Gold Market Review and Outlook

Prepared by GFMS Ltd on behalf of the CBOT®

Overview

Over the last five years gold has been in a sustained bull market, the dollar price more than doubling over this period. The last few months in particular have seen the yellow metal break through a series of multi-year highs, initially the $500-level and later, in 2006-to date, the $600 and $700-marks. At the time of writing, the price has fallen dramatically from its peaks to back below the $600 level. However, over the next 12 months or so a renewed rally, quite probably to new highs, is a distinct possibility.

The fuel for the gold price rally over the last few years, and particularly during the first five months of 2006, has been largely provided by an impressive expansion in investor interest in the metal. The switch in producers' behavior from aggressive hedging to de-hedging has arguably been the second most important driver of the price rise over the past few years. (Producer hedging refers to the sale of future production through the use of forwards and derivatives, while de-hedging occurs when producers deliver against such obligations.)

Changes in some of the other components of gold supply and demand have also had a part to play in the shift in gold's fortunes. In the sections below we analyze the contribution to price determination of these components of gold supply and demand - including investment - and comment on what we expect from them in the future.

Supply

Mine supply is like the proverbial supertanker: it takes a long time to change direction. Hence the expansion in production during the 1990s bear market that was largely based on earlier decisions, taken when prices were more attractive for the miners. In the shorter term, though, production is largely price-inelastic. That said, the increase in the price is keeping marginal mines in business that would otherwise have closed basis, for example, $400-$450 gold. This phenomenon, coupled with the startup of a handful of new projects, is expected to fuel the moderate growth in mine production GFMS forecast will take place in 2006 and 2007. However, underinvestment in exploration during the 1990s bear market means that there are relatively few projects in the pipeline, which suggests that in spite of very attractive prices a more significant rise in output is still some way off.

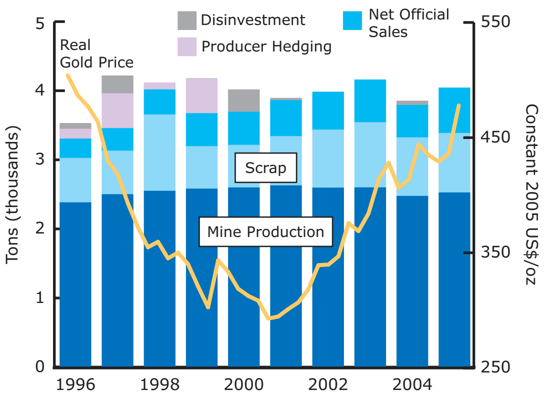
Since 1989 **central banks** have consistently been net suppliers of gold bullion to the market. This was a major supply shock for the gold market, as during the 1970s and 1980s the official sector was essentially neutral in terms of its market impact. The 1990s, however, saw increasing scepticism within central banking circles about the role of gold in official reserves. This factor plus growing fiscal pressures in many countries led to central banks becoming large net sellers of bullion. Indeed, last year official sales hit a record level. However, there are indications that 2005 may have represented a high water mark both in terms of the volume of supply from central banks and in terms of their collective attitude towards gold. As regards the latter, in a series of comments over the last few months of 2005, a number of central bank officials indicated that they considered gold to be an important reserve asset, particularly in terms of reserve diversification. Some also alluded to potential purchases being on the horizon.

In fact, the first few months of 2006 have seen net official sector sales decline substantially. On the one hand, sales from within the European Central Bank Gold Agreement (also sometimes known as the Washington Agreement) dropped significantly. On the other hand, countries outside the Agreement emerged as net buyers of bullion. Looking ahead, GFMS expect that this year official sector sales will remain substantially lower compared to 2005's record level.

Scrap is perhaps the most price-elastic component of supply in the short term. This is driven by the fact that most gold scrap comes from the recycling of old jewelry in regions where retail markups on jewelry over the gold price are very low, such as India or the Middle East (these markups can be as little as 5%-10% over the metal value). Over the last decade, scrap has, on average, accounted for just under a third of global gold supply.

The rally over the last few months has resulted in an impressive rise in scrap supply. Already in the last quarter of 2005, as the gold price rose towards and through the $500 mark, our information is that the volume of metal coming back to the market was rapidly rising.

