



Last week gold broke out to new 16 year highs - a great time to interview our favorite technical guru, Richard Reinhard, editor of [Growth Stocks Weekly](#). GoldEditor interviewed Reinhard to get some of his thoughts on why he uses technical analysis, and what his technical charts are telling us about the price of Gold (which is performing well), and gold stocks (which are not). We provide a summary for you below. Sit down in front of the fire and enjoy:

GoldEditor: **Why do you emphasize charting, aka technical analysis, for making investment decisions?**

Reinhard: Technical analysis separates emotions from logic. If we all have the same completely logical expectations prices would only change when quarterly reports or relevant news was released. This would make investing easy.

Technical analysis (TA) is the process of analyzing a security's historical prices in an effort to determine probable future prices. We compare current price action (current expectations) with comparable historical price action to predict a reasonable outcome.

Only a small minority of technicians can consistently and accurately determine future prices. However, even if you are unable to accurately forecast prices, technical analysis can be used to consistently reduce your risks and improve your profits.

The price of a security represents a consensus - one person is buying and another is selling. The price at which an investor is willing to buy or sell depends primarily on his expectations. If he expects the security's price to rise, he will buy it; if the investor expects the price to fall, he will sell it. TA is based almost entirely on the analysis of the resulting price and volume as evidenced via a chart. A picture truly is worth a thousand words.

Think of security prices as the result of a head-to-head battle between a bull (the buyer) and a bear (the seller). The bulls push prices higher and the bears push prices lower. The direction prices actually move reveals who is winning the battle.

Support and resistance areas form where strong "emotions" occur, and can be penetrated by a change in investor expectations (a shift of the supply/demand lines). This type of a change is often abrupt and "news based", and often emotional.

A trend represents a consistent change in prices (changing investor expectations). Trends differ from support/resistance levels in that trends represent change, whereas support/resistance levels represent barriers to change.

The use of TA, essentially observing the clues and actions of the "crowd", allows you to divorce yourself from what "they" are feeling. Somewhat clinically, you are in a position to anticipate their actions and so act either ahead, with or counter to the crowd – providing a much more timely (higher probability) basis for investment decisions.

TA provides a basis or frame of reference using a logical and consistent approach that minimizes risks and maximizes opportunities. Most investors spend their time looking for easy money (which is not an easy search) instead of learning the key factors to security prices - supply and demand.

GoldEditor: **What are some different technical indicators you use, what do they measure and how do you interpret them?**

Reinhard: Moving averages are one of the oldest and most popular technical analysis tools representing the average price of a security at a given time. They essentially smooth the trend and provide a useful reference to the market's trend. Many other indicators exist that are beyond a simple explanation, including several of our favorites: Fibonacci retracements, relative strength index and on-balance-volume. Any good book on TA will explain these clearly to students of the markets.

Basically, there are three distinct types or classes of indicators, which provide insight into:

1. The external monetary conditions affecting security prices. This tells us what security prices should do.
2. The sentiment of various sectors of the investment community. This tells us what investors expect prices to do.
3. The current momentum of the market. This tells us what prices are actually doing.

Keep in mind that interpretation is more an art than a science, so experience and instinct count for a lot!

GoldEditor: **What are your thoughts on the US dollar?**

Reinhard: The US dollar is in a secular bear market. You can't open a financial newspaper or watch the financial news channels without hearing about the dollar bear. This trend became technically apparent in early 2002, just like the mirror-image gold price lift-off, yet the press typically provided little if any coverage.

With the US Dollar Index finally breaking the 85 support level in recent weeks and now with gold breaking through its US\$430-435 resistance, we are clearly starting another upwave for gold. The stock markets are looking somewhat like a rabbit in the road staring at oncoming headlights – frozen in disbelief, fear or confusion. The lag in the gold stocks is symptomatic – but once the trends accelerate away from their key resistance (for gold) and support (US dollar) areas, there will be a rush to participate by the undecided or offside investors – eventually resulting in an accelerating trend that will shock the dozing public.

There are several technical reasons and many fundamental reasons why a US dollar bottom isn't here and that the trend is nowhere near approaching its ultimate end. Technically the US Dollar Index is trading high up in its downtrend channel near a wall of overhead resistance. To see this graphically you can visit my website www.gsweekly.com

Of course the dollar needs to periodically bounce or that fear would get out of hand. Technical bounces are a normal and desirable part of major downlegs, bleeding off excessive fear and rebalancing investor sentiment.

But make no mistake about it, we see a slow-motion crash of the US dollar. Key to remember is that all major commodities are denominated in US dollars, the world's de facto reserve currency. If the dollar is falling, you need more dollars to buy oil or wheat or steel or any commodity. Commodity prices across the board are responding to the dollar's weakening, but gold has a particularly strong correlation, as it is effectively America's best currency alternative.

Gold has now broken out to 16-year highs and other metals are following suit. Aluminum is selling at multi-year highs, as is copper, lead, silver and nickel. Grain prices are surging. If we're right about the long-term direction of the dollar (it really doesn't have any choice), these gains are just the beginning.



