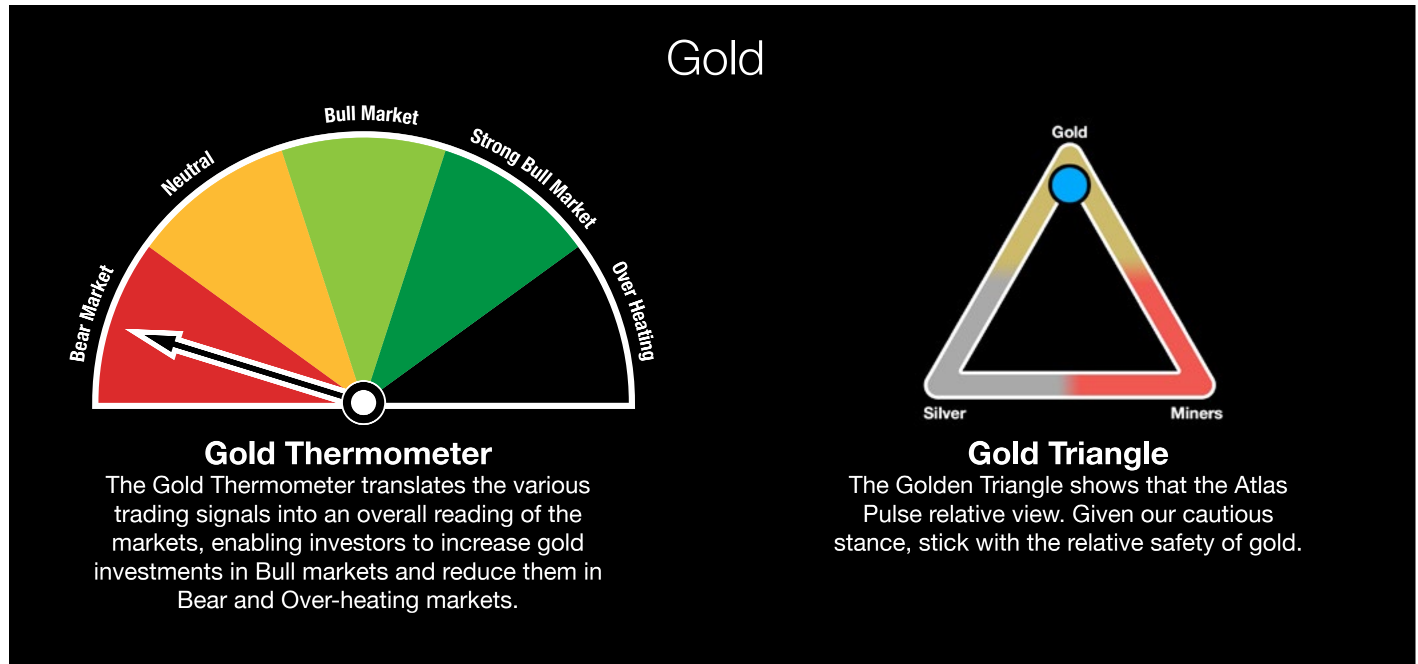
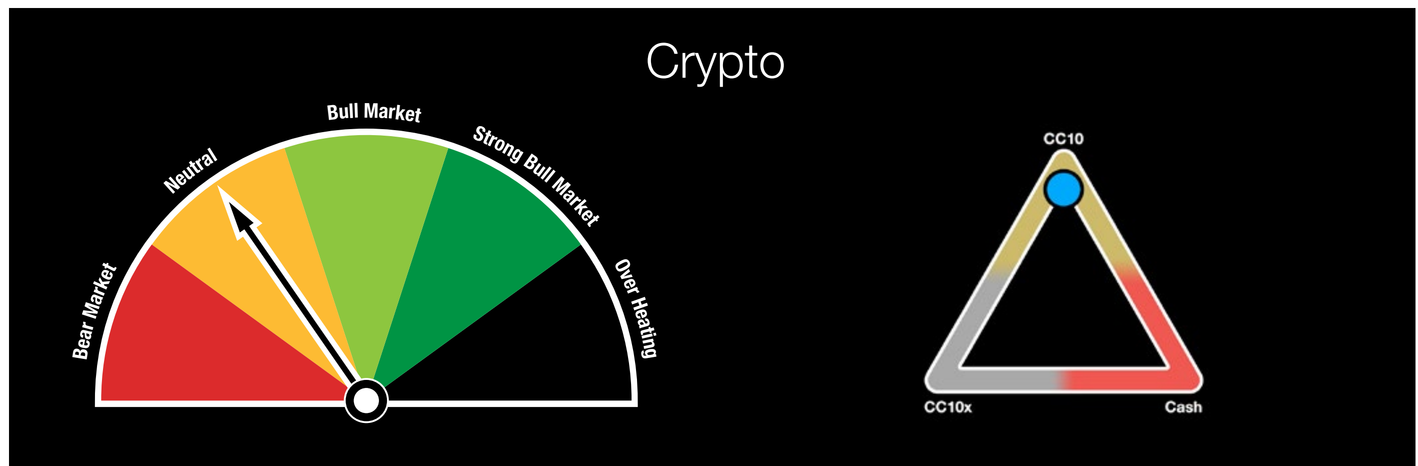
Atlas Pulse

See the facts, trade the action, ignore the noise



Gold Thermometer
The Gold Thermometer translates the various trading signals into an overall reading of the markets, enabling investors to increase gold investments in Bull markets and reduce them in Bear and Over-heating markets.

Gold Triangle
The Golden Triangle shows that the Atlas Pulse relative view. Given our cautious stance, stick with the relative safety of gold.



