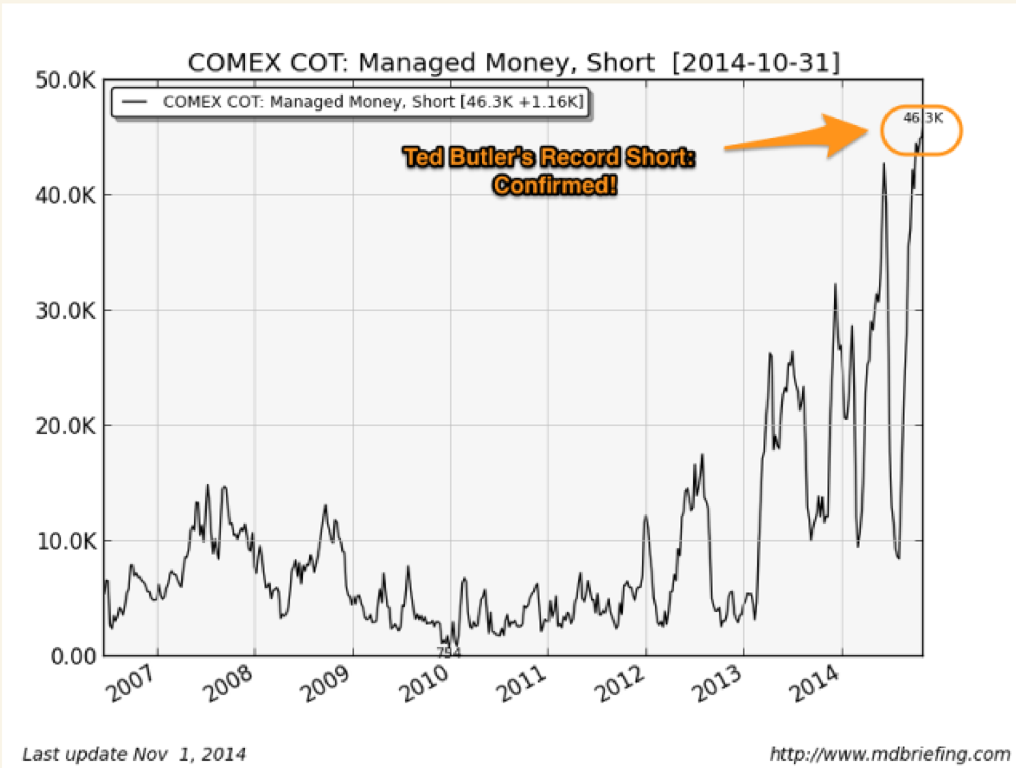
Another Review of the Miners and Gold Market.



Record money managed shorts and the big swings are symptomatic of huge leverage in the paper market. At some time these shorts will be caught offsides.

An "Anti-Bubble" Blow-Off in the Gold Sector

November 3, 2014 | Author *Pater Tenebrarum*

Technical Conditions

Last week the gold market was ambushed twice in close succession – first by the Fed's "everything is fine" statement (no-one can have been surprised by the well-telegraphed temporary end of "QE") and then by the BoJ's surprise assault on the yen. Since both events helped to boost both the US dollar and risk asset prices, gold's fundamental drivers worsened again. Another potential bump in the road awaits this week, namely the payrolls report.

In our update on gold sentiment in late September we noted that it was definitely possible that the support in gold would break, **but that the support break was unlikely to be sustained in view of extremely lopsided negative sentiment.** Since the support break has occurred last week, we will soon know how "sustainable" it turns out to be. Unfortunately, sentiment extremes have hitherto not really helped the gold market much, while support breaks have regularly led to additional selling.

Moreover, gold stocks have been extremely weak of late, which is usually not a good sign. However, the weakness was at least part likely due to **institutional tax loss selling**

and the decline has the characteristics of a "reverse blow-off" (the term "anti-bubble" was coined by Didier Sornette). Trading volume has been very high and the move in prices last week has been quite large as well. In fact, it was one of the fastest decline in gold stocks relative to gold we can remember. To the extent that this reflects current sentiment, it is certainly at a negative extreme (gold stocks are currently trading at an all time low relative to gold).

