Good afternoon ladies and gentlemen, and welcome to the final session today – A New Era for Gold? I don’t quote the Bible very often, but Ecclesiastes, Chapter 1 Verse 19 reads – “What has been is what will be, and what has been done is what will be done. There is nothing new under the sun”. On that basis, it’s perhaps something of a challenge for our speakers to convince us that there really is a new era in gold.

But we have a truly international panel to make this case for you – Narenda Gupta from ICICI Bank in India, Al Getz from the New York Mercantile Exchange, Jessica Cross from South Africa and Gerald Ashley, who has more stamps on his passport than Kofi Annan.

We had hoped that Shen Xiang Rong, Chairman of the Board of the Shanghai Gold Exchange, could be with us today to share his thoughts and hopes for the Shanghai Gold Market. Unfortunately that’s not possible, but I will do my best to give a précis of his paper – the full text of which will appear in your Conference proceedings.

I would now like to introduce Narenda Gupta of ICICI Bank who will speak on the topic of an Indian futures exchange. I had my first real look at the Indian market during the recent very successful LBMA seminar in New Delhi. We offered an independent forum for the whole Indian market and the discussions threw up several useful suggestions, one of which was a local exchange. I look forward to Narenda’s presentation.

I’ve known Al Getz since I worked with him in New York in the early 1980’s – since then he’s given up trading and got a more respectable job at the NYMEX. I’m delighted to welcome him to speak on new developments in his marketplace.

Jessica Cross has done more studies on hedging than a garden designer – and as the CEO of Virtual Metals Research and Consulting, she is arguably the best qualified person in the world to speak about the recent de-hedging phenomenon in the gold market. Jessica has been a regular presenter at LBMA Conferences since our first one in Dubai.

I’ve only known Gerald Ashley for a few years since his days at the BIS, but after a session in a city wine bar with him last week, I feel that we’ve been life long buddies. Not many people have made the switch from trader to successful author, and Gerald has managed to bring the highs and lows of the dealing experience to life in his recently published book, *Uncertainty and Expectation*. He’s managed to convey serious messages with insight and good humour – and if we take his advice to heart, then there’s a great chance for a new era in the market.
Ladies and gentlemen, it’s my privilege and great pleasure to make this speech on such an important occasion. At the outset, I wish to extend, on behalf of the Shanghai Gold Exchange, and also in my own name, our cordial greetings and best wishes to all those, present or not, who have helped us and will, as always, support us in the future.

I would also like to take this opportunity to express my sincere appreciation to the host for their invitation and I am delighted that this Conference has given me an excellent opportunity to make our Exchange more famous and popular within the international gold community.

The year 2002 witnessed a breakthrough in China’s reform of its gold administrative system. Under the supervision of the People’s Bank of China and with the full support of the State Council and Shanghai Municipal Government, SGE started its official operation on October 30, a milestone in China's move towards a free and open bullion market. The official opening of SGE heralded the start of a brand new era in the gold market in China, and is further evidence of the intention of our government to deregulate its precious metals market.

The Profile of the SGE

Approved by the State Council and founded by the People’s Bank of China, the SGE stands as a not-for-profit and self-disciplined legal entity and organises transactions in precious metals, including gold, silver and platinum in accordance with the principle of “open, fair, just and honest”.

The SGE has 108 members, all of whom are Chinese, including banks, producers, manufacturers and refineries registered in the People’s Republic of China, ratified by the PBOC to produce, smelt, process, wholesale, import and export precious metals including gold, silver, platinum, etc. Each company has had to pass stringent credit and probity requirements before becoming eligible for membership.

Currently, the SGE’s members include 13 commercial banks, 24 gold producing corporations, 61 gold consuming corporations and three mints. Spread across 26 provinces, autonomous regions and cities, all these members enjoy three distinct categories, namely, financial, general and principal membership in terms of different business scope.

Trading in the SGE is limited to physically-settled spot trading, executed between members either on the trading floor or on a computerised trading platform. Trading is also limited to standardised quantities of designated fineness designed around the needs of the physical rather than the speculative or investment market.

Following the principle of “price priority and time priority” in making deals, the SGE assigns ICBC, Bank of China, China Construction Bank and Agricultural Bank of China as its four clearing banks and conducts the clearing activity under the principle of “concentration, directness and net valuation”. The unit of quotation is RMB yuan/gram and the minimum delivery amount is six kilograms.

Prior to each transaction, the buying member must deposit cash in an exchange-specified account, and the seller should deposit gold in one of the 42 appointed warehouses across 32 cities around China. Members are allowed to stock or withdraw gold from any of these
locations and the SGE is responsible for ensuring that liquidity exists where required.

Having achieved the goal of trading gold as a commodity, satisfying the needs of business supply and demand and ensuring the safe and steady operation of spot trading, the SGE is aiming to do even better in the coming future.

**Market Review**

Since the opening day on October 30, the market witnessed a satisfactory performance with the system operating smoothly and its functions fulfilled for the first half-year.

As of 30 April 2003, all 108 members have been online with a total transaction volume of 89,984 kilograms for a turnover of RMB 8.219 billion in all and the average daily trading volume reached 731.58 kilograms.

At a rate of approximately one tonne per day, SGE’s gold volumes are already equivalent to the 220 tonnes per annum of Chinese national gold demand. It is clear that not all of these transactions are associated with physical bullion, since, although it is really largely a physical market, some members must have used SGE for speculation. But with the central bank’s much-diminished role in this market, all of these transactions will soon gravitate to our Exchange and will probably lead to incremental growth in turnover.

The Shanghai gold price has become an indispensable reference for China’s gold manufacturers and consuming enterprises in the process of selling, clearing and price fixing. Being the most authoritative price revealing the demographic gold supply and demand, it has received great attention from overseas markets. The price has risen from RMB 83.53 yuan/gram at the beginning of SGE’s operation to RMB 92.37 yuan/gram at the end of 2002 by 10.58% (the international gold price rose 8.86% during the same period of time), showing that the Chinese gold price has been quite close to that of the international market.

Four major domestic commercial banks have partly fulfilled the function of gold trading. Their active involvement in gold trading has been of great importance in establishing the market, matching supply and demand and improving the liquidity of the market. Furthermore, by taking advantage of their advanced networks and good credit, these commercial banks will effectively make an even bigger contribution to the development of the market.

The number of capital clearing increased from 50 per day to around 700 per day. Up to the end of April 2003, the clearing turnover of Shanghai Gold Exchange has reached 15.8 billion yuan, among which principal clearing turnover reached 12.187 billion yuan, or 77%, and agency clearing turnover reached 3.613 billion yuan, or 23%. ICBC and Bank of China occupied a large proportion of it by accounting for 87% of the total clearing turnover. All the clearing was accomplished in accordance with the principle of “T+O”, and there was no delay in the process of capital clearing.