Recent recommendations

Gold:

Jan	2013	downgrade to 'bull market' at $1,675
Feb	2013	downgrade to 'neutral' at $1,663
May	2013	downgrade to 'bear market' at $1,476
July	2013	bear market rally with range $1,180 to $1,400
Nov	2013	expect new lows into 2014
Sep	2014	silver smash

Crypto:

Dec	2013	initiating coverage
Mar	2014	buy Bitcoin
Oct	2014	thermometer begins at neutral

November 2014

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- Short-term technicals
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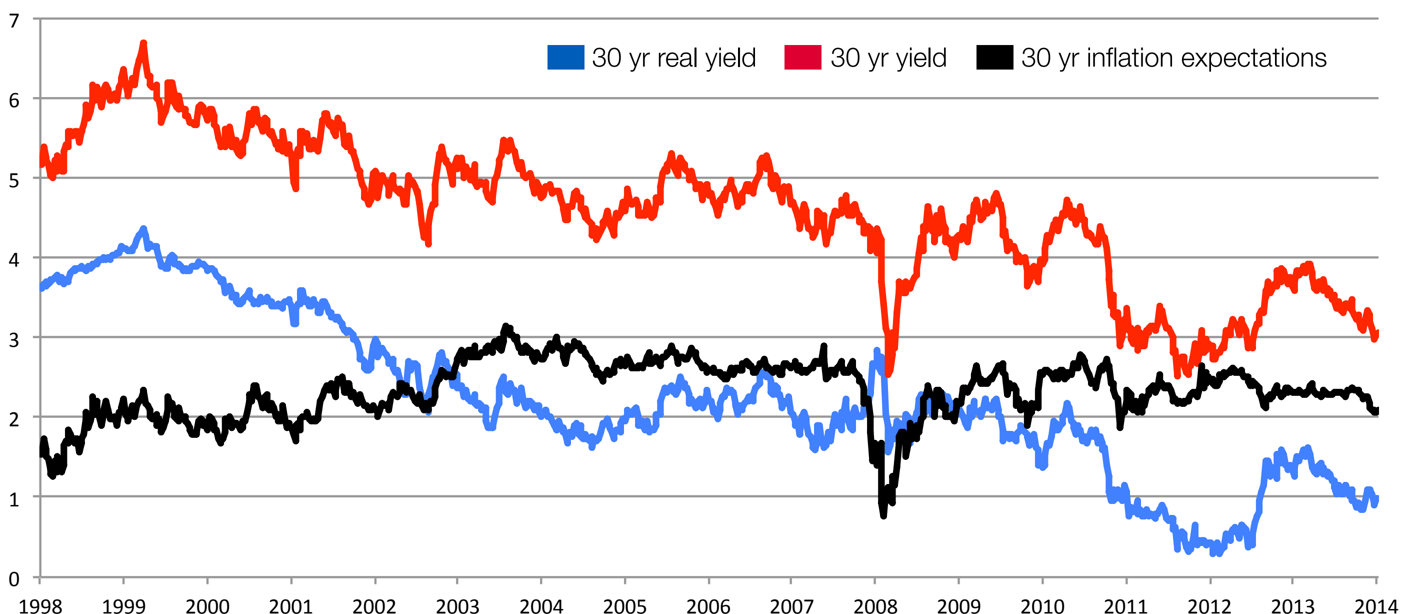
- COT, flows, 3x and sentiment
- Bitcoin and sidechains

Gold sends a message

These last few days have been painful. Gold has made a decisive snap below $1,180 and price weakness had been felt in multiple currencies. Bull stories such as the Swiss referendum, which would make the SNB a sturdy buyer, fell on deaf ears. No sooner than the Fed called an end to QE, our friends in Japan felt they needed another dose. Did that help gold? Probably not. QE was supposed to lift inflation expectations but it hasn't. Instead it has bolstered asset prices, particularly bonds, houses and US equities, but not gold.

QE in the USA has been instigated every time long-term inflation expectations have fallen below 2%. These bond-buying programmes were initiated in November 2008, November 2010 and September 2012. The latest round, QE3, saw over a trillion dollars injected into bonds yet inflation expectations have fallen as can be seen on the chart.

USA 30 year rates and inflation since 1998



Source: Bloomberg

Chart note: *The red line shows the 30 year US bond yield. The black line shows 30 year inflation expectations. The blue line shows the real yield, which is the difference between the two. The real yield has the greatest impact on the gold price, but the relationship is slightly more complex than that. In essence, low real yields mean that investors are forced to take risk. QE has been more successful in quashing real yields than boosting inflation expectations. In April 2013, we had the taper tantrum, where real yields jumped to 1.5% from 0.3% which coincided with the crash in the gold price. Now that QE has ended, could gold's weakness be telling us that real yields will rise again, possibly to 2%. If so, expect a storm.*

Remember my favourite person from 2014, David Ranson? He told us that gold was the best indicator of future inflation. It stands to reason because gold has led inflation shocks consistently over the years. Here are a few examples:

- In 1998, gold fell ahead of the Asian crisis.
- In 2008, gold snapped several weeks before the Lehman failure.
- In 2013, gold fell ahead of the taper tantrum.
- In recent days, gold has broken the key support level at $1,180.

Does this mean another deflation scare is impending?

I believe so. Real yields will jump and income bearing assets won't like it. Corporate bonds, REITs, emerging markets and defensive equities will feel the pain whilst the Nasdaq will shrug it off.

Yes, the Nasdaq. The boom in tech stocks is just getting going. I expect this to be the story of 2015. Look at that bond yield chart again. In the late 1990s, real yields exploded to 4.5%. The old economy hated it but the new economy loved it; growth was pursued at any price.

