

Introduction

Gold Wave Analysis

XAU Analysis

API Analysis

Australian Theoretical Gold Price Update

Closing Comments

Disclaimer

Contact Details

Email:  
[troy@globalspeculator.com.au](mailto:troy@globalspeculator.com.au)

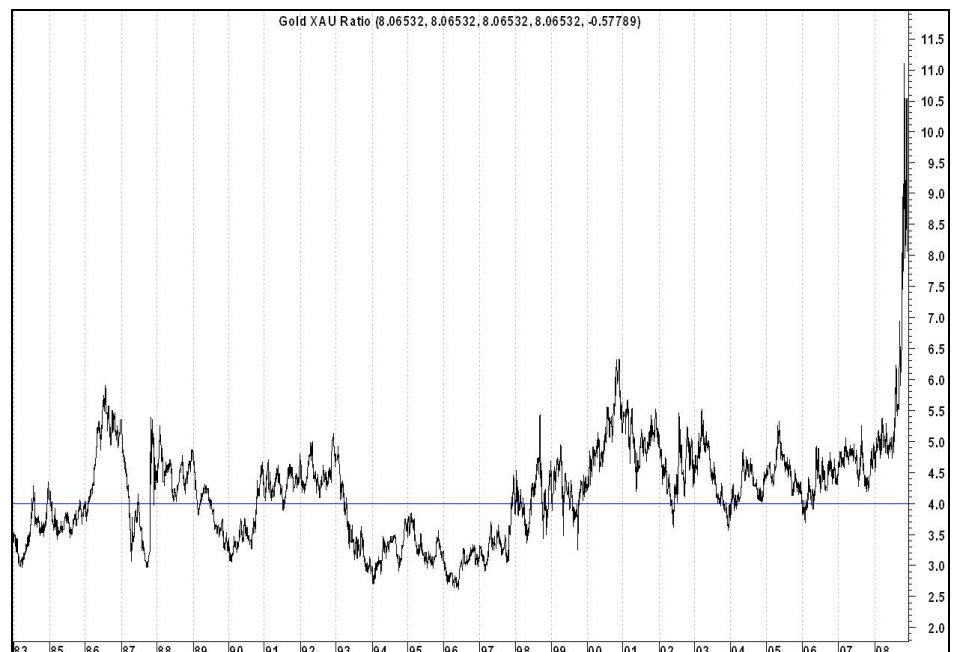
Internet Address:  
[www.globalspeculator.com.au](http://www.globalspeculator.com.au)



## INTRODUCTION

In the theme of market irrationality, I thought it would be interesting to take a look at the Gold XAU ratio for the last 25 years. Relative to the price of gold, gold shares in recent months have hit unprecedented oversold levels. We have heard extensively how deleveraging from hedge funds has driven the commodity complex sharply lower. Some major gold mining companies are trading at forward price earnings ratios of under 10, something I have not seen in the entire time I have been following these markets. Other junior miners with producing assets are trading for less than their Net Financial Asset positions. Could this dislocation worsen from here? Anything's possible given the tremendous fear that has gripped our markets. Long term however, history has proven that whilst anything can deviate significantly above and below its fair value, eventually gravitation to the average becomes inevitable. The long term average for the Gold XAU ratio is 4. At the present time, the ratio is close to double this level. In just 3 months it has doubled from 4.75 to over 10. If the ratio can move that quickly up, it can certainly rebound just as violently the other way. As a long term investor in the precious metals markets, you need to ask yourself whether you can afford to be sitting on the sidelines waiting for the dust to settle (speculative stance). As primarily a longer term investor, I am not prepared to take that risk.

