

GOLD STUDY

SEPTEMBER 1, 2000 BOB HOYE

Preface: Our study of June 15 observed "*An extended recovery in gold's deflated price requires more distress in the credit markets, a definite downtrend in base metal prices as well as in other commodities, and breakdown in the senior stock indexes. This could begin in September.*"

Technical: On the chart, gold's nominal price remains within a pattern that, in past examples, has been constructive. The recovery this week in the face of a stronger dollar is impressive, but as it is with recovering commodities, it is vulnerable to those failing in early October.

The last low was 271.10 on August 23 as Market Vane reported sentiment at 16 to 17 percent bulls for the three weeks to August 22. This compares with the same range for 5 weeks at the 254 low in August, 1999.

Fundamentals: Of course, what really counts on operating margins is the real or deflated price.

Considering the behaviour of the yield curve and base metal prices along with the sensational rally in the techs into early September, the year has some similarities with the new era conclusions of 1929 and 1873. Specifically, 1929 followed the 1873 pattern.

The key to gold's deflated price is the performance relative to commodities and, after October, it is likely that most commodities could begin to decline relative to gold.

Another key would be the yield curve in the midst of acute financial distress reversing to steepening. This is no ego-boosting intellectual conjecture by the editor as the main features following a bubble have been falling commodities and a steepening yield curve. It's the way financial history works, which often confounds those with personal convictions on how it *ought* to work.

The intelligence gathering abilities of serious participants in the gold community likely exceed and is more sophisticated than that of the fixed income fraternity. No matter how astute or far reaching this endeavour, it mainly comes down to "who is selling what to whom" gossip on the trading desks. This may assist short term traders, but it has limited predictive abilities.

For one thing, any impartial review of financial history observes that government treasurers and central bankers identify with any major trend and exacerbate the concluding moves. Nowhere is this more glaring than with the natural characteristic of the deflated price of gold declining to a significant low with the climax of a financial bubble.

So the only interest in monitoring the establishment's manipulations in the gold market is to watch them as they eventually change their story and behaviour to accommodate a rising real price of gold.

Position: Since late May, 2000, our advice to central bankers has been to add to gold reserves, producers to cover forward sales, and institutions to accumulate gold and gold shares.

Historically speaking, this would be sound advice at this stage of the credit cycle.

GOLD 1Q2002

BOB HOYE JANUARY 9, 2002

INVESTMENT DEMAND, REAL PRICE AND OPERATING MARGINS

"Of course, what really counts on operating margins is real prices; and after October most commodities could begin to decline relative to gold." - Institutional Advisors, September 1, 2000 [Gold's relative low was on September 21, 2000.]

Near Term: On the chart, gold's nominal price is in an intermediate uptrend with recently constructive technical action.

Of much greater importance, gold has been rising against proxies representing improving operating margins.

- Relative to our commodity index, gold has increased 36% since September 21, 2000. This compares with the 36% gain in the XAU and the 52% return from the much broader Toronto gold index.
- As measured by the CPI, the rate of inflation peaked at 3.7% at the end of 2000 and rolled over at 3.6% in April, 2001. Its chart has since broken down to the November report at 1.9%.
- Our May, 2000 study on base metals expected a cyclical business contraction with weakening base metal prices. Our index was then at 696 and the initial target of 375 was met in November, 2001.
- During the 18 months (to September, 2001), from their high in 2000, base metal prices plunged 78% relative to gold. This compares with the 73% decline in the first 18 months from their high in 1929. The "invisible hand" seems to be doing some fascinating things.

Longer Term: Gold's price behaviour has been consistent. It has now declined with every New Era and set a significant low in association with its concluding bubble.

In all five previous examples, this was followed by a 3-year recovery within a much longer period of around 20 years, or until the long credit contraction concluded.

Mechanism: For most of the past 300 years, gold and money have been synonymous and both, in real terms, have declined during the dramatic climax of a New Era. In that gold's real price has declined during ours suggests that gold has been behaving remarkably like money.

