

# ChartWorks

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## Gold Is Running Like A Cheetah Rather Than A Bull

Technical observations of [RossClark@shaw.ca](mailto:RossClark@shaw.ca)

The mining stocks have regained the investor enthusiasm seen in 2003. Interestingly it is coming as the rally is now 34-weeks old. (*The 2003 rally was 36 weeks*). However, this rally is exhibiting even greater overbought readings in my indicators than seen at the 2003 high. It matches levels that have only been experienced seven times in the past 105 years. **It is now time to become cautious.**

We have built an amended XAU index to incorporate all the Homestake Mining data that was available before the XAU was created. Using this index we find that the combined levels of the current upside readings in my Exhaustion Index and Summation Index have only been seen in 1908, 1916, 9/22/1933, 10/10/1980, 12/31/1983 and 4/24/1987.



Historically, the overbought signals in the oscillators tend to be **concurrent with the price high or lead it by up to two weeks. Price declines have then been in the magnitude of 15% to 40% within eight to ten weeks.** The catalyst has been a loss in upside momentum and the easiest way to recognize this is a week with a lower low.



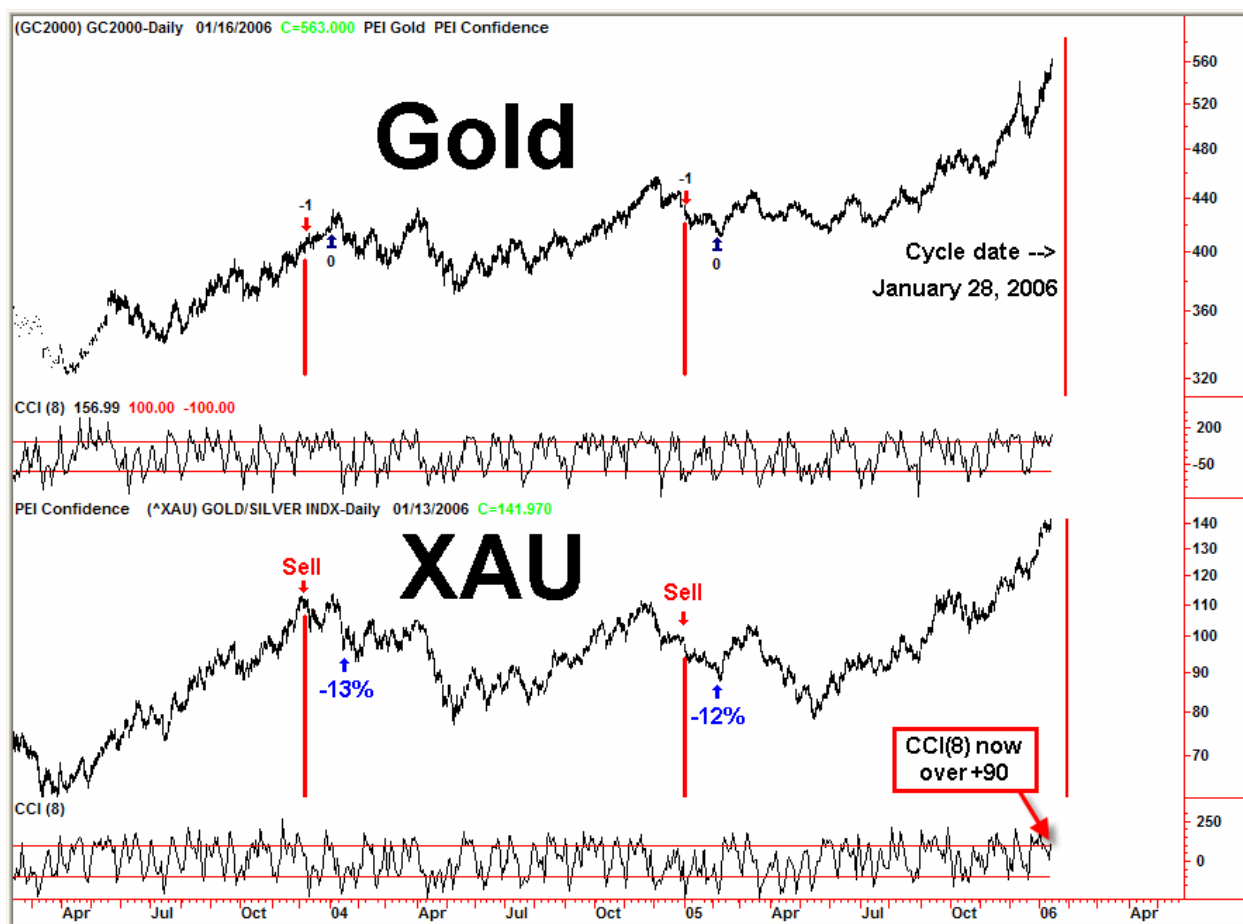
Support can be anticipated to be tested at the 34-week exponential moving average. The moving average currently sits at 110.90 and is rising at 1.5 points per week. Assuming that it takes 10 weeks to reach the average and that the pace of its advance slows, the likely support level would come in at 121 to 123. This would be within the parameters of the typical corrections.

