

September 16, 2011

The Weekly Peak

Gold to Fall By 50%

There are Wedges and then there are Wedges. *This is a Wedge.*



More specifically, it is a massive and bearish **Rising Wedge** formed over the last five years and its **target range** is **\$555** to **\$1,045** per ounce.

This long-term pattern in gold's monthly chart is so well-defined with its price bouncing back and forth between those upwardly-sloping and converging trendlines that there is little question that it will try to put in at least a partial fulfillment that will commence once gold drops back below \$1,500 per ounce.

And this brings me to an important point. All levels discussed in this note seem outrageously low in relation to gold's current levels and may present as extreme, shocking or even offensive to the gold bugs out there.

Please know that I am not trying to offend anyone and the reason these levels seem extreme is because they are extreme in relation to gold's recent attempt on \$2,000 per ounce.

However, this is the point because unlike a few other notes that I have released calling for near-term corrections in gold that would have benefited gold's long-term uptrend, this note is calling for a **correction to gold's long-term uptrend** whether such a correction begins today or starts to take shape in 2012 or even 2013.

Had those near-term corrections taken place in recent months, gold's long-term uptrend would not be as prone to a reversal of the same degree as it is today but with those missed opportunities for real consolidation, **gold's technical structure is highly unstable** at best and this instability shows in gold's near- and intermediate-term charts as well.

In fact, gold's potential long-term reversal may have begun with the recent **reversal of gold's near-term uptrend**.



This official reversal is shown by gold's recent drop below its near-term trendline considering that the true purpose of a trendline is to show when a trend reverses as opposed to showing a trend itself. So long as gold remains below this trendline, gold's near-term uptrend has officially reversed.

Put in other terms, **gold's near-term chart** is showing a series of **lower highs** and **lower lows** and this is a **bearish technical signal** for gold.

This bearish signal is backed up by the fact that gold appears to be trading in a **Diamond Top** and a pattern that is bearish 69% of the time. Its downside target is **\$1,600** per ounce while its less-likely-to-be-hit upside target is \$2,100 per ounce and something that would help to create another Great Peak in gold and a structure that would likely lead back to the long-term reversal eventually.

Overall, then, **gold's near-term trend appears to be reversing from up to down** and this will remain the case unless gold moves back above **\$1,881** per ounce to reclaim its last protruding high.

Relative to gold's intermediate-term uptrend, it, too, looks ripe for a reversal and one that will be fed by a possible downside fulfillment of that Diamond Top pattern. Such a potential reversal is best shown by looking at the nearly 16-month daily chart on the following page.

The trendline to the bottom marks the uptrend born of the informal announcement of QE2 by Fed Chairman Ben Bernanke last August in Jackson Hole, WY.

This intermediate-uptrend is comprised of three major segments: August 2010 through January 2011, February 2011 through June 2011 and July 2011 through present.



As can be seen, gold remains well above the uptrend born of Mr. Bernanke's early communication on QE2 while its recent trading resembles an extreme form of the other two "Crowns" or series of peak and troughs to comprise this intermediate-term uptrend. This resemblance may beg the question of whether gold will try to return to the trendline marking that uptrend on the Diamond Top or on some extension of that bearish pattern in something that would come to resemble a complex Head and Shoulders pattern or a Rounding Top.

Should any variation of these bearish patterns be successful in taking gold back down toward its QE2 Trendline at about \$1,570 per ounce currently, gold will cross below its 50 DMA to test its 150 DMA at about the same level of that trendline currently. Such a potential test will prove crucial to gold because this moving average has provided strong support for gold in the past and such support will be necessary around this possible intermediate-term trendline touchdown too.

I say this because the ultimate "goal" of that Diamond Top or any of its extended variations would be to take gold not just to its target of \$1,600 per ounce but to \$1,480 per ounce and the starting point of gold's summer spike up.

In turn, gold's intermediate-term uptrend will either be on the cusp of an official reversal as it would teeter with the ascending level of gold's QE2 trendline or show itself to have reversed by moving below that trendline.

And this leads me to an interesting point about gold's summer spike up. In the same way that gold's QE2 trendline reflected buyer enthusiasm over the prospects of a dollar that was likely to decline on another round of money printing-fueled bond-buying by the Fed, so too does the near-term trendline to mark gold's near-term uptrend.

One can make the case that gold's recent surge reflects investor fear over the uncertainties around the sovereign debt crisis and the global economic recovery, but I would argue otherwise.

Gold's recent surge reflects investor greed over not wanting to miss a possible parabolic move up with the recent memory of silver's recent spike up still fresh for most investors.

The driver for a potential parabolic move up in gold is not its partial safe-haven status in times of uncertainty but the thing that has driven its uptrend of the last eleven years and that is its prospects to strengthen on a weakening dollar.

