

## Gold and HUI Carnage?

Adam Hamilton January 12, 2007 3223 Words

This young New Year has not been kind to gold and gold stocks. In the first six trading days of 2007, general commodities selling pressure pushed gold down 3.9% which in turn drove the HUI unhedged gold-stock index 8.6% lower. Such ominous beginnings have led to a growing crescendo of pessimism chilling the hearts of investors and speculators.

It is not at all unusual to see the mainstream Wall-Street types that CNBC interviews bearish on gold. They will always hate gold since the conditions in which secular gold bulls flourish lead to poor general stock-market performance. But it is fairly rare to see the contrarian community on the web, including some long-time gold bulls, waxing pessimistic.

Over the past week I have received a bunch of e-mails from Zeal subscribers concerned about the rampantly proliferating bearish technical analysis on gold. Many of them ask me what I think of other analysts' analyses and conclusions. Since the endless challenges the markets themselves present are enough to keep me busy studying for dozens of lifetimes, I don't have time to critique the work of others. But you can do it yourself from the comfort of your own computer.

If the work of some analyst seems particularly compelling to you today and is generating concern, I humbly suggest checking his track record at the last two major turning points in gold. The massive gold upleg that ended last year started near July 2005 and ended in May 2006. The right calls to make at these pivotal times, of course, were to be very bullish in late summer 2005 and very bearish in late spring 2006.

If your analyst was right *at both of* these key inflection points, the two most important of the last two years, then he is probably worth listening to today. How can you tell? Google his name along with the word "index", like "Adam Hamilton Index". The top link will probably be that analyst's page on the excellent [Gold-Eagle.com](http://Gold-Eagle.com), the oldest and most venerable contrarian gold portal on the web. Gold Eagle went live way back in 1997. Over the last decade it has done a fantastic job building the biggest contrarian commentary archive on the internet.

If you do this exercise, and read exactly what analysts said publicly right at gold's last major interim tops and bottoms, you will probably be surprised. You will find out that very few analysts are true contrarians, who were very optimistic on gold when it was plumbing dismal lows and very pessimistic on it when it was achieving exciting bull-to-date record highs. Being a contrarian is hard work for an investor, but probably even harder for an analyst.

Why? Most non-Wall-Street analysts, including me, sell newsletters to finance their analytical work. There is tremendous pressure to *reflect* popular sentiment rather than fight it. You have to be a real black sheep and glutton for punishment to tell euphoric investors at a top that a sharp correction is due. Whenever you do this, tell people what they don't want to hear, you irritate them and lose subscribers and revenue.

Thankfully I have never had a high personal need for acceptance, which means I am not in the business of pleasing others. It is doing the right thing that motivates me. So taking all the flak and losing business by being truly contrarian at the inflection points doesn't bother me. I was publicly [bullish in late summer 2005](#) and publicly [bearish in late spring 2006](#), and traded accordingly. The hate mail these correct decisions generated at the time is no big deal, just part of the game.

Speculation is an incredibly demanding endeavor. The markets take all of our own personality flaws, especially emotional weaknesses, and throw them back in our faces to try and break us. Trading contrary to your own emotions and contrary to the consensus sentiment of others is unbelievably difficult. Yet this is what must be done in order to ultimately prove successful. There is no other way.

So today, when I survey the gold world, it is really exciting to see almost everyone bearish and depressed. At turning points the majority is always wrong because most people extrapolate existing trends out into infinity, a

fatal error in perpetually cyclical markets. So when the financial media and even the usually bullish web community join forces in trafficking in myriads of bearish gold theories, odds are a fantastic *buying* opportunity is near.

