Gold and Gold Stocks – Patterns, Cycles and Insider Activity, Part 1

December 27, 2017 | Author *Pater Tenebrarum*

Repeating Patterns and Positioning

A noteworthy confluence of patterns in gold and gold stocks is in evidence this year. At the close of trading on December 26, the HUI Index has given a (tentative) buy signal by completing a unique chart pattern, which is why we decided to briefly discuss the situation. As usual, things are not as straightforward and simple as they would ideally be, but there is always an element of uncertainty – one has to accept that as a given. Let us look at a chart illustrating one of said patterns:

This chart shows the gold price, the weekly net hedger position in gold futures (the inverse of the net speculative position), with the Fed's December rate hikes in 2015, 2016 and 2017 highlighted by red vertical lines. Keep in mind that the December 2015 hike was the start of the current rate hike campaign. In the weeks leading up to it, the gold market was in the grip of a bearish hysteria, just as it approached a major lateral support level. Nearly every day Bloomberg, Reuters and other mainstream financial media published articles by "experts" no-one had ever heard of before (or since!), along with reports from analysts working for various well-known investment banks, all of whom stridently insisted that the beginning rate hike cycle was going to be the most bearish thing that could possibly befall the gold market, and that a further collapse in prices was nearly certain to coincide with it. Not surprisingly, *the exact opposite has happened.* You were definitely not surprised if you were reading this blog at the time – see for instance "Gold and the Federal Funds Rate". As we pointed out therein: *"[The] guessers at SocGen might actually have improved their statistical odds a bit if they had said "now that the Fed is hiking rates, gold prices should rise"*. As noted in the chart annotation, **in all three years gold prices declined into a December low, seemingly driven by fear of the coming rate hike and then proceeded to rally in a typical "buy the news" scenario. The declines tended to lower net speculative long positions to levels conducive to a renewed advance.** So far the gold price lows coinciding with these rate hikes are increasing by approximately $100 per year. We expect this uptrend to accelerate noticeably once the rate hike campaign is unceremoniously thrown overboard. ETA: sometime next year, the precise timing depends on when the asset bubble peaks and reverses – the clock is ticking on that – click to enlarge.

Naturally, there is no guarantee that the December low will once again result in a playable multi-week (or even better) rally this year, but so far things look good for that idea. Here is a chart showing the moves in the HUI index and gold prices over the past 2 years and 7 months (i.e., including the drawn-out bottoming period from July 2015 to January 2016).

As this chart shows, the HUI has once again taken off like a scalded cat right after the rate hike. After the 2015 rate hike low, the index lurched lower one more time in early January, as the broader stock market suffered one of its biggest declines since the 2009 low. We have highlighted the false break of support (a.k.a. bear trap) that occurred at the time (it was even more pronounced in the XAU Index, which actually fell below its low of late 2000). **False breaks of major lateral support levels that put in a multi-year low tend to be of long term significance; usually these prices are never seen again.** A comparison that comes to mind is the false break of support in the S&P 500 Index in 1982, which at the time greatly excited Joe Granville and his flock as we recall. Granville expected it to lead to a major price collapse, but the excitement didn't last long and the index waved good-bye to these price levels forever. On the chart above we also want to draw your attention to the most recent divergence between the HUI and the gold price. While the gold price put in a higher low in December vs. its low in early July, the HUI broke below its July low before reversing. **Such divergences are typically seen near medium to long term turning points – click to enlarge.**

Eerie Self-Similarity

Below we take a closer look at the chart pattern in the HUI in isolation. **The extremely lengthy consolidation pattern following the strong rally in the first half of 2016 increasingly wore investors out. Their patience was undoubtedly tested quite a bit, particularly in light of other stocks and crypto-currencies going bananas at the same time.**

Per experience, such long-lasting, grinding sideways ranges often turn out to be very powerful set-ups though. In the gold sector we would for instance point to the consolidation from July 2015 to January 2016 (see the chart above) as a recent example of such a patience-challenging "grinding pattern". The HUI went nowhere for months, occasionally teased traders with false starts, and in the end even threatened to break down… only *then* did a powerful rally finally kick in.

