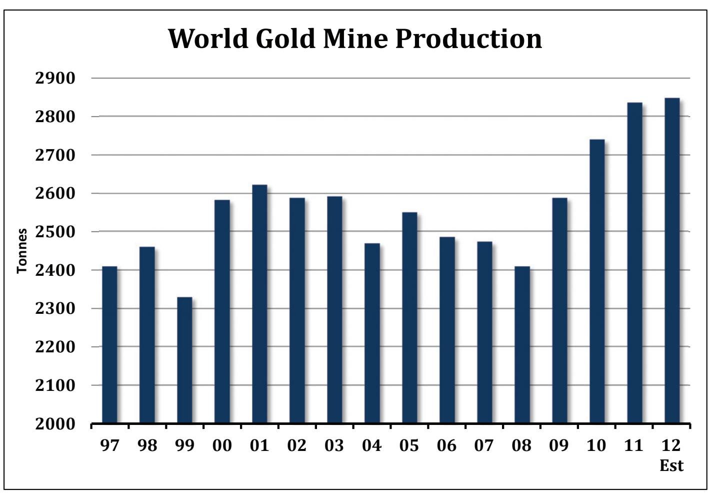
SUPPLY

The problem with gold's historical odyssey is that investors in gold have become disgruntled with the market's lack of performance off of the standard themes. Investors have also been put off by the two-year decline of $700 an ounce. But that development is already causing significant change to the supply side of the equation.

For many commodities, production areas have expanded beyond reliable, low-cost locations into places where costs are higher and the variability of output is greater. For example, gold mining in South Africa is going deeper and deeper into the earth, with water and materials movement becoming more costly, air quality and temperature management more complicated, and an increasingly dangerous environment for workers.

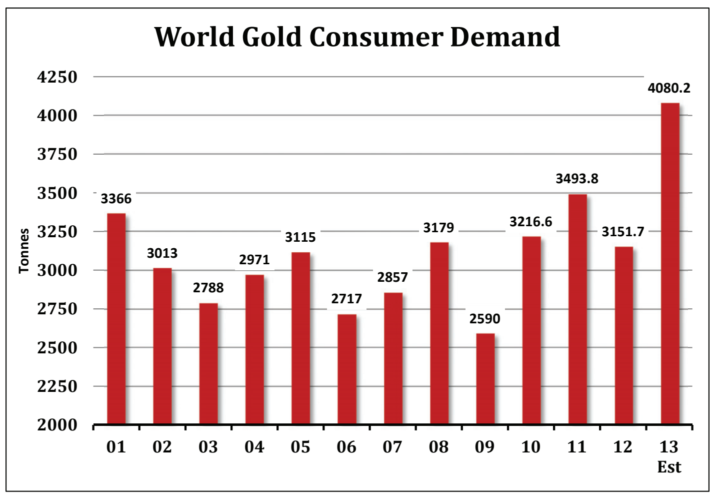
Therefore, it would appear that gold has come full circle and that gold and platinum are once again entering an era when classic supply and demand factors are set to drive prices upward. Without higher flat prices of gold during the next 6 months, the next round of wage gains by the mining unions could effectively remove exploration and capital spending by the mines in South Africa. Adding to the dilemma are South African and Zimbabwean governments that appear to be sympathetic to the need for higher wages. As of this writing, there has been strike action at South Africa's Northam Platinum Mining Facility for over a month, and the South African government has given authorization for the AMCU to strike at the Lonmin facility.



Gold production costs has risen dramatically due to deep mining and rising labor costs, and that combined with a 37% reduction in revenues for the gold and platinum mining companies means that something has to give.

DEMAND

It is quite possible that gold will continue to lose its investment appeal over the coming months, especially in the face of the long-feared start of US tapering. Furthermore, textbook analysis suggests that gold should find it extremely difficult to forge a sustained uptrend in buying in the face of the beginning of a Fed tightening cycle. We also think that prospects for inflationary-driven gains in gold are highly unlikely during the foreseeable future. While we are at it, we also think that a significant flight-to-quality run-up in gold prices is unlikely, as the global economy is recovering and intense concern toward the Euro zone is waning. In short, we think most of the usual bullish themes for gold that would drive the market higher are on the shelf.



Those bearish toward gold might be concerned with slack Indian demand, but favorable election prospects and sharp gains in the Indian stock market are improving the conditions facing the Indian central bank, and that could easily take their attention off limiting gold imports.

