Gold Getting Old?

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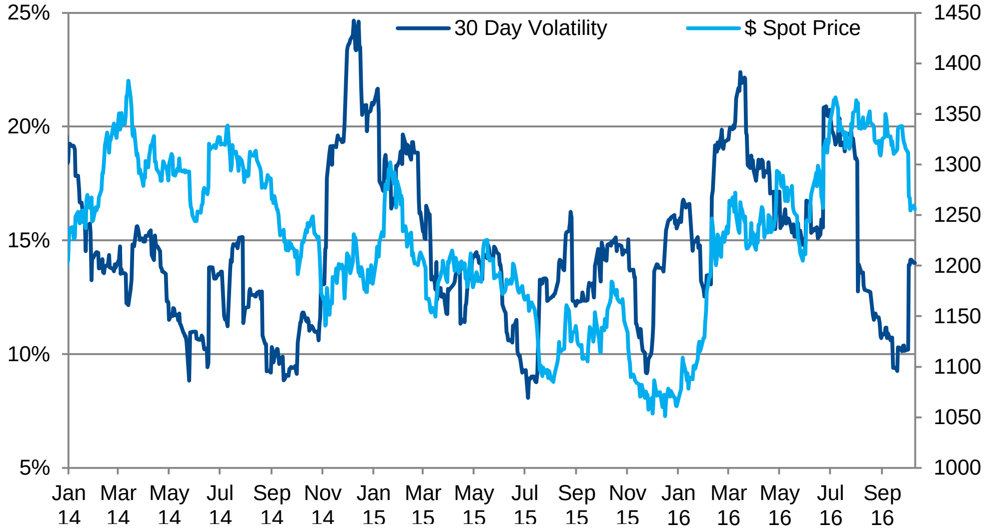
Gold Spot Price vs 30 Day Volatility: *Volatility remains elevated throughout 2016*



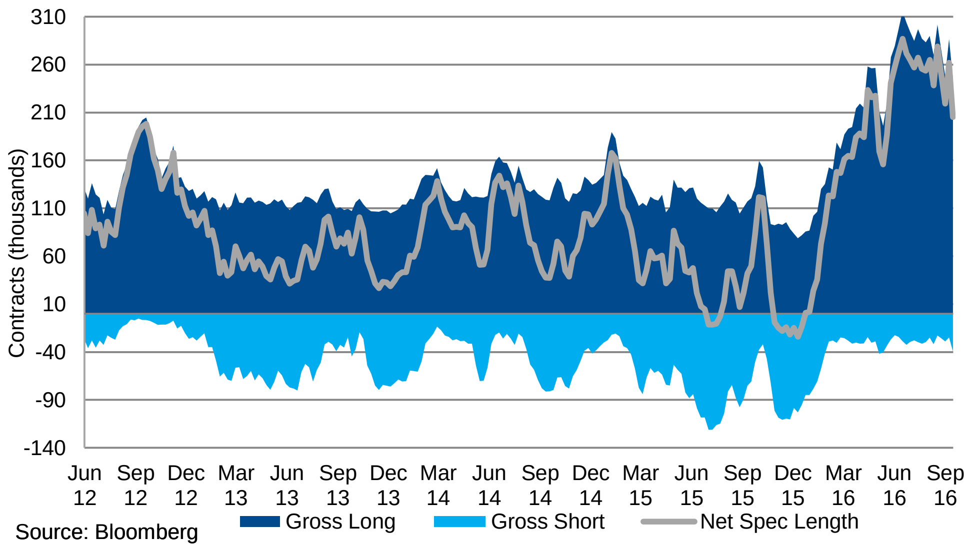
Source: Bloomberg

2016 so far has been a year characterised by significant event risk. Uncertainty owing to ongoing conflict in Syria, the looming spectre of an emerging markets crisis, liquidity concerns in China, the impeachment of Dilma Rousseff in Brazil and the UK's decision to leave the EU have presented the most notable obstacles in the first three quarters of the year and provide a tumultuous backdrop for global investors.

