Gold on the brink

By Ben Turney — Monday 20 May 2013

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Gold is on the brink. But the question is on the brink of what? This is shaping up to be one of the most exciting (nervous?!) periods for metal investors in recent years. A number of key charts are at extremely significant levels and patterns are forming all over the place. The confirmation or breakdown of these is likely to set the tone for the rest of this year's trade.

[Last week I wrote that copper was at a crossroads.]()

Now my attention is fixed firmly on gold. Take a look at the 20 year MIDAS chart for gold below.

When gold recently collapsed it initially shattered its NOV2008 support line. The NOV2008 support line is crucial, because its origin was at the nadir of the Financial Crisis (indicated above), immediately after the US Congress rejected the original plan for a bailout of Wall Street. The bull market which followed, driven largely by fears of an imminent financial collapse and/or expectations of rampant inflation, was a period of phenomenal returns for resource investors.

Gold went on to break the 30 year all time nominal high and seemed destined to smash through $2,000/oz, with some commentators even predicting $10,000/oz by the time any crisis peaked.

However things haven't played out as expected.

For most of this period I have been extremely bullish on gold, even when prices turned. I have been a vocal critic of monetary policy since the Financial Crisis began and I still do not believe the worst is behind us, only postponed. Excessive creation of money historically has led to high inflation and this has been perhaps one of the most extreme periods of money creation ever experienced by humanity. Being long gold throughout has seemed like the most logical play.

I have not been alone in this view. Yet now even the most ardent supporters of gold are staring into an abyss.

Growth is apparently returning (though not according to the Baltic Dry Index), inflation appears under control and major stock markets are surging euphorically. All the apparent crises of the last few years (e.g. the Deficit Ceiling, the PIIGs, the Fiscal Cliff etc.) haven't triggered a widespread collapse. The sun has continued rising and setting. Life has gone on and it's sometimes hard to see what all the fuss has been about.

But back to the charts.

Gold is clearly in a bear market. It is down over 25% from its peak.

However the question now is, is the Financial Crisis bull market completely over?

To answer this explains why the NOV2008 support line on the MIDAS chart could be so important. If the support line fails and gold continues to fall then the answer is likely to be "yes". Equally if the support line holds and gold rallies then the answer is likely to be "no" and this could be looked back on as a golden (sorry) buying opportunity.

For the bulls there was some recent encouragement.

When gold initially tumbled through the NOV2008 support line (intraday it went below $1,340/oz), it quickly recovered and rallied to $1,465/oz over the following fortnight. This was suggestive of considerable buying at the crucial moment and was a possible sign that gold's fortunes could be about to turnaround.
Further confirmation of this turnaround could be occurring right now.

Since the initial rally the price has pulled back below support and we might be midway through the formation of a double bottom. The double bottom pattern on a chart is usually regarded as a reliable indicator of imminent trend reversal and is a favourite among chartists. If confirmed, it can be a highly bullish indicator.

Broadly speaking [there are eight steps in a confirmed double bottom.] The 6 month standard chart of gold below suggests we are now at step 4 (reaching a second trough) if such a pattern is indeed developing.

If step 5 (advance from trough) now occurs, then many market participants will probably wait for $1,465/oz to be breached as confirmation a double bottom is in place. On the standard chart this is the most obvious place to look.

However I might chose to be a little more aggressive than that.

The MIDAS Method can be most powerful when used in conjunction with other technical analysis techniques.

The double bottom pattern is so widely recognised and respected that if it works in harmony with MIDAS it can be one of the most potent signals around.

The MIDAS chart is giving such a strong indication at $1,396/oz that a rise through this level could serve as validation for step 6 (resistance break) and be regarded as a trigger to buy. Once a MIDAS support line has been breached, it becomes resistance, so there is an argument this would serve well. Given the origin of the support line the rationalization for its use is increased.

However.

If the developing double bottom pattern proves false and the price of gold fails to rise from here, then strap in because there is nothing but fresh air underneath. Gold could easily shed another $150/oz.

MIDAS indicates the next key level of support (JUL2005; the purple line in the top picture) is at $1,197/oz. A fall to this level could be catastrophic for many small cap exploration and miners, especially those which are under-funded.

Whatever happens next is anyone's guess, but I expect to be watching this market like a hawk in the coming weeks.

These are exciting times.

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