

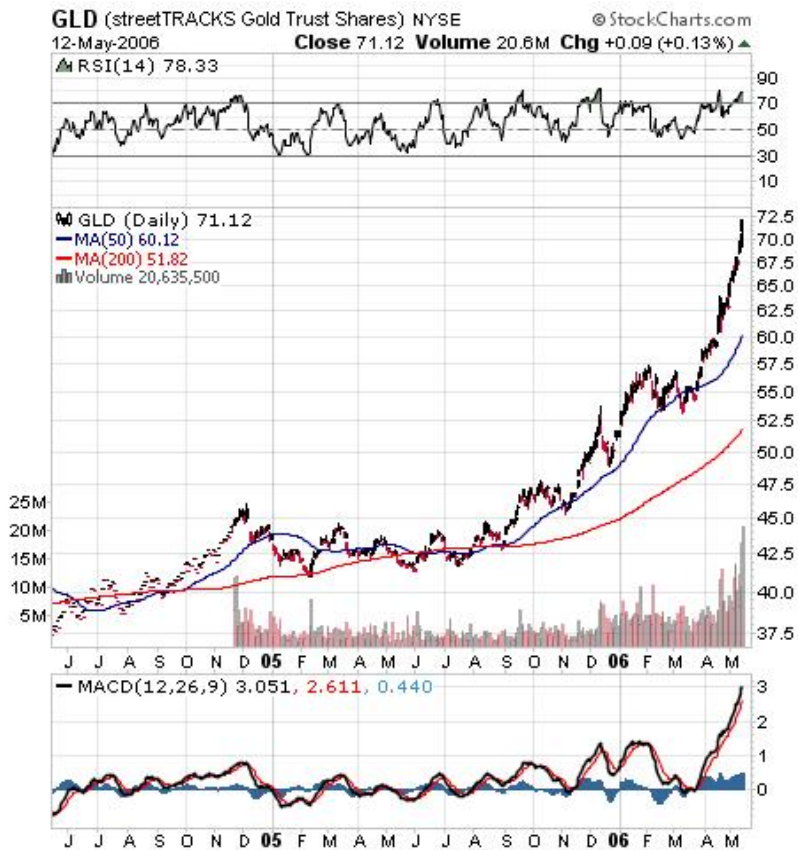


## The Gold Bug has landed! May 14, 2006

This may come as a surprise to you; but we sold most positions in gold (GLD) and all positions in gold related mutual funds on Friday. We wrote our last newsletter related to gold on April 20. That was only three weeks ago and an ounce of gold was fetching \$609.00 then. We sold out Friday at the equivalent of \$713.00. That is a \$104 rise in approximately three weeks and caps off our current tolerance for the parabolic rise.

We sold out of Gamco Gold Fund (GOLDX) at \$29.27. While we have purchased shares many times and at many different price levels, our first entry point was approximately two years ago at \$14.75 per share. We sold out of U.S. World Precious Metals Fund (UNWPX) at \$32.20 per share. We purchased shares many times at many prices, but we started at \$13.78 per share.

All this begs one big question—why now? Particularly when we have said many times that we see the very strong possibility that gold will go much higher before this bull market run is over.



Like a lot of decisions that we make the answer is not necessarily simple, nor is our reasoning irrefutable. But the main answer to the “why now” question can be seen in the chart to the left. It is an updated version of the one we showed you a few weeks ago. The simple fact is that gold has simply moved up way too fast, and now appears way ahead of itself. The 50 day moving average (50 MA) is all that way back down at \$601.20. See that blue line to the left in the graph. That is the 50 MA. Notice how the price of gold has moved

up and down across that line many times in the past two years. Notice how far it is from the line now. Gold closed Friday almost 20 percent above that line. That is what we

would have to call “stretched.” A retreat back to that line could happen just as quickly as the recent fun up, only in reverse!

