

MAY 2007

ScotiaMocatta Metal Matters

Precious metals extended their gains for most of April, but ran into profit-taking, this was most noticeable in Gold as prices approached \$700/oz

- Overall investment interest showed signs of recovering, although prices seem to have gone too far too fast, so are now consolidating
- With the dollar under pressure the outlook for Gold remains favourable
- Gold prices may need to retest support at \$660/oz or \$650/oz, but should then resume the up trend

Silver ran into resistance at \$14.11/oz and has now started to consolidate, expect dips to be well supported

- Longer term investors increased their holding in the ETF by 90 tonnes in April
- **The PGMs outperformed the other precious metals as news of various ETFs emerged**
- A broader base of investment buying should boost demand for both Platinum and Palladium and see prices push higher



Gold underpinned by good buying, but met resistance ahead of \$700/oz

Gold prices spent the last two weeks in March and the first two weeks in April recovering from the sell-off that started in late February following the weakness in Chinese equities. However although prices set new 2007 highs on April 23 at \$693.40/oz, prices have lacked the energy to rechallenge \$700/oz. So far profit-taking seems active in the mid \$690's/oz and as such it may take the market some time to erode overhead supply up to \$700/oz. Indeed the lack of follow through buying seems set to trigger disappointed liquidation selling that could see prices fall back to the \$660/oz or \$652/oz level.

Strong up trend dominates

Since the rally started to gain ground again last October, price have moved higher in three waves. The first two waves, from trough to peak, moved around \$90/oz each, although the third wave petered out after a \$60/oz rise, which is somewhat disappointing. However, it may be that the rally stopped short of expectations because prices ran into the psychologically important \$700/oz level, which proved to be a natural selling level.



Gold struggling despite weaker dollar

The proximity of the \$700/oz level may also explain why Gold prices have not reacted more positively to the weaker dollar. Basis the dollar index, the dollar has fallen from 83.20 in early April to 81.27, breaking the December 2006 low at 82.24. The multi-year low on the dollar index is at 80.39 from December 2004. A breach of this level could well increase concern in the financial markets. Indeed we are surprised Gold is not

being bought in anticipation of further dollar weakness and as such we think Gold has potential to play catch-up. However, opinion is mixed as to whether the dollar is now likely to bounce as it approaches support, or whether it will slide further.

Is the dollar facing up to reality?

Over the past three to four years the market has, to varying degrees, been concerned that the structural imbalances in the world's financial markets would drag the dollar down. Because nothing came of it, the market has become complacent. However, the risk is still there and maybe now that the markets' guard is down, the threat will strike. In the past foreign central banks, especially in Asia, have recycled their trade surpluses by investing in US treasuries, but in recent months there has been more talk of central bank diversification. In addition, with the US facing a slowdown in its housing market the outlook for consumer spending has deteriorated and with consumer spending accounting for 65% of US GDP, there is an increased risk of a slowdown. If the US economy starts to struggle then investor interest in the US is likely to suffer, which in turn could trigger a vicious circle. As such we feel there is a risk that the dollar will resume its trend lower and that Gold will once again be sought after by investors looking to diversify their dollar risk.

Record equities deter investor interest

Following the equity sell-off in February; share prices have bounced back aggressively and many indices have set fresh highs. However, given the outlook for the US economy, the equity markets look vulnerable and with the dollar also looking weak (hence not showing confidence in US markets), it would not be surprising to see further diversification into the likes of Gold as investors seek some insurance against another equity sell-off.

Fund buying returns

After the February and March risk reduction sell-off, fund interest in Gold

has picked up, even though it dipped slightly in late April after the market failed to climb through \$700/oz. On March 20, the net fund long position on COMEX had dipped to 93,424 contracts, but it shot back up to 135,358 contracts by April 17, before easing to 133,842 contracts by April 24. However, over the month the long position increased 42%.