The SGE aimed to provide first-grade services to its members as well as other market participants and support the market to realise its function in allocating gold resources. In this sense it has made contributions to the sound development of the physical gold market in China. Largely due to the initiative we displayed in our routine work, the market has been performing smoothly in a general sense, with the trading, storage, and clearing systems all operating in a stable manner and the end-of-the-day management of storage and clearing is also accurate and timely, therefore T+O delivery has been realised in all our warehouses.

**Future Plans**

The SGE is a young Exchange, and its development will take time and effort. Problems of all sorts may arise in the process of growing. The formation of a mature market requires our intelligence, diligence and innovation, and we should clearly recognise that spot transactions are only the very first step. As time goes on and the environment is enhanced, we shall expand strategically, first within the domestic market, then to markets abroad by developing brand-new trading methods and products step by step. Only with unremitting efforts and persistence in innovation can we gradually achieve our goals.

The SGE is getting bigger, certainly, and we will never forget to play our role as the vanguard of the deregulation of China’s bullion market. While the task is demanding, the future is bright. We will adhere to the theme of the “16th Chinese Communist Party Congress”, and continue to be driven by pioneering verve, a strong sense of spirit, and a commitment to generating sustained value for our members and all market participants. As always, our quest to create exceptional returns remains unabated.
The Shanghai Gold Exchange Shen Xiangrong

The SGE is on the move upward. We can and will do even better. At this epoch-making age, we are proud to be the first and the only gold Exchange in mainland China, and we are ready to stride over the threshold of a most prosperous and rewarding future.

In order for our Exchange to increase its turnover by more than just small increments, structural changes are still required. Next, I’d like to outline some of the steps that we have identified as part of a development roadmap for our Exchange.

Step One:

Open up the gold market to investment by offering a deferred delivery service. I believe it will be our ongoing mission to establish what domestic market participants need. The Hong Kong Gold & Silver Exchange Society has provided deferred trading for almost half a century and has made a great contribution towards satisfying their customers’ needs and activating the local market.

Step Two:

Attract individual investors by offering new products. Other major trading forums – COMEX, TOCOM and the London Bullion Market – allow investors, speculators, gold producers, physical consumers and the bullion banking community to transact a wide variety of financial products that are not limited to spot physical sales. Therefore our Exchange will, itself, need to provide a wider range of financial products than are currently on offer.

Meanwhile, products and international access are not the only factors behind gold market liquidity, as is evident from the small volumes trading on the Istanbul Gold Exchange. Since liquidity begets liquidity, growth in domestic trading volumes is a very important precursor to attracting higher volumes. We believe that the most likely source of this growth in liquidity will be generated from domestic investment and speculative demand, for which individual investors will be a rich source. Boasting the biggest population in the world, and at around one trillion U.S. dollars, Chinese savings are vast and growing at double-digit rates. So if even a small portion of this remarkable pool of savings were to be directed towards gold trading, this would swiftly lift trading volumes.

Due to booming demand, over the past few years China has become one of the largest gold consumers in the world. We see the individual market as a natural complement to the physical market, and are planning to develop new products for individual investment under the upcoming “Management Rules on Commercial Banks’ Gold Business” regulated by the PBOC in the appropriate future and we have every confidence to foresee boosting the individual market then.

Step Three:

Integrate the Exchange into the international gold market and transform it into a financial market focused on financial investment business.

We believe that the most challenging issue facing us is interconnection with the international market. Although four large domestic banks were granted approval to import and export gold back in 2002, they have not yet started these cross-border activities, and the PBOC still remains the only bridge connecting the international bullion market with China.

The opening up of gold imports by banks will have a major impact on bringing imports into the official market and virtually eliminating the unofficial market. In the inexorable march towards capital account convertibility, it must be recognised that a freeing of the gold import-export trade – with an abolition of the import duty on gold – is a necessary concomitant of meaningful capital account convertibility.

The authorisation of four domestic banks to import and export gold has been a step in the right direction, but eventually this permission should be granted to a much wider group of market participants. Ultimately we believe that membership of the SGE should be opened up to international companies or their Chinese subsidiaries, although this may require a fully convertible currency regime first.

Volumes on the SGE have already surpassed those of the Hong Kong Gold and Silver Exchange and (just) the Istanbul Gold Exchange. However, compared to the large markets of TOCOM in Japan, COMEX in New York and the over-the-counter clearing volumes recorded by the LBMA, the challenge for the SGE is rather daunting. In order to compete on a global scale, turnover needs to grow between 100 and even 1,000 fold.

The SGE has quickly turned into a successful domestic exchange for gold, and these developments will be remarkable milestones if
our Exchange is to one day take its place at the top table of gold exchanges around the world.

We believe that the developments outlined here will lay the foundations for a larger and more important marketplace for precious metals.

Last but not the least, I wish the 2003 LBMA Precious Metals Conference in Lisbon complete success. Thank you all. ■
I am delighted to be with you this afternoon and I thank the organisers for the opportunity given to me to address this Conference.

In the larger context of economic reform and liberalised policies towards capital account convertibility, the Indian government and central bank are seriously examining a number of policy initiatives relating to gold.

I will start with a brief account of India’s position in the global gold economy. The total gold stock in India is estimated to be around 13,000 tonnes plus, which is over 8% of total gold and over 65% of our GDP. Against this our share of land is at 2.4% and GDP of less than 2%. The share of mining and production of gold is insignificant.

Our share of global gold demand is pegged at 20%+. This needs to be viewed against our share of world trade, which is around 1%. Contrary to the general belief that demand for gold slows down with economic development, domestic demand continues to grow and touched 800 tonnes in 2001-2002.

From 1997 onwards, the bulk of gold and silver in the country has been imported by authorised banks and four canalising agencies.

What’s surprising is that notwithstanding India’s prominent position in investment and consumption of gold, global trading is concentrated in the USA, UK, Japan, Switzerland, etc. India does not figure among them. There are reasons for this. However, as stated, our government is aware of these issues and is very keen to develop India as a major bullion trading hub.

We are the biggest consumer of silver too. The major share of demand for silver is emerging in rural areas. The key demand drivers are agriculture and in turn, a good monsoon.
Let me brief you about the reforms happening on the gold front. One of the most significant policy announcements has been the lifting of the ban on futures trading of gold and silver in India. This follows the Central Bank permitting authorised banks to trade in gold futures and options, and banks in India are expected to commence trading in these products in the very near future.

The use of gold purely as a financial product is non-existent in India – however, gold in whatever form, including jewellery, is considered and treated as a hybrid investment. A survey conducted by the Securities and Exchange Board of India has revealed that gold continues to remain the second most preferred option of investment after bank deposits and ahead of equities and fixed income securities.