Relative to the CPI, gold has reversed to rising, which is typical of the first year following the close of a New Era and, in this regard, is continuing to act like money.

As shown on the following chart, gold's real price has been progressively increasing with each post-bubble period. This is the basis for our target of a 100% gain.

Standard Supply/Demand: It has been highly probable that gold's typical behaviour during a New Era would overwhelm the associated increase in jewelry and industrial consumption. Once past the boom, it has been equally probable that the reduction in this standard demand will be overwhelmed by growing investment demand.

INVESTMENT DEMAND

Our approach has been original and assumed that the investment demand would diminish until the New Era climaxed.

Our overall model integrates gold's real price with the stock market, base metal prices, credit spreads, and the treasury yield curve. Within this, the curve has been expected to be most closely associated with the start of gold's long recovery in its real price and investment demand.

Treasury Yield Curve: After two thrusts to inversion, the curve was expected to reverse to steepening around November, 2000 (✓) and retrace all the inversion within 1Q2001 (✓). With this, gold's price relative to the CPI or most commodities would begin to improve. As noted at the top of this study, the latter started on September 21, 2000.

Steepening was likely to be massive and initially accomplished as short rates declined. Treasury bill rates set a cyclical high of 6.40% in November, 2000 as the curve was inverted at -58 bp (longs to shorts). By the first week of 2002, the curve had steepened to 385 bp and the bill rate was 1.71%. Obviously, returns from the alternatives ranging from stocks to bonds to treasury bills have been becoming less rewarding.

Credit Spreads: Relative to long treasuries, yields for lower grade securities narrow inordinately during the culmination of a great financial boom and then they widen with the subsequent financial and economic contraction. Such widening would anticipate growing insolvencies and defaults.

Widening would likely confirm the change to contraction, but not expected to be as closely linked as the curve in monitoring gold's recovery.

Real Interest Rates: The orthodox view that gold goes down as real interest rates increase does not hold during the climax of a New Era and the subsequent contraction. Real long rates in the reserve currency have now declined with every financial mania. This is recorded on the accompanying page of charts, which also plots the increase since 2Q2001.

Real interest rates and gold prices have increased following each bubble and have been doing so through 2001.

Our Position: Since the summer of 2000, our advice has been that investors accumulate gold shares and golds, producers cover forwards, and central bankers increase their reserves.

OUTLOOK 2002

- Favourable developments for industrial commodities, credit spreads, and stock markets have been likely to be intermediate moves maturing around March. Our regular Friday publication, Pivotal Events, of January 4, 2002 noted that gold's nominal price would likely rise above 280 this week. [✓ on January 9] After mid/year, the financial and economic contraction is likely to resume. As an integral part of this, the improving trend for gold's real price and investment demand would also resume. [this resumed on May 15]

- Following previous New Eras, gold shares have soared with no change in gold's price. Although there is no gold standard, we assumed that the costs declining relative to gold would again be critical. The results from Homestake provide an example. Earnings declined until 1929 and increased by 139% on the 1932 report as the stock rallied 120%. Until 1933, gold was fixed at 20.67. In Canada, Dome results were similar.
- A multi-year bull market for gold shares has been confirmed.