"Spot prices have gained 30% in the first six months of the year…"

These negative shocks to the macroeconomic environment saw flows to safe haven assets propel gold back towards $1,379/oz at one point this year, building on the floor of $1,050/oz set in December last year. So far this year spot prices have gained 30% in the first six months of the year and the precious metal remains well supported towards $1,250/oz and beyond as a combination of physical and investment demand promotes a healthy appetite, offsetting sellers who are seeking higher bond yields.

Commitment of Traders: *Managed money net speculative length has increased significantly over the summer of this year*



Source: Bloomberg

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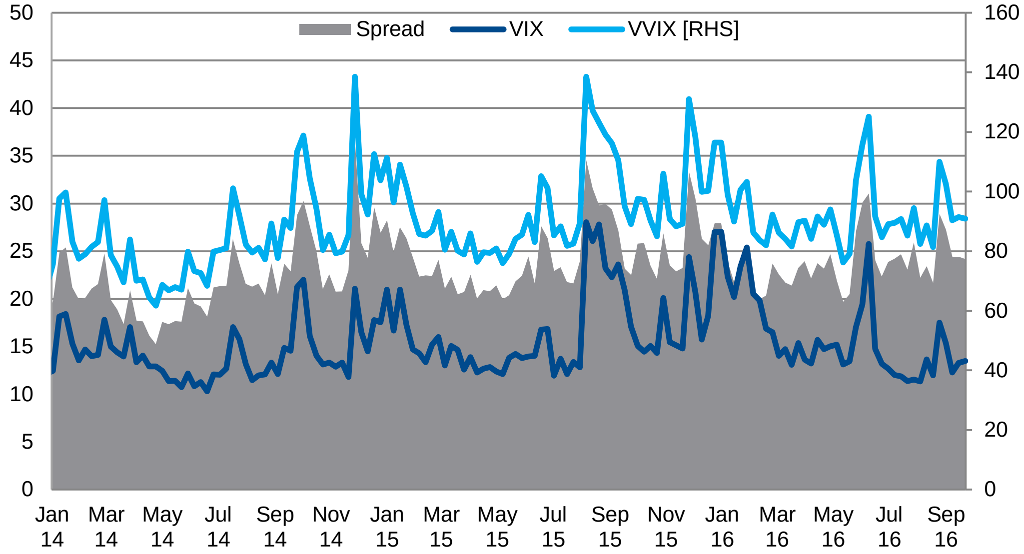
“…market conditions remain choppy with the VVIX index firmly above its 10 year average of 86 towards 91.40.”

Taking a look at current market volatility as presented by the CBOE’s Volatility Index, which measures the implied volatility of S&P 500 index options, investors would be complacent in thinking that the market outlook suggests smooth sailing ahead. The VIX now stands at 13.55 having dropped steadily throughout the year and when compared to last year’s spike above 28 it seems as if financial markets are pricing in a certain element of event risk.

However, while the equity markets aren’t displaying the sort of heightened volatility that was characteristic of the months during the financial crisis a deeper look at the VVIX index, that is the volatility of the Volatility Index which indicates the expected volatility of the 30-day forward price of VIX, suggests that market conditions remain choppy with the VVIX index firmly above its 10 year average of 86 towards 91.40.

VIX vs. VVIX: *Volatility rises as markets remain susceptible to negative shocks*



Source: Bloomberg

“Total ETF gold holdings have increased 39% year-to-date to 65.34m tonnes, the highest level since July 2013…”

Gold investments have been buoyed by healthy demand as risk aversion owing to negative market shocks sees demand for the safe haven rise. Total ETF gold holdings have increased 39% year-to-date to 65.34m tonnes, the highest level since July 2013. The ever popular SPDR Gold Trust ETF added 50% in size throughout the first half of the year, gaining at a substantial clip throughout June as an impeding Brexit vote marked the beginning of the end of the UK’s membership of the EU.

Currency volatility remains a big factor dominating investor’s decision making processes. Markets have been shrouded in uncertainty as details of Britain’s decision to leave the EU remain unclear as well as risks surrounding the upcoming US presidential election. Accordingly much of the impact of the recent event risk has played out in forex markets with dollar swings in recent weeks prompting sharper moves in the yellow metal; one such session saw gold prices register a 3% daily drop in early October.

