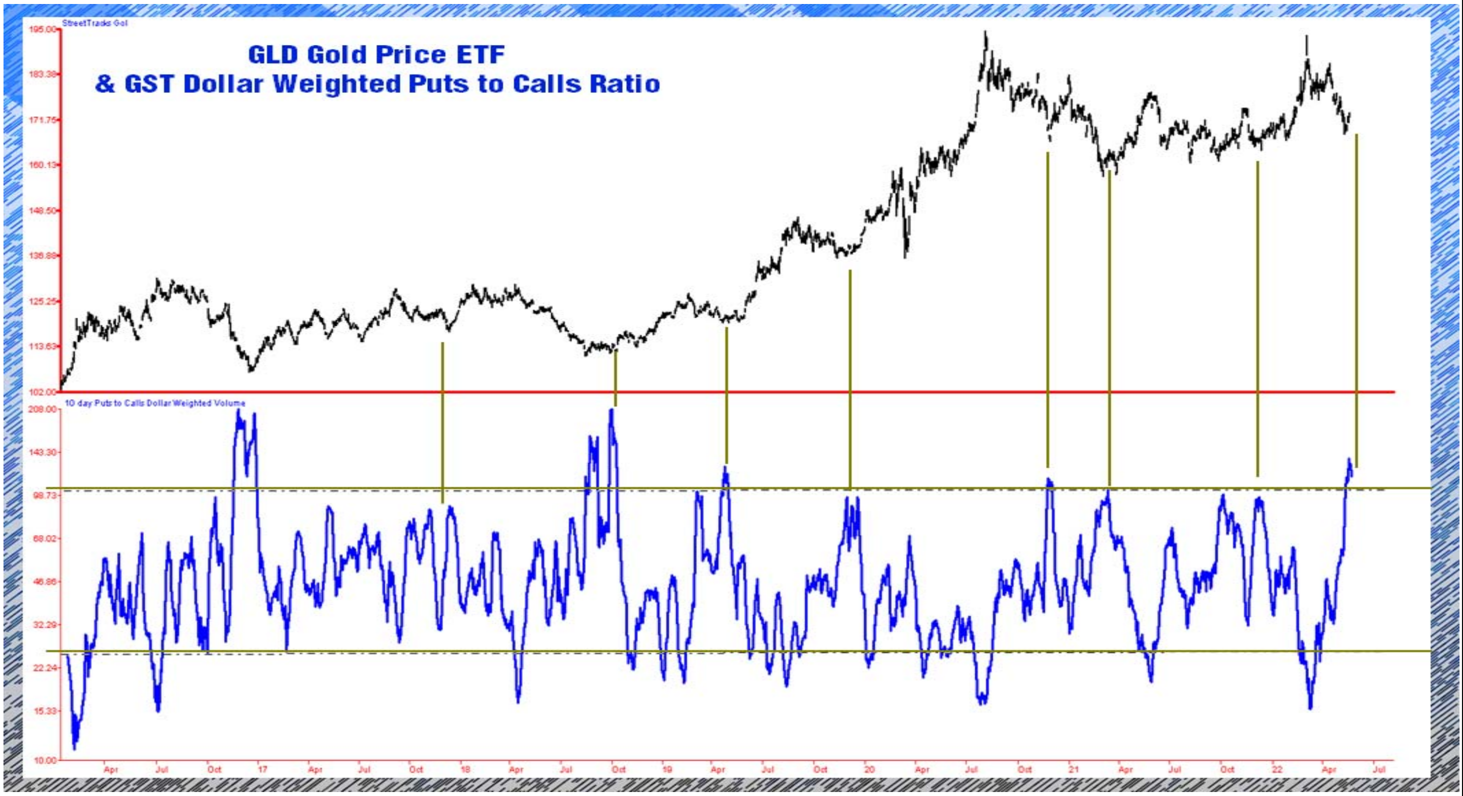
The Gold Stock Technician

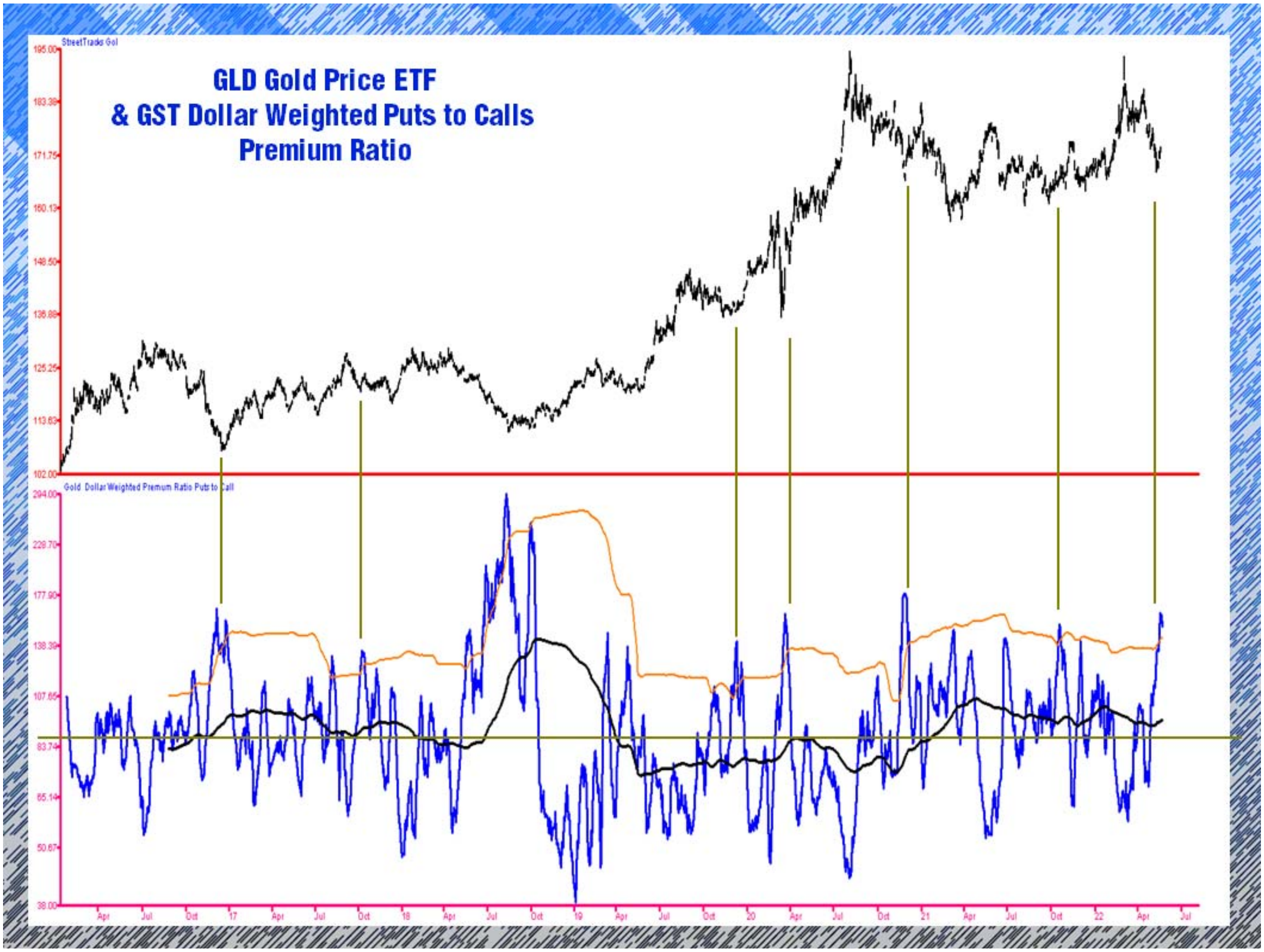
Thursday May 26th 2022

* *Focus on Physical Gold*

This week, the key focus for us is on the ***Physical Gold*** *market where we believe prices are in the process of completing a very important low*. In the chart below, we show the Dollar Weighted Puts to Calls Ratio for the **GLD ETF**. This ratio computes the total dollars (reaching into one's wallet) spent on calls and puts each day across the first five months of 3rd Friday options expirations. It's a great indicator because it is not a sentiment poll. Polls are cheap as they simply ask people, :What do you think, are you bullish or bearish?" This gauge, by

