New Gold Upleg

After gold's breathtaking $38 surge in 15 minutes Wednesday, there is much renewed interest in the Ancient Metal of Kings. The Federal Reserve, which is clearly being run by lunatics, publicly announced it is going to create over a trillion dollars out of thin air to monetize US debt. This degree of pure monetary inflation is utterly unprecedented.

Gold soared because it remains the best asset to own in inflationary times. Inflation is an immoral stealth tax levied on everyone. But it hits those of modest means the hardest, because rising everyday living expenses consume a higher proportion of their incomes. When the Fed injects fiat money into the economy, relatively more dollars chasing relatively fewer goods and services bid up prices *on everything*.

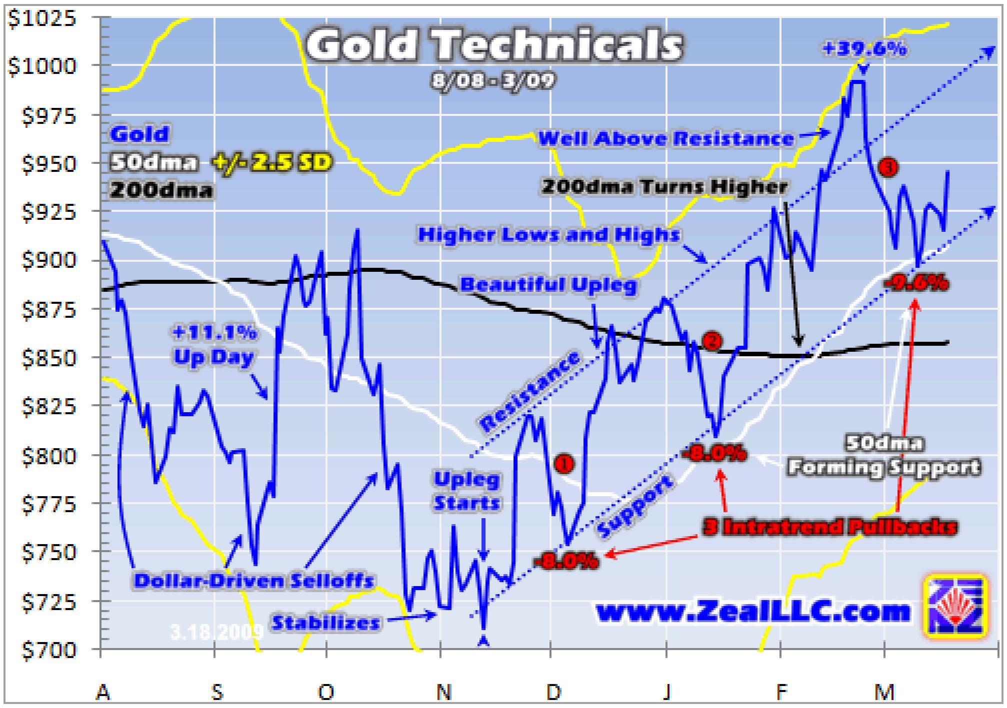
But gold always stays ahead of the rising inflationary tide. New mining only adds 1% to 2% to the global above-ground gold supply annually. Yet even *before* this week's monetization announcement, the Fed grew the US monetary base by an astounding and frightening 88.1% over the past year. With vastly more dollars bidding on relatively far less gold, a rising gold price is the inevitable result of this inflation.

The prospect of unbridled monetary inflation rightly terrifies investors. Mountains of cash, the highest relative and absolute levels ever, languish in money-market funds earnings zero interest today due to the Fed's interest-rate manipulations. As monetary inflation accelerates, this capital will suffer increasing real losses of purchasing power. So the natural defense against this central-bank predation is to move capital into gold.

Thanks to gold's inflation-driven surge this week, a lot of traders are starting to discuss a new gold upleg. They are right, a gold upleg is coming, but they are late to the party. Today's gold upleg started way back in the dark days of November when gold neared $700. Believe it or not, I had already planned to write this essay, and had these charts mostly built, before the stunning Fed announcement on Wednesday.

