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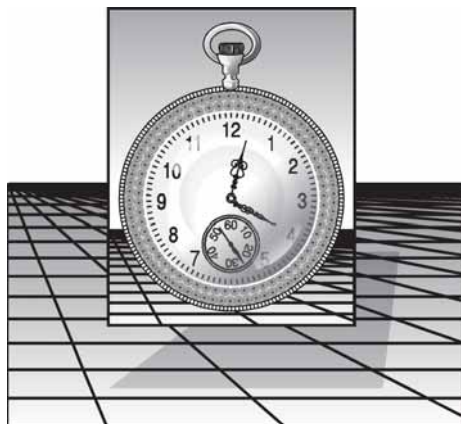
Curtis & Hester

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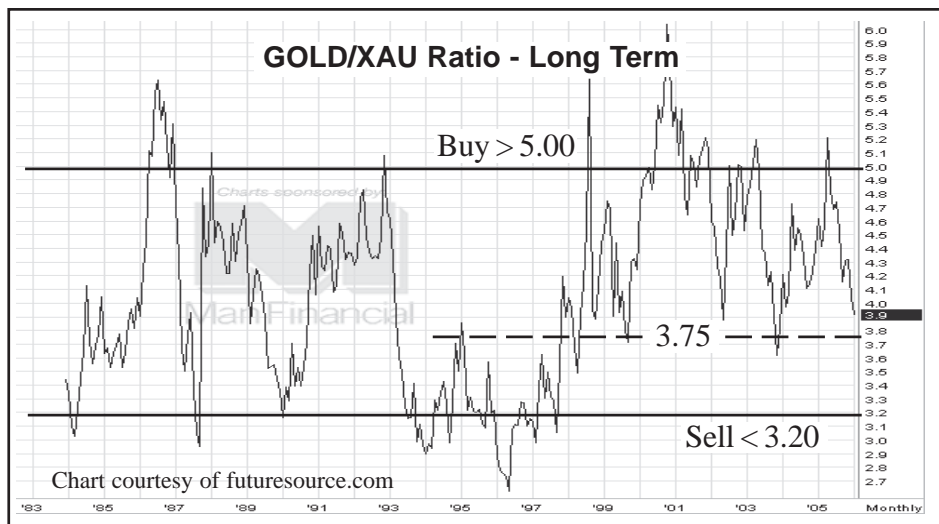
- If we get a correction signal for gold, what should you do?

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Gold Is Doing Well ... Too Well?



The bullion and the mining stocks have all been doing quite well lately. Gold put in a high at the \$550 level in December, and it corrected back to \$500 just before Christmas.

I was concerned that we might see a double top form as it rallied back to \$550 this month. However, it appears that we needn't be concerned since \$550 offered little resistance. So far, so good for gold thus far in 2006. It is marching along to multi-year highs.

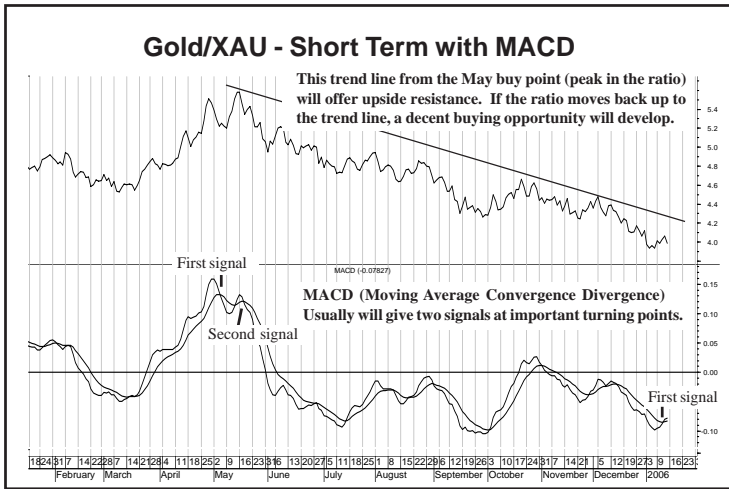
There are some interesting fundamental reasons surfacing that support the rise in gold. Mainly, central banks - many of which sold most of their gold in the 90's - are now diversifying out of U.S. dollar reserves and back into gold. China, in particular, is woefully light in their gold reserves. By some estimates, they need to purchase 2,000 to 3,000 tons. They may well require an entire year's global production.

