

Notes From the Rabbit Hole ©



Peter Newell's illustration of Alice surrounded by the characters of Wonderland. (1890)

NFTRH166

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December 18, 2011

A Plan Emerges

While the plunge from HUI support was not the direction NFTRH was leaning, markets are more readable because the consolidation in HUI and many other indices has ended with last week's declines, although there is still a glaring lack of resolution in the battle of the ratio indicators (Gold-Silver vs. JNK-LQD) just to keep things interesting. Broad markets hang in the balance, and the view is not positive on the intermediate term.

Gold was finally (and unceremoniously) smashed down to and through our target of 1590 (1562.50) before it rebounded to 1601.30. Was that all there is to the downside? Well, that is unknown, but what is known is the state of gold sector sentiment. It stinks, and that is a positive on a risk vs. reward basis for the short-term at least. I rest easier when there is terror (as opposed to greed) in the camp of Team Gold Bug.

Richard Russell has issued his "instructions" to the flock to sell all stocks, including gold miners. Nouriel Roubini is puffing out his chest and taunting gold bugs on Twitter, and Dennis Gartman has gone bearish on gold. These signs indicate lower short-term risk for the relic. But 'price' risk is still in play for gold and there could well be additional price downside to come. The 'real' risk was when gold was flying around at 1900 an ounce sponsored by dumb, emotional money; not now at 1600. This week, we look at gold, along with other asset markets within a clearer, evolving game plan. Unfortunately, the game plan is not coming from a positive place.

Current Outlook

Broad US Markets	Short-term neutral, intermediate term bearish . SPX is a hair below 1220 while Dow, NDX, RUT, TRAN, etc. grapple with support area generally around 50 day moving averages.
Broad Global Markets	Global emerging and developed markets generally weaker position than US, which is interesting, because EM's are destination for future NFTRH investment, given net creditor status & growth. Global markets generally testing support at 'higher lows' to Nov. low and well above Oct. lows. Bearish until proven otherwise .
Broad Commodities (unchanged)	We are of course still within an economic contraction, which is being battled by heroic inflators. Asset prices hang in the balance. Commodities are a mixed bag at this point, but in a big picture remain relatively bearish from a technical standpoint, right along with broad markets.
Gold	1590 now in the books. A target of 1450 is now open . This may be pending a relief rally or may not come about at all, given the dynamic monetary events in play. Important point is that the summer momentum is gone and that is good for this store of 'value' tool.
Silver	Silver failed at support and the chart now looks worse than it did previously. Technically, 31 could provide resistance, which calls into question the probability that the precious metals sector can rally strongly.
Gold-Silver Ratio (unchanged)	GSR remains in bullish looking consolidation . If it breaks down, get ready for an extended party. As long as it remains in the current state however, it would be prudent to at least be aware of its status as rally non confirmer .
Gold Mining	The hard breakdown from support was notable. It may prove to have been a buying opp for short-term trade. But it is recommended to know what you own and why you own it, and be ready for coming broad bear activity in Jan/Feb, which could hurt gold miners as well. Sector fundamentals still good and due to improve in 2012. A hold of 480-500 targets 888, a loss of that support targets low 400's per super long term analysis of Barron's Gold Mining Index presented in NFTRH165.
US Dollar	Target just above 81 is still in play, but USD could take a short breather before the next try at it. During this breather, asset markets could rally for Santa. But deflation remains in play until such time as Fed and/or ECB blinks. Could take longer than some expect, esp. if asset markets rally short-term. Confusing, I know. ☹
Risk (conventional)	A couple weeks ago we noted "high risk to bears". Then massive rally and risk to bulls came back into play. Things are currently neutral with a 'lean' toward continued bull into January. (New 12/18/11: Risk is very high beyond any short-term rally potential, only traders should be playing in markets) .
Risk (systemic) (unchanged)	The risk is that global and US managers will lose control this time, or simply be constrained by public opinion (i.e. growing discontent with business as usual policy) worldwide. Result? Cessation of functional markets as liquidity is sucked away in derivative whirlpool.
US Treasury Bonds	Long bond remains a candidate to top out (long term interest rates rise) for short-term at least, which could come in conjunction w/ an equity market rally. But deflation remains the dominant force until/unless policy makers blink.
Sentiment	Gold, silver & commodity Public Opinion profiles are generally bullish (sentiment very bearish, except in crude oil). AAI, Investors Intelligence, Hulbert Sentiment Survey all lurched bullish last week. Sentiment profile on broad market is now neutral AT BEST. Caution across all assets.