(Photo credit: fmh)

However, unless gold regains the former support level at $1,180 fairly quickly, the next price attractor is likely to be the 2008 high around $1,050, so it is by no means certain that gold and gold stocks are done going down. Unlike gold itself, the gold stock indexes have however already arrived at an important support level, **so a short term low in the sector is probably close – not least because turning points (both highs and lows) have in the past often occurred in October/November (as well as May/June).**

The action in gold stocks since March is in many ways reminiscent of the move in the gold stock indexes between May and November 2000, while the action in gold has so far been very similar to the late 1974 – to mid 1976 decline. The rally that preceded this decline had about the same extent as the 2000 – 2011 rally, but happened in about half the time, and the same applies to the subsequent decline. Both the pattern of the decline and its extent were however almost a spitting image of the decline since 2011 – click to enlarge.

Below is a number of charts illustrating the current situation, as well as a look at the comparisons mentioned above. We begin with the indexes, further below we also show the action in a few of the major producer stocks (which was quite astonishing in some cases).

The descending triangle in gold breaks below the support established in 2013. Below is the ratio of gold to the XAU – gold stocks have never traded at a lower level relative to gold, and the move is beginning to look like a blow-off.

Next, a long term chart of the HUI and gold. As can be seen, the HUI has reached a rather important support level last week. If gold's break of support leads to additional selling, then the price area indicated by the red dotted line is likely to attract its price:

The HUI index has reached the support defined by the 2008 crash low and the 2002-2003 high. Gold has broken the support defined by the June-December 2013 lows – click to enlarge.

Next we take a look at the action in SPX, HUI and gold from mid 1999 to mid 2001. In many ways it is reminiscent of what has recently happened (incidentally, this time period also coincided with the Fed tightening monetary policy after an extended period of rising liquidity).

SPX, HUI and gold mid 1999-mid 2001. Gold stocks also declined quite relentlessly relative to gold until November 2000, but then began to outperform the metal shortly after the SPX had reached its secondary peak. There is a long term negative correlation between gold/gold stocks and the stock market – click to enlarge.

Next a look at the current situation, which as noted above is actually reminiscent of 2000. Keep in mind that this process may not be finished yet, even if a short term bounce in the gold sector should soon begin. In order to gauge whether a low will be durable, the decisive characteristic that needs to be evident is relative strength in gold stocks, both vs. the SPX and gold (i.e., the exact opposite of what is happening at the moment).

The current situation in SPX, HUI and gold compared. This looks quite similar to what happened in 2000 (of course the two periods are different in many other respects, so whether this is meaningful remains to be seen) – click to enlarge.

Next we take a look at gold in the years 1973 to 1977. The so-called "mid-cycle correction" in the gold bull market of the 1970s shaved nearly 50% off gold's value, while the gold stock indexes declined by about 70%. Press reports at the time largely read like obituaries on the gold bull market that sounded surprisingly similar to today's press reports. This is e.g. what the New York Times wrote on August 29 1976 (gold had bottomed a few days earlier):

"Two years ago gold bugs ran wild as the price of gold rose nearly six times. But since cresting two years ago it has steadily declined, almost by half, putting the gold bugs in flight. ***The most recent advisory from a leading Wall Street firm suggests that the price will continue to drift downward, and may ultimately settle 40% below current levels.***

The rout says a lot about consumer confidence in the worldwide recovery. The sharply reduced rates of inflation combined with resurgence of other, more economically productive investments, such as stocks, real estate, and bank savings have combined to eliminate gold's allure. Although the American economy has reduced its rapid rate of recovery, it is still on a firm expansionary course. The fear that dominated two years ago has largely vanished, replaced by a recovery that has turned the gold speculators' dreams into a nightmare."

Apart from the slightly archaic style, this could just as well have been written last week. What is very interesting though is that the decline exhibited a pattern that was very similar to that of the decline since 2011:

Note the series of descending triangles followed by support breaks that characterized the 1974-1976 downturn in gold. The price decline from high to low amounted to 47%.

