Is it time to buy gold?

This article appeared in the August 2013 ASX Investor Update email newsletter. To subscribe to this newsletter please register with the MyASX section or visit the About MyASX page for past editions and more details.

What the charts say about gold bullion and key gold stocks.

By Robert Brain and Alan Clement, ATAA

Many investors can't help themselves when they see the gold price rally strongly. There is an age-old wisdom that tells us that gold is a store of wealth, so many investors feel they need to exchange some of their hard cash for some real hard gold.

But in what form of gold should we invest? Some hard bullion or shares in a gold miner, perhaps. But how to go about this and what do the charts tell us about the likely future moves in the gold price? Perhaps we should we heed the words of Warren Buffett, who declared that gold is an inanimate object that cannot do anything, and is best avoided.

Three common investment choices

There are three common ways that retail investors in Australia can invest in gold: buy bullion directly from the Perth Mint, buy listed gold securities that track the price movement of gold, or buy shares in gold-related mining companies.

Perhaps the easiest and most liquid method is to trade in shares in gold miners (for investors who are willing to accept additional risk, such as company and market risk, in addition to gold price risk).� There are about 20 listed large gold producers on the Australian market; but not all are considered liquid enough for traders to be able to buy and sell readily, with adequate daily volume and number of trades.

Just for reference, some of the larger and more liquid companies include (in order of market capitalisation, largest to smallest): Newcrest Mining (NCM), Regis Resources (RRL), Oceanagold Corp (OGC), Resolute Mining (RSG), Medusa Mining (MML), St Barbara (SBM), Alacer Gold (AQG), Kingsgate Consolidated (KCN), Focus Minerals (FML), Teranga Gold (TGZ), Saracen Mineral Holdings (SAR), and Ramelius Resources (RMS).

Some of the listed gold miners are pure gold plays, while others have additional interests. Some might closely track the published gold price at times, while any company's share price can be influenced by a whole range of external factors. Getting a share price judgement correct can be hit and miss.

Another possibility for retail investors is a listed exchange-traded product over commodities, such as the ETFS Metal Securities product ETFS Physical Gold (ASX code: GOLD) or the BetaShares Gold Bullion ETF (code: QAU). ETCs and ETFs are listed securities and can be purchased through a broker. Another possibility is to buy units in a managed fund that specialises in a selection of gold mining companies.

The weekly gold price chart

Between 2001 and 2011 gold was the darling of the investor, with a seemingly uncanny knack of moving higher, despite changes in the global economic outlook. It began its upward trajectory from a low of US$253 at the height of the dot.com bubble. It continued higher during the bull market in stocks from 2003 to 2007, and then barely missed a beat through the Global Financial Crisis. Finally, helped on by a continuing risk-off atmosphere, it pushed on to an ultimate top of US$1907 in 2011.

Looking at the weekly chart (below), we can see how things began to unravel. The first warning sign that the party might be over was in April 2012, when we saw a break of the trend that had held since the GFC low. Support at US$1550 then held for another year before a decisive move lower in April this year, which completed a large descending triangle top.

Gold (weekly candlestick chart)

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Once the breakdown happened, the liquidation was swift and gold has seen its price collapse 36 per cent from the 2011 high into a recent low of US$1212. Taking a measure from the GFC low to the final high, we can see the market has almost made it back to its 61.8 per cent Fibonacci retracement line at US$1170. There is also support in this area at US$1190, projected from a high and low from 2009 and 2010 respectively.

We may yet see gold make it down to tag these levels on this move, but with the severity of the sell-off, the market is now deeply oversold and a bounce could eventuate at any time. Indeed, with the recent short-term strength we have seen, it may already be under way.

The big question is, will this be the final low for gold or are we likely to see further selling?

The big picture on the quarterly gold price chart

Looking to the long-term quarterly log-scale chart (below) might give us a clue as to whether we might have seen a final low, or if there is possibly further selling to come.

Gold (quarterly candlestick chart)

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(using a logarithmic price scale*)

On this chart we can see that the selling has taken the market back to tag its long-term uptrend line, which has been in place since the 2001 lows. And with a trendline that has been in place for that long, it is likely it will offer some support, at least in the short term. Having said that, the very recent long bearish quarterly candle looks ominous, and it would be hard to imagine that gold could reverse and move to new highs directly from here with that bearish candle in place.

A more likely outcome for gold is near-term consolidation between the current level and upper resistance at US$1550. Of course, should gold break its long-term trendline on the quarterly chart that would probably spark a further sell-off. But if the uptrend remains intact, the longer-term outlook for gold remains bullish.

The currency issues

Most of the reported information and price charts for gold are quoted in US dollars. To invest in gold directly using the gold price chart for our decision-making is OK if we own some US currency. However, Australian investors who do not have US currency need to factor in the currency conversion costs. Whenever the exchange rate for this currency pair moves, the value of a holding in gold will probably move as well. But will it move in our favour or against it? This is just one quandary for the investor to consider.

(Editor's note: Do not read the following commentary as stock recommendations. Do further research of your own or talk to your financial adviser before acting on themes in this article).

