The Chartists Perspective 22 Dec, 2010

2010 the Golden Year

Was 2010 a golden year? There has been much talk of it. And indeed the gold price continued the strong "naughties" upward trend gaining over 30% during the year, but it may be more appropriate that 2010 be called the year with the silver lining as the silver price surged over 80%. As we review the year we focus on the impact of the commodities prices from the two tiers of metal prices and the soft commodities which are highlighted in the performance of the CRB index.

Our brief moment of parity with the US dollar caused more than a few hearts to flutter – and was it due to just the weakness of the US or were there other forces at play? As we turn to energy and track the oil price there is a strong correlation with the oil price and the Australian dollar.

For the equity markets, we step back and take the longer-term look at both Australia and the US. 2010 was a rough year for equities with both markets trapped in a 15-20% range, and does this fit in with the normal character of the markets? As we edge towards the top of those ranges we gauge the likelihood for significant change in 2011.

Finally, how many ounces of gold does it take to buy one share of the New York Dow Jones? The Dow/Gold ratio has been an impressive indicator for the trends in commodities and equities from 1900.

Turning to gold, the price surged from around US$30 in the early 1970s to reach $850 by March 1980. The steepness and magnitude of the rise saw momentum exhaust and sent the price into a 20 year corrective phase which eventually doubled as a base to carry the price higher during the "naughties".

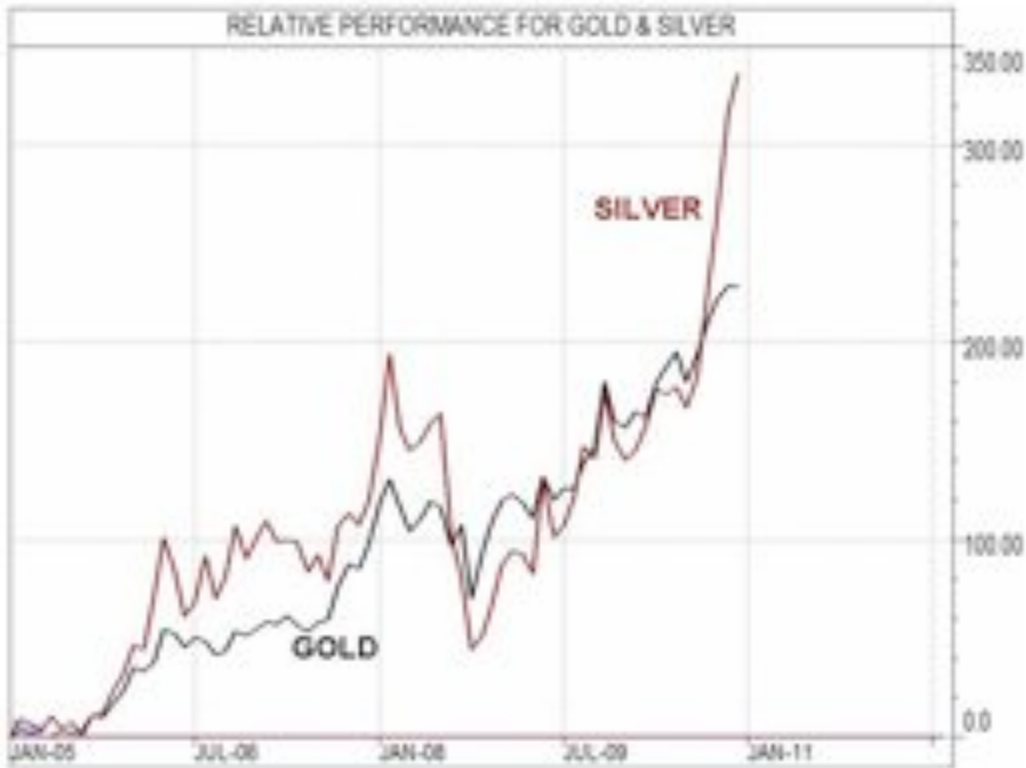
Finding a benchmark of support around $250 between mid 1999 and 2001, the price launched itself on a strong upward path with a minimum objective to around $1500. In previous reports we have highlighted interim targets, one of which has just been achieved at $1350-75. The overshoot through $1400 has sapped some of the upward momentum and the price has been churning within a slightly irregular phase during November and December.

