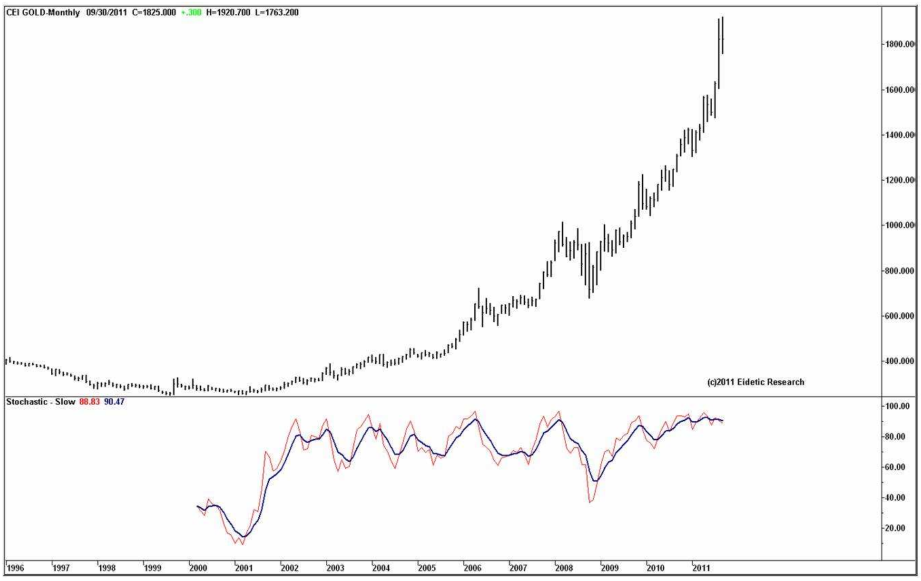
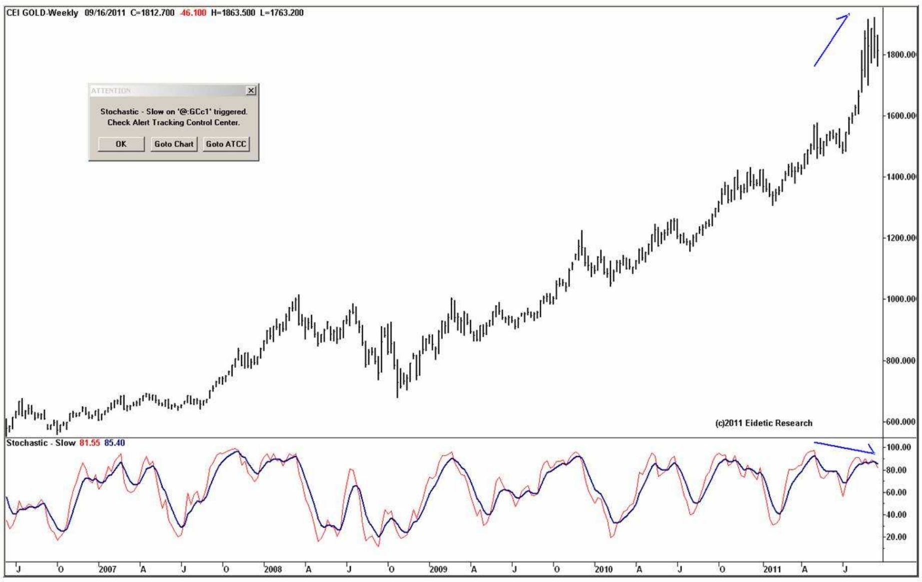
Our Stance on the Gold Market: September 15, 2011



August 2011 trading in Comex gold futures established the second-largest monthly true range in the market's history. Prices traversed $307.90 between the month's low at $1607 and a new all-time high at $1914.90 basis the nearby futures. Only the January 1980 true range of $332 surpasses that range. Halfway through the month of September, the market has not demonstrated whether it has the internal technical strength to improve on the August gains despite the fact that September witnessed another new all-time high at $1920.70.

The monthly gold continuation chart above is accompanied by its 14-period stochastic indicator. The monthly stochastic readings peaked in May just above 92.5, a level that is higher than the stochastic indicator peak that preceded the January 1980 cyclical price top. Applying momentum analysis to super bull markets, such as gold currently, that are in the mature stages of development can be a difficult if not fruitless endeavor. At such times momentum divergences with price action and/or absolutely high momentum indicator readings often have no predictive value with regard to the development of a trend top. Nonetheless, the absolute large size of the August range and the position of the monthly stochastic are factors that suggest the market may be at least temporarily running out of the underlying buying power that has supported recent uptrend acceleration.

The weekly chart price/momentum setup, shown on the weekly continuation chart below, is similar to that of the monthly chart.



The 14-period weekly stochastic indicator turned down in the week just ended September 15, 2011. The indicator down cross was more decisive than a similar downturn that proved to be a whipsaw August 26th. Thus, a bearish divergence has again been registered where the stochastic is below its April 2011 high while prices are above their respective high (see blue arrows on price chart and stochastic). Typically, weekly stochastic direction changes cum divergences are good intermediate-term signals of pending consolidation or reversal in an underlying price trend.

The daily gold continuation chart below features one of several possible wave interpretations of price swings that have occurred since a March 2010 low (labeled “4” and circled). From that point through a low in January 2011 we see a potential sequence of 4 waves that are annotated 5i through 5iv (in boxes). When the market cleared the high point of the sequence ($1431 at point 5iii), we measured the vertical distance from point 4 to point 5iii ($345) and considered that a unit equal to 1.00 (labeled M). Therefore, for projected measuring purposes, M = $345 and a Fibonacci-related 1.618(M) = $558. To derive potential upside targets that could prove to be concluding levels for the ongoing 5 wave sequence, i.e. the high point of wave 5v, we added $345 and $558 to the low point at 5iv - $1307. That gave us potential targets at $1652 and $1865 as is illustrated on the chart.

In early August, gold prices traded marginally above $1652 and then briefly consolidated around that level. Instead of succumbing to selling pressure, the market then gapped higher and accelerated dramatically up to $1914.90. Although our second potential target at $1865 was overrun, prices were unable to hold onto the gains above that price. Despite yet another new trend high at $1920.70, the market's upward progress has been checked within 3% of $1865 – actually right at the 3% level.

Since technical analysts have traditionally considered a plus-or-minus 3% band as a general zone within which prices can fall when achieving a target, at this point in time we think that the gold market has respected the $1865 projection that we made March. Given that condition in conjunction with the intermediate- and long-term momentum indicator developments discussed above, we want to be vigilant for near-term price action that would suggest downside vulnerability.

Usually, when weekly stochastic numbers turn, there is a grace period of 2-3 weeks in which prices can trade without declaring a trend reversal. Since the weekly stochastic only turned down on September 15, our thoughts are that the gold market has until the end of September or maybe the first week in October to demonstrate what it's next phase will be: either prices will almost immediately firm up and show new highs above $1920 that would nullify the potential implied by the position of the intermediate-term momentum indicator or they will trade with a sideways-to-lower bias that would illustrate continued momentum deterioration. By new highs above $1920 we do not mean the market eking out a marginal new high; we mean a decisive move similar to that seen during July – August.

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