If we look at the Nasdaq today, it's top names are Apple, Microsoft, Google, Gilead, Intel, Facebook and Amazon. Whilst social media gets the bubble attention, the collective growth from Silicon Valley is mouth watering. Investors still remember the year 2000 and so they steer clear. Today there are few technology funds whereas then, there were many. Flows into the ETFs are negative. Whereas investors have doubled up in gold miners and silver in 2014, they have fled tech. In this regard, investors have been very wrong. Tech stocks have risen in the absence of retail speculation.

The Nasdaq's collective profits have trebled since 2008, at a time when most other countries and sectors have struggled to regain new highs. This boom in tech is real. The forward PE is 19, which for that level of growth is modest. I won't turn Atlas Pulse into a tech letter, but just be wary of the bubble spotting bears. You ain't seen nothing yet. Tech will go nuts.

I have been negative on silver for some time. With a gold to silver ratio at 73, it is finally beginning to offer some value but the trend is down. As you know, I believe silver to be a late cycle asset that is sensitive to credit spreads. If the end of QE leads to a rise in real yields, then credit spreads will balloon. That's not good for silver.

I previously discussed the shanghai premium in silver which stood at 10%; a very high level. A story recently emerged that there has been a tax scam in China. Manufacturers have been 'exporting' silver wire in order to receive a tax credit. They have sold enough wire, that is used in loud speakers, to last a generation and the authorities have stepped in. As Buffett famously said, ***'when the tide goes out, you find out who has been swimming naked.'***

I had also highlighted that some silver miners were withholding sales in the hope of higher prices. Last month First Majestic announced that they had halted sales for precisely this reason but would now reverse that decision. Production was sharply higher as it has been for many gold and silver miners who have recently reported.

My surprise for the recent price action has been that the miners have sold off so much more sharply than silver. On value grounds, I'm a long-term buyer of the miners but won't jump until gold finally capitulates.

A bond issued by God

Going back to rates, you won't be surprised to learn that I've modelled the gold price as if it were a bond. Consider the following statement:

Gold is a zero coupon, irredeemable, inflation-linked bond issued by god.

Zero coupon means it pays no interest.

Irredeemable means it has a long time horizon.

Inflation linked means it is a store of value.

Issued by god means it is an element that will never disappear or default.

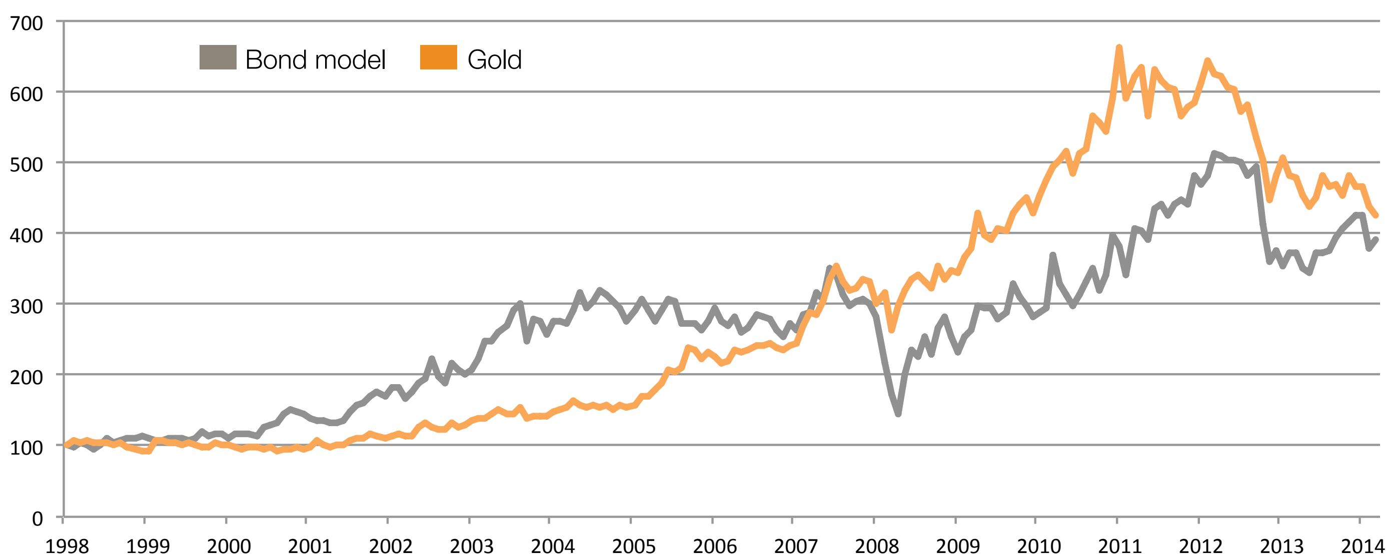
The US consumer price index (CPI) is currently 237. If 30 year inflation expectations are 2%, the market believes CPI will be at 429 in the year 2044. That is a nominal return of 81% and a real return of zero. To put it another way, the market currently believes the dollar will fall by 45% over the next three decades in terms of purchasing power.

What would you pay for that investment opportunity?

For a positive real yield, you would want to pay less than 237, so that your return would be higher than 81%. If real yields were 1%, you would want to pay 171 otherwise bonds would be a better bet. (stick with me, this is just theory)

So I've pretended that gold is a bond driven by current CPI, 30 year yields and 30 year inflation expectations.