The action clouds the near-term picture, but the medium to longer-term outlook which would carry the price into 2011 is underpinned by the prospect of significantly higher prices. Keeping this in mind, the shorter-term indications suggest that the recent irregular churning is likely to continue and may see the price pullback to seek support around $1300 before the upswing resumes.

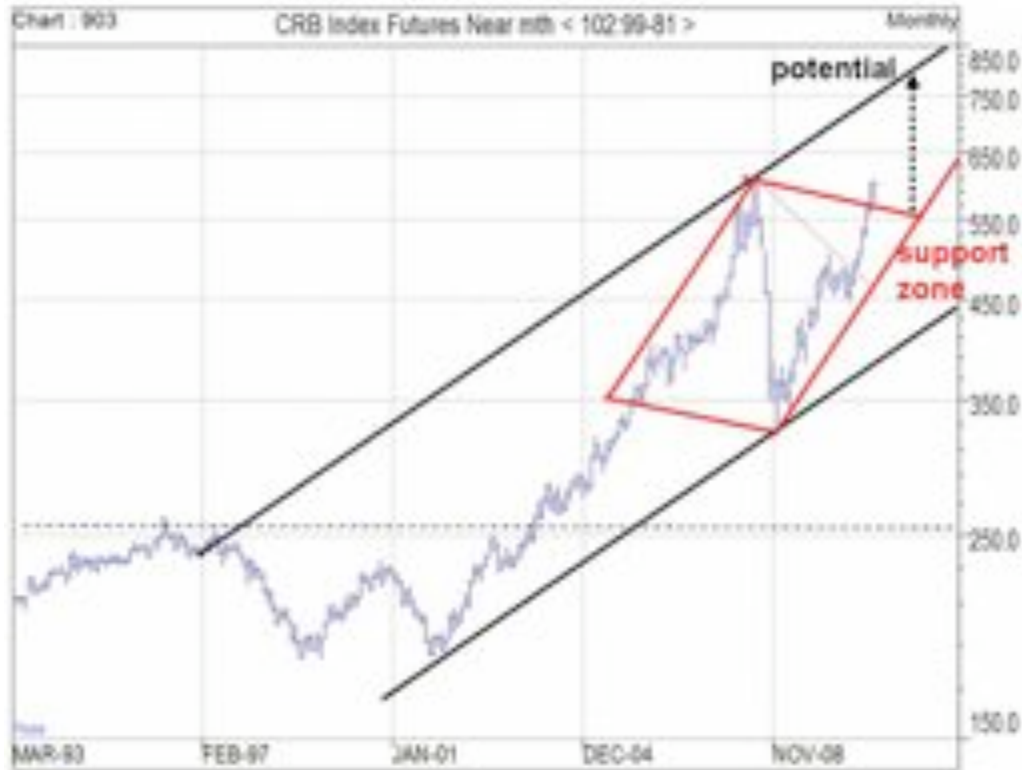
Unlike gold, the price for silver is yet to streak to new highs. The all-time high for silver was cast by the Hunt brothers in 1980 at US$480 and its subsequent dramatic downturn finally found support between 1991 and 1993 around $3.50. But in a similar fashion to gold, a basing process can be traced back to 1981 and was completed in 2005, providing the momentum for a steady rise into 2008 – where it stalled around $20 forming the pinnacle in a volatile diamond pattern with the sell-off to $8.77 producing the pivot.

The pattern was recently completed in September with the break above $20 and has seen the price continue its strong rise adding another 50% to its price in a little less than four months. Diamond patterns can be the most powerful within the technical analysis arsenal and the recent upward spiral is just the beginning for the silver price with a minimum

potential to around $450. The accompanying chart monitors the relative percentage performance for gold and silver from 2005 and highlights the silver take-off in September.