Proof of this difference seems to be provided by the fact that investors drove gold sharply up into Mr. Bernanke’s August 26 Jackson Hole speech of this year in hope of receiving a QE3-dollar weakening but backed off – and have stayed backed off on those lower highs and lower lows – just ahead of that speech in case such a nod did not occur.

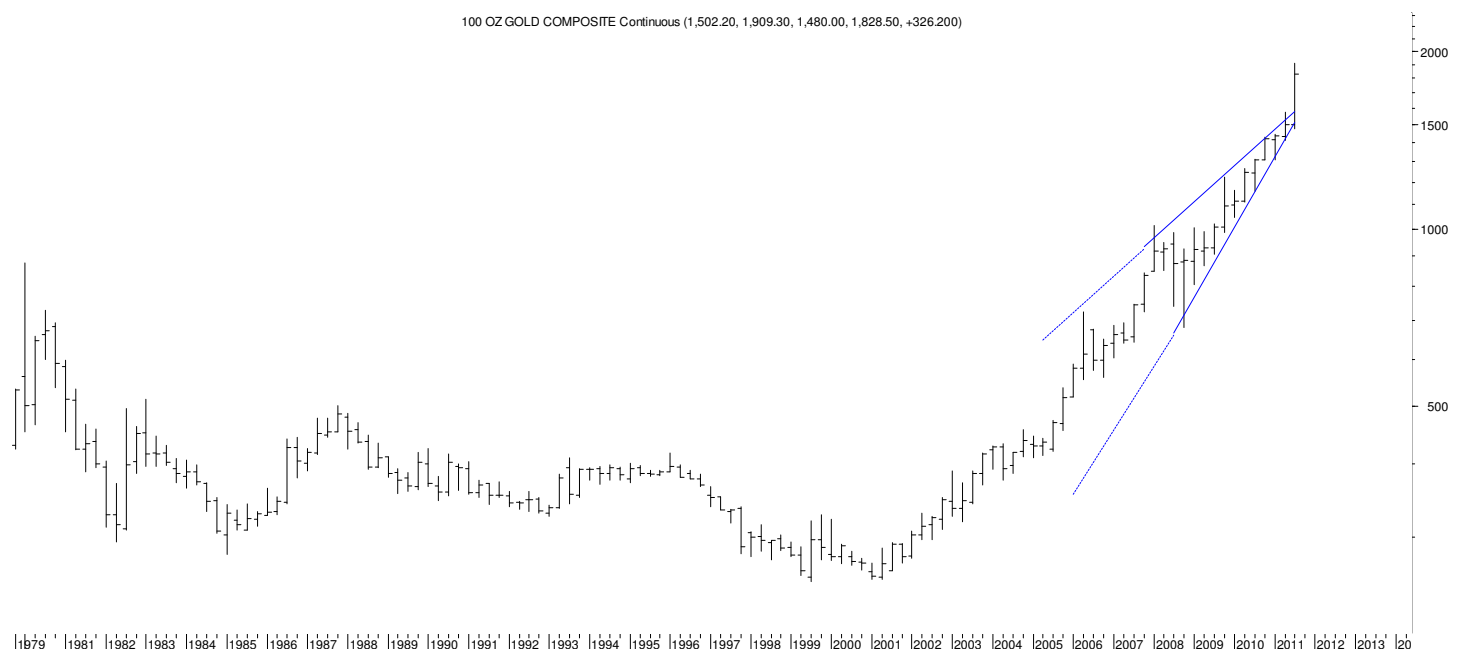
Well not only did Mr. Bernanke not give us the QE3-Wink back in August, but Mr. Bernanke has all but said through his various methods of communication that “small” and “unusual steps” are to be preferred in September over QE3. One of those steps to gain great traction through the press is something called “Operation Twist” and it would consist of a shift in the Fed’s portfolio toward longer-dated Treasuries and something that could have the effect of boosting the buck.

With such a possibility on the forefront for the September FOMC meeting or perhaps the November meeting, investors seem to be showing fear around the greed that drove up gold over the summer because it is unlikely that gold will continue to surge without the fuel of a weak dollar and without the rhetoric around a Fed that is continually trying to debase the dollar. Should QE3 be announced later this year or at some point next year, such rhetoric or logic can continue, but without the Fed going on another “money printing” spree, it is hard to justify driving this “alternative currency” higher in the face of a Fed that is backing away from money printing for at least the time being.

Instead, investors will be looking squarely at a relatively illiquid and non-electronic alternative currency. Donald Trump may accept deposits of gold for the potential purchase of property from him, but the last time I checked, grocery stores, gas stations and Home Depots want dollars.