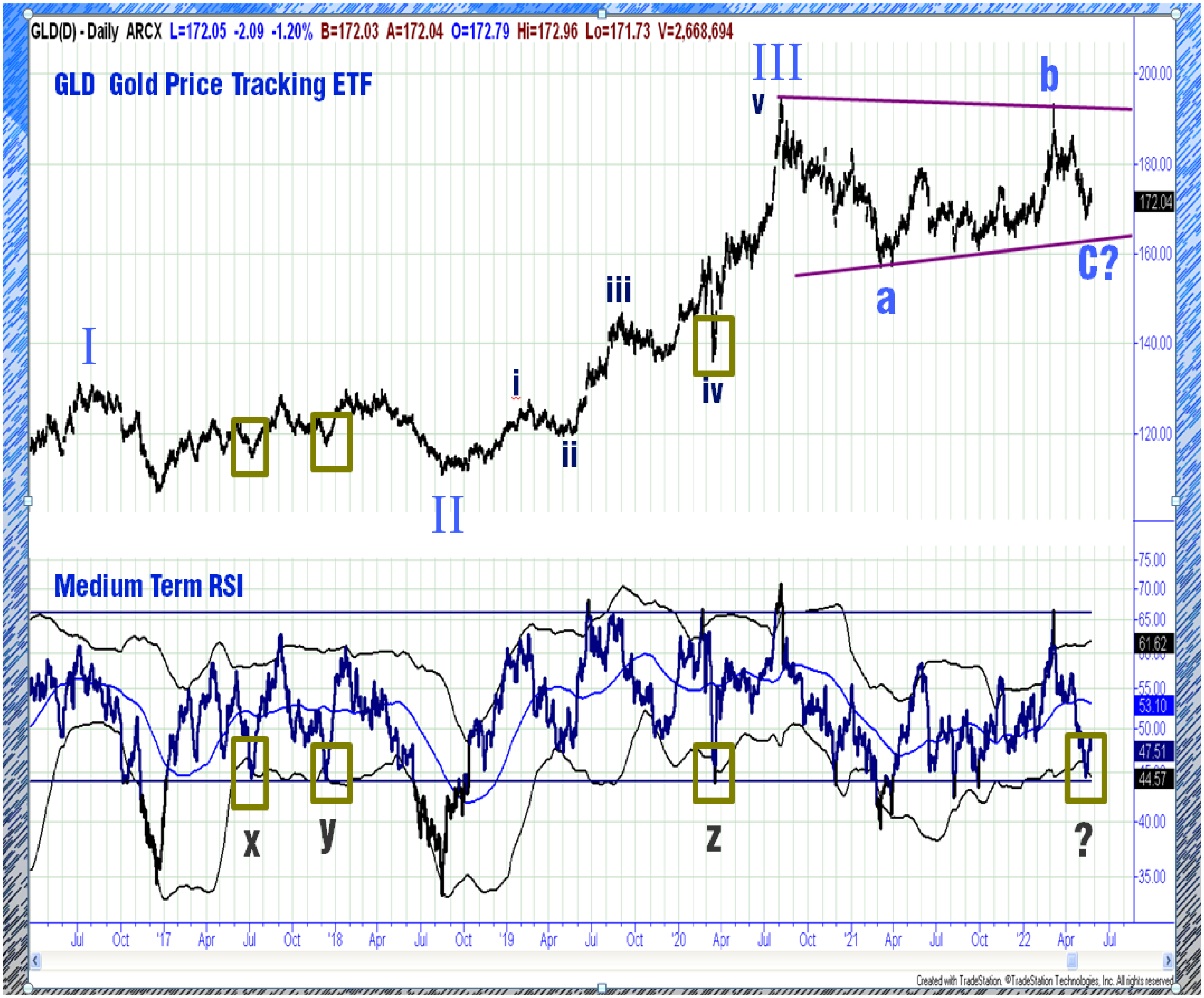


Contrast, is a flow of funds indicator predicated on what people are actually doing with their money. If they are nervous enough to hedge and they are buying puts, that counts, if they are so bearish that they are outright speculating on the purchase of puts, that counts as all of these actions show elevated levels of either negativity or caution. When that combined level of anxiety has been rising for a long time, as has now been the case, this gauge creeps up across the range and tells us that sentiment on a contrary opinion basis is ripe for a bottom.