Gold Supply 1996-2005



Source: GFMS

The major surge in scrap supply did not, however, come until the first few months of 2006, as the gold price breached a series of fresh multi-year highs. Given our contention that the price will continue to advance over at least the next year or so, GFMS expect jewelry recycling to continue at a high level over the rest of this year and through to 2007.

Demand

Accounting for around 73% of global gold demand over the past decade, **jewelry** fabrication is by far the largest component of demand. For much of last year, fabrication had remained resilient, despite the relatively high gold price regime. This was due to the trade getting used to prices in a $420-$450 range and, just as importantly, the fact that there was little price volatility to contend with. However, in the last few months of the year, as volatility increased and the gold price rose towards and through the $500-mark, demand plummeted. Since then, jewelry fabrication and consumption has experienced further weakness. GFMS expect the gold jewelry market to remain very soft over the rest of the year and, in fact, for as long as the gold price (and volatility) keeps to the higher levels seen recently.

The bulk of **other fabrication** demand is accounted for by industrial fabrication, especially electronics, which is relatively inelastic in the short-medium term to price changes and in large part is driven by trends in industrial production. GFMS therefore expect this component of demand to rise modestly during 2006 but probably weaken in 2007 as world GDP growth is expected to slow.

The declining **producer hedge book** has provided the gold market with an annual average of 234 tons of extra demand, since 2000, when de-hedging started. The swing from the aggressive hedging seen in the 1990s to de-hedging has been very supportive of the gold price and has certainly contributed significantly to the price rally of the last few years (as hedging did to the 1990s bear market).

Our expectations for 2006 and next year is that in spite of high forward prices net de-hedging by the producer community will continue, driven by miners' bullish sentiment and the virulently anti-hedging stance of their shareholders. The small amount of strategic and project related hedging we expect to see will be more than offset by continued deliveries against open positions as well as, at the margin, some buyback activity.

The other area of demand besides de-hedging and fabrication is investment. Gold investment demand is discussed in depth in the following section of this report.

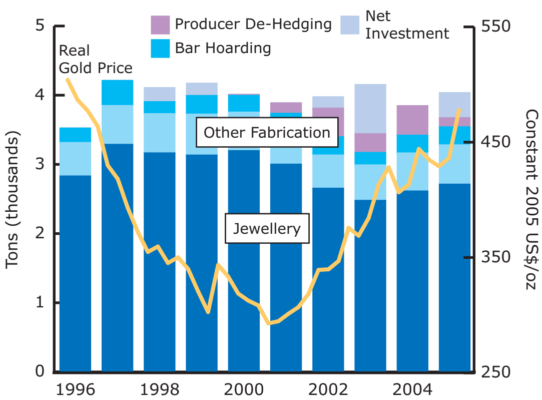
Gold Investment Demand

Gold investment demand can be split into three main components. These are bar hoarding (investment in bar form outside of Europe and North America), coin sales and the balance of investment activity which is not accounted for by either of the two aforementioned components. This is the residual or supply/demand balancing item, dubbed "implied net (dis)investment", in GFMS' analysis that is explained further below.

Implied net investment largely consists of the net impact on the market of "western" investment activity in physical gold (other than primary coin purchases), in derivatives listed on commodity exchanges, in the various gold Exchange Traded Funds (ETFs), the over-the-counter (OTC) market as well as gold exchange listed structured products. However, it should be noted that the residual number in GFMS' supply/demand balance that by definition should capture these elements of investment demand is an implied figure and not an independently calculated one.

Bar hoarding includes investment activity in physical gold in markets outside the "western" world. Unlike "western" investment demand, a rising price would not necessarily encourage a rise in bar hoarding. Indeed, traditionally in most Asian markets a high price has often acted as a disincentive for gold purchases and, indeed, a rising price has frequently triggered dishoarding of metal.

Gold Demand 1996-2005



Source: GFMS

It is thus not surprising that bar hoarding demand has kept to unimpressive levels throughout the rally of the last few years, in spite of an expansion in wealth and very high savings rates in many developing countries. Furthermore, given current price levels, we expect demand to decline year-on-year in 2006.