But ETF holders have been sellers

Although the more speculative money on COMEX has ridden the rally in Gold, the longer term investor has been less enthusiastic. Indeed although month-on-month the combined ETF position increased ten tonnes to 651 tonnes, the final two weeks has seen redemptions as the ETF position peaked at 658 tonnes on April 19. Again this suggests that investors may be feeling more comfortable about the global economic outlook and are seeking higher returns in other markets. With the ETF investors generally sitting on large profits, as are recent buyers on COMEX, it is not surprising that there has been some profit-taking and the absorption of this has led to price consolidation. However, overall the trend looks robust and investor buying is likely to carry prices higher still, especially if the dollar continues to trend lower.

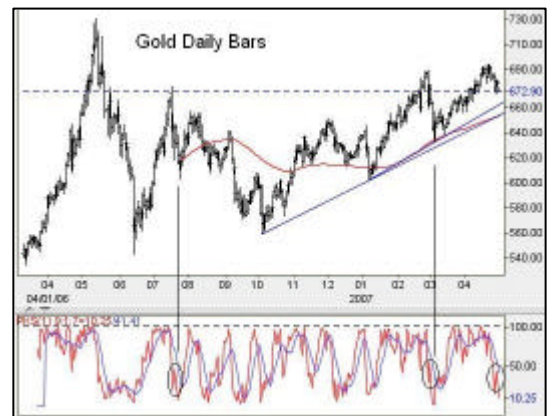
Signs of Central bank diversification

Central bank net sales of Gold are expected to decline again this year as sales under the Central Bank Gold Agreement may fall short of quota as Germany refrains from selling and as other central banks outside the agreement increase purchases. Russia has indicated that it may buy Gold straight from its producers; Qatar has stepped up its purchases, although they remain small, and a number of state investment authorities are also being formed to diversify state reserves. Abu Dhabi, China and Korea have all recently announced new investment agencies.

Technical – approaching a likely low

The freefall in the stochastic indicators and the failed kink higher, as seen in the

circle on the chart, suggests that we are approaching a low, but we may still see prices fall further in the short term. On previous occasions, see earlier areas marked by circles, the same failed kink higher in the fast stochastic has led to volatile trading and mini-spikes lower. These have tended to make good buying opportunities especially once the technical indicators have crossed higher again. The two up trend lines, the upper one at \$661/oz and the lower one at \$652/oz, are likely support areas, especially the lower one as that coincides with the 100 day moving average which is at \$652.75/oz. As such we expect dip buying to turn the market higher before too long, but would wait for an upside cross on the stochastics to confirm the sell off has run its course.



Summary - The up trend in Gold remains in force, even though the latest rally has run out of steam early, but most likely on the back of profit taking ahead of \$700/oz. In recent weeks, Gold prices have failed to react to ongoing weakness in the dollar and with the dollar approaching multi-year lows, there is an increased risk that the dollar will fall further. This is especially so considering the medium term outlook for the US economy is not strong and there seems a growing trend amongst foreign central banks to set up investment arms to diversify their foreign exchange holdings. As such we think the big picture for Gold remains constructive and we expect to see the rally resume before too long.