## 25 Year Gold XAU Ratio



## Gold Wave Analysis Update



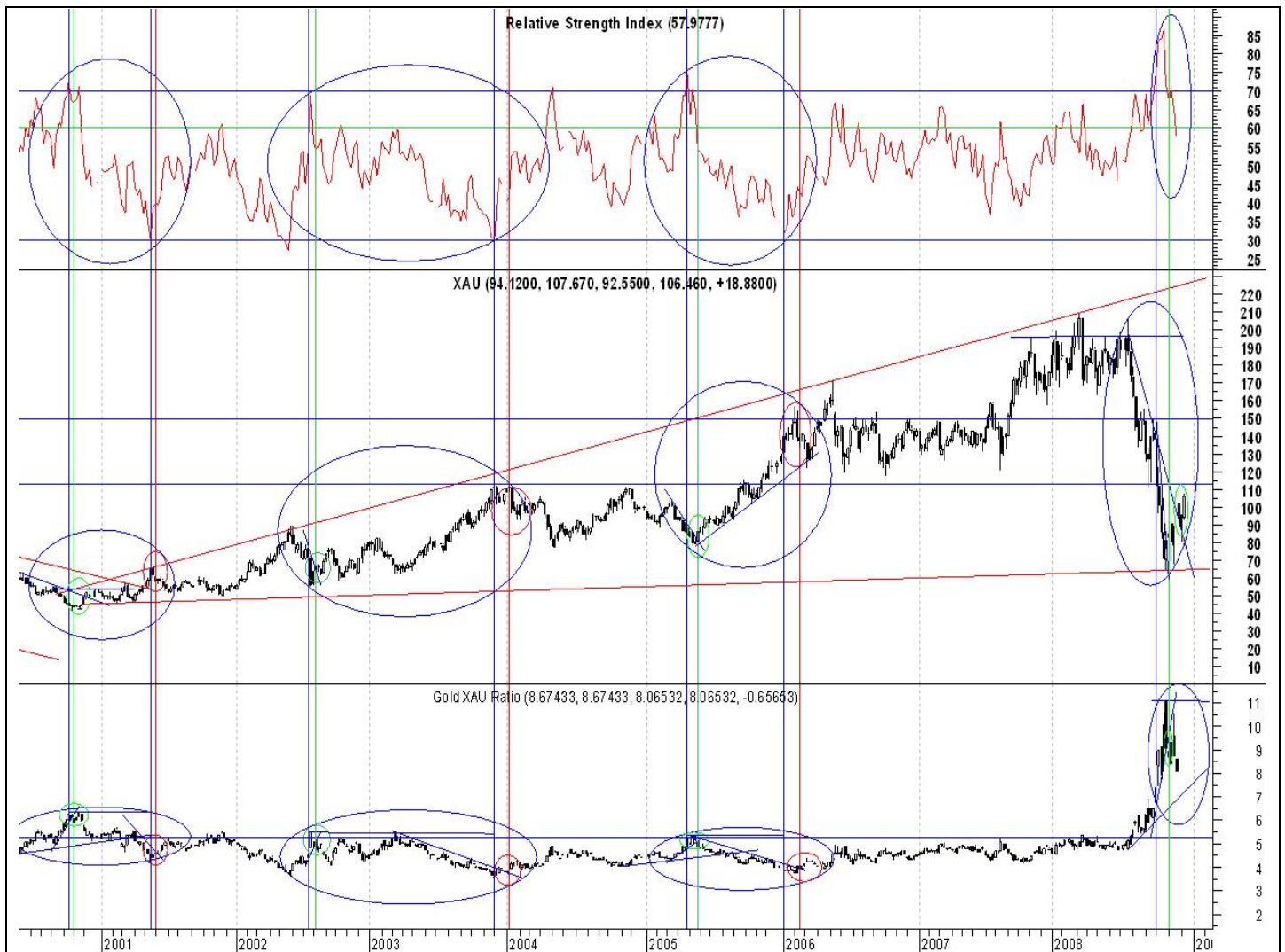
### COMMENTARY

The 'abcde' corrective pattern appears to be complete, paving the way for the next substantial wave 3 rally. The next intermediate term target is US\$1,200/oz, with significant resistance still to be overcome at US\$835, US\$860, US\$900 and then the previous weekly high of US\$1,010. We will continue to monitor the gold shares for a clue as to the probable success of these levels being broken over the coming weeks and months.

