# Gold, Silver and the Rand

December 2009

**Season's Greetings**
Wishing all of our stakeholders a safe and happy holiday season and a prosperous 2010

As a company, Harmony is exposed to the gold price as well as the R/US$ exchange rate. Therefore the Rand strength or weakness is critical to our company with most of our operations being in South Africa. The silver component relates to our Hidden Valley operation which is producing both gold and silver, and as a precious metal silver has an intimate relationship with gold.

We have engaged the services of VM Group to provide us with the contents of this newsletter. We hope that this newsletter provides further insight and value to you.

A stronger-than-expected US jobs number on 4th December sparked a dollar recovery and was enough to end gold's stunning rally. Having fixed in London at an all-time high of $1,212.50/oz on 2 December 2009 (and peaking at $1,226/oz in intra-day trading) gold wobbled in European trading on 4 December 2009 and then plunged lower in later US trading and continued to fall as Asian markets opened on the 7th, fixing in London on that day at $1,142.50/oz, $70/oz lower that its earlier London PM.

## Gold

The price was certainly looking frothy – when it peaked on 2 December 2009 it was more than $200/oz higher than it had been just two months ago, a rise of that magnitude and in that time period unmatched since the heady days of 1980. Even this correction only takes us to where the price was trading as recently as 20 November 2009, something for the bulls to take heart from but which the bears will suggest means a further fall is possible.

Given the largest investment positions much will depend on whether gold can hold its current levels. The medium-term outlook remains positive – one data series does not change the overall economic picture and indeed many economists have queried whether the US jobs data is as good as reported.

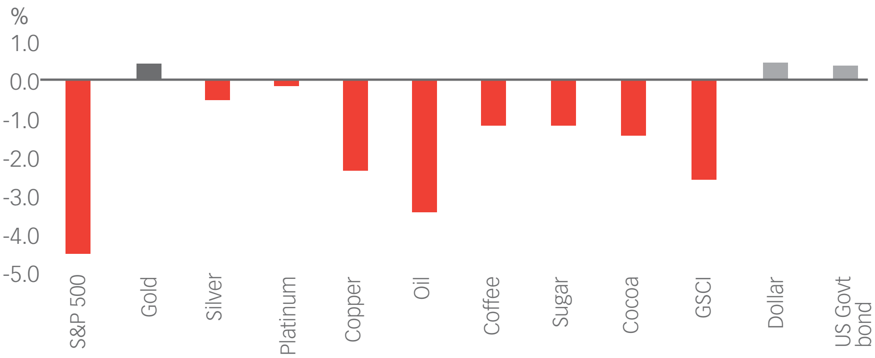
Encouragement comes from earlier in November 2009 when gold survived another scare after Dubai World, a state-controlled investment and property company, announced it was looking to reschedule up to $26bn of debt payments. Gold at one point tumbled nearly 5%, heading towards $1,030/oz. But in this instance the price held its ground and soon recovered to a new peak.

To understand this more closely we examined the returns of various commodities and financial assets on trading days since 2005 when the S&P 500, the world's leading stock index, fell by more than 3.0% (37 days, all but one since the start of 2008). As the chart shows of the commodities covered only gold rose, managing an average 0.4% gain. Silver and platinum fared relatively well falling by 0.6% and 0.2% respectively. But copper and oil performed poorly, falling on average 2.4% and 3.6%. Other safe-havens were the US dollar and US govt bonds, although no better than gold.

This brief analysis does support the claims that gold can be a safe-haven. Certainly there are times, most notably in September/October 2008, when gold fell sharply on very bad economic news. Advocates of gold's role explained this as investors needing to liquidate their profitable gold positions to fix losses incurred elsewhere; against that, sceptics suggest that gold's enormous price gains this decade (and


# Gold *cont.*

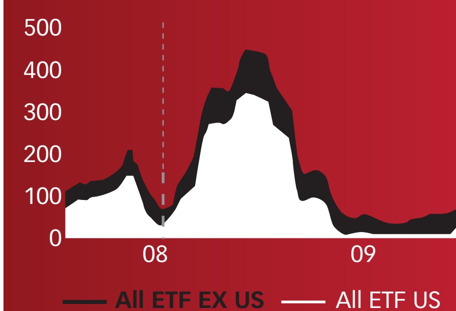
Average % daily price changes per month since 1990




Lease Rates, % per annum


Note: LBMA indicative rates not dealer rates.

