

Gold And Trading Activity Measures

Time-travel must be fun; otherwise, why would so many market analysts, self-proclaimed gurus and camera-chasing loudmouths persist in trying to explain price movements with lagging, as opposed to leading, indicators? One of my favorites in this regard has been the relationship between gold prices and ETF holdings of gold. Some continue to argue shrinking holdings of gold by ETFs have caused the decline in bullion prices.

Gold peaked in nominal terms four years ago next month, shortly after the launch of Operation Twist forced a bullish flattening of the yield curve and propelled risky financial assets higher. ETF holdings of gold peaked at the end of 2012, five quarters later, and have declined almost 43.6% since then.

That misalignment in peaks should tell you something already about which variable lead which. I have found if the holdings of the largest of the gold ETFs, the SPDR Gold Trust, lead gold prices at all they do so by a very long eleven months. I prefer using this measure as opposed to the all-known gold ETF holdings as the addition of new ETFs injects discontinuities into the series and who wants that?

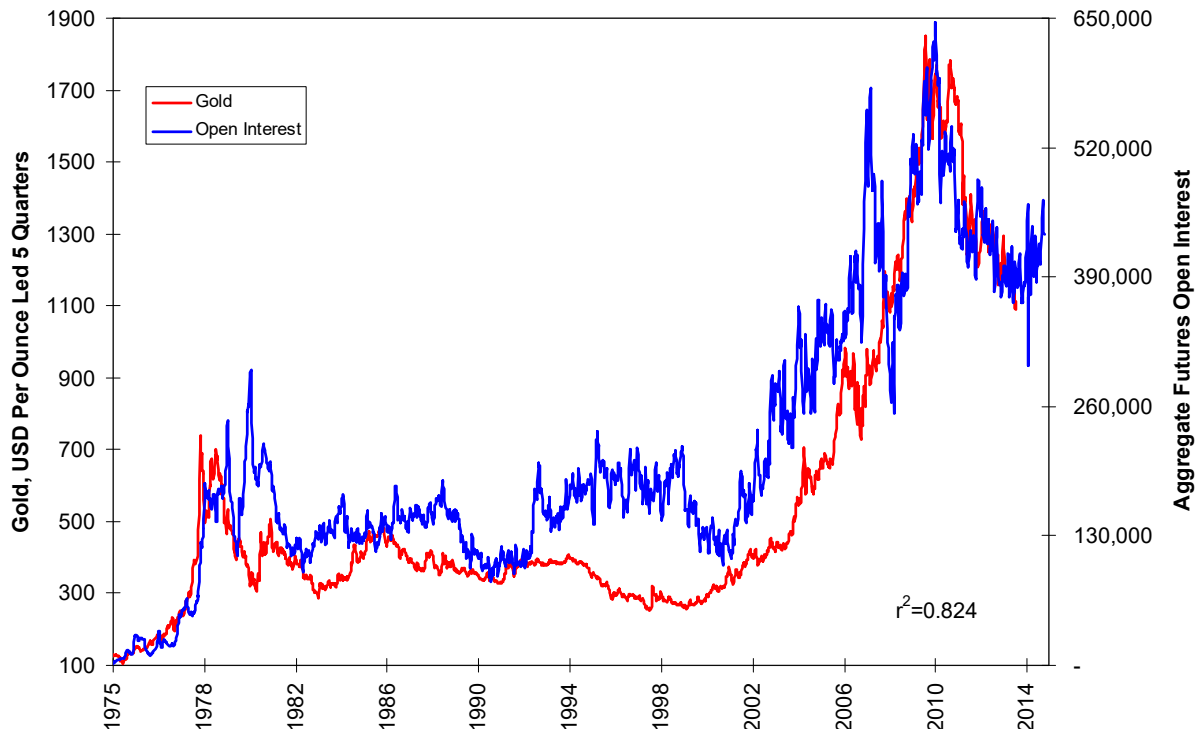
Trading interest in gold as measured by the open interest in Comex futures leads gold by five calendar quarters. I must add these two measures represent different things as gold held by ETFs is actual ownership, or actual ownership of a piece of paper saying you are the actual owner if you want to get snarky about it and have you ever known a gold bug to turn down an opportunity to get snarky? The open interest in a futures contract represents an extinguishable claim to take delivery of gold.

You Lead. I'll Follow

Let's take a look at these measures of gold trading activity and see what, if anything, they imply for gold prices going forward.

Gold futures have traded in New York since December 1974. Their aggregate open interest has led bullion prices by five quarters on average and with a very robust r-squared or percentage of variance explained of 0.824. The ongoing rise in open interest suggests gold prices will rise in the second half of 2016.

Gold And Aggregate Futures Open Interest



What about shares outstanding for the SPDR Gold Trust and their implication, if any, for gold prices? Here the GLD's shares outstanding lead bullion prices by an illogical yet consistent and robust eleven months; the r-squared here is 0.864. If this relationship holds, bullion will remain under pressure during the first half of 2016; no assessment can be made yet for the second half of 2016.

Gold And SPDR Gold Trust Shares Outstanding