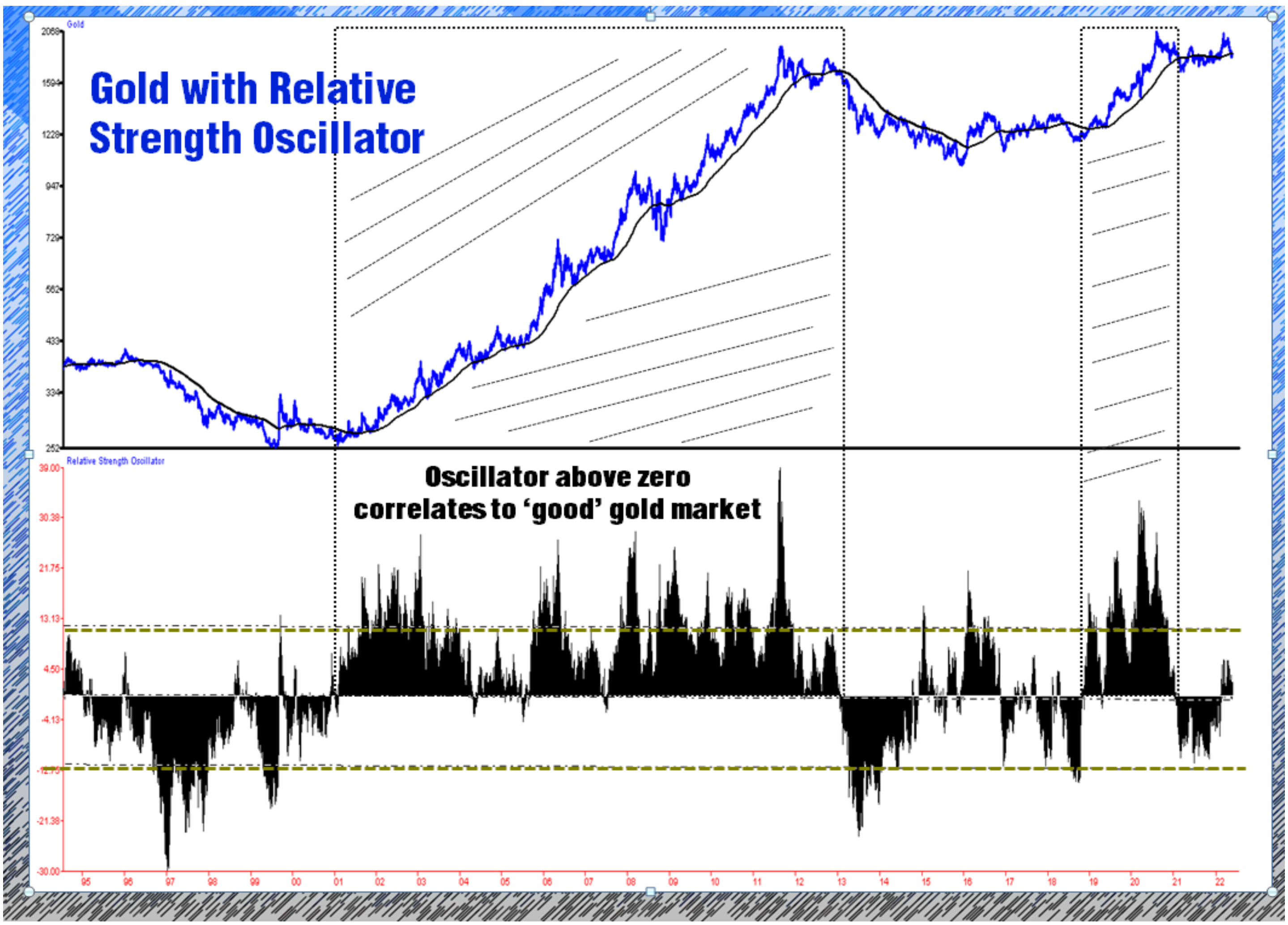


The next chart shows the same pattern. Here, we are looking at the Dollar Weighted average Put-to -Call Premium Ratio. This gauge takes total dollar call volume and divides by the total number of call options traded that day to arrive at average dollar weighted call premium. We then do the same thing for the puts, and we then compute a moving average of the ratio. It's a slightly different curve, but often a very similar result. We then plot a medium term moving average around it with an upper Bollinger Band set at 2 standard deviations. Right now, this gauge is outside that upper band, which means sentiment is two standard deviations away from the mean. ***That's a lot of fear.***

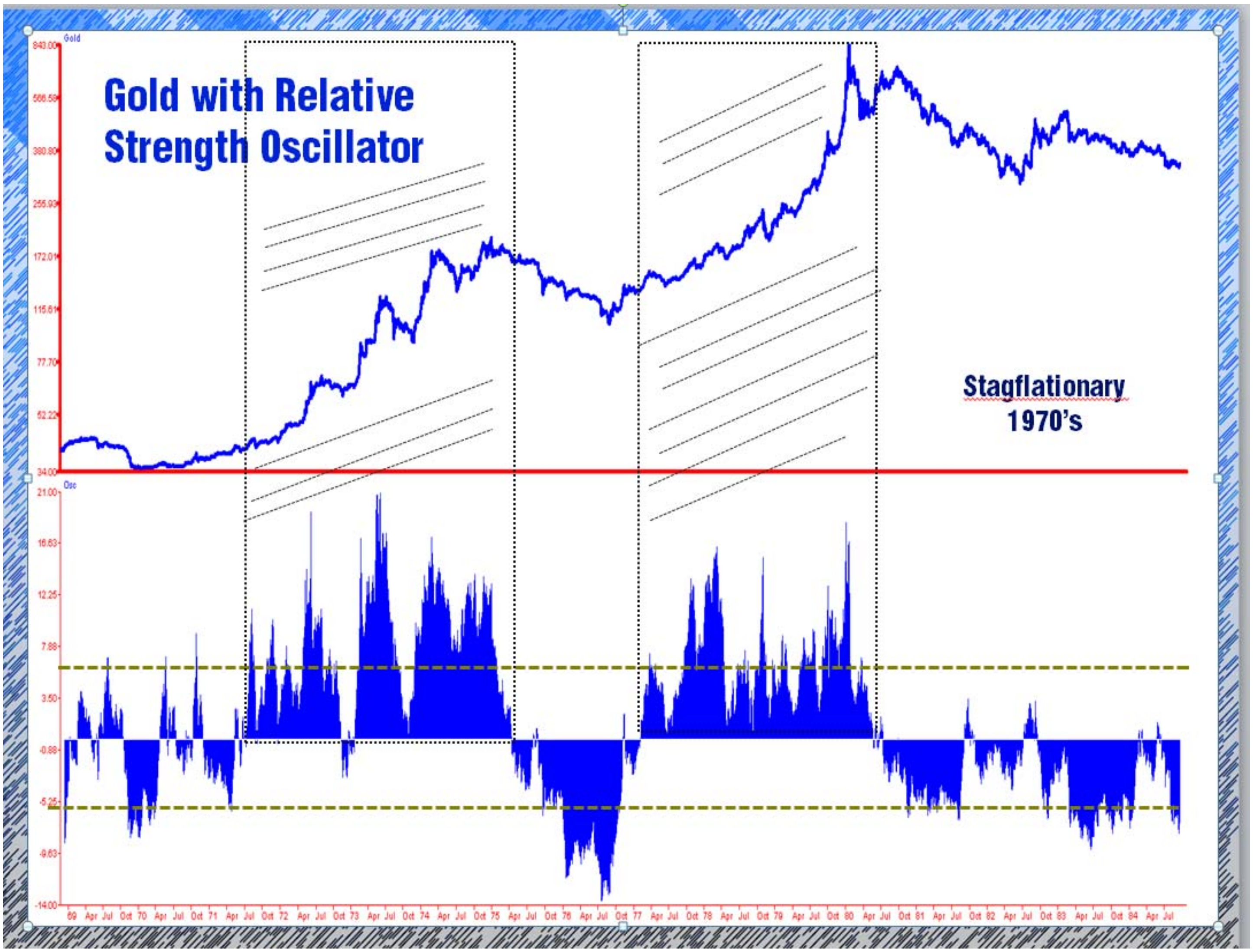
Medium Term momentum indicators are also echoing this same message. In the chart below, we show the GLD ETF with a medium term RSI. While it is true that RSI is not historically oversold and could potentially move materially lower, it is also pretty clear that right now, prices have depressed the RSI to levels that are consistent with a number of more common types of lows. Look at the readings at the lows at points X, Y, and X and then to the far right and see where we are right now….. *It's pretty much right there.*