Gold – Weekly View



Gold has qualified for support at current levels (1590 target registered), but if this is truly to be a deflationary ‘event’ prior to US and/or European QE style policy, gold can easily decline to the 38% Fib retrace level (roughly 1450) off of the rise out of Q4, 2008. Think about it, the fear at the end of 2008 was about as strong in the opposite direction as the euro crisis driven greed was last summer.

Now that we have gotten an initial break down, a target in the 1450’s is open. A major deflation issue would in my opinion attend anything lower than that (like 1150, which is also open). We do not want to go there, but the market being the market, could have other ideas. File this under ‘Forewarned is forearmed’, and nothing more at this time.

Recall how we managed the ongoing “platform” (yellow shaded area) on the weekly MACD for many months in 2010 and 2011. It was noted as a potential springboard to something, but what I did not know at the time was that it would be a springboard to such damaging events (to the sentiment profile) as the Euro Knee Jerk panic. So MACD is back on message, but I am nagged by the theory – in my own mind at least – of equal and opposite reactions to previous actions.

Please remember that the price of gold is not to be cheered and rooted for. It is a monetary barometer of the times and we want to take our signals from this barometer. If deflation wrecks the system, gold would likely be puked along with most other assets in a mad and panicked rush for cash; valueless, debt-backed cash. That would be the influence on gold’s ‘price’ by masses who do not and never did understand the concept of

value, especially relative value as gold would still well out perform other assets in such an environment.

Gold – Daily View



This was a hard crack and in becoming more over sold by RSI than during the previous three moderate to hard declines, gold is a candidate to bounce here. This is conveniently timed with the coming of Santa, assuming he ever gets here. Much like with the HUI as noted in Friday's email update, we would be getting ahead of ourselves if we were to target above the moving averages (1650 to 1700). Technically, the nose of the former Symmetrical Triangle is a reasonable best near term upside target for now as gold can easily ping 1700 on a rebound.

When gold lost the EMA 160 (green) at around 1650, technical damage was done that could take some time to undo. When impulsive moves happen, they often indicate more activity to come in the direction of the impulse.

While gold can rally in the short-term, and probably *needs* to rally to relieve the over sold status, it plays right into the evolving plan that sees a resumption of bearish activity sometime in January. Short of this, if gold should fail to rally and instead hits 1450 along with silver in the low-mid 20's sooner rather than later, NFTRH will be prepared to become quite bullish on a risk vs. reward basis on the entire precious metals complex.

Silver



NFTRH has gone from 'not bullish' to bearish on silver. How could I be bullish with a chart like this? Ag lost the noted support around 31 (now resistance) and 34 remains a strong and critical resistance area. Meanwhile, if we are to see Santa, silver can catch a brief bid. The targets on any relief rally would be 31 and then 34.

Interlude: Game Planning

This leads me to the rudiments of the evolving plan. Silver can rebound in nominal terms and it can rebound in relation to gold in the very short-term. **If the gold-silver ratio continues to merely consolidate while retaining its bullish look, a bearish divergence would be in place for silver, commodities, stock markets, possibly the gold miners and even the nominal price of gold.** Understand this possibility even if things get bullish and endorphins are released in the short-term.

One possible scenario:

Near term bounce into early January in most asset markets as the USD corrects → Potentially sharp but brief rally fails in January → The whole shootin' match rolls over into a February low that could be enough to make most people want to throw in the towel → From here we descend into an unthinkable and undeniable deflation or → Policy makers finally push the panic button.

Either way, exposure to gold will be important, no matter what the noise of the day (including Gartman and Roubini) at the time, or what gold's nominal price is doing.

The important thing will be to not be in a position of feeling vulnerable at such time. The events of the last week have given us indications, and we should listen to them. The best way I can think of to not feel vulnerable is to find the right combination of cash and gold.

If precious metals, commodities and stock markets continue down right now – no Santa, no holiday joy – then it is going to hurt in the short-term, but a quicker path to panicked policy making would be in play, which would be bullish for the precious metals. If however, the downside is delayed with a rally here and now, the analysis looks to be telling us to be prepared for new lows after it peters out.

Whether that means holding your positions and puking in your mouth in Q1, 2012 or selling into any coming short-term rally activity, is up to the individual. Whatever you do, have a plan and resist the urge to puke for the entire world to see during a strong decline or dare I say, crash.