Gold Statistics	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>4Q 2006</u>	<u>1Q 2007</u>	<u>Mar-07</u>	<u>Apr-07</u>
London Prices (US\$/oz)								
AM fix	363.83	409.33	444.87	604.34	614.33	650.45	655.89	680.01
Pm fix	363.32	409.21	444.88	603.77	605.47	650.27	654.90	679.37
Average	363.59	409.30	444.87	604.06	609.90	650.36	655.40	679.69
Parity prices								
Australian - A\$/oz	558	555	583	801	792	827.51	827	823
South Africa Rand/kg	85,445	81,868	87,876	126,763	138,644	146,226	149,668	150,443
Japan Y/g	1,305	1,371	1,519	2,175	2,227	2,409	2,385	2,505
India Rupee/oz	16,954	18,556	19,642	27,387	27,438	28,705	28,839	28,730
Lease Rates								
1 Month *	0.08	0.08	0.10	0.09	0.10	0.10	0.10	0.11
3 Month *	0.13	0.11	0.11	0.12	0.19	0.13	0.15	0.14
6 Month *	0.23	0.15	0.14	0.12	0.12	0.16	0.16	0.18
12 Month *	0.40	0.25	0.19	0.12	0.11	0.16	0.17	0.17
COMEX - futures contracts								
Stocks ('000oz)	2,643	4,547	6,178	7,655	7,517	7,485	7,479	7,603
Vol (million contracts)	12.24	14.96	15.89	15.92	4	5.58	1.51	1.86
OI ('000 contracts)	229	272	302	323	337	370.80	348	394
CFTC (futures only data)								
Net Spec position Long (Short)	70,888	78,084	109,798	96,930	68,003	107,239	95,123	133,842
TOCOM								
Stocks ('000oz)	234	207	193	356	458	397	402	368
Volume ('000 contracts)	26,637	17,385	17,958	22,228	1,215	1,466	1,664	1,291
OI ('000 contracts)	413	333	315	305	258	263	238	220
Other Indicators								
FT Au Mines Index	1,395	1,617	1,696	2,421	2,435	2,336	2,304	2,292
Dow Jones Index	9,035	10,326	10,528	11,457	12,255	12,407	12,400	13,100
US\$ Index	95	87	88	86	84	84	83	82
Gold Bullion Imports, tonnes (exports)								
Dubai	195	502	522	241 ^{H1}				
Hong Kong /China	(200)	(100)	(20)					
India	647	649	695					
Italy	260	260	225					
Japan	74	74	73	68				
Singapore	72	72	26Q3					
South Korea	122	254	40					
Taiwan	12	12	22					
Turkey	264	251	269	193				
Data: Financial Times; Bombay Bullion Association; LBMA; TOCOM; COMEX; CFTC, REUTERS								
Figures are period averages unless marked by *, indicating the period end. OI= Open Interest on the exchange								
~ = data not available, <i>italics</i> = estimates ^{Q3} = up to Q3'05								

Silver extended its rebound off the March low, before consolidating

Silver prices continued their advance last month, hitting a high at \$14.11/oz on April 13 when overhead supply started to dominate. In last month's report we noticed a pattern on the charts whereby the initial up legs were followed by a downward spike, before the rallies resumed. Although it looked as though a down spike was possible in early April, in the end it did not materialise until April 23. However the pattern still looks good, therefore the bout of weakness that has taken Silver back to \$13.05/oz in early May is soon likely to run out of steam and thereby provide another buying opportunity with a target possibly as high as \$15/oz.

Silver follows the crowd

Metal prices in general have spent the last two weeks of April consolidating early April strength and Silver was no exception. With the equity markets in rebound mode, it looks as though there were better opportunities outside the commodities. However this may turn out to be an opportunity to get on board again. Globally economic growth looks robust with strength in China, as seen by the 11.1% GDP growth in Q1, boosting demand across Asia and with Japan and Europe appearing to be stepping up a gear too. Hopefully this should help offset a likely slowdown in the US, but even that maybe delayed further. The latest US ISM manufacturing index showed strength with a reading of 54.7% against expectations of 51%. In such an environment, industrial metals should remain strong.

Room for more fund interest

In addition, if the business climate remains robust then those funds that reduced their exposure to commodities in the fourth quarter 2006, may well decide to reinvest in the metals again. This is especially so considering the equity markets are looking over stretched again and the equity sell-off at the end of February is likely to have increased

portfolio managers' desire to diversify further.

Silver ETF adds a further 90 tonnes

The Silver ETF now holds 4,195 tonnes of Silver, compared to 4,105 tonnes at the end of March and 3,768 tonnes at the start of the year. Although the ETF has no doubt been bullish for the Silver price, the bigger it becomes, the more it may act as a dark cloud hanging over the market. It is, after all, a highly visible and potentially very liquid source of supply if the price were right. As it stands the ETF position is now equivalent to some 15% of annual demand, or 8.25 weeks' worth of consumption.



Technical

The current pattern looks similar to the previous patterns as indicated by the circles. Indeed the circles on the stochastic indicators also show that the dip in the indicator following the start of each up leg, falls short of sinking below the previous low. If this pattern repeats itself, then we should be looking for an imminent rebound. Again the buy signal would come once the stochastics indicators have crossed higher again.

Summary

Given the overall bullish outlook for the all the metals, plus the weakness in the dollar, it does look as though Silver should find good underlying support. A move back above the April highs at \$14.11/oz should then put the metal in a good position to challenge the \$15/oz level.

