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LONGWAVE group

THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

IAN'S INVESTMENT INSIGHTS

Stock Markets Versus Gold

Are the general stock markets and precious metals and precious metals equities about to experience a reversal in fortunes? Based upon current evidence, I think so.

Buy on extreme weakness, sell on extreme strength. This is one of the fundamental laws of speculation, but one that is very difficult for most of us to act upon. Why? Because most of us have difficulty in being out of step with a crowd and the investment crowd is generally most bullish in times that markets are displaying extreme strength and most bearish at times when markets are experiencing extreme weakness.

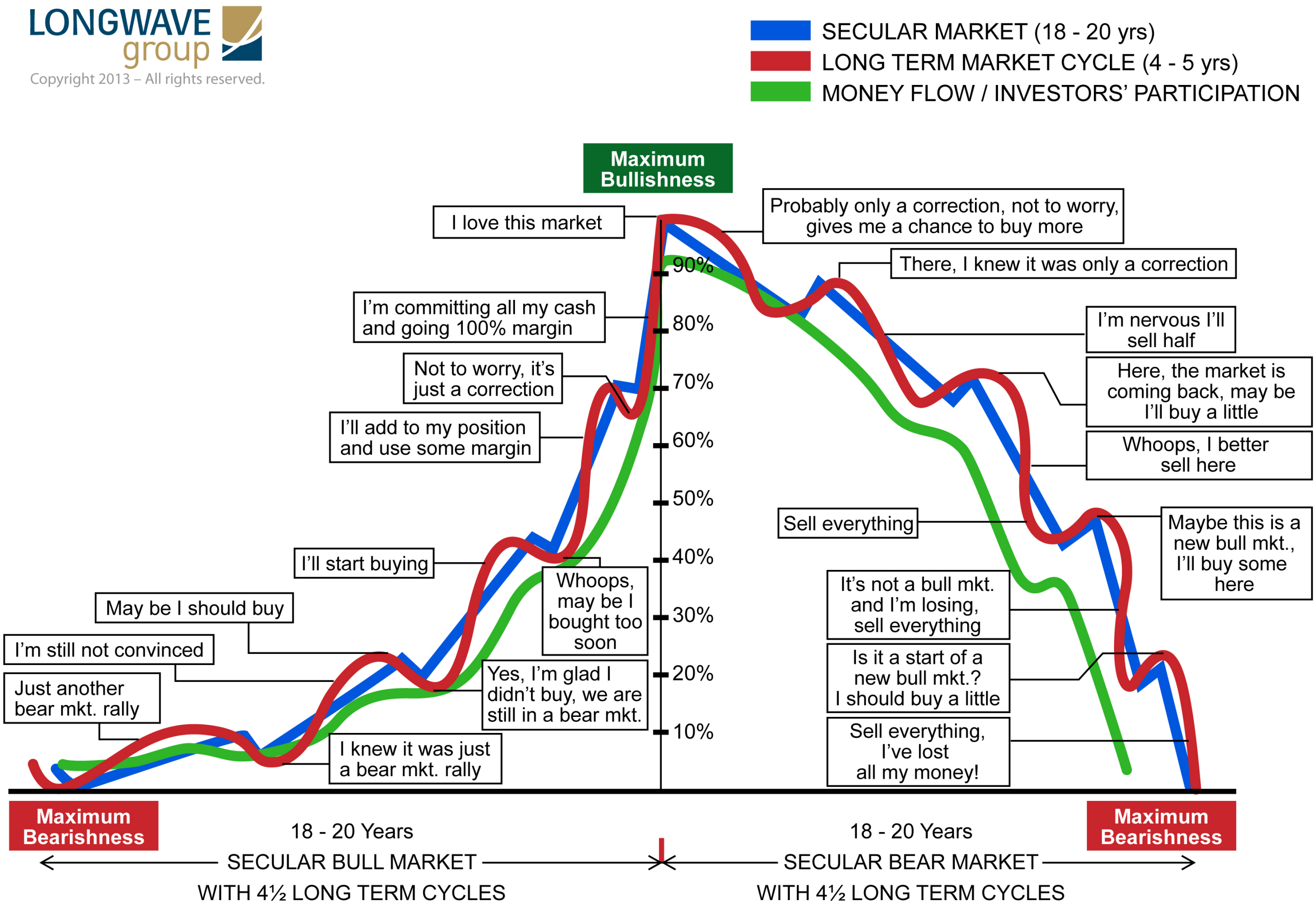
At this time, the general stock market is a position of extreme strength and gold and gold stocks are displaying extreme weakness. The S & P 500 has been bullish since March 2009 and since that bear market low the Index has increased in value by 200%. Gold and gold stocks have been in a bear market since September 2011, when the price of gold peaked at $1,920.00 (U.S.) per ounce and the HUI Gold Bugs Index reached a record high of 638.59 points. Gold is currently priced at about $1,320.00 (U.S.) per ounce down a little more than 30% from $1,920.00 (U.S.) per ounce and the current value of the HUI (Gold Bugs Index) is close to 240, which is down a whopping 62.50% from that existing record high level of 638.59.

