

Gold Stock Recovery 2

Gold stocks continue to face a stiff psychological headwind. As measured by their flagship HUI index, they were ripped to shreds in late 2008's brutal stock panic. In only 13 trading days, the HUI plummeted 49%! Many gold-stock investors simply gave up after seeing the HUI hit its worst levels in over 5 years.

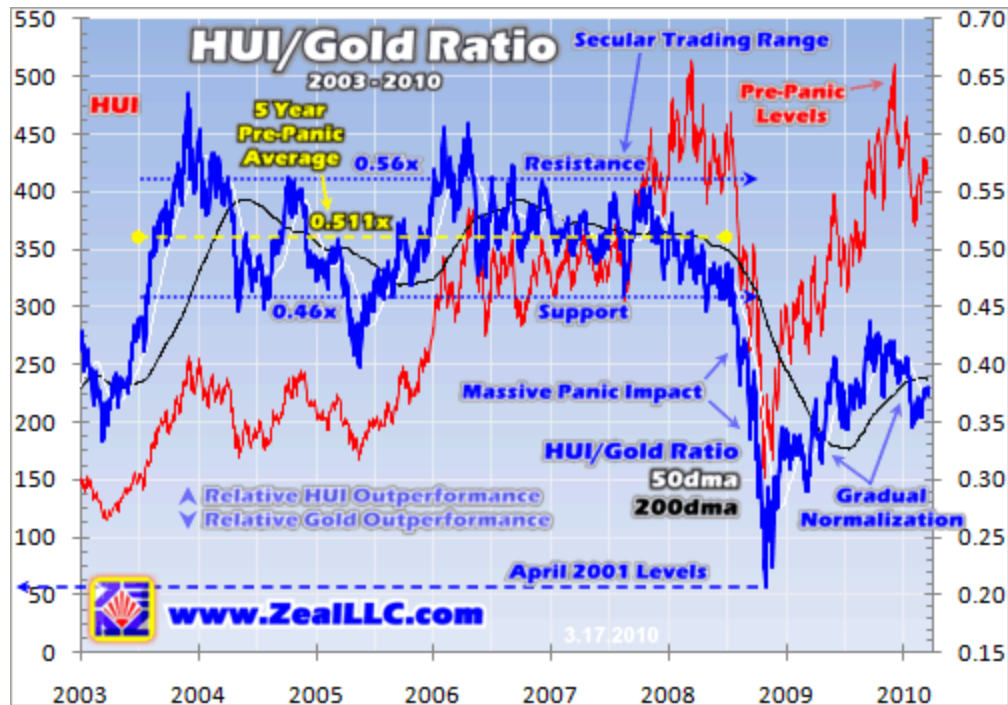
But stock panics are exceedingly-rare events, 2008's was the first true panic [since 1907](#) just over a century earlier. While *extremely* challenging psychologically, it was ultimately nothing more than a short-lived anomaly. Yet tragically, I suspect the majority of investors who fearfully dumped gold stocks in the panic have not returned. Languishing in zero-yielding cash, they have missed one of the best runs of this entire bull.

Emerging from such ridiculously-oversold lows, the HUI skyrocketed 237% higher by early December 2009. While it has been in correction mode since, as of this week it was still 181% above its panic lows. Former gold-stock investors who missed a rally of this magnitude have set themselves back *years*, it is very sad. But thankfully, it is not too late to redeploy. The post-panic gold-stock recovery isn't over yet.

What supports such an assertion? The levels of gold stocks *relative to gold* before, during, and since the panic. At Zeal we were aggressively buying and recommending elite precious-metals stocks in the [heart of the panic](#), our subscribers have already earned legendary gains in this post-panic recovery. And the very same HUI/Gold Ratio analysis that led us to buy back then continues to look very bullish today.

The HUI/Gold Ratio is exactly what it sounds like, the daily close of the HUI gold-stock index divided by the daily gold close. If this HGR is charted over time, it reveals where the HUI tends to trade relative to gold. And make no mistake, gold is and always has been gold stocks' primary long-term driver. The higher the gold price, the larger the profits for mining gold. The greater gold-miners' profits, the higher their stock prices are bid. This relationship is simple and ironclad, gold ultimately drives gold stocks.

And the HGR action since the panic not only shows why the HUI rallied so mightily out of that fear-laden anomaly, but why its post-panic recovery is probably only *about half over* today. In these charts, the HGR is rendered in blue and superimposed over the raw HUI in red. This analysis illuminates why some of the world's best hedge-fund managers have started to make *big* bets in gold stocks.



