

## Gold Stock Panic Ends

The [Great Stock Panic of 2008](#) was so mercilessly brutal that no sector escaped its ravages. Unfortunately gold stocks, despite their history of [performing really well](#) during general-stock bears, also succumbed to the universal panic selling. Extreme fear snowballed without relent until even long-time gold-stock enthusiasts capitulated and dumped their shares in disgust.

This perfect storm of fear spawned unprecedented carnage in the flagship HUI gold-stock index. From its all-time high of mid-March 2008, the HUI had plunged an unbelievable 70.6% by its panic low in late October! Yet even this sickening stat doesn't do this panic justice. In October alone with the general-stock panic, the HUI plummeted 51.8% *in a matter of weeks* before fear finally climaxed and it carved a bottom.

The psychological impact of seeing a sector *cut in half* within weeks is devastating beyond measure. Some gold-stock investors are understandably walking away forever. Far more are so scared, angry, and confused that they will remain suspicious and wary of gold stocks for years. Much of the capital that fled this gold-stock panic won't be eager to return anytime soon. Sentiment remains a wasteland of despair.

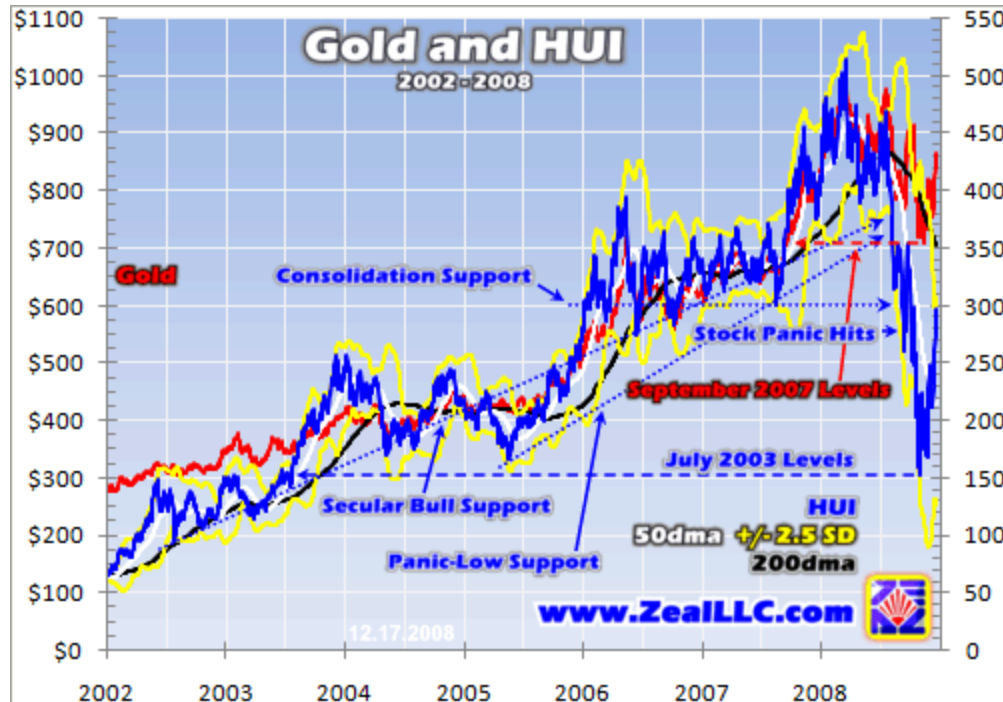
Despite such dire tidings, the future for gold stocks looks brighter than ever. As of this week the HUI had already soared 95.5% above its panic closing low, strong technical evidence that the worst is behind us. Fearless contrarians like our subscribers who were adding gold-stock investments and speculations in late October and early November as the panic raged around us have already been richly rewarded.

While this sharp post-panic HUI rally can't continue rocketing higher at such a blistering pace, I suspect the best gains in gold stocks are still yet to come. Gold stocks are ultimately a leveraged bet on the price of gold. They were driven far lower than gold warranted during the panic, so they have plenty of gains left merely to return to pre-panic equilibrium with gold. And gold itself has never looked more bullish, so as its secular bull continues unfolding gold stocks will mirror and amplify its march higher.

