



The Golden Bull

I'm bullish on "things"

by Jim Puplava

The Basics on Market Cycles

One of the central tenets of technical analysis is that markets run in cycles. We have bull cycles where an asset class is in a rising trend and bear market cycles where asset classes move in downward trends. A trend is a time measurement of the direction in price levels. Within a market cycle, three trends make up that cycle. They are the **primary trend**, the **intermediate trend**, and the **short-term trend**.

The primary trend is the longest lasting trend and its cycle can be as short as 9 months or as long as 2-4 years. In some cases, you can have extended cycles that last several decades as we saw in equities from 1982-2000. The intermediate trend is a trend that runs in the opposite direction of the primary trend. Its length can be as short as six weeks to as long as 9 months. In a bull market, an intermediate trend would be a correction period where prices fall in the opposite direction or in a bear market prices rally for a short period. Then there are the short-term trends that can last from 2 to 4 weeks. Short-term trends usually interrupt the course of the intermediate trend.

A typical market cycle is shown in this illustration. As you can see, the primary trend, which is longer lasting, is interrupted periodically by intermediate trends, which in turn are punctuated by shorter-term trends. As the reader will clearly see, no trend goes straight up or straight down. This may be news to many new investors who came into the stock market in the mid-90's.

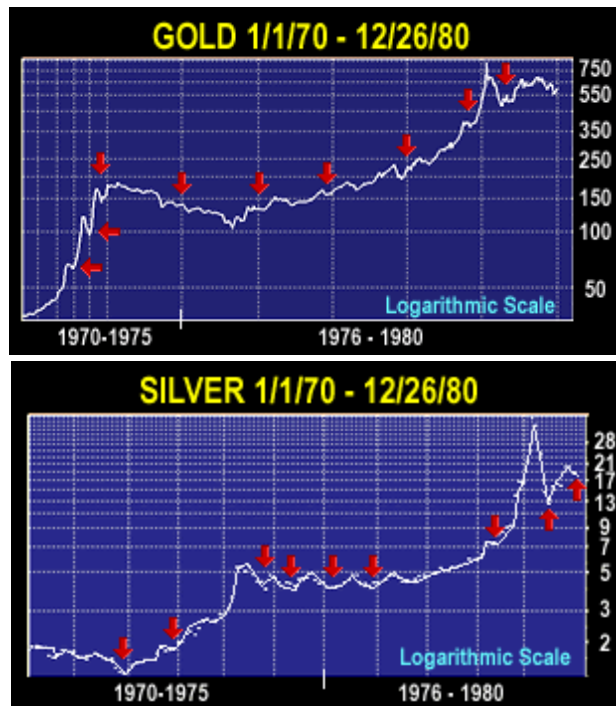
The mid-90's was a special period where stock prices went up double-digits each year and were only punctuated by brief short-term corrective trends. Most investors who owned stocks or stock mutual funds during this period saw their investments appreciate almost every month. However, every market cycle has these three trends embedded within its cycle. The point to understand is that in every bull or bear market there are short-term trends that run counter to the primary trend. Therefore, an investor should never expect to see their investments continue to run straight up. In fact, when investments run straight up in a break out move, you can expect that trend to correct just like the laws of gravity.

Gold's Current Market Cycle

This brings me to the current state of the gold market. After two successive years of spectacular gains, the gold market is currently going through a correction. Part of this correction is natural since many of the gold stocks had become overpriced and overbought. Technically, when this happens, traders begin to take profits and a countertrend follows. This is especially true when prices rise and reach key resistance levels. The \$380-\$400 level on gold was one of these key levels. As show on the weekly chart below the \$380-\$400 level has acted as both support and resistance for gold prices over the last decade.

It is not surprising then that when prices rose and breached these levels, they were quickly repelled as traders took profits thinking that the price could not hold. Since then gold has been in a corrective phase finding key support at around the \$325-\$330 level.

In a bull market, old resistance levels become barriers for price movements. They will be continually challenged and repelled until some new element of news or a change in fundamentals causes the trend to breakout. It is similar to a medieval siege. There will be a constant battle between buyers and sellers at these key resistance levels. There will be several attempts at challenging these key resistance levels until such time that buying power overwhelms selling power and the resistance level is breached. This last siege or battle took place at the \$325-\$330 level as shown in the chart above. This level is now acting as a key support level. Once resistance levels are breached, they in turn become support levels when prices correct. Note the charts of the last 1970s bull market in gold and silver below. There were corrective periods where the price pulled back as noted by the red arrows. However, also note that the primary bull market resumed it's upward trend. In other words, it is normal for any market cycle--whether it is bull or bear--to go through corrective countertrends.