Investment market prices are driven by the bullishness or bearishness of the investment crowd. The longer and further that prices move in a certain direction the more bullish or bearish are market participants. Rising prices bring an increasing number of participants to that particular market, whereas falling prices contribute to a reduction in the number of investors. The bigger the moves in either direction the more investors are drawn in or driven out of the market. On the bullish side in a market that has been ongoing several years and risen multiple times in value, almost all investors are buying the market. A bear market that has been ongoing for several years and has experienced huge price losses sees the opposite; virtually all investors have fled the market. As the saying goes and it is important that we not forget this, "Mood follows Price," and not the other way around.

Stock markets have now experienced more than 5 years of bullishness and prices have risen to record levels. I have calculated since the onset of the bull market in March 2009 that the DJIA has made an average daily gain of 5.44 points. The market low has long since been forgotten. As for the precious metals and their related mining stocks, the opposite is true; these markets have experienced a vicious bear and virtually all investors have given up on them. The market highs made in 2011 have long since been forgotten.

What this means is after long term and major price moves in either direction, the market will turn in the opposite direction. It only requires a modicum of selling to turn the bull bearish, because everyone who wants to buy into the market is already invested and there is no one left to buy. Another thing that adds to selling pressure at major price peaks is margin debt. Once prices turn down the margin clerks issue margin calls. These calls are generally answered by sell instructions, rather than the alternative which is to put up more margin; this of course increases selling (see margin debt chart P. 4). Conversely, after a long and significant bear market a small amount of buying can re-ignite the bull market, because there are few sellers left to counter the buyers.

ANATOMY OF A BULL AND BEAR MARKET WITH MONEY FLOW AND INVESTORS' PARTICIPATION



U.S. Stock Markets

The fact that U.S. stock prices have been bullish since March 2009 and since then have increased in value by at least 200% means that we are a point of extreme bullishness where investors have thrown all caution to the wind. The latest Elliott Wave Financial Forecast, July 3, 2014, cites several examples of this extreme level of bullishness which are now pervading the stock market. Allow me to quote directly from this excellent publication to which I subscribe.

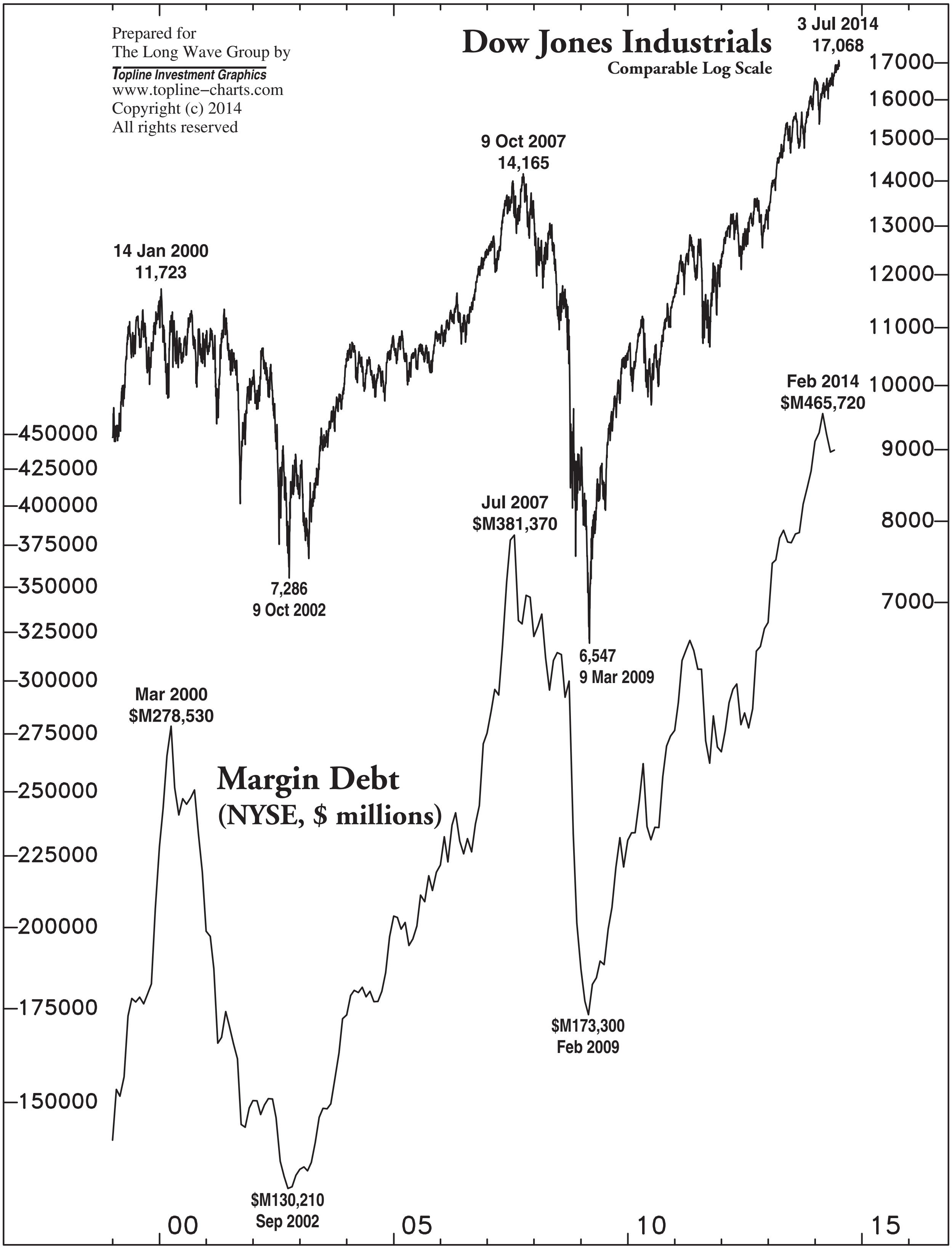
"Nothing exhilarates the bulls at a peak in stock prices like forecasts calling for magnificent new gains in the future. In 1999 and 2000, books such as Dow 36,000 and Dow 100,000 rolled off of the presses. June 2014 brought predictions for 'The Greatest Bull Market in 85 years' (CNBC, 6/8/14), 'Dow 20,000' (NASDAQ. COM, 6/18/14) and this headline from Yahoo Finance:

