

# A NEW ANALYSIS TECHNIQUE APPLIED TO THE GOLD MARKET

By Adrian Douglas

I have from time to time given the Café updates on a proprietary analysis technique that I have called “Market Force Analysis”. I have recently been developing an entirely new and complementary analysis technique that I have called “energy analysis”. When taken together these tools are very powerful at looking through the noise of financial markets to find out what the real underlying trends are and identifying where the turning points will be.

The energy analysis comprises two indicators, potential energy (PE) and kinetic energy (KE). I use these labels from physics because of the analogy with markets. Imagine a rocket heading into space. As it climbs it gains potential energy but the burning of its rockets also give it kinetic energy which increases as the speed of the rocket increases. If the PE & KE are both rising the rocket rises, if they are both falling the rocket falls. If there is contradiction between the energies, one is falling while the other is rising, or one is increasing and the other is static we can not be sure what the rocket trajectory will be. This is the same with these new indicators. They must be in agreement either up or down to be confident of the move. If there is uncertainty it can quite often be resolved by looking at the market force analysis.

To demonstrate these two indicators here is a plot of the gold price from 1974 to 2006 in yellow. The potential energy is in blue and the kinetic energy in green.

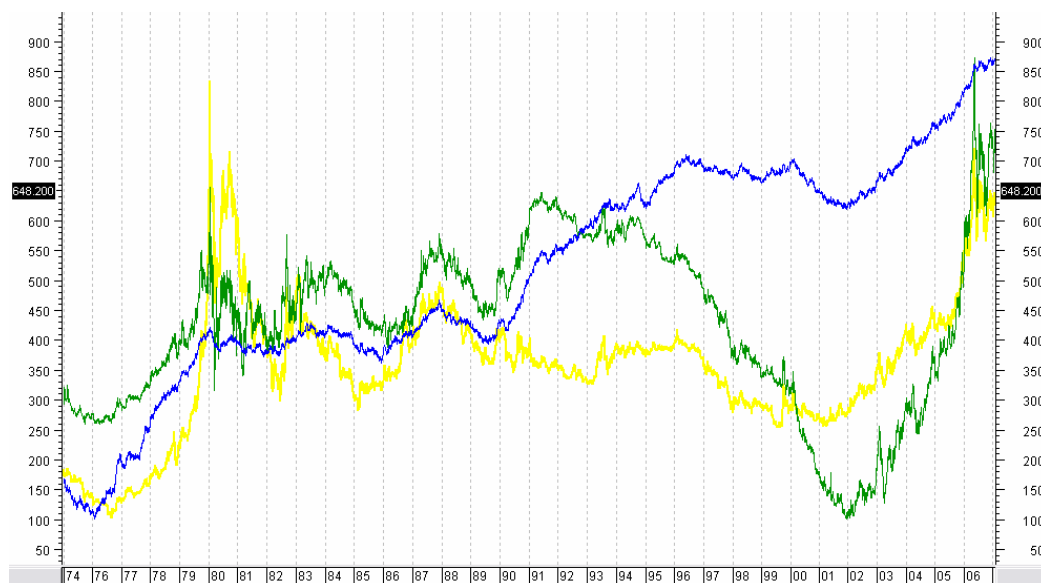
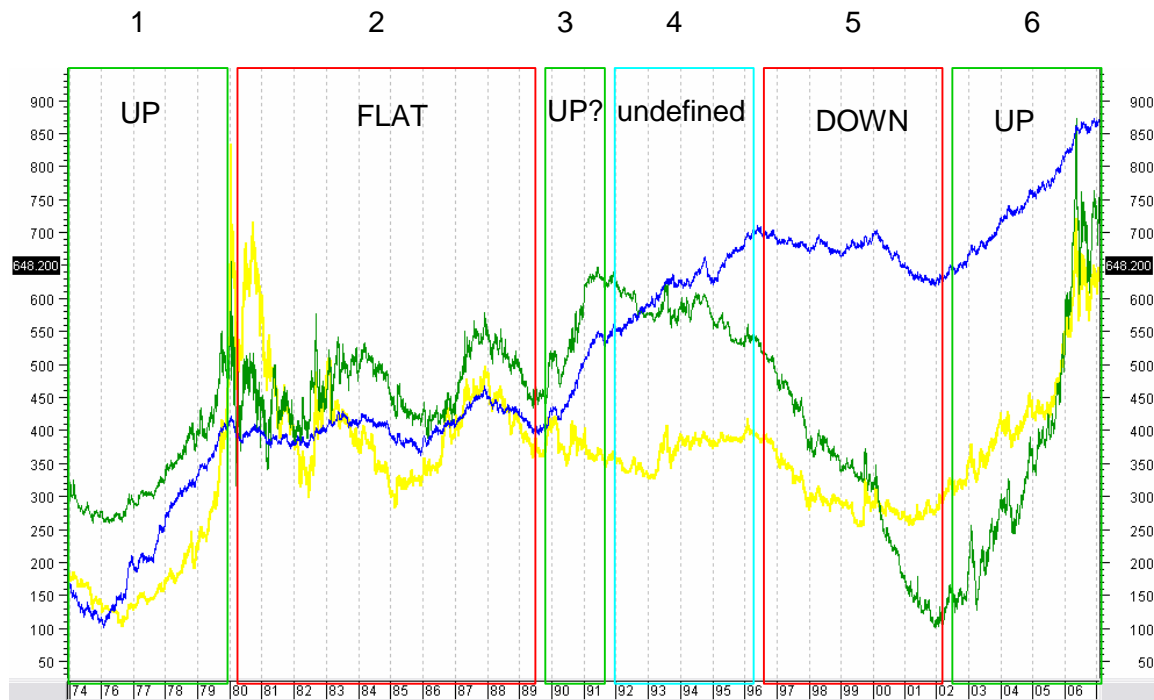


