Will History Repeat Itself in the Gold Market?

Mark Twain once said, ?*history doesn?t repeat itself, but it often rhymes*.? Since President Nixon removed the gold standard in the early 1970s, gold has seen several significant rallies, all of which have similar wave characteristics. Gold rallies seem to rhyme.

The first two price rallies began in 1971 and 1977, during and after the de-linking of the U.S. dollar from gold. The most recent price rally has its seeds in the dot-com bubble in the early 2000s.? The chart below shows two long-term monthly gold rallies, with the second rally appearing to be an amplified but similar version of the first.? I have overlaid Fibonacci sequence numbers to demonstrate how the price of gold has spiked upward in expanding, fractal waves during these prior surges.?

In the 1970s, gold traveled through four Fibonacci levels (by this measure) in less than a decade after the removal of the gold standard. From 2000 through 2012, amid the dot-com and housing bubbles, gold also traveled through four Fibonacci levels on the way to $1,900.

If history rhymes again, and I believe it will, then the price of gold will again spike upward through three or four Fibonacci extensions to the upside, but then re-trace 50% to 70% of that upward move. **If so, then the next upward spike could peak in the range between $7,000 and $11,000 per ounce.**

Investors tend to make rash decisions based on fear and greed. These emotions are typically amplified during times of financial stress. It is during such times that gold solicits fear and greed motivated buyers. During a crisis, fear investors will rotate into gold to hold value, and greed investors see the upward momentum and jump on the train. The upward momentum of the next gold rally might feel like the Bitcoin surge in 2017.

?Striking Out? in the 1980s

In baseball, its ?three strikes and you?re out.?? After the 1970?s surge and blow-off top in 1980, gold failed three key technical tests.? After these failures, the gold market floundered for another decade. ?Let?s take a closer look at those three technical failures.

First, in early 1983, gold failed to retake and hold the psychologically important $500/oz price level. This rejection resulted in sideways to lower movement for another year before gold failed again, breaking below its upward trend line near $360/oz. After falling to a low in early 1985, gold moved higher over the next three years, only to fail a third key resistance test near $500/oz in late 1987. After ?striking out? in the 1980s, gold fell throughout the next decade back to $250/oz.

Current Technical Structure Is Bullish

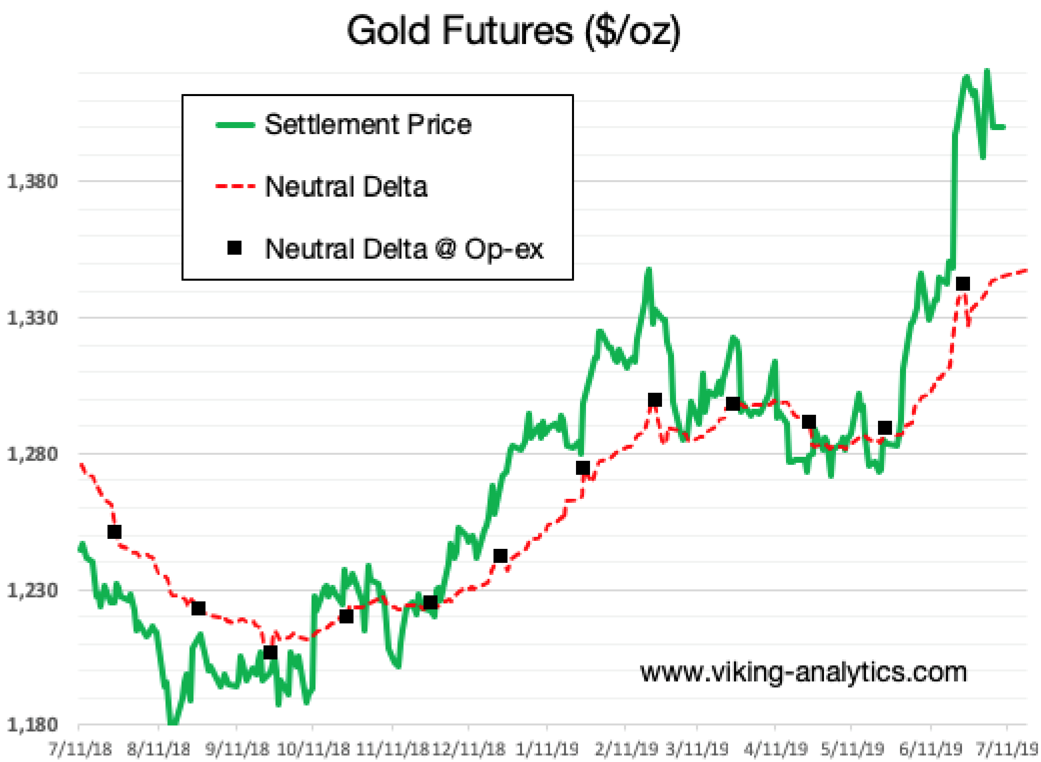
Unlike the gold bear market of the 1980s, gold has been passing periodic tests of support and resistance since its sharp decline in 2013. Gold?s price retracement from a high above $1,900 to a low near $1,040 kept the price above a 61.8% Fibonacci retracement level as well as the psychologically important $1,000 per ounce level.