Since the sheer irrationality of the gold-stock panic is one crucial foundational plank for gold stocks' hyper-bullish case today, we have to start with some panic analysis. If you don't understand exactly what happened in the panic and how crazy things got, you can't understand why gold stocks are screaming buys now. With some long-term perspective on the HUI's relationship with gold, this becomes very clear.

Gold stocks, of course, mine and sell gold. Thus their long-term profits are driven by prevailing gold price levels. Higher gold means higher profits on

balance, and higher profits ultimately lead to higher stock prices. So from a long-term perspective the gold price is really the only meaningful fundamental driver of gold-stock prices. But greed and fear excesses can drive anomalies that temporarily interrupt this relationship.



This chart encompasses the great majority of this secular gold-stock bull, with zeroed X-axes to ensure no visual distortion. Note how the blue HUI line generally follows the red gold line. Higher gold means higher HUI levels from a secular perspective. When gold powers to new bull highs, the HUI mirrors and amplifies it. And when gold trades sideways in a consolidation, the HUI tends to consolidate in sympathy.

Since gold stocks have tended to have such excellent [leverage to gold](#) historically, speculators love them. When strong gold drives widespread greed and excitement among the traders in this realm, they aggressively bid up gold stocks. This drives big HUI uplegs that soar higher than gold warrants at the time. Conversely weak gold sparks fear among gold-stock speculators, who then sell gold stocks aggressively. This drives big HUI corrections that fall farther than gold warrants at the time.

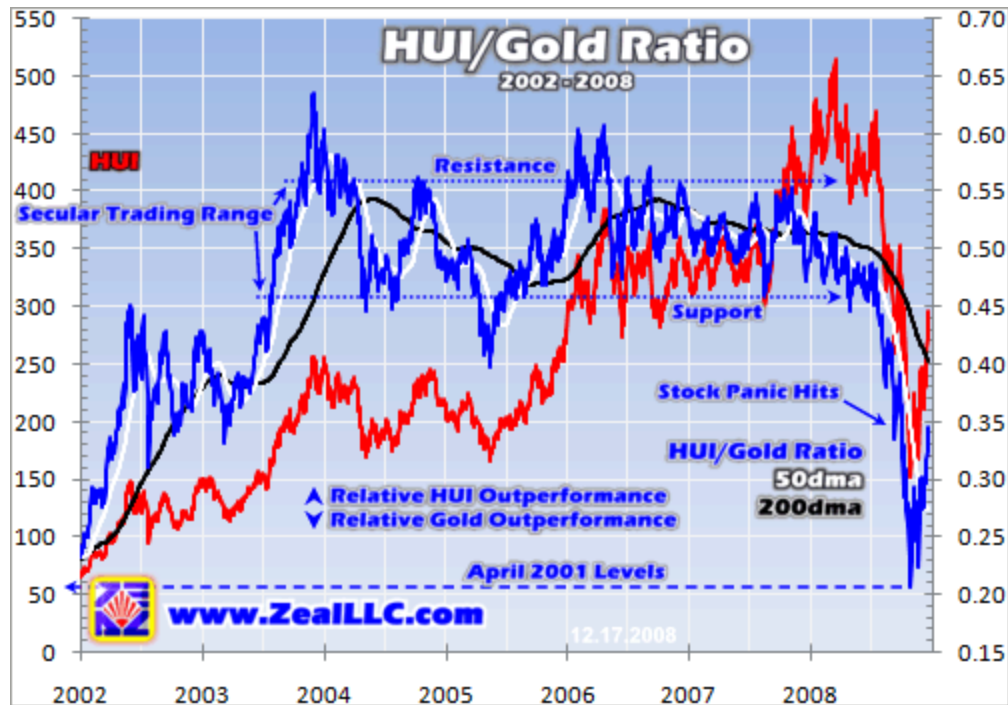
So while gold stocks have a core secular-bull path ultimately defined by gold's trajectory, manic-depressive trader sentiment forces the HUI to oscillate around it. The last few months were not the first time speculator fear got out of hand and drove the HUI well below where gold suggested it should be. We also had to weather sharp HUI selloffs in 2002, 2003, 2004, 2005, 2006, [and 2007](#). But 2008's panic was the biggest and most extreme by far.

