Declining Interest In Gold

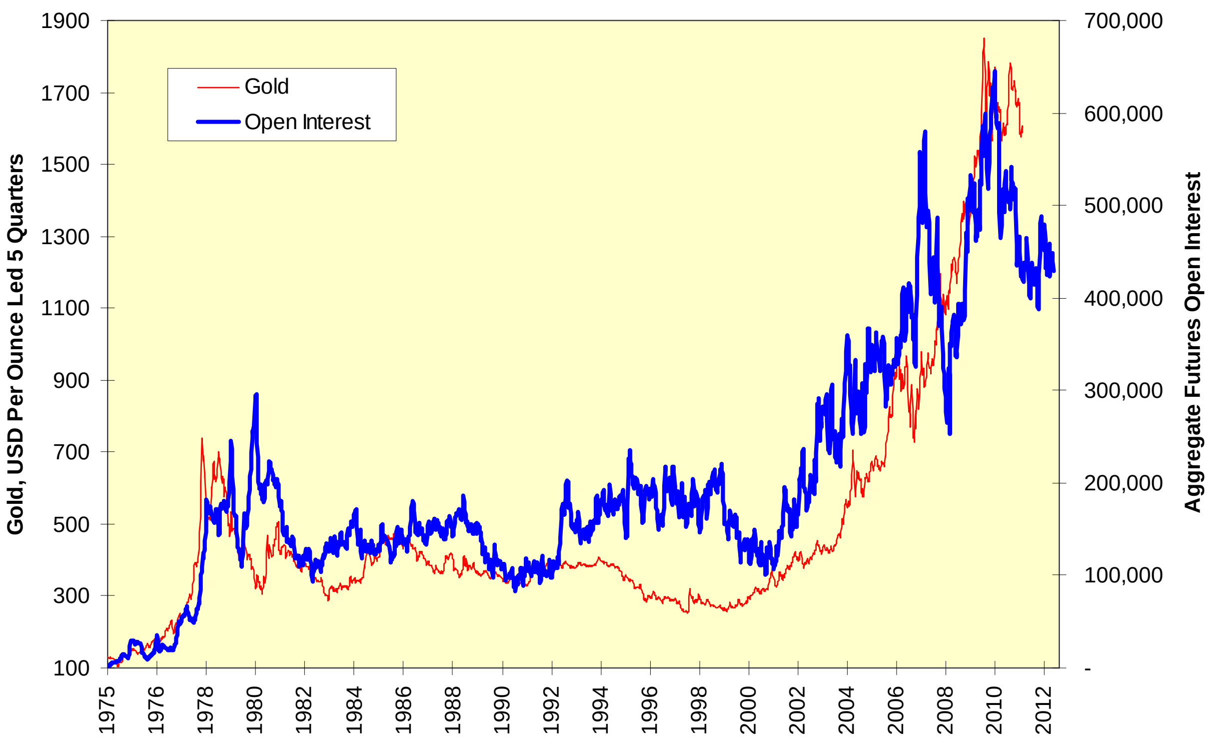
You no doubt have heard it said, "A market requires buying, a lot of buying, to rise, but it can fall for any reason." Really; I hope you heard that before now because like so much of what passes for perceived wisdom on Wall Street it is wrong, worthy only of *The Annals of Unsubstantiated Musings*, and therefore would not be said by me.

As a case in point, I recall a March 1989 conversation with a bond market technician who said, almost in passing, "There is not a lot for sale out there." Yields have declined ever since then. Similarly, stocks have been able to rise in the face of continued outflows from mutual funds as buyers are willing and indeed forced to accumulate them at higher prices. Markets that do not sell off on bad news can rise with only minimal buying interest.

