Running with the Bulls

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Where do we go from here?

Bull markets don't die of old age. Clearly, something is up that is driving equities higher. I don't know what that is, but the fact is the momentum is with the bulls.

		YTD Return
Gold Miners ETF	GDX	4.55%
Junior Gold Miners ETF	GDXJ	3.12%
Silver Explorers ETF	SIL	4.79%
Ph Gold & Silver Index	XAU	7.07%
NYSE Arca Gold Bugs Index	HUI	4.27%
S&P TSX Composite Index	OSPTX	14.94%
S&P TSX-V Composite Index	JX	12.08%
SPDR Gold ETF	GLD	0.37%
iShares Silver Trust	SLV	-1.80%
S&P 500 Index	.INX	16.01%
Nasdaq Composite	.IXIC	21.34%
Nasdaq 100	NDX	21.72%
DJIA	.DJI	13.70%
Russell 2000 Index	RUT	15.96%
NYSE Composite Index	NYA	14.19%

It most definitely will reverse… someday. If that someday is soon, then I'll look like a chump for not owning gold just as the cycle turns. If that day is far into the future, **gold is headed much, much lower.**

Imagine you're a fund manager facing a client. The dumb money, the passive investing crowd, has piled into the SPX or the Nasdaq and made stellar returns. You've diversified, tried to be safe, and underperformed. When the client asks why he's paying you so much for not beating the index, and repeating the Jack Bogle mantra that active doesn't beat passive, you either give up on your conviction and go long the best performing index, or the client fires you and puts that capital to work being long the best performing index. That's how bubbles are formed. It can go to any lengths. That it popped will only appear obvious in hindsight.

Shorting a bubble that has so much momentum behind it is dangerous.

So far, the gold miners have been swept along for the ride, but who knows when that will turn on a dime? If equities are indeed headed much higher from here (the pain trade for all the skeptics), and the trouble in the rest of the world gives the USD one more boost, gold and the miners are going to take a beating like they haven't since 2015. *Amidst all the signs of collapsing global growth, US equities are in a massive bull market*. The gold sector is seeing some M&A, but hasn't yet seen bankruptcies like the shale patch or uranium. It's hard to fathom that a beaten down sector could be headed much lower, but the bottom isn't apparent to me, not unless we see bankruptcies or see investors punish loss-making companies harder. I just don't see it. Oil is supposed to peak ahead of recessions. It peaked in October, ahead of the December market correction, but is now on a steady uptrend, just like US equities. If US stocks have peaked, we would be seeing a lot of churn, as the bulls and bears battle it out, adding to volatility, which will show up on price charts. We don't see anything of that kind. Volatility is subdued, the uptrend is smooth. The yield curve inverted, but there's a long lag (19 months on average) between yield curve inversion and peak in the SPX.

I'll take the bearish side and argue the top is in. Would I expect an orderly correction lasting several years? No way, that's not how bubbles burst. A 10-year bull market doesn't end with a slow paced decline over years; it'll go out with a bang, like in 2000 or 2008. If the USD has topped, its decline will be rapid as well. But if we enter a recession, the USD will rally as a safehaven. Sentiment will be in its favour. But it will be bullish for gold, and the miners if they move with gold. **To be a gold bull is to expect that the dollar has peaked.** If stocks have peaked, they are headed for a crash. Nothing survives a crash well except T-bills and long bond positions. Not gold, not the miners. So for gold to do well now, stocks shouldn't crash, but the dollar should have peaked. That's the outcome most favourable to gold bulls. I am ruling out an orderly bear market for equities; that's not going to happen.

If you're long precious metals and the miners, pray that the market goes sideways while the dollar turns lower. Inflation will rise, bonds will get slaughtered, gold will rally, and stocks will hold up. The Fed will hike rates, or let the economy run hot, but in either case the gold rally will be in progress. If equities correct, gold will then be a safehaven and the miners will become countercyclical defensive positions. Commodities as a class will enter a new bull market, with gold and oil leading the way. Ergo, we will have an inflationary depression.

To sum up,

- Equities are either on a massive bull run, or they are primed for a crash. In both cases, gold is headed lower from here, either because nobody cares, or because a firesale affects all assets.
- If the dollar has peaked, gold is set to rally, but only if stocks don't crash but move sideways. Gold will then continue to do well especially if inflation picks up and the Fed lets it run to compensate for inflation being under 2% for so long.

Has the dollar peaked?

I know the arguments for both camps. They are equally valid. I'll let the market tell me, since I cannot fundamentally decide one way or another. The price action tells me the dollar likely is headed higher. The euro is dead. The pound is stuck in limbo. Without a rally in commodities (the China news is something to watch out for), the CAD and AUD are in limbo as well. EM has finally started performing, but it is recovering from being a bombed out market, so it's too early to tell if this is a vanilla bear market recovery or the beginning of a new cycle. Again, I'll let the dollar tell me. Oil's stuck in a range, gold is stuck in a range. That doesn't tell me the dollar rally is over, nor does it tell me the dollar hasn't peaked. I will only know in hindsight.

If I'm long gold and the miners, I have many ways to lose and only one way to win. Some might argue that the odds are still worth it.

Fair point, but consider this. Gold hasn't been able to break past 1365, even when it reached the 1350 level. It has since corrected all the way back to the 1285-1295 range and doesn't seem to be able to hold 1300 or even 1290 consistently. The price action is weak. For a commodity that peaked in 2011, if it has bottomed and resumed its next bull run, prices shouldn't be stuck in this range. Gold is only up 23% since its December 2015 bottom. The Nasdaq is up that much just from last December's bottom. All those bullish factors that should be moving the gold price – the market doesn't care. Something is up here, something that the market is telling us. **When the most bullish catalysts you can find fail to have any impact on price, maybe you've got your thesis wrong. Not early, just wrong.**

S&P earnings preannouncements are negative, yet the bull market continues. Global trade is slowing dramatically, yet these companies which earn >50% of their revenue abroad are doing fine. The VC bubble appears to be bursting (Lyft IPO price action), yet the Russell 2000 is shrugging it off. The yield curve inverted, recession warnings abound, yet the Nasdaq 100 is taking a run at its all-time highs. Dow transports doesn't confirm the uptrend, that's about the only thing bears can cling on to. If liquidity is being drained, what explains the price action?

As Sherlock Holmes remarked, "*when you have eliminated the impossible, whatever remains, however improbable, must be the truth*". As hard as it is for me to believe, I think we are in the beginning stages of a massive bull run in equities, one that even the most bullish analysts will find hard to believe. The US is going to be the only game in town, the shorts will fight it, the dumb money will make the smart money seem stupid, and everyone will finally get over their disbelief and get long. We will have rationalizations as to why this time is different; we will have flimsy premises advocating why stocks should be bought even in the face of all the negative news (remember the justification for Japanese PEs in the '80s?). The bull will go on for far longer, head far higher than the most optimistic forecasts of today. And then it will die in euphoria.

We are not there yet, we are a long way from there. As ridiculous as it sounds, this seems to me the most likely outcome.

What will make this prognostication wrong?

- The dollar sinks, EM rallies hard
- We get a broad based rally in commodities that no one saw coming
- The return of volatility and whipsaw price action in equities (i.e. signs that the trend has indeed turned)

If we get any of these signs, I'll change my mind, do a complete 180 degree turn, and position accordingly. Barring that, just hold your nose and stay long the momentum stocks. In a bubble, fundamentals don't matter, all that matters is liquidity. The liquidity is in favour of the bulls.

Disclaimer: This is not investment advice. I may/may not be holding positions in accordance with the outlined thesis.

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