Recognize the Primary Trend

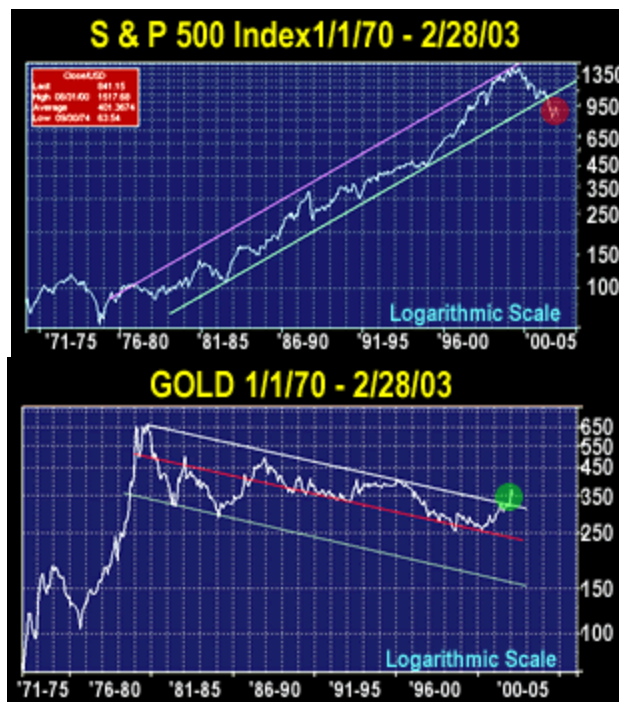
Having discussed the point that markets run cycles and that within a cycle there are corrective trends it is now important to look at what is the primary trend of the markets. As I wrote in [The Next Big Thing](#) and what [Marc Faber](#) has written before me, investors need to make only a few key investment decisions in their lifetime. If they can get on board a primary trend in its initial stages and then have the patience to ride that trend until it is discredited, they would do very well as an investor. In the last half century, there have been four key primary trends and investment themes where an investor could have done exceedingly well as an investor. They are listed below:

1. **U.S. stocks 1952-1966**
2. **Gold/silver and commodities 1971-1980**
3. **Japanese stocks 1980-1989**
4. **U.S. stocks, especially technology 1990-2000**

If all that you did were to find these trends, get on board and ride them out, your investment decisions would be simplified. On a similar note, it is what has made Warren Buffett the second richest man in the world. Buffett invests in companies with a durable competitive franchise and then has the patience and good sense to hold on to them. His investments in Geico, Washington Post, Coca Cola, American Express, and Gillette were made and held for as long as three decades resulting in an annual gain in book value of Berkshire Hathaway of 22.2 percent a year. Very few investors have realized that return because there are very few investors that have his insight and patience.

Maybe it is difficult to replicate Buffett's genius in ferreting out great business franchises, but it is possible to duplicate another element of his success, which is patience. If you can spot a new bull market or a new primary trend and then get on board and ride it until it is completed, that is how big fortunes are made.

The next set of charts show the last and newest primary trend in the financial markets. The last or old primary trend, which is breaking down, is the U.S. equity markets. The new bull market or primary trend is in the metals market as shown in the charts below. It should be pointed out that it is only in the third and final stage of a trend that the public becomes interested. The first stage of a new trend is made up of insiders or *smart money* that moves in early, buys at a cheap price and then rides the trend to completion. In the final stage of the trend when the public jumps in and drives prices up to maniacal levels is when the *smart money* moves out and sells. Does anyone remember the insiders selling tech stocks and cashing out in 1999? It may be noteworthy that Bill Gates has been a major seller of Microsoft stock in the last month as Microsoft has rallied along with the NASDAQ.



A New Bull Market in Metals

It is clear from the charts above which market is in a bull trend and which market is in a bear trend. Metals have begun a new primary bull market. The reasons are simple and are listed below:

1. **Supply/demand imbalances which have created bullion deficit**
2. **Large U.S. current account deficits**
3. **Breakdown of the monetary system and the drop in the dollar**
4. **Distrust in paper assets and their substitutes**
5. **Depression and war**

All of these elements are now in place, which is why gold is in a new bull market.

I have written extensively on these subjects in my [Storm Series](#) and [Storm Watch Updates](#), so I won't elaborate any further other than to point out that gold and silver are *money*. When paper assets start breaking down or are depreciated, gold resumes its historical role as money. Fiat currencies or freely floating currencies are inherently unstable. There is nothing backing them and governments can freely print as much of them as they will. Fiat currencies have a poor record of maintaining their value. Eventually paper money systems break down and governments turn back to some form of a gold-backed currency. It is the only way to bring stability to a monetary system.