"Pattern completion" in the HUI was achieved this Tuesday with a close above the red signal line (the decisive criterion was the reversal of the entire immediately preceding down-leg by closing above the upper boundary of the small sideways range which started in late October). Unfortunately, the 200 day-moving average is directly above the current index level; given the fact that this moving average provided stiff resistance for much of 2017, the index may struggle a bit in the near term, even if it eventually surpasses it. The broader XAU index has already overcome its 200-dma, but this is probably mainly due to FCX being one of its constituents, and has a large weight in the index. While FCX does produce a lot of gold (its gold production is estimated to reach 2.3 million ounces in 2018), it is *primarily* a copper producer (the world's second largest). In recent days the stock was particularly strong due to copper rallying to its highest level since early 2014 – click to enlarge.

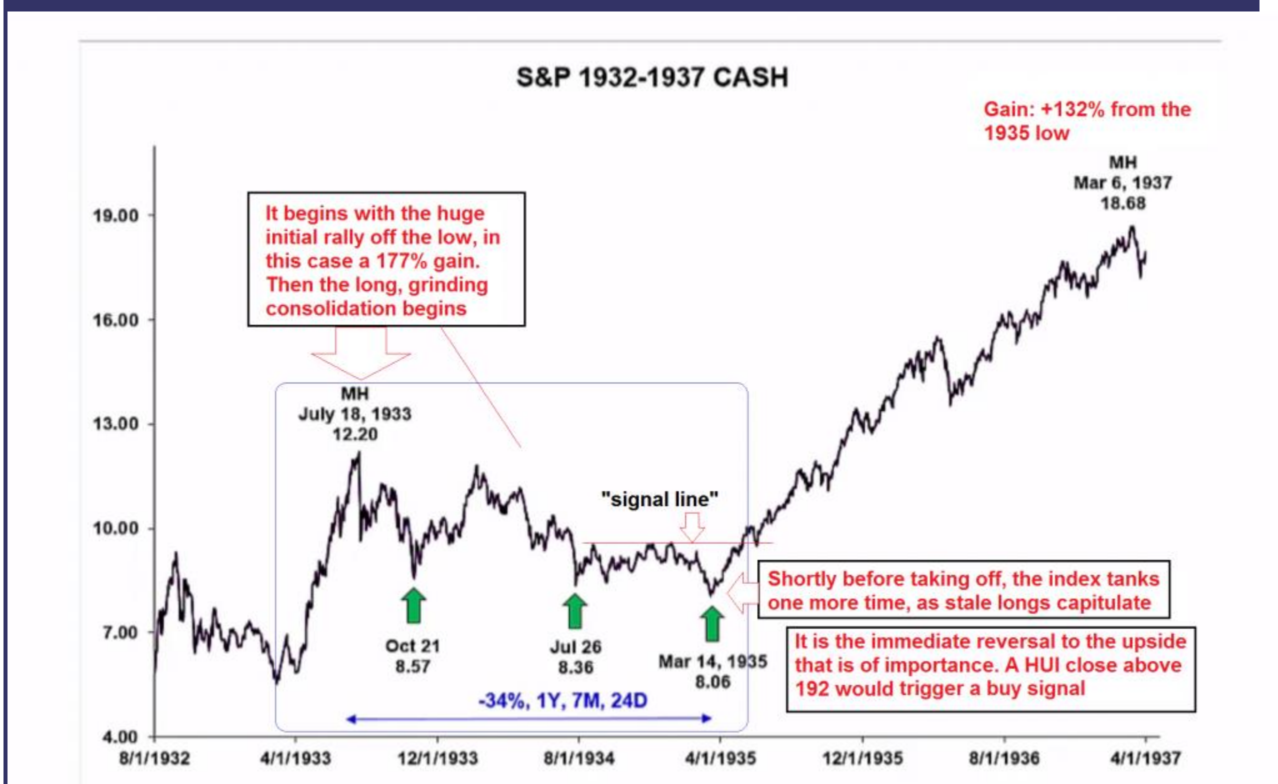
What makes the pattern especially interesting is that there exists a strikingly self-similar pattern that was *also* built after a major bear market (a slightly worse bear market even) – namely in the **S&P 500 Index right after the 1932 low.** This pattern similarity was discovered by James Flanagan of Gann Global, who spends quite a bit of time and effort looking for potentially useful **historical chart analogs** in the markets he analyzes.