The Atlas Pulse Bond model – since 1998



Source: Bloomberg, Atlas Pulse

Chart note: *This model charts the statement that the gold price is a function of real yields, inflation expectations and CPI. Since 1998, CPI has risen by 45%. The impact of the 30 year yield falling from 5% to 3% has contributed 75% whilst higher inflation expectations from 1.5% to 2% have contributed 20%. Putting these together explains why $100 invested in 1998 is today worth $400 which is more or less the same return from investing in gold. If this statement is true, gold was too cheap in 2005 and too expensive in 2011. Notice how gold leads the model, ever so slightly.*

I like this idea. Having struggled to get a consistent message from studying the two's (2 year bonds), inflation, rates and so on, this seems to fit like a glove. 30 year inflation expectations are only available since 1998, so sadly we will never know what people thought before that time. I have also looked at this in Canadian dollars, British pounds, Mexican Pesos and Brazilian Real. There is also data from Italy but it doesn't work at all due to the sovereign debt crisis. These studies generally suggest that the gold price is about right except for the sterling model. In that case, the pound is significantly overvalued and could be in for a nasty shock.

All in all, gold has reverted back towards this bond model. It will probably overshoot as investors panic, but I hope you will agree that this is one of the better ideas Atlas Pulse has published.

I will leave you with some scenario analysis in the following table. It has been calibrated to current data with the 30 year yield at 3% and inflation expectations at 2%.

Impact on the gold price (%) using the Atlas Pulse rates model

30 year inflation expectations %	30 year US Treasury yields %												
	0.0	0.5	1.0	1.5	2.0	2.5	3.0	3.5	4.0	4.5	5.0	5.5	6.0
0.0	-29	-39	-48	-55	-61	-66	-71	-75	-78	-81	-84	-86	-88
0.5	-5	-18	-29	-39	-48	-55	-61	-66	-71	-75	-78	-81	-84
1.0	29	11	-5	-18	-29	-39	-47	-55	-61	-66	-71	-75	-78
1.5	74	49	28	10	-5	-18	-29	-39	-47	-55	-61	-66	-71
2.0	134	101	73	49	28	10	-5	-18	-29	-39	-47	-54	-61
2.5	216	171	133	100	72	48	27	10	-5	-18	-29	-39	-47
3.0	327	266	214	170	132	99	71	47	27	10	-5	-18	-29
3.5	477	394	323	263	212	168	130	98	71	47	27	9	-6
4.0	679	566	471	389	320	260	209	166	129	97	70	46	26
4.5	952	799	669	559	465	384	316	257	207	164	128	96	69
5.0	1321	1114	938	788	660	552	459	380	312	254	205	163	126

Source: Bloomberg, Atlas Pulse

Table note: *If you want to see gold go to the moon, pray for Japanese long term interest rates (1%) combined with Argentinian inflation. If you want to buy gold cheaply, then hope that that rates increase in an inflation free world.*

During the credit crisis, the 30 year went to 2.5% and inflation expectations to 1%. A repeat would imply a 39% fall from current levels. Fortunately, that won't happen because gold will enjoy a doomsday premium during such times so the impact will be less.

In the late 1970s expectations were (presumably, more on this next month) around 6% with yields close by. A repeat of that scenario would see gold trade above $5,000. Of course this is just a model, but I like it.

Short-term technicals

Gold is trading at a five year low and technical support is at $1,000. It could reverse sooner, but that's hopeful. I've consistently stated that gold normally has four down moves in a bear, and up until now, it has only had three. An average fall has been 50% (or 48% to be precise) and the 38% drop to $1,180 hasn't been enough. If gold touches $1,000, the historic averages will have been met.

Gold monthly since 2000

Source: Bloomberg

***Chart note:** I've added the 12.7% trend line that broke last month. It's pretty decisive. $1,000 is probable but $700 is possible. The former will probably happen, but if real yields spike higher, say to 2%, then the lower target becomes more likely. Of course, a rates crisis will bring on the inflation machine as the authorities respond. This will be a superb buying opportunity for gold.*

Oil is expensive gas

Before I forget, a quick word on the dollar. It's rising and will continue to do so. A strong dollar translates to weaker gold IN DOLLARS. In the same way a rising euro would lead to a weaker gold price IN EUROS. It's little more than that. Of course, big dollar rallies and falls send other messages since it is still the reserve currency, but following the dollar doesn't translate into useful trading signals for gold, above and beyond the obvious short-term link. The recent falls have been felt across the board, but gold hasn't yet made a new low in global money, but it may well do soon assuming this weakness continues.

