



Global Securities Market Bulletin

February 26, 2010

Issue No.40

Courtesy: Global Securities Research

Tel: (604) 689-5400 Website: www.globalsec.com

Fax: (604) 647-2160 E-mail: analysts@globalsec.com

COMMENTARY

Gold and euro may diverge if the currency's woes worsen

Elvis Picardo, CFA

There has long been a positive degree of correlation between gold and the euro, but with the currency now facing its biggest crisis since its introduction in 1999, that historical relationship may be set to diverge quite significantly.

As the one-year chart below of gold (priced in US\$) versus the euro shows, the two have moved in lockstep until the beginning of this month. Gold rallied in tandem with the euro until November, when the escalating debt crisis in Greece began weighing on the currency, sending it and gold prices sharply lower. But the two have diverged since the beginning of February, with gold rebounding even as the euro trends lower.

Correlation analysis reveals that the relationship between gold and the euro has been strengthening in recent years. The correlation coefficient increased from 0.477 over the past two years, to 0.543 over the past year and 0.720 YTD. (The correlation coefficient is generally denoted by "r" and measures the strength of the linear relationship between two variables; it has values ranging from -1 to +1, with -1 denoting a perfect negative linear relationship and +1 a perfect positive linear relationship).

But that relationship may soon diverge, as the euro has been plagued by a debt crisis not just in Greece, but in other Euro-zone nations such as Portugal, Ireland and Spain as well. The head of the German Finance Agency has warned that the euro would collapse if Greece or any other European Union (EU) member defaults on its debt.

In our opinion, that worst-case scenario may not occur, as the EU may bailout Greece rather than run the risk of a financial contagion engulfing its other cash-strapped members and perhaps the entire continent. Nevertheless, we expect the euro to be under pressure in the near term until there is some degree of resolution to the debt crisis.

Under these circumstances, gold should benefit largely due to the currency vacuum. While the euro is currently bearing the brunt of selling in currency markets, the US dollar has well-publicized problems of its own, not the least of them being trillion-dollar budgetary deficits for the foreseeable future. The lack of a credible currency could well continue to increase gold's traditional appeal as a store of value.

On February 19, gold priced in euros closed at a record high of 824.45 euros/oz; this week, it reached an intra-day high of 832.05 euros/oz. Higher prices may lie ahead.

Our view is that gold may no longer be dragged down by the euro's problems, and in fact, the precious metal could be a major beneficiary if the currency turmoil worsens. Canadian gold stocks could well outperform in this environment.

Gold vs. the euro – One year (daily prices)



Source: Bloomberg

TRADE UPDATES

Yamana Gold and Kinross Gold are our top gold picks

Canadian gold stocks have been notable underperformers lately. While gold priced in Canadian dollars has advanced 2.5% YTD, the 34-member TSX Global Gold index has declined 4%.

Over the past year, however, the TSX Global Gold index – with a gain of 4.9% – has outperformed the precious metal, which in C\$ terms is virtually unchanged over this period. **Yamana Gold (TSX: YRI, \$11.06)** and **Kinross Gold (TSX: K, \$19.07)** have both underperformed the Gold index over the past year, with Yamana up 2.0% and Kinross down 9.2%.

These stocks currently constitute our top picks in the gold sector. We had recommended buying Yamana at levels below \$11 on February 5, following its 27% decline in the preceding two months. Yamana is the fifth-largest Canadian gold producer by market capitalization.

Kinross was recommended as a Buy at \$20.04 on November 6, 2009, subsequent to which it hit an interim high of \$23.07 on December 2. The stock plunged 24% since then, leading us to reiterate our Buy rating at \$17.45 on January 29.

Analysts' average EPS for Yamana Gold are forecast to surge 60% to US\$0.75 in FY10, from an estimated US\$0.47 in FY09. On that basis, the stock trades at less than 15x forecast FY10 EPS. For Kinross, analysts' average EPS estimates are currently at US\$0.66 for FY10, up 46% from US\$0.45 in FY09. On that basis, the stock trades at a forward multiple of about 28x.

We reiterate our Buy ratings on Yamana Gold, with a target of \$14, and on Kinross Gold, with a target of \$25.

Market Snapshot at 12:20 pm

S&P TSX	11632.49	+1.05	Commodities			Yields (%)	Can.	US
TSX Venture	1526.42	+8.48	Canadian \$	95.07	+0.80	90 Day T-Bill	0.15	0.11
DJIA	10341.97	+20.94	Gold (Spot)-US\$	1116.90	+10.55	2-Year Bond	1.26	0.80
S&P 500	1105.95	+3.01	Oil (WTI-Apr.)	79.59	+1.42	10-Yr. Bond	3.38	3.60
NASDAQ	2240.85	+6.63	CRB Index	274.77	+3.90	30-Yr. Bond	4.01	4.54

Thought for the Day

"Facts are stubborn, but statistics are more pliable." – Mark Twain

This publication is not, nor is it to be construed as, a solicitation or recommendation to investors to purchase, sell or hold any of the securities referred to herein. Investors should consult their own broker(s) to determine the suitability of any securities referred to herein as these securities and the trading strategies incorporated into any trading recommendations will not be suitable to all investors. Further information concerning this publication, including information respecting Global's research dissemination procedures, recommendation rating system, recommendation follow-up matters, suspension or discontinuance of coverage and related matters may be found at the research page on Global's website, the address for which is www.globalsec.com, under the caption "Research". Unless noted otherwise, none of the material operations of the issuers referred to herein have been viewed by the report writer(s). The contents hereof may not be reproduced in whole or in part without the prior written consent of Global Securities Corporation ("Global") Copyright 2010; All rights reserved. Member – Canadian Investor Protection Fund.