

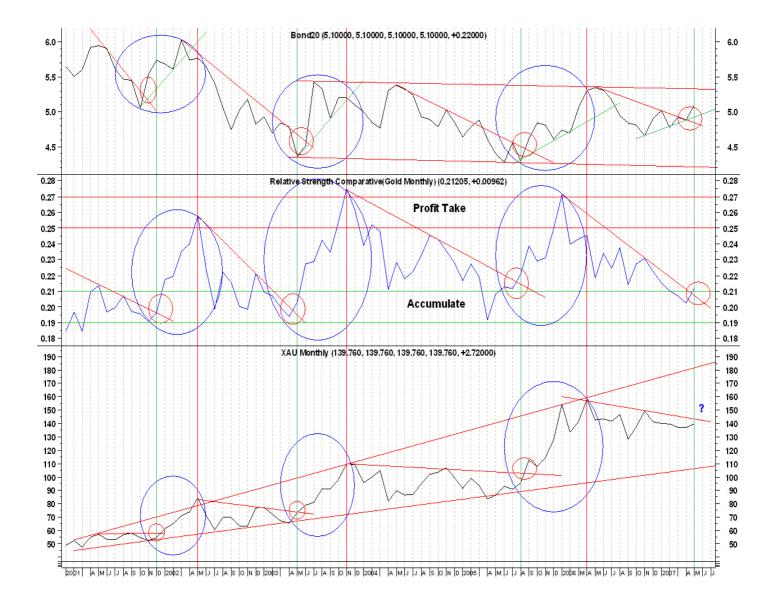
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## **BOND YIELDS AND GOLD SHARES**

In recent weeks we have seen a dramatic rise in long term bond yields in the US. There is clear evidence that foreigners are moving away from US long term bonds and this has largely contributed to the recent increase in yields. The rise in the long term yields may also be suggesting heightened inflation concerns going forward. This coupled with disappointing GDP growth is signaling a possible **Stagflation**. What does this mean for Gold shares?

People that have read my work know that I am a big advocate of the XAU/Gold ratio as an overall barometer of where the precious metals markets are placed at any given time. To demonstrate the effects of rising long term bond yields on the Gold sector, I want to share with you a monthly chart that looks at the 20 year US Bond yield, the XAU/Gold ratio, and the XAU. I have circled the three preceding rally stages of this bull market so that you can clearly see how the Gold sector performs in the midst of rising long term bond yields. The green vertical lines signal the beginning of rallies in the XAU index and the red vertical lines indicate the end of each respective rally.



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This chart clearly demonstrates that periods of rising long term bond yields tend to coincide with strong moves in the precious metals sector. If we look to where we are placed as at the end of May 07, we can see that the signs are looking very good. We have a 20 year bond yield which has been trending higher since November 2006 (Top Section). Last month has seen the XAU/Gold ratio break an intermediate term downward sloping trend line which has been in existence since the end of January 2006 (Middle section). The XAU/Gold ratio is usually a pretty reliable leading indicator. The last piece of the puzzle is the XAU index itself (Bottom section). This needs to break 143-145 in order to complete this bullish picture. As I type this the Gold price has fallen over US\$14 an ounce in US trade on Friday but the XAU has actually gained ground with the XAU/Gold ratio consequently rallying sharply. I continue to see this as bullish for the Gold sector and can essentially see nothing different to what we have witnessed during the closing stages of previous consolidation periods.

Looking at a monthly chart you tend to gain a much better perspective on where things are placed in the overall scheme of things. There has been a spate of negative articles on the Gold sector in the last 48 hours as one would expect given the present short term volatility. In looking at the above chart I think you would agree that we are probably in a much better position than what most people realize. These days a lot can happen in the space of a month and it doesn't make much sense to get caught up in the short term day to day volatility. In saying that, I want to also state that charts like the one above are based on observation only and are by no means a guarantee that what has happened in the past will necessarily happen in the future. As the old Mark Twain saying goes "History never repeats but it does often rhyme". For anyone interested, I write a free monthly newsletter on the precious metals markets which you can sign up for at the website below. You can also access past issues of the newsletter including the recent issue via the Articles/Newsletter menu item.

**Troy Schwensen** 

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