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GOLD STRATEGY:
YEAREND INDEX SYNOPSES

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In 1929, gold stocks fell in harmony with the stock market. In 1931, when the Crash's bear market resumed, gold stocks fell at first, but reversed and took off at one point as the Dow continued its decline through 1932.

Meanwhile, Homestake erupted 1000%.

The 25-year XAU chart on the next page illustrates a long term shoulder-head-shoulder pattern, with the left and right shoulders equidistant by 8 years from the head in 2001.

Consistent with its countertrend nature as a precious metals equity index, the XAU was falling through the 1996 – 2000 period. The XAU then made its all-time high in 2008, subsequently collapsing the same year to form the aforementioned right shoulder. So, silver's sharp wave-c decline was coincidental with the US equity market's collapse last year, correcting silver's entire advance this decade.

As often mentioned in these pages, the collapse also created a pattern extremely akin to that of silver, which, logically is also an item that is enjoying a secular bull market. Of course, this coincides with gold's march toward $3,500, as part of the latter's massive Wave-3 advance.

Presently, the XAU is underperforming gold, which it outperforms on a long term basis. Further, the XAU's outperformance expands the higher gold goes. Therefore, the potential for the XAU is extreme, since it is presently underperforming gold (overlay chart not shown).

The 5-year chart on the next page reflects the 300%-plus rally this year.

25-year XAU chart

The 2-year XAU chart which follows the 5-year graph illustrates a clear uptrend, and this correction's potential is to 150, for those concerned about an a-b-c flat correction of the rally that had ended at 180 in October.

However, the correction appears to be over, discounting an imminent low in gold to a level that temporarily breaks $1,100 (perhaps $1,080, as I have previously contemplated).

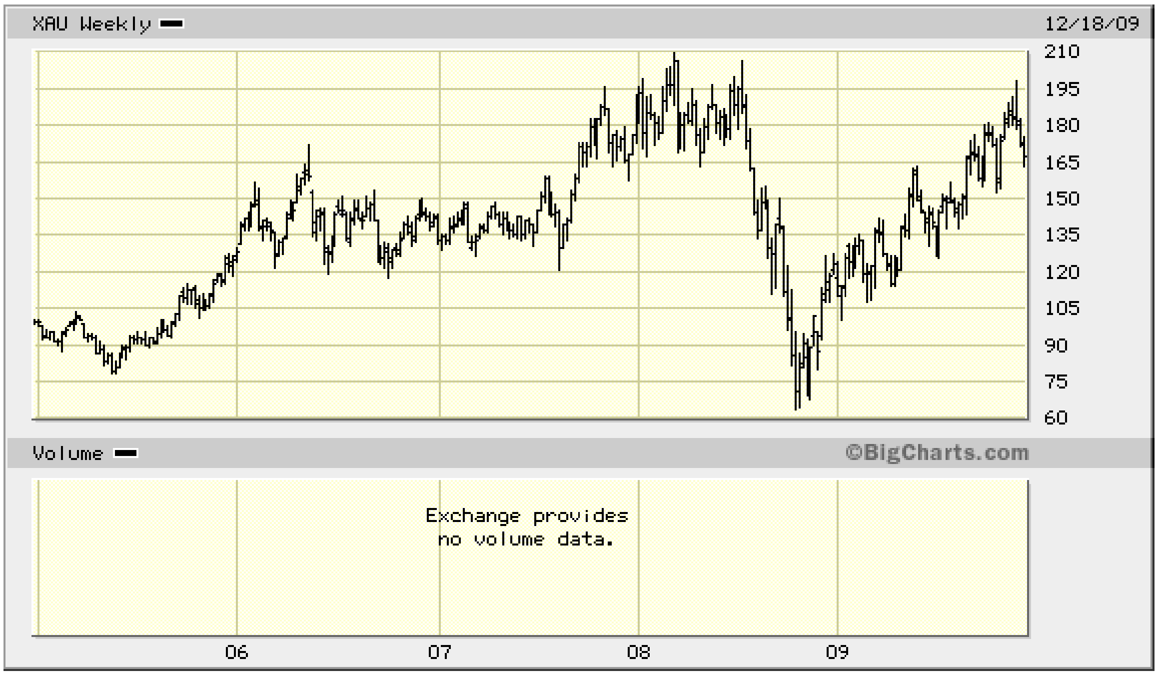
Then, the pattern would be similar to the April – July period of this year. Gold had corrected its preceding rally, not with an "a-b-c flat", but, rather, a rising and therefore bullish correction, where the April - July period included a new high since the 2008 low.

Similarly, the rally from the recent late October low led to a new year high, which has been followed by this low, which is higher than the October bottom.

Will the rate of advance decline over the coming quarter? Probably, but it will be an outperformer, with periods of sharp advances that follow what will have been net sideways corrections that coincide with larger declines in the equity markets.

My own investment decision-making process is based on the view that risk is to the upside [i.e. – more to gain than to lose, with a need for additional precious metals exposure (or more equity exposure in general), if such is the case for the investor].

5-year XAU chart



Please scroll to page 4.

2-year XAU chart

Strategy

The XAU is an optionable index only, and which does not have futures.

However, there is an index, the ticker symbol for which is GDX, which, while optionable as well, also is without attendant futures, but is a closed-end fund based on an index which is so similar to the XAU that any long term overlay of the indices reflects an almost perfect shadow.

With powerful support at 150, and with the world's investment choices so few, why would an investor NOT own some of this index? It is best held as a passive long term investment, ignoring the extreme volatility, and just going along for the ride.

Summary

At gold's peak, the XAU will be outperforming it. This suggests a swing in relative valuation, which provides a buffer of sorts for an investor who is only entering this market now. This is consistent with the XAU starting back up ahead of gold.

GLOBAL INDICES

The Nikkei has been rolling over, weaker and initially leading the Dow Industrials lower through 2010.

The Nikkei will retest 7000, even as the smaller stock indices are bottoming, having run contrary to the rest of the Japanese market throughout 2009. The most likely outcome, technically speaking, after the Topix Small index shot up about 9% in 3 days, is that it should see a higher low, as opposed to very minor intra-day low.

Shanghai has been leading Asia lower, forming a dangerous right shoulder, which approximates a post-bubble-collapse double-top.

When looking at Korea, India and others, we see volatility increasing against a backdrop of massive secular bull market double tops. Korea, for instance, is now in a precarious position, ready to resume sharp declines to much lower levels.

In both Korea and India, and consistent with bear markets in general, the declines are far more volatile than the rallies, as the number of days down remain lower than the number of up-days.

The VIX sits at lows, not confirming any of the recent highs in the stock market. This is a dangerous divergence and, in anticipation of imminent stock market collapses, we remain long from 24 or so, and maintain a close-only stop at 18.

We realized huge profits in the Yen from 118, while maintaining a sufficient long position to comply with the SKGS asset allocation model of:
50% gold; 33% Swiss Franc, Yen and USD, equally.

Merry Christmas and Happy New Year,

Sid Klein