Looking ahead, the coming quarters may present significant headwinds to the global economic outlook and as a result could see investment demand for gold pick up considerably. With the US presidential elections in November this year, a December referendum tabled in Italy, the expectation of Article 50 triggered by March 2017, French presidential elections in Q2 2017 and German federal elections shortly after that, uncertainty likely foster an opaque investment outlook.

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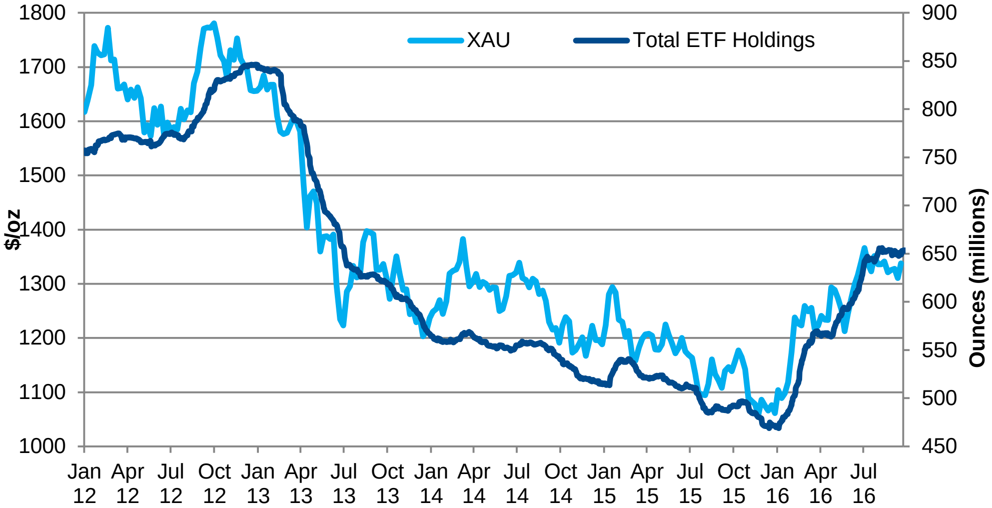
Spot Gold vs. Total ETF Holdings: *As gold prices rallied throughout the year total ETF holdings tracked the move higher*



Source: Bloomberg

Add to the mix a diverging outlook between central bankers at the US Federal Reserve, the European Central Bank, the Bank of Japan and the Bank of England and the forward looking investment environment quickly becomes a minefield which concerned participants will have a hard time navigating these obstacles.

Arguably the two most significant factors influencing the investment outlook for gold are the US presidential election in November and the last Fed meeting of the year in December. Given the current macroeconomic climate these two events are exerting seemingly opposing forces on spot gold prices as the former promotes an outlook of uncertainty and policy risk while the latter has investors expecting a rate hike before the year is done.

Indeed gold prices have benefited from the Fed's decision to hold off from raising rates in September, some would say a wise decision given the uncertain outcome Trump vs. Hillary.

However, with sentiment torn between a President Trump scenario which has buoyed investment demand and the Fed tightening in December which erodes the need for a safe haven we anticipate price activity throughout the remainder of the year to trade with increased volatility. This is clearly shown by the historical 30 day rolling volatility chart on the first page which has spiked back above 14% this month after dropping consistently throughout the summer.

"…30 day rolling volatility which has spiked back above 14% this month after dropping consistently throughout the summer…"