**Those of you who owned tech stocks in 2000 know exactly what I am talking about. It happened in stock after stock.**

The second reason is that gold mining shares have already started to break down. In fact while gold continued to go up Thursday and Friday, the gold mining shares backed off significantly. That is called a “divergence” and it isn’t necessarily a good one. The metal going up and the mining shares going down is the directional “divergence” in the path of the two related asset categories. That may be a signal that gold is about to take a breather, or worse.

In fact, commodity fever in general might have broken Thursday and Friday. Oil, gas, uranium, alternative fuels, water, timber, et al, have gotten whacked. There have been multiple rumors of a slow down in demand from China all year long, but those same warnings seemed to get taken much more seriously by the markets last week. Had an oil pipeline in Nigeria blown up three weeks ago, as it did Thursday night, the price of oil would have moved up. Friday it moved down, and so did most other commodities. The fever appears to be broken, at least temporarily.

I must admit that I have very mixed feelings about this decision to sell, and I am hoping that it was a very wise decision. But events that have yet to unfold will tell us that—or not. As I sit here writing this on Monday morning, I am looking like a genius as gold futures are off almost \$25.00 and cash gold is down \$27.90. But one day doesn’t make a trend.

The ideal scenario now would be for gold to sell off, back to that 50 day moving average, or lower, and for us to buy back in. We estimate the probability of that happening at more than 50 percent.

We will tell you that in making this decision we were influenced by the work of Peter Grandich who writes for Resource Investor.com. We offer this telling excerpt from the research paper that he published on May 11, 2006 essay, “Before proceeding, let’s you and I do the following:

Breathe in, and out. Breathe in, and out.

It’s been an exhilarating ride that has astounded us. Now that we caught our breath, let’s try to plot a strategy that makes sense going forward.

A significant sharp correction is lurking out there. It’s highly likely to come out of left field and at its depth, should end up giving cause to question if the bull market is over?...

But knowing history tends to repeat itself, I've called upon the good works of one of the best technical analysts I've ever known, Mr. Frank Barbera. He and I go way back (and I mean way back) to the good old days when America had a real, honest-to-goodness financial cable show called *The Financial News Network* (FNN). Frank was the assistant to FNN's technical analyst, John Bollinger. Frank then went on to provide technical analysis on a southern California financial program for many years and now manages money and writes a newsletter called "GST MarketFAX." In his May 9th issue, Frank made some very worthy observations below:

"In our view, today's action in gold and gold stocks looks to be climactic "blow off" activity, with gold gapping higher in what could be a late stage "exhaustion" gap. Volume in the gold stocks is presently at record levels and amplifying the already seriously overbought condition. In studying gold, I note that back in late 1979, between November 26th, 1979 and January 21st, 1980, Gold experienced a massive "blow off" advance which took the price from a reading of \$390.30 on 11/26/79 to a high of \$825 on 1/21/80. During that period of time, Gold advanced \$434.70 per ounce or 111% in price in a period of just 36 trading days. During that period of 36 trading days, gold closed higher 27 of the 36 days for an advancing day's ratio of 75%. Today, since March 24th of 2006, Gold has advanced from a reading of \$563.50 to a current value of \$702, a gain of \$138.50 or 24.57% over a period of 32 trading days thru today's close. So far, Gold has advanced 24 of the last 32 trading days for an advancing ratio of 75%. In looking back at the long term history of Gold rallies, we find that this type of highly concentrated advance is exceptionally unusual and extremely difficult to sustain."

The report that this excerpt came from is very long. Suffice it to say that the general tone of the report is that this was a magnificent rally--that should be over for now. We should be entering a period in which gold either consolidates at present levels or moves back down substantially. If and when we do start to buy back positions we are highly likely to ignore the mutual funds from here out and use the GLD share only. We like the liquidity of the GLD. It is simply easier to trade and provides us with more flexibility.

Remember this, when we first started buying GLD almost no one was interested. There was no "gold bug" in the top left corner of the screen on CNBC. Today everyone is talking about gold. Whether they own it or not is another thing, but everyone is talking about it. In fact most didn't own it during this entire run up. You just made a very nice profit!

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