"Why Dow 44,000 Is Coming"

"The story features a report predicting another ten years of outsized returns, to the tune of 10.5% per year, thus the Dow target. Bloomberg and the Financial Post featured the same scoop. The Wall Street Journal reported that 'money managers and analysts are beginning to talk about a melt-up, a sudden double digit percentage rise.' It notes that this is a concern to some because 'melt-ups can lead to melt-downs,' but other headlines state that investors are now literally afraid to be out of the market. 'Few Want to Risk Taking Profits, Missing Gains,' says a June 23 USA Today headline. So, it's now 'risky to take profits! 'Moves by central banks around the world make it costly not to be involved in stocks,' explains a representative financial expert. Another article features a 'super bull' who is 'confident that global markets are facing a five-year bull environment, as massive liquidity injections from central banks will start to do the trick.' Start?' In a similar vein, an article in the Saturday, July 5, 2014, Globe and Mail headlined "All Aboard: This Rally Is Built to Last," is based upon the premise that since most stocks are participating in the upward stock market price move, the bull market will continue- "Individual stock pickers can be more optimistic on the prospects for smaller-cap, attractively valued stocks for as long as the trend of more stocks joining the party lasts."

Stock buy backs in the first quarter of 2014 reached a total value of $159 billion (U.S.), which was the second highest quarterly amount on record. The record was $172 billion (U.S.) which was attained in the third quarter of 2007, which was just before the Dow's peak in October and the start of the bear market into March 2009. "As we have noted all these figures dwarf those of the late 1990s, when companies were also borrowing to pay for purchases of their own shares, just as they are now. At that time the Elliott Wave Theorist argued that this practice might pump buying power into the market initially, but it would damage company balance sheets and become a 'vast hidden source of margin debt' that would have 'an opposite effect in a downtrend.' This proved to be the case during the two great bear markets in 2001 (2000)-2 and 2008 (2007)-9, which produced long rosters of firms that gobbled up their own shares 'only to run mortally short of cash'. According to a December 2008 article from ChiefExecutive.net, 'The Buyback Bust?,' 'the practice dulled the 'luster of buybacks.' Of course that was near the end of the last bear phase. The opposite extreme is surely at hand now because, in addition to record levels, 'companies purchasing their own shares represent the single biggest category of stock buyers today.'" Elliott Wave Financial Forecast, July 3, 2014.

Margin debt, which is a measure of confidence in the stock market, is at record highs; at least it was until a couple of months ago. It is interesting to note that margin debt turned down before the market in 2000 and 2007 and that margin debt this year peaked in February and has since been reduced. Is the current downturn in margin debt from record levels signaling a new bear market as it has done in previous times?


Prepared for
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Dow Jones Industrials
Comparable Log Scale
3 Jul 2014
17,068
9 Oct 2007
14,165
14 Jan 2000
11,723
7,286
9 Oct 2002
6,547
9 Mar 2009
Feb 2014
$M465,720
Jul 2007
$M381,370
Mar 2000
$M278,530
Margin Debt
(NYSE, $ millions)
$M173,300
Feb 2009
$M130,210
Sep 2002
17000
16000
15000
14000
13000
12000
11000
10000
9000
8000
7000
450000
425000
400000
375000
350000
325000
300000
275000
250000
225000
200000
175000
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10
15

U.S. IPOs (Initial Public Offerings) for the first half of 2014 are experiencing their biggest premium since 2000; you know what followed. On June 30, 2014, the Wall Street Journal reported that so far this year there have been 20 merger deals valued at more than $10 billion (U.S.), which is the largest since the first half of 2007 and you know what followed.