This support will also be in the vicinity of the rising trendline drawn off the May & August 2005 lows.

The junior mining stocks are always more volatile than the seniors so a larger correction can be expected in this group.

## Pi Cycle

The timing of the overbought signals is interesting in that we are coming up on a Pi cycle date (01/28/06). Price action around this cycle has typically generated strength in precious metals leading up to the cycle date and weakness in the subsequent period (*this is even more reliable in the mining stocks than the bullion*). The stocks generally top first. We've found that a daily CCI(8) reading over 90 in the XAU within 10 trading days of the Pi date has been an optimum signal to lighten up on the mining stocks. If the XAU is unable to generate an overbought reading within that time window then a trailing stop should be used to exit longs.



The optimum re-entry for mining stocks and bullion occurs once the CCI(8) becomes oversold in gold following the Pi cycle:

After 8 trading days; buy any reading under -150

After 15 days; add a buy-stop above a trailing 20-day high

If no signal by the 20<sup>th</sup> day then add an additional criteria; buy on a CCI(8) crossover of -100

Using these rules the XAU has produced declines (*re-entry opportunities*) of 12%, 13%, 10%, 12%, 20%, 10% and 13% in recent years.

## Post-Bubble Environment update

### 2005 VIEW

**Background as presented on April 27, 2005:** “ The gold bullion market is performing just as we’d like, however the stocks continue to step lower. Not only has the gold price been stepping higher this month in term of the US\$ but also in terms of Euros and Canadian Dollars. While none have broken out we may be seeing a transition from the currency based action of the past three years to the long awaited next phase in gold where it moves when priced in any medium (stocks, bonds, commodities and currencies).

The post tech bubble environment produced the anticipated cyclic rally in precious metals and mining stocks. This was similar to the action following the equity bubble in 1929. The three year run into 2003 produced a 617% advance in the HUI basket of unhedged gold stocks. This compared favourably to the 397% rally in Homestake Mining and 560% rally in Dome Mines from 1929 to 1933 and similar action from 1969 through 1974.