I do not like silver, and I do not like the bullish structure of the gold-silver ratio (GSR).



So, if the most recent bullish formation in the GSR breaks down, we can talk of extended bullishness for asset markets. But the ratio remains above important moving averages and has a well formed shape to it. Even if it were to find strong resistance at around 63, the damage will have been done to asset markets in the interim. **In the absence of a breakdown in this ratio (the ultimate liquidity – or lack thereof – indicator), NFTRH is going to continue to highlight the risk to asset markets.**

Put another way, think about the potential buying opportunity that could be presented with a rise to 63 in the GSR, a corresponding plunge in asset markets and maybe, just maybe, a more panicked US Federal Reserve and European ECB.

This is the gateway to the “leveling of the global playing field”, which my friend Jonathan is busy working on. This is where debt ridden developed nations put

themselves ever further out on a leveraged limb, scaring capital to productive, net creditor nations as the global system realigns. These would be the Emerging Markets.

Gold Stocks



Here is an older chart correlating the GSR with the HUI in the lower panel. The chart attempts to show how HUI can often negatively diverge prior to an upsurge in the GSR. Yet in the current situation, HUI rose to a lower high (most recent red arrow) then simply tanked from there, despite a still consolidating GSR.

One implication is that if GSR were to launch upward right now, croaking asset markets as it does so, the HUI would lose the big picture 'blue sky' support zone of 480 to 500. Another possibility is that the gold stocks could begin a rare phase of positive correlation with the GSR (ref. the chart in NFTRH163 showing a phase of general positive correlation from 2001 to 2005). This becomes possible during times when deflation is the dominant backdrop, as opposed to what happened from 2005 to 2008 when the commodity/inflation bull touts got a hold of the play.

The message is that gold stock investors do not *always* need to fear the gold-silver ratio, although it is wise to have caution nonetheless as events unfold. This chart also gives us a valuable lesson in risk management. Recall that we managed a target that would fill the '610 gap' coming out of the October 'bull pivot' low. Well, that important target turned out to be as good as it would get and was among the last good selling opportunities. Depending on the backdrop in January, might the '550 gap' provide something similar?



The HUI-Gold ratio has thus far retained its 'higher low' and thus is not on a negative divergence. If this changes, a bearish short-term indicator would be active.



Here is the chart from Friday's email update, with a few more details painted in. HUI can bounce from the current support zone. If it does so, the target, given the sentiment and over sold condition of the sector, could be a sharp rise to 550 or so to fill the gap, as stated previously. This could be revised bullishly or bearishly going forward as we are in

very rough waters. 550 appears to be 'best' short-term target, but this is probably predicated on a Santa rally for broad markets.

Precious Metals Bottom Line

Gold is big picture bullish and due for a bounce. But the impulsiveness of the decline argues that there could be more downside after a recovery rally. Silver simply does not look good at all technically. The gold stocks target HUI 550 and a deeply over sold exploration segment could ignite some upside fireworks into 'January Effect' season. But the ultimate bottom may not be in for any of these items.

In short, NFTRH leans bullish for the short-term, but is open to a bearish outlook beyond early January. Big picture remains bullish. The short to intermediate term is subject to ongoing revision. The data points should be flying in each week going forward now that we have busted out of the consolidations of recent weeks. We will be bullish, bearish or neutral as needed in the effort to be the only thing that really matters, which is right.

My current portfolio stance (cobbled before I sat down to perform this week's analysis) must be regarded as leaning bullish in anticipation of some relief, but that is all that I am willing to call it right now. If the plan being formulated above strengthens in the coming days and weeks, my personal plan is to be an aggressive seller into early to mid January.

US Dollar & Euro

NFTRH is not in the camp that obsesses on the US dollar as a necessary enemy of gold or especially the gold stocks. To review an ongoing theme from the past, the very thing that is driving up the USD is also driving up the 'real' price of gold, which in turn drives up positive sector fundamentals for gold mining operations. This, as gold holds its value much better than the average market or commodity that is positively correlated to economic activity during a contraction and/or deflation. Gold is not necessarily hurt and could even benefit as nations battle each other in the devaluation sweepstakes. Gold miners on the other hand, actually benefit fundamentally.

But this is the USD segment; so let's get to it. The point above is, do not fear the USD just because legions of commodity bulls and inflation touts do. They need a whipping boy and they need a cartoon-like, easy to understand story to tell the masses. Well, this is not easy. None of it is easy. The USD is currently gaining the bid because it was the anti-market to all the speculative games that were pitched into the 2008 crash and again coming out of the 2009 bottom into last summer.