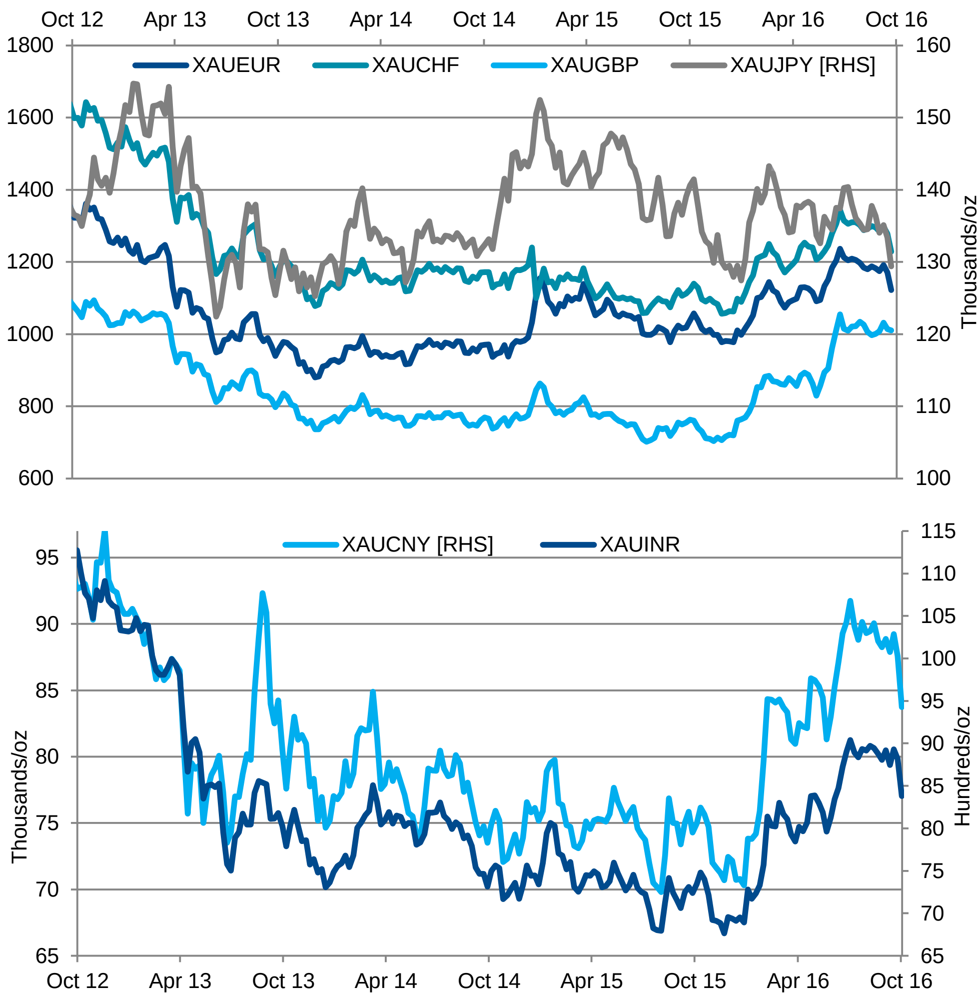
Gold's Asian Persuasion

The uncertainty outlined above has been the driving force behind bullion's performance this year. Appetite for safe haven assets has grown in the first three quarters of the year; however physical demand in Asia has been lacklustre.

India's long term relationship with gold is no secret but 2016 has hardly been business as usual when it comes to demand for bars and coins. The recent price volatility and sharp price spikes either side have made buyers think twice before purchasing jewellery or ornaments.

The spot price in India hit a recent high in July of Rs91,929 per troy ounce, close to the all-time of Rs97,124 achieved back in 2013. Since then, prices remained above Rs87,000 throughout the third quarter due to macro concerns. Even after the recent sharp fall, prices remain well above the five year average of Rs81,565 with the spot price currently standing at Rs84,071.

G10 vs. EM Spot Prices: *Recent divergence between the spot prices in major currencies adds a further element of risk to the outlook*



Source: Bloomberg

"September imports were down 43% year-on-year at an estimated 30 tonnes."

Gold flows into India constitute a large portion of current account inflows, however, according to GFMS data imports are down 59% in the first nine months of the year to 268.9 tonnes compared to the previous year. The most recent data showed that September imports were down 43% year-on-year at an estimated 30 tonnes. A combination of weak retail demand and higher domestic discounts were the primary drivers behind the reduction in overseas buying.

Indian consumers have a long tradition of holding jewellery as a store of value and symbol of wealth. As Prime Minister Narendra Modi seeks to draw citizens into the financial system as part of his "Make in India" initiative we could see household demand for bullion fall in years to come. 58% of Indian households have bank accounts; Modi seeks to provide accounts to an additional 30% of the population by 2018.

