

ARE WE THERE YET?

Recent months has seen a volatile period for holders of precious metals investments. Many are now asking the obvious question as to whether this correction is over or whether we still have some ways to go. Since my last article on volatility (http://www.gold-eagle.com/editorials_05/schwensen080406.html), the precious metals sector has continued to consolidate. Let us revisit the chart of the XAU.

XAU



XAU/GOLD RATIO

Key Dates	XAU/Gold	XAU	XAU Performance	Gold Price	Gold Performance	Net Position
19/11/2001	0.18	49.46		272.90		
28/05/2002	0.27	88.65	79.24%	325.50	19.27%	59.96%
26/07/2002	0.18	55.73	-37.13%	303.30	-6.82%	-30.31%
08/12/2003	0.28	112.21	101.35%	406.60	34.06%	67.29%
13/05/2005	0.19	78.99	-29.61%	420.70	3.47%	-33.07%
31/01/2006	0.27	154.19	95.20%	570.70	35.65%	59.55%
Current	0.21	120.53	-21.83%	576.10	0.95%	-22.78%

There are two things to note:

- **Volatility (Top Section):** The 100 day moving average volatility levels are continuing to trend downwards towards the zero level, indicating we are working nicely towards a corrective low. A look back over the bull market thus far suggests to us that volatility needs to drop further for any meaningful chance of a sustainable rally. Low volatility implies less conflict which is what you would expect when excellent value starts to present itself.
- **The XAU/Gold Ratio (Middle Section):** This has worked its way back to 0.209, taking us into the early stages of the **Buying Zone** (within the Green horizontal lines), as Gold and Silver shares start to represent better value. A look at the table accompanying this chart shows us that the XAU/Gold ratio has typically bottomed out at around 0.18 - 0.19 over the past 4 years. This indicates that there may still be some downside to this correction.

The longer my involvement in the precious metals sector, the more it occurs to me that this is a game of patience. Sure there is a lot of excitement from time to time but all in all, there are specific identifiable periods where you do some profit taking and equally there are periods where you take those profits and re-invest them. For the most part you just sit tight. Simple indicators like the XAU/Gold ratio can reliably tell us whether excellent value prevails, or whether sitting tight is the best course of action. Speculating in precious metals companies is a game of probabilities. By picking up most of your positions in the **Buying zone** (Green horizontal lines) and doing the bulk of your profit taking in the **Selling zone** (Red horizontal lines) with all else being equal, you give yourself the best chance of making a solid return over the long term. It's not sexy, and it sure as hell isn't terribly exciting, but in my experience it gets results and gives you the best opportunity of catching the inside two thirds of a sustainable bull market rally. At the end of the day, I firmly believe value dictates the severity and longevity of corrections such as the one we are presently experiencing.

WHERE DO WE GO FROM HERE?

At this point I want to stress that there is no perfect set of indicators that will tell you precisely where you should buy and at what point you should sell and get it 100% right. It is for this reason I advocate holding at least 50% of your precious metals portfolio for as long as gold and silver represent compelling value as they undeniably do today. The above indicators would suggest that we could see a continued consolidation for another 3-5 months at least whilst the last of the weak hands are bullied out of their positions. What I will be looking for during this period, will be for the XAU/Gold ratio to break 0.20 and for a period where the Gold price drops significantly whilst the Gold shares hold firm. This will strongly indicate that the Gold shares are bottoming and that excellent value is starting to assert some

ascendancy over the fear factor (Weak hands). I believe we will see some wonderful buying opportunities in this time and I strongly urge those of you that remain bullish on precious metals to make the most of it.

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