Who invests in gold? It’s not only the preferred form of wealth for Indian women and used as a hedge against inflation. The average Indian family – including the middle as well as affluent classes – creates demand for gold.

With the equities market not doing so well, people do realise the benefit of using gold investment as a risk diversifier. The slowdown if any in urban demand has been more than offset by prosperity in the rural and semi-urban areas. In new generations there is a distinct preference for treating gold merely as a financial product and have an ease of trading similar to equities, including holding gold in electronic or paper form. I firmly believe that with the ability to trade gold in an exchange accompanied by assaying and custodial services, gold in India would see increased demand from this segment, which as of now is unable to invest in gold as a financial product on account of the unavailability of these facilities.

The need is being felt for a fully integrated policy on gold covering trading, jewellery export, investment, refining, testing, custodial services etc. At government level, the management of demand and supply of gold as a tool for fiscal policy and exchange rate management and in recent times, the use of gold as a financial instrument – especially the mobilisation of domestic gold – has attracted attention. One step of utmost significance in this direction has been the lifting of the ban on futures trading in gold and silver. Options trading is also likely to be permitted shortly on exchanges.

It is natural to expect the development of a bullion futures and options market in India once it comes into existence. Prior to the ban in futures trading in 1962, there was an active gold and silver futures market in India. Apart from it being the largest physical market of gold with retail participation and adequate speculative interest, there are well-established foundations and practices for futures trading that could be built upon. The domestic market is not only fully aligned with global markets; it offers distinct advantages such as a convenient time zone. An efficient and freely tradable exchange in India would attract business from South East Asia, Australia, Tokyo, London and New York due to its convenient time zone position.

There are some concerns too, mostly on infrastructure side. The requirements for a vibrant futures market are not yet fully in place. These are mainly in areas of good refineries, efficient warehouses, assayers, etc. However, far from being a handicap, this throws up immense opportunities to global players to set up these facilities in India either by way of fully owned subsidiary or through a joint venture with domestic partner. We do assure you of all the assistance in this regard. Apart from setting up facilities as above, the refineries, global funds, market makers, traders, bullion banks, etc would be able to directly participate in the Indian market through the platform of exchange.

As a prelude to the opening of a bullion market, the government of India has allowed an ICICI Bank-led consortium to set up a nationwide online commodity exchange.

This exchange is jointly promoted by ICICI Bank, the second largest bank in the country, the National Stock Exchange, one of the top five exchanges in the world, the National Bank for Agriculture and Rural Development (NABARD), an apex bank in the agriculture sector which is fully government-owned and the
Central Bank and Life Insurance Corporation of India, owned by the government and the largest provider of life insurance product are all equal stakeholders in the new venture. This consortium brings together the institutions building expertise, nationwide reach and acceptance.

Our plans are to set up an exchange of international standards, thereby bringing global strengths and best practices into the domestic market. The exchange has already been registered as a separate corporate entity in the name and style of the National Commodity and Derivatives Exchange Ltd i.e. NCDEX.

The domestic banks’ participation in the bullion market is overseen by the country’s central bank. With a view to integrate the commodity futures market with the rest of the financial market, a task force has been set up to work towards bringing these markets under a single regulator.

Our vision is to set up an exchange of global ranking wherein global participants, such as financial institutional investors, mutual funds, bullion banks and refineries can easily participate either by setting up a 100% subsidiary or by getting themselves registered with the central bank. These entities can also consider setting up joint ventures with domestic players particularly in area of refining, assaying and custodial services. Some entities from South East Asia have already evinced interest in this regard.

Our plans are to go operational by October 2003. Futures contracts in gold and silver of up to three months maturity would be introduced to begin with. Options trading is likely to be added in the near future. We are also working towards moving from a cash market to an exchange platform. The discussions in this regard have already been initiated with the central bank. The exchange, apart from putting up reliable clearing and settlement systems, would guarantee the settlement of trades.

Commodity futures trading – including bullion – is regulated by the Forward Market Commission under the Ministry of Consumer Affairs and Civil Supplies, whereas the equities and debt markets are being regulated by Securities and Exchange Board of India (SEBI).
Managing Market Risk in Precious Metals

Albert J Getz
Senior Director, Metals Research, New York Mercantile Exchange, Inc

It is a real pleasure for me to be here in Lisbon with the London Bullion Market Association; to have the opportunity to meet old friends again and to establish new relationships with all the participants in the precious metals markets.

As most of you are aware, the New York Mercantile Exchange is the world's largest physical commodities futures exchange, providing price discovery through open outright trading to the metals and energy markets, through our futures contracts.

The futures markets fall into two broad categories: financial instruments and commodities. Precious metals are unique in that they straddle both categories. The liquidity and transparency of the Exchange serves both sectors well, offering commercial hedgers in the precious metals industry the ability to dampen price volatility in gold and silver, while at the same time allowing financial services firms the opportunity to exploit that volatility.

The gold and silver futures and options contracts that trade on the Exchange's COMEX Division draw their strength from a diverse pool of market participants who come to the Exchange for price discovery. The futures contracts are also widely used as pricing benchmarks, because participants in cash markets worldwide take their cues from the daily futures markets in New York.

Recent Developments in the Exchange

What I would like to do this afternoon is to bring you up-to-date on two really important developments that have taken place in the Exchange, a change in the structure of our clearinghouse, and the integration of our NYMEX ACCESS® electronic trading system into our new NYMEX ClearPort™ technology network.

The Exchange last month substantially strengthened its system of financial guarantees by merging recurring operations with the NYMEX and COMEX Divisions, and simultaneously obtaining a $100 million default insurance policy. The consolidation of the two clearinghouses combines the guarantee funds in each clearinghouse to total US $130 million. The insurance policy would be invoked in the unlikely event that the guarantee fund is completely depleted, due to a default by a clearing member firm.

The Exchange is also proud to announce that it has received a long-term AA Plus credit rating from Standard and Poor’s, and a short-term A1 minus plus counter-party credit rating. The short-term obligations rate A minus 1 plus by Standard and Poor’s is the highest category rating that Standard and Poor’s offers for short-term obligations.

The separate clearing organisations pre-date the merger of the New York Mercantile Exchange and COMEX in 1994, and both operated under the auspices of the Exchange clearing department since that time. Among the benefits of the consolidation, COMEX Division trades are now processed and cleared on the Clearing 21 system alongside the NYMEX Division trades in a single, more efficient processing system.

