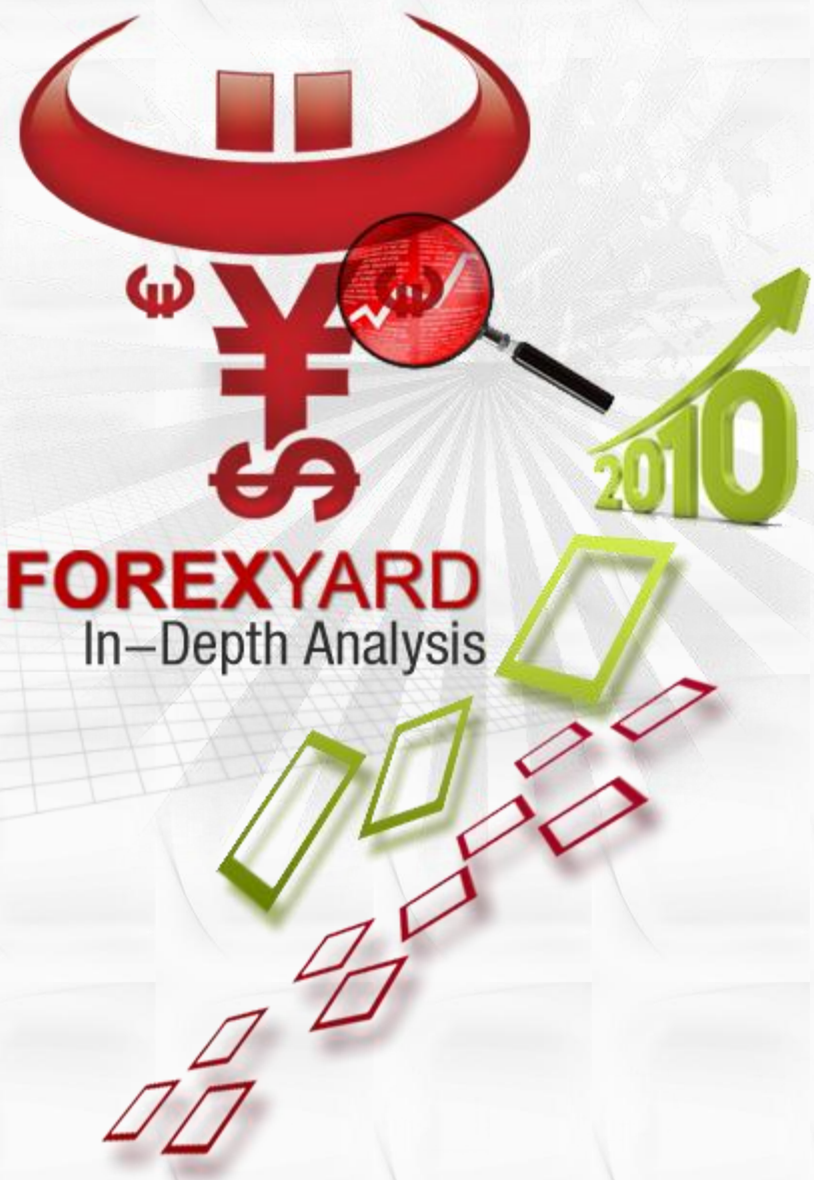

FOREXYARD
In–Depth Analysis

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The Impact of Gold Trading

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Gold: The Ultimate Safe-Haven

Introduction

Since 1975, when gold began being priced exclusively based on its free-market value, the precious metal has seen fluctuations that have brought it to historic highs and lows. Today, savvy investors often find that knowing the direction of the price of gold often contributes a great deal to increasing their fortunes. Fluctuations of 4,000-5,000 pips in a single day are not uncommon for gold, making the commodity one of the more volatile instruments in the forex market. First time traders will want to educate themselves regarding the different aspects of gold trading. What drives gold prices? How has the global financial crisis impacted the price of gold?

How have past traders taken the extreme volatility of gold and turned it to their advantage? Finally, what is the current trend for gold, and what can we expect to happen in the future? This article will provide you, the trader, with a concise explanation of all of these questions as well as helpful information about how to successfully profit from this valuable trading instrument.