ETF rolling 12wk change, tonnes




particularly in the past 12 months) stem from the main factor that has propelled other commodities and 'risky assets' much higher – cheap (and some would say excessive) liquidity. The reality is probably a bit of both: in the context of what is effectively a zero interest rate environment – as is the case in most mature economies right now – speculators inevitably are seeking a decent yield wherever that might be, and commodities, given the expected vigorous demand in Asia over the next two decades, are understandably seen as a good bet.

Despite the acres of press coverage, gold's rally from $1,000/oz to $1,200/oz remains relatively poorly understood. This time around it was hard to place much emphasis on the sickly US currency. Although the dollar did dip to 74.8 from 76.3 on its index (a broad measure of strength) between the end of October 2009 and end-November 2009, that is a decline of just 2%, compared with gold's gain of 13% over the same period. This broad-based strength meant that the gold price, when measured in euros, finally broke above its February 2009 all-time high (when the euro was much weaker) although it remains more than 10% below its all-time rand high, set in the same month.

Perhaps the most crucial factor has been central banks' apparent change of heart regarding gold as a reserve asset. Expectations of net sales by central banks in 2010 have been rapidly reduced on the back of the IMF's successful sale of 212t of its gold to the Indian and Sri Lankan central banks, leaving just 191t to sell on the open market, and that is assuming there are no other official sector buyers to come. The IMF matters as it was expected to provide most of the sales under the new Central Bank Gold Agreement (CBGA). Its signatories, the traditional European suppliers of official sector, were completely absent from the market in October, the first time this has happened since the first CBGA was signed in 1999 and a long way from the 400t/year maximum they are permitted. Although we are sceptical about central banks as a sector becoming large net buyers of gold, the lack of net central bank sales has certainly helped spur fresh private investment.

But interestingly enough the ETFs have not been a major part of this rally, with just 27t of net purchases in November from the 17 physically-backed funds we track. Instead, coin sales have been relatively strong (the US Mint was forced to suspend sales of its 1 oz Gold Eagle coin for lack of stock) and retail and institutional OTC investment has been extremely buoyant. It was some of these buyers who presumably took fright on 4th December .

**Monthly gold data**

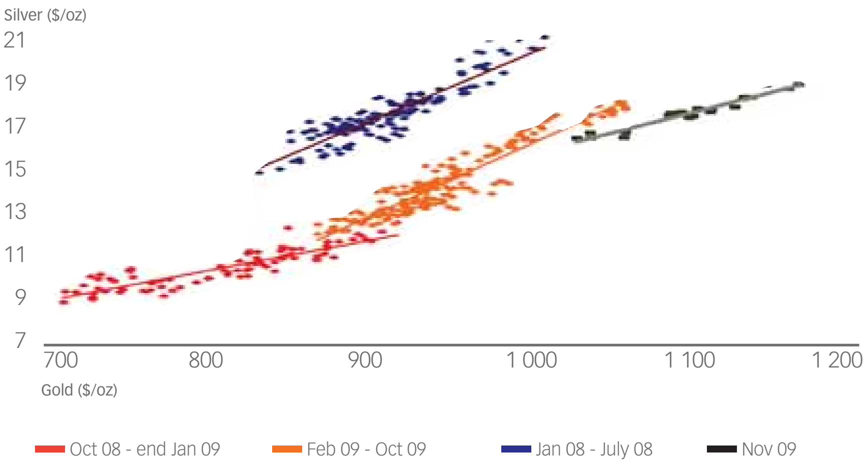
| **Prices** | **US$/oz** | **Euro/oz** | **Rand/kg** | **ETFs** | **Tonnes** | **Change** | **Lease Rates** | **1m** | **3m** | **6m** | **12m** | **Option volatility** | **(%)** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Average** | 1 043 | 704 | 249 944 | US (2) | 1 218.5 | 29.2 | **Average** | (0.05) | (0.06) | 0.14 | 0.58 | **1-month:** | 22.75 |
| **High** | 1 062 | 717 | 259 636 | UK (2) | 237.7 | (2.8) | **High** | 0.01 | (0.01) | 0.21 | 0.63 | **3-month:** | 23.70 |
| **Low** | 1 004 | 686 | 240 840 | Swiss | 214.5 | (2.1) | **Low** | (0.09) | (0.10) | 0.08 | 0.53 | **6-month:** | 25.70 |
| | | | | S. Africa | 52.7 | 0.0 | | | | | | **12-month:** | 28.20 |
| | | | | German | 35.3 | 1.2 | | | | | | **24-month:** | 28.70 |
| | | | | Australia | 14.7 | 0.4 | | | | | | | |
| | | | | Others | 7.7 | – | | | | | | | |

Silver set a high (on the London fix) of $19.18/oz on 2nd December, before falling back to around $18.00/oz by 7th December as gold plunged.

