

Gold's bull charge tempered by "muleta" standoff.

By Ron William, MSTA, CMT, Technical Strategist, Email: r.william@migbank.com

Gold's phenomenal bull charge which has risen over 468% since 1999 is now starting to unwind after being tempered by a "muleta" standoff. Akin to traditional Spanish bullfighting, a "muleta" or small red cape is raised in order to tire the animal's charge and offer a beautiful display of "faena". The yellow metal has been locked in a critical standoff ever since it carved out its all-time record high at \$1431 and is currently showing signs of rolling over. **Point & Figure** charts highlight a price squeeze within a range between \$1430 and \$1320 (see Figure 1). A break in either direction has the potential to drive a 20% change in the price of gold. The probabilities are now skewed for an extended downside reaction.

The Trend is your friend, until... Nine-consecutive years of higher reaction highs and lows has elevated gold to a unique stardom within technical analysis record books (see Figure 1. chart insert). With such a high caliber breed of bull, it would only be natural to believe that prices continue to run in a straight line. However, veteran market observers know that such accelerated price moves, no matter how robust, inevitably prove to be unsustainable in the short term. The aftermath of gold's previous bull cycle, between 1969 and 1980 (which has an 11-year time pattern that coincidentally mirrors the current secular uptrend that launched in 1999 and peaked in late 2010), acts as an extreme, but noteworthy omen to how market's can avalanche from mountainous peaks.



Figure 1. Point & Figure chart illustrates the primary and secondary trend in gold and its current "muleta" standoff between \$1430 and \$1320. Chart insert (i). Annual candle chart exhibits nine-consecutive years of higher reaction highs & lows. Chart insert (ii) Gold bull-cycles past and present, mirroring 11-year time patterns.

A confluence of important exhaustion signals were generated by Tom Demark's TD Sequential indicator across monthly, weekly and daily time fractals (Figure 3). The daily chart highlights that TD Sequential generated Red 13 exhaustion sell signals on two different countdowns within the current multi-month distribution pattern (head & shoulders/triangle). A break below \$1320 would confirm the reversal pattern and unlock an extended downside slide in gold.

Further bearish evidence can also be seen on the monthly chart which is currently developing a bearish engulfing candlestick pattern from the all-time record highs, following five consecutive higher reaction highs and lows. A sustained break below \$1320 would complete a potential Primary degree impulsive third wave within an Elliott Wave structure. The tendency for cycle alternation favours a sharp corrective fourth wave (opposite to the wave two sideways correction in 2001), which would help develop an important low for 2011. This potentially offers a rare buying opportunity for what is likely to be the most profitable future rise in gold to come.