Gold has a long history of being used as an equivalent to currency, especially by governments. It was not until the early 20th century, when many European countries went off the gold standard, and subsequently in 1975 when the US did the same, that gold trading began to gain popularity. By allowing gold to be priced according to the free market, as opposed to the fixed rate previously used, prices were able to adjust to their real value.

Today, gold is priced in US dollars per ounce. Because of gold's long history as an equivalent to currency, investors typically view it as a safe haven asset. In addition, as there is only a fixed amount of gold in the world, the precious metal is unlikely to drop significantly in value. In times of uncertainty, gold has always been considered a more secure and reliable asset than paper money. While commodities have always been seen as a safe investment in times of crisis, as there is always a demand for them, gold is considered to be unique. An examination of the different factors that affect commodity prices and why gold is considered exceptional among them will better assist new traders in the forex market.

What Affects Commodity Prices?

Unlike currencies, which can be mass printed on demand, commodities are finite. Crude oil for example will eventually run out, as there is only a fixed amount on the planet. While gold is also finite, (by the end of 2006, the total amount of gold ever mined was estimated at 158,000 tons), it is unique in that it is not used up like oil. The owners of gold tend to save it, either as a safety net in the event of a crisis, or in the form of jewelry and other consumer products. Theoretically speaking, gold can always be put back on the open market, for the right price of course, thereby throwing the existing supply and demand ratio into turmoil. This translates to governments as well. The recent purchase of 200 tons of gold by the Indian Central Bank was widely seen as a response to the global economic crisis, and its negative impact on the rupee. Following the purchase, gold prices jumped as investor confidence in the Indian economic recovery waned.

Since gold is not so much used as opposed to saved, the metal's value tends to skyrocket in times of crisis. Unlike oil, which during times of economic prosperity rises in value, gold prices tend to remain flat until a perceived catastrophe is on the horizon. While the most obvious example of this phenomenon is the global economic crisis starting in 2007, there are many more examples of gold prices increasing or decreasing during much smaller scale events.

Speaking generally, fundamental news events ranging from manufacturing data to interest rate decisions all affect gold prices. Obviously, the more significant the news, the bigger impact it will have on commodity prices. Using our previously stated explanation of how gold acts during times of economic turmoil we can deduce that, for example, a low figure on a home sales report may lead to a short-term spike for gold. On the opposite end, positive employment data is likely to cause gold prices to drop. While economic news from around the world tends to affect the price of gold, it is the United States that most directly impacts the market. One of the primary examples of this was during the Great Depression during the 1930's.

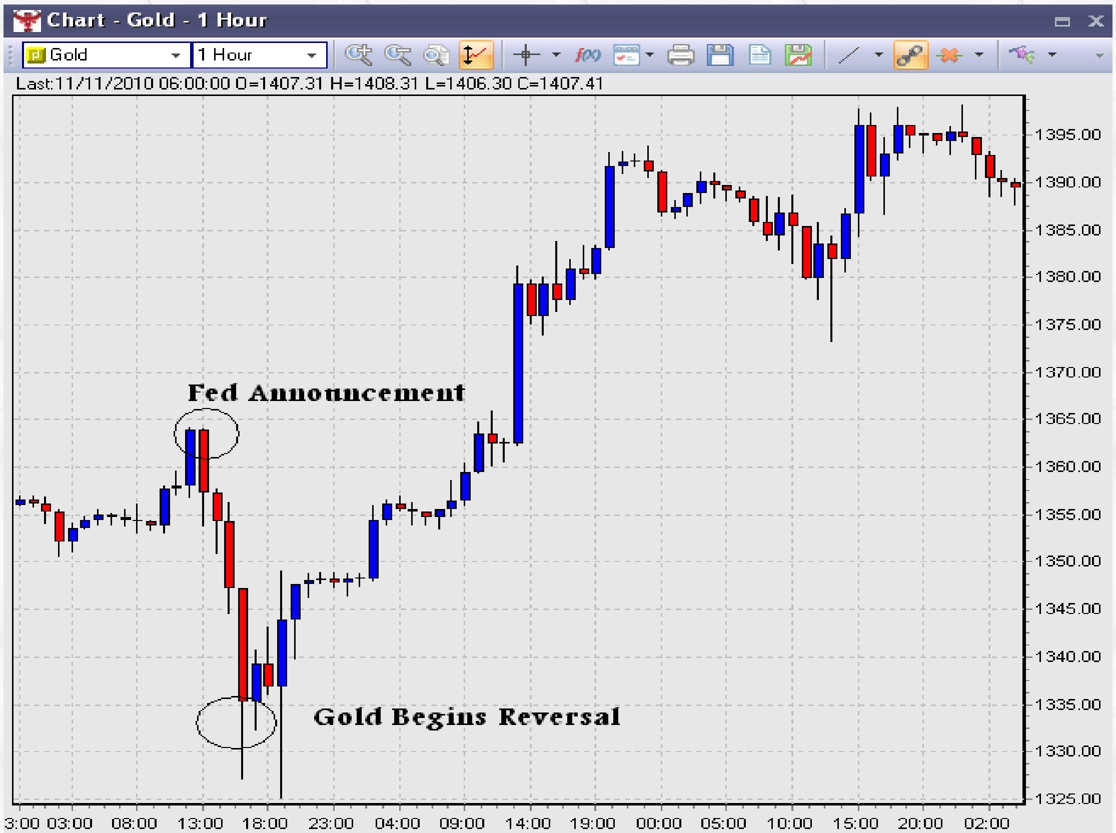
At the time, paper currency was practically worthless, while the price of gold was so high that an executive order was issued forbidding ownership of the commodity by US citizens. Taking a slightly more modern example, let's look at the recent Fed decision to buy up $600 billion of treasuries in order to stave off deflation and another US recession.