The monthly wave structure of gold is bullish, and the price is now trading above key resistance levels, with solid support at $1,379 and $1,250. Even if the price of gold falls back to support at $1,250 per ounce, the long term technical picture remains bullish. ?I view the recent breakout over $1,380 to be significant and has likely opened the door towards the $1,580 resistance area.

To the downside, technical breakdowns below $1,250 could lead the way to $1,211 and $1,043. If history does indeed rhyme, a breakdown below $1,043 could lead to another decade of futility. This downside scenario does not appear likely, especially not with the uber-accommodative interest rate policies worldwide. High U.S. dollar interest rates broke the back of the gold rally in the 1980s, and there does not appear to be any such risk of this happening again anytime soon.

Short-term Indicator

In addition to my longer-term view on gold, I also track shorter-term price signals to locate areas of accumulation and/or hedging.? An indicator I developed shows a mean-reversion relationship between price and the point of Neutral Delta in the options market.? Essentially, the point of Neutral Delta shows where the options market participants have placed their bets and hedges.? At the moment, Neutral Delta is near $1,345 per ounce for the options which expire on July 25th.?



When the price is over-bought in relation to Neutral Delta (as it is now), we tend to see headwinds for further price increases. Interpreting the current data, I am led to believe that the price of gold will re-test the $1,380 price level before July 25th, and this will give the options hedgers an opportunity to optimize their hedge book ahead of the next few option expirations. A lower probability event would be a price spike again towards $1,450 which would like force a short-covering rally by the call option sellers who may already be out-of-the-money.

If we are in the opening innings of a new rally in gold, a retest of $1,380 or even $1,250 will represent great opportunities to buy or add to your gold positions.

You can learn more about my research by clicking this link: Introduction to Options Sentiment.

Final Thoughts

Gold can be best viewed as financial insurance. If you believe that you should own insurance, then you should also own gold. In terms of investment performance, gold will do best during times of international financial stress. In the past, the price of gold has moved exponentially higher during these periods as demand for the ultimate safe haven goes viral.

The world is slowly but steadily transitioning from a U.S. dollar-backed financial system to a multi-currency, multi-polar system. One day, the leaders of our world will let the rest of us know the plan for a modified financial system, and we will have to admit that we were warned many times in advance. I expect that the gold price spike will happen before, during, and after a new Bretton Woods-type conference. While there are many signs that a new financial order is imminent, the transition to this new financial order could take more time than many have been led to believe.

From a short-term perspective, I use gold puts to protect my current precious metal allocations. This is like purchasing insurance on the value of my current insurance policy. It also helps preserve my wealth allowing me to buy more gold if prices do in fact, drop to $1,380 or $1,250.

Disclaimer and Notes

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