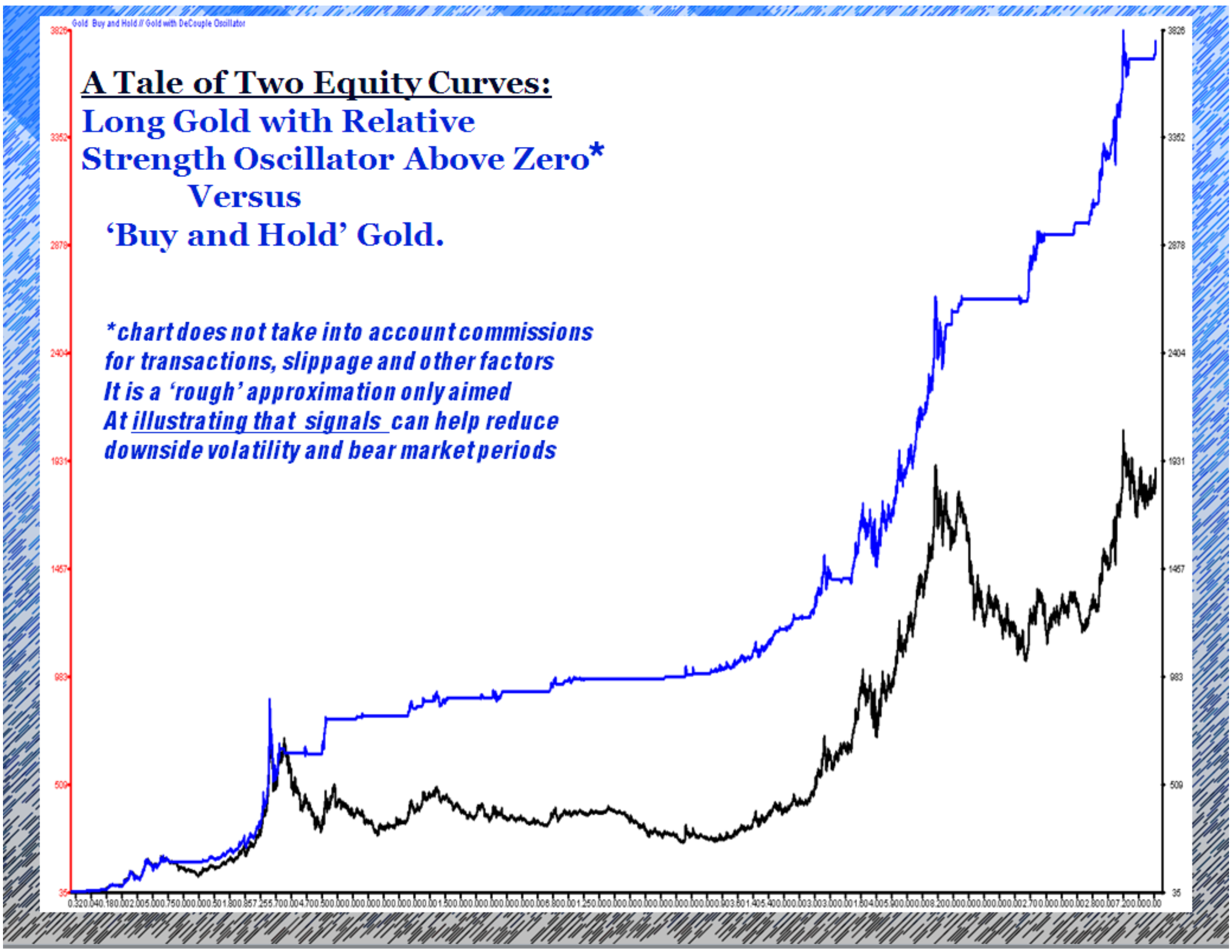
So there is no guarantee that prices can't still push down from here**, but that is why we are buying gold in staged entry points.** The most arrogant thing any investor can do is plop a lot of money into a position in one day. The odds of being perfect on your timing are never that good and perfect timing is never needed to make money as an investor. What you don't want to do is get shaken out of a big position at the wrong time. That means, doing some buying on the way down, some buying when prices really seem to be at a final low, and then some buying after the low when there is more confirmation of an upward turn. **It is strongly trending markets that make people real money and change their life situation**, not in and out trades. Yes, every now and then some trading can be accretive, and we do that from time to time, but on the whole, especially in light of today's situation where Gold is concerned, the focus has to be on assuring high level of staying power in the position. The U.S. economy is right now weakening, and stocks are in bear market. We doubt the Fed will have the will-power to push the economy and the markets off the cliff in order to wring down inflation the way Paul Volcker did in 1981. This situation is inherently far more leveraged and far more fragile and so a timid Fed will likely be the end result. ***They will likely pivot later this year, and once the money printing starts again, with inflation already now embedded, the next inflationary up cycle will really fall into place.*** Gold will lead. Later in that cycle, is possible (and perhaps likely that inflation could get completely out of hand) in which case the gold purchased today will be an inflation protection lifeline for many.