Bar and coin consumption in India was weak in the first 6 months of the year at 61.2 tonnes, down 22% on the previous year and 9% lower than the 5 year average.

"…more than half of India's physical gold and jewellery demand is drawn by those living in rural areas."

According to the World Gold Council, more than half of India's physical gold and jewellery demand is drawn by those living in rural areas. With agriculture being a major employer it is perhaps no surprise that jewellery demand in these areas has also fallen year-to-date.

An underwhelming monsoon season has seen weather conditions deteriorate and as a result, crop returns have fallen in recent years leading to a commensurate decline in farmer incomes, thus appetite for bullion has suffered as a result. This slump in demand could be halted as the first normal monsoon in three years is forecast, improving growing conditions and in turn crop yields, however, this may not be enough to dramatically improve the prospects for physical gold.

While physical demand for gold has been lacklustre year-to-date, we do see robust short term support due to Indian wedding season, Diwali and Dhanteras festivals approaching. According to the Indian government 35-40% of the cost of a typical Indian wedding is gold.

An additional reason for the fall in jewellery demand is regulation that was introduced by the Indian government, which added an additional 1% exercise duty on gold ornaments from March 2016. While jewellers with a turnover of up to Rs120million will be exempt from the duty it still proposed to squeeze margins.

This provided further headwinds to the sector and even resulted in jewellers taking strike action at the beginning of the year. The government since relaxed rules and now jewellers with a turnover up to Rs150 million will be exempt.

Short term support as a result of the Indian festival season, normal monsoon boosting crop yields and lower prices attracting some physical buying could provide tailwinds to India's consumer demand. However, historically the final quarter of the year has been good for Indian consumption of physical gold, this demand is unlikely to be strong enough to increase retail consumption in a meaningful way and therefore we see demand growth falling at a slower rate.

Jewellery & Investment Demand: *Chinese and Indian retail demand has taken a significant hit during the first half of the year*

	Jewellery Demand in Selected Countries (Tonnes)								
	Q1'15	Q2'15	Q3'15	Q4'15	2015	Q1'16	Q2'16	H1'16	H1'15 v H1'16
India	150.8	122.1	215.1	180.4	668.5	88.4	97.9	186.3	-32%
China	221.2	169.0	180.6	187.6	753.4	179.0	143.5	322.5	-17%
	Consumer demand in Selected Countries (Tonnes)								
	Q1'15	**Q2'15**	**Q3'15**	**Q4'15**	**2015**	**Q1'16**	**Q2'16**	**H1'16**	**H1'15 v H1'16**
India	191.7	159.8	272.1	240.6	864.3	116.5	131.0	247.4	-30%
China	290.2	214.1	233.8	253.4	991.5	260.3	183.7	444.0	-12%

Source: Metals Focus; World Gold Council

"Year on year figures have seen Chinese jewellery demand fall 17% to 324.7 tonnes."

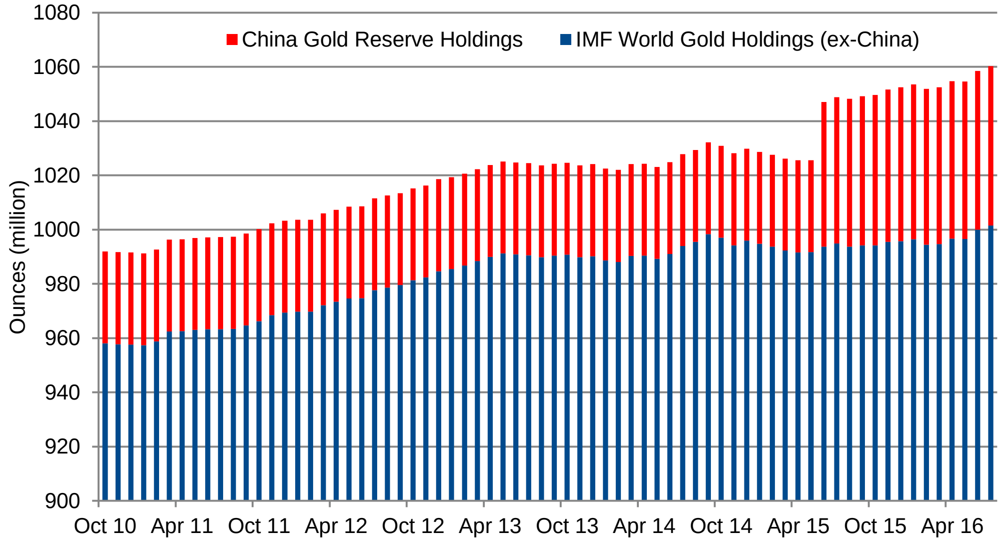
China stands as both the world's largest consumer and producer of gold, however wavering sentiment due to weak economic growth, high volatility, the anti-graft drive and rising prices have given buyers reason to reconsider purchases, registering a subsequent drop in retail demand for the yellow metal. Year on year figures have seen Chinese jewellery demand fall 17% to 322.5 tonnes.