Coin sales, which with the exception of Turkey are concentrated in North America, Europe and Japan, have been lackluster throughout the current millennium. Furthermore, GFMS expect they will remain weak during 2006. There are two main reasons for this. First, so far retail investors - who traditionally have accounted for the bulk of coin demand - have played only a small part in this rally. Second, buyers are tending to favor more investor-friendly paper gold products instead of direct purchases of physical bullion that usually incur much higher spreads and storage complications. A potentially important caveat though when it comes to the outlook for coin demand is the possibility that there is substantial buying later this year of the US Mint's forthcoming 9999 coin.

It is clear therefore that the most important driver of the rally has been the part of investment demand accounted for by "western" investors. This is apparent from GFMS' data on investment, which for 2005 shows a larger contribution from the implied component than either coin sales or bar hoarding. Furthermore, data for the first half of 2006 is expected to show a continuation of this trend. It is worth looking at the main factors that have attracted "western" investors (both funds and private individuals) into gold, and how these are likely to continue affecting the climate for the metal in the months to come. Furthermore, it is useful to identify who the main players are in the market, and how this might change in the foreseeable future. Finally, it is important to examine the different instruments that are being used by investors to gain exposure to gold.

Investment Motives

The most important factor that has attracted investors to the yellow metal has been the impressive performance of the gold price, particularly in comparison to "traditional" investments such as stocks and bonds. The rally of the last few months of 2005 in particular seems to have eradicated any residual "anti-gold" sentiment that had been lingering since the 1990s, when a disappointing price performance had taken gold off the radar screen of most investors. Indeed, not only has the pool of investors grown but also

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Live Book

Chicago Board of Trade

100 oz Gold — ZGM6 — Last: 665.7 — Change: + 5.5 — Time: 11:11:53

BUY ORDERS QTY	PRICE	SELL ORDERS QTY	PRICE
6	665.4	5	665.6
29	665.3	15	665.7
12	665.2	12	665.8
16	665.1	26	665.9
24	665.0	24	666.0
68	664.9	59	666.1
16	664.8	9	666.2
4	664.7	17	666.3

May 2, 2006 11:11:53 AM

Chicago Board of Trade

mini-sized Gold — YGM6 — Last: 665.6 — Change: + 5.4 — Time: 11:11:52

BUY ORDERS QTY	PRICE	SELL ORDERS QTY	PRICE
51	665.3	33	665.7
76	665.2	56	665.8
47	665.1	70	665.9
43	665.0	47	666.0
200	664.9	178	666.1
9	664.8	39	666.2
13	664.7	42	666.3
42	664.6	18	666.4

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The live order book (Market Depth) is available for free at the CBOT Web site. It displays all of the current buy and sell orders at various price levels along with the last price traded, change from the previous session settlement price, and last trade time stamp. A market summary table below the order book provides even more real time market information including real-time session volume.

CBOT Gold Futures and Options Salient Features

	100 oz Gold Futures	33.2 oz Gold Futures	100 oz Gold Options
Contract Size:	100 ounce	33.2 ounce	100 ounce
Ticker Symbols^:	ZG	YG	OZGC & OZGP
Tick Size:	$0.10/ounce ($10/contract)	$0.10/ounce ($3.32/contract)	$0.10/ounce ($10/contract)
Trading Hours:	6:16 p.m. – 4:00 p.m. (Central time)	6:16 p.m. – 4:00 p.m. (Central time)	6:16 p.m. – 4:00 p.m. (Central time)
Futures Delivery:	Physical gold basis New York or other Exchange designated locations	Physical gold basis New York or other Exchange designated locations	A position in the respective CBOT 100 ounce Gold futures contract month (American style option)
Trading Platform:	100% Electronic	100% Electronic	100% Electronic

^ Individual Quote Vendors may use alternate ticker symbols.

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sentiment has become increasingly bullish with higher and higher price targets being discussed in the financial media.

Dollar weakness is another important factor behind the resurgence of investor interest in gold. There is a well documented tendency for gold to be inversely correlated with the US dollar. Although the gold-dollar link is not a rigid one - for example it largely broke down from the latter part of 2005 through to early 2006 - over the longer run the traditional relationship does tend to assert itself. Expectations of future weakness in the US currency therefore continue to be important in attracting investors to gold, as are periodic declines in the greenback, such as those in April and early May 2006, in stimulating investor demand for gold.