For 5 years prior to late 2008's stock panic, gold stocks as measured by the HUI had a well-defined secular relationship with gold. The HUI generally meandered in a horizontal trading range between 0.46x and 0.56x the price of gold, as this HGR chart clearly shows. Sometimes when gold-stock investors got over-excited the HGR would briefly exceed its 0.56x resistance. And other times when they grew too scared it would temporarily fall under its 0.46x support. But for the most part, this HGR trading range held strong.

In the financial markets, the longer any particular relationship holds true the more likely it has an intrinsic fundamental underpinning. And this is certainly the case with gold stocks and gold, since the metal drives the miners' profits. And 5 years is an awfully-long time, well into the secular time range. Between mid-2003 and mid-2008 prior to the panic, the HGR averaged 0.511x. Daily HUI closes generally meandered around *just over half* the prevailing gold price at any given time.

But starting in summer 2008, the catastrophic impact of the bond panic followed by the stock panic is readily apparent. As investors panicked, the HUI just fell off a cliff relative to gold. The plunging bond and then stock prices led to a massive rush to park capital in US dollars and short-term Treasuries to weather the storm. The resulting gigantic US dollar rally was the largest ever witnessed. It hammered gold which flamed unbelievably-intense fears in gold stocks leading to their epic rout seen above.

The HGR plummeted to April 2001 levels, which was insane. This made no sense at all fundamentally, even at the time. Despite what the blood-drenched

tape was communicating about gold stocks, did the price of gold no longer matter for them? Would something else now drive their profits going forward? Of course not! Fear was wildly overdone, but the core fundamentals of gold mining hadn't changed one bit. This led us to buy aggressively and recommend the same in the dark heart of that stock panic.

The day after the HUI hit its panic low of 152 on October 27th, 2008, I pointed out this ridiculous anomaly to our [Zeal Speculator](#) subscribers. Though the HUI was trading at levels it hadn't seen since gold was *in the \$350s*, that day the gold price was over twice as high (\$732). So I recommended buying the [GDX gold-stock ETF](#) right then. The HUI/Gold Ratio was so far out of whack that it would have been foolish *not to buy* gold stocks.

This is relevant now because the exact same HGR-based rationale for being aggressively long gold stocks *still exists today*. Sure, they are nowhere near the once-in-a-lifetime bargains we saw during the stock panic. But nevertheless, the average HUI "valuation" relative to prevailing gold prices remains far below its pre-panic levels. And since the anomalous panic lows, we've seen a gradual normalization. On balance the gold stocks have been relentlessly recovering relative to the gold price.

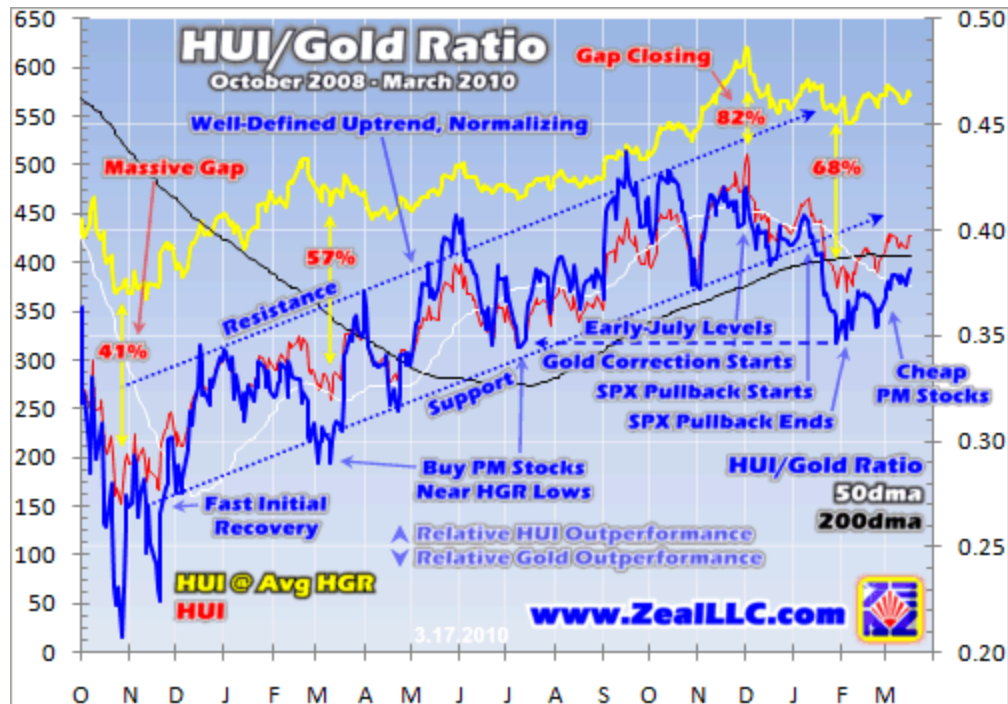
Check out the HGR in the chart above. After plummeting under 0.21x in the stock-panic abyss, this ratio steadily climbed to 0.42x by early December 2009 before this latest healthy HUI correction. This week it was sitting around 0.38x, just over *halfway between* its panic lows and pre-panic average. Is there any reason why this post-panic gold-stock recovery should suddenly stop now, at such low levels relative to history, after the HGR has already been recovering for over a year? Certainly not that I can discern.