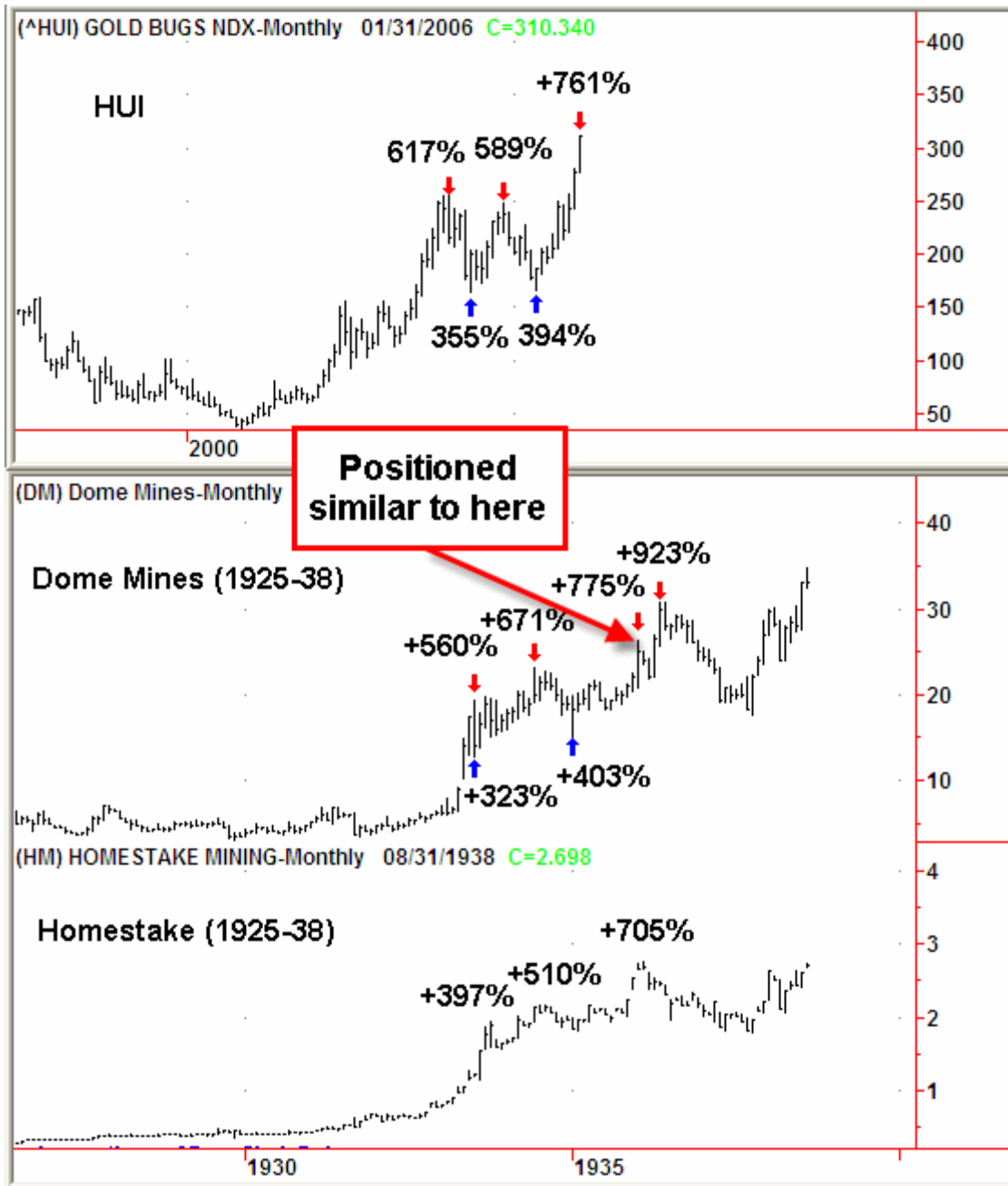
Dome Mines is the most representative of the gold stocks in the 1930’s and we can see that the 1934 low held 323% above the 1929 low. Appropriately, the HUI held at 355% in May of 2004. **To remain in context, the next low in the HUI should hold very close to the lows we are now experiencing (April 27, 2005).”**

### CURRENT VIEW

**January 16, 2006: Stepping forward to today (chart on following page) we find that the HUI is now up more that 760% from its 2000 bottom. This compares well with Dome Mines rally into January 1936 (+775% from 1929). Considering that the 1930’s rally in the gold’s is one for the record books it seems reasonable that as this one achieves benchmarks similar to those that investors should become cautious, locking some profits and instituting trailing stops. In this manner capital will be available once the inevitable correction occurs.**

**Another point of interest is that this is the eight consecutive month with higher lows. Looking back over the past century there are less than a dozen examples of the mining stocks rallying seven months or more without a breather.**

