Is Gold as an Investment Finished?

Before delving deeper into that question, perhaps we should see what the mainstream media thinks. In fairness to the MSM, we note there are plenty of articles on both sides of the debate. Yet there has been some media piling-on since the recent hard breakdown in gold. The aptly named Howard Gold explains:

**The Case for Owning Gold Has Collapsed;** Yellow metal could be headed much, much lower
http://is.gd/h5KW6v.

Gold could be headed not much lower, but much *much* lower. This was written on April 18, when the value assigned to the monetary relic (AKA its nominal price) resided at $1391 per ounce. So be warned, Mr. Gold advises that gold could go much *much* lower. Gold bugs take heed; Mr. Gold himself has put the double ‘*much*’ whammy on you!

After critical support at 1524 was lost our first downside target of 1440 or so was sawn through like Balsa Wood. Okay fine. For those who micro manage every tick in the price of gold (I am not one), then here is the situation; the current little rebound must extend back up to and through the broken support level at 1440 or the next target in the low 1200’s is up next.

See the weekly chart on page 3, which was produced 5 weeks ago in NFTRH 230. While not a favored outcome, recent events with gold’s price are not surprising.

To review, the two potential points to watch for in the event of a breakdown from 1524 were the weekly EMA 200, which supported the 2008 decline and then the conservative measurement from the pattern breakdown, which is in the low 1200’s, which also includes a visual support shelf from 2010. The less conservative measurement (the top at 1900 to 1524) would target around 1150.
So that is the price picture, now on to the fundamentals courtesy of Mr. Gold. From the article linked above:

“But gold’s price could be headed much, much lower, said Campbell Harvey, a professor at the Fuqua School of Business at Duke University. Harvey has looked at gold prices over the centuries, and concludes that it’s still trading at lofty multiples of inflation.”

In the article linked above there is another link where you can download the research of Mr. Harvey and colleague Claude Erb – currently making the rounds like a good gold bug horror movie – that talks about gold’s “real” price as measured by CPI and GDP. Boiling it all down, gold is historically over valued as compared to measures of the effects of inflation on consumer prices and relative to GDP.

We will steer clear of the debate about government number fudging, because it is a battle that is not necessary. The Federal Reserve and many of its counterparts around the globe are inflating, or trying their damnedest to inflate. They are using debt instruments to create money out of nowhere and pumping it into big banks, which are supposedly expected to release the money out to the public.

This could one day manifest in an out of control inflation problem (as measured by the lagging effects that Harvey and Erb call inflation, or resolve into a more intense deflationary phase as the thing that is just a whiff now gains momentum and swallows the entire spectrum of inflated assets in one big gulp of illiquidity.

The economy has depended on inflationary policy since the age of Inflation on Demand began under Alan Greenspan’s oversight in and around 2000.

Ask yourself this; why are they inflating? Why are they printing money at a furious pace if the GDP is real and sustainable? The answer is likely because they know that the financial system is a leveraged thing that must not be allowed to start deflating because if it starts deleveraging, it is not going to stop until the books are cleared.

Gold vs. Commodities, What is the Message?

The authors noted above measure gold’s ‘real’ price in CPI and GDP. Here we have always measured it relative to the commodity complex, which is generally positively correlated to the global economy. Above is gold vs. the CCI commodity index.

I had originally thought that a decline to the lower moving average would come with a continued economic bump, stock bull market and inflation-fueled commodity bounce. But instead, gold has tanked vs. commodities even as...
a deflationary pull starts to take hold with signs of economic deceleration, commodities down and the stock market potentially in some kind of a topping process.

Yet the ‘real’ price is still in a secular uptrend because the ratio has held above another parameter point we noted as important. If the blue arrow is confirmed by turning green one day, the message will continue to be a secular era of economic contraction, which has thus far been fought tooth and nail by inflationary policy. That is and has been the case for gold since day one. Not the case most gold bugs root for, which is inflationary effects, the likes of which are used as data points by Harvey and Erb. See?

Of course Harvey and Erb scare the gold “community” because a majority of the “community” sees gold as a hedge against higher prices. If the above chart breaks down and makes a lower low to the spring of 2011 (the height of the last commodity/inflation blowout) then we may have to admit Bernanke wins, Draghi wins, BoJ, China Central Planning and all other inflators win. They will have managed to create sustainable economies literally out of thin air.

The alternative to that is hyperinflation, where an asset grab of epic proportions could engage with gold under performing things you can actually eat, keep warm with and use for fuel. This asset grab would come out of a debased monetary system.

More realistically however, we might look for the real price of gold to gain support in its secular uptrend. This would see economic contraction and by extension, further decline in commodities and stocks markets. We have noted all along that the nominal gold price can decline in this environment, so people should know why they own the thing. Also, getting out of the ‘death of the dollar’ cult might be wise as well.

The USD, as long as implied confidence in our leaders remains intact, may be pulled upward with the real price of gold as a contraction phase bites harder. This is the world’s reserve currency in which a majority of global transactions are settled. As long as this remains the case, there will be claims on Uncle Buck. USD, as of the moment, is liquidity within the system. Gold by the way, is liquidity outside the system.

The average gold bug’s worst enemy is… the inflation tout. It is not the government or the big banks. It is the individual’s expectations of a lump of shiny metal. If they have not gotten this simple concept yet, after the recent damage, I am afraid they will never get it. And they will puke up their gold, which failed to protect them from the dreaded inflation that wasn’t.

**Bottom Line**

The “dreaded inflation” is measured in the mainstream by prices (CPI, etc.), not policy-making actions. Gold is a barometer and the pressure it would indicate could be inflationary or deflationary.

If one day you see the gold price skyrocket, then be prepared for a coming (lagging) inflation problem that would indeed eventually show up in prices. This could propel commodities, resources, productive economies and even stock markets to new heights.

If on the other hand gold just hangs around or declines, yet the ‘real’ price as measured in commodities rises again, the backdrop would be one of continued economic contraction and declining asset prices.

The third alternative is the least likely; gold hangs around or declines and yet the ‘real’ price loses its secular uptrend. This would indicate a sustainable economic expansion, created by inflationary policy has engaged. Thus
far, inflationary policy has served to build in distortions that subject the system to extreme liquidations. That right there is the continuing case for gold – and for the time being I might add – cash, lots of it.

Okay now, that’s the theory. I have got a technical report to write, so let’s get to it. NFTRH 235 then goes on to review the technical pictures of the precious metals, precious metals stocks, commodities and stock markets in an unbiased manner. This has kept the analysis on the right side of the markets throughout recent dynamic events. If you would like a hard-working service that does whatever it takes to be prepared for what the market throws at us, consider a subscription to NFTRH.

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