GoldEditor: Can you simplify the long term technical story behind gold?

Reinhard: In late 1999 gold sank below \$260 an ounce as the Dow headed over 12,000. This was in hindsight the best possible time to leave the roaring tech-boom party and reposition for what will likely be considered the trade of the decade – buy gold. One problem - there was no one ringing the bell that gold had hit an historic bottom!

Then in April 2001 gold hit a 21-year low near \$250, essentially the same lows of 1999, forming a technical double-bottom. Sentiment was understandably very negative, with headlined high-profile central bank sell-offs, and pundit predictions of sub-\$200 gold. As is fairly typical, gold chose its darkest hour to turn into a new secular bull market only now starting to get some mainstream recognition.

It's easy to focus on the day-to-day ripples, but it's the larger intermediate waves and the secular direction of the tide that determines where the big money is made, and this big picture perspective continues to set the tone for our unique early-stage, well-pedigreed-small-cap resource-sector investment focus.

TA monitors supply and demand - the key elements that determine price. As long as demand exceeds supply, prices will rise over the long term. The fun to be had is when this equilibrium price is a fair ways away from the status quo, and for many reasons I believe this to strongly be the case.

Global gold supply only grows incrementally each year because of the difficulty and huge capital costs required to bring new gold deposits to market. Gold is a relatively small market where a demand shift leads to magnified price adjustments, especially because unlike a typical commodity, gold is a unique store of long-term value.

The key to any secular gold bull is the demand or supply that private investors generate as they buy or sell gold, as this market represents about 80% of gold ownership. The collective gold transactions of millions or even billions of individual investors worldwide buying and selling gold will ultimately set the price.

Perversely, in the investment world the higher the price an investment climbs the greater demand becomes. Virtually no one wanted anything to do with gold near \$250 a few years ago, but anyone around in late 1979

through to January 1980 witnessed the madness of the crowd as gold rapidly accelerated to its peak at over \$850 per ounce.

The key to understanding any market bubble's distinctive parabolic curve is to understand the shifting investment demand over the life of a secular bull. The higher the investment price, the more attention it attracts, the higher demand grows, the higher the investment price goes – a virtuous circle.

Gold is ultimately a store of value, hard money, so far simply appreciating in US dollar terms to counter the devaluing US dollar. Many currencies such as the Euro and the commodity-based Canadian dollar are also appreciating strongly relative to the US dollar. When gold starts appreciating from the foreign investors' home-currency perspective, maybe as a result of their government's determination to remain competitive through competitive devaluation or a lowering of interest rates, the rush to own gold will accelerate.



GoldEditor: So many people have said that Gold's critical level is \$430 – why is that?

Reinhard: Gold has been repulsed by overhead supply near this price point many times, but the number \$430 has no particular significance. In actual fact \$430 is well north of where resistance is usually met. Just earlier this year enthusiastic gold investors were financially bagged when gold's largely uninterrupted run from the January 2001 \$250 area double bottom came to an abrupt halt on January 13 2004 at \$426. We suffered a correction to \$390, a run back up to \$427 in April (a double top!) and then a plunge to the \$375 area in short order. Of course this caused magnified volatility and a sharp decline amongst the junior gold stocks.

Looking back further, this is the same area that marked the January 1996 peak, January 1990 top, January 1987 resistance and even the late 1979 correction before the breakout to the ultimate \$850 secular peak (also in the month of January). For whatever reason, demand seems to meet supply in this area, and of course the market's always right!

On October 25, 2004 gold closed at \$429, to me a key close and the highest since February 1990's high close of \$424. Interestingly, gold barely pulled back at all these last 3 weeks (the closing low was \$424 on 2 days) and in fact has traded consistently above \$430 with progressively higher closes since November 4. Today's close (November 16) was \$439.40. Can you spell STEALTH BREAKOUT?

GoldEditor: **Is \$430 the big support level now?**

Reinhard: The \$425 area has indeed built up significant support over the last month. Any significant breakdown through the area would be a cold shower for the gold market, causing no small amount of pain to leveraged portfolios and hedge funds as offside investors stampede to liquidate. Investors are best served by having their positions paid for and being prepared to ride through the inevitable volatility. We're sailing with the tide, and able to withstand the odd rogue wave.

Interestingly, this is not an extended, over-bought market. In fact, many traders and gold bugs would have "faded" into this key resistance zone – that is, sold as price approached the resistance area, anticipating a pullback. This is one reason old resistance becomes new support once decisively breached. "Trader's remorse" is a well-known phenomenon, where market traders who sold too early and investors who missed the run become increasingly anxious to (re)establish positions but afraid to chase the price up.

GoldEditor: **Has Gold broken out for good?**

Reinhard: Yes. Gold has now broken through resistance and is continuing a trend unlikely to change for some time. A trend remains intact until it is broken. But keep in mind that a retest of this support is typical after a decisive move into the \$440's gets everyone excited. This would be an opportunity to add to trading positions. Right now from both a fundamental and technical perspective I'm convinced that we are setting up for an accelerated run to test the \$480-500 area.