The USD is the anti-market to an industry of touts that would have players putting everything they have into the inflation plays like copper, oil, steel and hogs. The US dollar has already been inflated into intrinsic worthlessness, but the forces of deflation keep its price nice and buoyant. If you own a barrel of oil, you own a precious resource. But that is no comment on what will be the price of that resource in the near term.



If the plan that is taking form this week is actually on track, a decline by USD to the 78.50 – 79.50 zone might attend a brief broad market Santa rally. USD is stretched pretty far above its 50 day moving average and could take a break before launching toward the next target, which is the resistance above 81.



Uncle Buck's main rival, the euro had better rally right here and now because if current support is lost a measured target of 109 will be activated off of a massive topping pattern. A rallying euro would of course, go hand in hand with a global Santa rally. The euro has some bullish divergence by MACD and RSI came to an oversold level that could launch a recovery, perhaps to the moving averages per the yellow shaded area.

US Treasury Bonds



The deflation problem is still biting hard. Yields need to turn up here or it is an express elevator to a real and intense deflation problem. In line with the short-term plan for a broad market rally, yields could rise to the noted resistance area at 3.5% before turning back down into an ever more serious deflation problem.

Wrap Up

I have gotten side tracked this week into the macro economics and into a game plan that seems to be taking the lead, with near term rally potential followed by destruction of asset prices. There is of course no way of knowing whether this will actually play out. But I am a firm believer that it is better to have plans, which can be subject to revision than to just go forward with no plan at all.

Quite frankly, to this point in the letter, the sum of what I have seen tells me that we should be very respectful of the negative potentials of the markets despite any near term rally action. This would mean dropping the attitude toward Richard Russell's "instructions" to his followers, though not those toward the deserving likes of Roubini, who I believe is little more than a deflation cheerleader and self-promoter in service to his continued high profile.

Commodities look terrible but can bounce per this daily chart of the CCI index. In fact, much like the euro, CCI had better bounce here at the 62% Fib amid bullish divergence by the momentum indicators... or else.



What concerns me is how bad commodities look in nominal terms in combination with how bad they look in relation to gold, per the following chart.

As I go further along with NFTRH166, I become more concerned with the forces of deflation, as opposed to being a brave contrarian (am I turning into a contrary indicator?). It is what the charts are telling me. I think I know that the Fed and/or ECB will panic into inflationary policies, but the thing is I do not want my assets to hang in the balance of a hoped-for outcome at any time. I want to be able to take advantage of opportunity.

Below is a view of the proxy for gold's 'real' price, the Au-CCI ratio. Rest assured Au-CRB looks just as bullish, as both are testing support to their 'blue sky' breakouts. Au-GYX (industrial metals) is well above support, but not yet broken to new highs. Au-Crude Oil is testing important support and while this would indicate a 'buy' on the gold stocks, the overall deflationary backdrop warrants caution.

Here we need to remember that in 2008 people were actually selling gold exploration companies for less than net cash on hand with the gold in the ground given away for free as a bonus. As long as the deflationary backdrop is in force, investors are subject to the

margin clerk and to the emotions of their fellow players. You want to have cash on hand in such situations, and not be a casualty of such situations.



Yet this chart continues to represent improving fundamentals for gold mining operations, as their cost inputs continue to decline relative to their product. The lower ratio, Au-Oil should be watched closely as it is an important individual cost driver, and while it looks like the ratio is now ready for continued upside, it has been weak since the summer.

We have not even gotten to broad markets, so let's end with a word about them. They are bearish; potentially very bearish. We are within a window where a rally can ignite but it looks to me like this would be a last chance to sell type of rally, if it comes about.

The favored gold stock sector, improving fundamentally as it is, remains too well correlated with the broad markets (although last week's activity may have begun a process of semi-decoupling) and any coming hard decline would represent a buying opportunity due to the fundamental backdrop. Technically, HUI 480 to 500 remains the big picture bullish line in the sand. As long as it holds, the upside target on the big

picture is the crazy sounding 3 Snowmen (888+). So today's cautionary tone balances out with the thought that a bubble in the gold stocks will be produced out of fear. I am well aware that this week NFTRH is playing into fear and may even be a voice of the dumb money camp. But I feel that in the near to intermediate term, capital preservation (in service to future opportunity) is the prudent course.