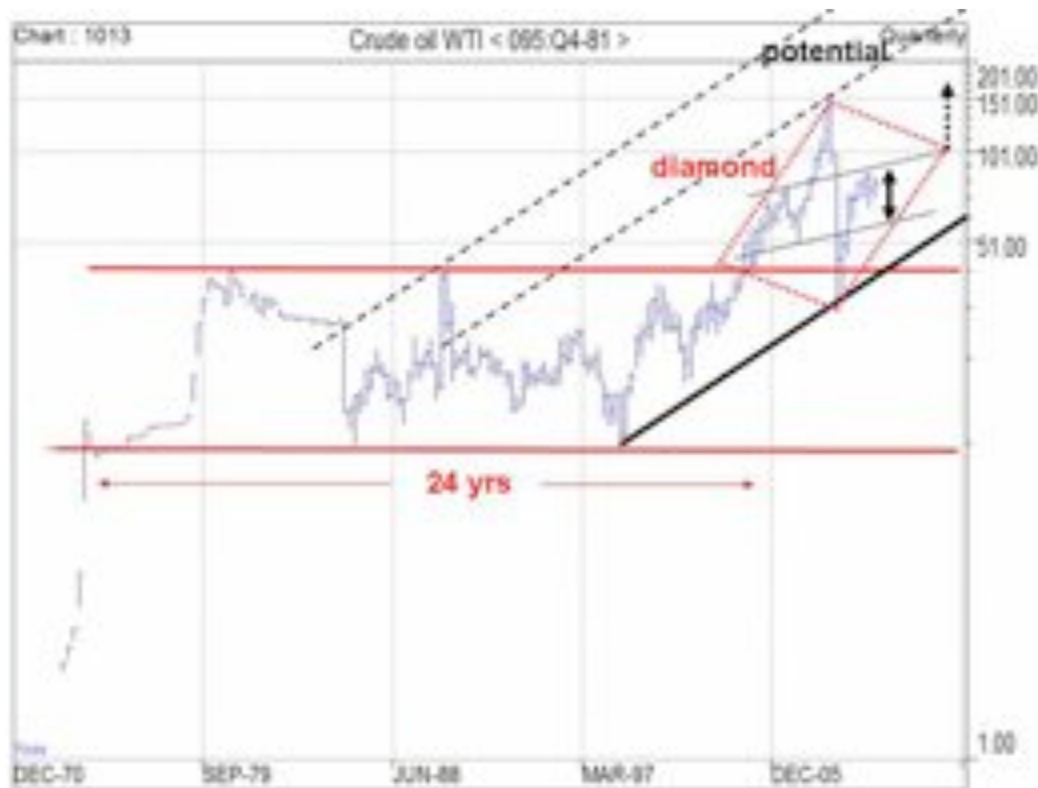


The CRB Futures Index lends us a broader look at commodities as it incorporates the precious metals and copper along with a spectrum of agricultural or soft commodities.



Almost all of its components have experienced a strong 2010, notably cotton, soy products, wheat and corn. As the index tests its peak zone there is room for some pullback/consolidation within its continuation of the path higher. Support in any pullback would be located in the 500-560 range while maintaining the ability to push past the peak at 618 and move on towards 700 and 800, and potentially significantly beyond.

For some time now, from our technical view, the oil price has been the “X” factor or potential “wild child” within the resources family.



The price for crude oil swung between US$10 and $40 for 24 years. Breaking away in 2004 the price surged to a momentum climax at $145 four years later, where a triple peak produced a plunge to base support in December 2008. The spike into support combined with a momentum shift to the positive, led to an effective reversal with the price climbing through 2009 to reach the $85-95 resistance zone. The zone has been created from an internal barrier within a large diamond phase. Diamonds are typically a reflection of market uncertainty, but as mentioned before are powerful and can be quite explosive in their determined direction.