Those pesky U.S. dollars are going to come to the fore in this market. It isn't so much that the dollar is going to fall, but that many countries are simply accumulating too many of them and they need to diversify elsewhere. Commodities - and in particular, gold and silver - will benefit.

I expect another quarter point interest rate hike at Greenspan's final meeting on January 31 and one more at Bernanke's first meeting on March 28. He will want to signal that he is maintaining current policy so as not to upset the markets with his new tenure.

The U.S. interest rate edge is dissolving, however, as other central banks around the world raise their rates. The dollar is going lower, but not in the fashion it displayed on January 3 when the dollar index took a hit for 1.39 points. That was stiff. U.S. policy is comfortable with a

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weaker dollar, but in an orderly fashion. No panics are allowed - just a decent, orderly lynching.

The gold/XAU ratio is designed to measure whether the mining stocks are getting too far ahead or behind the bullion. Last spring, I wrote a report called "Gold Timing With Simplicity" in which I discussed the parameters that indicated when gold stocks were too cheap in relation to bullion. In May, the ratio was over 5.00 - a screaming buy.

The report went on to outline some ways to fine-tune the approach with MACD and the RSI Oscillator. The wisdom of buying when the ratio was over 5.00 is proven by recent new highs in bullion and in the stocks. However, when I wrote that piece, I was interested in buying and only included a cursory discussion of the readings that would lead us to sell.

In the report, I posted 3.75 as the level in the ratio where one would begin looking for a sell signal. As you can see on the long term chart of the gold/XAU ratio (Page 1), although the ratio turned from approximately this level in 1999, 2002, and 2003, more serious low (sell) levels have occurred in the past.

Because the XAU didn't exist earlier, we can only go back to 1984 in the midst of the bear market off the 1980 high to study past behavior. You can see that the 3.20

especially in a bull market.

My take is that 3.75 is a yellow flag. It definitely is telling you that it is too late to buy. The odds are that you will find a better place to buy if you are patient.

If the ratio falls to 3.20, it will be time to take some serious money out of this market. That time is not upon us yet.

The trending techniques I presented in the original Simplicity report are important here as well. For example, MACD has managed a first signal. That is not enough to alert us to a correction, but a second MACD signal (as described in the report) would be.

If we get a correction signal, what should you do? First, hold what you have and use the correction to add to your positions at our buy prices. I am not adjusting the downside buy prices for our buy-and-hold stocks yet as it is simply too early for that. Those on the list are good for now. When conditions warrant a change, I will update them.

I don't see any indication that a correction at this time will be severe, but the mining stocks are volatile. Stay the course. Hold what you have and be patient. To paraphrase Jesse Livermore, it is hard to sit tight when you are right. The gold market will have its wiggles. Although the ratio is warning us to be

level is the extreme, and it's definitely a sell signal. Nevertheless, 3.75 should raise some caution since the ratio turned up from there in the past, but we need lower levels than that to force us out of our gold stocks,

cautious about new buying here, we will not see this market top out until the ratio hits 3.20.

Our energy forecaster is still probing higher. Crude oil is doing fine; but with the unusually mild weather we are having, crude may well trade sideways in a trading range until the weather turns nasty again. Natural gas has fallen to 8.80 basis the April futures - again, due to the mild weather. My experience is that the weather tends to change rather suddenly, and winter is far from over yet.

The energy stocks have cooled off a bit, and some are nudging back toward our buy prices. In particular, **Paramount (PMT.UN-TSX-\$22.00)** is close to our buy price. If I were to buy something today, this would be it.

The stock market has found new life. I don't think that anything is all that different, though. The key here is liquidity. Although the Fed has been raising rates, they have not been stingy at the spigot. Money supply growth has been accelerating dynamically.

It's interesting - higher interest rates, but plenty of liquidity? Well, those new dollars are finding their way into the metals, and they are finding their way into the bond market. The long bond has been doing well since our last buy signal.

Money supply (M2) has been accelerating dynamically since October, and those extra dollars seem to be finding a home in the stock market also. Our Rydex programs are both long, as well as the Nasdaq Slow Tracker and our experimental Palio model. I am not a stock market optimist; but on a technical basis, the market looks higher. How long or how far the averages can run is the question. The best answer is to simply stay with our trades until the models tell us to move out.