In the chart above, we debut some work we have been toiling on for some time. The chart shows spot Gold on the top clip and a relative strength gold oscillator on the bottom. This gauge tracks accumulated relative strength for Gold versus other important assets such as stocks, bonds, and commodities. When the oscillator is above zero, it means Gold is starting to out-perform other asset classes, *i.e. Gold coming into its own*. When the oscillator is negative it means that the investment climate is not friendly for Gold at that time. What's fascinating right now is that even as Gold has pulled back in recent weeks, it is nevertheless outperforming other asset classes on a relative basis and this has actually been pushing this oscillator positive. The missing ingredient here is some robust positive price action in Gold where the oscillator moves even more solidly positive. Yet in looking back over many years, this recent price action looks very encouraging and we were hard pressed to find other situations where even with Gold going down, the oscillator was moving up. ***We think this may be an early leading indicator for a positive change on the way soon***. The key drivers within this gauge are the S&P 500, Crude Oil and a long term Bond Index. We took the data for this gauge all the way back to 1-2-1968 in order to really focus on the highly stagflationary time period of the 1960's and 1970's and early 1980's.



Obviously, no gauge is ever going to be perfect, or even close to perfect. Yet we are actually kinda pleased with how this gauge has worked out as a ***timing aid*** over a period that we looked at spanning 52 years. The chart below shows ***a crude version*** of the output of a simple algorithm of being long physical Gold when this oscillator is above zero, and out of Gold when the oscillator is below zero. It does not take into account commissions and other factors. What's more because the oscillator (like all oscillators) tends to whip around a fair amount it is not a pragmatic trading formula as there would be a some significant slippage and commission fees especially in the past etc… And none of that is the reason we are showing this chart. The point of the graph – to be clear, is that the oscillator does tend to sort of trend above the line in bull markets and below the zero line in bear markets and that when it has been negative for a while and starts to flip back positive, ***it is worth making sure you are attentive to the market at that time.***