We should add that self-similar patterns *as such* often have only **limited value**. For many reasons, this particular analog is quite interesting though. For one thing, several *other* signals are currently falling into place as well, such as the speculative positioning in futures and the "buy the news" effect after the Fed rate hike we mentioned above (as you will see in Part 2, there are still more signals). Moreover, this consolidation pattern is both complex and quite unique, and the similarities are really striking.

Not only were the preceding bear markets of nearly the same size, the initial rally from the low in 1932 was just as rapid and produced almost the same percentage gain as the one seen in the HUI in early 2016; the subsequent consolidation took a roughly similar amount of time to play out; and lastly, the shape of the consolidation pattern extremely closely matches the one in HUI and XAU.

Especially noteworthy is the succession of slightly lower lows in the course of the sideways consolidation. This must have been quite frustrating for investors at the time. It probably felt as though the initial ray of hope provided by the rally off the bottom in 1932 was yet another false dawn. It turned out though that it had indeed heralded the end of the bear market.

Here is the chart of the SPX from 1932 to 1937 which shows the self-similar pattern and what happened after it concluded:



The SPX from 1932 to 1937 – this is a snapshot we have taken from a Gann Global presentation. The blue rectangle contains the initial rally and the subsequent consolidation pattern. The 132% rally following on the heels of the consolidation was definitely nothing to sneeze at – click to enlarge.

Playing it Safe

The recent break to a lower low in the HUI followed by an immediate reversal was the last ingredient that was hitherto still missing to complete the same pattern. If one wants to play it extra-safe, one can always wait for the index to move a bit further above the "signal line" level, as this would entail overcoming the 200-dma in the case of the HUI as well.

Of course, there is no guarantee whatsoever that the ultimate outcome will actually be similar. One can of course always limit the risk by setting a stop-loss level in case the idea fails to work out. Depending on what instruments one uses, options may offer a viable alternative as well (both for playing the rally potential and/ or to hedge a position).

In Part 2 we will look at cycle signals, sentiment as well as recent insider activity (the latter is particularly interesting: there was quite a big surge in insider buying, which rarely happens in this sector).

Charts by: SentimenTrader, StockCharts, Gann Global

Gold and Gold Stocks – Patterns, Cycles and Insider Activity, Part 2

December 28, 2017 | Author *Pater Tenebrarum*

Cycles and Sentiment

Another recurring pattern consists of the seasonally strong period in gold around the turn of the year, which is bisected by a mid to late December interim low in the gold price. An additional boost can be expected in January and Feburary from the strong seasonal uptrend in silver and platinum group metals as well (to see the seasonal PGM charts, scroll down to our addendum to this recent article by Dimitri Speck).

