The Signal That Has Turned Everyone Into A Gold Contrarian

***e*Research Corporation** is pleased to provide an article, authored by Bernie Schaeffer, for Schaeffer's Investment Research. Today's article looks at gold.

The article begins on the next page and is entitled: "**The Signal That Has Turned Everyone Into A Gold Contrarian**".

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Bob Weir, CFA: Director of Research

August 28, 2018

THE SIGNAL THAT HAS TURNED EVERYONE INTO A GOLD CONTRARIAN

The precious metal tends to decline during the month of September, looking at returns since 2010

The following is a reprint of the market commentary from the September 2018 edition of The Option Advisor*, published on August 24. For more information, or to subscribe to* The Option Advisor *-- featuring 10 new option trades each month -- visit our* ***online store****.*

The centerpiece of most stock market media coverage this past week was the age of the rapidly-maturing bull market, and whether the current run higher can be accurately and fairly described as the longest in history. It was a debate that clearly divided the financial world into the "closing level" and "intra-day level" camps, and a useful diversion during this traditionally quiet post-earnings, pre-Labor Day stretch of August (although this particular late-summer period has certainly not been without its share of political drama, but stocks have been so far relatively unmoved by it, on balance).

So, while pundits have been debating the breadth and depth of various historical stock market corrections and rallies, investors appear to have grown increasingly -- and perhaps climactically -- bearish on the prospects for gold, the precious metal traditionally viewed as a "safe haven" asset during times of turmoil.

Per Commitments of Traders (CoT) data for the week ended August 7, large speculators moved to a net short position on gold futures for the first time in nearly 16 years (since August 13, 2002, to be exact). In the week ended August 14, this group of investors doubled down on their short gold futures position -- or, more accurately, they "more-than-tripled down," with net short contracts ballooning from 6,995 to 25,349. Meanwhile, Schaeffer's Quantitative Analyst, Chris Prybal, observes that the sheer size of the large specs' total position on gold is unusually large, arriving in excess of 400,000 contracts.

There have already been some financial media headlines touting this exceedingly rare net short position on gold futures as a likely contrarian boon for the precious metal, best summarized by CNBC's August 22 piece, "Bears pile into gold, but it could be at exactly the wrong time."

Let us take a moment to assess the technical backdrop against which this shocking display of pessimism on gold has occurred.

Here we turn to the **SPDR Gold Shares (GLD)** exchange-traded fund (ETF), with its over $29 billion in assets under management (AUM), as our preferred proxy for tracking gold prices. As of this writing, GLD has lost just about 9% year-to-date, which is not surprising given the equities market's positive performance in 2018. For comparison, the S&P 500 Index (SPX) is up about 6.8%.

However, digging deeper into GLD's decline reveals some inarguably ugly statistics. GLD has closed lower in each of the last four months, matching a record for the longest monthly losing streak that dates back to December 2013. The fund is down more than 2% since the start of August, meaning it is on track to extend this streak of monthly losses to its longest since February 2013.

While GLD has fallen far enough on the charts to touch only a 19-month low, the fund's 20-day Relative Momentum Index (RMI) recently cratered (as of August 21) to its lowest reading on record, at 6.24. In recent years, this metric's lows have tended to occur around the 10 region (as in December 2016 and July 2015), so the current rock-bottom RMI level effectively underlines the speed and force with which gold has sold off in recent weeks.