Figure 1

I will now take the same chart and identify the main market changes from the PE and KE during this 32 year period.



**FIGURE 2**

In period 1 the synchronous rise in PE and KE showed when the last major bull market in gold commenced. Notice that PE turned before the gold price. The top of the market is identified by a major slope change in PE from a rising slope to a very flat slope. The KE reversed and went down. The market had run out of energy and so the top was assured. In period 2 the PE remained fairly flat in general but three synchronous rise and falls in PE and KE could have been used to trade the market and as can be seen the gold price had three major uplegs in the period. In period 3 the indicators show a synchronous rise which was a false signal because the gold price didn't follow. This could have been recognized as a false signal by looking at the Market Force Analysis in conjunction with the energy (for reasons of brevity this is not shown in this essay). Period 4 has a conflict in that PE is rising and KE is falling. The market direction is therefore undefined. This gets resolved in period 5 where they both fall as did the gold price. The strong synchronous turning of PE and KE in period 6 announced the arrival of the current bull market. You can see that the period of weakness in 2006 after achieving 740/oz could have been predicted by a lowering of the slope of the rise of PE. In the last few days that slope has started to rise again suggesting that a prolific new upleg is commencing.

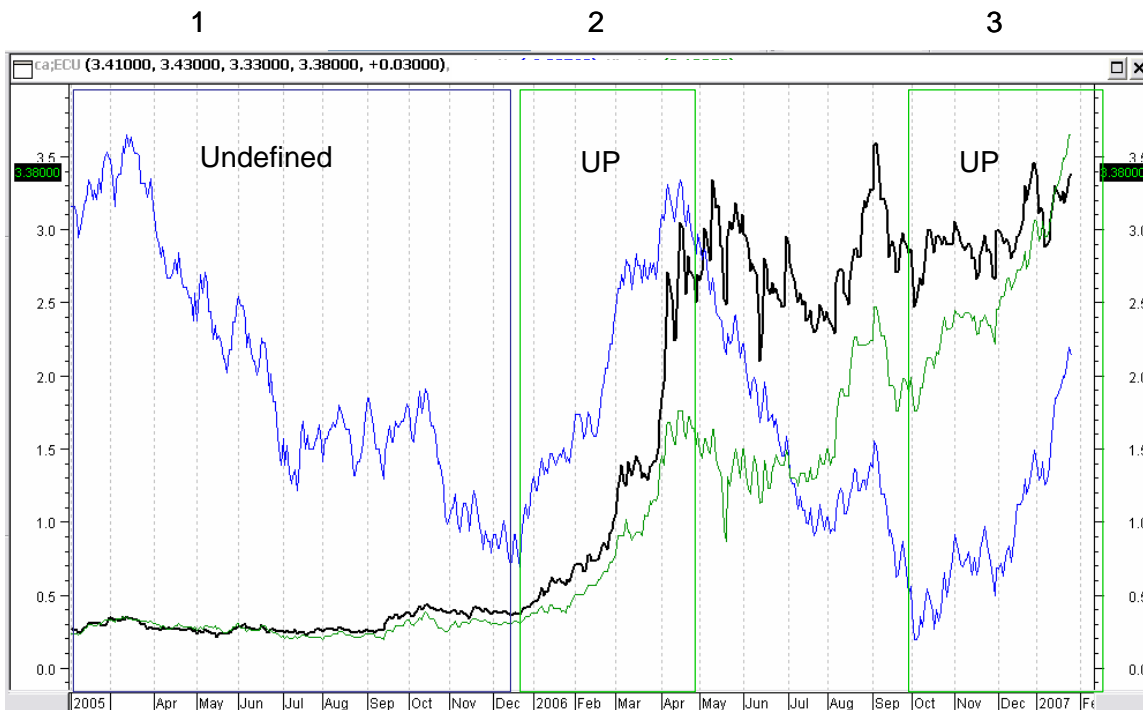
If one stands back from this chart it can be seen that the PE indicator is in general rising and the KE indicator follows it until about 1994. The huge departure of the KE from the PE trend for a decade is astonishing. For reasons of protection of Intellectual Property I will not explain how these indicators are derived but this departure can only be reasonably explained by market manipulation. If someone flips a coin a million times it is statistically possible, but highly improbable, that it gives heads every single time. It is much more likely that there has been foul play and that the coin is a double-headed coin! And so it is with these indicators. It is statistically possible for such a deviation to occur naturally, but highly improbable. Since 1971 there has been nothing backing the US dollar and so the fundamentals for gold have not changed which is clearly shown by the general trend in PE. The trend in KE suggests tampering with the market. This is totally consistent with the mountain of evidence that GATA has collected. The fact that the KE is returning to its previous trend may suggest that the market manipulation is on its last legs, which is also consistent with other evidence collected by GATA that the Central Banks are running out of physical gold.