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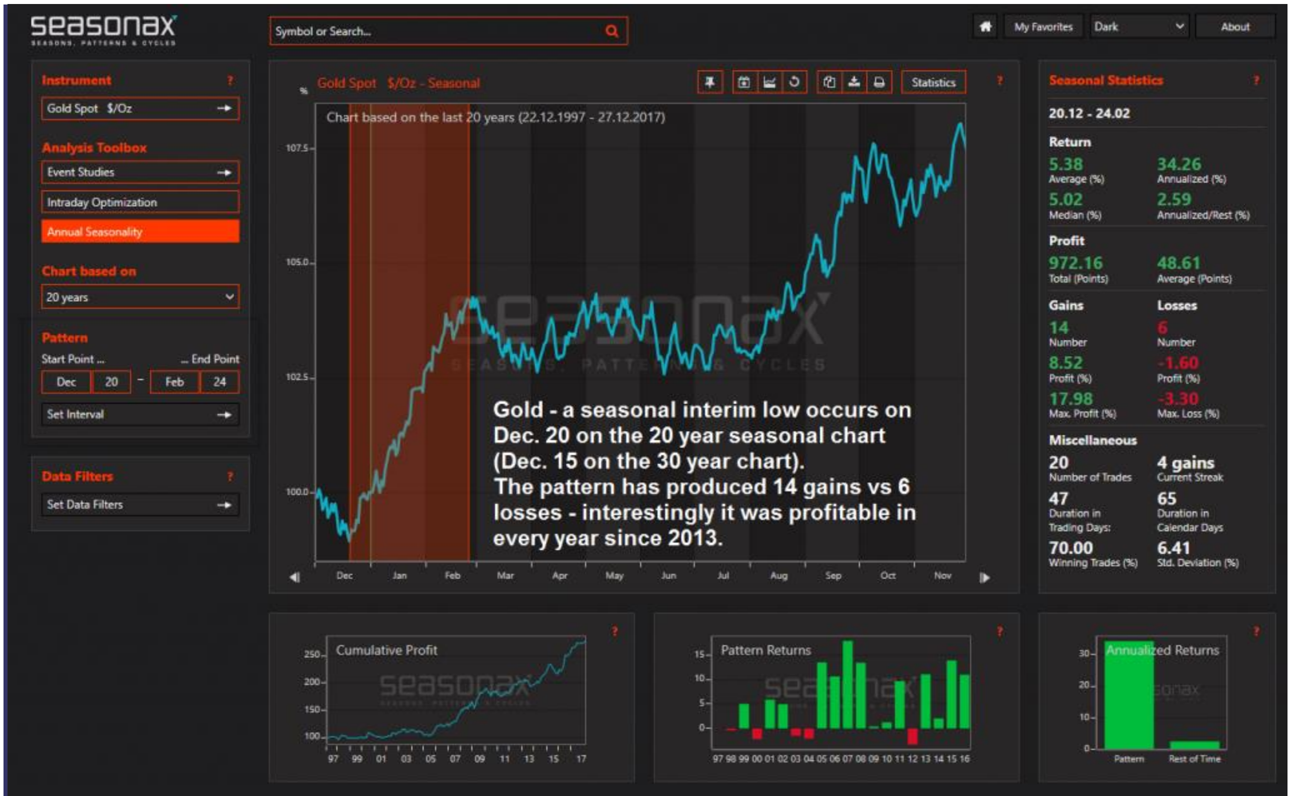
Rallies in silver tend to be quite supportive for precious metals stock indexes, as silver stocks have an even higher beta than their gold brethren (note in this context that the XAU is the more broad-based of the two indexes these days and contains far more silver stocks than the HUI – see these lists of the current XAU and HUI constituents for details).

Below is the 20-year seasonal gold chart, with the period from the December 20 interim low to the late February peak highlighted. Note that the statistical data shown on the chart refer specifically to the highlighted period, which in turn is an average of the action at this time of the year over the past 20 years.