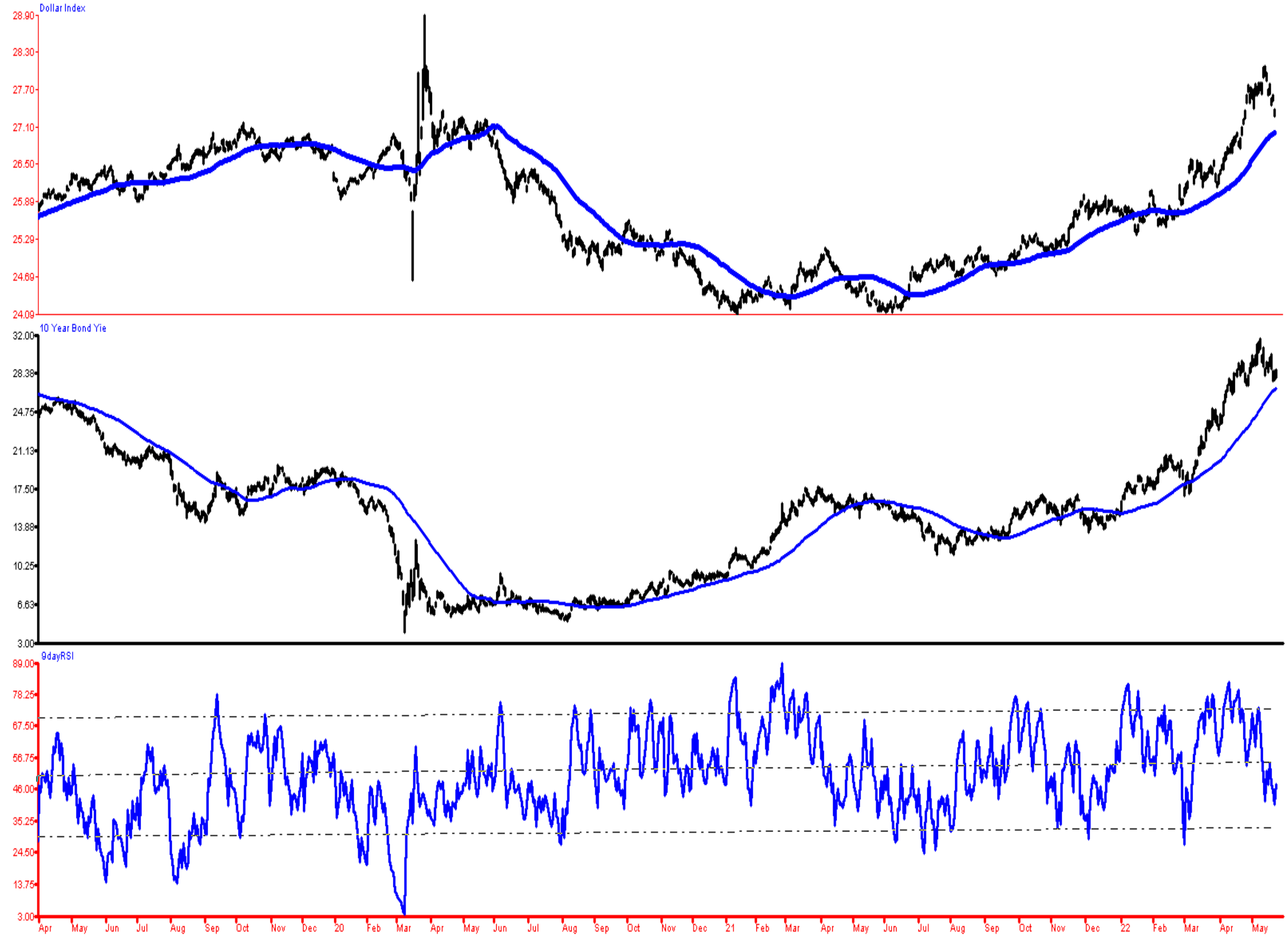


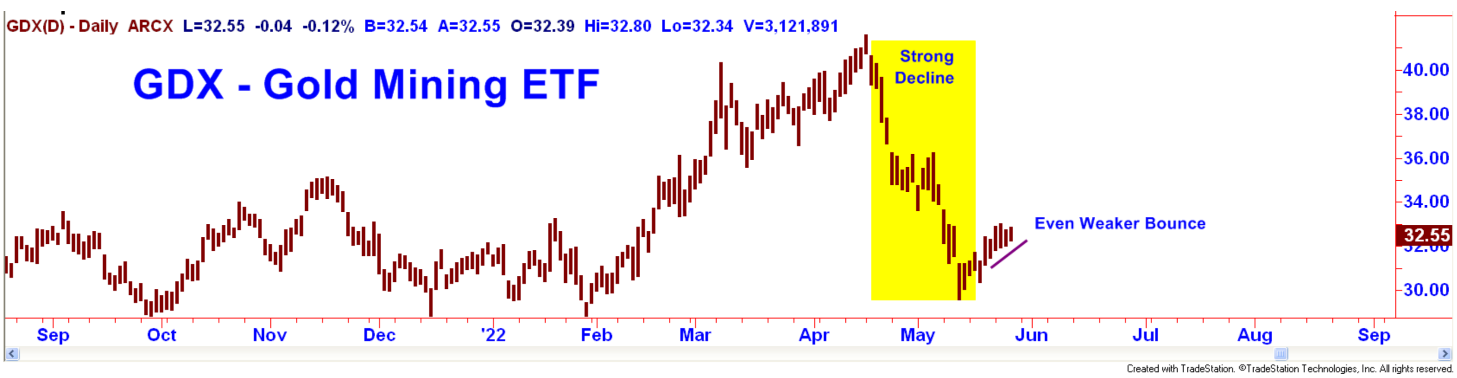
This is the case now, and if in the days and weeks ahead, we see some real improvement in the

Gold price and the oscillator starts moving more materially into positive territory, we would take that as good confirmation that Gold is decoupling from other asset prices and starting to trend in typical bull market fashion.

Intermarket Analysis:

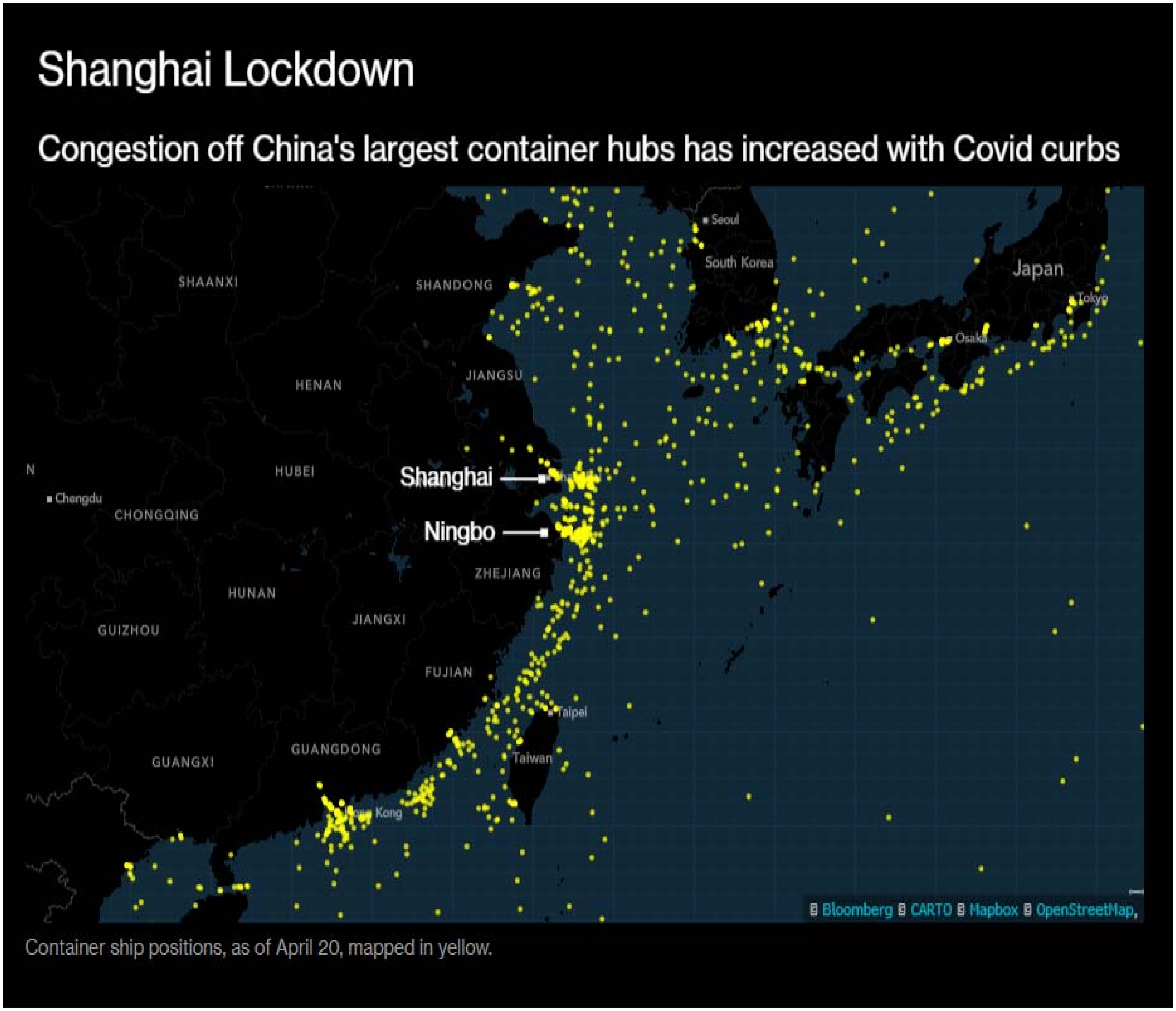
Over the last 10 days, we have seen what could be well described as a recession fear interlude inserting itself into the market. Over that time, Treasury Bond yields have declined (come off their highs) and the U.S. Dollar, which had been very strong has pulled back. The chart below shows the Dollar Index on the top clip, and the 10 Year Bond Yield in the middle clip, and then a 9 day RSI on the 10 Year Bond Yield on the lower clip. Effectively, what had been a very overbought set of readings in the Dollar and in Bond Yields have now come most of the day down toward oversold. The dip in the Dollar and Bond Yields has been predicated on the idea that the economy is slowing (which it is) and that economic weakness might cause the Fed to do only two more rates hikes and then go on a September pause.





