Gold outlook

The analysis below on gold is based on blending fundamental and technical indicators into charts for better representation.

The chart below is on a monthly basis for the last 20 years. Since 1999 gold is in a clearly defined uptrend with positive returns each consecutive year. However the rate of return is decreasing in the last couple of years suggesting the upward potential is exhausted on an annual basis.

Change in price of gold for the period 1993 – 2013

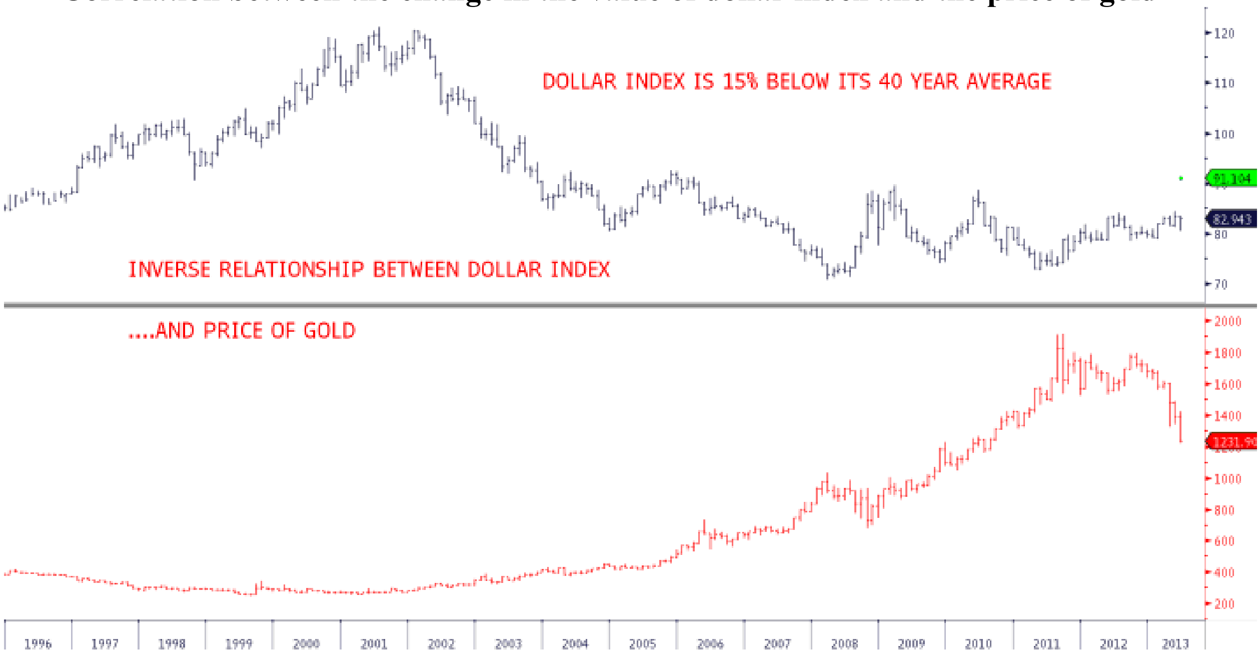
Weekly chart of gold for the last 10 years

The chart above is on a weekly basis for the last ten years with the respective 50- and 200- period averages. In mid April after intense sell-off gold broke below its long-term psychological support of the 200-week moving average which suggests change in trend and the establishment of a new downtrend.

Next chart displays gold on a daily basis. After successfully testing its long-term support at $1530 for almost 2 years gold finally broke below it in mid April, and further extended losses. It should be noted that the levels at $1530 (ex-long-term support) are almost 20% below the absolute peak reached in September 2011 at $1923. I.e. after the break below $1530 gold is officially in a bear market.