To summarize all of the above, I have lurched bearish this week and thus so too has NFTRH. This allows for a couple or few weeks of rally activity, but I think there was some validity to Russell's 'Instructions: Sell all your stocks' message. I would never tell readers what to do like that but my intention, based on what happened in the markets last week, the GSR's still bullish stance and based on NFTRH166's analysis is to preserve capital. This could include selling anything and everything in the portfolios, or it could take the form of high cash levels and bear positions offsetting core holdings. I just do not know yet. **But liquidity is in serious question.**

I do not want to be caught hoping that Ben Bernanke will be my savior. He is not, whether or not he opens up a can of QE3. It is up to the individual to proceed according to his or her own compass, and mine now says PRESERVE CAPITAL. So while I think there is a better than even chance of a brief rally, until/unless the analysis changes, I am going to manage risk aggressively.

Year End / Holiday Note

Once again dear subscribers, as we approach the end of another year together, I want to thank you from the bottom of my heart for putting your trust in me and the NFTRH service. This has been a very difficult year with a lot of work for no net gain (in my personal 'paper' portfolios at least). These are the markets and sometimes this is the kind of hand that they deal. We must effectively deal with whatever markets and the global macro environment present. I have done so to the best of my ability and will continue to try to improve and make this a newsletter that hopefully adds value to people's lives.

I am not always going to be right, but I am going to be one hard working writer with no goal other than the well being of the readership and our mutual success in an otherwise challenging time. When you think about it, what times have not been challenging? All of history has been a challenge and we need to try to be exceptional in order to out perform in life, in business and in the markets. It takes perspective, balance and it takes work. These three things are my commitment to you.

I wish you and your families the very best during this special time as we celebrate the holidays. Please enjoy family, friends and take some time to step back and appreciate life. The markets will be here when we return for more abuse ☹ in January.

With respect to Christmas and New Years, NFTRH will next be published in abbreviated 'summary' form on December 24th and 31st before resuming normally on January 8.

Portfolio Notes

Portfolio Notes are provided for a look at how the writer is applying the analysis in NFTRH to real world functional investment at any given time. Portfolios are not intended as recommendations and are subject to change at any time due to the unpredictable nature of markets. Capital Preservation Portfolio is 'balanced' by things of value, which can include 'non-paper' monetary assets ;-), property and business enterprise.

The **Capital Preservation** portfolio is preserving capital in a very strict manner.

The **Speculation** portfolio shows you why I am uncomfortable making a big deal about individual 'stock picks' and even portfolio composition. As a trader, I sometimes feel unsure, as with last week where after managing risk into the HUI decline, I bought back several items (like MFN, BCM.V, SLW, LYD.TO and GDV calls) that I would not want to own into bearish events. So now, the speculation portfolio is set up such that it needs the anticipated relief rally to come about, so that I can consider selling into it. I do not like having to NEED anything. And that is the point of NFTRH166 and really the subtext of every letter leading up to it. Be in a position – through ongoing risk management – to not NEED anything. Sometimes these bastards will not give you what you need. But just maybe, they will give you what you want, with patience.

Finally, due to limited time I have not calculated the percentage weighting of holdings, and will drop this time consuming exercise in 2012 to the benefit of actual analysis.