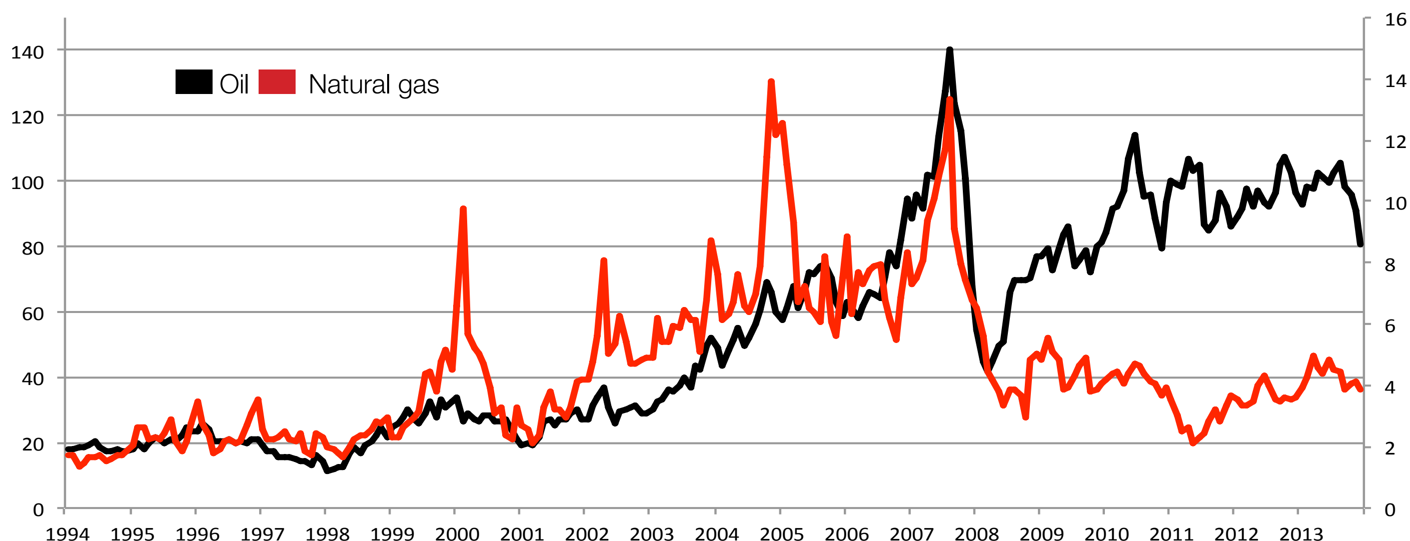
A stronger dollar, for this same reason, has added to the pain in all commodities. Agriculture has been dying for three years. Iron ore, gas and coal have also been weak but now oil has broken down to $80. Unsurprisingly, oil, commodities and wages are the bedrock of inflation expectations. Few people seem to be getting a pay rise these days and so it's easy to see why inflation expectations are falling.

I had the pleasure to meet a chemical guru called Paul Hodges from International eChem last month. He made the point that the chemical industry is a leading indicator on global growth and that things were dire. He knew his stuff and the point that fascinated me was his expectation that oil would fall to $50.

His argument was that the shale boom in the USA had meant supply pressures had receded. Natural gas prices were low, due to new technology, and would stay low. Whilst many believe gas is a buy because it is cheap relative to oil, he stated that oil would collapse to a point where it would compete with gas. Substitution from diesel to gas is exploding in trucks and rail, thereby reducing long-term demand. Cars are more efficient than ever before and the millennials aren't buying them. The collective efficiency gains in other areas mean that the growth in energy demand over the next 40 years will be met with no increase in production. Wow.

Remember peak oil pre 2008? It's all change. This is bad for Russia, Brazil, the Middle East and others. The Scots should be grateful that the stupid population in Glasgow wasn't ever so slightly higher; the North Sea would never have made them rich.

Oil and natural gas – since 1994



Source: Bloomberg

Chart note: *Oil (lhs) and gas (rhs) were highly correlated until 2008. It's amazing what technological progress can do. Whereas many previously believed that gas was cheap versus oil, it may be the other way around. Oil is falling so that it can compete with gas. Oil has recently dropped below a 'squeeze' pattern which is generally bearish.*

The key point here is that commodity prices are falling. With low wage growth and falling commodities, inflation expectations are also falling. Gold will struggle until these factors turn up. They will eventually, but probably not soon.

COT, flows, 3x and sentiment

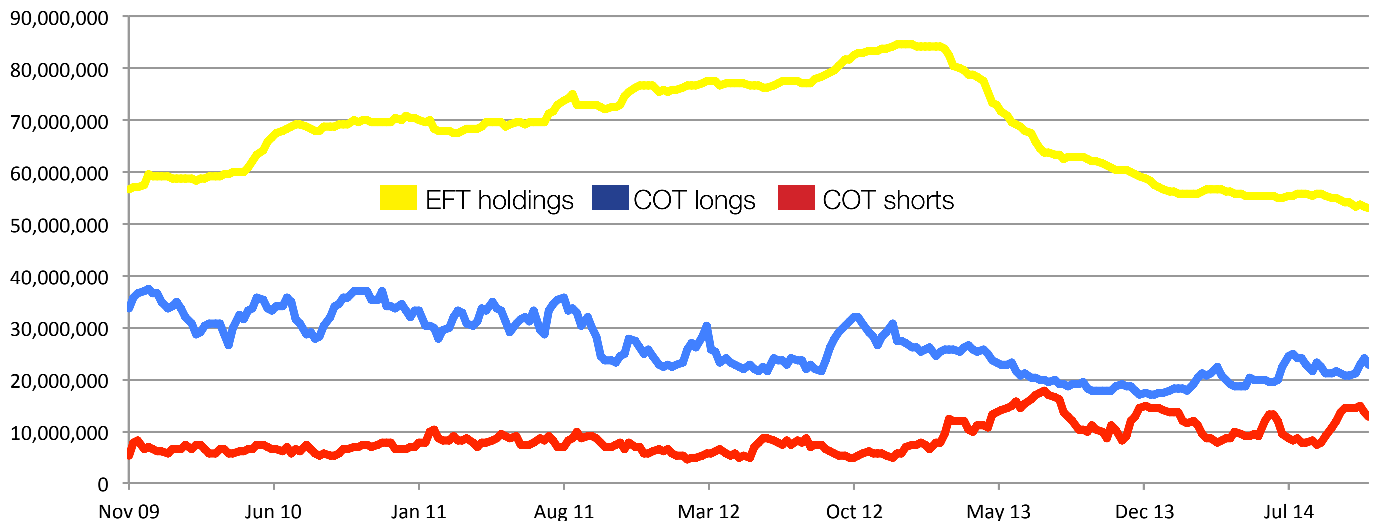
COT stands for commitment of traders; it is the data series from the Chicago exchange that shows the positioning of speculative, as opposed to commercial, investors. Those are typically hedge funds.