## Percentage moves above the major bottoms of 1929 and 2000

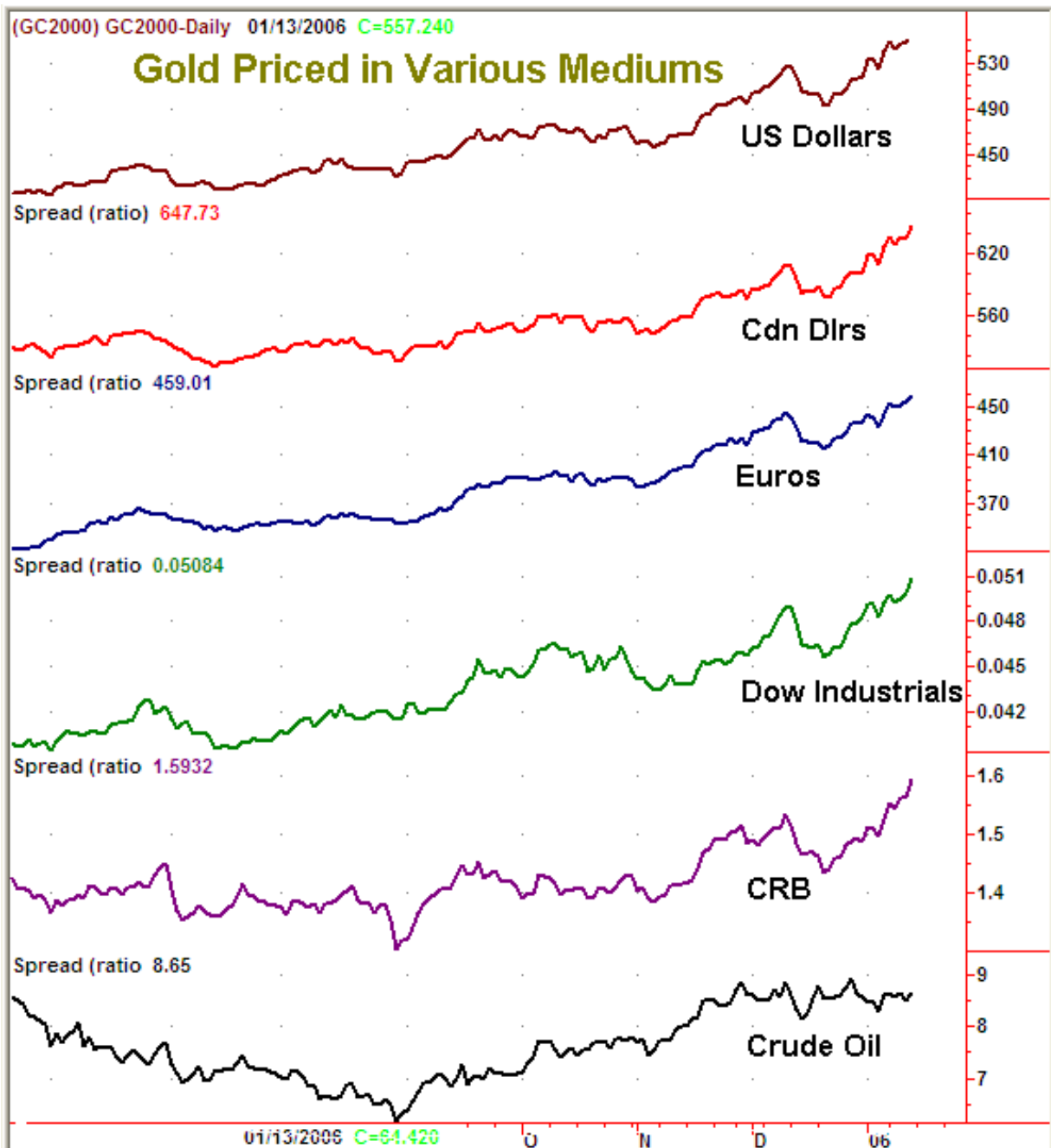


*At ~\$60, Newmont is into the upper end of its multi-year rising channel.  
A pullback to the breakout would not be surprising.*



