

Is the gold bull market over?

Here is an extract from commentary posted at www.speculative-investor.com on 23rd March 2003:

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We think the above is a nonsensical question given the facts, but since it is a question that appears to be at the forefront of the minds of many speculators in gold and gold stocks we'll answer it.

Firstly, the correction in the gold price and the gold sector of the stock market has been deeper than we had originally expected. Our view, a few weeks ago, was that the HUI had maximum downside risk to its intermediate-term uptrend-line at around the 125 level and that the gold price would hold above support at the \$340 level. In the short-term, though, markets are driven by emotion, not by an objective appraisal of all the evidence, the result of which is that prices regularly swing too far in both directions. These swings create opportunities for those who understand the fundamentals, who don't base trading/investment decision on an emotional response to price movements, and who do a good job of managing their money.

Secondly, we cannot find any evidence that the gold bull market is over. The gold bull market is primarily a result of the US\$ bear market, so in order for the gold bull market to be over the US\$ bear market must have ended. This, in our opinion, is not possible since the US current account deficit is still near all-time highs. The dollar bear market cannot end until a) this deficit has been reduced to zero, or b) dollar-denominated investments once again start providing foreign investors with a high enough real return to entice sufficient new money into the US each month to offset this deficit.

So, what is the probability that the US will be able to attract enough new foreign investment each month to offset the current account deficit? In our opinion, almost zero. Real yields on high-quality dollar-denominated debt securities are likely to remain low for the foreseeable future and the US stock market is still about twice as expensive as it should be if we were actually near the bottom of the bear market.

Current Market Situation

In last week's commentaries we said that the gold price had short-term downside risk to the mid-320s, but that the Amex Gold BUGS Index (HUI) had probably bottomed. The bottom for the HUI probably occurred when it traded down to 112.61 on 13th March (the day after the overall stock market made its low).

Friday's drop in the gold price to around \$325 and the concurrent decline in gold stock prices might have unnerved some gold stock investors, but it wasn't a particularly bearish day for the gold sector. This is because the gold price broke well below its previous correction low while the HUI made a higher low. In fact, over the past 7 trading days the gold price has fallen by \$20 while the HUI has failed to make a new correction low.

The recent up-tick on the below chart of the HUI/gold ratio reflects the strength in gold stocks, relative to the gold price, over the past 7 trading days. The HUI/gold ratio bottomed at 0.329 on 12th March and should remain above this level if the correction in the gold market is almost complete.



As far as the gold price itself is concerned, Friday's close was in the middle of a range of very strong support (see chart below). Even if the correction is not yet complete a bounce from around current levels is highly probable.



In the current emotion-driven market environment there is a possibility of a final downward spike in the gold price in reaction to the best of all possible news on the Iraq front (the immediate surrender of Iraq). This might result in a drop to the bottom of the channel shown on the above chart and would, in our opinion, set-up the best buying opportunity in years for gold and gold stocks.

As is the case with the stock market's recovery rally, the best part of the rebound in the US\$ is probably behind us. Based on the speed at which commercial traders have covered their short

positions in the Swiss Franc and other currencies we expect that resistance at around the 104 level will hold for the cash Dollar Index (versus Friday's close of around 102).

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