Cycles are also suggesting that the peak in stock prices is near and is more than likely to occur sometime in 2014. W. D. Gann, the great cycle proponent and highly successful trader, wrote that the number 7 was a tragic number. I referenced this number and other Gann numbers in my work 'This Is It' (available on the website in the Special Editions section), which was published in 2007 and accurately forecast the stock bear market and the banking crisis. There are two different number 7s associated with the stock market this year. The first is that in numerology terms the year 2014 is equal to seven, 2+0+1+4=7. The second is that the year 2014 is 7 years beyond the previous bull market peak in 2007. That bull market peak was itself 7 years beyond the 2000 bull market price peak. The two bear market lows 2002 and 2009 were also 7 years apart. On the following page I show a stylized version of the bull and bear markets since great autumn stock bull market ended in 2000. Note the beautiful symmetry, which is an important feature of cycle analysis. Each bear market lasts approximately 2 years. The bull market 2002 to 2007 lasted 5 years and the current bull market is well into its fifth year. The numbers 2 and 5 are Fibonacci numbers and these numbers are used extensively in technical analysis and in particular in Elliott Wave analysis.

Gann also drew high importance to the number 49, (7 X7), which he stated was the jubilee number and a number that signifies important market price turns. The year 2015, next year, just so happens to be 49 years from 1966, which was the year in which spring and the spring stock bull market ended in the current long wave cycle. Thus, in the unlikely event that stock markets do not reach their bull market price peaks this year, they will almost certainly do that next year.

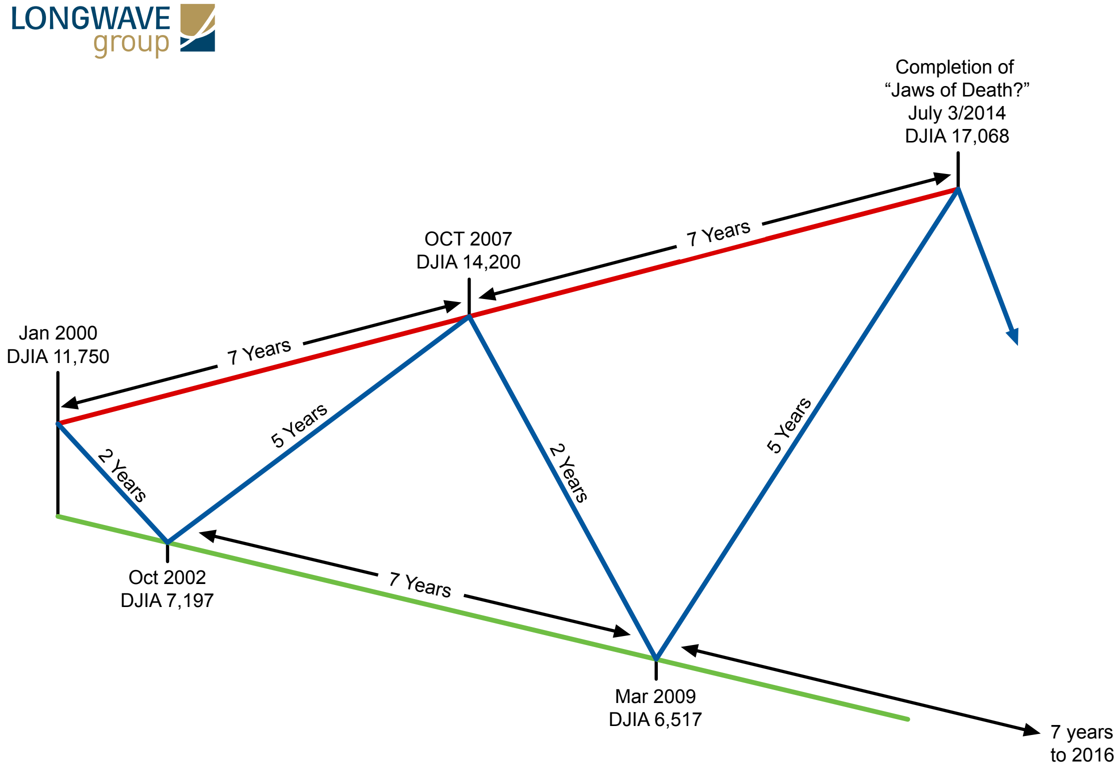
"What are Fibonacci numbers? They are an incredible set of numbers that seem to rule markets, both in terms of distance and price moves and timing, and rule physics and art (and nature) throughout the universe."

"The Fibonacci number sequence starts with the number one and then when it adds to itself it produces the next Fib number which would be 2(1+1), then if we take that resultant number and add it to the previous Fib number in the sequence, it produces the next Fib number, which would be 3 (2+1), then the next number is 3 + the previous number in this sequence which was 2 resulting in 5 (3 +2), then 8 (5+3), then 13 (8 + 5), then 21 (13 + 8), etc...., which gets us the sequence 34, 55, 89, 144, 233, 377, 610, 987, 1597, 2584, etc..."

