GOLD: BACK TO THE FUTURE

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In his epic poem "The Aeneid", Virgil declares: "To what extremes
Will you not drive the hearts of men, accurst
Hunger for gold!" (Book III, lines 79-81)

CONCLUSION

Gold reached an all-time high of $1431 per ounce on 12/7/10 (COMEX nearest futures continuation). Will gold ever fall from the heavens back to earth, or at least toward earth?

With the exception of the recent rounds of Middle Eastern turmoil, many fundamental factors related to gold are old news. Thus a review of price and time analysis warns that gold probably will establish a noteworthy top soon. Calendar March 2011 is a likely time.

Given gold's intertwining with other financial marketplaces and the current international political scene, this prediction is cautious. An allegedly imminent high of course may be postponed in gold or any other marketplace, perhaps for quite some time. Also, any near term summit may be merely a preliminary one, with the final plateau succeeding it several or even many months later.

Think of the familiar chant: weak US dollar equals (results in; is paralleled by) strong gold, strong dollar means weak gold. Recall a related popular mantra in recent years. Weak dollar makes for strong US (and many other) equities, with a strong dollar reflected by declining or feeble equities. Some historical perspectives indicate that these ritualistic refrains often have merit. The dusty past also indicates that such financial perspectives are not Natural laws. Is a very weak US dollar (reflected by high gold prices, perhaps) in a rising interest rate environment bullish for the S+P 500 and similar stock benchmarks? Not necessarily, and not forever.

Although the dollar's dreary dive often encourages gold to fly higher (and let's keep viewing gold in US dollar terms), what about a very weak dollar? How enthusiastic will foreigners (and many Americans) remain in regard to the financing of the US fiscal deficit disaster? Sooner or later, the current significant dollar weakness- and certainly another round of noteworthy dollar depreciation- alongside rising interest rates will undermine the US and global economic recovery and create a bear trend for equities. These interrelated variables will reverse gold's ascent and create (or accelerate) a bear marketplace for gold (and eventually commodities "in general").

INEVITABLE POTS OF GOLD?

"What do you know about gold, Moneypenny?", asks James Bond in "Goldfinger" (Guy Hamilton, director; 1964).

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Numerous intertwined variables influence gold prices. However, many of these important and still influential considerations are familiar, old news. Think of the extent and patterns of commercial and (especially) noncommercial gold demand- whether from so-called investors, speculators, or those diversifying a financial portfolio. Many players monitor currency trends, particularly US dollar strength or weakness. Extended periods of currency depreciation often enhance the appeal of precious metals. The more widespread the lack of faith in numerous currencies and the deeper the concerns about unbridled inflation, the greater is gold's allure. All else equal, low nominal interest rates (as in America and much of Europe), especially in times of economic prosperity, tend to spark and sustain gold demand. The more intense the economic and political insecurity in a given nation or around the globe, the more attractive bullion appears. Gold producers hedge less nowadays than several years ago.

Are gold production costs anywhere near $1400 an ounce?

Well-known international economic and political unrest and conflict partly accounts for rallies in gold, regardless of whether one takes the starting point the lows of 1999 (8/25/99 at around 253), 2006 (6/14/06 at 555; 10/6/06 at 560), 2008 (10/24/08 at 681), or 2010 (7/28/10 at 1156).

Admittedly, a wild card ("new news") is the current Middle East upheaval in Egypt, Libya, and elsewhere. Significantly threatened or sustained actual interruption of petroleum production in a key nation (especially Saudi Arabia) obviously risks propelling worldwide petroleum prices higher, thus encouraging gold to rise or even skyrocket alongside them.

Yet in general, people ("civilization and the industrialized world as we know it") do not "have to have" gold to the same extent they require petroleum. **And gold and other precious metals are not crops like corn, cotton, sugar, or wheat**. We all know that food is far more necessary than gold. Moreover, it usually takes a fair amount of time to boost total world food production. In agriculture, since growing takes time, it usually takes months to produce and harvest and thus really boost "free supply" and replenish inventories.