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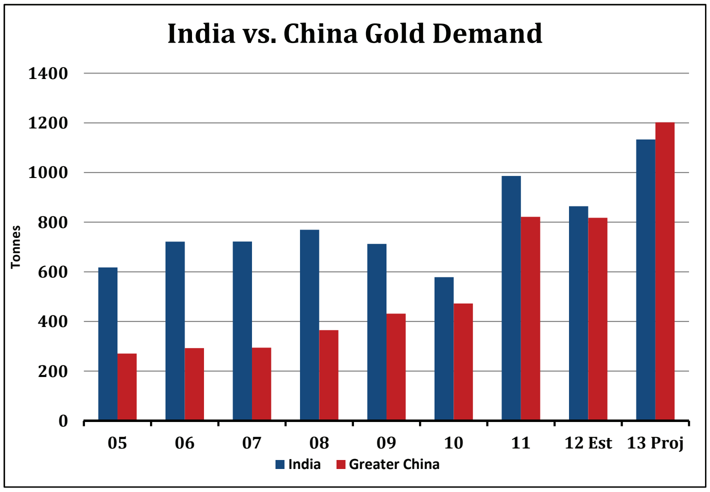

Another positive factor for gold could come with a US budget deal, as a longer-term deal would serve to remove significant uncertainty from the forward outlook. In other words, a budget deal could result in a physical commodity like gold appreciating significantly as forward demand views are revised higher.

CAMPAIGN

We consider a "Campaign Trade" to be a long-term commitment to a particular market. It will usually contain a primary position that is to be protected, hedged, enhanced and managed by various options and futures components. This type of trade might stretch beyond the duration of a particular futures contract and entail rolling part of the position forward. Our intention for these trades will be to establish a core position, whether long or short, and to attempt to meter the risk and reward using options or spreads wrapped around that core position.

In the initial phase of each trade, we will aggressively attempt to rein-in risk and give it definition, with the hope that some timely adjustments to the "wings" or "options" will allow us to reshape and narrow our risk. At times, the wings will attempt to finance or reduce the risk of our overall position. For a better understanding of this concept please follow our first Campaign Trade in the gold market (shown below) as it unfolds over the coming months.

This first Campaign Trade focuses on gold. We would have preferred platinum, but the lack of liquidity in platinum options prevents us from entering into that market.

Suggested Trading Strategy

BUY a December 2014 Gold $1,200 put at 77.00 or better and then look to BUY a December 2014 Gold futures contract at the market. Once filled on those positions, look to SELL a December 2014 Gold $1,300 call for 65.00 or better. We expect to make adjustments to short call position as we attempt to finance a portion of the long put coverage and to ascertain when the fundamentals in gold appear to improving.

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Campaign Trades:
Platinum & Live Cattle

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MAJOR ECONOMIC EVENTS
January 15
- Producer Price Index
- Retail Sales
January 16
- Consumer Price Index
- Industrial Productio
January 17
- Jobless Claims
- Housing Starts
- Philly Fed Survey
January 18
- Chines GDP/Retail Sales
- Consumer Sentiment

January 11, 2013

Next Week's Economic Focus

Commodity prices got a boost from this week's news of a recovery in Chinese exports and imports during the month of December. While the outlooks for the US and Europe remain suspect, seeing more positive developments out of China should dampen some of the negative sentiment toward copper demand. Adding to the positive sentiment was news that Spain and Italy saw strong demand for their debt during recent auctions. Unfortunately, the New Year failed to bring a complete end to the fiscal cliff debate, which has transitioned into a looming US debt ceiling debate. With several political pundits encouraging the President to unilaterally raise the debt ceiling and leave future ceiling adjustments in his office's hands, one might expect the GOP to dig in its heels instead of opening up to compromise. One also has to wonder if evidence of lower after-tax income in the first paychecks of 2013 will result in some negative sentiment during the coming weeks. Over the near term it is possible that positive news from China, less uncertainty from Europe and ongoing positive US economic data will provide physical commodities with a positive backdrop. On the other hand, markets like crude oil, soybeans and natural gas continue to face burdensome supply conditions that might be difficult to overcome.

-Dave Hightower

US Retail Store Sales
Percent Change From Year Ago
December 2012: -2.0% Hightower Estimate

OUR OPINION... MARKET BY MARKET

Market		*
Stocks	Improvement in China leaves the bulls in control.	L
Bonds	The bear camp retains a fundamental edge.	S
Dollar	Inability to hold rallies hints at an upcoming top.	S
Euro	Favorable auctions reduces risk for fresh longs.	L
Gold	Robust growth views needed to reverse downtrend.	S
Silver	Downside waves not extending with key reversal.	L
Copper	Near-term upside move possible from China news.	L
Crude	March Crude fails at $95.00 level.	S
Gasoline	Surge in supply & weak demand offer headwinds.	S
Nat Gas	Bounce from $3.10 leaves $3.50 as next objective.	L
Soybeans	S America weather good; downtrend continues.	S
Corn	Demand & 2013/14 planting seen as negative.	S
Wheat	Export demand still slow; precipitation in the east.	S
Hogs	Production decline seen through mid-February.	L
L Cattle	June and August look too cheap versus outlook.	L
Sugar	Oversold with more positive tone for commodities.	L
Coffee	Funds still hold big net short with shift in supply.	L
Cocoa	Will need signs of tighter supply to turn trend.	S
Cotton	Threat of China selling reserves may pressure.	S

* For traders/commercials who need to be in a market, L = Long, S=Short

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