Taking a look at the charts below, we see the sharp drop the dollar took against two of its main currency rivals, the euro and yen. Investor expectations that US Treasury yields would fall further led to a further drop in confidence in the US economic recovery, causing the dollar to tumble.


Chart - EURUSD - 1 Hour
Last:11/11/2010 06:00:00 O=1.3782 H=1.3792 L=1.3771 C=1.3781
Fed Announcement


Chart - USDJPY - 1 Hour
Last:11/11/2010 06:00:00 O=82.27 H=82.27 L=82.16 C=82.26
Fed Announcement

Now let's take a look at the chart for gold during the same time period.



While a sudden and rather extreme drop in the price of gold was seen immediately following the Fed announcement, the commodity began to stabilize shortly after. As we can see, gold was not only able to bounce back to the record highs before the Fed decision, but it was also able to dramatically increase in value. The dollar on the other hand, continued to fall in the same time period

Without a doubt, the global financial crisis of the last few years has been the most significant economic event since the Great Depression. It is for this reason that a closer look at the affect the crisis had on gold is worth examining.

The Global Financial Crisis and Gold

The global financial crisis of 2007 originated in the United States, and was a direct result of extremely low liquidity in the US banking sector. The resultant collapse and bailout of certain financial institutions had a ripple affect worldwide, which is still very much being felt today. In the US, virtually every sector of the economy has suffered. Unemployment remains high, while homes are being foreclosed on at an alarming rate. Dollar levels over the last 3 years have fluctuated greatly, and have largely been dependent on both internal and external economic events.

For example, the Greek debt crisis during the summer of 2010, led to dramatic gains for the USD against the EUR. On the other hand, investor concern regarding the US quantitative easing package previously mentioned, cause the greenback to slide to near record lows against several of its main currency rivals. Throughout the last three years, gold has seen several dramatic price fluctuations, which have largely been a result of perceived global economic conditions.

Currently, gold is trading near record highs. The precious metal has been boosted by the tumbling dollar and a general lack of confidence in the US economic recovery. This has not been the case throughout the economic crisis. During the height of Greek debt worries, the dollar was steadily making gains against its European counterparts. The EUR/USD pair dropped as low as the 1.1800 level, close to a record low. During the same time, gold was range trading between $1100 and $1250 an ounce. It was not until the euro-zone began to regain control over its banking sector, and the dollar began to subsequently fall, that gold began taking off. In October of this year, the EUR/USD took off to well above the 1.4000 level. At the same time, gold began spiking, and eventually went above the $1300 level. With the dollar still being weighed down, gold is now trading above the $1400 level.

