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Golden Dragon
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The Shanghai Futures Exchange's new gold contract, which opened January 9, will take world gold prices over the $1000/ounce mark, predicts Victor "Trader Vic" Sperandeo, CEO of N.Y. City-based Alpha Financial Technologies LLC.

Speaking from Dallas, Texas, Sperandeo told HardAssetsInvestor.com that he worked out the numbers by watching the public's reaction to the new streetTRACKS Gold Shares (NYSE Arca: GLD), an exchange-traded fund (ETF). People want to hold gold, not necessarily companies that mine or use gold, he says, and the ETF has already contributed to a rise in the price of gold. GLD shares were trading at $89.51/share at press time; the ETF holds over $16 billion in gold bullion.

Judging by the first day of gold futures trading on the Shanghai Exchange, on Jan. 9, Sperandeo may be right: the contract prices for June, July and December all surged to their maximum possible gain on the first day of trading. At this writing, gold was trading on the spot market for $905.60/oz.

To hear Trader Vic tell it, it's really a no-brainer. "There has been a lot of success in China's stock market, as you know," he says. "Whoever owns that stock will want gold for diversification as a chaos hedge."

And the futures allow them an easy way to access that gold … in a sense. The standard trading contract for gold futures on the Shanghai Futures Exchange is 1000 grams per lot, with a 5% limit on daily price movements and a minimum margin of 7% of the gold contract value. The specifics are available here.

The catch is that, to discourage speculation by individual investors, Shanghai has put a number of restrictions on the futures contract. For one, the relatively large size of the contract is designed to tilt the scales in favor of institutional interest. But just as importantly, individual investors cannot take physical delivery of the underlying gold; only institutions can.

Still, net-net, the impact on gold demand could be significant if (as expected) it becomes a favored trading tool for all types of investors. Consider this quote from the China-based *People's Daily:*

*Trade at the Shanghai Gold Exchange, the country's spot market, was 1,828 tons last year, with a total value of 316.5 billion yuan. Based on that figure, said [*Zheng Xueqin, a Chicago Board Options Exchange senior counselor]*, the futures market could hit 10.5 trillion yuan, because international experience showed that futures trade was usually 33 times spot trade.*

In other words, $1.5 trillion.

Of course, it'll take a while to get there. At press time, there were over 30,000 contracts in open interest for the June contract.

"Obviously the World Gold Council welcomes any new development that allows more investors in more countries to have appropriate access to gold's investment benefits," says Roland Wang, the general manager of the Greater China office of the World Gold Council. "The Chinese government is to be congratulated on this latest step in the process of deregulation it embarked upon several years ago."

Gold futures are sold on many other exchanges, including the COMEX, division of the NY Mercantile Exchange, the Tokyo Commodity Exchange, and exchanges in Australia and South Africa. Gold bullion ETFs are also available on many markets.

"China's fascination in gold stems from the fact that for centuries the nation has been a large gold producer," says Andrew Wilkinson, senior market analyst with Interactive Brokers (IB), in Greenwich, Conn. "Given the ongoing industrial revolution in China, it seems that there is an even greater ability to physically recover more ounces of gold. In typical smart Chinese style, producers are fast-teaming up with international partners to learn how to execute the recovery of deeper and more difficult areas. The city of Zhaoyuan, known as the gold capital of China, produces around one-seventh of Chinese gold output and has spent much of this decade shaping the region to become a globally recognized jewelry producer.

"Meanwhile existing action [trading volume] in the currently listed gold contract in Shanghai has more than doubled from below 30,000 contracts, to more than 73,000, according to the exchange's website," Wilkinson continues. "It's likely that the Chinese fascination for speculation is equally as responsible for increased investor interest as is last year's surge in the price.

"With the price of gold reaching close to $900 per ounce, it's moving independently of a slightly stronger dollar these days. Whether this trend continues will be crucial. Gold, which is seen as an alternative to fiat money, generally climbs when the value of the dollar erodes. But it seems as though stronger final demand from population growth is finally extracting greater value from gold, which is pushing up record highs. There possibly couldn't be a better time to launch a new contract."