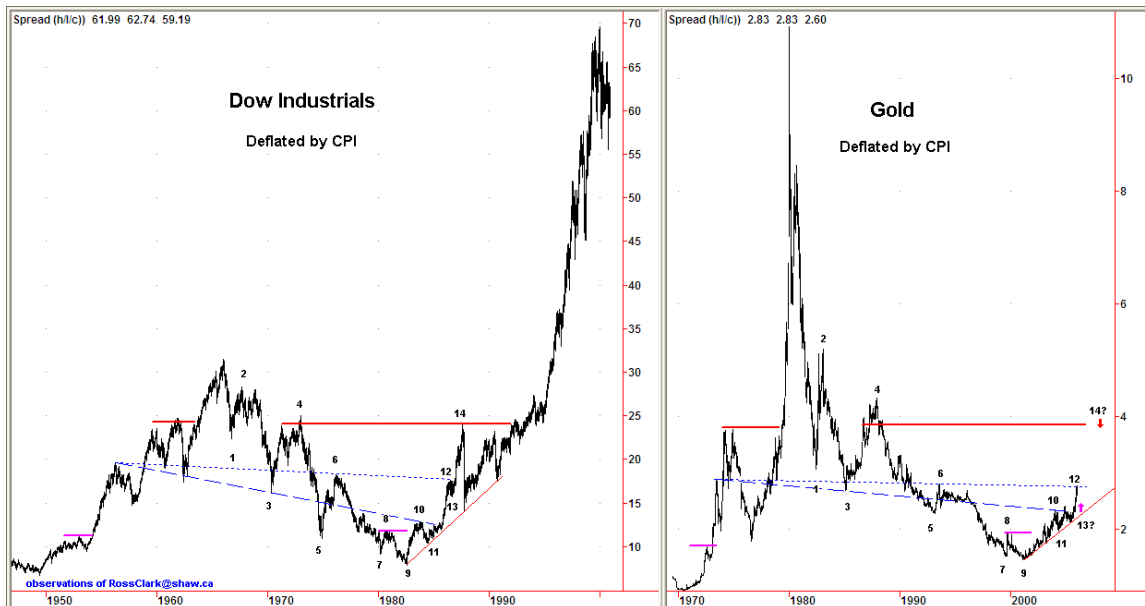
# Gold

Gold is into the second phase of its bull market, showing strength relative to all major currencies. The first phase was three years in duration (*March 2001 to January 2004*) and was primarily driven by the weak US Dollar. The second phase evolved slowly, starting last May, with momentum building through the year. **It can be anticipated to last longer, taking prices to all-time highs as measured in US Dollars.**



## Gold – Deflated by CPI

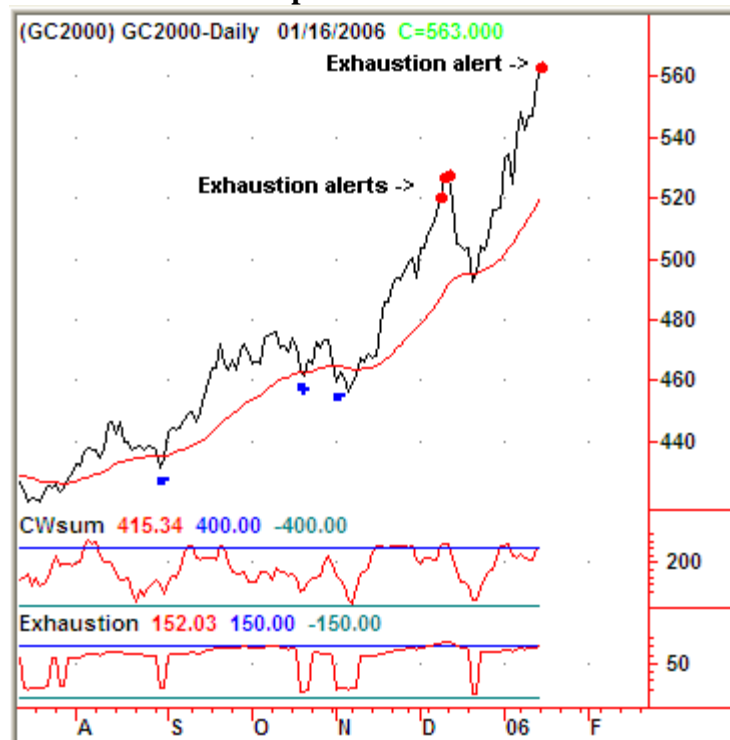
On a deflated basis the US gold price is now into the heart of projected resistance for this time frame (*point 12*). A pullback here would set the stage for a rally to point 14 in the model. On a deflated basis point 14 will be a test of the 1987 high (\$510), but on a nominal basis this will become a test of the all-time high (\$873). This is likely within the next two years.