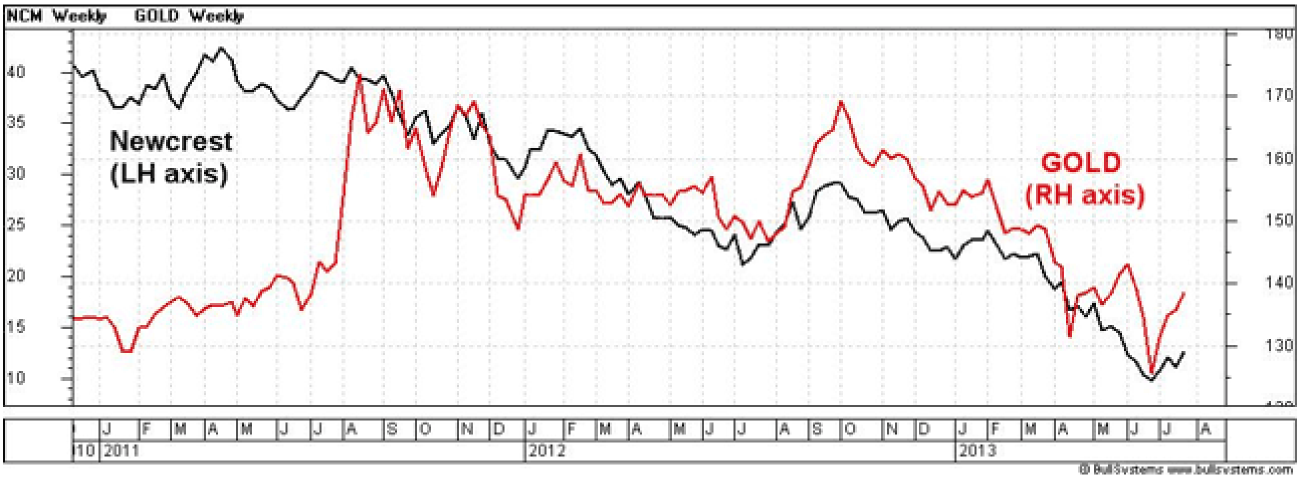
Newcrest Mining - the Aussie gold heavyweight

Many investors will recognise the company name Newcrest and understand that it is a large gold mining company. Many might not realise that it is one of the world's�top five gold mining companies by reserves and market capitalisation, and operates mines in four countries with a global workforce exceeding 19,000 (*source:- Newcrest Mining Limited).*

The weekly price chart of Newcrest Mining (below) shows Newcrest (the black line with price on the left-hand axis) falling from around $40 in early 2011 down to under $15 in July 2013. Chartists will note an almost consistent downtrend with a series of lower peaks and lower troughs on the chart. A price downtrend continues while there is an excess of market participants who are convinced the current price is too high.

The small upticks in price occur because of bargain hunters who are convinced that it is worth more. But they are soon overwhelmed by the abundance of sellers who force the price to continue lower. A downtrend finishes when all the sellers have gone and only buyers are left in the market.

Newcrest Mining and the GOLD ETF



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This chart also shows the listed exchange traded fund (ASX Code: GOLD � the red line with price on the right-hand axis). Compare the chart of GOLD to the earlier weekly chart of the gold price above (in US dollars), and note that they are both very similar - a high correlation. A useful observation is that the chart here of Newcrest is somewhat similar to that of GOLD and the US-dollar gold price for most of the time, but not always.

Australian gold stocks and the XGD index

To assist investors who want to focus on gold stocks, there is the S&P/ASX All Ordinaries Gold index (code XGD).

The XGD index currently comprises 40 stocks, ranging in size of market capitalisation from Newcrest ($9.16 billion) down to Reed Resources ($23.5 million). For the astute investor wanting to trade any of these in the shorter term, be aware that some of these stocks are not very liquid, with some trading fewer than 100 million shares per day, and at least 14 of them trading fewer than 50 trades per day.

This is considered a lower limit by many keen traders who want to be able to have a quick exit at the time of their choosing (50 trades per day equates to one trade about every 7 minutes - quite a long time to wait when you want to sell in a hurry).

When eye-balling the price charts for the 40 stocks in this index, it can be seen that many of them are somewhat closely correlated to the index itself; but many are not. Still, there might be some possibilities here.

The chart below of Regis Resources (RRL) and the XGD index is a good illustration. Note that even though these two entities were tracking in a similar direction through 2009 and 2010, they diverged for a period through 2011 and into 2012 - Regis was rallying upwards in 2011 while the XGD index plateaued and fell away.

For Regis to rally like this there must have been an overwhelming view that the share price was worth more than the market price on the day, resulting in buyers outbidding each other for a piece of the action. This continued until the price peaked at $5.87 on October 2, 2012, after which the share price trended lower.

Regis Resources (RRL) and the XGD index

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Conclusion

The charts can tell us a lot about the underlying sentiment and opinions of the market participants, and whether they think the price of a security should be higher or lower. When it comes to hard gold there are a variety of ways to invest, if that is what an investor really wants to do. But who is going to be right about predicting the direction of the gold price?

About the authors

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*Logarithmic price scales - when viewing some price charts, a log scale on the vertical axis can be very beneficial, especially if viewing a chart over a long term where earlier prices were somewhat lower. In this case, a standard linear price scale would show the earlier prices in a very tight range, and it would be difficult to discern the details of the peaks and troughs. Using a log scale basically stretches the lower values up and down to reveal the detail price action.

About the Australian Technical Analysts Association (ATAA)

The Australian Technical Analysts Association is a not-for-profit association of people who are interested in the application of technical analysis. Many of the members operate their own SMSF, some are private traders/investors and some are professionals in the financial services Industry. The ATAA has nine Chapters in Australia, based in capital cities and provincial centres. Visit the ATAA website for details.

From ASX

ASX Charting Library has a wealth of information on technical analysis.