The price of gold still drives the ultimate profits of the gold miners today like it always has throughout history. And also as always before, any individual-company's profits ultimately drive its stock price. If it can grow profits, investors will inevitably bid its stock higher. Gold miners are earning far-higher profits today around \$1100 gold than they were making in late 2007 (a year before the panic) at \$800 gold. Inevitably investors will recognize this, which is why major hedge funds are getting bullish on gold stocks.

So this post-panic gold-stock recovery makes perfect fundamental sense. And there is no reason for gold stocks to stop advancing until they regain their historical levels relative to gold. At the HGR's secular average for most of this pre-panic bull of 0.511x, this week the HUI ought to have been trading near 572. This is an additional 34% higher from today's levels, suggesting new investors today can easily expect such gains as the post-panic normalization continues.

This next chart zooms into the gold-stock recovery to date. Again the HGR is rendered in blue and superimposed over the HUI in red. I added an additional

series in yellow, a hypothetical HUI. This is where the HUI *would have been* trading since the panic if it had regained its historic HGR average of 0.511x. The difference between this line and the actual HUI is quite telling. The gold-stock recovery is indeed alive and well.



At its panic nadir in October 2008, the actual HUI was only trading at 41% of where the average-HGR HUI would have been. By the secondary panic low in early March 2009, this gap had closed dramatically to 57%. This was actually a big bullish tell at the time. Over that seriously-depressing span between October and March where the S&P 500 ground another 20% lower, the HUI actually rallied 82% higher!

This massive positive divergence should have been missed by no one, but as far as I know we were almost unique in talking about it last March. It proved how ridiculously and unsustainably oversold the gold stocks had been in October 2008, and foretold how powerful their resulting recovery would be regardless of general-stock-market fortunes. Were your financial advisors pounding the table to get you buying gold stocks in March 2009 when general fear reigned?

By early December 2009 as the latest major gold upleg peaked, the gap between the actual HUI and the average-HGR HUI had closed to 82%. The HUI was trading at 82% of where secular pre-panic averages suggest it should have been. This was *double* the anomalous lows it had seen just over a year earlier. And even at the bottom of this latest healthy 28% correction in early February 2010, this relationship had only retreated to 68%. There can be no doubt at all that the post-panic gold-stock recovery is proceeding nicely.

This is also apparent in the HGR's uptrend rendered above. After a fast initial recovery out of the panic depths, the HUI started normalizing relative to gold in a well-defined uptrend. Prudent investors and speculators like our subscribers bought precious-metals stocks aggressively whenever the HGR neared support and fell to lows. The HUI naturally flows and ebbs relative to gold, seeing periods of outperformance (gold-stock uplegs) followed by periods of underperformance (gold-stock corrections).

Buying low and selling high is the key to multiplying your wealth in the financial markets, and in gold-stock terms this means buying *when the HUI is low relative to gold*. And provocatively, that is certainly the case today. And not only compared to the HGR's secular average, but relative to this in-progress gold-stock recovery as well. Gold stocks have just been hit hard by a double whammy, a gold correction immediately followed by a general-stock-market pullback.

In early December after rocketing 15% higher in just a month, gold was overbought and needed to correct. As always in gold corrections, the HUI fell faster than its primary driver. Yet as you can see in the chart above, the HGR remained above its recovery support line. Gold stocks were faring great. But then in mid-January, the general stock markets started to retreat in their first meaningful pullback since last summer. The S&P 500 (SPX) only gave back a rather modest 8%, but it still spooked excitable gold-stock traders.

The HUI fell rather dramatically over this SPX-pullback span, down 15.4% to the SPX's 8.1%. Gold only lost 6.6%. While frustrating for some gold-stock investors, this is just par for the course in the gold-stock world. Gold stocks have always attracted a paranoid fringe of highly-emotional traders. After actively trading this sector for a decade, I'm amazed how virtually *anything* can freak them out. A fly sneezes, they rush to sell gold stocks. Their hyper-emotionality is great for us though, it creates outstanding buy points.