What is incredibly unique about this sequence is the two component numbers, when divided by their combined result, will approximate at the low end, and otherwise equal either .382 or .618. The ratio .618 is known as phi. For example, for the Fibonacci number 21, its two components are 13 and 8. If we divide 13 into 21, 13/21 = .618 and 8/21= .382. The larger the numbers the more precise they come to .382 and .618." Robert McHugh. (Note the symmetry)

If you want to study this further I would suggest you read Tony Plummer's excellent book, <u>The Psychology of Technical Analysis.</u>

Symmetry in the Stock Market and The 7 Year Itch



One other thing to note is what Dr. Robert McHugh calls the 'Jaws of Death' or the megaphone pattern may be complete. "The industrials have essentially reached the upper boundary of the Jaws of Death pattern, the top for Grand Super cycle degree wave (111) up. It suggests the Industrials could rally toward 17,000ish (they did, closing at 17, 068 on July 3, 2014) at the conclusion of wave c-up and e-up, but by reaching a high of 16,588.25 on December 31, 2013, it is close enough for pattern completion. The decline since December 31, 2013 may suggest the pattern is finished and the coming economic ice age has started." McHugh's Market Forecast & Trading Report, Thursday, July 3, 2014, P. 30.

So there we are, there is a large amount of evidence which suggests the stock bull market is either finished or close to a finish. The bear market that follows will be one for the ages. It will make the bear markets of 2000- 2002 and 2007-2009 appear like minor glitches. I am sticking to my Dow 1,000 target. What that means is an 'Economic Ice Age', which just so happens to be the title of Dr. McHugh's recently published book.

In an opposite mode to the very bearish outlook for stock markets, developing evidence suggests that precious metals and in particular gold and gold stocks have completed a bear market low (See Gold Versus Silver, Economic Winter, June 17, 2014) and have already begun a major bull market.

The bearishness in this domain is palpable. The junior sector has been decimated and investor participation in the sector is virtually non-existent. "After all, who needs gold when stock markets are at record high values?"

In such a bearish environment most of the sellers are long gone and now all that it will take is some tentative buying to push prices slowly higher. There are indications that is now occurring. Many gold stocks' prices have already moved significantly off their lows. In the junior sector such movement is very limited. That is to be expected, money flows to the juniors only as confidence in the bullish outlook for gold and the gold stock miners builds. That process has further to go, before junior miners begin to attract money. In the meantime many of them are building large basing patterns that foretell significant price moves to the upside.

If you have not already done so, I would urge you to read the recently written 'Gold Versus Silver' in our Economic Winter publications. In this edition, I show that when the debt bubble bursts, as it surely will, and deflation is the result, the run to gold and gold stocks, including the junior exploration companies will turn into a stampede. We are very close to this catastrophic period in the long wave cycle. The recent reports of major banking problems in Portugal and Austria may be the precursors.

Bullish consensus, measured by Market Vane, for gold has moved off an extreme low of 33% recorded in the week of December 3, 2013. This the lowest level recorded since 2001 when the price of gold was hardly $300 (U.S.) per ounce. That in itself is an indication of how dispirited gold investors have become. All previous bullish consensus lows since 2001 were above 50%, even following times of fairly significant corrections to the gold price. For a contrarian that extreme low is a bullish 'buy' signal. Since that low the Consensus moved to 53% in the week of March 18, 2014. After that a small correction took the consensus down into the low 40s%. From there the bullish consensus has again risen to the low 50s%.

As for the price of gold, it made a double bottom in June and December 2013 at $1,192 (U.S.) and $1,195 (U.S.) per ounce based on the London PM fix. In technical analysis, double price bottoms are important indicators of a price reversal. As I write, the gold price closed today, Friday, June 11th. at $1,337.84 (U.S.) per ounce, that is an increase of $143.00 (U.S.) per ounce or 12% since that late December low.

Meanwhile, the HUI (Gold Bugs Index) reached its low of $190.08 in late December 2013 and then moved up to $258.27 In the middle of March 2014. from that point the Index dropped to a low of $203.50 on May 28th, 2014. Since then the Index has again moved higher and closed Friday July 11, 2014 at $247.22. From a technical standpoint prices have made a higher low than the December $190.08 low; it would be very constructive if prices could close meaningfully above the high of $258.27. This would convincingly demonstrate that the bearish trend consisting of lower high prices and lower low prices had changed in favour of a renewed bullish trend on the basis that HUI prices would be making higher high prices and higher low prices, which is confirmation of a bullish trend.