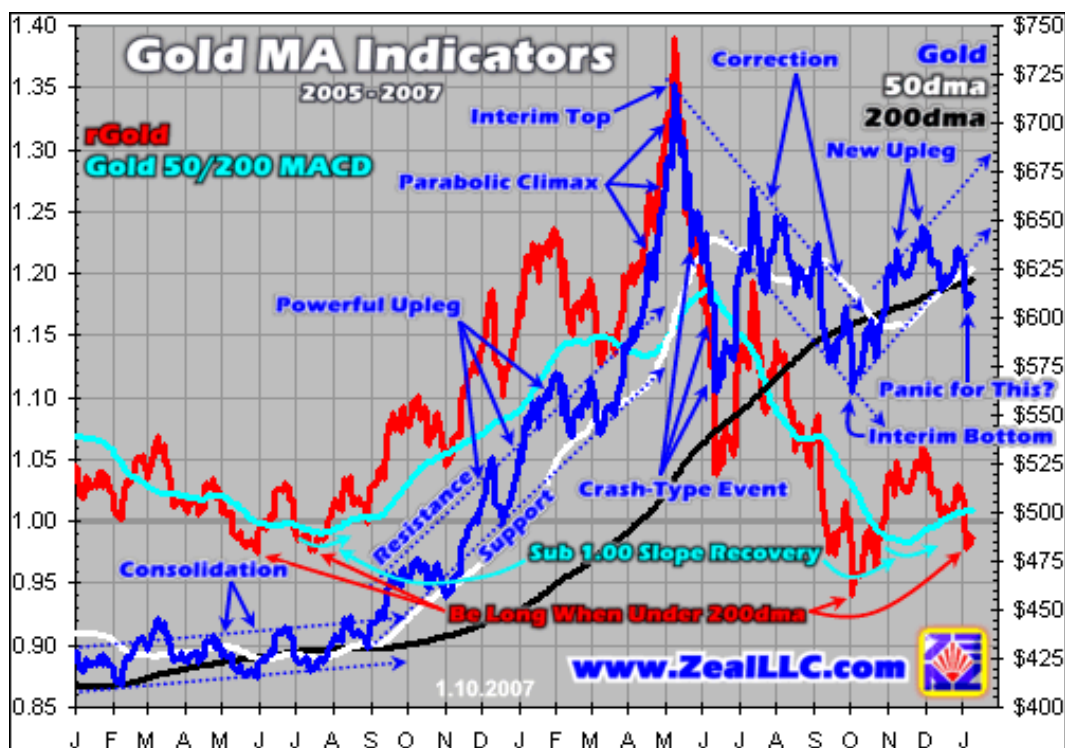
People are bearish today simply because gold has struggled in early December and early January, five weeks at the most. That this utterly trivial span of time is apparently enough to spawn widespread fear boggles my mind. Secular commodities bulls tend to run for 17 years in history, so why fret about adverse price moves over 1/200th of this time span? And the really ironic thing is gold's retreat lately is totally trivial and minor anyway.

In this essay I want to offer an unpopular contrary opinion on gold, to explain why I remain extremely *bullish* today for this bear-dominated sector. There is absolutely nothing that has happened in the last five weeks, both fundamentally and technically, that warrants such widespread pessimism. If you are willing to throw off the tyranny of being influenced by others' emotional weaknesses, I think you'll agree gold looks like it is in the early months of a major new upleg.

Truly the fundamental front is the most important, the global supply and demand dynamics affecting the gold price. If you are concerned about the state of this gold bull, I strongly urge you to go read an essay I wrote several weeks ago on [gold's fundamentals](#). They are dazzlingly bullish today, there is no doubt about it. Today's gold fundamentals are identical to those that existed in summer 2005 before gold launched its greatest upleg of this bull that earned fortunes for astute contrarians.

But it is not a fundamental attack on gold that is driving the incredible bearishness today, but an attack on its technicals. Pure technical analysts who refuse to study the fundamental side of gold as well as its price action seriously hobble their own ability to think clearly. The greatest danger for technicians is to consider too short a period of time, to lose focus on the crucial big picture and get mired down in trivial short-term details.

I have seen such short-sighted technical analysts, just in the past week, use words like "carnage" and "crash" and "downward spiral" to describe the price action in gold and gold stocks. Frankly such assertions are just plain silly. When considered in proper strategic context, gold's move lower so far in 2007 is tiny and immaterial on the charts. Note below that gold has fallen steeper and faster than it has in this past week around a half dozen times since its latest interim top in May.



If technicians want a real plunge in gold, all they have to do is look back to the blistering 21.9% and \$158 plunge over one trading month in May and June. Now that was something to be concerned about! Yet in the first six trading days of this year, gold is just down 3.9% and \$25. A \$25 plunge in a \$600 asset is "carnage"? Give me a break. Anyone who has weathered the worst corrections gold has thrown at us since 2001 wouldn't even raise an

eyebrow at a 3.9% selloff.

As near as I can tell, technicians are freaked out about the real plunges in oil and copper over the past week and they are transferring these fears to gold. While oil, copper, and gold are all commodities, neither their bull markets nor all of their key fundamental drivers are the same. Gold's secular bull started years after oil's and years before copper's, it is a very different beast. Sometimes gold runs parallel with either oil or copper, and sometimes it doesn't. The global investment market for gold is totally unique and is not dependent on other commodities.