# Silver

Even after the latest fall it is impossible to deny these are strong prices – silver was just $9.91/oz this time last year. But curiously silver has not performed as strongly as one would expect, given gold prices. The chart below is an update of one we showed in the October issue of this report – it plots each day's silver and gold price since January 2008.

Silver and gold prices

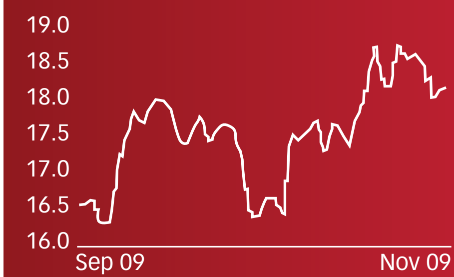



Clearly the gold/silver relationship changes at key points, most notably after July 2008, when the recession began to bite. But interestingly it also seems to have changed in November 2009, and not in silver's favour. If the relationship seen between February 2009 and now still held, then silver would be around $21/oz to $22/oz; instead it is less than $19/oz.

We explain this in two ways. First, gold has received a boost in recent months from a re-rating of expectations regarding central bank sales. Silver has not had the problem of central bank sales, and so cannot benefit from its cessation. Second, the recovery in demand expectations that has pushed base metals and silver higher has recently become much more reliant on Chinese stockpiling than real demand – and again, silver doesn't have this advantage.

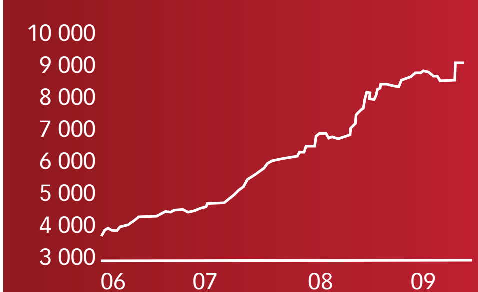
There's clearly a risk of overstating this. Silver has nearly doubled in a year, and is trading near its 2008 high, despite the global recession. A bit less froth now might stand it in good stead if the going gets trickier. And (relatively) lower prices should encourage the new demand uses it needs to have a confident future. What's more, when gold tumbled in early December, silver didn't fall quite as much – redressing some of the underperformance.

Silver price, $/oz




Silver price, ZAR/Kg


BGI silver ETF holdings, tonnes




**Monthly silver data**

| Prices | US$/oz | Euro/oz | £/oz | ETFs | Tonnes | Change | Lease Rates | 1m | 3m | 6m | 12m | Option volatility | (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Average** | 17.24 | 11.63 | 10.65 | US | 8 914.0 | 31.0 | **Average** | (0.32) | (0.28) | 0.01 | 0.62 | **1-month:** | 34.50 |
| **High** | 17.99 | 12.11 | 11.33 | UK | 714.0 | (1.4) | **High** | (0.28) | (0.25) | 0.04 | 0.67 | **3-month:** | 36.25 |
| **Low** | 16.21 | 11.01 | 9.86 | Swiss | 1 763.0 | 65.9 | **Low** | (0.38) | (0.34) | (0.05) | 0.54 | **6-month:** | 37.50 |
| | | | | | | | | | | | | **12-month:** | 38.00 |
| | | | | | | | | | | | | **24-month:** | 38.75 |

# Rand

The rand remained firm in November 2009 against the dollar, hitting its highest (7.28) on 25 November 2009, the strongest showing since mid-October 2009, from 7.96 on 2nd November 2009. The currency gained on news that South Africa's GDP rose by an annualised 0.9% in Q3 2009, the first positive quarter since the same period of 2008, and a continuing appetite globally for 'riskier' assets.

This latter factor came to the fore late in November 2009, when the rand fell back to around the 7.4 level against the US currency. The bad news from Dubai caused concern in international markets about the possibility of a wider sovereign default, and sent investors scurrying to the safety of US government bonds and the dollar. Local issues also hurt the currency, following news that the South African trade deficit widened to R6.7bn ($906m) in October 2009, raising fears that the currency's strength this year has battered the country's export competitiveness.

