The Inflation Genie Is Out Of The Bottle

"Inflation is always and everywhere a monetary phenomenon." - Milton Friedman

Dear Investor,

The nature of inflation is widely misunderstood and misinterpreted. "Inflation" and "currency devaluation" are tautological - they are two phrases that mean the same thing. When the money supply increases at a rate that is greater than the wealth output of an economic system, it reduces the value of each marginal dollar created. Dollar devaluation has been occurring since the early 1970's. The value of the dollar relative to gold (real money) has declined 98%. In 1971 $40,000 would buy a 4,000 square foot home in a good suburb. Now it takes $700,000 on average to buy that same home.

Price inflation is the evidence of currency devaluation. The CPI is not a real measure of price inflation. The CPI is methodically massaged - starting with the Arthur Burns Federal Reserve (it was his idea) - to hide the real degree of currency devaluation from all of the money that has been printed since 1971. The CPI report is little more than a tool for political propaganda.

Furthermore, the Fed has made the public's ability to measure the money supply considerably more difficult over the past 15 years. In 2006 the Bernanke Fed stopped reporting M3, the most accurate measure of the money supply. You can't see M3 past March 2006. Why? Early in 2021, the Fed changed the definitions of M1 and M2. Why? The Fed has done this to cover-up the true amount of money (bank reserves) that has been created over time.

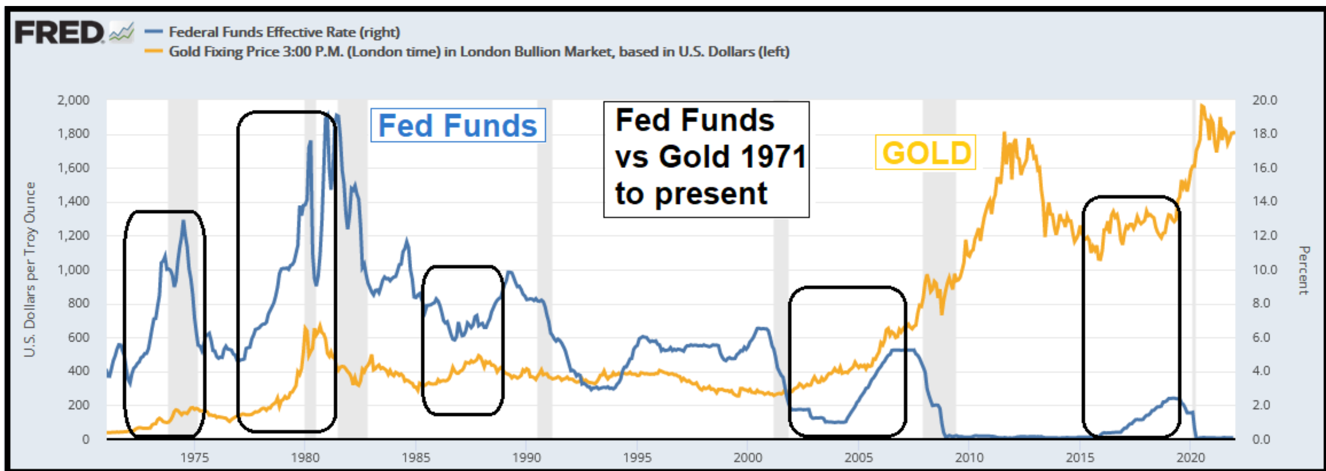
The M2 money supply has increased at an annualized rate of 20.2% Since February 2020. The M2 measurement is now 90% of GDP vs 44.4% at the beginning of 2000. Going into 2022, gold is considerably mispriced relative to the amount of currency that has been printed. And silver, at a gold/silver ratio of 79, silver is extraordinarily mispriced vs gold.

The December CPI report showed that, using the Government methodology of measuring and calculating the change in the general level of prices, the annualized price inflation rate increased 7.04% from December 2020. This is up from a 6.81% annualized rate in November. This is the highest Goverment-measured rate of inflation since June 1980.

However, since the Arthur Burns Federal Reserve in the 1970's, and since the world switched to a dollar-based fiat currency monetary system, the Government has systematically "massaged" the data and the CPI calculus in order to "dumb down" the real increase in prices for the goods and services purchased routinely or out of necessity by the average household. In other words, the CPI is not designed to measure true price inflation.

John Williams, who has been writing the "Shadow Government Statistics" newsletter for over two decades, recalculates the CPI every month using the methodologies in place in 1980. By his calculations, the real rate of inflation currently is 15%. This number reflects more closely the inflation rate we all have been experiencing with our daily/weekly expenditures.

Now that the Fed has acknowledged that price inflation is not "transitory" and that it will take measures to "fix that problem," what happens to the price of gold when the Fed begins a rate hike cycle? Adam Hamilton, who publishes his Zeal Intelligence newsletter, did a statistical study which concluded that some of gold's best rate of return periods going back to 1971 have occurred when the Fed goes into a rate hike cycle. The chart below shows this:



Contrary to the mainstream narrative - seeded in ignorance, we might add - that gold moves inversely with interest rates, as it turns out in the modern fiat monetary system gold rises when the Fed hikes the Fed funds rate.

The rationale behind this is that, in every instance, when the Fed finally acknowledges that price inflation is a problem that needs to be addressed with tighter monetary policy, flight to safety money moves into gold because the market has determined that the Fed is way behind the inflation curve and the start of a rate hike cycle is the signal to the market that inflation is going to get worse. Furthermore, the Fed will not act quickly enough to get ahead of the problem.

Since the 1990's, the Fed tends to start an interest rate hike cycle at a time when the economy is already rolling over. Gold's price rise is also based on the expectation that the Fed will have to cut its rate hike cycle well short of plan in an effort to re-stimulate the economy. You can see that in the chart above in which each rate hike cycle since the mid-1980's gets shorter and then is abandoned and reversed at a lower Fed funds rate.

Recall that Paul Volcker ultimately jacked the Fed funds rate up to 20% because that is what it took to fight the 1970's money printing price inflation. Although the current rate of inflation is now worse than in 1980, if the Fed hiked the Fed funds rate up to just 5% it would cause a massive crash across all financial assets (stocks, debt, mortgages, derivatives).

To the extent that there's weakness in the precious metals sector connected to the Fed's shifting policy stance and the resultant bloodbath in the stock market, we expect the weakness to be short-lived and that the dynamic reflected in the chart above will kick-in.

Per your account statement from Perennial Fund Services, PMOF was up 7.26% after all fees and expenses in Q4. We outperformed the sector generically by about 120 basis points (1.2%). This is because we raised the cash position during Q1 to north of 20% in anticipation that the precious metals sector would be sluggish for most of 2021.

We have the stock portfolio positioned for a big move in 2022 if we get the cooperation that we expect from gold and silver prices. We also believe that the pick-up in the merger/acquisition activity could positively affect some of our positions (Pure Gold Mining, US Gold, New Gold, for instance).

Wishing you a healthy, safe 2022 - Dean and Dave - Golden Returns Capital