So if you want to analyze gold, don't get bogged down in peripheral events like fears of a slowing US housing market hurting copper demand or fears of scarce oil miraculously flooding the markets. Gold needs to be considered *on its own* since it has totally unique investment and monetary merits unequalled in any other commodity or asset on the planet. If gold's fundamentals remain intact, and they do, the only question is whether gold is a good buy or not right now technically.

My charts in this essay encompass the last two years. Back in early 2005 gold was in a healthy consolidation after achieving a bull-to-date record high near \$455 in late 2004. After major uplegs all bull markets consolidate, and trade sideways, or correct, and trade lower, in order to rebalance sentiment. People get too euphoric near tops so sideways or lower trading is necessary to bleed off this greed as well as to get traders comfortable with considering the new higher price levels as normal.

Consolidations and corrections, especially once they mature, offer fantastic buying opportunities. Technically they drag bull-market prices back down near their 200-day moving averages, which are usually the best places in long-term bulls to add new long positions. At Zeal we use some moving-average-based indicators to help us decide when corrections are mature and the time to aggressively buy again is near.

The first is rGold, gold divided by its 200dma. This is the red line above. It expresses gold as a constant multiple of its 200dma over time. This creates a horizontal trading band where gold's 200dma remains at 1.00 while rGold oscillates above and below this in its major uplegs and corrections. One of the reasons I was bullish in late summer 2005 when most analysts were reflecting the popular bearish sentiment of the time was because rGold was under 1.00.

We have a big long-term rGold chart posted on a private area of our website for our subscribers, and on it you can easily see that without a doubt the very best times to buy gold in the last five years were when it was under its 200dma. This Relativity trading theory is very simple, yet very effective due to the mathematical way in which bull markets advance. After gold languished under its 200dma in the summer of 2005, it launched on its mightiest upleg we've seen in decades. It was awesome!

Well, guess what. Today as technicians jump on the short bandwagon playing the short-term downward momentum in gold, it is once again under its 200dma. It was also under its 200dma earlier in September and October which is when we started layering in new gold-stock trades at Zeal. So far the early October \$560ish levels look like a major interim bottom, and I really doubt gold will fall lower as the groupthink bearish hordes are screaming for now.

Today gold is once again under its 200dma which is running near \$620. If this secular gold bull remains intact in fundamental terms, then this could very well prove to be the last great buying opportunity of this young upleg. As I have traded every single upleg of this entire bull, I know full well it is totally normal for the majority of market participants to be bearish at just the wrong time. True contrarians have always been and always will be exceptionally rare since it is such an unnatural mindset to cultivate.

A second indicator we've used at Zeal considers the relationship of gold's 50-day moving average with its slower-moving 200dma. The really cool thing about the Gold 50/200 MACD is it doesn't turn very often. So whenever its slope does turn from negative to positive or vice versa, it usually means a major new upleg or correction is in progress. I wrote about this indicator in depth a couple months ago.

Back in the late summer of 2005, when most everyone was bearish, gold's 50/200 MACD turned higher again. It started climbing in an upslope after recovering under 1.00 on the chart. And along with this pivotal technical event gold stealthily entered its mightiest upleg we've seen in this bull market. The sub-1.00 Gold 50/200 MACD slope recovery offered strong confirmation that a new upleg was almost certainly in progress despite the

naysayers.

Fast-forward to today where gold bears are once again breeding like rabbits. In November, for the first time in over a year, the Gold 50/200 MACD once again recovered under 1.00 and started trending higher as you can see above in the light-blue line. In this entire gold bull to date, there has never been a false positive on this indicator for a new upleg. So since it is turning north again from under 1.00 after a consolidation, then the odds are very high that a new upleg is already underway.

I look at technicals like these, and think about the general negativity surrounding the early days of all of gold's major uplegs, and the only logical conclusion I can reach is to be *very* bullish today. Gold's fundamentals look gorgeous, it just ended a correction in October and remains well above those lows despite recent weakness, and both rGold and the Gold 50/200 MACD are in super-bullish positions right now. It's time to be aggressively long!

Investment and speculation are probabilities games because no mere mortal can see the future. To win an odds game, you have to bet when the odds are wildly in your favor. And today they look wildly in our favor in gold. Only a small fraction of traders can fight their own emotions and ignore the crushing peer pressure of the thundering herd at such times, and they ultimately earn huge profits for their steadfast contrarianism.

Although there is no carnage in gold, it looks great fundamentally, technically, and sentimentally, the argument for HUI carnage has a little more validity. As this next chart shows, the HUI broke farther under its 200dma than gold and has fallen much more steeply. Gold-stock investors and speculators are obviously spooked as they have been liquidating positions since early December. Are the pure chart guys right in fearing this?