Of course the dollar is not the only currency that drives the price of gold. We already mentioned that the sizeable purchase of the commodity India made several years ago led to a spike in prices. In addition, both Russia and China have expressed interest in recent years in increasing their gold stockpiles. In November of 2006, prices shot up to a two month high following a statement form a Chinese official indicating that the country may want to diversify further with gold.

Now that we see how a major global event like the economic crisis was able to influence the price of gold in such a dramatic way, now is a good time to look into how past traders have been able to accurately predict upcoming trends and maximize their profits.

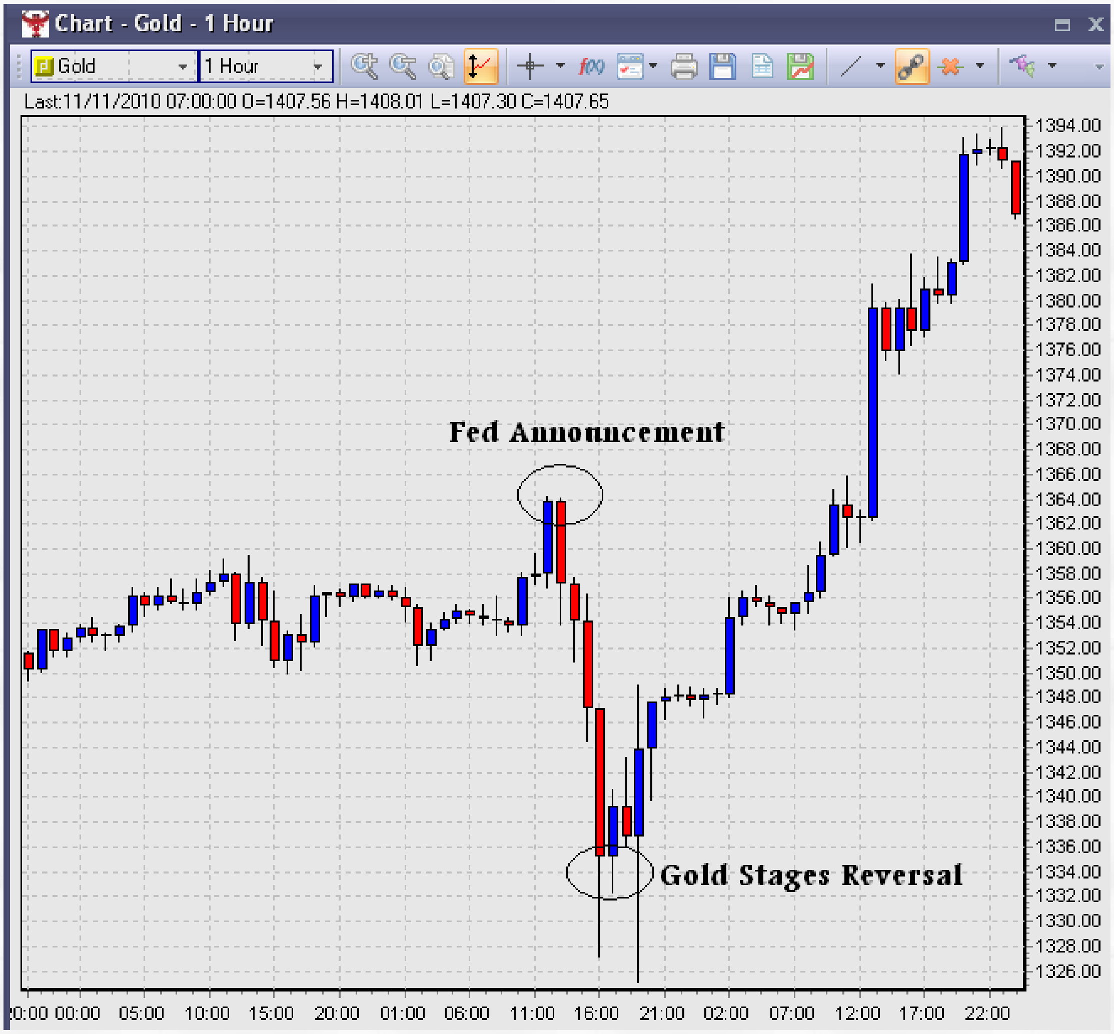
How Gold Turned Average Traders into Millionaires

Accurately predicting gold trends can seem like a daunting task. With such drastic price fluctuations seen on a daily basis, making short term profits is indeed not as easy as other commodities or currency pairs. At the same time, traders who have kept up to date with the latest market news have been able to make a very significant profit in a short amount of time. Taking a look at some past market events, we can see how a careful trader would have been able to use the news to turn a sizeable profit.

