



Registered Investment Adviser

September 2, 2009 Commentary
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S&P 500: 998
NASDAQ: 1968
Gold: 955

“No generation can contract debts greater than may be paid during the course of its own existence.” –*Thomas Jefferson, in a letter to James Madison in 1789*

Bonds

Dow Gold Ratio

Gold vs. Global Currencies

Bonds

I am back from vacation, although I did sell a bond fund while away. PPT is a closed end bond fund we owned which invested in corporate bonds. With risk tolerance in this market coming back a little too much and too fast I decided to exit the corporate bond market for fear of it pulling back again on renewed, realistic, fears on the economy. There is a decent chance the stock market will mimic the Depression path which implies another decline, possible even deeper, is coming. Should this happen bonds will decline as well.

Dow Gold Ratio

The past few trading days have exhibited the kind of behavior that represents the long term trend more closely: Stock Market Down, Gold Stable. The simplest way to track the trend of the relationship between paper assets created by central bankers and real money like Gold is to use the ratio of the price of the Dow to the price of Gold. You have seen this ratio in previous *Commentaries*. If the ratio is rising that means paper assets like stocks, as represented by the Dow Jones Industrial Average, are outperforming real money - Gold. This generally reflects sentiment in favor of taking more risk. If the ratio declines it reflects a decline in risk tolerance and a shift toward fearfulness as investors move money out of paper assets and into Gold.

The chart below shows the 2009 rally of this ratio within the long term down trend which can be tracked using the 50 week moving average (50WMA - blue line). As you can see

this ratio rallied into the 50WMA in Sept-Oct. 2008. At that point, fear began to take over again as the ratio declined (Gold outperformed) and remained under the 50WMA.



Something else important in this chart is the momentum indicator at the bottom. As the ratio rallied to new highs during the past few months, momentum did not exceed previous highs, as indicated by the blue bars rising a bit but not exceeding the previous peak of blue bars which occurred this past May.

To view this in a more bullish manner, for glass is half-full perception, I've flipped the ratio to Gold/Dow below with the same parameters. The 50WMA is now support and the red line way below is the 200WMA which has not been violated since the ratio broke through it back in 2002 when fear was accelerating during the 200-2003 bear market in stocks.



Regardless of which way you look at it, if we resume the long term trend of Gold outperforming the Dow our accounts should outperform since we are long Gold and short the market.

It is probably no coincidence that this previous three day period, or at least the past two days, is also the time that market participants return from the summer down time. Indeed volume was sharply higher on today's decline which adds to the negative tone. In other words, reality may be creeping back in to investor perception.

The U.S. Dollar Index is an index tracking the blended performance of the U.S. Dollar versus a basket of other currencies. When it rises, this implies the U.S. Dollar is generally rising against other major currencies and vice versa.

Gold vs. Global Currencies

The market dropping on strong volume and Gold rising at the same time as the Dollar supports is also significant. Recently Gold has been up with the market and a test of its strength is if it holds up when the market declines. Recently it has. Also, traditionally, Gold is inversely correlated with the Dollar. Lately, it is rising in the face of a rising Dollar. This is significant because a rising Dollar should make everything denominated in Dollars decline, including gold. The fact that Gold is rising implies it is rising even more against other major currencies. This confirms my theory of global currency devaluation versus Gold (due to massive paper money and debt creation) - the world's currency for thousands of years. Also, with the market declining and gold holding up, we see that it is resuming its place as an independent asset.

Three days does not a trend make, but since it matches the long term trend and coincides with an approach to the 50WMA it should not come as a surprise and is likely to persist should the 50WMA resistance hold up.

Successful Investing!

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