It should be noted how little volatility there is in the PE indicator. There is no smoothing algorithm what so ever. This lack of volatility makes it a very good tool because any substantial changes in slope can be considered as significant.

In closing I would like to show case the new analysis by using it in a predictive mode. I have previously written about the excellent fundamentals of ECU Silver Mining

<http://www.lemetropolecafe.com/Pfv1.cfm?pfvID=5671&SearchParam=adrian%20douglas>)

I will demonstrate how energy analysis can be applied to this stock.



**FIGURE 3**

During 2005 KE had been flat to rising slightly while PE was falling (period #1). This is an undefined period. Then in early 2006 KE started to rise and PE reversed to a strong upward trend (period #2). The stock price had barely started to move and was around \$0.60. This was a strong buy signal. The PE and KE turned down when the stock reached about \$3.0 which was before the peak of around \$3.40. The technique could have been used to aid trading in and out of the stock during the second half of 2006 but I will not discuss this. Period #3 is of great interest because this covers Oct 2006 to today. The KE and PE have turned strongly positive and look very similar to their profile at the beginning of 2006. This indicates a move is likely that would mirror the strength of the move last year. This is extremely interesting because the stock has not moved very much over the same time period. The energy indicators are indicating that the coming move could be orders of magnitude higher than the current price. As discussed in the analysis of the gold market these indicators are capable of occasionally giving a false signal but from the experience that I am gaining from its application it is very often correct. It can be seen from the very quick review of its application to the gold market over 30 years it reveals a very coherent

interpretation with what actually happened to the price of gold. This lends credibility to the technique.

I have now documented a predictive use of this new analysis technique so we will see if I end up with egg on my face or a feather in my cap!

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For full disclosure I am pleased to say that I am a long standing share holder of ECU. Mineral exploration is a tough business with many risks involved; please factor your own risk tolerance into any investment decisions. My motivation in writing this article is the same as with all my contributions to the Café that I wish to bring information that will help the Café community ride this precious metals bull to the best returns.