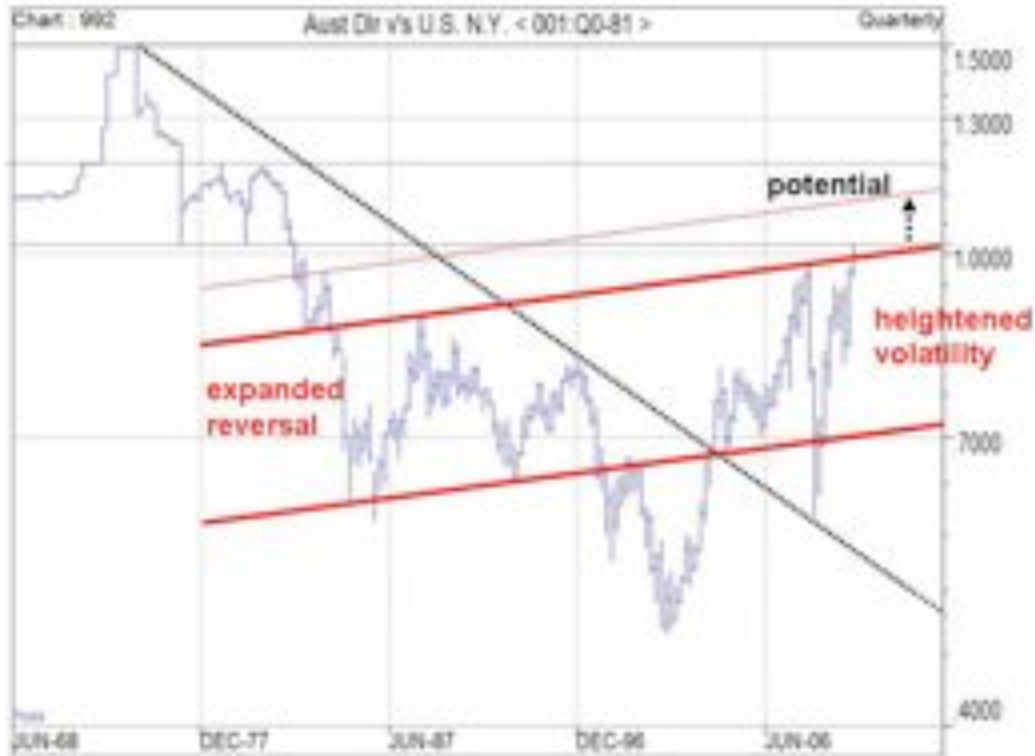
As the price encounters the barrier zone, it needs to clear $100 to confirm the completion of the phase and trigger the next pulse higher towards $110-20 – and then to tackle the peak and potentially towards $160 and beyond. The danger to this scenario remains that the diamond phase is not yet finalised and failure to break the upper barrier would see a set-back in price and the possibility that the phase resolves to the downside. The current parameters of the phase lie between $60 and $95, but an early warning for the setback would be signaled on a drop below $78.

At this stage, the chart supports an upward break.

Inter-market relationships provide some of the most important links and guides and one of the most notable is the strong correlation between the Australian dollar and the oil price. The two move very much in tandem, enjoying similar turning points within their respective trends.

