Mind The Gap

Two forces shape price charts (1) trending action and (2) reversion to mean. Nothing ever moves in a straight line for long. This is because at some point the price becomes so extended from the average entry price of those early to the trend, that they begin to take profits. At the same time, those who like to fade extended moves, see the large gap between the price and a moving average. And they look to enter counter-trend. This drives bouts of mean reversion.

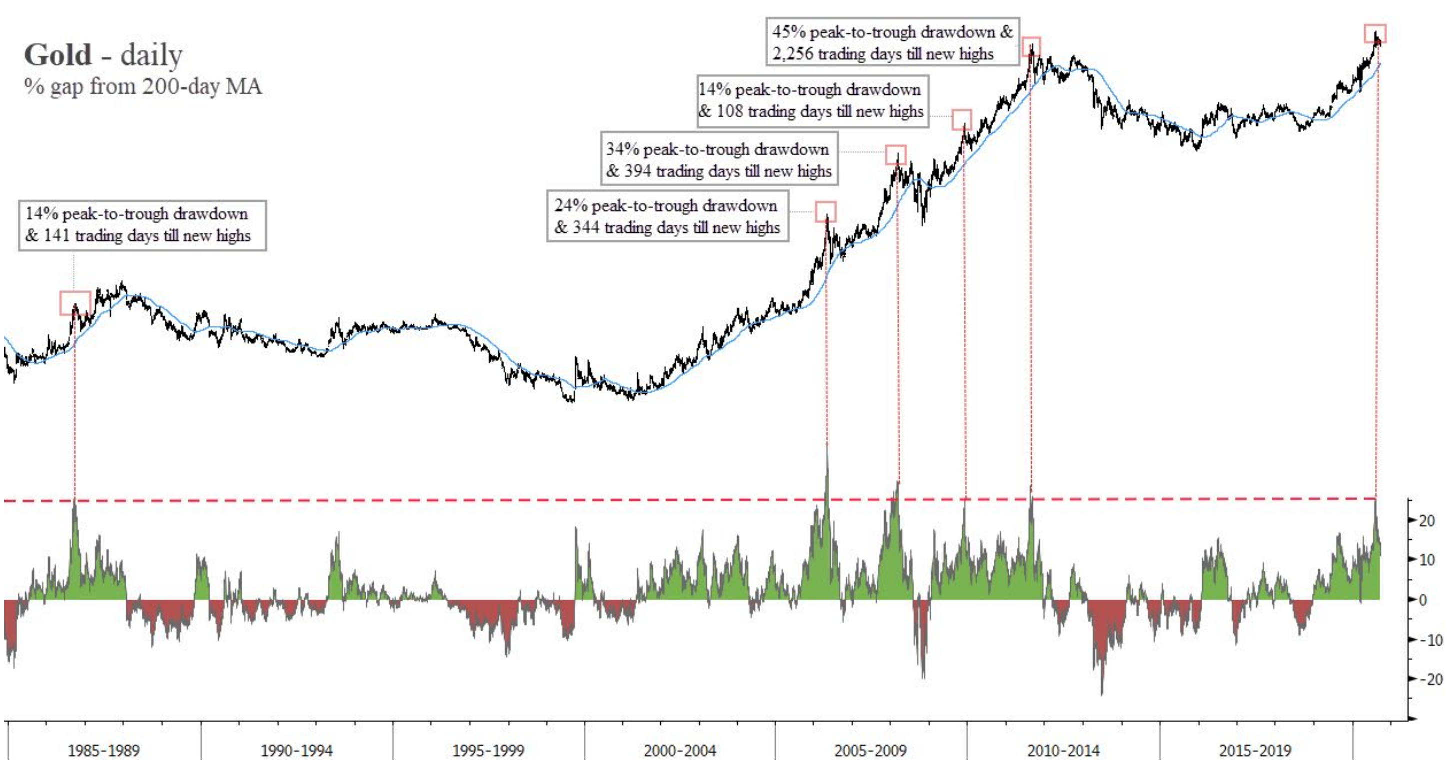
If there's still gas left in the trend, then price will retrace closer to an average level where participants find enough value to enter again and drive the next leg of the trend.

A popular moving average used by traders on shorter timeframes is the 21-day. Larger funds tend to look at longer-term averages, such as the 200-day. They don't like to buy too high above the 200dma or sell too far below it.

It's this structural behavior that drives these large swings and counter-moves within larger trends, as shown on the chart below.

This chart shows the previous 35-years of gold and its percentage gap from its 200-day moving average.

Over this period, gold has hit trend-extension levels of 25% or more from its 200dma only 6 times, including its most recent buy climax.



A 25%+ spread from its 200dma is a rich level. So what does it mean?

Well, here's what happened next each time gold was this extended:

1. **1986:** 14% peak-to-trough drawdown and 141 trading days till new highs
2. **2006:** 24% peak-to-trough drawdown and 344 trading days till new highs
3. **2008:** 34% peak-to-trough drawdown and 394 trading days till new highs
4. **2009:** 14% peak-to-trough drawdown and 141 trading days till new highs
5. **2011:** 45% peak-to-trough drawdown and 2,256 trading days till new highs

When gold has traded over 25% above its 200dma, it's seen an average correction of 26% which has taken 648 trading days to regain new highs. If you exclude the near decade long bear market following 2011, the average drawdown is 21% and the time to new highs is 255 trading days.

Now… 5 is not a large sample-set and just because something has happened in the past doesn't mean it'll happen again today. But, if you get stretched technicals like this that's also confirmed by crowded positioning and a narrative consensus — remember, small specs are over 2std dev long right now — combined with a technical breakdown, then your odds are pretty good that you'll end up somewhere in the ballpark of past reversions to mean.

Gold is currently down 10% from its recent peak, which was 33 bars ago. If we see an average bull market retrace from a 25% 200dma gap, then gold should trade below 1,700 in the near future. At which point, it'll be below its 200dma and traders will see a bargain to add to or enter new positions.

There's a number of ways to play this potential move. You can short gold or silver futures or go long an inverted precious metals etf such as GLL, ZSL, or DUST (just make sure to size wisely if using one of the more levered etfs). We flattened out our Core Gold position yesterday and went short gold futures this morning.

Trade details are below.

Short Gold minis (QOZ2020)

- **Entry:** 1874
- **Exit:** 1931 (daily close above)
- **At-Risk:** 100bps

The US equity market is working through a similar though less extreme level of trend-extension. I'll be out with a note tomorrow discussing what that likely means for price action in the coming weeks.

Until then, stay safe and keep your head on a swivel!

Oh, and also, we did some portfolio cleaning and cut some names that weren't performing in order to free up some cash for a number of opportunities that we're excited about. The names we cut are LEU, RVLV, and LPG.

Your Macro Operator,

Alex