ETF stands for exchange-traded fund. These hold physical gold and silver and are mainly traded by institutional

and retail investors. The number of ounces of gold or silver that they hold is reported on a daily or weekly basis. All holdings are shown in million ounces (MOZ) on a like for like basis. The ETF movements tend to be slow, the COT longs faster, whilst the COT shorts move very quickly.

3x refers to the leveraged exchange-traded notes that are used by investors to express a strong view. The daily returns are 3 times (hence 3x) the daily percentage move of the underlying asset either long or short. These funds are highly speculative.

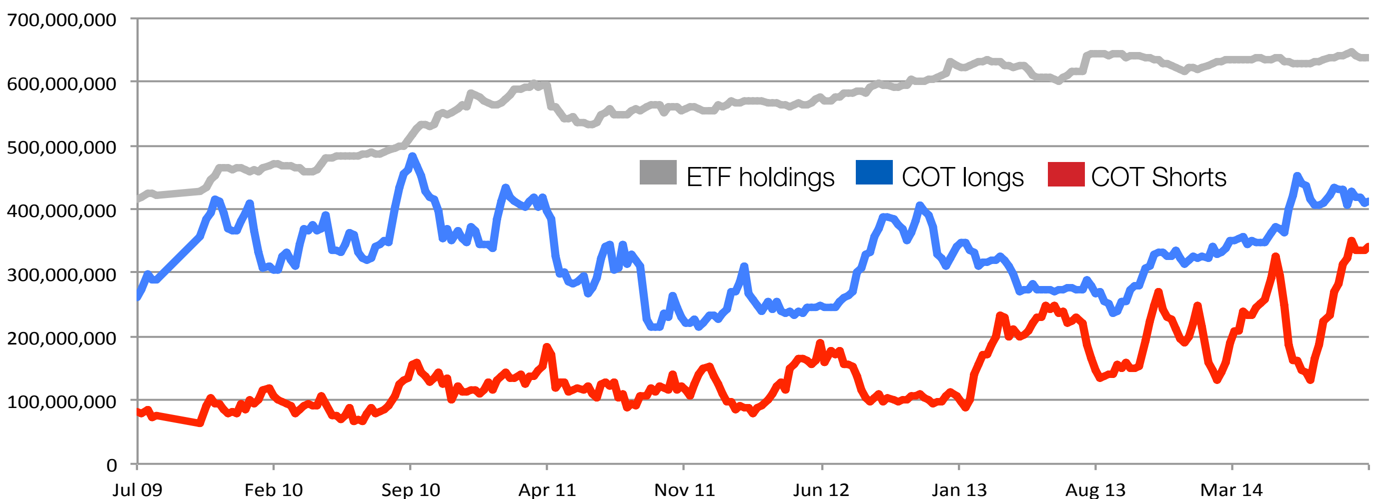
Gold COT and ETF flows – past five years



Source: Bloomberg

Chart note: *The ETFs continue to sell their ounces of gold, but the futures market remains little changed. The shorts are high whilst the longs remain relatively committed. This picture understates the severity of the price action. There is room for continued unwinding, particularly from the ETFs. A short squeeze is possible, but greater forces are now in control of events.*

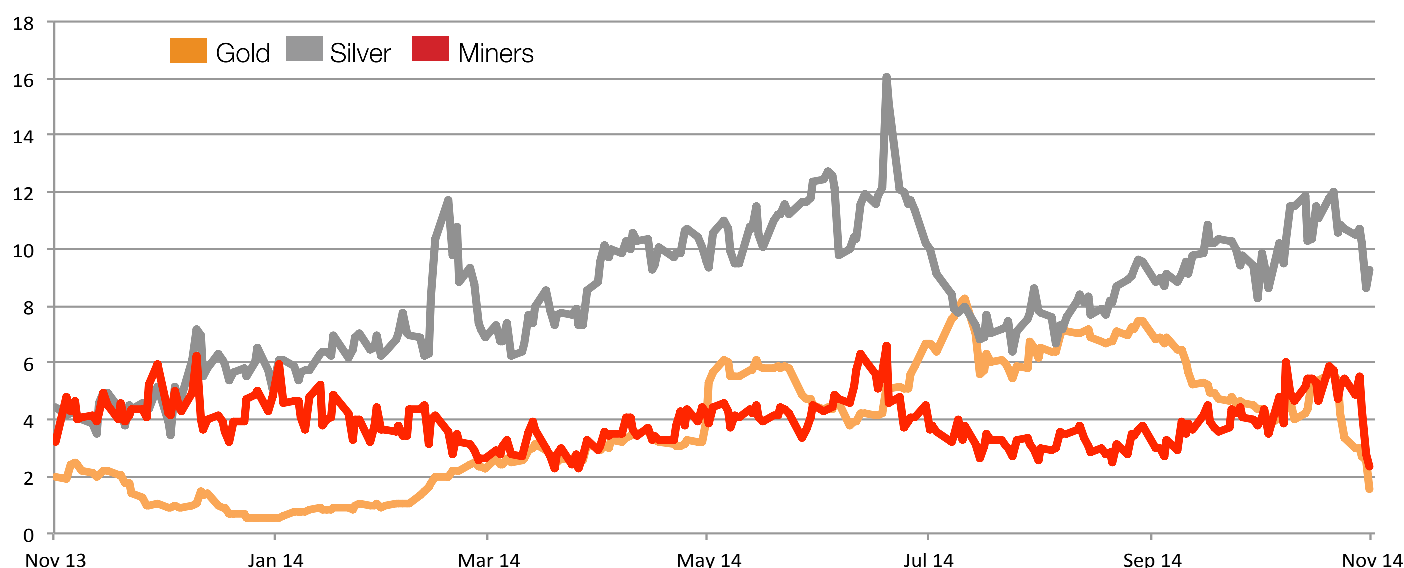
Silver COT and ETF flows – past five years