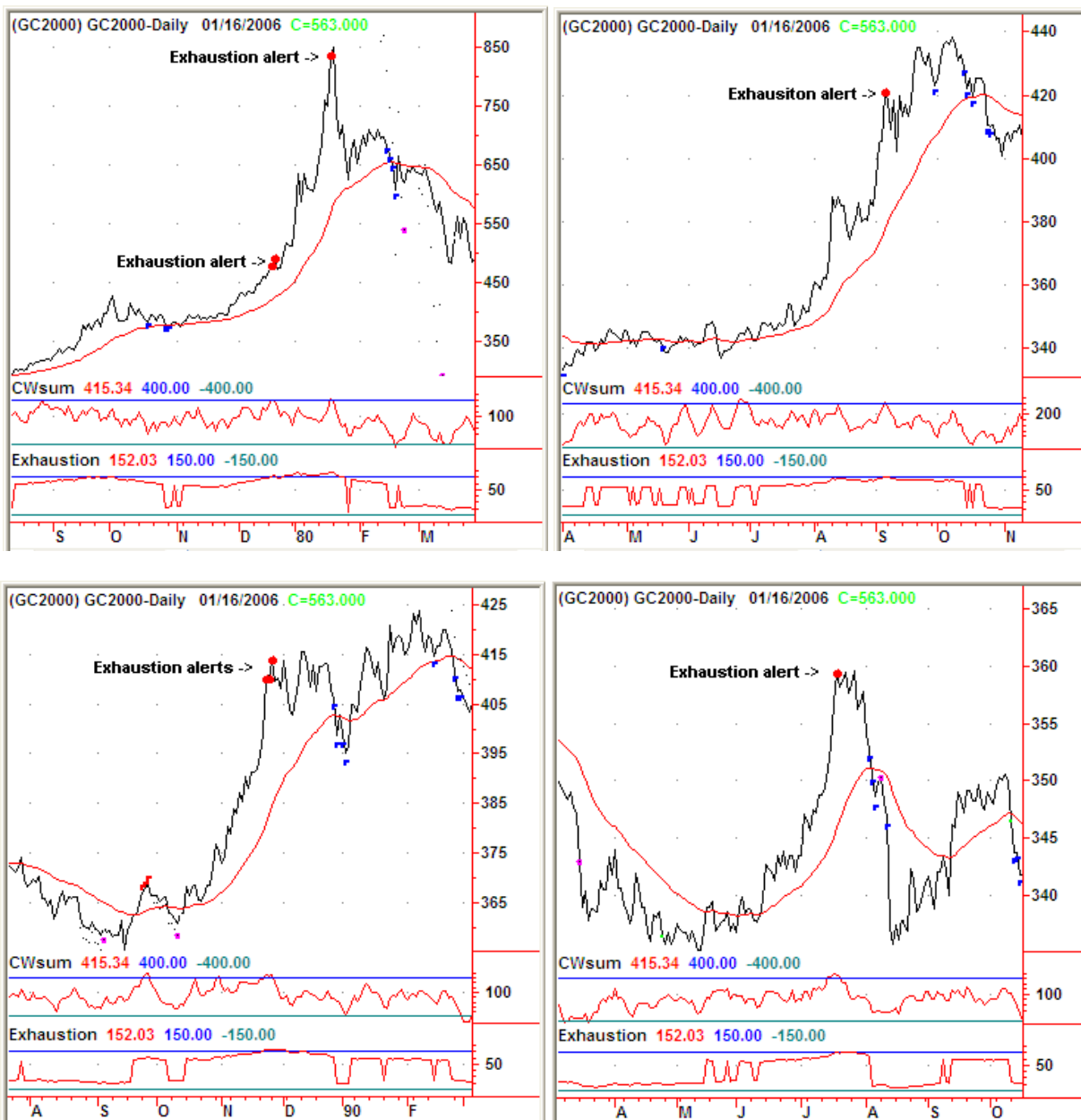
## Gold – Monthly And Daily Upside Exhaustion

In another unusual set of circumstance, both the monthly and daily charts of gold are producing upside exhaustion readings. Either one would be noteworthy; however simultaneous readings are a rarity.

### Current upside exhaustion alerts



**Most recent daily upside exhaustion alerts in gold bullion: 1992, 1989, 1986, 1980 & 1979**



**In summary, we expect a correction to unfold, probably in the pattern of a wide trading range, into at least mid-February.**

HOWEVER, what we are talking about here is that investors may want to lighten up from 'overweight' positions. Strategically from a risk/reward standpoint and from a tax implication standpoint it probably will not be worth it to sell too much here. Gold is telling us something by the way it acts. We have so many exogenous factors in the background too, with developments in Iran getting on a faster track and with other global developments increasing overall portfolio risk. There is a very big risk that if one is out of gold they will miss a large move up due to outside events this year. Therefore, we are really recommending investors use the expected correction to add to existing holdings and eventually get back to an overweight position.

## US Dollar Index

In a partially related market, the US Dollar Index is producing initial oversold readings on the weekly chart as it moves closer to the standard deviation band support (86.31). The weekly RSI (14) still needs to decline by another five points or more, but this could easily be taken care of with a single down week.



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