In fact, in a time of fear, real fear, as in deflationary fear when the price of “stuff” just starts dropping on anticipation that it will drop even more and can be bought for less in the future, gold is likely to be lumped in with such “stuff” even though there is some evidence that gold does better in a time of deflation than inflation.

And this brings me back to the chart shown on the first page only this time it is in quarterly form going back to 1978 and a time when strong inflation was rearing its ugly but controllable head.



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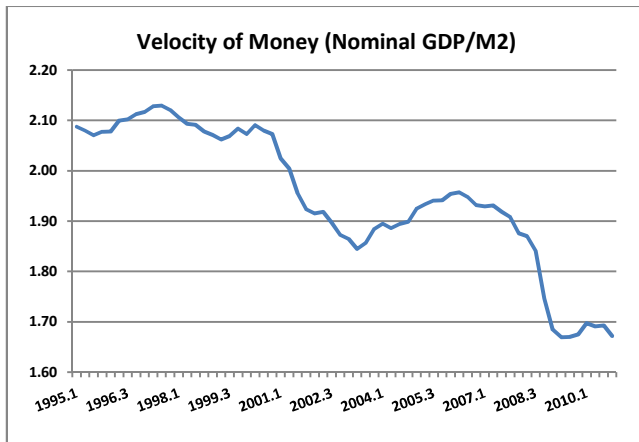
Please see important disclosure statements at the end of this document. Most charts by MetaStock/Reuters.

As can be seen, gold's spike up of this summer can be compared to some degree to the spike up shown in 1978 only this time, there is no inflation.

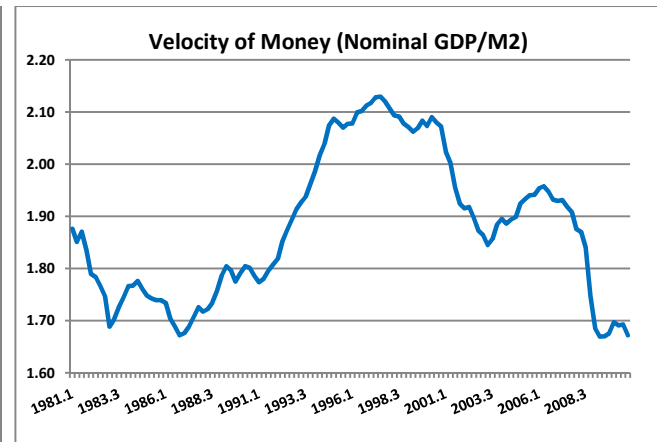
There is only investor anticipation over hyperinflation that *might be* brought on by more QE. However, the possibility of past QE or future QE bringing on inflation, let alone hyperinflation, is nil until all of that printed money comes off of bank balance sheets to actually circulate in the economy.

Famed economist Milton Friedman explains this well in having suggested broadly that **inflation is a function of how much money a central bank manages to get moving through an economy**. The more money that moves through an economy the more inflation is created.

Considering that the velocity of money remains at a 30-year low, such inflationary fears might be better left for the future if ever.



Source: Federal Reserve, BEA



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And because a low velocity of money is a sign of a cesspool of stagnant money, it is a **liquidity trap** that is the more realistic fear right now.

This occurs when a country's nominal interest rate has been lowered to zero or thereabouts to avoid recession but the resulting liquidity fails to stimulate the economy to healthy employment while additional liquidity is unlikely to stimulate the economy further either. It is believed that this condition can lead to deflation while there are no proven ways to fight it as there are known ways to fight inflation.

Bringing this back to gold, though, and its major and bearish Rising Wedge, it seems that this pattern reflects long-term investor anticipation over a bout with inflation or even a collapse of the dollar.

In the absence of either and in the presence of a possible lull in the Fed's until-now unsuccessful re-inflationary pump, it seems the Rising Wedge may have the opportunity to take gold down toward its target range of \$555 to \$1,045 per ounce. Such a possibility may become more real if the Fed holds off on QE3 next week because it is just such a QE3-On-Hold-If-Ever that may cause the near-term Diamond Top to fulfill completely.

Such a potential fulfillment may become even more likely if the Fed does announce "Operation Twist" as investors may interpret it as an early attempt to put a floor under the dollar.