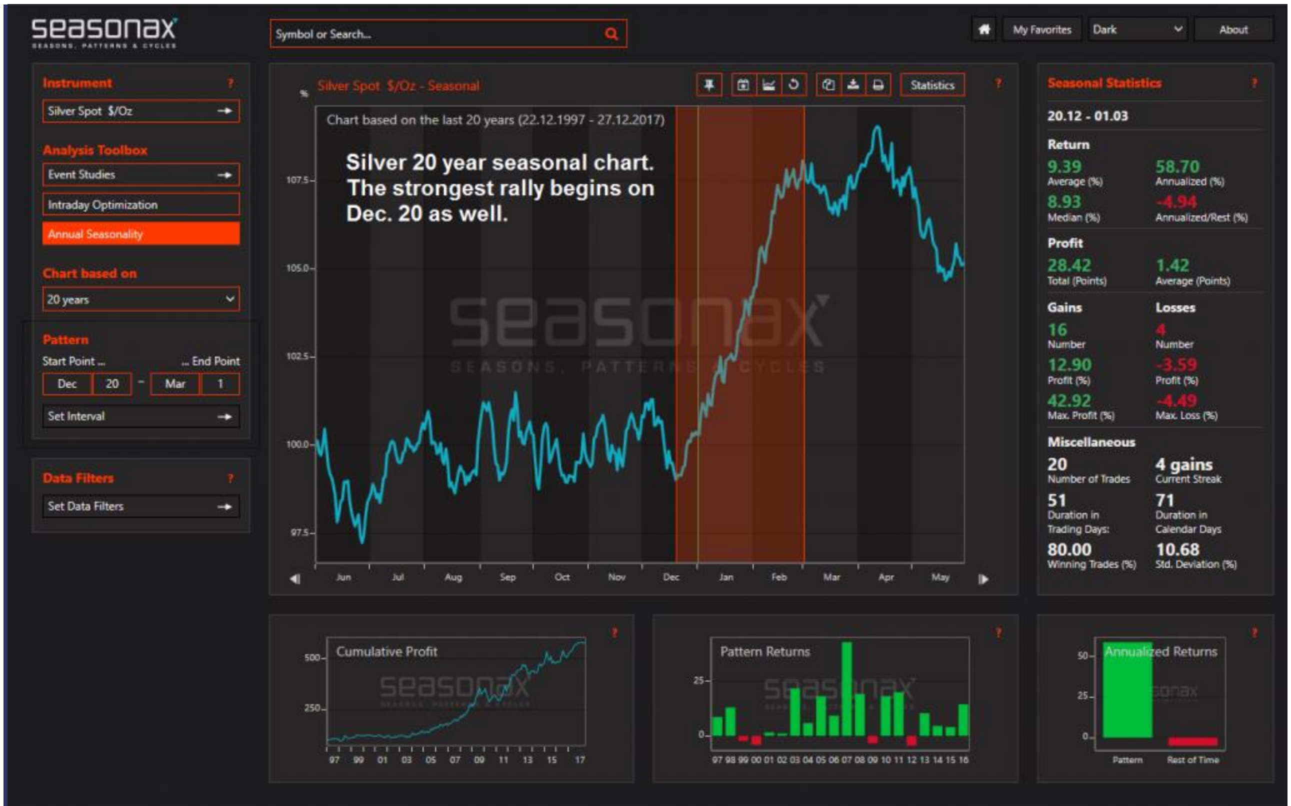
Obviously, there are years in which no gain is achieved in the seasonally strong period, but over the past 20 years the probability that prices would rally was 70% (14:6 = 7:3). Moreover, while the gains in profitable years ranged from +8.52 to +17.98%, losses were much smaller, confined to a range of just -1.60 to -3.30%.

Interestingly, even if one averages only the performance of bear market years (i.e., years which close at a y/y loss), the period of strength still shows up during January. We suspect this is due to the exceptional seasonal strength in silver during this time period, gold probably tends to rise in sympathy.



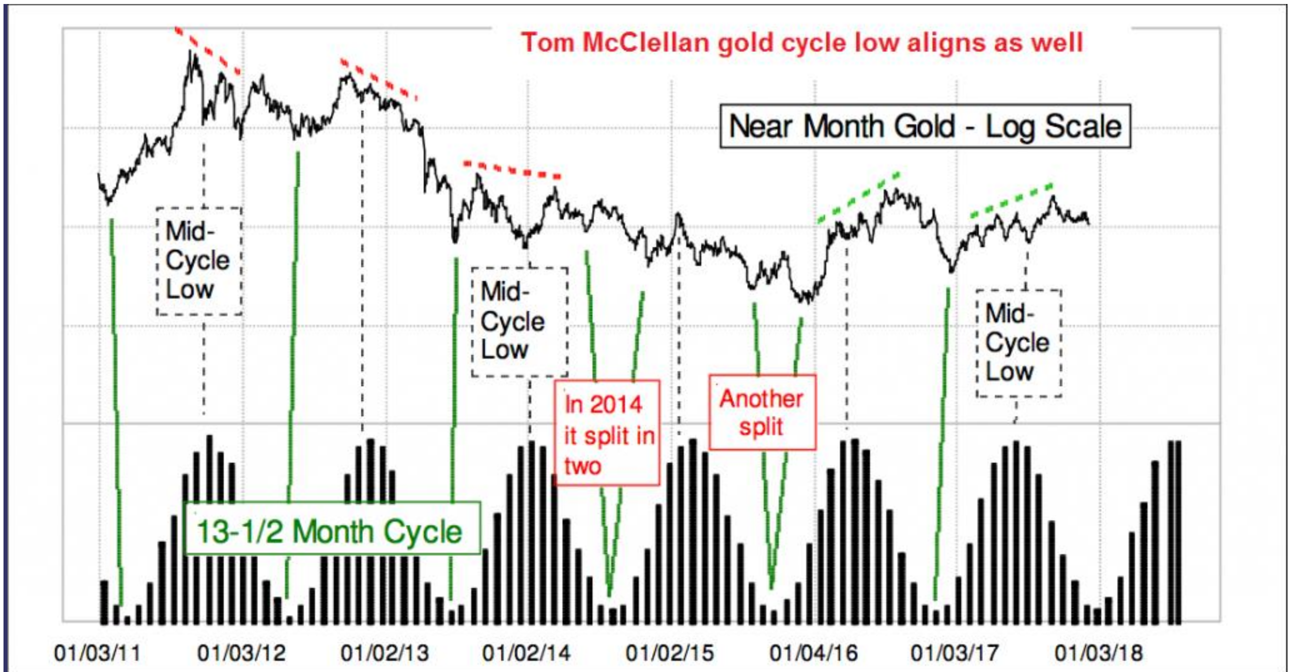
Gold, 20-year seasonal chart with all relevant statistics. The December interim low is close to the mid December Fed meeting, i.e., in recent years the seasonal pattern and the "FOMC relief rally" were going hand in hand – click to enlarge.