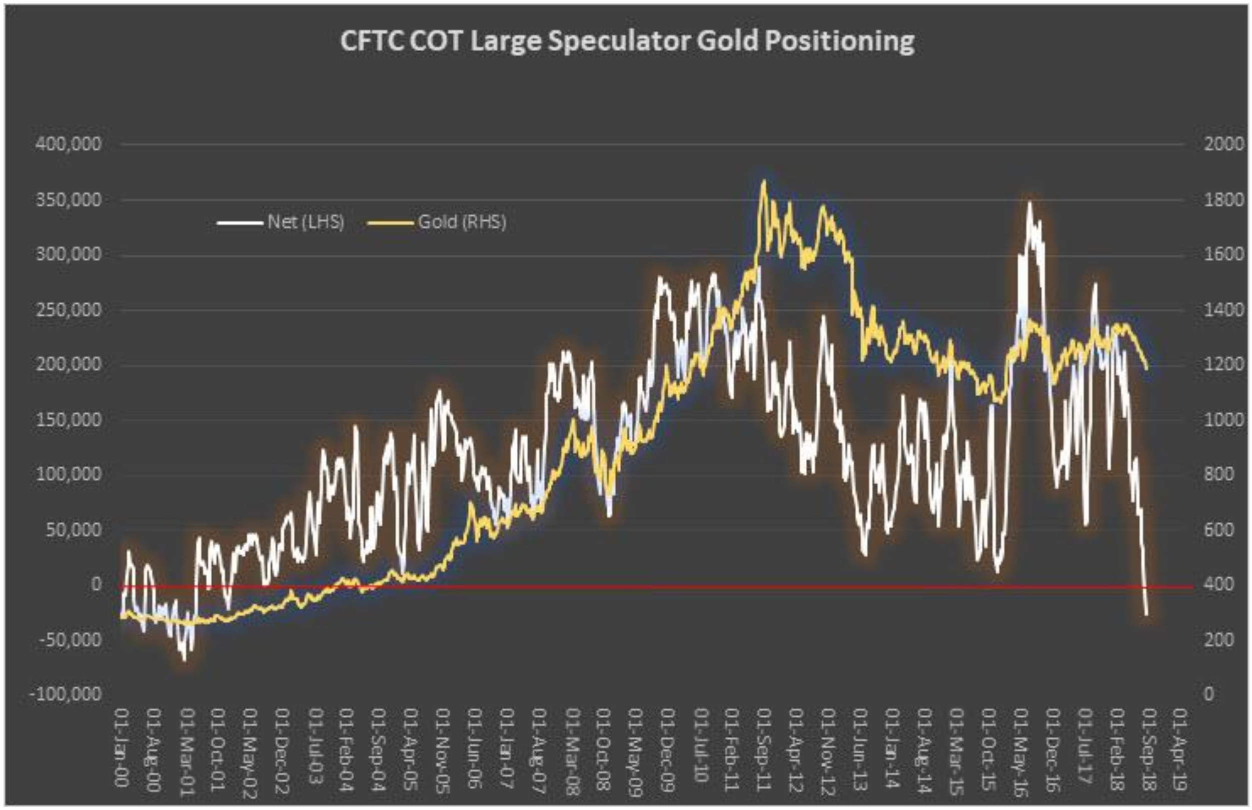
Outflows have been equally fast and furious of late. Data from etf.com shows $3.11 billion in outflows from GLD during the 12 weeks ended August 22, dwarfing the $481.1 million worth of inflows collected during the first five months of 2018.

Given this generally brutal price action in gold, we would observe that the flip to a net short stance by CoT large speculators is perhaps quite a bit behind the curve, if not at all "undeserved" -- so we can follow the logic by which analysts are pointing to this rare bearish positioning as a "final capitulation" of sorts to mark the bottom of the gold decline. Simultaneously, the cluster of extremes generated by GLD's sell-off -- such as the RMI low, massive outflows, and extended monthly losing streak -- would seem to suggest to seasoned market watchers that the battered and bruised metal might reasonably be due for a bounce, even if only of the "dead-cat" variety.

That said, the fact that we have already seen a number of headlines touting the net short CoT positioning as a valuable bullish signal for gold is reason enough for contrarian investors to proceed with caution before going long on bullion. Then there is seasonality to consider; Schaeffer's Senior Quantitative Analyst Rocky White notes that gold averages a loss of 2.07% during the month of September, looking back to 2010, with the median return arriving at a 2.43% drop (with only 37.5% of returns positive).

Meanwhile, with GLD's mid-August lows occurring just pennies north of $111, short-term speculators have focused on the September 111 strike for their put plays. This narrowly out-of-the-money option is home to peak front-month put open interest of 23,093 contracts, setting up $111 as a "do or die" price point for GLD to hold in the month ahead.

See the CoT chart on the following page.


CFTC COT Large Speculator Gold Positioning
Net (LHS)
Gold (RHS)
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300,000
250,000
200,000
150,000
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-100,000
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1800
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1400
1200
1000
800
600
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200
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01-Jan-00
01-Aug-00
01-Mar-01
01-Oct-01
01-May-02
01-Dec-02
01-Jul-03
01-Feb-04
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01-Apr-19

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