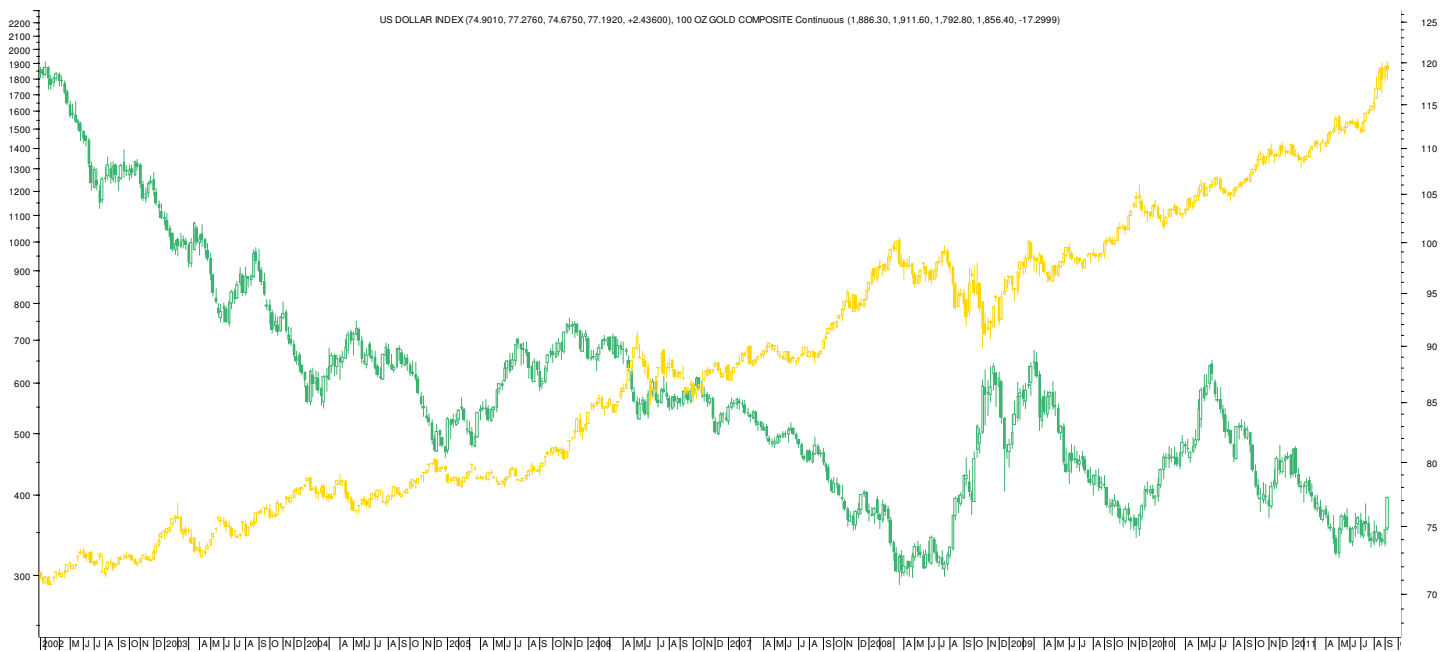
In turn, perhaps gold's near-term reversal could continue on that Diamond Top and even lead to an intermediate-term reversal that would signal the beginning of gold's Rising Wedge entering its fulfillment stage.

Should this occur with gold dropping below \$1,500 per ounce, it is unclear whether gold will make it to even the top of the pattern's target range of \$1,045 per ounce because Rising Wedge's tend to perform poorly with only half hitting the target.

In this case, though, the real target of that pattern is \$555 per ounce and so even a partially-fulfilled pattern could lead to a 50% fall in gold and a correction to its long-term uptrend.

Sam's Stash, Gold and the S&P

Speaking of the dollar, there it is plotted out with gold over the last 10 years and it is interesting to note that the two crossed back in 2006 and right around the start of gold's Rising Wedge.



It seems that such a cross provides a bit more proof around the last 5 years of gold's uptrend reflecting – correctly – the dollar's decline. However, such a decline was mitigated by some serious sideways trading over the last three years and a period of consolidation that may support a big move up in the dollar, and particularly in 2012, as is to be detailed at another time.

If the dollar does continue to find a bid as is evident by last week's spike up, it is likely to push gold further down. If the dollar fails to find a continued bid, it may be on yet another Band-Aid solution to the sovereign debt crisis in Europe and a Band-Aid that will weaken the dollar but present the temporary picture that all is well in the world on the investor aphrodisiac known as amnesia.

Such a picture, however temporary, could be the picture, though, to prop up the equity indices for a period of time with the Nasdaq Composite showing a possible signal of a breakout to the upside even though it may include a bit more of a gruesomely bullish decline ahead.

In turn, such a round of dollar weakening on the back of EURUSD “strengthening” may prove propitious to equities but not so much so for gold as investors recall the “safety” portion of its dual safe-haven and risk-on asset status.

Thank you for taking the time to read this week’s piece and have a relaxing and restorative weekend.

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PLEASE NOTE: I am long GLL and ZSL.