The system of financial guarantees provided through the clearinghouse mitigates counterpart
credit risk, an issue that has been receiving considerable attention since the fourth quarter of 2001, when Enron Corporation filed for Chapter 11 bankruptcy protection. Its collapse led to increased scrutiny of the trading sector, and disclosures of questionable activities in other prominent trading firms, resulting in industry-wide credit reviews and downgrades, particularly among energy traders, a tremendous loss of market capitalization among energy traders, and the reluctance or inability – depending on one's credit rating – of many companies to enter into bilateral trades in the energy markets. All of this has made counter-party credit risk a primary issue.

Almost two years after the fact, the company’s collapse is still reverberating through the marketplace. Traders plying over-the-counter markets are more subdued than they used to be, no matter who is on the other side of the trade. Credit standards have been tightened, and there is a noticeable loss of liquidity in certain OTC markets.

The lessons of incurring exposure to counterpart risk stand as a historic reminder to market participants that, no matter who your counterpart may be, or what may be their size or even reputation, things can go wrong very quickly, leaving you with an illiquid position, or perhaps even worse.

Through the Exchange clearing process, all Exchange positions are marked to market each day, so that each participant knows exactly his financial standpoint. Market participants whose positions suffer adverse price moves may be required, at the end of the day, to pay additional funds, while those whose positions have appreciated have monies credited to their accounts.

It is true that participants in off-exchange transactions may also require collateral, and the gaining and losing positions also have a practical effect on offsetting each other. There is, however, frequently no formal mechanism guaranteeing that offset in the OTC markets.

The question of clearing hinges on the fact that a guarantee is only as sound as the guarantor. The Exchange clearing rules spell out the policies that are in place to avoid default. The required performance bonds, or initial margins for each market, are based on risk assessments for the respective markets. Variation margins limit the price exposure to a single day, and an active system of market, financial and trade practice surveillance continually monitors all of our markets. Additionally, the Exchange is subject to the oversight of the Commodities Futures Trading Commission, a regulatory government body.

Liquidity and price transparency of the Exchange's gold and silver markets derives, in part, from their around-the-clock availability. Shortly after the trading floor closes for the day, the metals and energy markets re-open on the Internet-based NYMEX ACCESS® electronic trading system, until shortly before the opening bell sounds on the trading floor the following morning. In the eight years that these contracts have been offered for after-hours trading, it has been brought through three increasingly sophisticated trading platforms. Later this year, the gold and silver futures contracts, along with our other metal futures contracts and core energy products, will be shifted to a fourth platform, when NYMEX ACCESS® is integrated with NYMEX ClearPort™. NYMEX ClearPort™ was launched last January, with a slate of energy contracts that are similar to OTC energy instruments, that add to an already-efficient market by giving market participants the flexibility to trade in electronic contracts, competitively or submit bilateral deals for clearing.

The Efficiency of the Exchange

The Exchange’s efficiency and its ability to perform even under extreme market conditions was seen in the smooth handling of the dramatic increases in market volatility, particularly in gold, in the weeks leading up to the Iraq war. Starting in early February, gold volatility increased steadily and substantially for a month, reaching its highest levels in about two years. It stayed there throughout the height of the war and its aftermath. As part of the Exchange’s proactive stance on market, financial, and trade practice surveillance, regular communication on the overall financial condition of their customers was maintained throughout with clearing members.

Trading volume continues to grow this year, even after an excellent Exchange-wide trading record in 2002, when trading volume grew by approximately 30%. Gold and silver futures are showing extreme particular strength, with increases of 40% and 19% respectively.

The efficiency of the markets of the Exchange is attributable to their ability to attract the liquidity necessary for comparative trading. There are guarantees that mitigate counterparty credit risk, the economies of scale, our constantly evolving
technology platform, and additional steps such as the consolidation of the clearing associations.

Summary

The oldest reference to gold is found in the Book of Genesis, dating back about 5,000 years. The dealer market for gold emerged about 600 years ago. The futures market for gold is just shy of 30 years old, but only took a short while from its launch, on the last day of 1974, to become one of the world’s most-quoted metals prices. The financial resources of the Exchange and the clearing members that stand behind each trade, the liquidity generated by those who participate in the markets, and the technology that supports this market, would be the envy of every counting house during the Renaissance.

These are among the reasons why gold and silver are strategic commodities for industry, and continue to play such a vital role in modern finance. Of course, many people feel there is another, more basic, reason, which was explained by George Bernard Shaw, and I quote: “You have a choice between a natural stability of gold, and the honesty and intelligence of members of government. With all due respect for those gentlemen, as long as the capitalist system lasts, I advise you to vote for gold.” Thank you.
A very good morning to you all and thank you to the LBMA for inviting me to speak on hedging and derivatives. The change of venue from Shanghai to Lisbon fortunately does not change the content of my speech, although I am rather puzzled as to why SARS has caused such a stir. In the South African context, SARS stands for “South African Revenue Services”, and I have grown up being plagued by the SARS virus in the form of the dreaded taxman and accountants.

And it is indeed the taxman in the form of a financial authority who is the villain of this particular piece, as I will later demonstrate, for it is he who has probably had some of the most direct bearing on the way hedging has evolved in the past three years.

But before going into the reasons behind what has become known as the dehedging phenomenon, let me quickly update you on the very latest numbers, a data series literally hot off the press.

Our Gold Hedge Indicator, the industry benchmark collated by Ted Reeve of Haliburton Mineral Services and sponsored by NM Rothschild, indicates that for the first quarter of 2003, the hedge book shrank by a further 5%.

But the next chart shows the monthly dollar gold prices from 1987 onwards. It was against the background of these persistently declining gold prices that the majority of the global hedge book was established.

First and foremost there is the price. Hedging and price risk management in general from the gold producers’ point of view has been conducted mainly in a climate of declining prices. Of all audiences, this is one I do not need to remind of the prolonged bear market that we have all endured. The cause and effect of this bear market and the role that hedging has played has been subject to endless debate and it is not my intention to revisit this here today.

But the market a more accurate picture of the real impact the hedge book has on the market, as opposed to the committed ounce figure, which can overstate the true situation. As one then would expect with the committed ounces, the decline is more pronounced because this does not take into account the effect of the net deltas associated with option positions. Regardless of how you might elect to measure the level of overall hedging, the message is the same; the hedge book on a global basis has been declining and my intention today is to explore some of the reasons for this.

First and foremost there is the price. Hedging and price risk management in general from the gold producers’ point of view has been conducted mainly in a climate of declining prices. Of all audiences, this is one I do not need to remind of the prolonged bear market that we have all endured. The cause and effect of this bear market and the role that hedging has played has been subject to endless debate and it is not my intention to revisit this here today.

But the next chart shows the monthly dollar gold prices from 1987 onwards. It was against the background of these persistently declining gold prices that the majority of the global hedge book was established.
This stands to reason. Why would a producer elect to lock in prices through forward sales or put in cap and floor prices in a bull market?