Sentiment and Price Ratios

Almost needless to say, a number of sentiment indicators have reached new extremes. Surveys have not yet had time to "catch up" with the moves that happened in the latter half of last week, but the discounts to net asset value of closed end bullion funds have reached new lows. Below is a chart showing the discounts to NAV of GTU and CEF, as well as Rydex precious metals fund assets and the Rydex cumulative cash flow ratio:

GTU's discount to NAV equals its previous all time low, CEF's is at a new low. Rydex precious metals assets have reached a new low for the move as well, but the cumulative cash flow ratio is still holding slightly above its 2012 lows – click to enlarge.

The last "hold-out" in terms of gold stock-to-gold ratios was the HUI-gold ratio. However, last week it fell to an all time low as well:

The HUI-gold ratio has fallen to an all time low as well, below the previous record low made in 2000 – click to enlarge.

With that, the HUI-gold ratio is now diverging quite a bit from the gold-CCI ratio (gold against commodities), which so far remains above its summer lows, in spite of last week's rapid price decline in gold:

A large divergence between the gold-CCI ratio and Hui-gold ratio has emerged – click to enlarge.

Gold Stock ETFs and Individual Stocks

As mentioned above, there has been huge trading volume in gold stocks last week. In some cases volume was below that seen during the 2008 crash, in some cases it was roughly similar and in some it was even slightly higher. **Clearly though, last week's trading volume was indicative of**

panic selling.

GDX and GDXJ – volume in GDX was very heavy. While GDXJ volume is not shown on this chart, it actually reached a record high of more than 26 million shares on Friday. Thursday saw the third heaviest trading volume in GDXJ's history – click to enlarge.

Among the senior gold stocks, only Goldcorp (GG) actually managed to recover on Friday. It closed slightly in positive territory and **since is a favorite of institutions, this is perhaps an early warning sign of an impending short term low in the sector.** Trading volume in the stock on Thursday and Friday was about one third below the records highs seen in 2008. Still, it was historically extremely high trading volume:

GG – the only senior producer stock that managed to close in positive territory on Friday – click to enlarge.

Newmont Mining (NEM) and Barrick Gold (ABX) performed a great deal worse. ABX closed well below its 2008 crash low on Friday – in fact, the stock closed at a 15 year low, in spite of "beating expectations" on both earnings and cost guidance last week (this is certainly also saying something about the current state of sentiment):

Volume in NEM was below the record high made in February this year, but on Friday it spiked above the highest daily trading volume seen during the 2008 crash. Its price also slightly undercut its 2008 closing low – click to enlarge.

ABX "beats" and promptly falls to a 15 year low. The last time it traded below $12/share was in late 2000. Gold was about 75% lower than today at the time – click to enlarge.

We've kept the worst performer among the senior stocks for last – a stock that currently trades 20% *below* its low of 2000. That could be a sign that things are possibly a tad overdone by now. Below is a long term chart of Anglogold (AU) with the gold price shown below it for comparison:

AU has been the worst performer among the senior producers. It delivered an earnings disappointment last week, so the difference to ABX which remains a tad above its lows of 2000 in the wake of its positive earnings surprise presumably makes sense … click to enlarge.

Conclusion

It may be hard to believe at the moment, **but every downturn ends at some point**. As the example of the 1970s mid-cycle bear market shows, even downturns of 50% (resp. 70% in the gold stocks) can later turn out to have been mere interruptions of a secular bull market. This is rarely discernible in real time – in fact, at the time lows are put in, things usually look quite bleak. In stock markets there are essentially two types of lows: disinterest lows, which occur with prices reaching multi-year lows at historically very low volume combined with contracting price ranges, and **panic lows, which go hand in hand with very high trading volume and large price moves. Gold stocks seem to be in the process of producing the latter.**

However, the gold price is certainly in a vulnerable position after breaking support and the weakness in gold stocks suggests there may be more downside in store for the metal. If things play out the way they normally do, gold stocks should bottom out before gold does. One thing is already certain, and that is that the sector has never been more oversold relative to gold.

Charts by: StockCharts, Saint Louis Federal Reserve Research