Gold investment has also benefitted handsomely from investors' growing interest in commodities. As can be seen in the graph below, fund positions in 13 commodity futures across a variety of exchanges have grown to reporting records in real terms. Much of the investment in commodities has been through the purchase of indices or baskets that often will contain a small percentage of gold. Given the growing sums being invested in commodities this has translated into a sizable investment - albeit a somewhat indirect one - in gold. This phenomenon seems to have become particularly important during 2006-to date, with further growth in such investments probable, as long as the general commodities complex remains strong.
The global economic and political backdrop has also been very supportive of gold investment. The worldwide threat of terrorism, the continued war in Iraq and tensions between Iran and a number of western countries over the former country's nuclear ambitions, are just some of the pertinent issues. For example, the growing crisis over Iran has on the one hand fueled inflationary expectations, through the anticipation of rising oil prices, and on the other, created a general feeling of insecurity. Both these factors are proving to be positive for gold, which is traditionally both a hedge against inflation and a safe haven asset.

The Investors

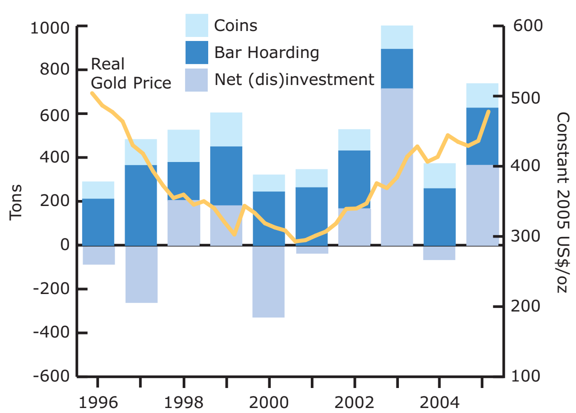
The bulk of investment activity in gold has come from institutional and high net worth players. (As mentioned earlier in this section, retail investors have to-date had only a minor role.) Furthermore, many of these investors are at the more speculative end of the spectrum. Although growing, the involvement of longer-term institutional players, such as pension funds, remains fairly marginal. Among high net worth investors, on the other hand, there appears to be a somewhat greater proportion of "buy and hold" types perhaps because for many wealth preservation is as much a priority as short term capital gains.

The Instruments

Looking at the instruments used by investors and commencing with perhaps the easiest to track, due to their inherent transparency, activity in gold futures listed on the main commodity exchanges has rocketed in recent years. As can be seen in the accompanying graph, for the United States in particular, volumes and open interest have grown substantially over the last two years.

World Investment Demand

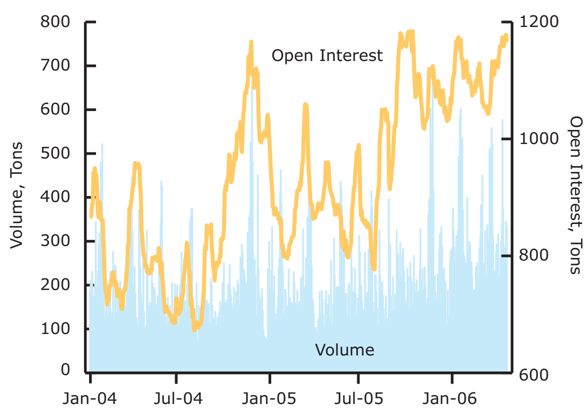
Consists of bar hoarding, coin sales and implied net investment



Source: GFMS

Futures Volume & Open Interest in US-listed 100-oz futures

Daily data, transformed in ton equivalents



Source: GFMS

Gold ETFs have also been very successful, since they first appeared on the market in March 2003. Over 2005 alone, 208 tons of gold were added to the holdings of the five ETFs that were active at that time, while the first quarter of 2006 saw 109 tons of additional demand for these products. It is worth noting that the bulk of activity on ETFs is accounted for by that on the streetTRACKS Gold Shares product, whose holdings at end-April took up more than 70% of the overall figure for the ETF universe.