GOLD SPECIAL MAY 24, 2002

- **Model:** The model that expected the cyclical low for gold's real price and shares in November, 2000 (actual in October) called for the initial phase of the bull market to last for 3 years.
- For the shares, possibly speculative highs in March and then around May, 2002 would initiate a tradable correction.
- Once started, it could take a month or so to stabilize. After that, there could be some vulnerability to heavy stock market liquidation around September-October, from which the powerful bull market in golds could continue.
- The largest gold fund in Canada is up 120% since the first of the year and has tripled since November, 2000. Worth stressing is that there has been negligible net buying of the fund.
- So the public, retail brokers, and mutual fund dealers are not in the market. They will be at the eventual top.
- Relative to commodities, gold's real price rallied to February when the first correction due to rising commodities was likely to come in. This was likely to complete as commodities rolled over in April.
- Our gold/commodities index rallied 44% to 273 in February, corrected to 241 in early May, and has jumped to 260 this week. However, much of gold's recent buying has been inspired by the weaker dollar and the expectation of soaring commodity prices. Both of these could reverse in the next week or so and dismay the goldbugs as well as senior economists who jumped on the bandwagon this week.
- **Advice 2000:** In August, 2000, our advice was that investors should have representative positions in gold and gold shares; producers should get unhedged, and central banks should increase their gold reserves.
- **Technicals:** Three weeks ago, the ChartWorks noted that gold itself was reaching a rare overbought condition not seen since 1996. What was missing was rampant speculation in the stocks.
- This has now come in with gold and the stocks reaching significant "overbought" readings together. This is on a monthly basis and was last recorded in 1993.
- Only six such examples have occurred since 1970 and each was followed by a 24% to 31% correction in the stocks over a few months. In looking at the structure of the top, it requires a tested high (i.e. a high followed by a lower high) over two to three weeks. Typically, the failure to break out then leads to a violation of the support line and a deep correction.
- Even in 1977, which was only one year into a four-year bull market, gold stocks corrected significantly as gold corrected only from 149 to 137. Tuesday's ChartWorks included details for recognizing the reliable entry point.

Advice Now: The action is spiking close to a possible reversal in the stock market.

Readings on the dollar index indicate an imminent low. Gold can correct, but not enough for investors to trade. Gold shares can do a tradable correction.

The impetus is probably becoming disquieting to the establishment, if not distressful to ill-advised shorts. As the price drops, officialdom will likely make some announcement to "drive" the price down.

ChartWorks

June 21, 2002

GOLD AND GOLD SHARES

A Pause Following the Most Overbought Reading Since 1993 Gold and gold stocks are following the typical action subsequent to the "classic" simultaneous sell signals registered in May.

The price action of the stocks should take the form of an A-B-C downside correction. The A leg down was concluded on June 10 th. The B leg recovery rally (50-70% of the decline from the highs) is expected to top next week.