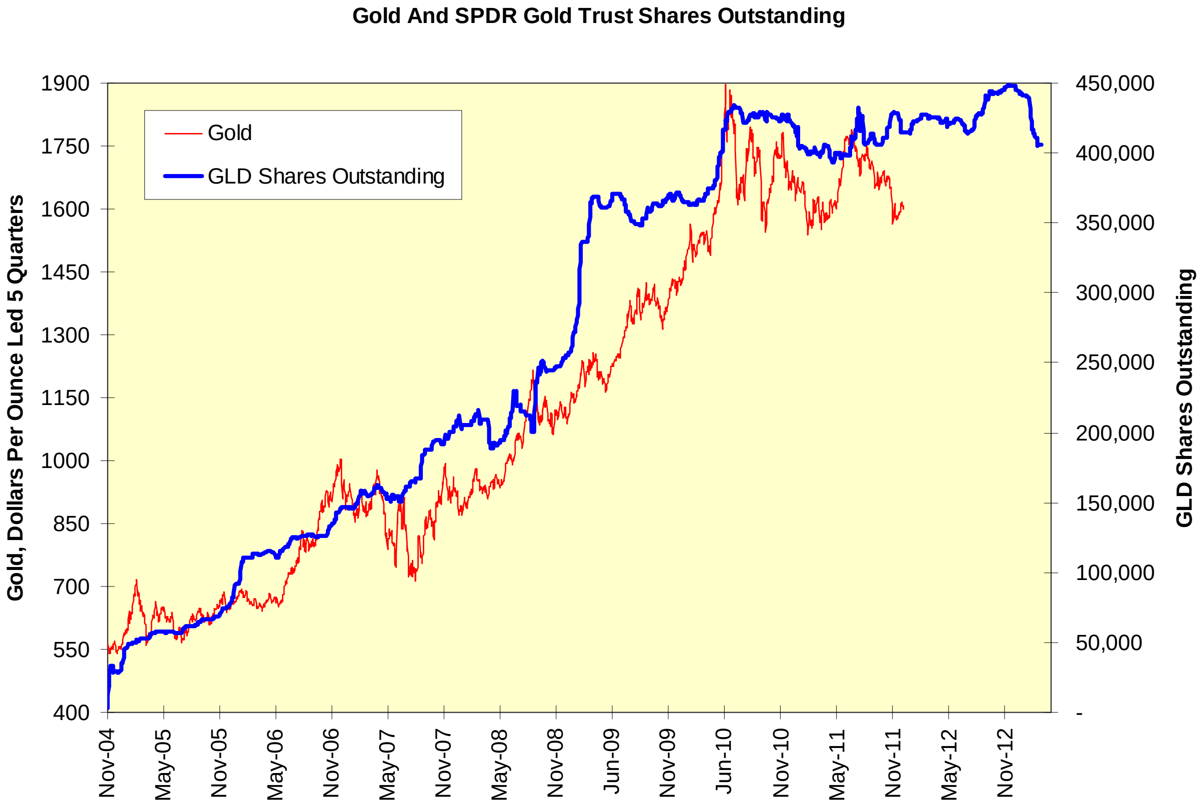
Shrinking Participation In Gold
What about a market such as gold where supply grows only slowly and is augmented by continuously high levels of recycling and where much of the final demand simply represents transference of ownership between old and new hoarders? As many gold buyers are willing to hold paper representations of the metal in the form of ETFs such as the SPDR Gold Trust or simply extinguishable claims on a long position such as gold futures, the ebb and flow of ETF shares outstanding or open interest in the futures market gives us an idea of the actual ebb and flow of participative interest in the market.

Here the news is not all that good gold bugs. If we map the weekly average of aggregate open interest in gold futures going back to their introduction in the U.S. in December 1974 against the weekly average of cash bullion prices, a very strong 65-week or five calendar-quarter relationship emerges with an r^2, or percentage of variance explained, of 0.795. As open interest in gold futures traded has declined by more than 33% since its November 2010 peak, the implication is negative for gold bullion prices through the second quarter of 2014.

Gold And Aggregate Futures Open Interest



The data from GLD's shares outstanding are not quite so negative in their implication. Here the relationship between daily shares outstanding and bullion prices since November 2004 also involves a five-quarter lead-time and the r^2 is a strikingly high 0.944. The 9.6% decline in shares outstanding since December 2012 is more neutral for gold than was the decline in open interest, but no one can construe this and its contemporaneous 6.2% decline in bullion prices as a sign investors are interested in joining the train-ride in gold more than a decade after it left the station.



Here I might offer some other Wall Street wisdom often honored in the breach: The market does not discount the same thing twice. It does, repeatedly. However, if the principal argument for owning gold is central banks cannot print it and if we are five years into the greatest collective money-printing extravaganza the world has ever seen and yet trader and investor interest in gold is petering out with sellers accepting lower prices for gold, then we should be able to conclude the party is over for now.

Investors buy hope and dreams. At this stage in the game, the paper representations of future earnings offer more hope than does a lump of metal. All that glitters in investors' eyes is not gold.