

## Trading HUI Volume 2

Adam Hamilton January 19, 2007 3344 Words

After its rather ugly initial week of 2007, the HUI unhedged gold-stock index has started to recover in the past week. Not surprisingly, this has created a kind of psychological whipsawing for gold-stock traders wondering what is coming next. Did we just witness a minor pullback within an upleg or are we now seeing a bear rally within a correction?

As I outlined in my essay last week, my bet is on the former thesis. Technically the HUI, and its primary driver gold, are carving higher highs and higher lows since early October. In addition to this, some powerful technical indicators are lining up into the same positions where they have been early on in past major uplegs. The evidence is growing suggesting the HUI is in a young upleg and the recent carnage was merely a minor pullback.

Nevertheless, as a student of the markets I am always seeking more information. Even in best-case scenarios, there is always a probability that analyses that have worked for past uplegs will prove wrong this time around. The markets can be capricious and fickle, but the better we understand them the less likely we will be caught totally unaware by some lower-probability move.

One way to better understand the markets and prepare for their vagaries is to illuminate them from additional analytical perspectives. Imagine a price is like an artifact in a museum sitting in a display case on top of a waist-high column. If you have only one spotlight on the artifact, you can see quite a bit of it but some detail is lost in the shadows. But if you add more spotlights illuminating it from different angles, you can see it even better.

The equivalent to adding spotlights in the markets is considering a given price through additional analytical approaches. Last week I looked at gold and the HUI using some moving-average-based technical tools I have developed, a couple spotlights. This week I would like to add another spotlight coming in from a totally different angle, a look at HUI volume. It will help flesh out our overall HUI understanding today.

Trading-volume data for the HUI is not readily available. If you pull up a HUI chart in any chart service, there will be no volume charted because the HUI itself does not actually trade. To the best of my knowledge there are no HUI ETFs and no HUI futures. Like many indexes, its sole purpose for existence is simply to track a basket of underlying stocks. Traders buy and sell shares in its component stocks, but they can't trade the index itself.

Several years ago though a gentleman graciously wrote in and clued me in to the secret of analyzing HUI volume. Although the HUI itself has none, its 15 component stocks all have their own individual volumes. So all we have to do to get a rock-solid proxy for HUI volume is add up the individual daily volumes of its components. The result is HUI composite volume, which I wrote an initial essay about and have discussed periodically since.

With composite volume data available to analyze, conventional volume analysis can be performed on the HUI. And the HUI, of course, is probably the best proxy for the gold-mining sector as a whole. So switching on the volume spotlight to better illuminate the HUI should give us an even better idea of where it is likely heading in the months ahead.

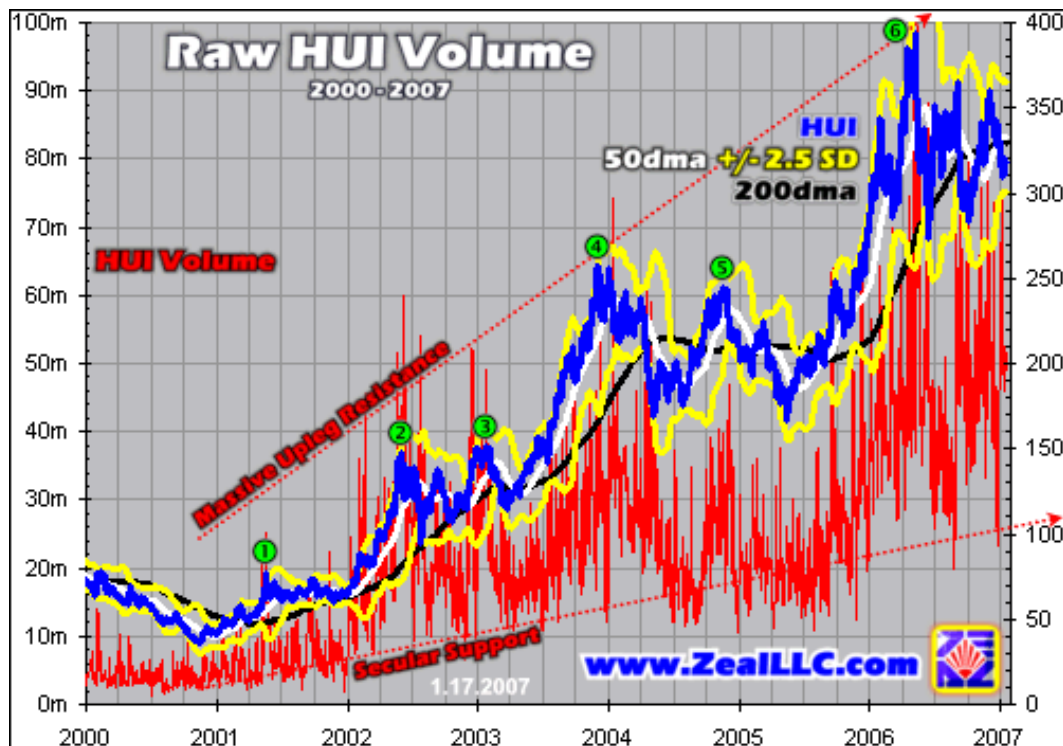
But as far as technical indicators go, volume is rather peculiar. Many technical indicators have clear long and short states at the opposite ends of their spectrums that are mutually exclusive. For example, when the Relative HUI is low as it is today, it means traders have a much higher probability of winning if they bet on the long side. And when this same rHUI is high, the odds favor a coming correction so neutrality or short trades have the best chances for success.

