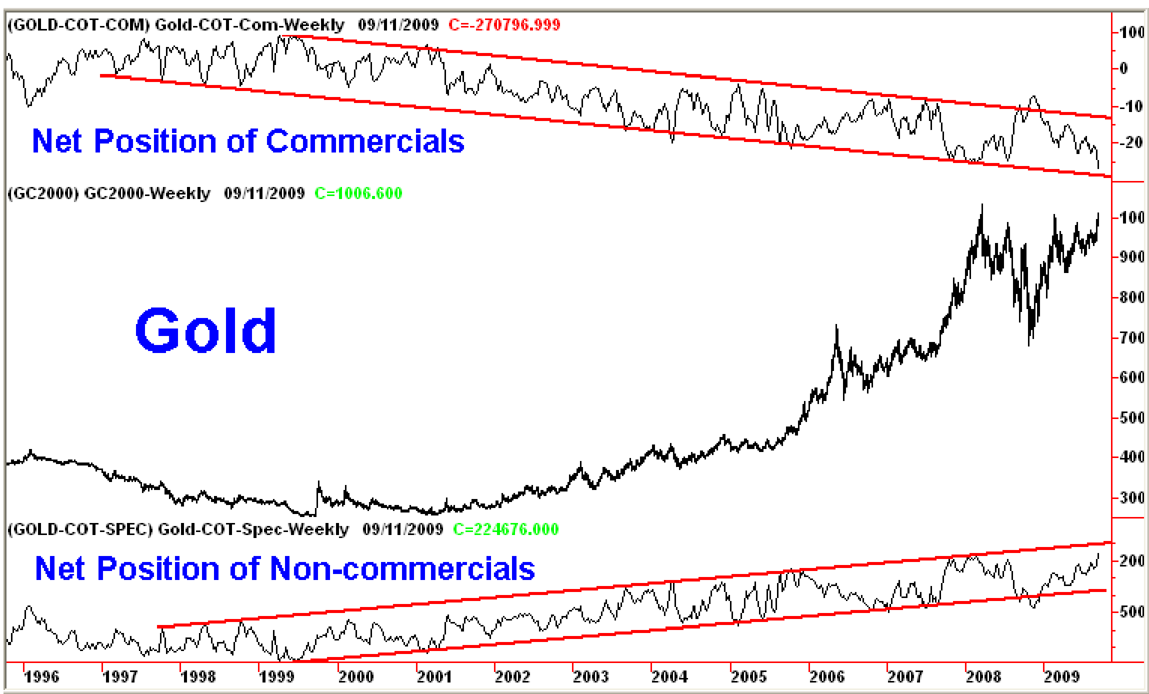
ChartWorks

PUBLISHED BY INSTITUTIONAL ADVISORS
September 14, 2009

Technical observations of RossClark@shaw.ca

Gold – COT Data Warns it is Time to be Wary

The Commitment of Traders data (COT) is compiled each Tuesday for release on Friday. It reports the total number of long and short positions of futures contracts held by commercials, non-commercials and the percentages held by the largest 4 & 8 traders. For the past ten years the commitments of speculators (non-commercials) have been in a rising trend together with the price while the commercials have made a long series of new lows (*i.e. net short*). This week made all-time extreme reading in each. The data series is only available back to 1986 so we are precluded from analyzing the two biggest bull markets; 1971 to 1974, \$35 to \$196 and 1976 to 1980, \$103 to \$875. **However, the findings of this study suggest that whatever upside action occurs in the next few weeks should be followed by a test of the breakout.**



Our technique of choice in analyzing the COT data series has been the use of a Relative Strength Index. While the advent of ETF products has definitely impacted the size of futures positions, the RSI oscillator continues to perform. The RSI avoids analysis of the absolute levels of the data, allowing for the evolution of positions over time by only reaching extremes when there is a push in the velocity of the trend. **This week is a standout in the 23-year history of the data. The RSI on speculative positions is at 71.29. The non-commercials RSI is at 30.63.**

The only weeks with an RSI of this level for non-commercials were:

- April 12, 1993; the end of a five year bear market followed by a breakout and small correction to the 20-week moving average.
- August 6, 1993; beginning of a 6-week decline of 16%
- January 26, 1996; one week before a top that lead to a 3-year decline of 40%
- February 25, 2000; beginning of a 1-year decline of 21%.
- May 25, 2001; followed by a 2-week decline of 11%, then sideways for nine weeks.

The only weeks for commercials at this level were:

- April 12, 1993; the end of a five year bear market followed by a small correction to the 20-week moving average.
- January 19, 1996; two weeks before a top that lead to a 3-year decline of 40%
- October 10, 1997; start of an 18% decline over 13 weeks
- May 25, 2001; 2-week decline of 11%, then sideways for nine weeks.
- September 5, 2003; topped within two weeks, then declined by 7%

There can be an unlimited number of futures contracts in any commodity. When a new seller and new buyer establish positions the number of outstanding contracts (open interest) expands. When both an existing long or short exits their position the open interest declines. However, when an existing long or short exits and a new buyer or seller takes their position the open interest remains unchanged.