Since these weak hands sold so frantically on that mild SPX pullback, the HGR plunged well below its post-panic-recovery support line. In late January it actually hit the same levels last seen in early July! At the time you could buy gold stocks and silver stocks as cheaply as last summer, a heck of an opportunity. So again we bought aggressively and recommended our subscribers do the same. And even today, 6 weeks after those HUI-correction lows, the precious-metals stocks still look really cheap relative to gold.

At an HGR of 0.38x this week, the gold stocks remain well below their pre-panic average of 0.511x of course. But they are also under the HGR's recovery support line, which is now near 0.41x. To merely get back to this support, the HUI would have to rally 8% from here. And as mentioned, to get back to its pre-

panic average it would need to run 34% higher. And these metrics are based on a couple of pretty conservative assumptions.

First, they assume the gold price will stay flat. But gold's intrinsic supply-and-demand [fundamentals](#) remain super-bullish and this metal is entering its seasonally-strong [spring-rally](#) timeframe. In addition the [US dollar's bear rally](#) is rolling over, which is very bullish for gold. I suspect we will see a strong gold rally in the next couple months, and if you plug a higher gold price into the HGR equation you naturally get a higher HUI target. And the HGR average itself is conservative too.

Periodically bull markets witness an intense flare-up of excitement and greed. We haven't seen such an episode in gold stocks since early 2006, almost 4 years ago, so we are certainly overdue. In April and May that year the last time investors got excited about gold stocks, the HGR averaged 0.552x. And I have no doubt we'll see widespread gold-stock excitement again, especially given the increasing hedge-fund interest in this deeply-undervalued sector. Plug \$1200 gold (a trivial 7% rally from here) into a 0.55x HGR, and you get a 660 HUI target. This is 55% higher than today's levels!

Now making specific price predictions is a fool's errand, no one can see the future. As a mere mortal bound by the chains of time, I have no idea how big the HUI's spring rally will ultimately prove. But I do know, beyond any doubt, that gold stocks remain way undervalued relative to gold and that they have been steadily recovering relative to gold since the panic. There is no reason to expect this trend to cease.

If you've been out of gold stocks since the panic, it certainly isn't too late to get back in. While you missed the low-hanging fruit off the panic lows, there are plenty of gains left to ride. If you've never invested in gold stocks before, now is a great time to start given their technical levels within their ongoing recovery. And if you are paying for gold-stock advice but weren't aware *since the panic* of this HGR recovery and its implications, you've been robbed. Bad advice from superficial analyses has *vast* opportunity costs.

But good advice based on thorough analysis is priceless, which is why we are hardcore students of the markets at Zeal. We study gold stocks, and commodities stocks in general, from many different fundamental, technical, and sentimental perspectives and then integrate all this work into a coherent and actionable whole. The current issue of our acclaimed [Zeal Intelligence](#) monthly newsletter is full of fascinating gold-oriented analysis including a look at who the big hedge-fund gold-stock buyers are and which gold stocks they are buying. [Subscribe today](#) to learn much and mirror our latest gold-stock trades!

And this week we just published our latest comprehensive [fundamental report](#). Over the last several months, we painstakingly researched a universe of *nearly*

400 junior gold stocks. We gradually whittled down this population to our dozen favorite *advanced-stage* juniors, those companies actively moving their projects towards becoming operating gold mines in the near future.

Making the transition from explorer to producer is quite rare, so these are very impressive companies. We profiled each fundamentally in a comprehensive new 26-page report, the result of hundreds of hours of world-class research. Since gold juniors are likely to far-outperform the majors in this continuing gold-stock recovery, now is a great time to learn about the best. [Buy your new report today!](#)

The bottom line is the gold-stock recovery is very much alive and well. Despite facing the proverbial wall of worries, the HUI has rallied tremendously off its ridiculous panic lows. And even more importantly, it has steadily regained ground *relative to gold*. Nevertheless, even today it still remains very undervalued relative to gold. Gold stocks have only recovered *around halfway* to their pre-panic levels relative to gold.

It is kind of funny, as elite hedge-fund managers who weren't the least bit interested in gold stocks prior to the stock panic are increasingly comprehending this sector's exceedingly-bullish outlook. Yet many, if not most, individual investors who were heavily long gold stocks prior to the panic have yet to return. If you are in this camp, I encourage you to stop worrying and start investing. Great gains remain to be won.

Adam Hamilton, CPA

March 19, 2010

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!

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