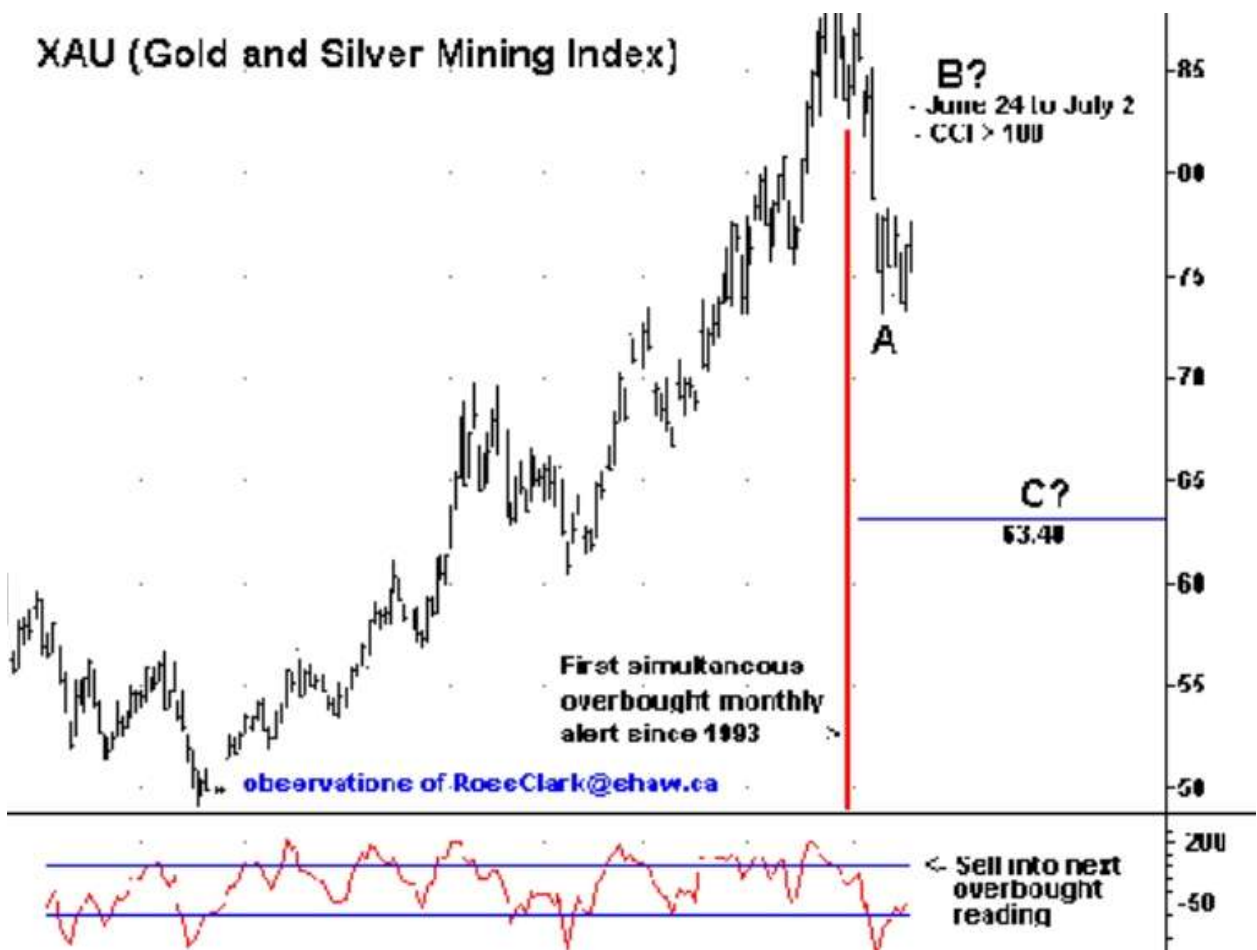
Specifically, an overbought reading on the CCI (Commodity Channel Index) has identified the recovery highs in the past six examples. At a minimum, stops should be raised to a one-day trailing low once the CCI becomes overbought. The C leg down should then begin. The target for the XAU (Gold and Silver Index) is 63.40. Hopefully, this coincides with gold testing it's \$306-\$309 breakout and the long term moving average support.

The three most recent examples of a simultaneous monthly overbought Gold / Homestake stock signal generated an A-B-C correction followed by a continuation of the uptrend.