But Ben Bernanke desperately trying to become the most notorious inflationist the world has ever seen only adds bullish fuel to the gold fire. While this week's monetization pledge surprised mainstreamers and the deluded deflationists, the gold strength is no surprise to students of the markets. Gold's new upleg was very technically impressive and well-established for months before the Fed's inflation unveiling.

As you can see in this chart, Wednesday's amazing gold action is barely a blip relative to gold's relentless upleg progress since its panic lows. This metal's exceptional strength during the tough market months we've witnessed lately has made it one of the best-performing assets anywhere. Walking through this upleg's technicals leads to a better understanding of where gold is likely to go from here.



Before we get to the birth of this magnificent young upleg, some background is in order to provide context. Gold sold off sharply in August, September, and October. This confused countless traders, since gold is supposed to soar when the financial markets are plunging into a panic. I found it very disappointing too. Yet extreme stock-market fear and selling was not the direct catalyst for gold's weakness, but *indirect*.

As mortgage-backed bonds sold off first, and then general stocks a couple months later, capital flooded into US Treasuries as a refuge. And foreign investors had to first buy US dollars before buying Treasuries, which drove an unprecedented monster rally in the US Dollar Index. Futures traders, seeing this incredible dollar strength, dumped gold futures aggressively. This indirect panic dynamic was readily apparent even in late October near gold's lows.

Interestingly though, even then the markets were signaling that this artificial selling pressure on gold was unsustainable. Big investment buying was countering futures selling. The best example of this was gold's epic 11.1% rally on September 17th, its biggest daily gain since January 1980. Gold did not want to be held down by the artificial panic-driven dollar rally and fought the futures selling every step of the way.

By late October, gold had started to stabilize as its futures sellers were exhausted. While it plunged to $720 in late October, it didn't edge down to its $711 panic low until November 12th. That dark day, when even long-time gold analysts and fans were universally calling for gold in the $600s, today's powerful gold upleg was stealthily born. As always at major turning points, only hardcore contrarians were buying gold then.

Gold surged fast out of those lows, making its biggest initial gains simultaneously with the US stock markets surging out of their own November panic lows. On November 21st and 24th (a Friday and Monday), the S&P 500 rocketed 13.2% higher. Over these very days, gold soared 10.2% and first established this upleg's resistance line. This episode was very revealing as it again showed that extreme stock-market strength was not bearish for gold as a lot of traders wrongly believe even today.

After this fast initial surge in late November, gold corrected sharply. It fell 8.0% in 7 trading days before bouncing, which initially defined its strong support line rendered above. This also offered an important lesson that many traders forgot by late February, that gold pullbacks are often sharp *even within* powerful uplegs. Each time gold fell to support, the majority of traders wrongly waxed morose and bearish on it.

Gold rapidly recovered though and shot higher in December, back up to its resistance for a second time. By the end of that month, gold was already up 23.9% from its panic lows. It was carving a series of higher highs and higher lows, a beautiful textbook-perfect uptrend. Meanwhile over this same span, the S&P 500 was only up 6.0%. Even though gold was doing fantastically well, the great majority of traders still refused to acknowledge its young upleg at that point.

Another bullish sign happened in late December when gold powered over its key 200-day moving average for the first time in months. Nevertheless, this metal had climbed to resistance so a pullback within its uptrend back down to support was not unexpected. And indeed gold fell sharply in early January, losing another 8.0% in 9 trading days. Again traders became irrationally bearish, worrying gold was going to slide back into the $700s.

But not only was this metal at its upleg's established support line at these lows, it was just above its 50-day moving average as well. In bull-market uplegs, the 50dma is often the highest-probability point for a pullback to run out of steam. Many technically-oriented traders, after seeing 50dma bounces countless times in virtually every market, tend to buy aggressively on a 50dma approach by an asset trending higher.