Gold may be in high demand and short supply for the near term. It may take a while for new or existing mines to readily meet ravenous demand. **Yet there are heaps of gold inventory in the hands of numerous owners (especially noncommercial ones). Such gold quickly can appear and be sold, thus boosting "free supply" fast.** If for whatever reasons, packs of gold owners decide to sell their beloved treasure, there may be a supply avalanche.

Besides, don't very high petroleum (and food and base metal) prices damage economic growth and consumer net worth and spending? Won't such considerations at some point weaken gold?

Central bankers do not favor a sky-high gold price.

The higher the nominal bullion price, the greater must be the arithmetic move to capture a given percentage return. Besides, physical gold does not earn interest (except when leased).

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With gold at current mountainous heights, maybe some polished political and economic leaders will propose official gold sales. These revenues could be sent to needy consumers around the world suffering from the spike in petroleum and food prices.

A NEW GOLDEN AGE, FOREVER?

"I think I'll go to sleep and dream about piles of gold getting bigger and bigger and bigger." Fred C. Dobbs, in the 1948 movie, "The Treasure of the Sierra Madre" (John Huston, director)

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Gold prices have climbed a long way, surpassing prior major peaks. The duration and extent of the bull move over various noteworthy time horizons suggests that bullish

considerations, even if still enduring, are well advertised. In any event, they've ventured a very long distance over a very long time if one goes back over a decade to 1999. Statistics suggest that a change in the gold trend from bullish to bearish sometime fairly soon is probable.

Gold at 1430 equals a towering rally of almost 5.7 times versus the low over ten years ago on 8/25/99 at 252.5 (466 percent). It is a truism that marketplaces can keep soaring up and up and up, or even "go vertical". Gold catapulted around 8.6 times its 8/30/76 low around 102 to its major high on 1/21/80 over 870. Recent highs are somewhat over two years after and roughly double the 681 bottom of 10/24/08. Since the midsummer low around 1156 (7/28/10), gold has rallied almost 24 percent.

Means and standard deviations are guidelines, not gospels. Which are reasonable time horizons to select? And prices can move beyond mean plus (minus) two or even three standard deviation levels. Prices do not have to revert to their mean, or move to any given level. Nevertheless, as a guideline for a notable bull or bear expedition over a so-called long period of time, a two or three standard deviation advance relative to a mean price is a "pretty big one".

Review mean and standard deviation levels for gold from notable price bottoms (nearest futures continuation). These suggest that gold prices are rather elevated, even if arguments exist justifying a further rush into gold and a related price rally. **In sum, 1360/1400 is a key "high" range for gold. Then comes 1460 and 1525/1545; beyond them looms 1615/1640, an even more striking height (and theoretical resistance level or target).**

Since the 8/25/99 low around 253, the mean plus two standard deviations is around 1230, the mean plus three SD about 1545 (the average of the mean plus two SD and the mean plus three SD is 1385). From the 10/6/06 trough around 561, the mean plus two SD is about 1390 (about double the October 2008 low), the mean plus three SD 1615. Since the important bottom on 10/24/08, the mean plus two SD is around 1457 (not far from the recent high), the mean plus three SD 1640. Finally, since the 7/28/10 blast-off point near 1156, the mean is around 1325, the mean plus one SD about 1395, the mean plus two SD about 1460, the mean plus three SD around 1525 (a thirty-three percent move from 1156 is about 1540).

Marketplace levels and distance traveled should be interpreted alongside other timing considerations. What about calendar March and gold? Recall that gold made its previous major high on St. Patrick's Day 2008 (3/17/08) around 1034. It then collapsed about 34.1 percent in seven months to 681 (10/24/08). How did this tie to the US dollar trend? The March 2008 gold peak occurred shortly before a low in the broad real trade-weighted dollar ("TWD")- April 2008's low at 84.0 (monthly average). The nominal trade-weighted dollar low (for which daily prices exist) was 4/16/08 (at 94.9). What about equities? Although the S+P 500 reached its major high in mid-October 2007 at 1576, its final high at 1440 on 5/19/08 occurred not long after the March 2008 gold top. Though thirty years ago is rather ancient history, the major gold peak of 873 occurred during calendar first quarter (1/21/80).

For the intertwining of gold trend changes relative to "around calendar March", note that other evidence suggests that "around then" is an important time period for the US dollar and equities.