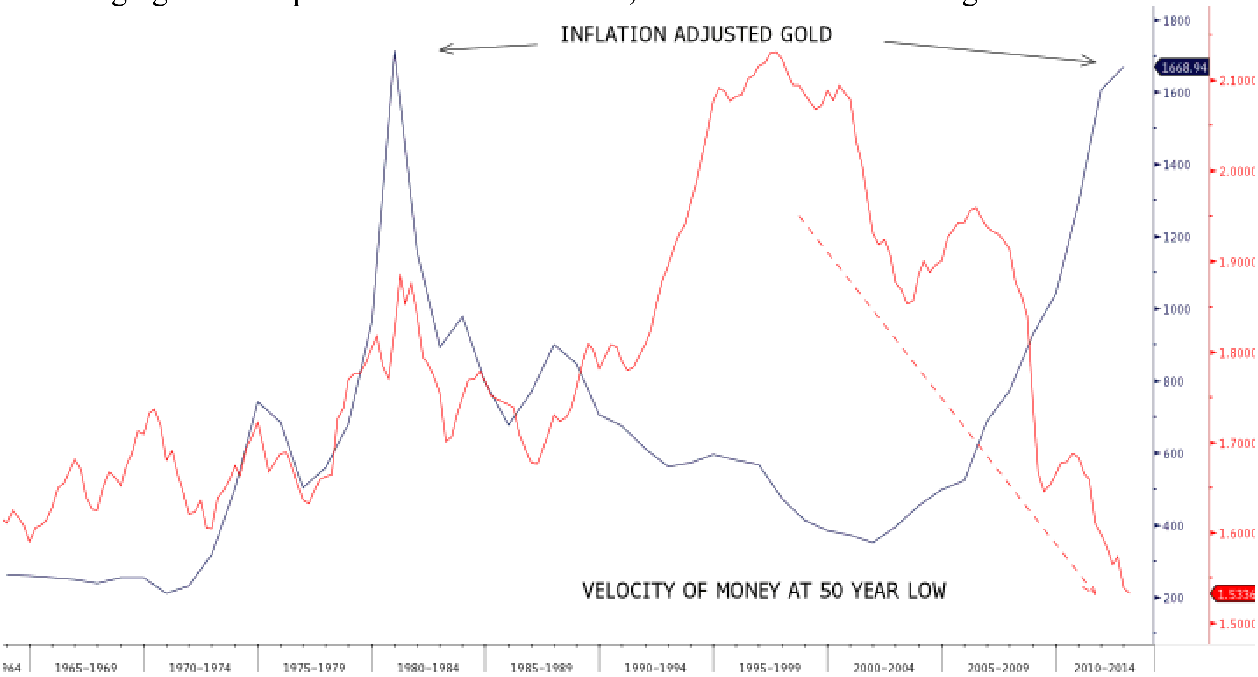
The monthly coefficient of correlation between dollar index and gold is at -0.454 which pretty well explains the change in price of gold due to changes in the value of the dollar index. The inverse relationship is quite visible on the chart below.

Correlation between the change in the value of dollar index and the price of gold



Since 1999 till 2008 the index has a clearly defined downtrend. In the next three years has formed a double bottom with support at 71, while gold was in impressive uptrend in the same period, and started deteriorating since 2012. Furthermore, gold registered its lowest level at $290 just when the dollar index hit its high at 160. Current levels of the index are around 15% lower than its forty year average, and if the uptrend continues lower levels in gold should be expected.

Inflation adjusted gold (blue line in the chart below) hit a double top which confirms the expectations for lower gold prices ahead. One of the pillars of buying gold so far was the fear of extreme inflation. Due to the unprecedented money easing the fear of high inflation seemed quite reasonable but the red line in the chart below negates this idea. It show the velocity of money in the system which hit a 50-year low, i.e. there is a process of deleveraging which explains the lack of inflation, and hence the sell-off in gold.