AMEX HUI (Gold Bugs)
Prepared for
The Long Wave Group by
Topline Investment Graphics
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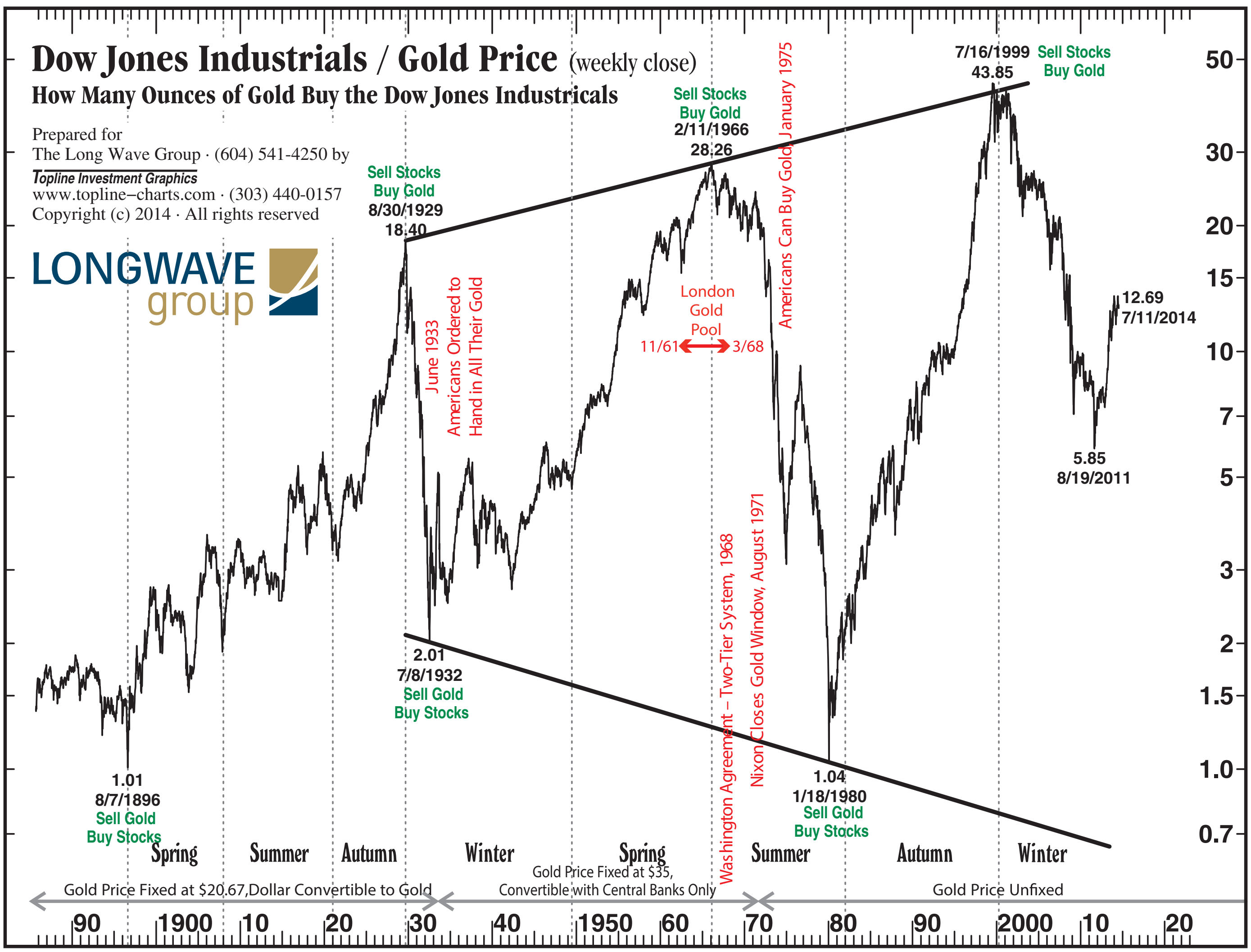
35.99 11/14/00
6/3/02 147.82
95.00 7/26/02
12/2/03 256.84
168.80 5/7/04
11/17/04 245.13
166.46 5/16/05
5/10/06 394.32
273.73 6/13/06
3/14/08 514.89
151.57 10/27/08
9/8/11 635.04
375.77 5/15/12
9/19/12 525.84
3/14/14 258.27
190.08 12/20/13
203.50
Gold (London PM Fix)
2/7/00 313
256 4/2/01
2/5/03 382
320 4/7/03
4/1/04 427
375 5/10/04
5/12/06 725
561 10/6/06
3/17/08 1011
713 10/24/08
12/2/09 1213
1058 2/5/10
9/5/11 1895
1531 12/29/11
10/4/12 1792
8/28/13 1420
3/14/14 1385
1192 6/28/13
1195 12/20/13
1243
2/8/00 51%
14% 1/16/01
1/28/03 89%
49% 4/8/03
12/9/03 88%
58% 5/11/04
5/2/06 91%
53% 6/13/06
11/6/07 93%
53% 11/11/08
10/6/09 88%
61% 7/20/10
8/9/11 89%
52% 5/15/12
9/18/12 74%
33% 12/3/13
3/18/14 53%
www.marketvane.net
Percent Bulls (Gold)
2000
05
10
15