Traders know that the biggest monthly market event is the US Non-Farm Payrolls figure. The employment data, released on the first Friday of every month, typically sets the pace for the dollar for that entire month. Commodity prices, in particular gold, usually experience heavy volatility right around the time the Non-Farm figure is released. The October 2010 Non-Farm figure came in at a disappointing -41K, after analysts had predicted a result of around 1K. The disappointing figure caused further erosion in investor confidence in the US economic recovery, and caused the dollar to tumble against virtually all of its main currency rivals. At the same time as the dollar was falling, gold shot up close to 2000 pips to close out the week.

Let's go back to the quantitative easing measures taken by the Fed that we discussed earlier. In the months preceding the implementation of the quantitative easing measures, the dollar was plummeting to fresh record lows almost daily. The EUR/USD pair had been trading well above the 1.4000 level, while the USD/JPY pair seemed to be on its way to breaching the psychologically significant 80.00 level. In the meantime, gold was rapidly increasing in value, moving up close to 10,000 pips in a matter of weeks.

When the Fed finally did get around to announcing its plan to buy up $600 billion in treasuries, the markets went into a selling frenzy. Not only did the dollar rapidly drop in value, but commodities like gold did as well. Analysts attribute the drop in the price of gold to general market confusion after the release of major news. A novice trader may have seen the downward trajectory gold was taken, and decided to short the commodity. Such a move may have been profitable in the short term, but shortly after the news was announced and the markets settled, gold staged an upward correction that is still going on today. Let's take another look at the gold chart we were examining earlier.

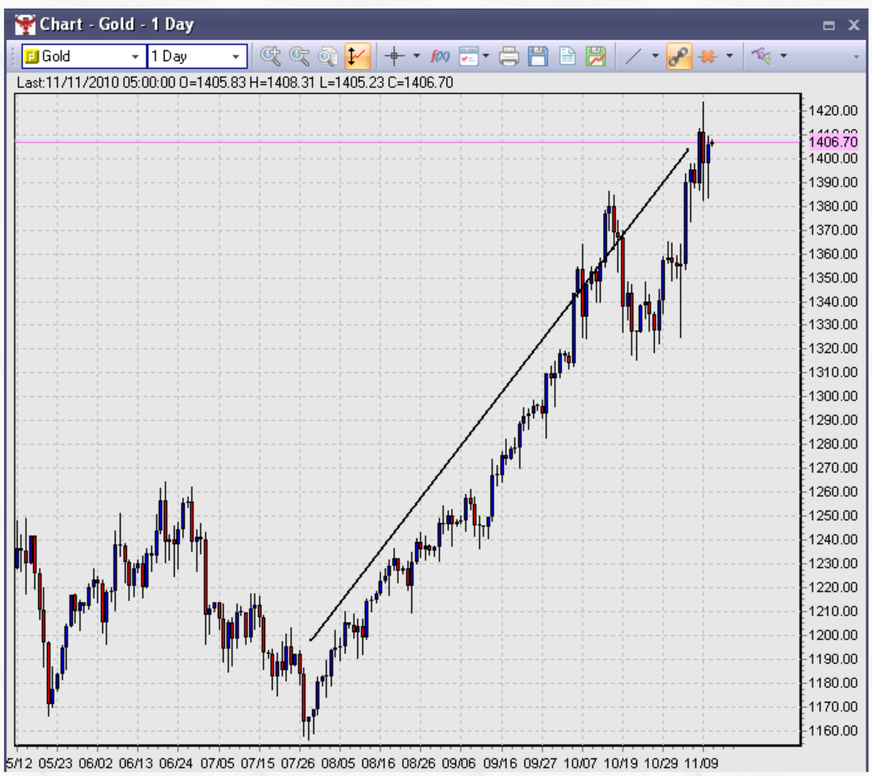


Before the news, gold had been trading around the 1365 level. Following the news, prices began tumbling, reaching as low 1327 in about four hours. After gold hit its support line, it staged a rather large and significant correction that has yet to stop. Not only did the metal reach its price before the Fed made its announcement. It has also managed to rise to new record highs, approaching $1400 an oz.