Gold was no exception, after its short and intense pullback it promptly reversed course and surged higher within its upleg's trend channel again in mid-January. It hit resistance in late January, and then another key bullish signal flashed in early February. Gold's 200dma, which had been declining for months, subtly turned positive again. While early, a rising 200dma is still a major technical sign of a bull market.

Gold started pulling back again in early February, but this fledgling pullback was halted high in its uptrend. Incredible buying pressure, which I will discuss below after the next chart, rapidly drove this metal above resistance for the first time in this upleg. Before this particular gold rally exhausted itself, gold shot well above resistance and challenged $1000 nominal for only the second time ever.

By late February, gold was up 39.6% since its mid-November panic lows. I figured this would end all argument about whether gold was really in a new upleg or not. The difference between a mere technical rally out of oversold levels and an upleg is simply a question of magnitude and duration. And after a 40% move higher in just over 3 months, this was obviously something much more significant than a technical bounce. Over this very span, the S&P 500 *fell* 12.8%. Gold should have been the markets' rockstar.

Then in late February, which isn't surprising since gold was so far above resistance, it fell sharply. Incredibly this decline convinced most mainstreamers and many contrarians that gold's rally was over. It led to the widespread belief that gold was doomed whenever the beleaguered stock markets staged their inevitable recovery rally. Yet this gold-opposing-stocks notion was a negative-sentiment-inspired falsehood that recent market history certainly didn't support.

By early March, gold had fallen 9.6% in 11 days. Even though this metal was near $900, a *very* impressive price historically, its sentiment was pretty poor. This was most apparent in the dismal performances of the gold stocks, which are the ultimate proxy on how traders feel about gold's prospects. Again I marveled at all the bearishness. Not only was gold still looking great, but its technicals showed nothing at all to be concerned about.

When gold was at $897 on March 10th, it was right at both its upleg's support line and its 50dma. Both technical zones had provided strong support in previous sharp gold pullbacks. And it wasn't like this latest gold pullback was the first of this upleg. Gold had fallen sharply in early December and mid-January, by very similar percentage amounts over very similar timeframes, yet gold's upleg was not compromised. Why bet against gold at support and its 50dma when these levels have held strong for months?

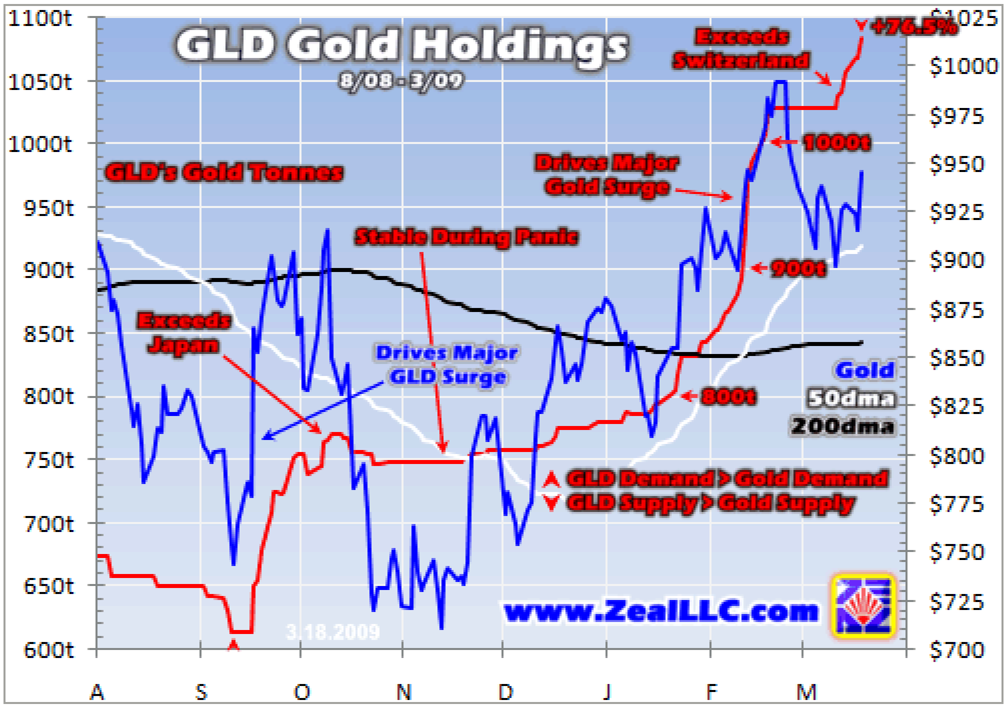
Just as we'd done since late October, at Zeal we continued aggressively buying elite gold and silver stocks with gold low in its upleg's trend channel. There was absolutely nothing to fear in early March, including a massive stock-market rally. Yet gold traders had somehow managed to convince themselves that gold was going to plunge a lot farther despite these undeniably bullish technicals.