Data source: Virtual Metals

In May of 2000, however, the direction of the gold price at last turned around and this forced the miners to rethink their derivative philosophies. Hedging into a rising market obviously made little sense but more than that, the miners began to review their existing positions and hence brought about the change in the direction of total hedging.

The next important issue was undoubtedly the decline in interest rates which had the impact of reducing the contango to be earned by the miners.

Data source: Virtual Metals

Unlike base metals, which can and frequently do lapse into steep and prolonged backwardations, the ready availability of gold market liquidity means that, except on very rare occasions, gold remains in contango, and the earning of that contango was a prime reason for hedging in the first place. But when the contango falls to the low levels seen in the past three years, there is not much incentive for the miners to hedge and this development triggered a rethink.

Then of course there is the shareholder and his perception of hedging. Over the years there has been a gradual but persistent and noticeable shift in sentiment away from being largely pro-hedging to questioning closely the role hedging ought to play – if any – in a company’s overall strategy.

I believe that three landmark events led to this change of heart on the part of the shareholder. These follow listed chronologically – all had an incremental effect on thinking.

First came the European Gold Agreement in September 1999, which for a very short period of time disrupted the lending market and caused lease rates to spike. The backwardation that resulted was indeed very short lived but it did expose the vulnerabilities of a small number of hedge books via their more exotic and volatile derivative products. The fallout seen in specifically two companies is well known to this audience and there is no need to pick over old wounds. But the resultant media attention and in some cases the direct impact this had on share prices and the shareholders’ investment brought the whole issue to the fore and to the attention of the private and institutional investment communities alike. I like to think of it as three out of the seven veils being lifted – probably forever.

Second came FAS133 and the requirement that derivative reporting become substantially fuller and more transparent. I am going to return to this later in my paper. FAS133 effectively lifted another three of the seven veils and on the back of the fact that shareholders were already starting to feel a bit vulnerable with respect to hedging, their degree of discomfort was further heightened when the intricacies and size of the many of the hedge books were revealed in the public accounts. Someone said to me: “it’s like
knowing that you have a reptile behind your sofa in your living room. It’s in the back of your mind all the time but because you actually don’t see it, you decide that you can live with it – until you actually see the thing and note that it might be venomous and larger than you thought. Suddenly you cannot ignore it any more.”

No wonder one financial executive bemoaned the fact that at equity road shows he was obliged to spend 40 of his allocated 45 minutes defending the hedge book as opposed to getting to say what he really wanted to convey about the growth and prospects for the company. As I already mentioned, I will return to FAS133 in a minute since the impact that this has had on how shareholders view hedging is in fact somewhat more complicated over and above the question of transparency and reporting.

And finally, came the recent but long awaited price increase in which shareholders have rather understandably wanted and indeed expected to participate. Loss of potential upside participation has always been a major complaint levied by the shareholders against a large hedge book and here, right before their eyes, in their opinion, their worst nightmare was played out.

And now back to the SARS virus and the accounting nightmare.

In my research completed for the WGC in August 2000 on the subject of derivatives, FAS133 was still on the horizon and yet to be implemented. It was therefore too early to comment on the effects that it might have on the hedge book. Acutely aware of the looming situation, however, I wrote in the summary:

“The introduction of the new FAS133… accounting system is certainly going to influence future hedging decisions, primarily with respect to the choice of product and the degree of expected disclosure which will render the intricacies of the hedge book substantially more visible. Product choice will be influenced by the way in which a derivative is defined for accounting purposes.”

Well, three years after FAS’ implementation, it is interesting to see how things have unfolded and in many instances, unfolded they certainly have with a number of knock on effects.

First FAS133 in a nutshell:

It represents the culmination of a decade’s worth of work on the part primarily of the Financial Accounting Standards Board in an attempt to establish generally accepted accounting practices. The emphasis was on US-based companies or affiliates, but in practice the impact has been global. With simplicity not its strongest point, FAS133 essentially is a halfway compromise falling short of full fair value accounting (which ultimately must be the goal) but having moved a long way from its predecessor dating back to before the 1980s. Earlier accounting norms focused on the commodity or the currency in question. FAS133 focuses on derivatives no matter how they are used or to what they are applied. Derivatives being what they are, this of course has begged the complex question of definition.

The definition of whether or not a product is a pure hedge or a speculative instrument for accounting purposes has without question affected the mining industry’s choice of product. Inevitably, the very process of definition has not been without considerable debate revealing a world not conveniently separated clearly into black and white but one displaying many, many shades of grey.

The result has been a continued move towards more basic products, such as forwards, which can be categorically defined as a hedge in the pure sense and therefore their accounting treatment has remained largely unaffected. Where a product is defined as a speculative one or a non-hedge the experience has been different.

Take the writing of calls for example. Defined as speculative, these options have to be marked to market at birth and then brought into the quarterly reported income statement. Thus in any quarter or reporting period, the derivative is either above or below the water, giving rise to volatility in the earnings throughout the option life. As the FAS133.com website says, “...Even if the option hedge is perfectly effective at limiting the company’s downside risk with respect to future cash flows, the cost of the hedge...can become a source of undue volatility.” The result is simple: with this kind of potential impact on earnings, fewer miners have been writing calls. But even the simple definition of writing calls appears to be fraught with difficulties and these products can be treated for accounting purposes as a forward sale provided the hedger undertakes to deliver into the option if called.

Another problem highlighted by the hedgers is that marking products to market on a quarterly basis only serves to focus the world’s attention on the latest set of financial results, a problem
already encountered in not just the gold industry. As another miner said: “The preoccupation with the latest quarterlies with marked to market values that are the result of static measures frozen in time does nothing to bring about a better appreciation of the long term wisdom of a well managed hedge book.” Certainly options that in one quarter can be out of the money and thus show a large negative mark to market, over the full life of the option cannot do a hedge book proud – no matter how well structured or managed that book might be.

The reaction to this was predictable. Neither company management (CFOs and CEOs) nor equity markets like earnings surprises at quarterly results presentations. This in turn implies that risk management advisors are now charged with the brief of reducing the volatility generated by hedge products. But the impact this volatility has is a lot more complex and potentially more serious than merely causing some periodic discomfort some quarters. A knock in earnings in any reporting period can in fact result a breach in loan covenants through the erosion of the company’s equity value, the consequences of the company being financially very serious. Ironically this can happen just when the company is actually doing well on other fronts with the unhedged production and reserves rising in value with a rising gold price.