Portfolio is -.5% for 2011 and +150% from NFTRH baseline @ Sept. 28, 2008*

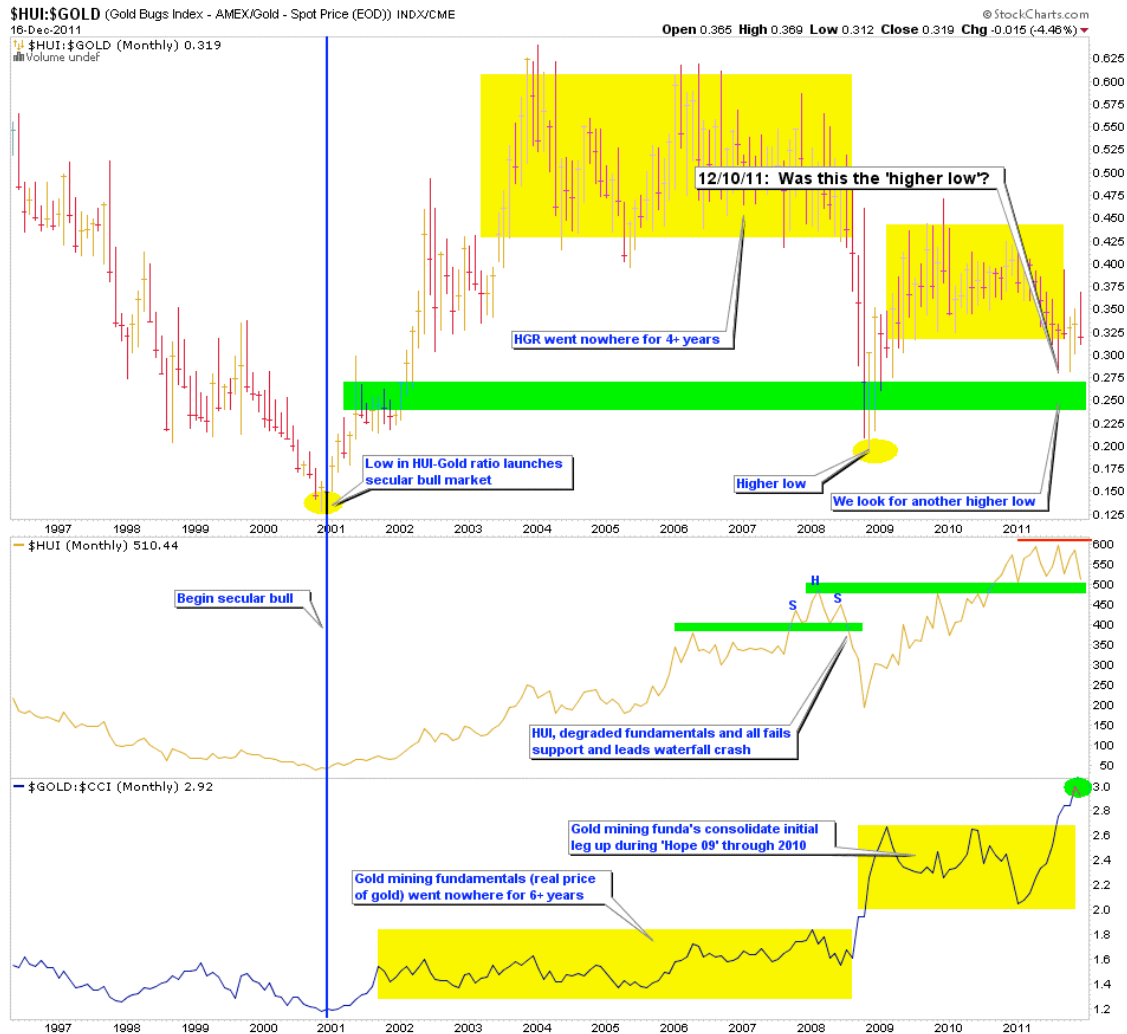
Symbol	TSX	PM Producers, Royalty, Exploration, Non-PM, Bear
FDRXX		FIDELITY CASH RESERVES = 53%
AAU		ALMADEN MINERALS **
ARNGF	AR.TO	ARGONAUT GOLD INC **
BCEKF	BCM.V	BEAR CREEK MINING CORPORATION
BGLPF	BTO.TO	B2GOLD CORP (dropping from core)
EMF		TEMPLETON EMERGING MKTS FD INC
GDV120616C62		CALL (GDV) MARKET VECTORS ETF
GPRXF	GPD.TO	GOLDEN PREDATOR CORP expl. & royalty **
LYDIF	LYD.TO	LYDIAN INTERNATIONAL LIMITED
MFN		MINEFINDERS CORP
PXZRF	PVG.TO	PRETIUM RESOURCES INC **
RBY		RUBICON MINERALS CORP
RIOAF	RIO.V	RIO ALTO MINING LIMITED **
SGSVF	SBB.TO	SABINA GOLD & SILVER CORPORATION **
SLW		SILVER WHEATON CORPORATION
SNDXF	SSL.V	SANDSTORM GOLD LIMITED (dropping from core)

***Performance includes trading commission charges**

****Items considered 'core' at time of publishing**

Percentages are rounded to nearest decimal

Space Filler Chart... After the bearishness that found its way into this report, it is notable that no matter what, this monthly chart says that the HUI-Gold ratio (leading indicator) remains in a potential double bottom (higher low) stance, nominal HUI is above a massive breakout line and gold's 'real' price, as measured in commodities, is in blue sky territory. Hence the big picture gold stock bullish case has not been damaged, no matter what the writer may be conjuring in the more near term scenarios.



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Charts used in today's report courtesy of [Stockcharts.com](http://www.stockcharts.com)

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