## XAU

With the unprecedented moves we have seen in the XAU in recent months, I have been forced to rethink my use of the XAU/Gold ratio. The use of absolute values worked well for the first 5 years of this bull market, but with the increased volatility it is no longer effective. Instead, I have devised a modification which incorporates the Gold XAU ratio in a weekly chart with a look at a relative strength index to indicate the extreme movements and potential entry and exit points. It seems to work more effectively and highlights key points in time when the XAU is overbought relative to gold (RSI 30) and oversold (RSI 70). Once the respective indicators trigger (blue vertical lines), it then becomes a task of following trends in the ratio looking for definitive breaks to signify entry (green vertical lines) and exit (red vertical lines) points. The gold price wave analysis helps us get our bearings.

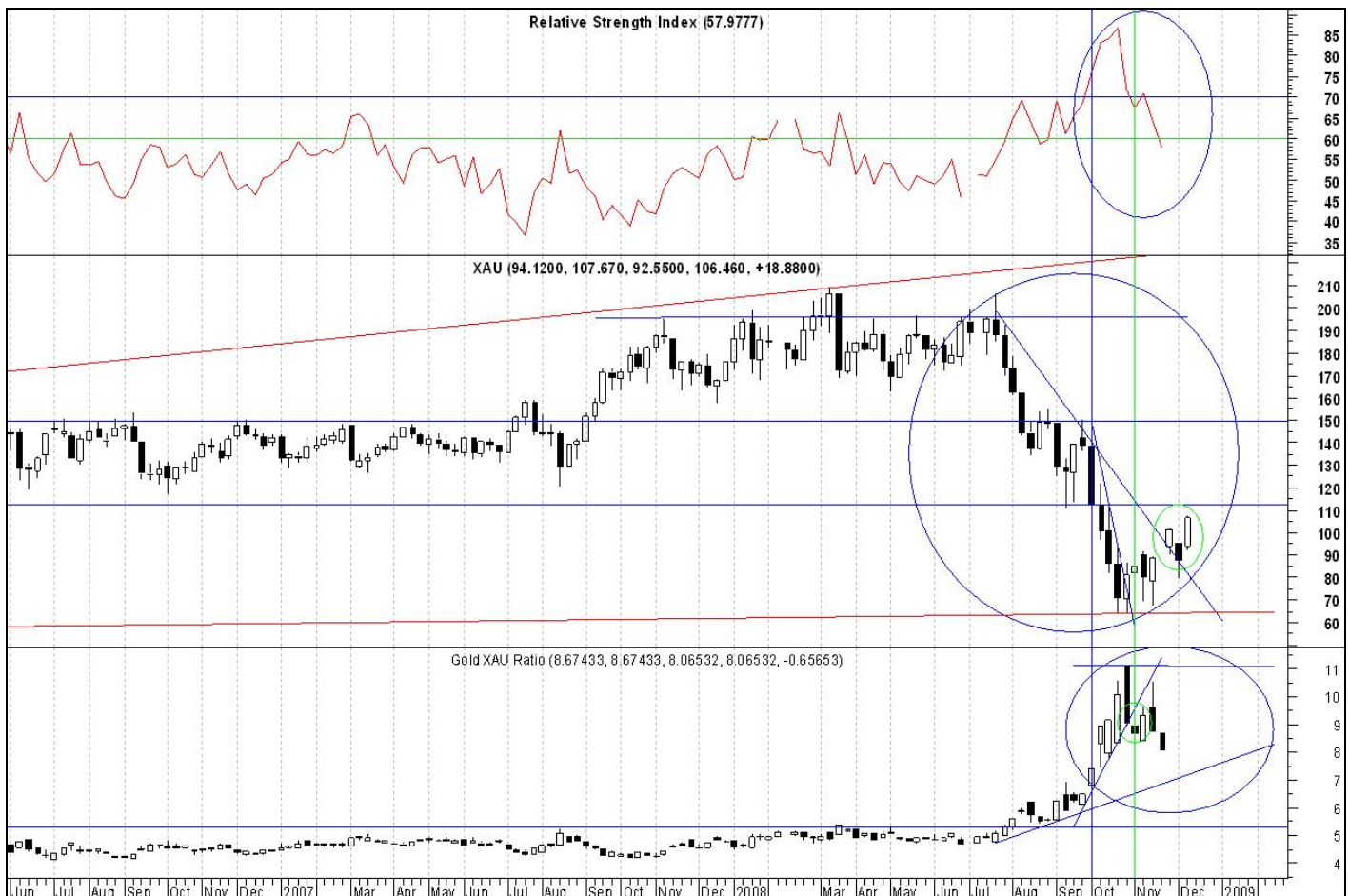
## GOLD/XAU LONG TERM PICTURE



## GOLD XAU RATIO

Extreme Key Dates	Gold/XAU	XAU	XAU Performance	Gold Price	Gold Performance	Net Position
3/11/2000	6.07	44		265		
25/05/2001	4.56	58	33%	276	4%	29%
02/08/2002	4.82	63	9%	305	11%	-2%
09/01/2004	3.83	111	75%	423	39%	36%
27/05/2005	4.84	84	-26%	418	-1%	-25%
17/02/2006	3.97	139	64%	552	32%	32%
<b>Current (10/12/08)</b>	<b>7.62</b>	<b>106</b>	<b>-24%</b>	<b>809</b>	<b>46%</b>	<b>-70%</b>