But there are day-to-day issues as well. The major affect of FAS133 from a hedger’s point of view is that it limits the flexibility with which an existing book can be restructured. The extent to which a miner might see the benefits of restructuring is often negated by the accountants who maintain the way the hedges are put through in the income statements remains virtually unchanged. Once a non-hedge product has been introduced into a hedge book, it can leave a sort of permanent accounting footprint irrespective of the way it might be altered in the future. Now when does this occur? If a hedge is restructured via the original counterparty, then in general this problem does not develop assuming of course that valuation changes are fully reflected up to the date of the restructure. But if a hedge originally undertaken with one counterpart is then restructured with another bank then there is no accounting offset permitted and the miner has to report the gross level of hedging which of course leaves the footprint.

This, according to the mining industry, greatly limits what they do with whom and complicates rather than simplifies how the miners convey this to the shareholder and how the shareholder appreciates the overall price risk management programme. As one treasurer said: “Hedging is an already complex concept to get across to shareholders in a cogent and unemotive way that places the rationale into perspective. Superimpose on these the apparently not particularly rational intricacies of the accounting mist and the situation becomes as clear as mud on a foggy day. This does nothing to enhance our ability get across to the shareholder the benefits of the hedge or indeed the wisdom of restructuring to accommodate changing market circumstance. Of course we then play hostage to fortune with respect to comments from our non-hedging colleagues.”

What all this does is highlight the difficulties faced by equity analysts when they have to complete company results comparisons. This is no longer a concern about how to fairly compare hedged against non-hedged producers. It is now a lot more complex than that. It is more an intricate question of appreciating in full the structure of the hedge book, what is defined as hedges and are thus off balance sheet and what are speculative products that introduce the volatility into the income statements and how all this compares with other hedge books and results.

One final point to note that I have already alluded to is that the implementation of these accounting practices is an ongoing process, part of an evolutionary progression. The next step is certainly the intention to include all risk management products into the fair value accounting net, irrespective of their current hedge or non-hedge status. This will imply that all hedging will have to go through the income statements. The downside is: expect more of what the miners have been bemoaning with respect to income statement volatility. The upside however will be in the fact that any debate as to product definition will be ironed out the system, circumventing the time consuming debates that have characterised the past three years. It also will automatically allow equity analysts a shot at genuinely fair comparisons.

In my 2000 report I included some rather caustic comments from the mining industry on the subject of the accounting standards.

“The authorities are removing the incentive to mine” was one, and which with hindsight probably should have read: “The authorities are removing the incentive to hedge.”

Another comment was: “FAS133 is poorly prepared and in general is unreasonable”. This complaint obviously came from the heart but it
was said just as FAS was beginning to impact and we can expect more to come. Regardless of how the miners feel about FAS133 they are not alone since FAS133 is affecting almost every business that might make use of derivatives, from producers of commodities right through to hedge funds, from banks through to traders – in short both users and creators of derivatives are being affected. FAS133 is here to stay and we can only expect accounting standards to become more onerous and encompassing in the years to come.

Thus overall, the hedger has not had an easy life of late. Higher gold prices, lower contangos, onerous accounting standards and in some cases grumpy shareholders – not exactly the recipe for blissful existence. Is it any wonder that we have seen a persistent decline in hedging? And to add insult to injury those producers who have actively reduced their book, a process which certainly has been supportive of the price, have received no credit for this course of action. They have been criticised for years for their hedging policies and then when they unwind them, no one bothers to acknowledge their effect on the market.

But what of the future? In this current price and contango regime we would expect more of the same but there must come a stage when the rate of decline slows and we are left, all other parameters being equal, with a core level of price risk management.

On a delta hedge basis the hedge book since June 2001 was contracted from a fraction under 99 million ounces to a little over 77 million ounces, a difference of 21.6 million ounces. This equates to a decline of 673 tonnes or almost twice South African gold production at 2002 levels. Looking at this slightly differently, this 673 tonnes is actually demand; it is gold coming off the market. This begs the question: what other source of demand is going to fill the vacuum if and indeed when the dehedging phenomenon has run its course?
Behaviour and Decision Making in the Bullion Market

Gerald Ashley
Consultant

How do we make decisions in life? Are we as rational as we think we are? Can we do anything to improve the way we make decisions both in the markets and our general day-to-day business existence? The answer to these questions may possibly be found in studying both our own individual behaviour and the market’s behaviour, and crucially how these two elements intertwine.

John Maynard Keynes once wryly observed that it is better to be roughly right than precisely wrong. We live in an age of unparalleled computing power and significant innovation in complex mathematics and risk management techniques – yet why have so many people lost so much money, particularly in equities, over the past few years?

Of course, it has not just been the individual investor who has suffered, but also the big institutions and professionals, despite their access to large resources to tackle financial risk. The whole business premise of the risk management industry is predicated on reducing exposures and losses, and helping investors, fund managers and executives in banking and insurance avoid these problems. Has the financial world been chasing rainbows by believing that mathematical models can contain risk, and are we all guilty of putting too much faith in these ideas? As a result, have we fallen into Keynes’ trap and lost sight of being roughly right, and instead have ended up being evermore precisely wrong?

It would seem that recent equity market events (to take a familiar and painful example) may seriously bring into doubt the usefulness of some quantitative risk techniques – or at the very least force us to put a significant caveat on their ability to contain losses. The desire for precise measurement and the human need for certainty and control have not led to fewer losses. Perhaps instead of endlessly fine tuning mathematical models we should be directing our efforts into other areas and methods.

In very broad terms we can divide financial risk into three “P’s” – Price, Probability and Psychology. The area of pricing (by this I mean issues such as spread, liquidity, access to accurate and timely data, etc.) is well understood and usually properly addressed by most players in the market. It is in the second area where much of the current focus is centred. There is now much emphasis on probability; constructing risk models, defining risk measurement regimes, and understanding potential non-linear relationships in time series data, etc. This area has been bombarded by huge spending, significant computing power, and, not least of all, a large amount of high level brain power – but the ‘breakthrough’ to understanding, containing and mastering risk still seems to be tantalisingly just beyond our grasp. Perhaps it’s time to focus more on the third ‘P’ of psychology.

Behavioural Finance

• Behavioural Finance, with its roots in the psychological study of human decision making, seeks to explain how and why most investors:
  – Are more confident than they should be in their forecasting ability.
  – Do not process information efficiently.
  – Make different trade-off decisions depending on the current context.
  – Give undue credence to management and research gurus/experts.
  – Hang on and even add to losing positions

The very word psychology often conjures up images of ‘New Age’ mumbo jumbo and woolly
thinking. In fact the science of behavioural finance is very respectable (a leading exponent won last year’s Nobel prize for economics) and has been around in some circles of financial thinking for a good while. It is however still very early days and we have yet to develop a proper language to articulate and fully develop its ideas.