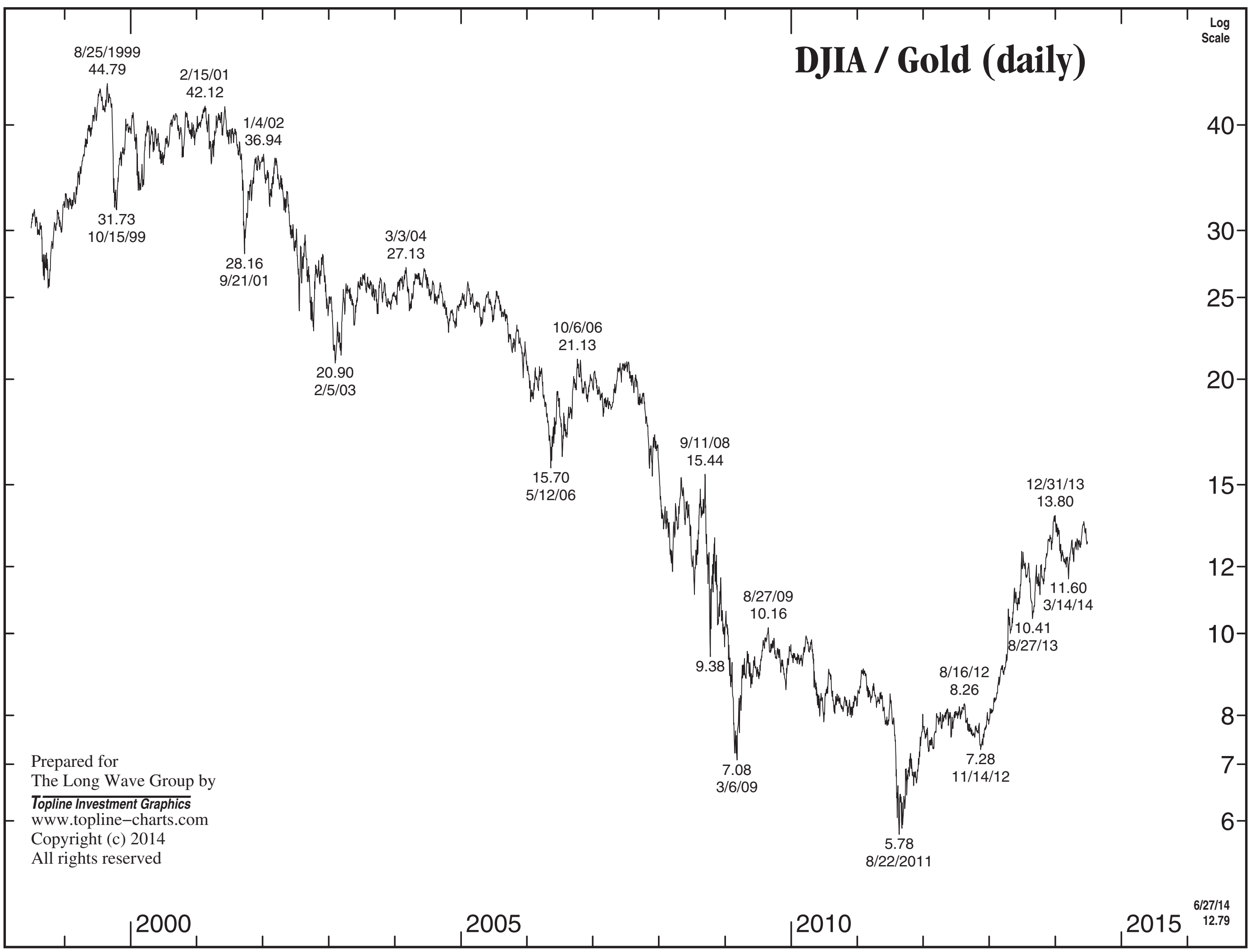
I have often drawn your attention to the Dow/Gold ratio. I consider this to be one of the most important relative measures of two competing investment themes. Yes, stocks and gold are always in competition with one another, at least over the longer term. That competition for investment money is apparent within the long wave seasons. When stocks are in favour with investors, as in spring and autumn, gold is not; when stocks are out of favour with investors as in summer and winter, gold is always the investment of choice. This can be seen by the highs and lows that the ratio achieves, typically at the end of the long wave seasons. In spring, which heralds the rebirth of the economy, stocks rise in sync with the growing economy. In the current long wave cycle spring (1949-1966), the DJIA increased in value from 161 points to 995 points and the Dow/Gold ratio peaked at 28.26. Summer (1966-1980/82) is always the inflationary season in the cycle and stocks are out of favour, whereas gold is purchased as an inflation hedge. The price of gold increased from $35.00 (U.S.) per ounce at the beginning of summer and reached $850.00 (U.S.) per ounce at summer's end in 1980, dropping the ratio to 1 to 1. Autumn (1980/82-2000) is always the speculative season in the cycle, and in this season, stock markets always make enormous price gains (4th. Cycle autumn-DJIA 777 points-11,750 points). The price of gold on the other hand experienced a bear market. During the long wave autumn of the current long wave cycle the gold price dropped from the summer ending $850.00 (U.S.) per ounce to $252.00 (U.S.) at the end of autumn. The Dow/Gold ratio as a result of the huge stock bull market and the major gold price bear market reached a record high of 43.85 in July 1999. That high signaled the end of autumn and the onset of winter, which is the most bearish season for stocks and the most bullish for gold.