At its October lows near 150, the HUI was driven so low by [once-in-a-lifetime](#) fear extremes that it traded at levels not seen *since July 2003!* But this wasn't rational or fundamentally-driven, despite what many naysayers were claiming at the time in late October. In July 2003 gold averaged \$352, while in October 2008 it averaged \$804. With gold 128% higher there was no reason for the HUI to trade at identical levels.

In fact, at its own panic low of mid-November gold merely revisited September 2007 levels. Yet that month the HUI averaged 373, 145% higher than its late-October closing low! See the disconnect here? It is ridiculously silly. Yes the HUI looked unbearably scary technically in late October, with all major secular support lines rendered above radically broken. Yet there was no fundamental basis for these panic lows.

In [Zeal Speculator](#) on October 28th, the day after the HUI closed at 152, I pointed out this anomaly for our subscribers in real-time. I recommended buying the [GDX gold-stock ETF](#) *that day* because there was no way the HUI should be trading as if gold was in the \$350s when gold was *over twice as high*. That indeed proved a great time to go long gold stocks, as GDX is now 73% higher than where I recommended it.

While the profits from the low-hanging fruits of this panic anomaly have already been realized, the HUI has still not returned to its long-term equilibrium with the gold price. In other words, even if gold remained flat in the \$700s today's gold-stock prices *are still too low*. This is readily apparent when you look at a long-term [HUI/Gold Ratio](#) chart. The HGR distills the HUI's relationship with gold into one clean technical line.



When the HGR is rising, the HUI is outperforming gold. This mostly happens during [gold-stock uplegs](#) when speculators get greedy. When the HGR is falling, gold is outperforming the HUI. Often this means gold is *falling slower* than the HUI, something that happens during gold-stock corrections when speculators get scared. Over many years, a secular trading range has been established in the HGR.

In financial-market analysis, the longer a particular relationship between prices holds the more likely it is to be fundamentally-based. If you take two prices and analyze their relative behavior over 10 minutes, it doesn't tell you anything. Random noise and emotions drive prices over short spans. But these same two prices considered over 10 years will tell you a great deal. The longer the span, the more randomness is filtered out and the more fundamentals assert themselves.

In the HGR's case, we have a secular trading range that largely held between mid-2003 and mid-2008. 5 full years is a long time to compare gold and gold-stock prices, which are ultimately driven by profits, which are driven by gold price levels. There were plenty of emotional extremes within this long span as well, greed climaxes at upleg peaks and fear climaxes at correction troughs. So there is no doubt this HGR range is fundamentally important and sound.

Visually support is near 0.46 or so and resistance is up around 0.56. The daily average HGR between July 2003 and June 2008 is 0.511. In other words, on average over this secular span of time the HUI traded at 0.511x the price of gold. We'll just round it to 0.5x for this essay. Despite everything that happened in the

volatile gold-stock world since mid-2003, in general the HUI tended to trade at half gold's level.

Well, the intense fear spawned by recent months' general-stock panic drove the HUI so low relative to gold that the HGR hit 0.207 on October 27th when the HUI closed under 152. To put this into perspective, it was the lowest HGR witnessed *in this entire gold bull*. You have to go back to April 2001 to see a lower level, and that was the very month gold carved its secular bottom! Gold stocks were ludicrously undervalued in the panic.

And note above that even after the mighty 95.5% rally since that panic low, the HGR is still languishing under 0.35x. The panic anomaly hasn't fully unwound yet. During December so far, gold has averaged \$801 on close. If the HUI merely returned to its 0.5x HGR average of this secular bull, we'd have to see it shoot to 400! And that is merely to reflect today's gold levels, not any future gold appreciation.

And of course the financial markets have a strong tendency to overshoot the other way after any extreme. So it would not surprise me at all to see the HUI rally far enough to push the HGR well *above* its secular resistance, above a 0.56x level, before more normal market conditions return. How far above? I don't know, make a guess. But the point is we can likely expect more than a mere HGR mean reversion which is even more bullish for gold-stock prices.

