

THE GOLD DISCOVERY LETTER

A Newsbrief focussed on Gold Discoveries and critical drivers for Gold

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HUI - Not Dead Yet !

EDITORIAL

by Eric Hommelberg

"If you are lucky enough to buy into an exploration company that makes a discovery, you can effectively buy your own auto teller machine. Some of these things are just phenomenally profitable."

John Bridge
Senior Gold Analyst
at
J.P. Morgan Chase & Co

Sold your gold shares this week ? Afraid of the high COT open interest numbers ? Too many analysts calling for a major top ? So therefore there must be a top ? Well, since nobody can predict the future maybe they're right. Sure enough the HUI – crash of this week was a scary one and yes, the HUI could drop even a bit further from here but the question arises if this will be a major top indeed. Should we prepare for another down-cycle here or could this be the last short correction before taking out its long time resistance at 250 ? Again, nobody can predict the future and neither can I but the relative Gold/HUI charts are telling me that we're nowhere near a major top yet and that there's plenty of upward potential left. This piece examines the relative Gold/HUI charts and compares the present situation with the one of July 2003. The similarities are striking and the conclusions stunning.

In May of this year I wrote my piece 'Gold/HUI Divorce part II' in which I made the case for higher gold-share prices since they were oversold to such extremes that something simply had to give. Extreme over/under-valuations never persist for a long period of time and the pendulum always swings from one side to the other. So I argued that after witnessing these extreme oversold levels (severe overstretch of its own 200 dma to the downside) in May we could expect a return towards more 'normal' levels (200 dma) regardless of the current trend (bull or bear).

It's simple, no single item can escape its own 200 dma permanently. So when for example the HUI moves too far ahead from its own 200 dma and gets over extended gravity will pull it back. Therefore deeply oversold conditions in the HUI are therefore mostly followed by sharp upward moves regardless of the current trend (bull or bear).

The 200 dma deviations (actual reading vs its own 200 dma) never exceed a certain limit. I mean we'll never witness a HUI trading at 5 times its own 200 dma (for that to happen the HUI should be trading around 1000 pts today !!). During the HUI bull market over the last 4 years, the HUI only exceeded its 200 dma by 40% (times 1.4) twice. On the downside the HUI only dropped below its 200 dma by 10% (times 0.9) twice.

So by charting the HUI against its own 200 dma and marking the 40% and -10% areas as being selling/buying zones you should get a good indication of its current condition (overbought/oversold). It's a simple concept which picks the extreme over/under valuations quite easily. This concept has been given birth by gold-writer Adam Hamilton. He dubbed this whole concept into 'relativity' and wrote some brilliant pieces in which he practiced this simple but powerful concept (eg The Relative Dollar and Gold).





The relative HUI chart gave a screaming buy in May of this year and again it has proven to be a reliable indicator for picking major bottoms indeed since the HUI gained almost 50 points since then. But where are we now ? Is it time to sell ? Are we at a major top indeed ? What are the relative charts telling us now ? Are they telling us to sell ? Are they pointing to more upside potential ? Enough questions here so let's take a peek at the relative HUI chart straight away :



The charts on next page are detailed HUI charts of the 2003 and 2005 periods. See how striking the similarities are :





So what do these charts tell us :

- There's a striking similarity with 2003, three major approaches towards a long-time resistance line (155 and 250)
- In July 2003 the HUI made its third attempt to break the 155 mark but it seemed to fail. The HUI dropped back rapidly to 140 but then took off and never looked back. The analogy with 2005 is astonishing. Also three attempts have been made to slash the 250 mark and again it seems to fail since the HUI dropped to the 215 mark.
- There's plenty of room left for the relative HUI to the upside before hitting previous major top indicators (previous major tops occurred at rHUI >1.45 while current reading =1.05)
- This chart doesn't tell us anything about the HUI chances to break its long-time resistance of 250 soon since that largely depends on the price of Gold coming months

Another striking similarity with 2003 concerns current sentiment.

Sentiment 2003 vs sentiment 2005

The bearishness in 2003 after failing to break its long-term resistance of 155 is similar as that of today. Bill Murphy of LeMetropoleCafe reported on July 15, 2003 :

July 15, 2003

The gold shares were annihilated. The HUI dropped a sizeable 8.23 to 143.61 and the XAU fell 3.66 to 74.78.

The HUI broke down out of its wedge formation instead of up and also broke its long running up-trend. END.

Needless to say most of the analysts were on the sell-side (just like today). Bill Murphy quoted the very next day Gold Analyst Mike Norman who advised to sell gold stocks and to short Newmont. (Newmont traded at 31\$ these days).

Mike Norman

Still time to sell gold stocks

7/17/03 10:11 AM ET

Bullion price is breaking down due to a slew of bearish factors that include:

- a.. Rising interest rates
- b.. Economic improvement
- c.. Resumption of hedging



d.. Rising output

e.. Falling jewelry demand

Gold stocks have held up because the current price is very profitable and producers have begun to lock in that price by selling forward. Ultimately, gold stocks will follow bullion prices lower.

Short NEM (31\$) END.

(Bill Murphy used this quote in order to reflect the bearish sentiment, needless to say that he opposed these kind of bearish views strongly...)

Well as we've seen in the HUI 2003 charts this correction only preceded the final attack on its long time resistance at 155, this time taking it out and never looked back. Those who shorted NEM at 31\$ couldn't have done it at a worse time than this since NEM rocketed all the way to 49\$ in just 5 months only.

Investors thinking about shorting gold stocks these days should pay attention to what happened in 2003, there's no rush to sell imo.

Conclusion : There're a lot of similarities with July 2003 indeed today and the relative HUI chart does not rule out a repeat of this scenario (HUI blow-off like what happened in the second half of 2003) since previous major HUI highs occurred at much higher rHUI levels (>1.45 vs 1.05 current)

OK, but a lot depends on the price of gold coming months, so what about gold itself ? Are we at a major top indeed ? Is there any upward potential left ? What does the relative Gold chart say ?

SEE RELATIVE GOLD CHART ON NEXT PAGE :



What does this chart tell us :

- Gold is making new highs these days. Whenever gold made a new major high before it did so by hitting a rGold of at least 1.13 or more. Since current rGold reading is just a mere 1.07 it ain't very likely this will mark the new major top.
- Every previous major top was being reached after a minimum of 4 months after the rGold chart had flashed a major 'BUY' (green zones). Since the latest major 'BUY' signal generated by the rGold chart is only just 3 month young it ain't likely that we've hit the new major top already.



Conclusion : The rGold/Gold charts don't rule out a further advance of gold. If Gold would reach a new major 'HIGH' based on previous rGold readings then we shouldn't be surprised to see \$500 by end of this year. (1.15 * 434) (1.15 is an average of previous rGold highs and 434 gold's current 200 dma)

A new high in Gold could launch the HUI beyond its long-term resistance at 250 thereby providing it a free ride towards the 300+ area...

- END -

Did you enjoy this analysis ? This kind of analysis will be integrated in our up-coming monthly issue of the 'Gold Discovery Letter' which is scheduled for October 29.

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