The Inflation Genie Is Out Of The Bottle

“Gold is still considered to be one of the world’s safest assets, whose characteristics can be attributed to gold’s unique properties such as finite supply of physical gold, and lack of credit and counterparty risk given that gold is not a claim against a specific partner or country.”

Dear Investor,

The quote above is from the Hungarian Central Bank (Magyar Nemzeti Bank), which announced on April 5, 2021 that it purchased another 63 tonnes of gold bullion, thereby tripling its gold reserves to 94.5 tonnes. I might add that the MNB sources its gold in London but repatriates back to Hungary to ensure possession and ownership. Gold bullion now represents over 14% of the Central Bank's reserves.

In late March, Russia's Finance Ministry announced that it has authorized the National Wealth Fund (Russia's sovereign investment fund) to diversify its assets by investing part of the funds into physical gold and silver (not GLD, SLV, PHYS or PSLV). The Ministry also stated that the share of gold has been significantly boosted in Russia's foreign currency reserves. Per an announcement in January that Russia was continuing to unload its U.S. Treasury holdings, it means Russia is dumping dollars and buying physical gold and silver.

Many eastern hemisphere countries and Central Banks have been adding gold to their holdings in order to hedge their exposure to the dollar. We also believe it's in preparation for eventually reincorporating gold into the global monetary system. China this month has given its banks permission import large quantities of gold into the country. Previously the PBoC controlled 100% of the flow of gold in China.

While it is true that all Central Banks are printing money, the Fed has been the most prolific of the money printers. In a sign that the Fed intends to print considerably more money, it took the steps of further hiding its money supply disclosures.

Nothing the Fed does happens by coincidence or merely on a whim. Recall that the Fed decided to no longer report the all-encompassing M3 monetary supply aggregate in 2006. The Fed’s stated reason for this was that it was not worth the expense involved with calculating and reporting M3 because the difference between M2 and M3 was primarily eurodollar deposits (not an insignificant quantity of money). The disingenuity of this excuse was palpable. The U.S. is the only major industrialized nation that hides the M3 calculation.

More likely, it was a move to hide the best measure of the money supply in preparation for the “QE” era. Many of us saw the banking system collapse unfolding well before 2006. As such, it’s clear – at least to me – that the Fed knew it would be forced to start inflating the money supply ahead of the actual event. Now the Fed has substantially reduced the transparency of its M1 and M2 money supply measures.

M1 measures "demand" money. This is money a bank has to keep on hand because depositors can "demand" use of it at any time. Primarily checking accounts, traveler's checks and free-floating currency. M2 measures M1 plus "term" deposits. Much of this is money that is not necessarily available without prior notice. This includes savings accounts, CDs in amounts less than $100,000 and retail money market funds. Last summer one of the truth-seeking financial writers we follow noticed a massive shift of funds out of M2 and into M1. This was a low-grade run on the banks in that depositors moved a large amount of money out of term deposits and into demand deposits.

In order to hide this development, the Fed decided to largely consolidate M1 and M2 and change the reporting of the two money supply measures from weekly to monthly. Moreover, the monthly number will contain only the "average" monthly data. Finally, the Fed will no longer publish non-M1/M2 account balances, primarily institutional money funds. This is significant because this data helps analysts reconstruct the M3 metric.

Ironically, Jerome Powell promised "more transparency" from the Fed when he assumed the Chairmanship. Instead, we get the opposite. What purposes does this serve? The economy for the majority of the populace has not improved since the virus crisis induced economic depression. In fact, in February 22% of all small business were closed. This was the highest level of monthly closures since 23% closed in May 2020. Once the latest stimulus check distribution is spent, we expect the economy to take another nose-dive, thereby forcing the Fed to increase considerably the amount of money it is currently printing.

The Fed knows this and also knows it will be forced to increase the amount of money it is printing currently on a monthly basis ($120 billion) in order to keep the financial system from tanking hard. Thus, the Fed is further obscuring the money supply numbers, as it did in 2006, ahead of another massive round of money printing. The Fed's latest obscuration of the money supply numbers is an indicator that the Fed's printing press will go "Weimar" over the next 12-24 months. This will translate directly into raging price inflation and soaring gold and silver prices.

After the huge run-up in the precious metals sector in Q2 and part of Q3 2020, gold, silver and mining stocks have been in a price correction/consolidation phase since August 2020. We believe that correction cycle may have bottomed in late March and early April. While are loathe to ever call a market cycle "bottom," many of the technical indicators we monitor suggest that the precious metals sector is poised for another move higher. This view is reinforced by the strongest fundamentals for gold and silver in the last 20 years. These factors include the rising money supply, a rapidly increasing rate of price inflation and evidence of shortages in the supply of physical gold and silver in London and New York.

While we were not happy with the performance of the fund in Q1, we outperformed the quarterly performance of a "basket index" (GDXJ, gold, silver - each weighted 33%) representative of our fund. We also trimmed our positions considerably in the last two weeks of Q1 and the first week of April, which enabled us to partially avoid the last segment of the sector pullback. We plan to redeploy the cash raised into mining stocks that we believe, based on our research, will outperform the sector as we grow more confident that the next leg higher is underway.

At some point, the market's love affair with cryptocurrencies and insanely overvalued tech and tech-related stocks will be ruined with another painful stock market sell-off. At this juncture we believe the precious metals sector will benefit from a large flow of capital that flows out of risk assets and into safe-haven investments. Would not be surprised to see this happen before the end of 2021.

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