The 20-year seasonal chart of silver exhibits even more strength over a slightly longer time period starting on the same date: the probability of a rally is 80%, and the average gain is 9.39% (profits ranging from +12.90 to +42.92%), which is a stunning 58.70% annualized.



Note: regardless of how long the period chosen for the calculation is, the seasonally strong period in silver is always clearly visible and exceptionally large; it is even noticeable if one averages only bearish years. Apparently industrial users traditionally stock up at the beginning of the year. Strength in silver tends to particularly helpful for the performance of the XAU and HUI indexes – click to enlarge.

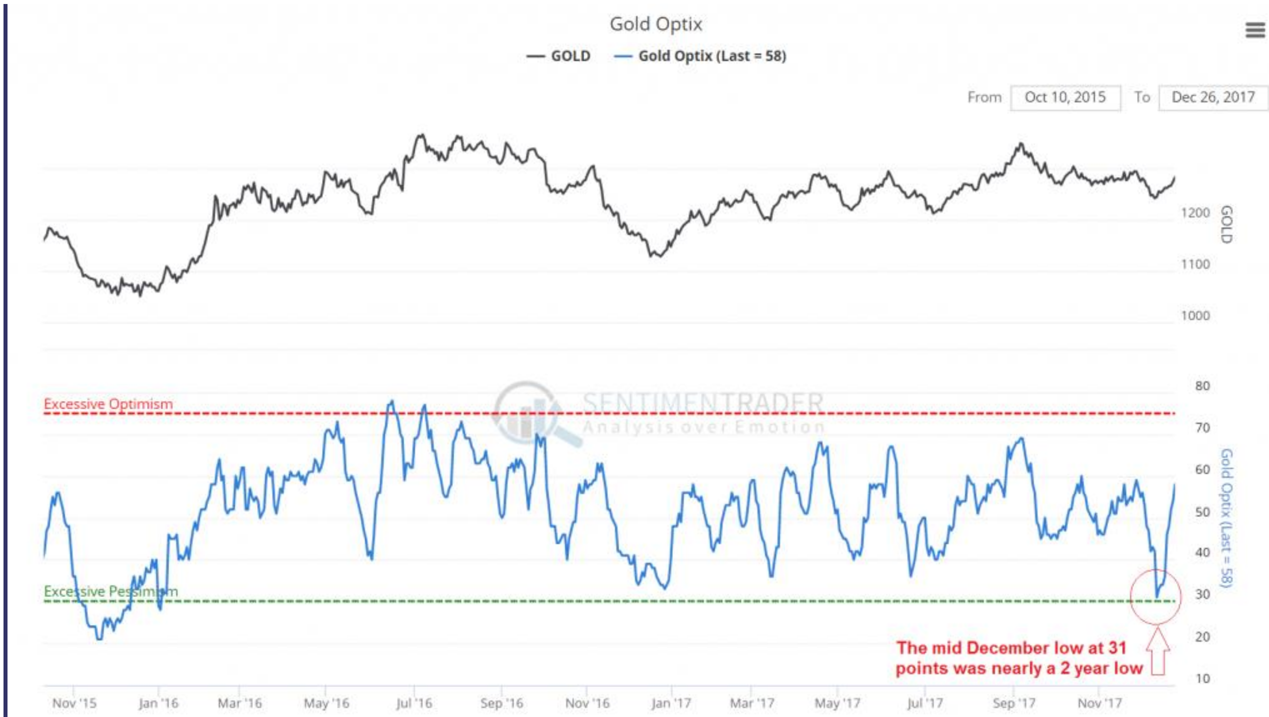
By coincidence, a 13 ½ month gold time cycle discussed by Tom McClellan in this article also aligns very closely with the seasonal trend this year, as it bottoms in December. Here is a chart that shows this cycle. Note that both full and half-cycles apparently often tend to align with lows and occasionally consecutive lows “surround” the projected cycle low. In short, this is not the most precise of cycles.