Contra to the retail market, China's central bank has increased their gold holdings by 25.9 tonnes (832,704 ounces) through to June. The People's Bank of China (PBOC) is demanding more bars and coins; as a result their gold reserves continue to rise, albeit at a slower rate than previous years with purchasing flat in May, reaching 58.95m troy ounces at the end of August.

"…world reserve gold holdings swelling to their highest level in over fifteen years to 1058.54 million ounces… "

Indeed, central banks around the world have taken steps to shelter from global macro headwinds with world reserve holdings swelling to their highest level in over fifteen years to 1058.54 million ounces (approximately 30,000 tonnes) as of the end of July, according to IMF data. This trend looks set to continue as an agreement with Russia's second largest lender will see the PBOC's vaults add 15-20 tonnes of bullion in the next 12 months.

Global Gold Reserve Holdings: *Chinese reserve buying has accelerated pace since the start of last year owing to attractive spot prices and macro headwinds*



Source: Bloomberg

On a global scale, World Gold Council data shows resilient bar and coin demand in Q2 as consumption increased 1% year-on-year to 211.6 tonnes. Consumption for bars and coins alone during the first half of the year hit 484.7 tonnes, up 4% from the same period last year.

"…total gold investments reached a record 1063.9 tonnes in H1 2016, worth approximately $41.6b "

Adding in ETF demand which represented the lions share, total gold investments reached a record 1063.9 tonnes in H1 2016, worth approximately $41.6bn. Given that global market conditions throughout the second half of the year so far stand in relatively good stead and in stark contrast to the first half, has gold investment demand reached a peak?

The recent prices slump could also trigger a sharp response in the consumption of jewellery, bars and coins similar to Q3 2015 when a 7% decline in prices led to a 33% increase in bar and coin demand globally according to World Gold Council Data.

"Central bank flows could further underpin a healthy demand outlook…"

Central bank flows could further underpin a healthy demand outlook, leading us to conclude that on the whole the fundamental drivers for gold, while not overly bullish, remain firm. However, it is our view that investor sentiment and importantly fund flows that will dictate the precious metal's price outlook for the remainder of the year.

Early moves this month show just how fragile support underpinning the bullish case for gold is, with spot prices dropping 3.3% in a one day on the 4th October as the yellow metal posted its largest one day decline in over three years.

As argued above, up until recently support levels for spot prices had been bolstered by significant event risk, geopolitical concerns and an all-around bearish global macroeconomic outlook. However, as these key calendar events pass while we anticipate some apprehension in the run up, supporting spot prices above $1,250/oz and perhaps towards $1,300/oz throughout the final quarter of the year, we anticipate these headwinds to fade quickly heading into 2017.

"As a result we project spot prices to drift back towards $1,210-20/oz over the near term…"

Furthermore, as the US Fed continues on its path to tightening, with additional rate increases anticipated next year, the investment outlook for gold as a safe haven will fade accordingly. As a result we project spot prices to drift back towards $1,210-20/oz over the near term with the potential for an accelerated decline towards $1,170/oz over the medium term.

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