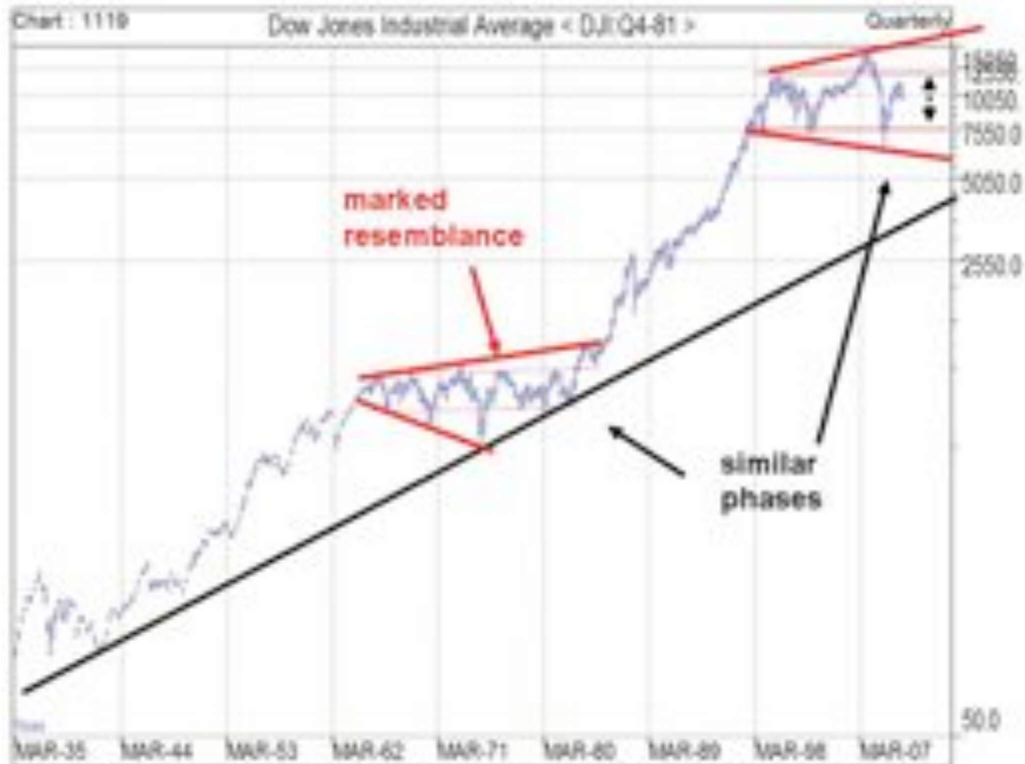
The chart follows the relationship from 2000 and it appears that the Aussie dollar has been the leader, giving an early indication of the major turning points ahead of the oil price.

With this in mind we turn our focus to the Australian dollar's roller coaster ride against the US. From its peak around $150 in 1973 the Australian dollar fell within a series of waves to reach a low at about 48c in mid 2001. This point became the axis for a broadening reversal which provided the momentum to break the ten-year downtrend late in 2003. At 80c in 2004 the price paused and further developed the base before pushing higher to fall short of parity at 98.49c in July 2008. The combination of resistance and spent momentum set off a downward spiral sinking to a parallel of support at 60c. Once again the A$ propelled itself higher, pausing between 80c and 94c between November 2009 and September this year before firing its next attack on the key $1.00 area.



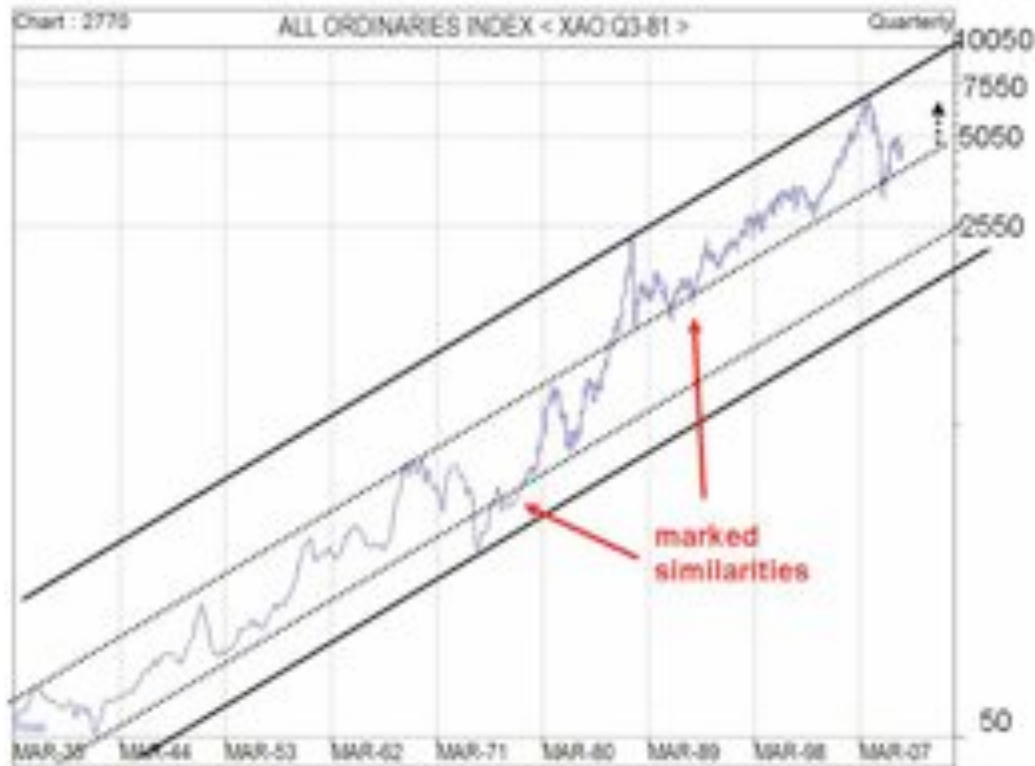
The last time that the A$ was above US$1.00 was late in 1982 and while the most recent attempt to break above was stymied, the subsequent pullback and consolidation suggests that the momentum is rebuilding for the final attack. A move above the $1.02 level would see the A$ climb to $1.05 and then $1.10 but with the force of a major base to carry the new upward trend very much higher and would ignite potent implications for the “wild child” oil. An early indication of a danger or delay to the trend would be a drop back beneath 90c.

