7-24-2008

The link to my "Mid-Day Videos" videos is below.

http://www.iepstein.com/videos_start.aspx

The Big Guns!

The cast of characters on TV this week was truly awesome. The Fed Chairman, the Treasurer of the United States, the President of the United States and the head of the SEC all talking up the Dollar and US economy right in the face of IndyMac failing and serious troubles with GSE's, Fannie Mae and Freddie Mac. Wow!

The simple fact is that the credit woes are not over. No where near it. How many more bodies have to be carried out weighs on the markets. Yes, the stock markets have rallied in the past two days. So what? Nothing has changed. After the dust settles, more problems will surface.

Inflation is getting worse around the world, not only here in the USA. Energy and food price rises are starting to "bleed" into core PPI.

In the short term, Crude Oil looks to me as though it has topped out. I'm sure you realize that practically anything can get it going again to the upside, but the chart action in crude and the energy products is no longer near term bullish. What's interesting to me is how fast the initial downside targets were hit and the speed at which the Stochastic readings are entering oversold territory. $122 might eventually be seen if a more serious washout were to take place.

What Should the Markets Expect from Uncle Sam?

Expect tough talk and little substance behind that talk. That's not to say that some reforms such as making sure "short sellers" in stock have borrowed stock to sell short. However the biggest and most important action the Fed has to now take on is unlimited support for Fannie Mae and Freddie Mac. If these GSE's were to fail our financial system would collapse. Mr. Paulson got it right when he said he needed a "bazooka", not a pistol to let the financial markets know that under no circumstances would the USA let these GSE's go under. The problem with this is that it may take untold amounts of capital to shore things up. If so, the Fed will print money and so goes inflation. The threat that the Fed will add whatever is necessary to support these GSE's is very important to stem panic thinking.

Crude Oil and the Inflation Story

Energy markets have been under heavy selling pressure, with all parts of the energy complex correcting sharply as supplies of energy are starting to rebuild, refineries come back online and energy consumption habits change around the world. The question right now is whether or not the break in energy will take gold and silver down with it and if so, how far?

Currently, the break in energy has not had a lasting impact on higher metal prices, but I would expect lower energy prices to at least temporarily limit or curtail attempts at advances in gold and silver.

I don't think anyone is any longer wondering or arguing about core inflation. It is on the move up which basically means the value of the US Dollar will remain under attack since the Fed's primary weapon, the raising of interest rates can't be used at this time due to the condition of the credit market. As the Dollar falls, inflation is fed, which is the breeding ground for hard asset plays like gold and silver.

The road up in metals will surely be filled with price corrections, but I believe that prices will be higher by year end than they are now, possibly a lot higher.