A further decline came in early December 2009as gold tumbled, knocking the rand down to 7.517 against the dollar, its lowest in two weeks.

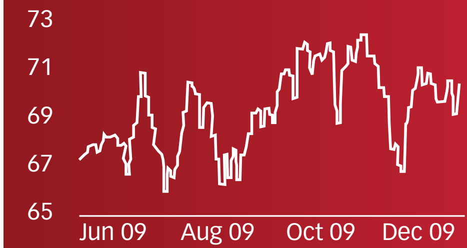
**Prices and financial data**

| Prices | 30-Nov | W% | M% | Y% | Equities | 30-Nov | W% | M% | Y% |
|---|---|---|---|---|---|---|---|---|---|
| Gold, PM fix | 1 175.75 | 1 | 13 | 44 | FTSE 250 | 8 918 | -4 | 0 | 46 |
| Silver, fix | 18.14 | -3 | 9 | 79 | DJI | 10 345 | -1 | 4 | 17 |
| | | | | | SSE | 3 195 | -4 | 8 | 71 |
| | | | | | Nikkei 255 | 9 346 | -2 | -6 | 10 |
| WTI oil | 78.47 | 1 | 4 | 40 | Hang Seng | 21 822 | -4 | 3 | 57 |
| GSCI | 512.57 | 0 | 3 | 31 | S&P 500 | 3 900 | -1 | 3 | 25 |
| DJ-AIG | 352.49 | 1 | 4 | 33 | NASDAQ | 2 145 | -1 | 2 | 40 |
| **Bonds, %** | **30-Nov** | **W%** | **M%** | **Y%** | **Ex. Rates** | **30-Nov** | **W%** | **M%** | **Y%** |
| US 10yr | 3.20 | -5 | -5 | 9 | $/GBP | 1.64 | -1 | -1 | 7 |
| US 3m | 0.06 | 120 | -9 | 57 | $/EUR | 1.42 | 0 | 1 | 18 |
| Euro 10yr | 3.15 | -4 | -1 | -3 | $/JPY | 94.54 | -3 | -6 | -10 |
| Japan 10yr | 1.26 | -4 | -3 | -10 | $/Rand | 7.81 | -1 | -4 | -27 |
| Other | | | | | $/Yuan | 6.83 | 0 | 0 | 0 |
| VIX | 24.51 | 16 | 2 | -56 | $/SDR | 0.64 | 0 | -1 | -8 |
| Markitt 10yr | 121 | 4 | 2 | -43 | $/INR | 48.20 | 0 | -1 | -6 |

*Notes: W% = change in % on week, M% = change in % on month. Prices in US dollars, equity indices in local currency. Bonds refer to yields in %. VIX – volatility index showing expectations of 30d volatility on S&P 500. Markitt 10yr is spread over Treasuries.*

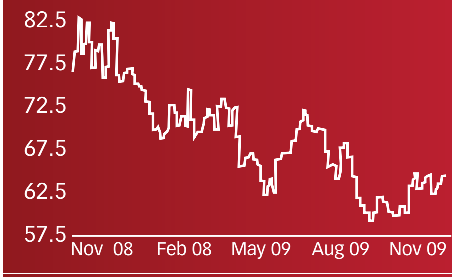
Dollar/rand


Rand index (2000=100)

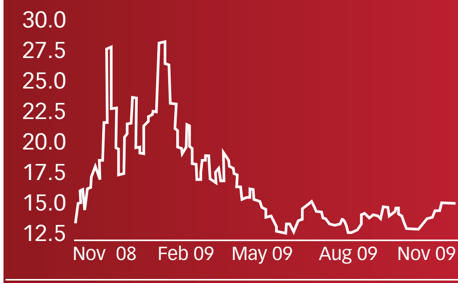



## Ratios

Gold/silver ratio




Gold/WTI oil ratio




Gold/DJIA ratio


Copper/silver ratio

# Harmony Investors' Diary

**2010**

| | |
|---|---|
| **8 February:** | Quarterly results presentation |
| **10 May:** | Quarterly results presentation |
| **16 August:** | Year-end results presentation |
| **1 November:** | Quarterly results presentation |
| **24 November:** | Harmony AGM |

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