Political and economic hazards have buffeted US and Australian equity markets in 2010 with both moving virtually sideways within a 15-20% band. But stepping back to look at the long-term picture we find that this is not out of line with their respective histories.



When the New York Dow Jones index stalled at close to 12000 in early 2000 it began a broadly ranging sideways phase which exhibited marked similarities to that triggered in 1966. When the phase was completed in 1982 it commenced an 18 year bull run.

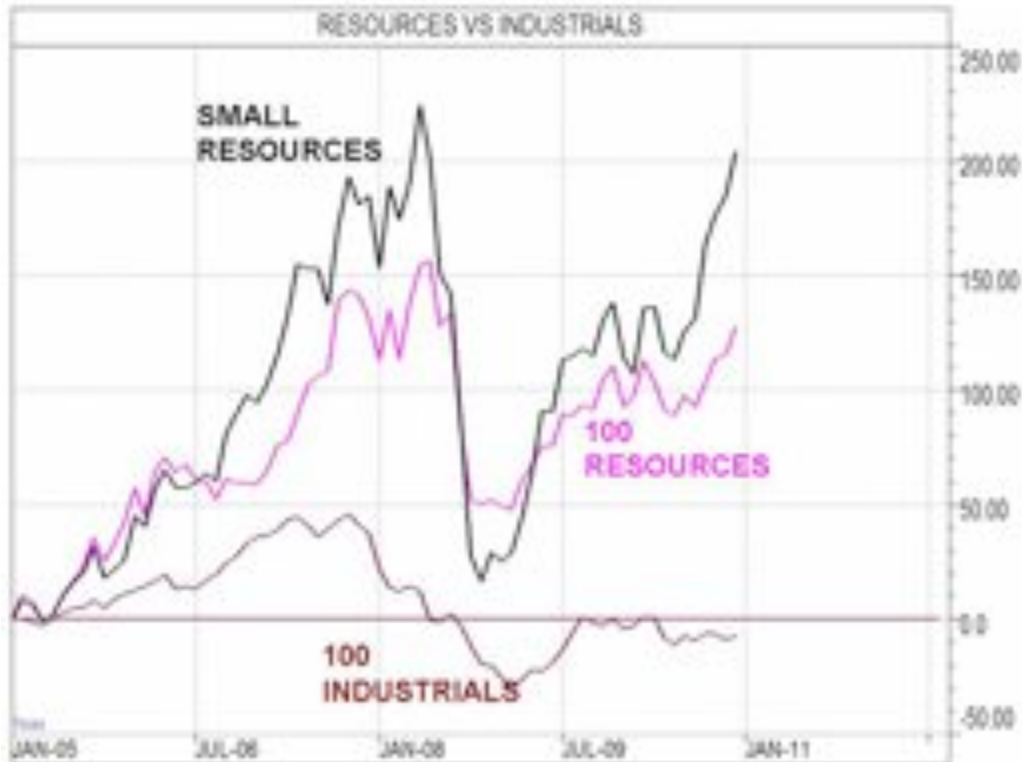
At present the Dow's action resembles two points in its history; the mid 1970s and around 1980. On both these occasions the index paused before pushing higher, but did not go on to force a new peak until later. This suggests that the Dow may continue to oscillate within its 15-20% range while building the potential to push into the 12,000-13,000 barrier zone – but that a more substantial move higher is unlikely as we move into 2011.