## GOLD/XAU INTERMEDIATE TERM



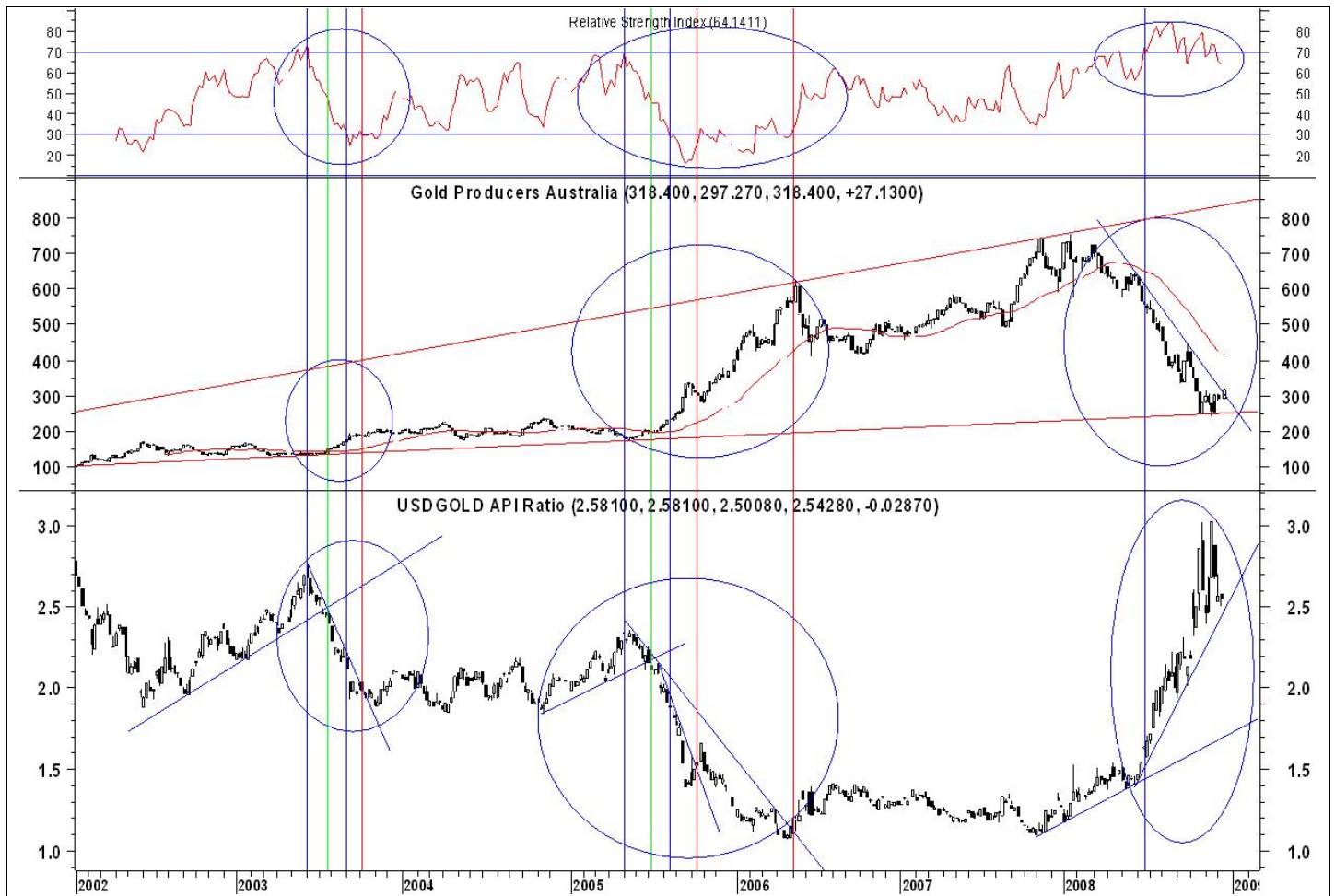
## COMMENTARY

We can see, looking at the extreme movement in the RSI in late Oct 08, that there has been one huge dislocation in the PM markets with the shares strongly underperforming the metal (I didn't need to tell you that!). On a brighter note, things look to have stabilized with a nice breakout occurring in the XAU (middle section). The gold shares are displaying strength versus the metal with a move in the Gold/XAU ratio breaking a shorter term up trend (green vertical line) being bullish in its implications. The next trend line of more significance sits at around the 7 level. A break of this trend line would reinforce the theory that the gold price has commenced its next wave 3 move and that gold shares are typically leading the way.

## AUSTRALIAN PRODUCERS INDEX (API)

The Australian Gold Producers Index has undergone similar changes to those made to the XAU. You will notice a consistent format. I have also altered the relative strength comparison to a USD gold price instead of the Australian dollar gold price. The simple reason for this is the Australian gold shares seem to be influenced more by gold in USD.