In addition to April 2008's low at 84.0 in the broad real TWD, other broad real TWD marketplace turns occurred at a calendar period not much distant from "around now" (roughly calendar March). A major high in the broad real trade-weighted dollar was 112.6 in February 2002 (monthly average; the nominal TWD peaked 2/27/02 at 130.2). Note March 2009's interim TWD high at 96.7, part of the long run dollar bear move. Nominal daily highs for the TWD on 3/3 and 3/9/09 near 115.0 were around the stock marketplace trough. Recall the S+P 500's major low in its current bull trend was 3/6/09 at 667. For other calendar March equity price turns in recent times, don't forget the final low on 3/12/03 in the fierce bear trend that began in first quarter 2000. Incidentally, the S+P 500's 2000 pinnacle was on 3/24 around 1553 (though the Dow Jones Industrial Average top was in January).

The Federal Reserve meets 3/15/11. The Fed is determined to use its tools to produce what it views as sufficient inflation. Not only headline inflation indicators such as consumer and producer prices, but also stock marketplace levels, unemployment figures, housing data, fiscal deficit concerns, and so forth will influence Federal Reserve policy. Might some of these economic indicators (including commodity prices and the weak dollar) inspire the Fed to hint that it may fairly soon (as in a few months) become less accommodative in its policies? Thus maybe no extension of quantitative easing after second quarter 2011, plus suggestions of somewhat higher interest rates (implementation of exit strategies)?

DIGGING IN: CAN COMMODITIES BE UNDERMINED?

"Marty, we've already agreed that having information about the future can have disastrous consequences. Even if your intentions are good, it can backfire drastically." Dr. Emmett Brown, a character in the 1985 film "Back to the Future" (Robert Zemeckis, director)

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Gold is not eaten or used as an energy source. Gold industrial use relative to total gold demand is less significant than is the case for base metals like copper. **Yet overall commodity price trends often roughly parallel those of gold.**

Review gold and commodities "in general" in the past three years, using the broad Goldman Sachs Commodity Index ("GSCI") as a benchmark. They do not necessarily move together in lock step. However, the directional dance moves of gold and commodities have been similar, with gold the leader from the time perspective. Keep in mind the dollar and equity action alongside them.

The gold high of 3/17/08 eventually was followed by the 7/3/08 top in the broad GSCI around 890. Thus an important high for commodities in general may not be simultaneous or almost so with one in gold. But three and a half months is not forever.

The gold low 10/24/08 at 681 was followed about four months later by the broad GSCI low 2/17/09 around 300 (ultimate lows in Brent and NYMEX crude oil were in December 2008, but their final bottoms were in mid-February 2009).

In 2010, the gold low of 2/5/10 at 1045 was followed a few months later by a GSCI low on 5/25/10 at 459. Note the accompanying minor high in the TWD in June 2010 at 89.7 (tops in the nominal TWD were 5/25/10 at 106.6 and 6/7/10 at 106.7).

The gold low on 7/28/10 at 1156 preceded by one month the GSCI valley around 490 on 8/25/10. Though the S+P 500 reached a minor low on 7/1/10 at 1011, its take-off point was in late August (8/27/10) at 1040. Although the broad real trade-weighted dollar had suffered a renewed fall since June 2010, a low of the greenback versus the Euro FX currency was put in place around 1.2590 on 8/27/10.

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Keep in mind the lofty gold levels suggested via mean and standard deviation and related price measurement review in the context of similar exercises for the broad GSCI and the S+P 500. In sifting for “current” important levels and potential marketplace turns, the timing and statistics of the 10/24/08 gold low, the 2/17/09 GSCI floor, and the 3/6/09 S+P 500 bottom in particular (“especially”) should be read together. These illustrious marketplaces do not have to all voyage the around the same distance (as in mean plus two SD terms from a key “related” time/price low) before peaking, but they may approximate such a trip.