Source: Bloomberg

Chart note: *The shorts are high but as prices have fallen, the 'cash' exposure is markedly lower. The longs are beginning to sell from high levels, but the ETF holders are in denial. Silver ETF investors have not only given back their $18.5 bn dollars of profit from 2011, but are now collectively underwater by $1 bn which is 10% below their choke point ($17.70). Silver's price action has been brutal. There's over supply from the miners, fraud in China, rising credit spreads, a deflation shock and the unwinding of the ETFs hasn't even begun. I wish I had something nice to write about the silver market, but I don't.*

3x in gold, silver and the miners



Source: Bloomberg

Chart note: *These 3x series are driven by price and flows. What you see is largely the impact of price. The value of the longs has collapsed and no flows at all have gone into the shorts. For example the NUGT (gold miners 3x ETF) was $50 in August and is now $10. Good money has been thrown after bad. These numbers have come down due to price destruction. Sentiment remains high because investors keep on buying. Silver is still 8:1 bulls:bears. That's four times higher than gold or the miners. Unbelievable.*

I won't show capitulation indicators this month, but will tell you the key signal I'm watching is gold's implied volatility. The ticker is GVZ; it's gold's VIX. My rule of thumb is that twice the average historic volatility means a reversal is likely. The historic average is around 15. Therefore a spike will have a reading above 30. You can follow this for free on bigcharts.com. Above 30 isn't a sure buy, but at that point, a short-term reversal in trend should be believed and acted upon.

The end of the gold bear market is now in sight. I'm hopeful we'll have upgrade to neural by the year end. When it happens, Atlas Pulse subscribers will be notified by an interim message.

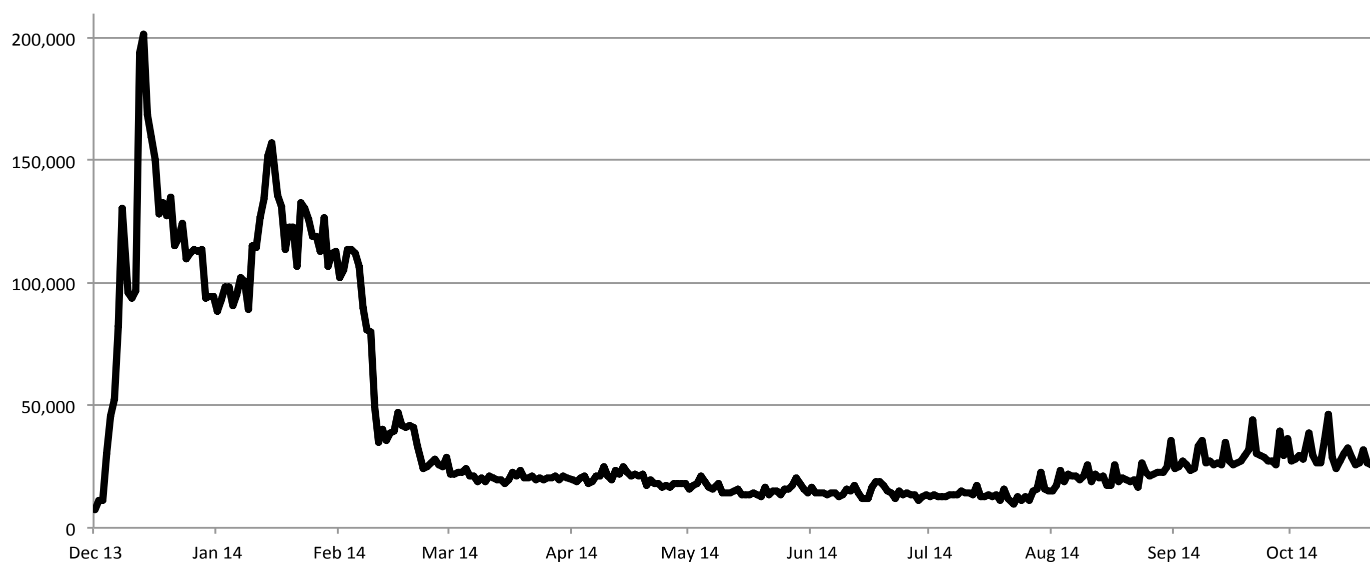
Bitcoin and sidechains

A paper was published last month by some Bitcoin diehards on the potential for 'side chains'. The idea is that you freeze some Bitcoins on the blockchain and recreate them on a new blockchain that runs in parallel. That side chain could, for example, specialise in trading gold or Bitcoin companies. It is Bitcoin's way of innovating so that it can

squeeze out the competitive threat from innovative altcoins. The paper is heavy going but it's an interesting idea. My hesitation is that if this space is real, there is room for several networks and not just one. After all, would the world work with a single currency? Of course not.

The price action is still weak but last month I promised some insights into altcoin networks. I promise to do great things here but right now, there's little to say. Most of the statistics on altcoins are so erratic that it's hard to display them. For that reason, I've gone back to basics and show Dogecoin's number of daily transactions. I don't believe this has ever been published before. Another Atlas Pulse first.

Dogecoin transactions per day since launch



Source: Cryptocomp.com

Chart note: *Dogecoin got off to a great start in late 2013, but since Easter has collapsed. The mini revival in the summer hasn't continued. Sadly, people are bored of Dogecoin. Daily transactions are 25k having peaked above 200k and falling.*

I could show you more altcoins, but it's just more of the same. The big message is to hold your horses until something interesting happens. Focus on your day job until Atlas Pulse says it's time to get excited.