I don't think so for three reasons. First, it is not the gold stocks that drive the gold price but *the gold price that drives the gold stocks*. If gold is really in the early months of a major new upleg and is destined to head higher, then the gold stocks *will* follow. Because people are so skeptical of new uplegs early on, usually the HUI lags gold considerably early on in major uplegs then rockets higher later to catch up with and ultimately exceed gold's gains.

And not only is gold the key to the gold stocks' fortunes, but gold stocks have wonderful leverage which amplifies the gains *and* losses of gold. Overall through their respective bulls to date, the HUI has risen 996% and gold 183%, so gold stocks have leveraged gold by 5.4x. Traders, of course, love this leverage to the upside but have to realize it is a double-edged sword. When gold falls, gold stocks amplify its downside too.

Considered in this context, the HUI's 14.1% pullback since December 4th is fairly typical relative to gold's almost congruent 6.4% pullback. The HUI's recent 2.2x downside leverage is actually moderate, since on average the

HUI has leveraged gold's downside by 4.1x during its major corrections in this bull to date. In fact, the HUI's low downside leverage in the past month or so provides more peripheral evidence that we have merely witnessed a minor pullback within an upleg and not a new correction.

Finally, I don't think the recent HUI "carnage" is anything to fear because today's very negative gold-stock sentiment is typical of what shows up early on in a new upleg. Since most traders aren't and cannot be contrarians by definition, the fact that the majority is bearish suggests we are in a young new upleg. Traders tend to have the most doubts, fears, and angst *after* corrections and consolidations because they make the common mistake of extrapolating recent short-term trends out into infinity.

You've probably heard the classic market aphorism that "bull markets climb a wall of worries". This is so true in gold and gold stocks too. Literally every step of the way since April 2001's \$255ish multi-decade lows, there have been countless bearish theories expounded on about why gold should head lower. Many were even logical and compelling at the time. *Yet they've all been dead wrong.* Today's popular bearish fears will almost certainly meet the same fate.

In reality, the vertical wall of worries facing gold and gold stocks today is really fantastic news. Why? It means that this gold bull market remains young in a secular sense. Remember back in 1999 in the NASDAQ when every single pullback was widely heralded as a wonderful opportunity to "buy the dips"? In mature bulls near their ends everyone has bought into their stories to such a great degree that they can't imagine them ever ending. Thus the proverbial wall of worries vanishes near the *ends* of secular bulls.

Yet in gold and gold stocks today, most people see pullbacks not as buying opportunities but as dire harbingers of spirals lower to come. Technicians, wanting to do the comfortable thing and reflect sentiment rather than fight it so they don't irritate everyone, fan these bearish flames. Pretty soon nearly everyone is whipped up into a fearful frenzy and they expect gold to crash. This type of thought pattern doesn't occur in mature bull markets.

At Zeal we absolutely love times like these when fear abounds. They are the very best buying opportunities possible within secular bull markets. We have been aggressively adding high-potential gold-stock positions in both our monthly newsletter and separate weekly alert service. If this new upleg indeed accelerates higher soon as I expect it to, our subscribers are going to earn phenomenal returns. It is not too late to join us as you can still exploit these lows.

A few weeks ago we finished a comprehensive fundamental-research study on junior gold stocks, and wrote up profiles of our 20 favorites in a new report. This research is fueling the higher-risk component of our new gold-stock campaign. Since it takes months to research to this depth, we were really blessed that we finished just as junior gold stocks are getting beaten to a pulp by the panic fleeing on myopic technical advice. If you want a shot at buying these elite juniors today while they are still very beaten down, buy our latest fundamental report today.

The bottom line is there really *hasn't been* any carnage in gold and the HUI. Ultra-short-term crowd-momentum-following technical analyses are stirring up fears and leading people to be scared, but the reality is pretty benign. Pure technical bearish groupthink is always witnessed near major interim lows, this is nothing new.

If you can dig deep down and fight the bearish consensus, and objectively view gold holistically by integrating its broader fundamental, technical, and sentimental health today into one coherent strategic picture, then you'll probably reach the conclusion that gold's bull remains alive and strong. But only true contrarians will realize this in time to reap the biggest profits, everyone else is forced to play catch-up later.

**Adam Hamilton, CPA** January 12, 2007 [Subscribe](#)

©Copyright 2000-2007 Zeal LLC All Rights Reserved