As the Dollar has pulled back, both Gold and Gold Stocks have experienced a modest bounce. In the prior instance a few weeks earlier, when the Dollar was very strong, both Gold and Gold Stocks were very weak. At the moment, we believe that the Dollar and Bond Yields have another possibly final advance (at least for this cycle) to new higher highs shaping up in the days just ahead. We say this because the prior rally had huge positive momentum and normally a more definitive turn in a sector that strong will push up to a distinct set of new higher highs with lower MACD and RSI readings. That is what we believe is dead ahead and a return to a strong Dollar and rising rates should in the days ahead begin to pressure the stock market lower once again. In the very short term, we believe ***the stock market is trying a more elaborate Wave 2 counter-trend bounce which probably has one or three days more days left to go. The 4080 to 4140 area looks like a good target zone for this near term stock market rally to possibly peak and as it does, we will probably see yields and the Dollar bottom out***. We should note that some of the better Wall Street firm strategists have downside targets for the

S&P in the 3300 to 3400 zone, which would bring the market multiple down to a less pricey 14X times earnings. For the kind of climate we are in, a 14X multiple seems totally reasonable and those same strategists (Morgan Stanley, BofA) are looking for weakness into September, again, seems totally reasonable to us. That means that the odds are pretty high that there is more slog ahead for the stock market as the high inflation rate pressured by gasoline and diesel fuels costs is likely to continue exerting downside pressure on market multiples.

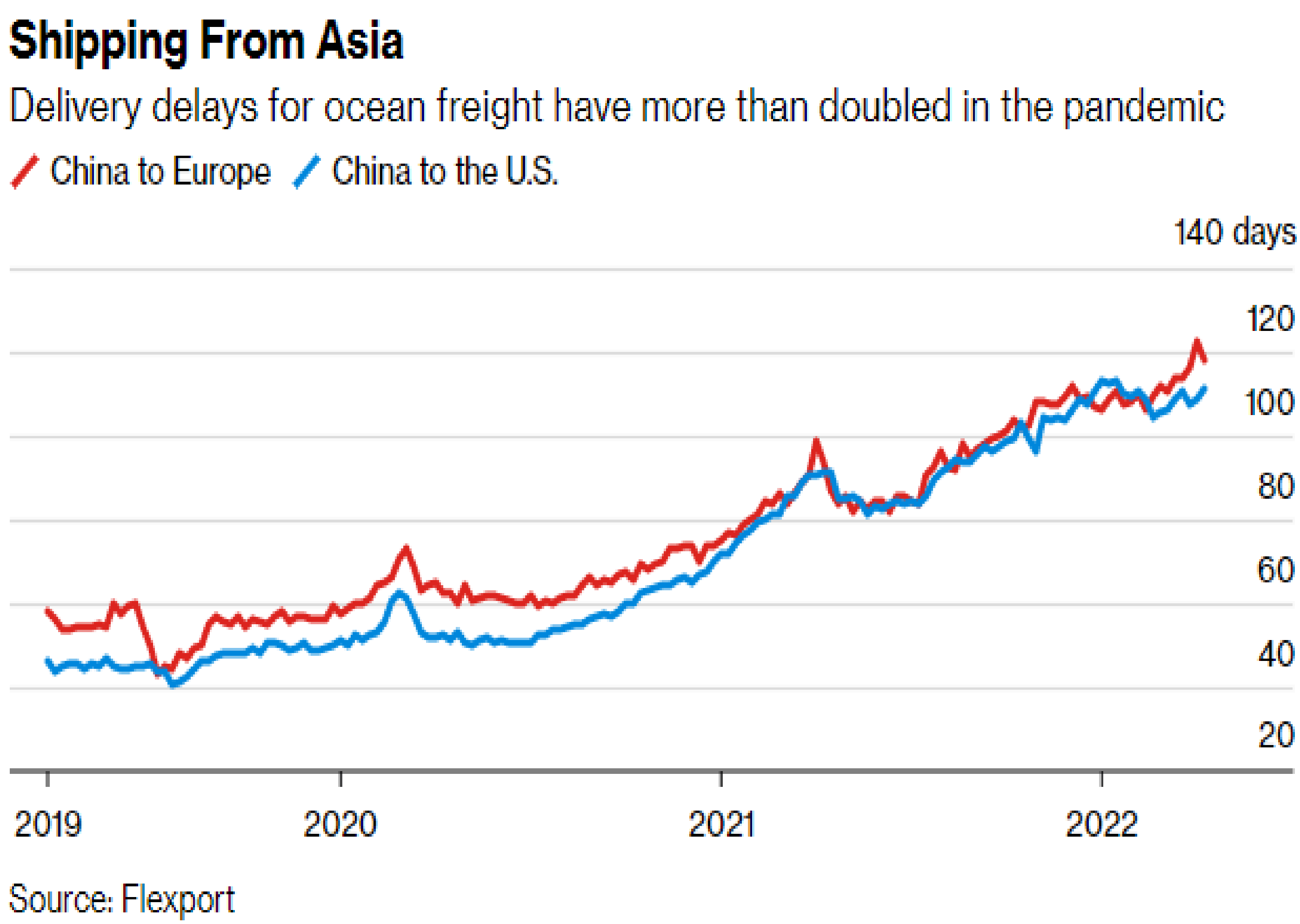


Container ship positions, as of April 20, mapped in yellow.

Above: from Bloomberg Business news a recent shot of the Shanghai and other ports showing anchored container ships. Each dot is a container ship!

In addition, and we know this may be a ‘black swan’ which is hard to predict, but the container ship sailings situation still looks pretty problematic. According to a Bloomberg interview with

Jacques Vandermeiren, the CEO of the Port of Antwerp, one of Europe's biggest container volume ports, "***This will have a negative impact, and a big negative impact for the whole of 2022. We expect a bigger mess than last year***". At the moment, despite port improvements and a catch up in processing, other issues relating to trucking semiconductor shortages and fewer sailings according to Bloomberg, these issues have ***"translated into a situation the total time it takes for goods to reach a warehouse in the U.S from the moment they're ready to leave an Asian factory is 111 days, and this is still very close to the record of 113 days set back in January."*** Over time this situation looks likely to force many businesses to begin exploring regional on-shoring of supply chains which means globalization may be running into a serious structural change. All of that will take time and in the meantime, upward pressure on costs is one likely result.



Supply chain issues are just rippling across many businesses right now making the market especially treacherous. Yesterday, Nutanix (NTNX) a very good technology play recorded very strong sales but a bigger than expected loss with the CEO stating that "***increased supply chain delays with our hardware partners account for the significant majority of the impact to our outlook"*** The stock absolutely cratered today and mind you, this is in our humble opinion a very good company with a great business and in a place where it should be poised for dramatic growth and the stock was not that expensive, especially by Tech stock standards. And yet, a train wreck times ten. When we see things like this – it is usually a huge red flag to just be very patient and wait til the smoke clears. At the right time, we see a lot of great business getting chopped to ribbons right now and there will come a moment – hopefully in the not too distant future where this bear market will end and great stocks will once again be great investments. *We hope it comes soon, as we love buying stocks, but for now, odds suggest we are not there yet, (in our humble view).*

Above: **Nutanix (NTNX**) down nearly 25% just today….