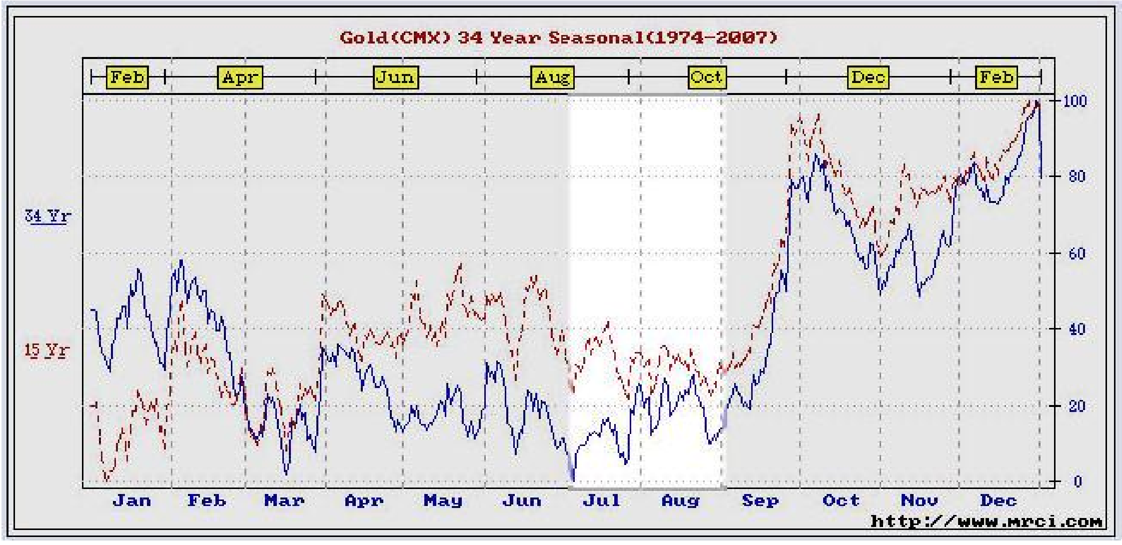
The Crude Oil vs. Gold Ratio

Few make mention of the ratio of crude oil to gold. The traditional relationship has been around ten to one, meaning historically its taken ten barrels of crude oil to buy one ounce of gold. I know that people like to say that in modern times relationships change. These are probably the same people that bought at the high of the NASDAQ bubble and found justification in by price multiples that made absolutely no sense. The simple fact is that until we see a reason to abandon ratio thinking, we like to have history on our side. As such, it conceivable that at current prices, gold is underpriced by $400 an ounce given that August Crude Oil is trading near $134 a barrel which under this ratio would have gold trading at $1340 an ounce.

Gold's Seasonal Story

For weeks on end I have been displaying a Seasonal Gold, provided to us by the good folks of Moore Research Center…www.mrci.com

Let's look at a Seasonal Chart of Gold.



As I wrote about last week, what I look at when viewing historical seasonal charts is market momentum. Without question, the above chart makes an argument upward price momentum into year end. Remember, gold demand picks up now for the Christmas Season.

December Gold

Lets start out by looking at a Daily Chart of December Gold Futures

The Stochastic Study is breaking down, but is still in overbought territory. This leaves the 18-Day Moving Average of Closes as the likely downside target, as the market corrects its overbought status.

The current Stochastic reading is in the high 60's and high 70's. While the "K" line, the "red" line is now under 70, the "D" line is not. Therefore Stochastics should correct even more and get back to a more neutral stance over the next week or so.

Conclusion and Recommendation

Those that follow my Twice Daily Updates are long the December Bull Call $1000-$1025 Spread at 6.30.

This spread has until the end of November. If the seasonals in gold and silver take hold and Crude simply holds steady or slowly declines, the gains ahead could be very substantial. If you or I am wrong, your risk is limited to the cost of the spread plus fees. Don't forget that this strategy is not a do or die situation. You have the flexibility to get out at any time prior to expiration for whatever the spread is worth. Expiration is in late November, so you have a lot of time to see trends develop.

My recommendation at this time is to hold tight.

Video Link:
http://www.iepstein.com/videoAds/fa_video_1/fa_video_1.html

Getting started is easy. Simply click here to learn more or to subscribe....

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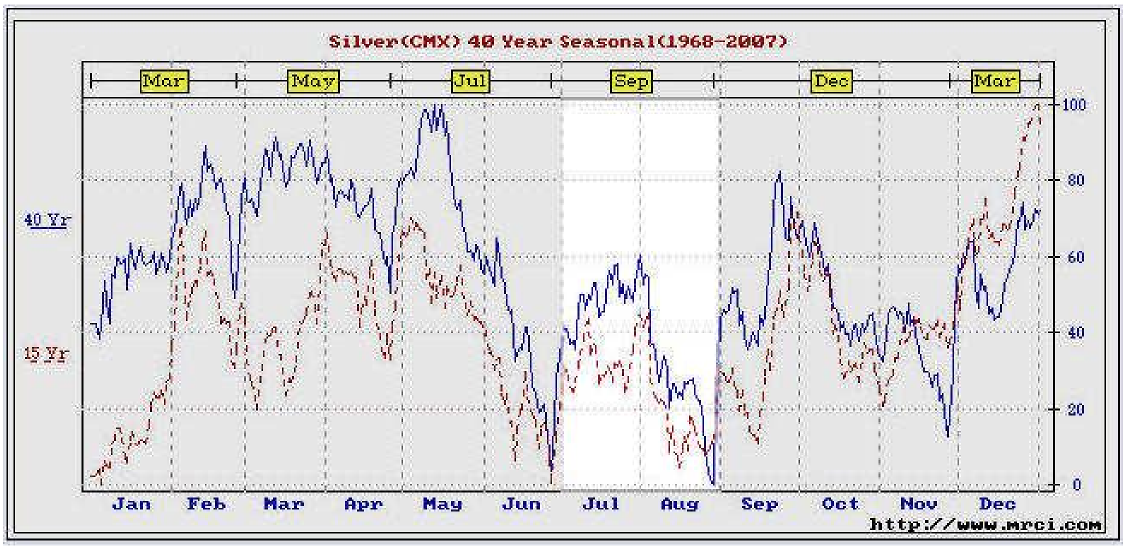
Silver

