

Eelco's Gold Market Update dd 2011-07-06 – Gold up or down into September

Following Gold's 2.5 year channel bound run (below), it would normally be due for a 38.2% correction. Although Gold is due for a correction, it is acting surprisingly strongly, especially considering that it should have corrected before it leads into its traditional period of seasonal strength commencing latest end August. Below we see the Spot Gold Weekly chart's Elliott Waves.



Elliott Waves manifest throughout the markets in a 5/3 wave pattern and each wave in turn breaks down into ever smaller 5/3 wave patterns at shorter time frames. For this Gold boom, Generational Bull Market Wave 1 took Gold from \$255 to \$1034, where-after Wave 2 corrected to \$682 and above you see my count for Sub Wave 1(of 5) of Generational Bull Market Wave 3. We know this is all Sub Wave 1 as it remained and still remains channel bound. Now you can see the blue Minor Waves 1 to 4, which reflect their 5/3 breakdown as Waves i-v and A-C. Now it gets tricky. The corrections in Minor Wave 5 were too small to signal the end of Sub Wave 1, which is why it became an extended Wave 5 with smaller Waves (1)-(4) with (5) unfolding. Now a normal correction for Sub Wave 1 would take Gold down to \$1250, a 38.2% correction of the rise from \$682 to say \$1600, which would finally break Gold out of this 2.5 year channel and which is what I have been expecting. This would give us a final projected target of \$8 000 by say 2016. Although there are many signs that Gold is acting strong

and many are predicting a run up, I would be much happier if we saw a rapid correction down to \$1250 before End August – which would be an excellent buying opportunity. I find the current action since May could herald a weakening. However, a global bond market collapse could result in a flight to the safety of Gold and artificially extend these waves. The following “Jim Willie” article’s 1st chart is very insightful as the “commitment of traders” is usually a very reliable signal and it says Gold (&Silver) are ready to run up

<http://www.marketoracle.co.uk/Article29121.html>.

So how do we determine what Gold is going to do, bearing in mind that **it goes up when markets offer negative real returns as they are at present and when there is a flight to safety in times of crisis**. In essence, there are at least four big issues that could affect the Gold & Silver markets. These are as follows:

- The EU Bond Market Crisis could trigger a global Bond Market collapse and a 2nd Derivative Crisis. This would almost certainly cause an instant flight to the safety of Precious Metals. The EU has just raised rates, which is not good for bond markets and Greece, Portugal, Ireland and Italy are currently causing major Bond Market jitters. In addition, the EU as a whole is embarking on austerity cuts that would slow economic growth;
- The US’s QE2 ended in June. This was widely acknowledged to have been driving a speculative boom in Commodities & Equities. The absence of the QE stimulus effect could lead to a collapse in these markets and that would initially be bad for Gold and Silver and their related equities. Bearing in mind that the US markets usually correct in the fall I think it is highly likely that we will see a substantial seasonal correction in equities this year, since we did not see one last year and next year is US election year so they will do everything to stimulate the economy. This article makes a strong case that a major correction/collapse in equity markets is imminent http://www.gold-eagle.com/editorials_08/summers070711.html;
- The US is technically insolvent and having to embark on major austerity measures as their huge annual deficits are baked in the cake. Although

there is no political will in the lead up to the 2012 elections, there is no doubt that Severe Cutbacks and Substantial Tax Rises are inevitable in the long term. The lack of consumer spending coupled with these cuts means that economic growth will be elusive for the next decade. This could be bad for PM's in the short term, if markets crash, but good in the long term as negative real returns rule; and finally

- The Chinese markets are severely overheated. They have been growing for 30 years at 8-10% p.a. without pause and this has caused certain imbalances. There are those who believe the Chinese property market is overheated, there are those who say they have US\$1 Trillion of distressed debt etc etc. If the Chinese markets crash, that will be bad for commodities and that would be bad for Australia, Canada, RSA etc. That would be bad for Silver and Gold.

This is all confusing in our Gold/Silver analysis as some events will cause them to rise and others will cause them to decline. The answer lies in the fact that all three the major economic blocks that drive the global economy are in trouble at the same time. There is no doubt that the collapse of one will cause the collapse of the others. Therefore, it is like a house of cards that comprises the Global bond and Equity Markets that is set to collapse at the slightest hiccup. This is probably why Gold is acting so strong at a time when it would normally correct – investors sense that the Global Bond and Equity Markets are on a knife edge and that this may be a time for a flight to the safety of Gold.

Now for a look at some other drivers, but first I want to show a chart of the Rand Gold Price as an aside.



Rand Gold finally broke out of its 2.5 year consolidation triangle, retested beautifully and should now be headed up from R10 000 to R15 000 within a year, or at most two. This co-incidentally heralds considerable Rand Weakness in the relatively near future and we know how fast that can happen based on past experience.

Lets first look at the Dollar as a contra-cyclical driver of PM's.



Little direction here. The Daily is range bound by a blue triangle. The weekly is forming a bearish flat top pennant and the monthly oscillators are bearishly aligned. I was expecting the Dollar Index to drop to 70 odd before retesting support turned resistance at 76 odd. However, following its break out of the big

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monthly triangle formed over the last 4 years, I maintain the longer term bias is down despite the fact that the DI could make one more run to 86 (low probability). Short term, a DI rally would be bad for Gold and Silver. All in all, the short term picture is uncertain but the long term picture remains bearish – with the DI more than halving in the next 5 years – as reflected in previous Chirps & Thoughts.

Next the Volatility Index and Treasuries



The VIX (Volatility Index) offers little direction, but there is strong support at 15/16, which implies a probable Equity Drop is near. If the VIX breaks 25, I would say the big correction/crash is starting, but 23 would already be bad.



The 10 Year TNX offers little and after 25 years, the break point that would signal the probable start of a bond market collapse is 4%+.



The 30 Year TYX is pointing to higher rates as it has broken a 25 year trendline. However, this could take a while to unfold. There is no doubt that a Global Bond Market Collapse is due, the big question is when.

Conclusion. I think it is highly likely that we will see a seasonal correction in equities this year, since we did not see one last year and next year is US election year so they will do everything to paint a rosy picture. Therefore, I see a high

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probability that we will have at least a significant correction in equity markets in July, August, September. This is usually bad for Gold and Silver and their related equities. However, I also see some EU Bond Market crisis at the same time and this could herald the start of the Global Bond Market Collapse, in which case all bets are off as Gold and Silver will rocket. Therefore, I am holding my Gold and Silver positions and will accumulate if Gold and Silver correct. I think it is risky to bank on normal September seasonal strength in the Gold and Silver markets as the Equity Markets will almost certainly correct substantially, which would cause an initial fall in Gold and Silver. However, in the face of Negative Real Bond Returns, the prospect of a Bond Market Collapse and the possibility of a severe Equity Market Collapse, there is ample reason to be optimistic for Gold and Silver in the longer term.