In addition to gold and silver acting as the only form of real money, we are also dealing with major supply and demand deficits. Both gold and silver have been running supply deficits for over a decade. Readers of my articles may be familiar with the charts of gold and silver deficits as well as draw downs of aboveground stockpiles. I have featured in previous articles, but I believe they are important enough to show them again. My reason for showing them is that you cannot run supply deficits of any commodity forever. Eventually you run into shortages and higher prices. Wall Street and the financial press would have you believe that deficits and lower prices are the natural state of affairs for gold and silver and will always remain so. In other words, prices will always remain low and mining companies will continue to produce these metals at a loss. Does this make economic sense? Why would you go into the mining business or stay in the mining business, if you could not earn a profit? In fact, because of the bear market in gold and silver, many companies have gone out of business or have been taken over by larger companies. These actions have not increased supply.

Today leading mining companies acknowledge that the production of gold and silver will decline over the next decade. Lower prices have discouraged new exploration even while worldwide demand has expanded. Outside western industrial nations, investments in gold and silver are much more important to lesser-developed nations. The developing world, which does not have established financial markets gold and silver, are the preferred investments of choice. As Asia becomes a center of economic power in this century and in this decade in particular, investments in gold and silver will become more important. There are already movements in Asia and in the Middle East to go to gold-backed currencies. Gold and silver are slowly transitioning back to their historical role as money. This is an important point to remember as you view the deterioration of paper assets over this coming decade. We have already experienced our fourth year of negative returns for equities here in the U.S. With these facts in mind and in reference to the charts above, it is clearly established that equities are in a bear market and gold is in a new bull market.

The Current Lull in Metals

I have already mentioned that within primary trends, there are countertrends that emerge periodically. Gold and precious metal equities are currently in one of those countertrends that should shortly end over the next few weeks. The average investor and professional money manager is still chasing the last primary trend in the belief that equities are in a new bull market that began last October. Professionals are bidding up the shares of tech stocks, Internet companies and many of the growth stocks of the last bull market. I believe this is only an intermediate trend that will not last long as more news on the economy, earnings, and war finally put this trend to an end. It is still possible that we could get a 10-15 percent move in the markets if the war goes well or when final victory is achieved. However, this temporary rally will be short lived. Fundamentals are now running strongly against a long-lasting bull market in stocks unless the Fed starts its own mutual fund and starts monetizing the equity markets. As ridiculous as that sounds, they have written papers on this very concept. Currently in Japan, the government is propping up the markets by buying shares in bankrupt banks in order to prop up their banking system. It could happen here. However, this will not detract from the strong fundamentals that now favor precious metals equities.

The Establishment's Bias Against Metals

They're Not Prepared

Remember that when a new trend first emerges, it is most likely to be discredited by the establishment. Wall Street has no interest in seeing gold and silver bullion or precious metals equities rise in price. The government has no strong love of gold because it discredits its own paper. A rise in gold and silver serve as a barometer of investor fear or distrust trust in paper assets. So don't expect any encouragement from Wall Street or Washington. All you can expect from the establishment is disinformation and discouragement. They have a stake against metals. Wall Street is in the business of selling paper and Washington is in the business of printing paper. The Street doesn't follow the sector and isn't set up to handle a major bull market in precious metals equities. The precious metals equity sector is too small. Total market capitalization of all the world's metals stocks is somewhere around \$70-\$80 billion or about a third of the market cap of Microsoft. There aren't enough precious metals equities to make it worthwhile to follow the sector. The commodity markets in actual bullion are even smaller.

Positioning Against Metals

In addition to no interest in the sector, the financial industry has taken positions against the metals sector. In the commodity markets commercials hedgers have made fortunes shorting the metals still and do so today. This is evident in viewing the major short positions in both gold and silver and the monster derivative positions on the books of major bullion banks such as J.P. Morgan Chase and Citigroup. In addition to their short positions in actual bullion, Wall Street and the financial community is also short the precious metal equities. Below you view the table of the current short positions in major unhedged gold and silver producers. With the exception of a few recent short coverings in a few companies, short positions have gone up every month since the beginning of last year. These short positions increase every time the metals shares rally. This is remarkable when you consider the float of many of these company shares and especially considering that *strong hands* hold many of these companies.

The Dis-Advantaged Advantage

There are many in the gold camps that are disgusted by this short selling. They shouldn't be. Just as investors have the right to sell short stocks, investors or institutions have the same right to sell short gold and silver equities short. I say God bless them for doing so. It tells me that when short positions get this large, those short sellers are going to have to eventually cover their position. Given the very thin nature of the precious metals and equity markets, and the fact that *strong hands* hold many of the shares of these companies, there will some day be a major short

squeeze. I love the fact that they are doing so, because in effect they are subsidizing my purchases. Each month either for my own account or for my clients, I buy shares of these companies. These shares are going to be taken out of circulation. I especially favor well-positioned juniors that I believe will be taken over by majors or mid-tiered gold companies. The market for these shares is even thinner, and the companies we purchase are held by not only the owners, but by fund managers who believe in the sector.