I have on several occasions discussed why it is that stock prices have not adhered to the typical pattern of a winter stock bear market. In past long wave winter bear markets, while they have been devastating for stock prices, they have taken a relatively short time to run their course. For example, in the previous long wave winter, the DJIA reached the autumn stock bull market peak of 381.17 points on September 3, 1929 and the winter bear market was complete by July 8, 1932 at 41.22 points, which amounted to a little less than a 90% loss in price. Suffice to say, the present long wave winter bear market, which technically commenced in 2000 has been manipulated and controlled by the authorities and in particular the Federal Reserve. As discussed earlier that control is about to end and the ensuing bear market will overwhelm all attempts to forestall the natural process of a winter bear market.

This ongoing unscrupulous interference in the natural process of the stock market has contributed to a distortion in the Dow/Gold ratio in favour of the Dow.

It is evident that this perversion of the ratio occurred following the counter trend rally into August 2012 when the ratio reached a level of 8.26 following the ratio low of 5.78 in August 2011. Following that rally into August 2012, the ratio should have turned down to make a lower low than 5.78 if it had been following normal bear market price action, which until then had been a series of lower highs and lower lows. That was not to be.



Those of us who are in the gold camp can take solace in knowing that ultimately this ratio is going to fall to a minimum of 1 to 1. As I see it, however that ratio will drop to something significantly lower than that. I have long maintained the ratio will reach 1 to .0.25 or Dow 1,000 and the price of gold $4,000 (U.S.) per ounce. In other words, 1 gold sovereign (1/4 of an ounce) will buy the Dow Jones Industrial Average.

There is an old trader's rule that reads-"If a stock in a bear market hasn't made a new low in four months, it has probably seen its low for the cycle. Conversely in a bull market, if a stock hasn't made a new high in four months, it has probably seen its high for the cycle." The price of both the HUI and Gold have not made new lows in four months, thus according to the rule they have likely made their lows for the cycle and are now in a cyclical bullish phase. On the other hand, the general stock markets continue to make new highs, thus we can't use the four month rule to determine whether stock markets have turned bearish.

Company	Date price low	Price low	Current price*	% Gain
Gold	31 Dec 2013	$1,181.40	$1,307.34	10.66%
HUI	19 Dec 2013	$188.39	$240.97	27.9%
Agnico Eagle	16 Oct 2013	$24.66	$43.30	75.5%
GoldCorp	12 Dec 2013	$21.87	$29.81	36.3%
Detour Gold	25 Nov 2013	$2.88	$14.21	393%
New Gold	3 Dec 2013	$4.99	$6.83	37%
Timmins Gold	20 Dec 2013	$1.00	$1.94	94%

* Closing price Monday July 14, 2014

These are just a few examples of Gold, the HUI and some producing gold companies that have not made a new low in four months. There are some juniors that I have quickly analyzed which are in the same situation, these include Almaden up 43.5%, Brazil Resources up 100%, Dynasty Metals and Mining up 230%, Premier Gold up 148%, Terraco Gold up 135%.

Using this traders 'yardstick' we can conclude that the price low has already been reached for gold and for gold equities and that we are now at the start of a new bull run, which should ultimately take prices to record highs.

Although the price of gold has not made a new low in the past 4 months, it requires less than a 10% drop in the price from current levels to make a new low price. Can this happen? Of course it can, the price of gold has always been manipulated during fiat currency eras. Eventually, however, the desire to own gold and transact in gold, effectively destroys any official attempts to force paper currency as the medium of exchange. (Review John Law's and the Assignat paper currency schemes in France about which we have written extensively).

When prices turn from bearish to bullish, the turn fails to be recognized by the majority of investors because they remain a part of the bearish crowd. It is for this reason that at the beginning of a new bull market prices rise slowly. Any set back to the price advance brings selling from frightened investors, who think that they may have jumped in early and that the bear market is actually still in vogue. Hence the saying, "all bull markets climb a wall of worry." That is true during the initial stages of the bull market, but near its climatic conclusion the only 'worry' that remains is 'how can I get more'?

So for stocks at this time, the question you are all asking is "how can I get more?" Well, you can borrow through margin to leverage yourself. However, you are already doing that. You and many others are margined to the hilt and have collectively taken margin debt to record levels. But what's the worry? Everybody is just so bullish. There's talk about the bull market lasting another ten years and the Dow reaching 44,000. "Wow, that's more than a double from here, just think how rich we are all going to be."

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LONGWAVE group

"Gold? Are you crazy, you can't make money in that rubbish; just look at what happened to the price yesterday, down 32 bucks and down another 12 today. It's a loser and I'd much rather be in with the winners and that's why I am in stocks and making lots of money. Gold is only for gold bugs and most of them have been crushed, ha, ha, ha."

Written By: Ian Gordon