Perhaps the current bear market in equities will spur renewed thinking, and see attempts to create ‘soft metrics’ type products that will attempt to define and understand the way we make decisions in the market place, because it is the decision making process (or often the lack thereof) that really determines how we cope with financial risk. Examples of this new language will need to include ideas such as:

**False Confirmation**

We tend to overestimate the extent to which others share our views, beliefs, and experiences—this is the so-called false consensus effect. Some examples of this are:

- **Confirmation Bias:** We have a tendency to seek out opinions and facts that support our own beliefs and hypotheses.
- **Selective Recall:** We have a habit of remembering only facts and experiences that reinforce our assumptions.
- **Biased Evaluation:** We are swift to accept evidence that supports our hypotheses, while contradictory evidence is subjected to overly rigorous evaluation, and almost certain rejection.

**Investor Overconfidence**

Our minds are wired to make us feel overconfident. We are taught from an early age to be confident and that we have to persist in life to succeed. Whilst this may be a good motto in many walks of life, in investment and trading it can be financially ruinous.

We are particularly overconfident of our ability to make accurate estimates. And equally, research shows we are very impressed by seemingly accurate predictions made by ‘experts’ and gurus. A good example of this is the spurious accuracy often offered by chartists when predicting future market price moves (“gold will find strong support at $324.40”), as are the claims made by some financial software companies about their ‘secret trading systems’, who habitually make grandiose and at the same time minutely accurate claims (“84.7% of the signals were winners!”).

We also tend to be overconfident in our own abilities. People nearly always rank themselves ‘above-average’ when asked to assess their own skills compared to their peer group. Related to this overconfidence is the problem of over-optimism. We all tend to be optimistic, and our performance and investment forecasts tend toward the rosier end of the spectrum. These twin problems of overconfidence and over-optimism can have dangerous consequences when it comes to making investment strategies. Our market strategies are usually based on future estimates, but are often unrealistically precise and overly optimistic about what are essentially inherently uncertain future outcomes.

**Status Quo**

In one well-known experiment, a group of undergraduates were asked how they would invest a hypothetical inheritance. One group received a million dollars in low-risk, low-return bonds and typically chose to leave most of the investments alone. The second group were told their million dollars was in higher-risk securities—and they also left most of the money in these positions.

What determined the students’ allocation in this experiment was the initial allocation, not their risk preference. People would rather leave things as they are (there is an element of blame shifting in this behaviour, of course).

A possible explanation for this status quo bias is an aversion to taking a loss – people are more concerned about the risk of loss than they are excited by the prospect of gain. Paradoxically this can be part of the reason we hold onto poor performing investments (see also Sunk Loss Bias below).

The students’ fear of switching into securities that might end up losing value prevented them from making the rational choice; rebalancing and adjusting their portfolios.

The status quo bias and an aversion to loss contribute to poor investment decisions; in particular they make investors reluctant to dispose of failing investments and bad trading positions.

These phenomena also make it hard for investors to shift their asset allocations. For example, before the current equity bear market, the UK insurer Prudential decided that equities were overvalued and made the wise decision to rebalance its fund toward bonds. Many other UK life insurers, unwilling to break with the status quo, stuck with their high equity weightings and have suffered more severe losses, and as a consequence reductions in their solvency ratios.

**Sunk-Loss Bias**

Another problem about our market behaviour centres around context and circumstance;
framing is the more scientific term used by followers of behavioural finance. Chief amongst these issues is regret and sunk loss bias.

It appears that when faced with a loss it is not just the monetary aspect that pains us, but it is the fact we have to acknowledge responsibility for the loss. This regret is a powerful block for many trying to control their losses; it can be an almost impossible hurdle for some, and is very debilitating in financial trading, given that we have to control and cut our losses on a continuous basis.

It is axiomatic that we have to keep our losses under control, but for many the pain and regret (perhaps even shame?) is just too great. This is how small losses get larger, why investors often try to average a loss by actually increasing their position in an adverse market, and how large company and government projects often spiral out of budgetary control. Perhaps the British government’s experience with the Millennium Dome is an example par excellence of the sort of fiasco that can result from not getting out of bad decisions. This behaviour is sometimes called sunk-cost bias, and really refers to the problem of throwing good money after bad.

**Conclusion**

Mathematical models are simply unable to capture these factors and emotions. Financial markets are not a neat definable problem that can be solved by a clever model. They are dynamic in their characteristics, and so static models and systems whether for risk measurement or prediction of future outcomes can never be consistently successful. It is time for us to look for new tools and approaches to improve our understanding and decision-making in finance.

**Further Reading**

*Butterfly Economics*, by Paul Ormerod

*Choices, Values and Frames*, edited by Teversky & Kahneman


*Mapping the Mind*, by Rita Carter

*Why Smart People Make Big Money Mistakes and How to Correct Them*, by Gary Belsky and Thomas Gilovich

*Uncertainty and Expectation – Strategies for Trading Risk*, by Gerald Ashley

*Innumeracy*, by John Allen Paulos

**Interesting Web Sites**


[http://www-bcs.mit.edu/gaz/#](http://www-bcs.mit.edu/gaz/#) – Fascinating site from MIT that shows how the eye is fooled by shape and shade and how we have ‘preconceived’ ideas of pictures in front of us. We see what we want to – a cautionary tale for chartists.

[http://www.tilsonfunds.com/mungerpsych.html](http://www.tilsonfunds.com/mungerpsych.html) – An instant classic – this is the transcript of a speech given by Charlie Munger (Vice-Chairman of Berkshire Hathaway and right hand man of Warren Buffet) at Harvard University in June 1995. This is probably the best description of ‘financial market psychology’ available.

Session 4: Summary

Martin Stokes
Vice-President, JPMorgan Chase Bank

Before I invite questions for our speakers, I’d just like to add a few observations of my own. I really applaud all the work done by so many people in India and China to liberalise their gold markets. It’s clear that these new places to do business will create some interesting trading opportunities in local markets – but I’m worried that it will be some time before the international banks become comfortable in trading in such exchanges.

Issues such as enforceability of contracts and tax will doubtless require significant lawyer focus. In the meantime, the banks’ commitment to the traditional consignment business may reduce, largely because it doesn’t yield sufficient profitability, given the relatively small ticket size and other issues such as credit and sovereign risk exposure. Historically this has been a very competitive business which delivers gold to the ultimate consumer for wafer-thin margins – but before the efficiency of local exchange mechanisms can be established, there may be some escalation in the cost of the traditional supply chain as some banks reduce their commitment.

It seems to me that the reduction in producer hedging has pushed part of the market back towards the simplicity of the 1970s – not so much a new era, more a reversion to former times. Gold trading then was basically a merchanting business where a small number of banks bought gold from producers and sold it to private clients or via consignment stocks to consumers. Most of the trading activity was spot and the market was fairly opaque. Prices could be very volatile as clients had no access to price protection products and everyone had to trade spot.

In such a market, there was little need for significant amounts of gold liquidity and the lending and borrowing market hardly existed. Furthermore, banks’ overheads were relatively small.