If you believe as I do that precious metals are in a new bull market and that this new bull market is still in its early formative stage, then you want to be accumulating shares and bullion. When you have willing accomplices that are dumb enough to subsidize your purchases, then why not take advantage of their offer? Do you want to wait until the new bull market becomes obvious to everyone? In the last great bull market in equities the vast majority of investors bought into the market after 1995. They became investors only during the final third of the bull market.

Bull markets have three phases to them. The first phase occurs when insiders and the smart money discovers the trend. They move in early and take their positions. Eventually this trend becomes obvious to professionals and institutions who buy into the trend during the second stage of the bull market. Finally, during the third and final phase of the bull market the public finally catches on. It is actually in the third and final phase of the bull market when the public jumps in that you see the most spectacular gains. You can see this trend not only in the chart of the last bull market in commodities in the late 1970s, but also the last bull market in equities beginning in 1995 and running all the way to early 2000.

Strategy: Accumulate & Hold

So how do you take advantage of this new bull market? You begin buying and holding your positions. The gold market has a habit of exploding on the upside unexpectedly. So if you don't own any shares or bullion you will not participate in the early stages of the move. As Bill Murphy of GATA is fond of saying, "Got to be in it to win it!" There are many who favor trading in and out of the sector, which is fine if you are adept at trading. This strategy may work well inside of a pension plan. But because all short-term gains are taxed as ordinary income and are subject to the highest tax rates, you should plan on holding the majority of your position. One thing Warren Buffett has learned well--besides having patience with his investments--is tax strategy. By holding on to superior investments, he has avoided paying income taxes. Furthermore, when he does sell out positions, they are taxed at more favorable capital gain rates. For these reasons as well as the difficulty of timing, I would suggest accumulating your positions over time and then holding on to them. This strategy works well in the early phase of a bull market. You are buying when prices are cheap. Constant trading in and out of equities can be difficult and I have never met a trader who has had a perfect record.

Strategy: Discipline

If you believe that this is just the beginning stages of a new bull market, then relax. Hold on to your shares and don't panic every time a countertrend develops. Instead, plan to add to your positions during every corrective phase. Even simpler would be to dollar-cost-average your purchases. I favor this approach at this stage of the new bull market because it is just beginning. You can do so easily with actual bullion or coins depending on your financial circumstances or with a gold mutual fund. I favor dollar-cost-averaging because it creates discipline, which is completely lacking in the gold camp at the moment. Many new investors have tried to time the market without much luck due to improper training and technical skills. Since we are still in the early stages of a new bull market the disciplined approach of regular purchases is favored.

Instead of focusing only on price, start thinking of quantity. Start thinking in terms of how many ounces or shares you own. Lastly stop worrying and fretting every time share prices or bullion prices drop. Instead, view them as buying opportunities. Your goal at this point should be to accumulate as many shares or ounces as you can during phase one of the bull market. You should also try to familiarize yourself with the fundamentals as much as possible. This will not only help you understand the new bull market, but also keep you from panicking every time there is a correction in the price of bullion or the precious metals shares.

Metals Weather The Storm

As shown in these charts, whether it is deflation (1930s) or inflation (1970s), gold performs well as the ultimate insurance against either economic condition. This is because it resumes its role as *real* money. In the 1930s, when Americans weren't allowed to own physical gold, you could have owned gold mining stocks such as Homestake Mining. Homestake went up almost ten-fold during the 1930s. In addition to asset appreciation, an original investment in Homestake was returned in the form of dividends that fully repaid the original investment.



During the inflationary 1970s, Homestake Mining also performed well and protected investors from the ravages of inflationary policies pursued by the government and the Federal Reserve. During the 70's, Americans were once again allowed to own physical gold. So bullion led and outperformed many of the gold equities as reflected in the Toronto Stock Exchange chart which serves as a proxy for gold shares.



So, whether we suffer through severe deflation or severe inflation, gold and silver bullion and precious metals equities are the ultimate economic hedge during periods of economic and political uncertainty. It is the ultimate hedge insurance against financial storms.

One more point...

Note that even during the gold bull market of the 1930s and during the 1970s, there were periods in which during the primary bull trend, there were corrections. These were ideal times to add to positions. The primary trend resumed its course.

I believe the current correction in gold is in one of these times. Gold and silver will resume its primary trend of a long-term bull market.

In summary, gold and precious metals are now in the early stages of anew bull market. This is evident by the charts up above. This new bull market will go through corrective stages and periodic pullbacks. These periods should be used as opportunities to add to your holdings. As the charts of Homestake Mining during the Great Depression and the commodity bull market of the 70's indicate, bull markets in "things" can last a long time. Please take time to review these historical charts. Ponder them. Once you reflect long on the picture they tell, I believe you will come to the same conclusion as I have. You only need to make a few investment decisions in your lifetime. If you can discover a new trend and get on board that trend early and then ride that trend until it ends, that is how real fortunes are made.

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