A gold time cycle followed by Tom McClellan – its 2017 trough is in the last week of December – click to enlarge.

Such "fixed" time cycles generally have less validity than seasonal patterns, but we thought it was interesting that this particular one happens to coincide with the December turning point in the seasonal trend and the other data points pointing to a December trend change this year.

Regarding sentiment, we want to mention two data points that stood out around the time of the mid-December low: a) just ahead of the FOMC meeting the second-lowest DSI reading of the year occurred (DSI= daily sentiment index of futures traders: 13% bulls – the lowest was 10% at the July low), and b) at the same time the sentimentrader Optix indicator (which combines positioning data in futures and options with the most prominent surveys) fell to 31 points – the lowest reading since early January of 2016.



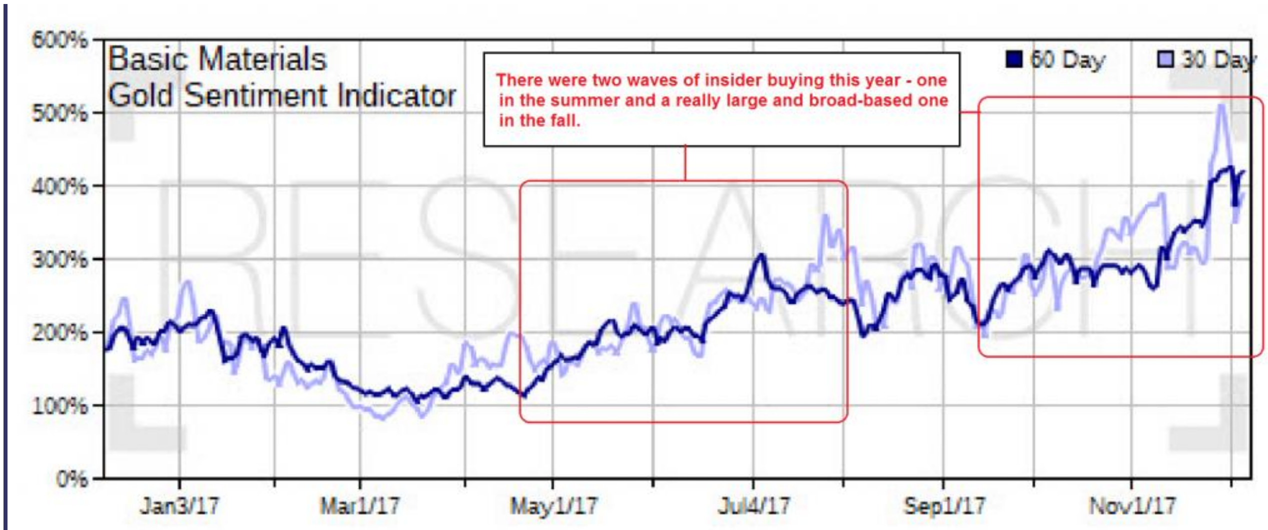
Gold Optix – not only was the reading of 31 points the lowest since 04 January 2016, it also indicated that bearish sentiment became more pronounced despite gold trading at a higher level than on previous occasions when the Optix reached short term lows this year. This can be interpreted as a bullish divergence. In fact, gold price/ Optix level divergences at lows are quite a common feature (interestingly, they are not as frequent at peaks) – click to enlarge.