The Australian share market also shows an historical resemblance to the 1970s, but there is also a strong likeness to the 1990s just before the market began its run to take on the 1987 peak. This suggests that while the Aussie market has been locked in its own sideways phase this year it is in a stronger position for 2011 then the US market.

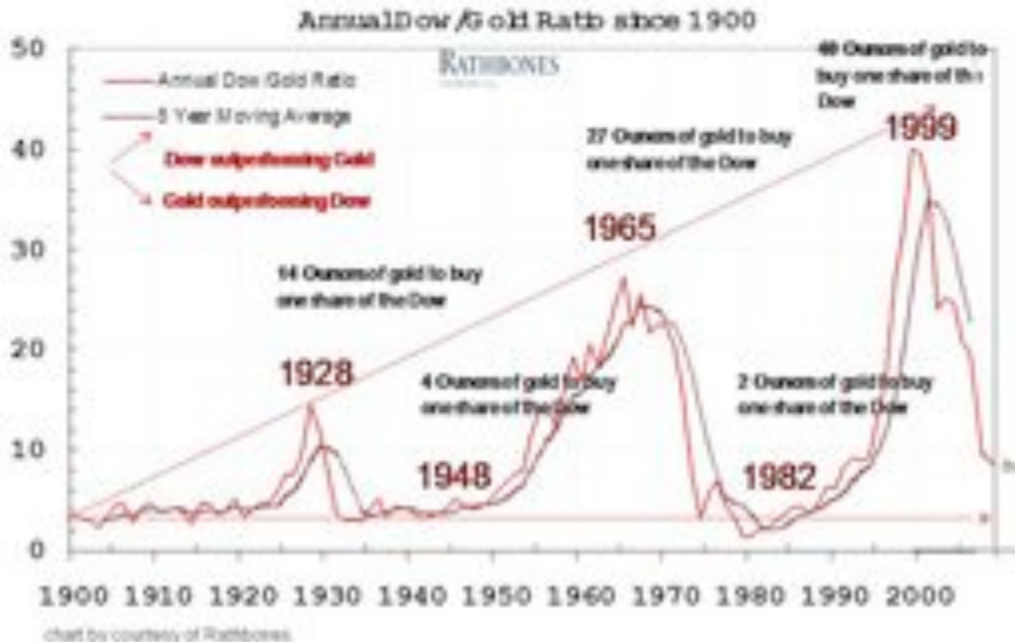
The All Ordinaries Index, currently around 4850, has its key barrier to the upside around 5000, and as with the Dow we may see more short-term churning – but there is a much higher likelihood they we will clear our hurdles ahead of the US.

As we examine our market it is important that we dissect it into its major parts as the Resource and Industrial sectors have had very different experiences during the year.



It is clear from the chart that the Australian market has been bolstered by its strong resources sector with the small resource stocks creating their own magic during the last half of this year. We do not see an end to this performance and believe that we will be relying for the most part on the resources sector and most importantly the smaller cap representation to carry us over our hurdles in 2011.

So to conclude from the charts: We believe that the Australian equity market will move into a stronger position in 2011 and will be able to break away from the sideways phase that encapsulated it in 2010 – but this is very much reliant on our resources sector. And for that performance to continue we must focus on the underlying commodities and suggest that gold, silver and copper will continue to perform in 2011, but that there will also be some action from other base metals, especially zinc and nickel.



Our final chart, the Dow/Gold ratio guides us through the secular trends in commodities and US equities from 1900. It supports our view that the Dow will continue to be trapped for some time and that gold will be the stronger performer. At the historical turning points in this relationship:

- in 1948 it took four ounces of gold to buy one Dow share, and
- in 1982 it took two ounces of gold.

The current relationship stands at 8.85 ounces, which suggests that gold will continue to shine into 2011.

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