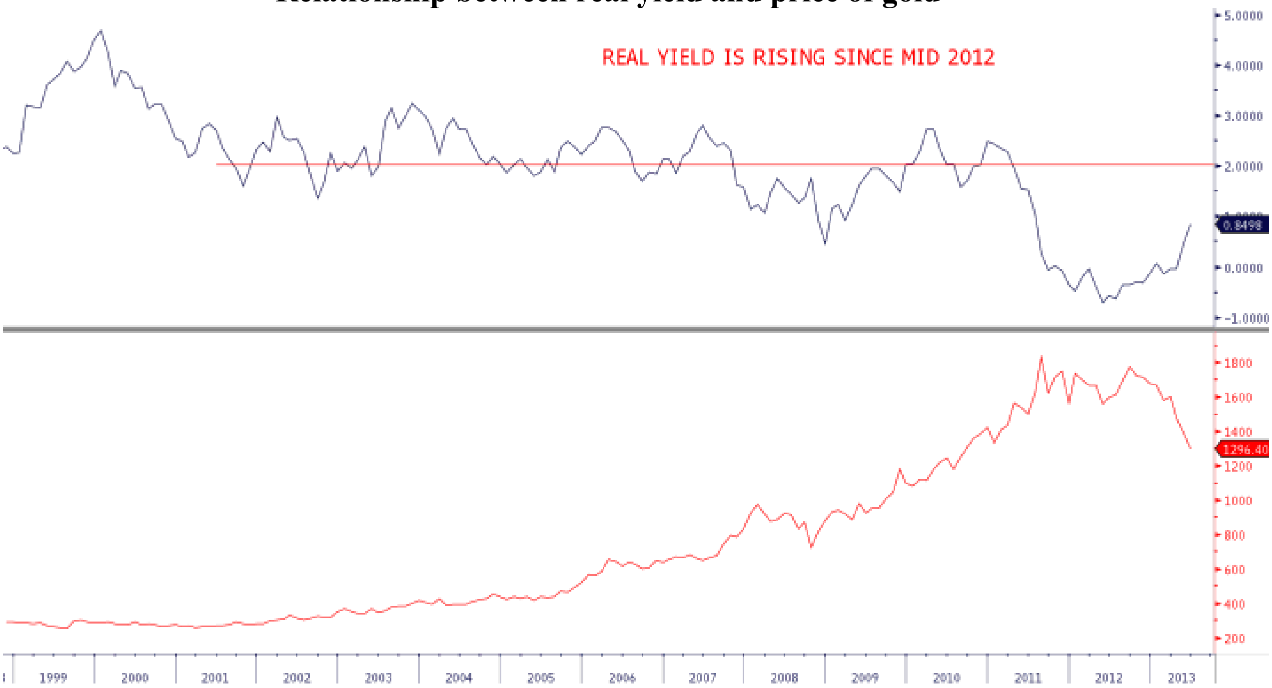


Index of inflation expectations

Additionally, the index of inflation expectations broke below its two-year uptrend line confirming the downtrend in gold price.

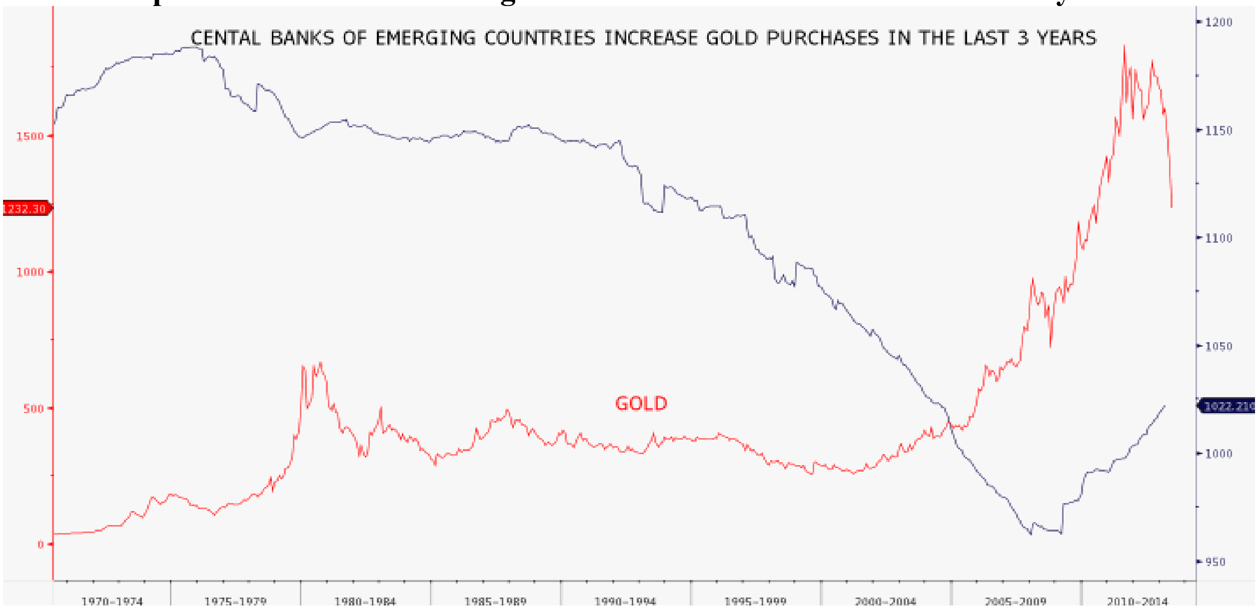
The chart below shows the relationship between real yield and price of gold. When real yield declines, and especially when it is below 2%, this is usually the time to own gold. Since mid 2012 the indicator is rising which coincided with the double-top formation in gold prices. While real yield maintains its uptrend the implications are for lower gold prices, although the values of the indicator are way below the threshold of 2%.

Relationship between real yield and price of gold



The above mentioned indicators, relationships and chart suggest a negative outlook for gold. On the demand side gold find strong support from the central banks of emerging markets. For the last three years the demand for bullion from those countries has increased significantly. Over 15 million tr oz have been purchased only in 2012 which is an absolute record for the last three years. The fact that current gold price is over 30% below its peak at $1923 may entice more buyers, and support the price of gold from further decline.

Sharp increase in demand for gold from central banks in the last three years



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