Since the major low in the GSCI in December 1998 around 127, the mean plus two SD is about 680 (compare recent highs), the mean plus three SD around 840. From the 2/17/09 low around 300 (a few months after the October 2008 gold bottom, and not long before that of the S+P 500 in March 2009), the mean plus two SD is 650, the mean plus three SD about 725. What about since the GSCI’s 8/25/10 valley at 490? For that, the mean plus one SD is about 633 (a thirty-three pc move from the 8/25/10 low is 652), the mean plus two SD is 678, and the mean plus three SD almost 725. Thus for near-term important resistance, watch 650/680, then 725/735 (a fifty pc move from the August 2010 low is 734). The 7/3/08 GSCI pinnacle was about 890 (840 is the mean plus three SD from the December 1998 major low).

Now scan the S+P 500 vista. Since the 3/6/09 low just under 667, the mean plus two standard deviations is about 1337 (compare with recent highs; twice the March 2009 low is around 1334), the mean plus three SD 1465 (compare the May 2008 final high of 1440). Since the 8/27/10 low around 1040 (a better start date choice than the earlier low on 7/1/10 at 1011), the mean plus one SD is about 1285, the mean plus two SD 1355, the mean plus three SD 1425. So 1335/1355 and 1425/1465 represent quite high levels (resistance ranges). Prices of course could exceed these. The all-time S+P 500 high was a glittering 1576 in October 2007.

RISKS: EXPLOSIONS AND GOLDILOCKS, REVISITED

All financial forecasters, including would-be auric oracles, should issue warnings. A substantial escalation in current international/Middle East unrest, particularly if it affects petroleum battlefields, might postpone a gold peak, or produce a second one.

In addition, continued dollar weakness- or even a bit more depreciation relative to current levels- and related inflation fears might help to delay the forming of a gold top and the creation of a peak for commodities “in general”, or produce a second pinnacle in them.

Or, the dollar may rally “fairly soon”, thus assisting gold’s descent, only to resume another decline later.

Monitor equity prices and Federal Reserve policy alongside the weak dollar scenario. US corporate earnings have been strong. Stock buyback programs have been significant. The Federal Reserve and its comrades are determined to support recovery. That in practice has meant a policy seeking to restore nominal consumer net worth via stock marketplace rallies and a weak dollar. Quantitative easing does not end until end 2Q11. Might the Fed extend its money printing program if its inflation targets are not met or if it feared economic weakness and renewed damage to consumer balance sheets (especially via falling equity prices)? The Fed also probably would keep policy rates (Federal Funds) around rock bottom levels if it believes its desperate quest to recreate a Goldilocks economy is endangered. Even if equities and commodities in general decline “fairly soon” in time, one or both of these marketplace sectors may rally again to form a second top. Also, to some extent, the deep pit of deficit spending (fiscal stimulus) has helped to underpin the US economy and equity and commodity prices.

ANOTHER VEIN

However, some dollar weakness "in itself" is one thing for equity, interest rate, and commodity arenas, substantial dollar weakness another (particularly when major dollar support is being broken to bits). Focus on equities. More dollar slippage than merely "some" in the context of other variables is not necessarily or perpetually bullish for stocks. The sparkling hymn in recent years of strong dollar/weak stocks, weak dollar/strong stocks has its limits.

Suppose that this dollar depreciation (relative to the prior all-time low around 84.0 in the broad real trade-weighted dollar) becomes substantial. Picture a bloody fall of five or even 10 percent relative to the 84.0 floor to 79.8 or 75.6. Suppose a dollar cratering of that magnitude occurs alongside a significant jump in interest rates in America and overseas. This potential marketplace scene for the dollar and rates, even if it ultimately does not play out, is much more likely than many prospectors believe.

However, if that terrifying story unfolds, it will undermine equities such as the S+P 500. See "American Debt Gardens- Higher Yields ('Desperate Housewives', Episode 7)" (2/8/11) for details on the US interest rate context. Using the 10 year US Treasury note as a guideline, rates made a major (final) low 10/18/10 at 2.33 percent, midway between the Fed's renewed rounds of quantitative easing (around 8/10/10 and 11/3/10). Huge current and potential long run budget deficits in the United States (and many other places) risk such higher interest rates and dollar slumps. Money printing spectaculars and low interest rates alongside this massive deficit spending magnifies the risk to the dollar. This cascade of events probably will end up with a deflationary twist, and a deflationary outlook eventually will help to tarnish gold and send it tumbling downwards.