GoldEditor: **Where do you think the next major resistance level is?**

Reinhard: A re-visit to gold's long term chart shows that once the \$430 area is cleared next major resistance will be met at around \$500, and above that it's about \$720. Again, this is historical and based on several distinct data-points separate in time, lending some confidence to each level's ongoing significance. \$500 also has that "large round number" psychological aspect to it.

GoldEditor: **How does investor psychology affect charting patterns and their analysis?**

Reinhard: Some basic key observations investors need to consider:

1. Price represents the fair market value as agreed between buyers (bulls) and sellers (bears) at a point in time.
2. Changes in price are the result of changes in investor expectations of the security's future price.
3. Support levels occur when the consensus is that the price will not move lower. It is the point where buyers outnumber sellers.
4. Resistance levels occur when the consensus is that the price will not move higher. It is the point where sellers outnumber buyers.
5. The penetration of a support or resistance level indicates a change in investor expectations and a shift in the supply/demand lines.
6. Volume is useful in determining how strong the change of expectations really is.
7. Traders' remorse often follows the penetration of a support or resistance level as prices retreat to the penetrated level. Which means what? The buyers regret having bought and want to break even, or the sellers feel stupid for having sold and want back in!

GoldEditor: **Technically where is Gold's critical support level for the bull market remain intact?**

Reinhard: If one looks at the 4-year chart, effectively covering the double-bottom of early 2001 and the full move of this first phase of what is now a confirmed secular gold bull market, a clear channel can be plotted which bounds the higher-lows and higher-highs with parallel up-trend lines. Today, to break the bottom trend line we would need to see price break down through the \$390 area, and then there still exists major support at the old resistance band around the \$375 level. A break in the established uptrend would not negate the bull market,

but a breakdown through major support would put it in jeopardy – effectively the lows of April 2004 would need to be breached to the downside.

GoldEditor: Why are some of the gold stocks not breaking out with the price of Gold?

Reinhard: Actually very few gold stocks are breaking out or achieving new highs along with the price of gold. There are probably several reasons for this, but a major one has to be investor's reluctance to buy when price is perceived to be at the top of a trading range – a "been there, done that, won't do that again" psychology. This will change once the gold price leaves this range behind and investors start to believe there's upside. A "once bitten twice shy" memory is strong – fear will need to be overcome by greed.

Another factor to consider is that there was a record amount of financings last year as long-suffering juniors took advantage of the first wave to load up the treasury at relatively cheap prices. There's a lot of paper that needs to be absorbed. The HUI Gold Share Index has gained about 600% over the last 3-1/2 years and most investment managers and retail brokers missed the market. Typically any bull market's first phase is marked by denial and this one is no different. By the time phase two progresses to the point that average people start to become aware and accept that this is for real, we should see some serious professional capital inflow to the sector.

Once the senior companies do become fully or overvalued in anticipation of gold's continued rise, there will be a natural migration of investment capital to the undervalued intermediate and then junior sectors. Because it takes three to five years to find a decent discovery, and another several years to build a mine – there's no quick way to catch up for the lack of exploration and development of the 1997-2002 resource slump, and so to position into perceived value will mean buying into deserving early-stage opportunities now, or pay-up down the road. Resources are now scarce, and the competition from investors, funds, mining companies and foreign countries will only become more intense until somehow supply increases to the point where demand is met – and this is unlikely to occur for several years.

GoldEditor: Do you buy strictly on technical factors or do you always include fundamental considerations and why?

Reinhard: You need both. There have been many scams and market manipulations where the technicals were orchestrated to appear compelling. Likewise, the fundamentals have been wontonly manipulated (remember Bre-X) in an effort to deceive. At least with Bre-X the technicals would have stopped you out even as the story remained compelling. It's never a good idea to ignore any data entirely, although if I had to make a choice, technical analysis and good money management discipline is all one needs to make consistent returns.

GoldEditor: What is your biggest trading rule? (i.e. never average down; your first loss is always the best loss, etc.)

Reinhard: A rising tide raises all ships, and vice versa, so assess the tide, not the ships.

Some of my other timeless favorites:

- Be patient: don't be rattled by fluctuations.
- When all you're left with is hope, get out.
- Never catch a falling knife.
- Cut your losers, and let your winners ride.
- Bear markets begin in good times. Bull markets begin in bad times.
- Draw trendlines. If a stock is in a downtrend don't go long, and visa versa.
- If you learn one candlestick pattern, learn Doji at the top of a trend.
- Contrarians are correct at turning points in the market, but wrong the rest of the time.

GoldEditor: What books do you recommend for the beginning trader?

Reinhard: Technical Analysis of the Financial Markets: A Comprehensive Guide to Trading Methods and Applications by John J. Murphy

- Trading for a Living: Psychology, Trading Tactics, Money Management by Alexander Elder
- Financial Reckoning Day: Surviving the Soft Depression of the 21st Century by William Bonner
- Reminiscences of a Stock Operator by Edwin Lefèvre

GoldEditor: Our heartfelt thanks go to Richard for his willingness to share his time and well-thought-out views. For more insight into Richard's very profitable investing world please visit www.gsweekly.com