Let's look at the Seasonal Silver Chart to see what it offers.



Historically speaking its possible that today may represent the near term high in silver in terms of seasonality as prices had an "Outside Day Down", a chart pattern often associated with turn in market trend. If this proves to be the case, a move down is likely.

Silver

Today was a failure day for Silver. An 'Outside Day Down" means to me that until today's high is taken out, the likelihood of prices moving down to the 18-Day Moving Average of Closes is highly probable. It's at that price that I think additional long Call Spreads should be considered.

Let's look at chart of December Silver.

As you can see, today was an "Outside Day Down", which means both yesterday's high and low were taken out by today's market action and prices closed lower on the day. Stochastics are breaking down as well. Support is at the 18-Day Moving Average of Closes, which is about 40-cents away.

Unlike Gold, Silver has changed its chart pattern to one of a lower high and lower low. Gold still has a higher high and higher low pattern which is more bullish.

The key here is that both Silver and Gold are over "key moving averages", which should offer a cushion of support on price breaks.

Recommendation

I think you use the price break at hand to start picking up some December Silver Call Spreads. Like Gold Call Spreads the risk is what is paid plus commission, NFA and associated Exchange Fees.

I like the flexibility of these spreads and the amount of time they have left in them.

Below is a price matrix I had one of my broker's, Mark Pasek create for us.

Bull Call Spread Table

December 2008 Silver

This is based on the Comex 5,000oz Contract
Prices are quoted as of 4:00pm EDT, 7/16/08

Expires: 11/20/2008
Days to Exp 127
Today: 7/16/2008

Spread	Spread Lock	Long	- Short	= Net	Cost	All In	50% Return	75% Return	100% Return	Theoretical Full Value	Risk to Return
18.00/19.00	1.0000	2.0220	1.5330	0.4890	$2,445.00	**$2,555.00**	$3,832.50	$4,471.25	$5,110.00	**$5,000.00**	195.69%
18.50/19.50	1.0000	1.7650	1.3480	0.4170	$2,085.00	**$2,195.00**	$3,292.50	$3,841.25	$4,390.00	**$5,000.00**	227.79%
19.00/20.00	1.0000	1.5330	1.1850	0.3480	$1,740.00	**$1,850.00**	$2,775.00	$3,237.50	$3,700.00	**$5,000.00**	270.27%
19.50/20.50	1.0000	1.3480	1.0450	0.3030	$1,515.00	**$1,625.00**	$2,437.50	$2,843.75	$3,250.00	**$5,000.00**	307.69%

I think any of these to be reasonable and in my Twice Daily Updates will keep track of the ones I recommend in that publication. Today many could have put on the 1900-2000 spread at 35-cents.

Fully Electronic Metals...Gold, Silver, Copper

Exchange	Contract	Clearing Fees	+	Exchange Fees	=	Total Exchange Fees	+	NFA Fees	+	Electronic Routing Fee	+	Commission	=	Total Fees and Commission
COMEX	GOLD	$1.45	+	0	=	$1.45	+	0.02	+	0.15	+	$1.00	=	$2.61
COMEX	SILVER	$1.45	+	0	=	$1.45	+	0.02	+	0.15	+	$1.00	=	$2.61
COMEX	COPPER	$1.45	+	0	=	$1.45	+	0.02	+	0.15	+	$1.00	=	$2.61
CBOT	GOLD	0.06		$1.00		$1.06		0.02		0.15		$1.00		$2.08
CBOT	SILVER	0.06		$1.00		$1.06		0.02		0.15		$1.00		$2.08

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