Sentiment data follow prices, which tends to limit their usefulness, especially in strongly trending markets. We have noticed that depending on whether a strong overarching uptrend or downtrend is underway, the range in which the Optix moves will shift up or down. Once one has a good idea of what this range is, one can expect that readings near its upper and/or lower bounds will at least lead to short term counter-trend moves, regardless of the primary trend.

If the gold market moves sideways – as it has done over the past 1 ½ years – the Optix tends to be quite reliable as a short term contrary indicator. An *extremely* low (or high) reading that occurs near the boundaries of a sideways price range is usually associated with a medium to longer term opportunity.

Insider Activity

We have kept the best for last – this may well be the most interesting and encouraging of the data points we have discussed. As our friends at INK Research in Canada recently reported, lately insider buying at gold companies has basically “gone off the charts” compared to historical standards.



The spike in insider buying in the gold sector this fall (which went hand in hand with the decline in prices) was already the second one this year, but it attained extraordinary proportions. – click to enlarge.

There are several things worth noting here: first of all, insider buying in the gold sector is rare, especially outside of the exploration/ junior sub-sector. When exploration company insiders buy, it signals that they are confident in discoveries they have made and believe that investors have yet to realize what their true value is.

While explorers no doubt benefit from rising metal prices, they are not a *sine qua non* for their success – it is enough if prices manage to remain fairly stable. By way of example, if a company starts out with nothing but a hunch about where to drill, and it suddenly finds a million ounces of near-surface high-grade gold, it won’t matter much whether gold trades at $1,200 or $1,300 – a re-rating of the stock is certain to happen either way.

Two things were remarkable about the recent surge in insider buying: for one thing, it was the biggest since the fall of 2015 (which was one of the most noteworthy such buying sprees in a long time as well). Secondly, it was quite broad-based: there was a lot of buying from insiders at senior and mid-tier producers. As an example, numerous Barrick Gold (ABX) insiders purchased sizable amounts of stock in the public markets (n.b.: it is best to consult Canadian filings, a number of US data providers are silent on the matter).

ABX, daily over the past two years. The chart pattern is of course reminiscent of the HUI pattern, only it looks actually a bit weaker. Since April the declines seem to be a lot more vigorous than the bounces. Insiders have bought the stock hand over fist between late November and late December though – presumably the chart will soon improve – click to enlarge.

Keep in mind that gold mining insiders have no special insight in future gold price trends. So what is the message when insiders at senior and mid-tier producers buy stock in the companies they run? Obviously their buying has to be based on what they *do* know and have control over. We would take it as a sign that the trend toward better cost control and improving margins continues apace, and insiders evidently believe the market is still underestimating it.

Lastly, gold mining insiders have definitely proved savvy with respect to their timing in recent years. Their purchases from mid to late 2015 were certainly amply rewarded, and they actually happened to catch at least a short term low this summer as well. In any case, it is definitely worth paying heed when they buy as much as they recently have – one would normally expect this to be at least of medium term significance.

Conclusion

To summarize: chart patterns, seasonal trends and cycles, sentiment and insider buying all paint a fairly positive picture for the gold sector at the moment. This should at least be good enough to support a short term move higher, and perhaps more.

However, as we noted at the beginning of Part 1, things are never as clear-cut as one would like. One fly in the ointment is the fact that the major fundamental gold price drivers are not exactly bullishly aligned right now. Similar to what we observed earlier this year already, they are at best in a neutral or slightly bearish position.

That said, they are pregnant with possibilities (i.e., they all could quite easily turn bullish in view of the increasingly hostile monetary backdrop). We will discuss fundamentals and inter-market relationships relevant to gold in a follow-up post shortly.

Moribund gold bug hoping for better times.

Charts by: Seasonax, Tom McClellan, SentimenTrader, INK Research, StockCharts