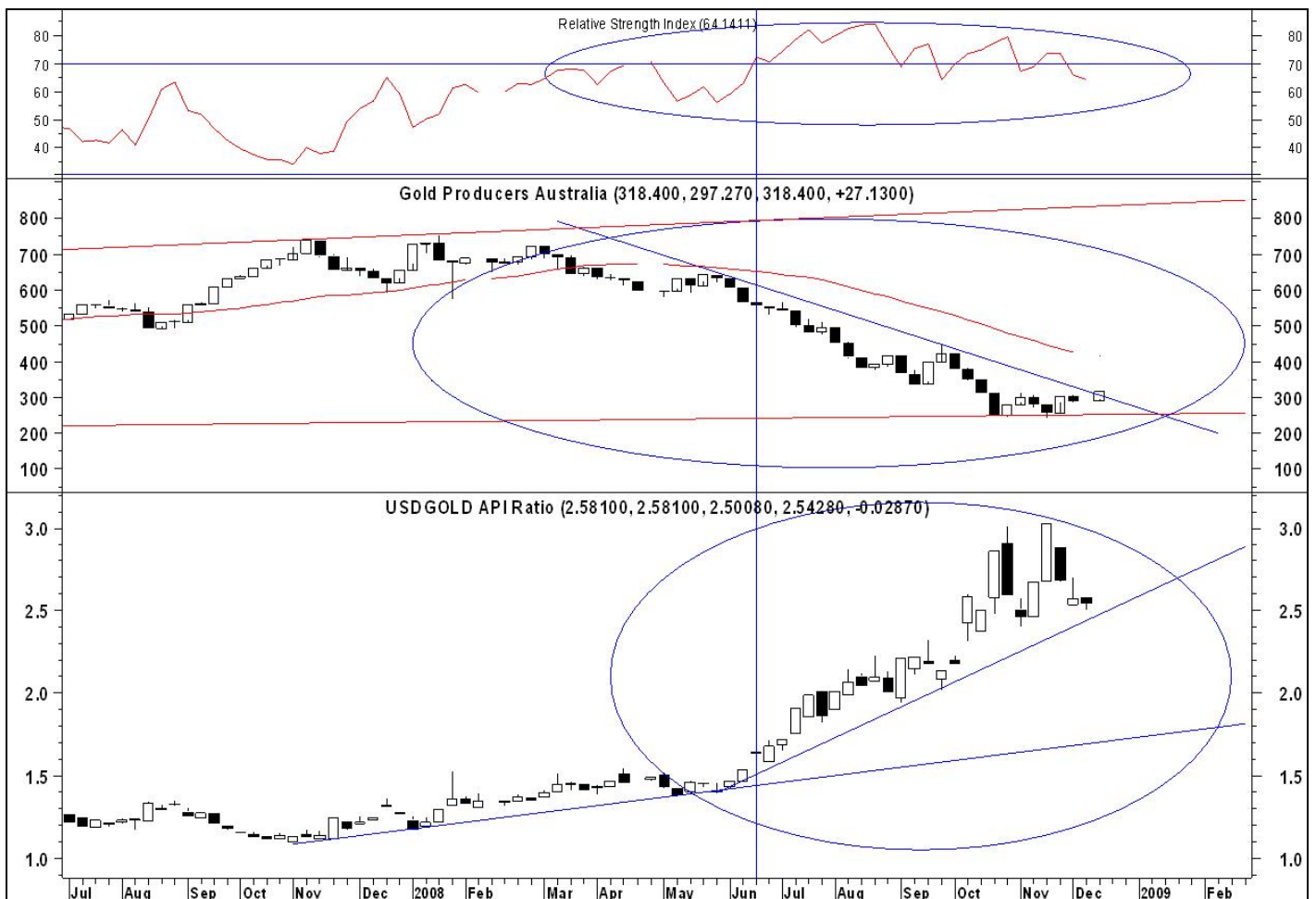
## GOLD (USD)/API LONG TERM PICTURE



## GOLD (USD) API RATIO

Extreme Key Dates	Gold/API	API	API Performance	Gold Price	Gold Performance	Net Position
25/07/2003	2.39	152		363		
10/10/2003	1.98	188	24%	372	9%	15%
08/07/2005	2.14	198	5%	424	14%	-9%
05/05/2006	1.20	564	185%	678	60%	125%
<b>Current (10/12/08)</b>	<b>2.54</b>	<b>291</b>	<b>-48%</b>	<b>802</b>	<b>18%</b>	<b>66%</b>

## GOLD (USD)/API INTERMEDIATE TERM



## COMMENTARY

The API, like the XAU, is consolidating and looks ready to break out (middle section). When we look at the Gold/API ratio in the bottom section, it still shows a definitive up trend which is yet to give us our buy signal. A break of this trend line at 2.50 would give us our first signal that momentum has shifted. When you consider the gold price in Australian dollar terms is near record level highs, it could only be a matter of time before things start to get moving. The market is not however rational at the present time and fundamentals are playing second fiddle to fear and uncertainty.