So even if you didn't seize the opportunity to add gold-stock investments and speculations at once-in-a-lifetime bargain prices in late October and early November like our subscribers did, you can still game this panic anomaly. To merely return to average levels relative to gold, the HUI would need to rally *another* 45% from this week's levels. There is no doubt that gold stocks will have to realistically reflect their underlying gold fundamentals again in the near future.

This final chart zooms in on gold and the HUI in 2008, offering a higher-resolution view of their respective behaviors during the Great Stock Panic of 2008. Their performances over various big-swing spans, and the HUI's leverage to gold ratio (yellow) over them, are noted. Once again this drives home the point that gold-stock traders sold irrationally because they couldn't control their own fear, not because of gold-driven fundamentals.



Up until early August, the HUI was drifting along not far from all-time highs and looking healthy technically. Gold often tends to drift sideways in the summer, which means [silver](#) and the precious-metals stocks follow it sideways like usual. I call these the [PM summer doldrums](#), they are par for the course. The HUI amplified a gold correction ending in late April by 1.9x and a minor gold rally ending in mid-July by 1.8x.

While this leverage was a bit on the low side [by historic standards](#), all looked normal until August. Although the stock panic hadn't started yet, a bond panic had begun. Bond investors fled imploding mortgage-backed and corporate debt and sought safe haven in US Treasuries. But foreign investors first had to buy US dollars before they could deploy in the least-risky debt securities in the world. This drove a *big and fast* US dollar rally.

Many futures traders ignore gold's own fundamental merits (declining global mined supplies, shrinking central-bank hoards and selling, relentlessly-growing global investment demand) and think of this metal as merely the anti-dollar. So when they saw the giant US dollar rally, they sold gold aggressively in early August. I wrote about this [dollar-driven gold plunge](#) in depth in late October if you want more background.

Of course the only reason to own gold stocks is to leverage gold, so as gold plunged through \$900 and then \$800 *within just 2 weeks* in early August, gold-stock investors and speculators got scared and sold. This drove the HUI under 325 by the time gold stabilized. The HUI then stabilized too, but gold-stock

owners remained spooked. Many analysts were calling for sub-\$600 gold and pessimism was rampant.

So in early September when gold selling resumed, gold-stock traders launched a mini-panic of their own. The HUI plunged 24.4% in just 6 trading days to 260. Of course gold didn't warrant such a deep selloff so the HUI soon recovered to 350. But unfortunately then, late September, the general-stock panic was just starting. This slammed the gold stocks simultaneously on two major fronts.

First, flight capital fleeing the stock markets flooded into short-term US Treasuries. Again foreign investors had to buy dollars first, which was like pouring rocket fuel on the already abnormally strong and fast dollar rally. The resulting accelerating dollar sparked much futures selling in gold. With gold looking weak, especially for during a stock panic when it ought to soar, gold-stock investors and speculators dumped their shares aggressively.

On top of that, as I discussed last week, the general-stock-market selling and [volatility](#) was mind-blowing. When the flagship S&P 500 stock index, representing the broader US stock markets, can plummet 27.1% in less than 4 weeks in October, gold stocks didn't stand a chance. Everyone was so scared in this panic that all stocks were sold indiscriminately. Over this very span, the HUI plummeted 51.8%! Without this general-stock panic, the HUI probably wouldn't even have gone under 300 again.

As discussed above, gold-stock prices were driven so irrationally low relative to gold that the anomaly couldn't persist. And it didn't, even though the general stock markets fell to new panic lows in November. Over a span where the S&P 500 fell *another* 11.4% to its late November low, the HUI actually managed to rally 10.2%. Gold-stock traders, who had embarrassingly totally succumbed to irrational fear, were slowly starting to return to their senses.

And this trend continues today. Despite all the problems in the stock markets and underlying economy, gold-stock profits and hence future stock prices are driven by the price of gold. So no matter where gold settles out, \$700, \$800, \$900, or higher, gold-stock prices *are* going to reflect this sooner or later. Sentiment anomalies are always short-term events, over the long-term fundamentals hold sway.