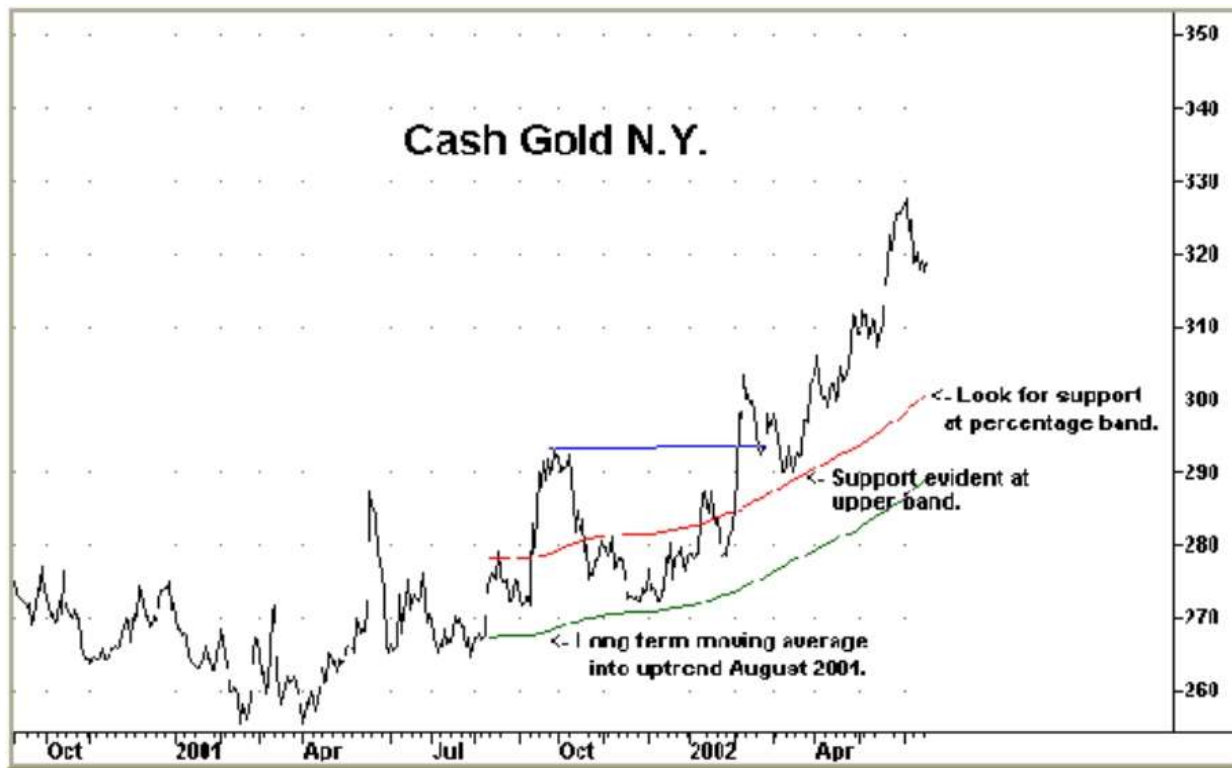
WRAP:

- This updates the May 21 and May 24 technical studies.
- Gold was expected to correct to the rising band, which is currently near 300.
- Gold shares were expected to offer a tradable correction within the long bull market.
- Recognition of recurring patterns seems less reckless than intuitive conjecture.

XAU (Gold and Silver Mining Index)







GOLD RESEARCH PACKAGE

2000 - 2004 BOB HOYE

UPDATE JUNE 24, 2002

- Following the dramatic conclusion to every new financial era, gold stocks have been outstanding performers.
- Once the stock market top was in in early 2000, the cyclical low for golds was expected around November (actually in October) with the first speculative surge accomplished in March and May, 2002; the latter would be against a generally weak stock market.
- As we are in a long bull market for gold shares, our objective is to anticipate attractive entry points.
- The May, 2000 advice was to accumulate gold shares and in November, 2000 this became an "aggressive buy". In February, 2002 this advice was extended to include "small cap golds".

REAL PRICE UPDATE

- Relative to our commodity index, gold is up 37% since the cyclical low in October, 2000.
- The calculation of the CPI is suspect and, notwithstanding this, gold is up 20% relative to the CPI (deflated price) from its low in March, 2001.

The historical charts are updated and follow. The following documents our research through the historical transition.

Deflated Gold Prices and Financial Bubbles

As recorded in the reserve currency, the recovery in gold's real price following each new financial era has been reliable and represents an increase in investment demand (as jewelry demand slipped) and operating margins. So far, the price increase is 20% and the conclusions below were made in June of 2000.

Gold Can Double:

- In the 3 years following the last bubble in London and New York, gold's real price doubled. Post-bubble gains have progressively increased: 1825 (+11%), 1873 (+35%), 1929 (+114%).
- One of the rules of history is that policymakers magnify financial events. The greater the intervention, the greater the volatility.
- Intervention has been more pervasive than in the 1920s and accumulation of speculative imbalances has likely exceeded that new era. With a full loss of speculative abilities, gold's deflated price could more than double over the following 3 years.