## AUSTRALIAN THEORETICAL PRICE OF GOLD UPDATE

Date	10 Year BB Interest Rates	Headline CPI	M3 Aggregate Money Supply	Rate of Australian M3 Change	Gold Production Av Annual Increase (1.73%)	Australian Theoretical Gold Price	Actual Gold Price (AUD)	Actual as a % of Theoretical
Jun-08	6.45	4.50	1,032.9	2.79%	0.14%	3,231.06	969.36	30.00%
Jul-08	6.23		1,051.0	1.75%	0.14%	3,283.16	976.02	29.73%
Aug-08	5.75		1,065.9	1.42%	0.14%	3,325.10	967.25	29.09%
Sep-08	5.40	5.00	1,090.1	2.27%	0.14%	3,395.94	1,111.11	32.72%
Oct-08	5.18		1,106.4	1.50%	0.14%	3,441.96	1,107.62	32.18%

### 5 Year Performance Snapshot

	2008/09*	2007/08	2006/07	2005/06	2004/05
Actual Gold	14%	26%	16%	18%	8%
Theoretical Gold	6%	17%	14%	16%	6%
M3 Growth	7%	19%	16%	17%	8%
CPI	5%	4.5%	2%	4%	2.5%

\* This financial year so far

## COMMENTARY

The monetary spigots have well and truly been turned on as M3 money supply has rocketed skywards in the 2008/09 year. The annualized growth rate is 21%. This is not surprising when you consider the RBA is pulling out all the stops in an attempt to avert Australia's first recession since 1990. It will be to no avail as a recession is inevitable and is ironically just what our economy is crying out for to purge itself of all the mal-investment that has taken place over the last 2 decades. Yet the powers that be are doing everything to try and avoid the inevitable. Kevin Rudd is playing his part by throwing money down the drain which could have been better invested into the "long term" future of our business sector. Instead, cheques have been mailed out to a select group of Australians complete with directions to spend and not save. You can not grow an economy sustainably by stimulating consumption. It is a complete and utter economic fallacy. You are putting the cart (the consumer) before the horse (business and capital investment). You only have to look at the countless failed stimulus packages in the US to see what a waste of time and money it is. Yet politicians and central bankers have to be seen to be "doing something" about the problem, even if that something is only prolonging the agony. We can see in 2008/09 that the gold price in Australian dollars has returned 14% and has continued in the same vein as 2007/08 by outperforming the theoretical price of gold. I expect this to continue and accelerate from here until the actual and theoretical prices meet some time in the future. We have to go back 20 years to 1988 to find the last time these two figures agreed.

## AUSTRALIAN GOLD PRICE (EFT: ASX:GOLD)



## CLOSING COMMENTS

It has been an amazing three month period since the last issue. We have seen the XAU fall to levels not seen since 2002, shortly after the secular bear market in gold finished. We have seen gold shares, relative to the gold price, hit levels never seen before in the history of the XAU. Nothing has changed fundamentally for gold as central banks around the world continue to cut rates drastically in an attempt to stimulate the world economy and save countless financial institutions from collapsing. 2009 promises to be a very difficult year as people endeavor to seek financial safety. At the moment that perceived safety is in cash and government bonds. When you look at how governments and central banks are attempting to solve this growing list of problems (via increasing levels of stimulus), I find it increasingly difficult to see attractiveness in either of these alternatives. One thing that has become very apparent to me is neither the governments nor the central banks have a grip on this problem. To keep your savings in pieces of paper which essentially rely on both organizations getting things right is an incredible leap of faith in my humble opinion. Gold is at record levels in many currencies and has provided the perfect hedge against what is going on around us. My feeling is it will continue to fulfill this role as it has done countless times before throughout history.

Troy Schwensen

Research Analyst  
[www.goldnerds.com.au](http://www.goldnerds.com.au)

Editor  
[www.globalspeculator.com.au](http://www.globalspeculator.com.au)

## DISCLAIMER

This publication has been prepared from a wide variety of sources which the editor, to the best of his knowledge and belief, considers accurate. The editor does not warrant the accuracy of the information and forecasts contained in this publication. This information is provided for educational purposes and nothing written should be construed as a solicitation to buy and sell securities.