Getting back to the main subject of Physical Gold, the real test is dead ahead and it will be to see if Gold can begin to improve and make steady upward progress even if the Dollar is rallying. We think there is a good chance of this because Gold is oversold and quite compressed and the next rally in the Dollar is likely to be a more struggled "lurch" to new highs, rather than a violent sprint to new highs as was seen a few weeks ago. So a slowing in the pace of a Dollar rally might just be setting up the chink in the armor Gold needs to start moving higher. As a long term investor, we have to say that the speed of this transition has really shocked us, even from earlier this year when we penned our special report on **"The Greater Invisible Crash"** which talked about the secular return of inflation and its impact on asset prices. For investors facing a potentially intractable inflationary situation, the Gold market is a critical focus and right now, our judgement tells us this is what needs to be top of mind.

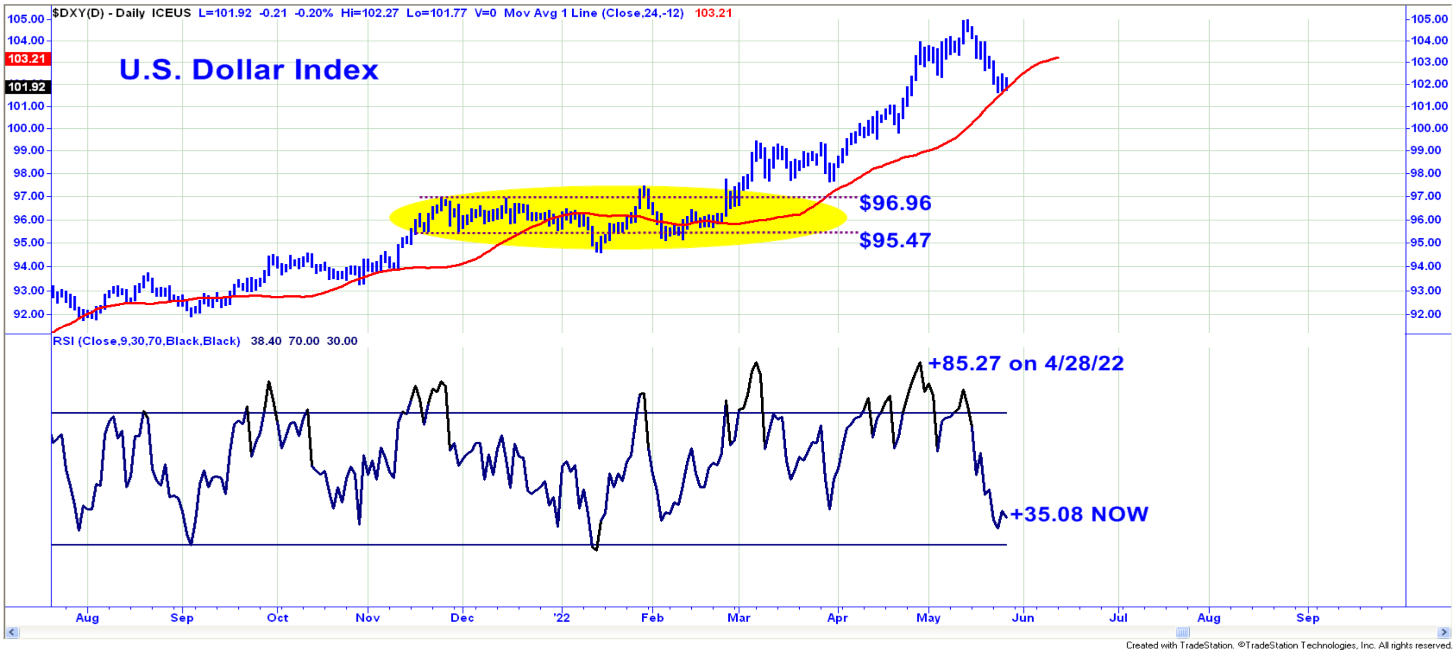
Another point, this concept of a Fed pause latter this year ***is by no means a given***. Depending on what happens with supply chain issues in the weeks ahead, it may well turn out that instead of a pause, the Fed ends up doing a stronger pivot to tightening come September and that will cause even more uncertainty in capital markets.

For Gold, this could end being a kind of a ‘win-win’ situation. If the economy really slows and the Fed pivots back to QE, Gold wins on the return of cheap money. Alternatively, if the economy is weak, but inflation continues to pick up, that could force even more Fed tightening, effectively creating an unexpected Fed pivot to tightening post September and that could cause real chaos in stocks and Gold could benefit as a flight toward safety and inflation hedges intensifies. ---***We don't know*** and because of that we are going to proceed slowly.

In this update, we are just going to add a little more to the core Gold position on the basis that the market (a) has had a material pull back (b) that pull back has registered decent oversold readings,(not record, but decent) (c) the upcoming advance in the Dollar and Bond Yields looks likely to be late stage, and with Gold being anticipatory (leading) in nature, it may well be close to being done in terms of discounting in the initial phases of Fed tightening. Gold Stocks are very oversold but in our opinion are still vulnerable to a sharp stock market decline should that re-ignite in the days dead ahead and so right now, we think the Gold Stocks still represent to much risk.

Above: We think stocks could peak in the next few days, just a bit higher than we are right now, watch thereafter for a reversal ***lower in stocks, higher in yields and higher in the Dollar***

with the biggest question being, -- ***IF all of that starts taking shape, is Gold starting to do a lot better?***



We'd rather own Bullion and for the time being, we will leave it at that. As we go to press, Gold is sitting at $1854 the ounce. Our very short-term work suggests could dip down below $1830 in the days just ahead in something of a partial retest of the $1820 to $1830 zone that marked the recent lows. **For investors, we want to increase the allocation to the Physical Metal to 7% from the current 5.25% and so you may buy PHYS, anytime spot Gold trades below $1835 in the days ahead.** It could take a few sessions for prices to dip back that low but we believe a partial retest of the lows has a good probability. For PHYS, the equivalent move would be a move down below $14.30. While we believe it is less likely near term, any move above $1875 would be a sign of strength for Gold and we will issue a Flash Update if that occurs. (Note: We will use a market on close order for our official record keeping.)

That's all for now,
Frank