Which brings us to this week. Gold's big surge that felt so enormous and awe-inspiring Wednesday merely blends in as average in this upleg when viewed in context in this chart. Yes, traders are right that the Fed's crazy inflation is going to spawn huge gold investment demand which will drive a new upleg. But they are certainly late in realizing this. Big inflation coming has been obvious for many months now and gold's new upleg was already beautiful and very well-established before this week's events.

So what's driving gold higher? Strong gold investment demand. The carnage of the stock panic is making more investors realize what they should have known all along. *Every* investor's portfolio should have some gold exposure, at least 5%, *all the time*. Gold is an anchor of stability in a world with none, and having even a modest fraction of one's capital in gold greatly reduces overall portfolio volatility and risk.

The big driver of gold's strong surge from $810 in mid-January to $992 in late February, an awesome 22.5% mid-upleg rally in only 5 weeks, was unprecedented gold investment demand *from traditional stock-market investors*. They were aggressively buying GLD, the world's largest gold ETF by far, at a phenomenal rate. GLD's custodians dutifully equalized this excess buying pressure directly into physical gold bullion.

This next chart shows GLD's gold holdings, in metric tons, over this wild stock-panic span. They reveal stock-market capital flowing into gold at rates and magnitudes never before witnessed in all of world history. GLD is such a crucial component of today's gold upleg that if you are not following GLD you won't understand why gold is moving and where it is going.



GLD is the ultimate proxy of traditional stock investors' interest in buying gold. This is due to the mechanics underlying this ETF. GLD's mission is to track the gold price. In order to do this, it must equalize any demand differentials between the GLD shares and physical gold itself. If you aren't familiar with this mechanism, which is *really* important to understand, read my latest essay on GLD specifically.

When GLD share demand grows at a faster rate than the underlying gold demand, GLD's price threatens to decouple to the upside. So GLD's custodians issue new GLD shares and use the resulting cash proceeds to buy physical gold bullion for their vaults. Thus anytime GLD's holdings are rising, stock investors are demanding gold exposure at a faster rate than gold's own demand is growing.

The opposite is true if GLD's holdings are falling. In this case GLD share supply exceeds gold supply so the custodians must sell some gold bullion and use the resulting cash to buy back GLD shares to keep the ETF tracking gold properly. Thus charting GLD's holdings offers a valuable glimpse into how stock-market investors are perceiving gold. When they really want it GLD buys more gold and when they don't GLD sells gold.

Other than a brief period in early September when GLD's holdings fell, stock investors have generally wanted to own this ETF to add gold exposure to their own portfolios. This has led to such massive GLD growth in a short period of time that I'm sure it wildly exceeded the expectations of even GLD's biggest fans.

Generally stock investors were buying GLD at a much faster rate than gold itself was being bought.

After GLD's holdings bottomed in early September, they surged after gold's massive 11.1% rally on September 17th rekindled investment interest in gold. By early October, GLD's holdings had exceeded the Bank of Japan's. This made GLD the world's 7th largest owner of physical gold bullion after 5 major central banks (US, Germany, France, Italy, Switzerland) and the IMF.

Then during the stock panic, when gold fell sharply due to the enormous US dollar rally driven by flight capital, GLD's holdings remained stable. When GLD's holdings are flat, it means the supply/demand balance for GLD shares on the stock markets is nearly the same as that for gold itself on the physical and futures markets. So stock investors owning GLD were not selling at faster rates than traditional gold traders in October.