Total reversion to such a market today would see a dramatic reduction in participation by the banks. The environment would be dire, especially as the greater transparency in spot prices now as a result of electronic platforms has created fewer opportunities for intermediation. As I’ve mentioned before, the primary physical demand/supply chain is only some 3,000 tonnes and given the escalating overheads of the banks, there would be no logic for them to be in the game.

Now we certainly have not got back to the 70s yet but we’re some way on this road and if the banks do not see a decent return, then they will continue to diminish their commitment.

In the short term, as the producers have reduced their need for hedging products, in my view, the banks have done three very logical things – focused their attention on the investor community, increased their own proprietary trading activity and reduced costs.

There is no doubt that in the last couple of years the gold market has attracted investment interest – a weaker dollar, political and economic uncertainty and producer buybacks have created a heady mix of positive factors for gold. Unfortunately, in my personal view, a great deal of this interest is what I would classify as hot money rather than longer-term investment. This was clearly demonstrated by the price action in the early part of the year which was characterised by extreme volatility with many of the players clearly driven by the same technical/chart based data. Perhaps the world’s investors have had such a succession of shocks over the last three years that they will keep some gold in their portfolios for extended periods of time – but while it’s great to be the focus of attention now, we should build for the future. I really hope that the various initiatives to create gold as equity will prove more successful in attracting longer-term interest from the mainstream real money funds.

The market should also consider whether we can reconcile the interests of traditional gold equity holders – for whom no hedging is a mantra –
with the interests of stakeholders and prudent management of gold producers who are looking for a consistent cashflow. Structures that directly link equity performance with that of the underlying commodity deserve more attention.

Maybe people like Kamal and myself carry too much historical baggage and perhaps we should look at the market from the perspective of someone who has only seen it for the last couple of years – a real bull market that could easily surmount $500 per ounce.

However, I can’t get away from the fact that a rally built to a significant extent upon producer buy-backs will not be sustainable without widening investor participation. In broad terms, many producers were forced into survival hedging strategies when prices were sub-$280. Buy-backs have continued at prices up to around $340.

I only hope that if prices do fall again in a low contango market, that the banks have sufficient credit appetite and willingness to support a renewed bout of hedging interest at low prices.

I haven’t spoken of the central banks yet, but in an environment where gold yields have fallen to virtually zero in the periods up to one year, there will surely be more thought given to increased sales. In some regard gold can be seen as a bond in which the capital value has risen as interest rates have fallen – but if you don’t sell, then you can reap no benefit.

In the medium term, I definitely see a continuation of spot price volatility, perhaps even more than we’ve seen in recent months – both down as well as up – but we must concentrate on making the market more easily accessible to investors if we really want to see a new era for gold.
Session Four: A New Era for Gold?
Questions and Answers

Ed Jette, Stillwater Mining Company

This is a question to Al Getz. With the increased participation on the Exchange, and increase in volume, does the Exchange see any possibility of extending the opening hours to the “old days”, or will you just predicate the increased volume into the electronic systems?

Al Getz

I think you are referring to changing the trading hours back to the 2.30 p.m. time frame. Any change in the trading hours in the COMEX division rests with the members of the COMEX division of the Exchange itself. I would encourage those market participants who are active users of our market to contact the COMEX members they trade with on the floor and discuss this issue with them personally.

Jessica Cross

I would like to address a question to Gerald. In the context of your analysis, how should we, the folks out there, interpret George Soros’s very public statement that he is short in dollars and long in gold?

Gerald Ashley

One of the speakers this morning made the point that if you announce your position with all the subtlety of telling the international press, one would be tempted to think that he is looking for a number of less-informed players to provide him with a bid.

It is interesting. Once again, it comes back to the point I made as to whether it is a closed or an open system. Somebody like Soros is given credence, and quite rightly because of his past record and so on, but he is not outside the system making an observation. The same is true for Warren Buffet. None of us are innocents in this situation. We are all trying to influence each other, and are talking our own positions in both, and hoping that people will react in ways that are favourable to our own position. We must remember that.

Kamal Naqvi, Macquarie Bank

Jessica – not in the least trying to influence you, but looking forward, you are saying that you expect producer de-hedging to decline. What sort of quantum do you think is likely, maybe not on a quarterly basis, but in terms of trend? Currently it looks like a reduction of about 150 tonnes or so a quarter for the last three quarters. Do you think it will be a significant reduction from that level, or a relatively modest one?

Jessica Cross

I discussed this in some detail with Ted Reeve, because we have been navel-gazing about it. It has intrigued us a lot. We feel that we have another two or three quarters at probably about the same rate as we have seen over the last two quarters, if that helps.

Beyond that, we do not know. It is a ceteris paribus thing – all other things being equal. If we have a turnaround in interest rates, which is unlikely, a turnaround in the price and so on, you could see why hedging might wind up again. It is a very difficult thing. If everything stays as it is, then there could be another two or three quarters but, beyond that, we really do not know. We will just have to wait and see what happens.

Martin Stokes

It worries me personally that a large part of this rally is built on producer buy-backs and, as Jessica said, we do need a lot of faith that the investor will pick up the slack.

Jessica, if the market got back to a level like $280, do you think we would get into survival hedging problems? Do you think the producers would be obliged to go into forward sales, with a horribly low contango?

Jessica Cross

My feeling at the moment is that any further strengthening of the price would probably keep the hedges out, on the basis that, as Gerald said, you do not want to miss out on that rise. If the price were to come down, that is when I think we could see more hedging coming in.

That would worry me a lot, but there again, I do not know at what level that would come in. Psychologically, through the $300 level, I suspect that we could see some people wondering whether to return and put in some price protection. Then the whole vicious cycle could start winding up again, which would make life interesting for me, as it would provide more
statistics to collect. However, it would probably not be such a good thing for the market.

**Martin Stokes**

At least the central banks might get a slightly better yield for their asset than at present.

Thank you very much for your participation this afternoon, and thank you to our speakers

I do have one last item. We have a letter here from Shen Xiang Rong addressed to Stewart Murray. I think it encapsulates some of the spirit in the market. He says: “It is my great pleasure to congratulate you on the 2003 LBMA Precious Metals Annual Conference held in Lisbon this coming June.

This is a most appropriate time to look back on our co-operation in the previous year – 2002 – a year of keeping the issue alive, and all efforts to make Shanghai the original host, and our Exchange the local co-ordinator. This was possible because our relationship was built on the basis of mutual trust and benefits. Together we were, and are, a million strong. The importance of the LBMA’s role is undoubted. Not only must you and all similar organisations continue your activities, but we must all redouble and triple our efforts. Together we are sure to boast a bright future.”

On that happy note, thank you for your participation this afternoon.