Readers of this article are probably thinking: If I could go back in time, this information might have been useful…While this may be true, new traders would be wise to take the examples given in this article so far and apply the same principles to future events. On that note, now may be a good time to take a look at gold's current trend, and where it is likely to go in the future.

Where Is Gold Heading, and How Can You Profit?

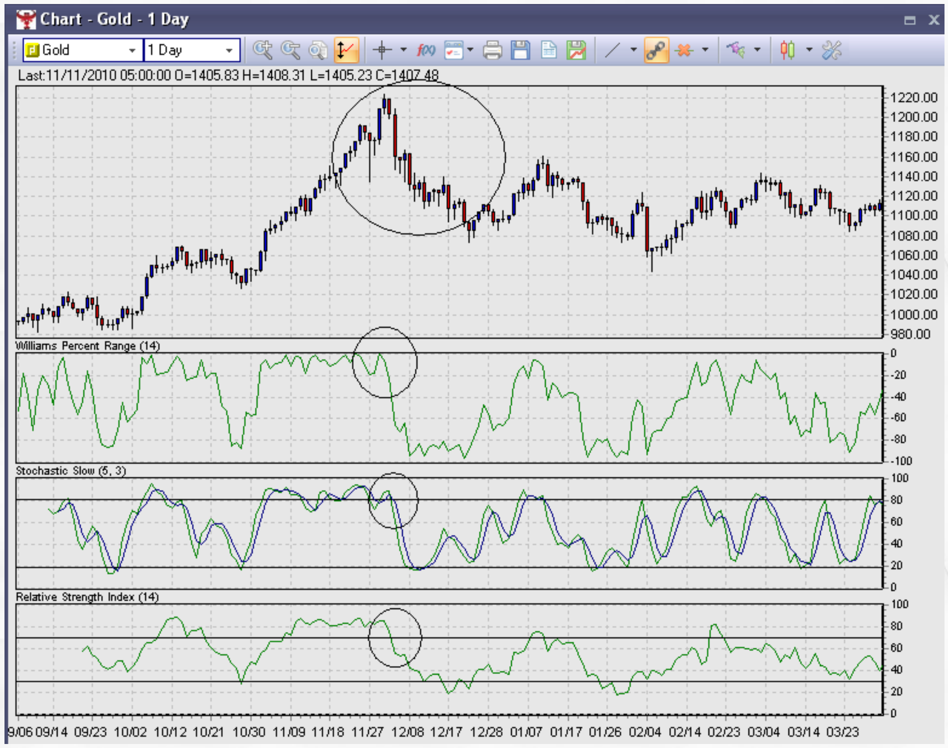
Needless to say, the overall trend for gold is definitively up. Taking a look at the daily chart for gold, provided by Forexyard, a trader can reasonably assume that the upward trajectory we have seen up to this point will undoubtedly continue. While this may not be so far off in the long term, it is the short term gains and losses that gold takes that could be potentially profitable for the forex trader.



While forecasting the direction gold is taking may not be easy, it is by no means impossible. There are a number of tools at a trader's disposal that make their job easier. We have already gone over the fundamental aspect of gold trading. It is absolutely necessary that traders pay attention to the overall trend of the global economy, while looking deeper at other indicators, like employment and interest rate statistics in countries like the US, euro-zone and Japan. In addition, the technical aspect of forex trading could prove to be invaluable to gold traders.

As we discussed earlier, gold is one of the more volatile instruments in the forex market. Technical indicators are a very efficient way to predict future trends, especially when the fundamental news appears to be confusing or contradictory. While gold typically rises in times of economic turmoil, it is not unusual for it to go down after a poor employment report or home sales figure is released. In cases like these, turning to the technical data is a good option.

In the example below, we see how technical indicators like the Williams Percent Range, Stochastic Slow and Relative Strength Index all accurately predicted the downward trend gold took. While using technical indicators may take some practice and getting used to, they often times are of great assistance to the expert trader.



Now that you have gotten a taste for the different aspects of trading in gold, now is the time to get started. Sign up now for a trading account at Forexyard today in order to take advantage of all the potential opportunities gold trading offers.

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