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Trendy Markets

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The **gold** price has swept past the US $1200 mark - in both directions - so it's time to check numbers against concepts and patterns. The yellow metal's modern history began with Western economic expansion in the 19th century. That outstripped our ability to supply gold equivalent to economic activity, at fixed rates. With currencies delinking from gold by the early 1970s, miners couldn't supply enough of it at the old fixed rates. Contrast that with copper which was in a supply glut at the time due to technological changes. Paper currencies were already a large multiple of gold horde values by this point.

Unfettered gold took one of the most incredible price runs in history during the 1970's, peaking near 2500% above its old official US$ price in 1981. That brought bulk mining technologies to gold akin to those copper miners had used since early in the century, and a big increase in supply. That, plus selling from official hordes, pushed gold miners into the same cycle of profitable spurts sandwiched between longer red ink troughs that copper producers were already suffering.

The last spurt was the commodities run of the mid 1990s that dashed against the Asian Tigers currency based defaults in 1997. The long trough that followed shut down most generative work in the mining sector as a whole. It was unready for the boom of larger growth economies. As is typical, gold sat in the backseat while base metals lead off this "super-cycle", but it *was* in the car.

Gold's price has, in US$ terms, been in a staged advance since 2002. That steepened in late '05 with a quick 40% run-up that was mostly about storing wealth in a boom period. There after gold shifted into a "traditional" hedge role.

The gain for gold from the "start-of-US-debt-worries" base in late '06 to the pre "all-hell-is-breaking-loose" peak in early '08 was also about 40%. An "Ok, now we're-scared-@%#$less" reversal in mid '08 as instinct moved capital into the most liquid US$ market wiped out about 3/4 of that earlier gain. The gain this year from the "play-the-bounce" base of March has again been about 40%, in US$ terms. Is that that?

The answer to 'that' requires parsing the shift from "play-the-bounce" to "take-my-greenbacks-please" that has polished hard assets to a shine not seen for a century. Keep in mind the NZ$ and Australian$ have done even better than gold this year, which hasn't stopped Australia from replacing the USA as number two gold producer this year. The CDN$ has done almost as well as gold despite Canada having low interest rates and important manufacturing ties to the US economy.

Gold is trading in line with a basket of mid tier currencies the market is warm on because of underlying commodity ties, and recent histories of prudent management. Of course one major difference between gold and fiat currency is the latter are usually leveraged by trading pairs. Gold is a counter trade, either one of two transactions or bought to store against further turmoil.

As a commodity, gold is doing less well this year than is **copper** which from bottom to, well now, is up about 125%. **Silver's** percentage gain is twice that of its yellow cousin. This of course reflects the deeper discounts the other metals suffered last year. Copper has recovered only 70% of its peak value, and silver about 85% of its. Gold is almost 15% above its old high.

For some technicians it's the last 15% (which was 20% at one point last Thursday) that really matters since it is well below the magnitude of earlier moves. Pre-Crunch moves of 40% had established new base levels at or near the peaks of those earlier runs. This time around gold was also coming off of a low created by Debt-Crunch selling, which we note again is the yellow metal doing its job as a crisis hedge. On the basis of previous oversold conditions, there would be room left in this uptick.

Lows and highs aside, the pattern looks similar to a typical cycle. Even in this atypical post-Crunch period the relative gains, and relative strengths, still has copper moving ahead of gold. However, in most cycles gold strengthens as base metals and the broader economy begin to flag on supply gains. Therein lies the current quandary.

As we've noted for the past few months, the continued strength of copper's price is surprising us. Copper has better visibility than gold since the bulk of its available warehouse stocks are offered by a few markets. Clearly there has been little interest in betting against the red metal lately. It has been acting as a US$ hedge, and presumably with counter trades in place to dampen a market reversal. However, its producers have been moving sideways. That speaks to a lack of conviction about sustaining this price level, which we have agreed with and which still prompts us to look for copper price consolidation.

With gold the above ground hordes are not so visible. The official sector holdings can be added up, and the bulk of these central bank holdings are subject to either imposed selling restrictions or required consent before selling can take place. We doubt much of this gold is "spoken for" now that many miners have closed their hedge books and gold production loans are less prevalent, but some of it probably is already borrowed by speculators and unavailable for sale. Official sector net buying for the first time in a generation has in fact helped the gold price.