Much investor business flows through the OTC market. However, there is no hard data available on this activity. Nevertheless, GFMS can form a view of the trends in the OTC market, based on information collected through field research, using our extensive network of contacts. These contacts confirm that a significant share of investment demand is in the form of OTC products, mainly spot and forward gold and vanilla options. There has also been some interest in fixed income-type products, with notes and bonds structured on gold or baskets of commodities becoming fairly popular. In contrast, demand has been lackluster for more complex OTC derivative instruments or structured products.

Exchange listed structured products, namely warrants and certificates, are cash-settled standardized derivatives on the metal, listed on several European stock exchanges. Although in general activity in such products has been patchy, at times investor demand has been strong.

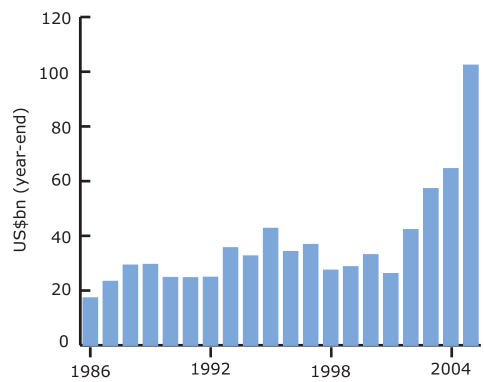
Finally, despite the impressive rise in investment overall, direct purchases of physical bullion (as opposed to those on a metal account basis) have remained lackluster. This in part due to the increasing availability of easily accessible alternatives to physical gold. It also is a reflection of the so-far limited participation of retail investors.

Conclusion and Price Outlook

Looking ahead, GFMS believe that in the shorter term it is possible that the recent liquidations, which have brought the gold price to well below the $600-mark, will be followed by a modest recovery in the price, with gold then likely to be more rangebound over the rest of the summer than it has been in 2006-to date. In the latter part of the year and through to 2007, we expect investment demand will return strongly, pushing the gold price to fresh highs. Given the US dollar's poor fundamentals, rising energy and commodity prices in general and increasing geopolitical tensions, the investment case for gold remains powerful. Furthermore, higher short term interest rates and the generous contango on gold are unlikely to prove sufficient incentives to entice many short sellers or producer hedgers. Finally, given the ever widening investor base for commodities, the potential "weight" of money that could enter the gold market is immense. To-date this rally has only involved a small minority of institutional and private investors. Indeed, should the inflow of new money into gold prove sufficient, there is even a good chance that the 1980 nominal high of $850/oz will eventually be taken out.

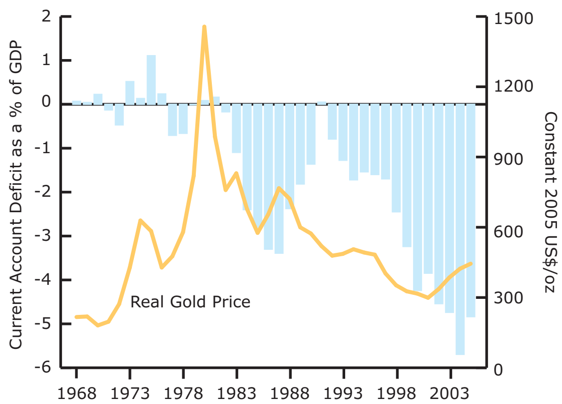
"Fund" positions in 13 commodities

Real value of non-commercial and non-reportable positions in 13 commodity futures; Source: CFTC, Reuters



Source: CFTC, Reuters

The US Current Account Deficit



Source: Reuters

About GFMS Ltd

GFMS is the world's premier precious metals consultancy, specialising in research into the global gold, silver, platinum and palladium markets. GFMS is based in London, UK, but has representation in Australia, India, China, Spain, Germany and Russia, and a vast range of contacts and associates across the world.

GFMS has established three sister companies, GFMS Metals Consulting, GFMS Mining & Exploration Consulting and GFMS Analytics, in order to address the increasing need for independent and tailored research and consultancy in base metals & steel, in mining & exploration and as regards immediate market analysis.

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