Volume doesn't follow this typical convention. Volume ramps up when people *get excited and want to trade more*. But since there are two opposing emotions that generate excitement in the markets, greed and fear, volume can spike to great heights when *either* of these emotions dominates. High volume is seen near *both* major interim tops, the times to be neutral, and sharp selling panics following tops, the times to be bullish.

Because both greed and fear can drive high trading volumes, big volume spikes must be considered within their recent price context to decide whether they are bullish or bearish. If prices have been rising for months in an apparent upleg, a big volume spike is probably signaling a top. But if prices have been plummeting for days and panic is setting in, a similar big volume spike is probably signaling a bottom. Context matters here.

While high volume spikes have a dual binary nature depending on whether they were greed- or fear-driven, thankfully low volume only signals one thing. Low-volume episodes are only witnessed when traders are complacent, bored, discouraged, apathetic, and generally not very excited. This typically happens near major interim lows and later in long consolidations. Low volume signals the absence of meaningful levels of greed and fear.

With this in mind, let's dive into this first chart of raw HUI composite volume over our fantastic gold-stock bull to date. This volume data is considered raw because it is simply the daily totals of the 15 HUI component stocks' individual daily share-trading volumes added together. There is no smoothing in this chart either, such as through moving averages.



The most immediately striking thing about this chart is the *tremendous* growth in HUI volume over the past 6+ years of this powerful bull market. In November 2000, the month the HUI hit its secular bottom, on one day the total volume of all the HUI component companies was a measly 2.3m shares. Yet by May 2006, the month the HUI achieved its latest secular top, one day witnessed a staggering 99.4m shares of composite volume!

This trough-to-peak growth rate is nothing less than phenomenal. We are talking about a 4,200% gain in daily trading volume in the raw number of HUI component shares in less than six years! To put this into perspective, the HUI itself is "only" up 996% over this same period of time. If you have ever doubted that participation in gold stocks is getting wider as this bull matures, this chart should kill those fears instantly.

Another thing to bear in mind is that this gargantuan volume increase actually massively *understates* the capital involved in this sector. Just as trading volume was rising, average share prices were also getting higher simultaneously. An average HUI share traded on November 2000's 2.3m share day had a share price of just \$4.21. Multiplying these numbers together yields a *capital volume* level of just \$9.7m. Talk about an unloved sector!

Meanwhile on May 2006's stellar 99.4m share day, the average HUI component share price was \$21.68. This yields total capital volume on that day of \$2,155m. So in daily capital-volume terms from trough to peak, the HUI gold stocks have exploded up by 22,100% or so! Interest in and participation in the HUI is really deepening and growing broader as it marches higher. This is typical of all long-term bull markets, the longer they run the

more people want to buy in.

Lest you wonder if such a crazy increase means the gold-stock bull must be ending, I wouldn't worry at all about that. Even at today's levels this entire sector is trivial in size. The total market capitalizations of all the HUI stocks, as of the end of 2006, were only running at \$91,794m. This compares to \$304,840m or so for Microsoft alone. During the last 90 trading days, MSFT's daily capital volume *averaged* \$1,804m, so the HUI is still very small relatively even on its biggest volume day in history.

Back to the chart above, the extremes in raw HUI composite volume are forming an enormous ascending and opening wedge. I drew a couple lines in this chart that capture most of these extreme raw volume days. The lower one is the HUI's volume support line and the upper is its massive-upleg resistance line. I don't think we should read too much into these volume technical boundaries, but they are interesting nevertheless.