GLD's holdings started rising again in late November, which certainly helped boost gold's fledgling upleg. But the real fireworks didn't start until gold's January lows. At that point, GLD's holdings started exploding. For some reason, probably the continuing weakness in the stock markets, stock investors flocked to add GLD to their portfolios for gold exposure like never before. GLD's holdings rocketed upwards as its custodians shunted the excess ETF demand directly into physical gold bullion, and records fell.

In late January, GLD exceeded 800 tonnes for the first time ever. Soon after in mid-February, the 900t and 1000t milestones were surpassed in quick succession as well. If you look closely at this chart, it is readily evident that the gigantic GLD demand from stock investors mirrors the biggest gold rally of this upleg perfectly. It was GLD buying, with traditional stock-market capital, that drove gold's 22.5% gain ending in late February.

Gold then started pulling back, but the GLD owners didn't sell their shares at a faster rate than gold's selling so its holdings again remained stable. And they soon started growing again in March as excess GLD demand again developed. GLD's holdings passed the Swiss National Bank's to make this ETF the 6th largest owner of gold bullion on the planet. American stock investors, via GLD's gold held in trust for them, have become a force to be reckoned with in the gold world. They have driven GLD's holdings 76.5% higher *since September!*

Now I certainly realize GLD is controversial in some circles. But like it or loathe it, this ETF is growing into a gold juggernaut. Its behavior is so important now that I devoted the current issue of our acclaimed Zeal Intelligence monthly newsletter to exploring GLD and its implications for this gold bull. Subscribe today and learn how you can profit from GLD's market impact. First-time e-mail-PDF-edition subscribers will get a complimentary copy of this popular March issue.

For our purposes today though, realize that *mainstream stock-investor demand* is driving this new gold upleg. And as GLD's holdings' latest spike higher on the Fed's dire tidings of inflation showed, this mainstream gold demand has clearly not run its course. Compared to the vast pools of stock-market capital, and capital wasting away in money-market accounts at zero yields, the global gold market is *tiny*. Increasing mainstream gold demand could accelerate this new gold upleg dramatically.

With gold's fundamentals incredibly bullish today, GLD certainly isn't the only way for stock investors to ride gold higher. At Zeal we have always enjoyed gold-stock investing and speculation. The best gold stocks, unlike GLD, can really leverage the underlying gains in gold. And provocatively, today the gold stocks are radically *undervalued* relative to gold because residual fears from the stock panic have really frightened the traditional gold-stock traders.

While the big gold producers will thrive, the truly epic gains will only arise in the junior gold stocks. So we've spent the past several months painstakingly researching the universe of junior golds. After many hundreds of hours, we've whittled this massive list down to our 12 favorites in this high-risk high-reward realm. And we just finished summarizing their fundamental prospects in a comprehensive new report. If you are interested in learning about elite high-potential junior-gold stocks, buy our new report today.

The bottom line is gold is indeed in a new upleg. But this week's inflationist-Fed announcement, while it will accelerate this gold upleg, certainly didn't ignite it. Gold has already been powering higher for over 4 months now. This upleg's technicals have been textbook-perfect and very bullish. The Fed-driven inflation spike, while exciting, is merely a blip within this already well-established uptrend.

And as the breathtaking growth in GLD's holdings reveals, it is mainstream stock investors who are leading this charge into gold. Even before the Fed declared to the world it was going to inflate without limit, stock demand via this ETF was hitting records. All this newfound awareness of the coming inflation should accelerate this bullish trend for mainstream investors to prudently add gold exposure to their portfolios.

Adam Hamilton, CPA

March 20, 2009

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 … www.zealllc.com/subscribe.htm

Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit www.zealllc.com/adam.htm for more information.

Thoughts, comments, or flames? Fire away at zelotes@zealllc.com. Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to respond to comments personally. I will read all messages though and really appreciate your feedback!