Silver Statistics								
	2003	2004	2005	2006	4Q 2006	1Q 2007	Mar-07	Apr-07
London Prices (US\$/oz)								
Daily Fix	4.88	6.65	7.31	11.55	11.40	13.31	13.18	13.74
Parity (London) prices								
Japan (Y/g)	17	22	24.97	41.68	40.53	49.31	47.97	50.64
India (Rupee/oz)	227	301	322.83	524.76	529.45	587.48	579.95	580.79
COMEX – futures contracts								
Stocks (Moz)*	111.0	114.5	109.6	112.36	102.17	120.33	126.5	126.5
Vol (million contracts)	4.1	5.0	5.5	5.43	1.35	1.40	0.39	0.38
OI ('000 contracts)*	94.7	103.4	117.9	112.85	105.97	113.73	111.3	111.4
CFTC (Futures Only Data) non-commercial								
Net Positions *	33,414	42,831	39,986	34,830	24,374	40,707	32,078	32,078
TOCOM								
Stocks (Moz)*	0.7	0.5	0.63	0.36	0.35	0.72	1.30	0.27
Futures Vol ('000 contracts)	1,160	1,473	818	859	47.52	49.56	53.3	42.3
Futures OI ('000 contracts)*	21.3	24.1	17.84	16.47	15.11	14.21	12.8	14.8
Other Indicators								
Gold/Silver ratio*	74.1	61.1	60.60	60.60	52.37	49.51	49.5	50.9
Silver Bullion Imports (tonnes)								
USA	3998	4095	4545					
UK	2141	1523	1250					
Japan	1156	1591	1141	1748				
India	3100	2000	3400					
Italy	1526	1638	1458					
Hong Kong **	(2500)	1748	2576					
China (exports)	(2500)	(3500)	(3558)					
* figures are period averages unless marked; ~ not available, <i>italics</i> = estimate.								
** For 2003 data is for Hong Kong and China combined (exports); ^{Q3} = up to Q3'05								

PGMs followed the metals complex higher but were boosted by ETF news

Against a background of strong commodity performances in early April, the PGM's received an extra boost when news of a Platinum and Palladium ETF emerged. Palladium reacted the most as prices leapt from lows around \$345/oz to highs of \$384/oz, a rise of 11%, while Platinum moved from lows of \$1,230/oz to a high of \$1,336/oz, an 8% increase. This compared to a 4% rise in Gold over the same period.

Response to ETF news fairly subdued

Considering rumours of an Platinum ETF last November saw prices spike momentarily to \$1,400/oz, April's rally to \$1,336/oz on concrete news of launch of two PGM ETF's was somewhat subdued. Indeed neither of these announcements referred to a US based ETF and as one is likely to follow at some stage, it is surprising that prices have not rallied more in anticipation of a US ETF.