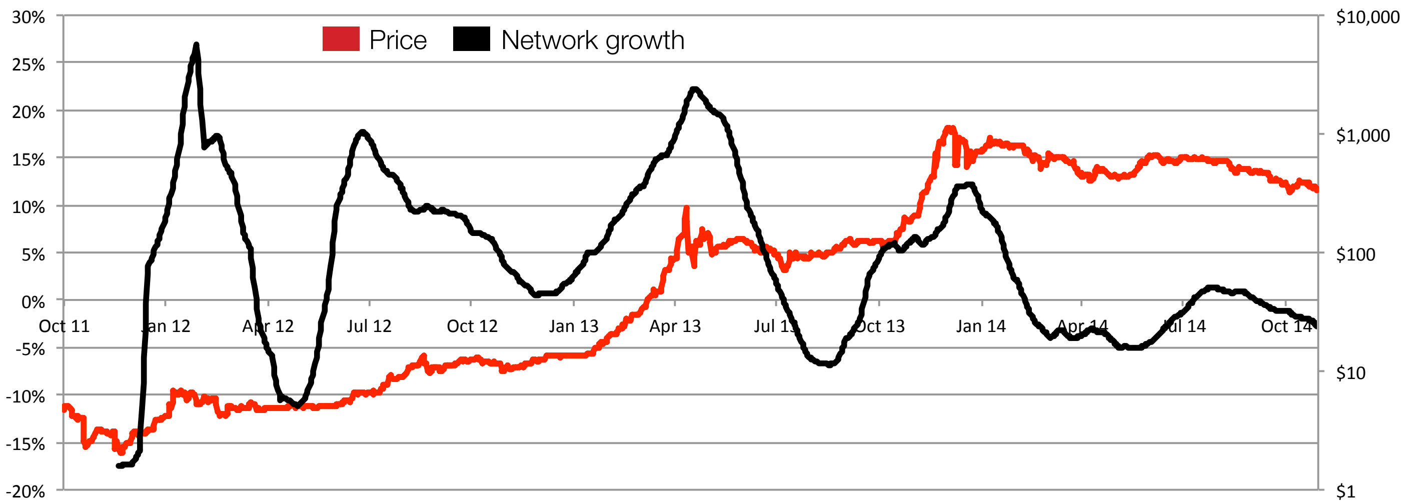
Many crypto enthusiasts seem to think coins are some form of property that has similarities to gold. I disagree as they have no intrinsic value. I mean, they may one day reflect inflation expectations in some way or another, but they were hardly issued by god.

I believe their value is a reflection of their utility. In other words, the more we use them, the more valuable they will be. I own a couple of Bitcoins but have only ever managed to buy two glasses of wine in Chamonix and a latte in Shoreditch. When I search for retailers in central London, there's a massage parlour in Shepherd's Market where I suppose you could enjoy an erotic experience. Much that a happy ending courtesy of Bitcoin would be an interesting experience, I don't see the financial system being uprooted just yet.

This is internet money; issued by the internet for the internet. I see the future in data and content. Grab some data off a website or enjoy a service without exchanging details. This is web cash. When we buy a newspaper for cash, it's quick and simple. Why does the system want to know who you are, where you live and your bank details for a simple transaction?

Once this idea starts to gain traction, I believe cryptos will spring to life. Until then, I'm sad to say that the Bitcoin network continues to contract.

Bitcoin growth in network fees since



Source: Cryptocomp.com

Chart note: *The fees have been converted into dollars and combined on a rolling weekly basis. Using fees is the most accurate proxy for representing the size of the Bitcoin network. The number of transactions hides the fact that transactions could be small. It is difficult to measure the actual value of transaction because the network deliberately hides it. The black line shows the change in fees and the red line, the Bitcoin price. Price follows the network growth.*

We get slightly better news from the number of transactions. These have grown but not by much. Much of it has come from gaming websites which are heavy in transactions, but don't add much to the ecosystem.

Bitcoin total weekly transactions

Source: Cryptocomp.com

Chart note: *Transactions recently exceeded 500k per week. Whilst this is an enormous achievement, many transactions seem to relate to a gaming site called Satoshi Dice. However you look at it, growth of 100k transactions per week over the past 18 months, is far too low to signal lift off. If the Bitcoin network was ready to challenge the status quo, weekly transactions would be in the millions by now.*

I remain strategically bullish on cryptos but can't see a reason why the price will rise in the short term. So far, much has been built around speculation, but little for real use. Let's hope 2015 changes that. If a new Bitcoin bull run could coincide with a boom in the Nasdaq, anything is possible.

Summary

Gold has broken below key support at $1,180. In recent years, sharp gold falls have preceded deflation shocks. Looking at oil and the failure of QE to bolster inflation, we may see another crisis before too long. If we do, real yields will rise and many assets will suffer. The safe haven, I kid you not, will be the Nasdaq. Obviously it will fall during the shock, but by less than most. Thereafter, it will go nuts as it's the only growth story on this great planet.

Silver and the miners are in trouble. The miners are now below the 2008 lows and cheap on most measures. They will bounce with vigour when gold finally bottoms. Silver is a market in true denial. Too many people believe it's something it isn't. It's in plentiful supply and it's not even precious. The unwinding hasn't yet happened but I can't see why it won't. Given the over supply, it won't take much to cause severe damage.

The Bitcoin network has contracted. Prices have fallen so it's slightly cheaper but there's no hurry. It's not gold, it's a tech currency. A boom in the Nasdaq combined with a killer application will be the opportunity of a lifetime. It'll come.

The gold thermometer remains in a bear market (get the white flag).

The Crypto thermometer is neutral (we need to spread the word).

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