And since gold is gold stocks' only meaningful long-term driver, and gold fundamentals are looking so dazzlingly bullish, gold stocks are likely to go a heck of a lot higher in the coming years. Gold mining is [so challenging](#) that mined supply has been *shrinking for years*. And all the currency turmoil is making central banks even less likely to sell their gold. And as their gold hoards shrink, their "market share" and hence influence over gold supplies is waning dramatically. Meanwhile global investment demand is soaring.

The major governments of the world, led by ours in Washington, have just made the future for gold radically more bullish than it was even a few months ago. Rather than let the free markets run their course as they should, the socialists in power panicked. They frantically created literally *trillions* of dollars of fiat money out of thin air to inject into the financial system. We've just seen the biggest inflationary event in world history.

Of course gold thrives in inflationary times, and as this unprecedented surge of money filters into the real economy inflationary expectations are going to start roaring. This alone would increase gold investment demand tremendously, as gold is the single best investment in inflationary times. And by driving real interest rates radically negative, the US Fed has made gold even more attractive to investors.

While I wrote about how [negative real rates](#) are the most bullish possible monetary environment for gold a couple weeks ago, the Fed's insane actions this week have supercharged gold's potential. By forcing rates artificially low near zero, the Fed has declared open war on savers. The madmen running the Fed want to make saving so unappealing and useless that investors are bullied back into risky mortgage-backed bonds.

But when safe Treasuries yield nothing, indeed investors lose real purchasing power each year by owning them, the opportunity cost of gold investing drops to zero. Mainstream bond investors' main argument against gold is it has no yield. But thanks to the Fed, US Treasuries now have big *negative* yields after inflation. This rightly infuriates bond investors and leads to a growing exodus from bonds to gold.

Because of this ruinous fiat inflation in the pipeline and never-before-witnessed extremes of monetary excess, I have never been more bullish on gold than I am today. And I first recommended physical gold coins to our subscribers in May 2001 when gold traded in the \$260s, so this includes the entire gold-bull span. Thanks to the once-in-a-lifetime gold-stock bargains this panic drove, at Zeal we've spent the last few months zealously researching all the world's gold stocks to uncover our favorite opportunities.

Just this week we published a comprehensive [new fundamental report](#) on our 12 favorite gold-producing stocks. We started with a universe of all the publically-traded primary gold producers we could find on the planet. Then we researched each in depth, gradually narrowing down the field to our favorites. Through hundreds of hours of painstaking research, we maintained a focus on these companies' financial strength and survivability in these crazy times.

The end result is 36 pages of fascinating fundamental analysis on what we believe are the 12 best gold producers in the world. We look at each stock in depth, on a project-by-project basis, and explain why each has such great

potential fundamentally. With gold stocks looking so promising in 2009 as this secular gold bull powers higher, now is an ideal time to deploy capital. [Buy our new report today!](#)

We also publish acclaimed [weekly](#) and [monthly newsletters](#). We added new long-term precious-metals-stock investments in late October at *incredible* prices when no one wanted them. We've been buying gold- and silver-stock trades as well, gaming this unsustainable HGR anomaly. To greatly deepen your knowledge of the markets, of when to launch trades (and to see which specific trades we're making), [subscribe today!](#)

The bottom line is gold stocks unfortunately got sucked into the general-stock panic as well. This event generated such extreme fear that gold stocks plummeted to levels last seen when gold traded in the \$350s. Obviously such prices are ridiculously irrational in a world where gold is trading over twice as high. Such a silly anomaly simply could not persist, and the HUI's recent surge has indeed started to erase it.

With the panic over and gold stocks still far too cheap relative to gold, and gold itself likely to power much higher thanks to governments' enormous inflationary excesses, I've never seen a more bullish environment for gold stocks. If you want a high-potential sector in which to deploy capital for 2009 and beyond, gold stocks are it. True contrarians are buying these bargains like mad while they still exist. Carpe diem!

Adam Hamilton, CPA

December 19, 2008

So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ...

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