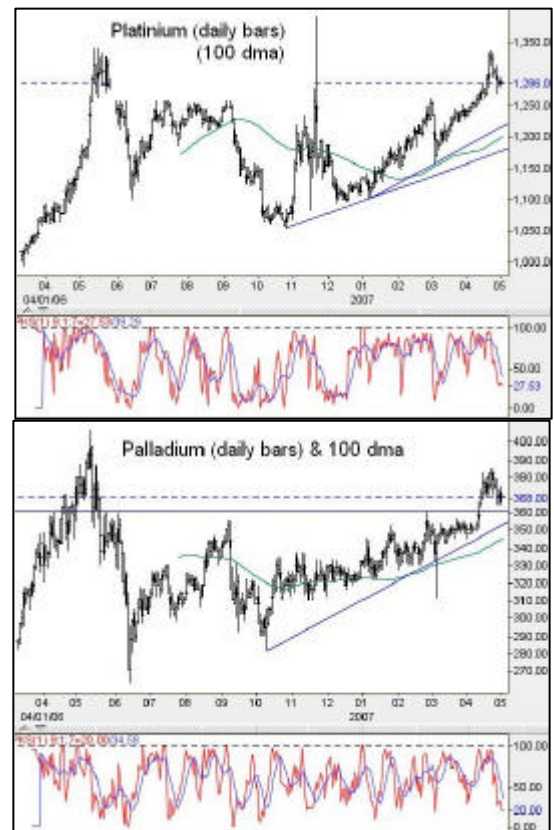
PGM demand to rise on back of ETF

With the outlook for the PGMs looking strong anyway as both metals seem to be facing growing secular industrial demand from electronics, glass and the all important auto industry, not to mention jewellery demand too, any increase in investment demand is likely to make things even tighter. As such, it looks like demand will grow strongly which in turn could underpin prices. Non-essential PGM demand, ie from the jewellery industry, which accounts for 25% of Platinum consumption and 16% of Palladium consumption, is therefore likely to be the sector of the market that suffers the most. However, with the industrial applications more price inelastic, it will be the demand for Platinum jewellery and investors who end up determining how high prices go. 1,740 tonnes of Platinum was used by the jewellery industry last year, but that was already down 38% from the 2,820 tonnes used in 2002. Having already seen demand fall that far, it is questionable whether jewellery demand will remain as

price elastic as it has in recent years. However in Palladium's case, the ETF may well tighten up the fundamentals considerably, by absorbing some of the surplus stocks that overhang the market. Overall in both metals, the emergence of the ETFs is likely to send prices into a higher trading band, as has been the case with Silver following the launch of the Silver ETF last year.

CFTC shows jump in fund interest

Not surprisingly the announcements that ETFs were being launched saw a jump in the net long fund positions on NYMEX. The Platinum position jumped from 5,553 contracts to 8,263 contracts, while Palladium climbed from 6,650 contracts to 10,821 contracts. Again, similar to the price action, the reaction seems to have been greater on Palladium than in Platinum, this seems odd given that Platinum has the tighter fundamentals.



Technical and Summary

After the rallies accelerated in mid-April prices became overbought and the high prices attracted profit-taking. But fundamentally the PGMs are well placed to rally further after this consolidation.

PGM Statistics									
	2003	2004	2005	2006 4Q	2006 1Q	2007	Mar-07	Apr-07	
London Prices (US\$/oz)									
Platinum	698	849	897	1,144	1,132	1,193	1,221	1,280	
Palladium	205	233	200	323	324	345	352	370	
Rhodium	531	980	2,039	4,555	5,060	5,915	6,063	6,301	
Japanese Parity Prices (Y/g)									
Platinum	2,501	2,845	3,060	4,118	4,133	4,424	4,429	4,718	
Palladium	736	781	684	1,162	1,182	1,282	1,280	1,364	
South African Parity Prices (Rand/kg)									
Platinum	164,523	169,994	177,105	240,309	257,533	268,209	278,838	292,310	
NYMEX Stocks ('000oz)									
Platinum	13.9	15.6	22	27	35	33	34	34	
Palladium	102.9	646.7	710	1,037	902	700	672	672	
CFTC Futures Only Data Long / (short) non-commercial									
Platinum	4,048	2,422	5,931	3,653	1,983	4,769	5,553	8,263	
Palladium	1,528.8	4,115	5,271	4,875	2,492	6,239	6,650	10,821	
Tocom - Platinum									
Stocks ('000oz)	16.9	15.5	15.7	14.0	13	11	10.7	10.7	
Vol (Million contracts)	14.2	13.9	8.6	11.0	1	1	0.8	0.8	
OI ('000 contracts)	220.4	183.6	136.9	106	91	87	76.7	99.7	
Tocom - Palladium									
Stocks ('000oz)	1.6	5.8	22.6	26	24	20	18	18	
Vol ('000 contracts)	275	439	323	361	14	20	18	22	
OI ('000 contracts)	3	11	18	15	9	10	9.1	11.8	
Other Indicators (US\$/oz)									
Pt-Au spread	234	337	457	457	523	541	581	621	
Pt-Pd spread	214	496	701	701	816	846	892	920	
Platinum Bullion imports (kg)									
USA	111,000	48,100	28,800 Q3						
Japan	50,000	57,000	52,000	65,000					
Palladium Bullion imports (kg)									
USA	83,000	50,900	52,900						
Japan	41,093	48,300	68,400	77,455					

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