On the lower secular support side of this wedge, raw HUI volume has hit this support line many times. While there are occasionally short spikes lower to support lasting just a day or a few, the big clusters of persistent HUI volume support approaches are far more relevant. In most cases, when HUI volume is consistently low and near support, it happens near major interim bottoms or late in long consolidations.

This makes sense. If the HUI has been grinding lower or sideways for months on end, traders are getting discouraged. Some are bored, others are apathetic, and still others are concerned. All of these emotions add up to a low-excitement environment. Nothing saps excitement like consistently flat or falling prices. The HUI volume dries up during such times. This knowledge of when HUI volume is typically near support is very useful to traders.

Over the long term, it is underlying fundamentals that drive prices. But over the short term all that matters is sentiment. If traders are greedy they will bid up prices regardless of fundamentals, and if they are scared they will sell and drive prices lower regardless of fundamentals. But when they are neither, when excitement wanes and volume dries up, odds are a psychological turning point is near. Periods of low excitement are followed by periods of high excitement, which usually means new uplegs launching from the sentiment ashes.

Thus low HUI volume is a good indicator that traders are done selling. The ones who wanted to sell have sold and the ones remaining in the game are just not excited following the poor price action in the preceding months. As all contrarians know, the best time to go long is when few others want to. This occurs deep in corrections and consolidations when boredom, apathy, and concern reign and few want to trade.

On the top end of this HUI volume formation, near resistance, the trading cues spawned by volume spikes are not as clear but they are still useful to consider. Since high volume corresponds with high excitement, and high excitement can be driven by either greed or fear, high volume can be seen both near tops and near sharp selloffs. I found it interesting that the upper resistance line is defined by volume tops spawned near the ends of massive uplegs.

So far in this HUI bull market, it has advanced in an interesting alternating pattern. The first part of this pattern is an enormous upleg that I call a "massive upleg". It drives the HUI up to incredible new bull-to-date highs in huge runs averaging 136% per upleg in this bull market. The massive upleg tops are labeled above as 2, 4, and 6. They really pushed the envelopes in traders' minds of what this bull is truly capable of.

But after massive uplegs, it seems like the markets are not quite sure about the new highs just achieved. It takes a considerable period of time for traders to accept levels as a new base that once seemed fantastically high. This has manifested itself in the form of uplegs after massive uplegs being much smaller. These "consolidation uplegs" have averaged gains of just 53% in this bull. Examples above are 3 and 5.

If you are interested in learning more about this massive-consolidation alternating upleg pattern, I've written about it in some depth [in the past](#). Like all patterns though, this one could fail at anytime. Since we are now in the much more powerful [Stage Two](#) of this gold bull, I could see the next upleg achieving new highs and breaking the consolidation expectations. But just as easily it could be another smaller consolidation upleg. Right now I am handicapping the odds of this new upleg being massive or consolidation at 50/50.

Although a whole separate issue, the massive uplegs tie into this volume analysis because it is near their tops when HUI composite volume has spiked to its upper resistance line rendered above. In massive uplegs 2, 4, and

6, the extreme high HUI volume spikes grew in a pretty linear fashion. If this pattern holds into the future, we should see a 130m+ share composite HUI volume day near the top of the next massive upleg, whether that proves to be today's young upleg or the next one after.

One last observation on this first chart is pretty interesting. If you look at the center of mass of the wild red volume line over the last quarter or so, it is generally in the lower third of the big ascending wedge. If you look back through the history of this wedge, you will note that HUI volume tends to linger in that lower third in the early months of major new uplegs. We saw this in massive uplegs 2, 4, and 6. So from this perspective, today's HUI volume levels are right in line with the young-new-upleg thesis.

One problem with raw volume data is it is incredibly volatile and erratic. It is not all that rare to see a high volume day followed by a low volume day, which drives the volume line all over the chart. This creates the low signal-to-noise ratio you can see in the chart above. There is a lot of visual noise to weed out in order to determine the underlying volume trends. Thankfully this wild data can be smoothed via a moving average.

While I've looked at different moving averages over the years to smooth volume, my favorite is the five-day moving average. It averages daily trading volumes over the past week's worth of trading days. This degree of smoothing is subtle enough so volume extremes still match up well with the bigger moves in prices that spawned them. Yet it is also strong enough to yield a far-better-defined visual trend to follow.