But private sector gold holdings are of similar scale, and intended sales are hardly likely to be trumpeted. That reality was evident when the building corporations in Dubai announced they were halting debt payments. The emirate has a major gold market and it seemed logical enough to assume gold selling would be part of a solution there. That abated when Abu Dhabi signaled it would work something out.

Friday's selling was a more straight forward reversal of the greenback's decline on news of strong US employment numbers. Whether that marks a trend it's too soon to say. It won't of itself mean the US debt issues are cleared up, and that has been the real basis for the US$ decline. It was time for some reversal and consolidation, and fortunately it came on good news.

The sentiment shift will be tested by the holiday shopping season amongst other issues. We hope these too show the US economy is improving. Though our bit of the market will mainly be governed by how well the growth economies are doing, the long process of paying for this decade's party needs to get underway as quickly as possible.

It is that bill paying that will continue to be the economic focus, and for years to come. It is important to recognize that the reversal on Friday, a move into the US$ on good news for its economy, is quite different than the panic driven moves that had created previous upticks for the greenback. After a steep shift out of the US$ and into varied alternatives, the employment numbers became an event for gains taking.

This piece was supposed to be a warning that after a long steep run it was likely there would be some trade reversals in January on profits taking. Instead that is getting underway in time for seasonal shopping. We didn't and don't view the profits taking as a basic change to the trend line. Whether gold will rise enough to make this a 40% up leg we don't know. But the gold market is trading in a fairly balanced fashion even after the move it has already had. Perceptions about the yellow metal have changed, to its benefit.

For all of the hand wringing and "I told you so" in some quarters the gold "crash" is all of about 8%. The 40 day moving average has been a pretty reliable base that gold has bounced off of several times on the way up. That
stands at about $1100 right now and hasn't even been tested yet. If it holds, then a resumption of the upward move would not be long in coming. If it does not the 200 day average that has provided a floor on several larger dips in the past eight years would be the next target, at about $1000. In short, it's a normal correction in a rising market so far.

The story isn't much different for the Dollar. It has been a long one way ride down so a counter trend rally is no surprise. So far, it has not been an impressive one given some of the economic news in the US that started it came as a surprise to virtually everyone. Like the gold market, the greenback has had a couple of big days but doesn't look like the longer term trend has been reversed.

We could see a more sideways trading pattern on the Dollar. If that happens it can't be either praised or blamed for moves in metal prices. We think precious metals would fare better in that scenario than base metals, in the short term at least.

The relative lack of fireworks extended to the major equity markets. Most major indices really haven't gone anywhere for a month or more.   There is a sense that things are again in a holding pattern.

For the remainder of the year markets will increasingly be dominated by year end book squaring and positioning. We've noted several times this year that the major rally has been supported by surprisingly light volume. Participation has not been strong, but those funds that did get long early are looking pretty smart.

How the indices fare as the year closes out will be determined by the actions of the relative few that rode this rally. We expect funds that are long will be skittish, wanting to carry the gain through year end but ready to take profits on a moment's notice to protect strong performance numbers. If we get through year end relatively unscathed we expect those same funds will be profit taking to lock in gains in January. It may take substantial good news to give the market a large lift early in the year.

In our own sector, metal prices will obviously be a factor, but we expect a smaller version of the trades described above to play out. There have been a number of very strong stories that look like they are ahead of themselves. Most were wise enough to use their market strength to carry out substantial financings. As we enter the New Year we suspect there will be profit taking in a number of these deals as that financing stock becomes tradable, and that money will be spread around on newer stories in the sector.

We expect M&A activity to continue ramping up. Mid sized companies that didn't buy when the getting was cheap seem to be holding off waiting for a better ratio between their and their target's share prices. Short of gold having a large move that is more than matched by the producer indices, we don't think they will get their wish. At some point we expect them to just give up and bid. This will free up more capital in the space to pursue newer stories.

We'll spend more time on the big picture items and what next year's market may look like in the next issue. One last item we want to touch on here is year end tax loss selling.

There is concern that this years selling will be heavy, but we think it will be both light and quite selective. A look at last year's chart of the TSX Venture makes it clear how vicious that selling was. Volumes were huge, as was the bounce the index had (20% in a week, more or less) as soon as the last day for tax selling passed.

We expect traders will be more interested in carrying gains through year end this time. The exception will be companies that had bad or no results this year. Look at the chart for your stock. If it goes upper left to lower right, than there may be more "lower right" before the month is over.

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