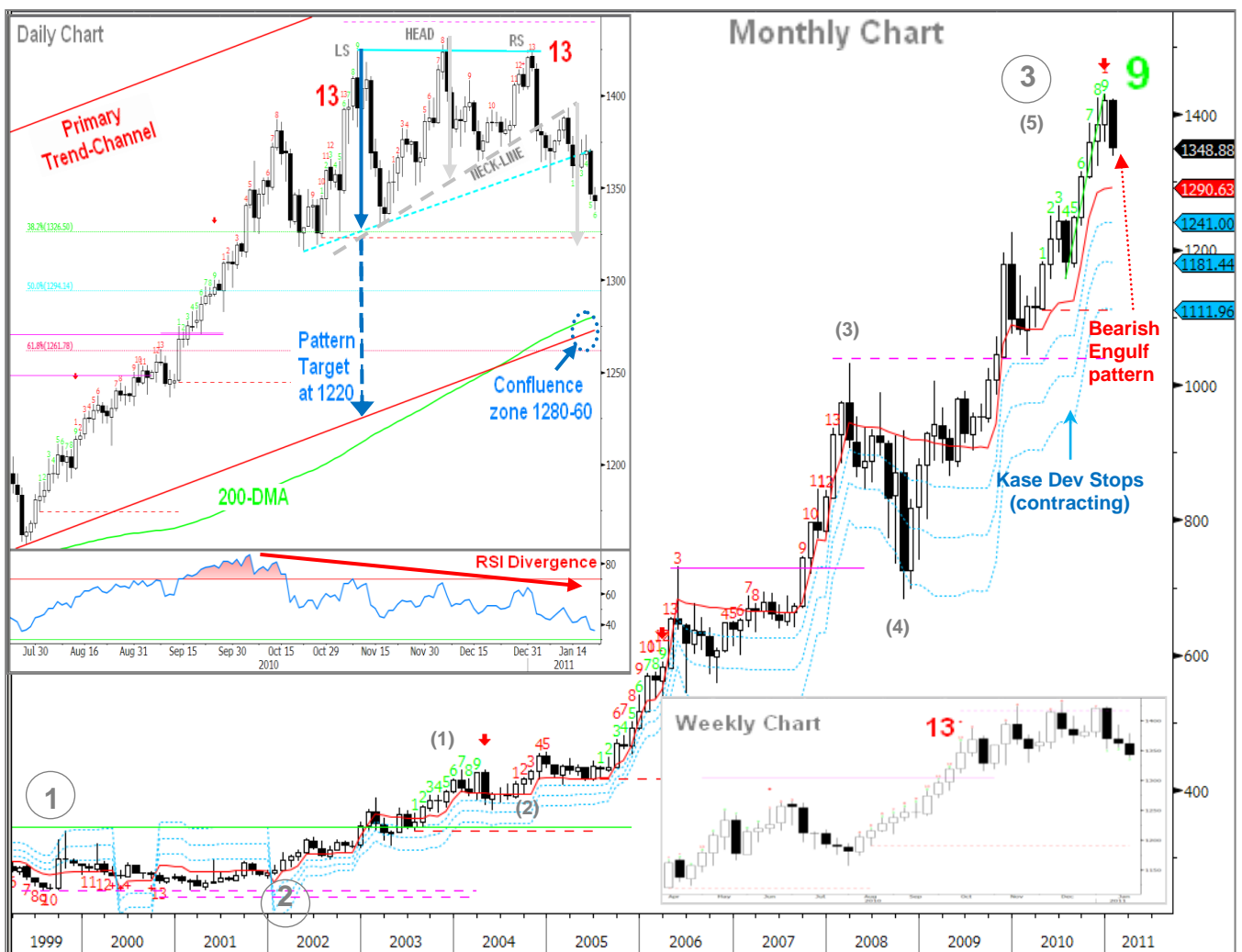


Figure 2. Time Fractals of Monthly, Weekly and Daily charts showing a confluence of exhaustion signals derived from Tom DeMark's TD Sequential indicator. Monthly chart also has Kase Dev stops overlayed for potential levels to take profits or exit positions. Source. Bloomberg L.P.

Demand cycles and Speculative Flows

All these headwinds have been further magnified by a traditionally seasonal weak period (Figure 3), coupled with sharp unwinding from speculative activity for the yellow metal (Figure 4). Gold demand cycles are generally weaker within the early months of the year, following the summer to winter period when wholesalers typically build up inventory for the Indian Wedding season and end of year retail Christmas pickup.



Figure 3. Seasonality chart of Gold across 10-years; which highlights underline weakness within the early months of the year and significant strength between summer and winter months. Source. Bloomberg L.P.

The COT chart (Figure 4) shows gold’s net position of large speculators (Commitment of Traders), which is predominantly made up of hedge fund liquidity. This measure had pushed to all-time highs, marking an extreme reading in bullish sentiment as the investment community became fully committed to gold’s rise after it shattered through that all-important psychological \$1000 barrier.

However, COT readings are now sharply unwinding from these extreme levels and approaching the lower side of its bullish structural range. Over one and a half years of sizeable long gold positions will be under threat once this structural range breaks. This would offer an attractive price vacuum for bears to seize control and anchor prices lower. Further deteriorating sentiment can also be found in the 20% fall across several Gold mining stocks, including Newmont, Goldcorp and Rand Resources (Figure 4 chart insert). All these charts illustrate strong downside scope and imply that extended setbacks in gold are being actively priced into the market.



Figure 4. COT Net Large Speculator Positioning unwinding from all-time record highs and testing bullish structural range. Chart Insert shows further deterioration in gold sentiment with a 20% correction across notable gold mining stocks. Source. Bloomberg L.P.

Conclusion

Gold's primary trend remains intact, but even the strongest of bulls need to stop for a healthy siesta. The "muleta" standoff is likely to leave an important signature on the precious metal's roadmap and offer virtuous lessons to investors at large. To profit from gold's awe-inspiring rise, we must first learn to respect the nature of its "yin-yang" behavior, just as a "Torero" would respect the beauty and tenacity of a raging bull.

To do this we need to accept the market's highly volatile, double-edged, characteristics and enforce disciplined management of risk. Astute trailing stop strategies such as Kase Dev Stops, help protect from sharp trend deviations and can provide short to medium-term profit taking opportunities. Watch for levels at \$1240, \$1181 and \$1111 which are statistically calculated from gold's current monthly 'true range'.

Any corrective setbacks are likely to be tentatively cushioned into the \$1280-60 confluence zone (primary trend-channel support, 200-day MA, 61.8% Fib retrace) and \$1220 (reversal pattern objective), with risk for an overshoot back to the July 2010 lows at \$1157. This would be just shy of a 20% correction from the all-time record highs. These moves should provide bulls with adequate re-fuelled energy for another charge onto much higher altitudes. Remember that it will more than likely be gold's strongest ascent, as characteristic of the fifth wave structure (the equivalent to Dow's primary stage three, irrational exuberance, parabolic "excess", within a long-term bull market cycle).

Confirmation above \$1500-20 (secondary uptrend ceiling), offers moves to \$1830 (P&F target), with eventual acceleration to the next psychological glass-ceiling at \$2000 and beyond. By this time, further tailwind will likely be offered by significant weakness on the US dollar as its major downtrend resumes and other fiat currencies continue to underperform. Moreover, the weak relative performance of key asset classes and renewed increase in the overall secular uptrend across commodities, driven by rising demand and inelastic supply, will compound ample scope for the "barbaric metal" to stage its "grand finale" bull charge.

Knowledge Section

Point and Figure – A chart that does not factor in time and as a consequence helps reduce price noise (volatility), while clearly identifying trends, key levels and potential breakouts. It is drawn with a series of Xs or Os, with the Xs illustrating rising price movements and Os reflecting falling price activity.

Candle Patterns – A chart that offers a visual insight on the emotional health of the market through use of colour coding and over 50 unique patterns. Candlesticks use exactly the same price data points as a bar chart (open, high, low close). However, they place significant focus on the difference between the open and close, otherwise known as the “real body”, which underlines sentiment in the market.

Elliott Wave – A theory that is based on market cycles, primarily based on mass psychology and related patterns that can be observed over time. The technique is partly derived from Dow Theory’s principle that markets move in waves. However, Elliott Wave manages to break down market moves into more detail, otherwise known as fractals, where natural patterns are self repeating. Elliott Wave practitioners will breakdown market trends into five wave impulsive moves and three corrective stages, making a total of eight waves with a market cycle.

DeMark Indicators – These are proprietary indicators designed by Tom DeMark which primarily identify counter-trend opportunities. TD Sequential, which is one of the most popularly used indicators, searches for exhaustion in momentum through a unique counting methodology. From a basic standpoint, minor corrections within the trend are signaled with green 9s, while trend reversal alerts are flagged with red 13s.

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