Expanding open interest is supportive of an underlying trend. Why? In the case of a rising trend it means that new buyers are overwhelming the new selling. If open interest declines it means that the price is rising because short sellers are being forced out of their positions, not because of rising demand. Once the shorts have covered, the market becomes vulnerable. Declining open interest was seen in the last month of the wheat and crude oil market rallies before their collapse in 2008.

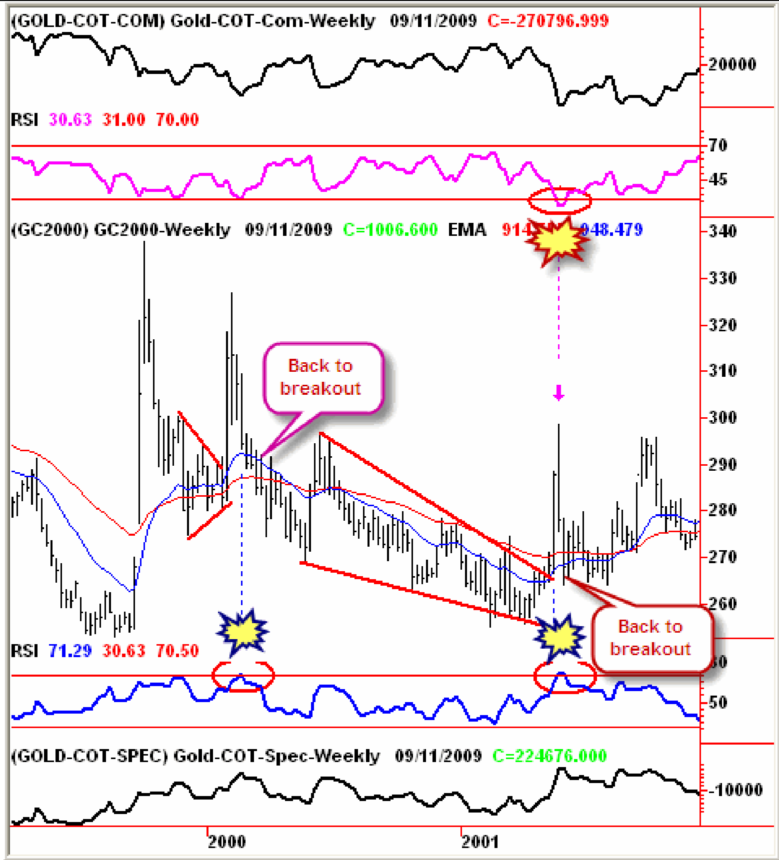
Similar to margin debt in the equity market, there is a powerful correlation with rising open interest and the underlying trend. As long as new buyers keep stepping up to the plate the trend is perpetuated. However, the larger the positions become, the more vulnerable a market is when the ‘party’ comes to an end.

The rising open interest in gold has been supportive to the trend and the minimum measurement of $1,034 from the breakout continues to appear attainable, but excesses have now appeared so be prepared for increased volatility.

When reviewing the charts of gold we note that the extreme levels of the RSI in the COT are concurrent with breakouts of triangular or wedge patterns. **Each instance was followed by a correction back to the lower of the 20-week exponential moving average (*$948 and rising at $6 per week*) or the breakout (*$968*).**


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 948.479
Back to breakout
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
2006
2007


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 914.755 948.479
Back to breakout
Back to breakout
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
2002
2003
2004


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 91
948.479
Back to breakout
Back to breakout
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
2000
2001


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 914.755 948.479
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
1997
1998


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 914.755 948.479
Back to breakout
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
1994
1995
1996
1997


(GOLD-COT-COM) Gold-COT-Com-Weekly 09/11/2009 C=-270796.999
Commercials
RSI 30.63 31.00 70.00
(GC2000) GC2000-Weekly 09/11/2009 C=1006.600 EMA 914.755 948.479
Gold
Back to breakout
RSI 71.29 30.63 70.50
(GOLD-COT-SPEC) Gold-COT-Spec-Weekly 09/11/2009 C=224676.000
Non-Commercials
1991
1992
1993
1994

The opinions in this report are solely those of the author. The information herein was obtained from various sources; however we do not guarantee its accuracy or completeness. This research report is prepared for general circulation and is circulated for general information only. It does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities or investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized.
Investors should note that income from such securities, if any, may fluctuate and that each security's price or value may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not necessarily a guide to future performance. Neither the information nor any opinion expressed constitutes an offer to buy or sell any securities or options or futures contracts. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk. Moreover, from time to time, members of the Institutional Advisors team may be long or short positions discussed in our publications.

BOB HOYE, INSTITUTIONAL ADVISORS
EMAIL bobhoye@institutionaladvisors.com
WEBSITE www.institutionaladvisors.com