When the 5dma filter is applied, the HUI volume extremes become more tame and generally fall within the linear uptrend rendered above. HUI volume sometimes drifts below the effective support line when excitement is low and trading dries up like during the long 2004-2005 consolidation. And HUI volume can spike above its effective resistance when excitement is high and trading explodes like near the HUI's last major interim top in May. But for the most part, the 5dma of composite HUI volume remains in this uptrend channel.

Just as with the raw data, high-volume spikes represent either extreme greed- or fear-driven excitement while low-volume spikes represent apathy and other non-excited emotions. With the higher signal-to-noise ratio of this chart, it is easier to see that volume tends to be high near major interim tops and low near major interim bottoms. This pattern holds perfectly throughout the HUI's entire bull to date.

For our purposes today, I am most interested in the far right portion of this chart, the area between May's HUI top and today. Soon after this May top, the expected selling materialized and fear gripped the hearts of gold-stock traders as the selling intensified. With the HUI in a virtual freefall, selling triggered ever more selling which culminated in the staggering 99m share day discussed above. High fear drove very high trading volumes.

But soon the HUI bounced in June and rapidly headed up towards 350 again. This was a dangerous time as I warned our newsletter subscribers all summer because the HUI's correction wasn't yet mature which meant more downside was highly probable. Yet complacency reigned in a kind of no-mans'-land between greed and fear so the HUI volume 5dma meandered back down near support. When September's sharp slide lower shattered this complacency, fear skyrocketed driving another huge volume spike above resistance.

But this September spike, on pretty intense fear, turned out to be a bottoming-type event. This makes sense in context. While the sharp HUI plunge in May and June was *right after* a top, way too early in a correction for sentiment to be properly rebalanced, by September the correction was maturing. A fear-driven volume spike *late* in a correction is a much better candidate to herald an interim bottom. And indeed this bottom came in early October.

Since then the HUI volume 5dma has generally been gradually rising, although it trickled off dramatically late last year as trading dried up on HUI weakness in December as well as the usual trading distractions of the holiday season. But then as soon as trading opened in 2007 after an unforeseen delay, the HUI sold off hard along with gold and other commodities. Fear ramped up incredibly quickly and drove a big volume spike above resistance yet again.

Now as always with volume analysis, the key here is the context surrounding this latest spike. The HUI had been climbing higher for a couple months in what looked like a new upleg, but this young upleg neither went high enough nor lasted long enough to be considered mature. Even if it is merely a consolidation upleg, it should still at least challenge its old May highs before it gives up its ghost. It didn't even come close before it started sliding in December.

One key characteristic of young uplegs is that few folks believe in them initially, skepticism still remains high from the preceding correction. So a fear-driven volume spike just a few months into a new upleg before it has matured or approached an old high has a much higher probability of coinciding with a healthy pullback than a correction-type event. During corrections, as you can see above, volume tends to fade, not spike. It doesn't typically spike unless there is a climax selloff at the correction's end.

While volume analysis is fairly technical and subjective compared to other indicators, it still helps offer an additional spotlight of illumination on a price. In the case of gold stocks, the volume picture rendered above seems much more consistent with the early months of a major new upleg than with the late months deep in a correction. Only time will tell if this interpretation is right, but I suspect it is given other indicators' corroborating messages.

At Zeal we have been aggressively buying gold stocks this year to exploit these fear-laden lows that should not last. We recently published a detailed [fundamental research report](#) on our favorite junior gold stocks and we are actively buying some of these as well as more conservative gold stocks in our newsletters. It is not too late to [subscribe to our acclaimed monthly newsletter](#) today if you want to add high-potential gold-stock positions near these apparent lows. What a wonderful opportunity!

As an added bonus, our subscribers have exclusive access to a private charts area on our website that includes high-resolution versions of these HUI volume charts that we update weekly. We also update many dozens of other unique and difficult-to-make charts that we use to aid our own trading decisions. Our subscribers can see all of them anytime on our website.

The bottom line is the composite HUI volume signature we've seen in the last six weeks or so is much more congruent with a young new upleg than an old and not-yet-finished correction. The high levels of fear seen in recent weeks are more consistent with the wall of worries that all new uplegs must climb. In mature corrections prices have been grinding sideways to lower for so long that few care anymore and volume just dries up.

While volume analysis is not as straightforward as other technical indicators since both greed and fear can drive high-volume events, it still offers another useful perspective through which to illuminate price action. The more we understand the HUI or indeed any price, the higher the odds our trades will prove correct and successful.

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