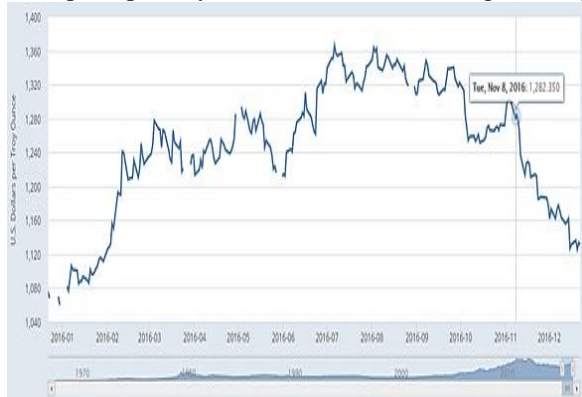




DK Analytics, Post #16: Gold price plummets after Trump win; huge PM purchase opportunity 12/27/16r
T.W. US\$ M.C.: 96.02; US 10-yr: 2.54%; S&P 500: 2,260; Oil: \$53.02; Gold: \$1,134; Silver: \$15.79 (12/26/16 prices)

Gold price per troy ounce in USD (London “p.m. fix”)



Trade-weighted value of USD index: major currencies



Sources: <https://fred.stlouisfed.org/series/GOLDPMGBD228NLBM>, <https://fred.stlouisfed.org/series/DTWEXM>

Introduction:

Gold per troy ounce (toz or oz) in \$ terms has slumped by a whopping 11% since the November 8, 2016 election. The dollar's trade-weighted value, meanwhile, has risen by 4% over the same period, while the value of the 10-year Treasury has fallen by a considerable 6% and the **S&P 500 has rallied by 6%**. What happened? In a nutshell, perception changed. Traders bet on more fiscal stimulus-based growth, lower corporate taxes, higher federal deficits, higher nominal interest rates, and higher inflation, so stocks went up, bonds went down, and the buck went up.

Strangely, and in contrast to the above “playbook,” gold and silver prices, or precious metals (PM) prices, fell and fell. The threat of wider deficits, even bigger debt mountains, more pronounced debt monetization (debt repaid via the printing press or via “quantitative easing” or “QE,” also known as dollar debasement), and higher inflation prospects that have so unnerved the bond market typically “levitate” PM (real money for thousands of years) prices, *especially in an environment of negative real interest rates (the ones directly controlled by the Fed) likely to become even more so*. We’ll examine the above and the “paper gold disconnect” below, and why we believe **current futures market-based PM dollar price weakness** is a huge strategic *portfolio insurance* purchasing opportunity. But before we do, we’d like to frame our gold and silver purchase opportunity theme with the following quote:

“In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold ... The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves. This is the shabby secret of the welfare statists’ tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists’ antagonism toward the gold standard.” **Author: Alan Greenspan, 1966**

(Worthy of mention: physical gold and silver in your possession, unlike electronic “**Bitcoin money**,” not only constitute absolutely peerless, time-tested stores of **wealth**, but they a) can’t be ensnared in digital bail-ins or in Internet “lockdowns,” b) aren’t subject to power grid shutdowns, c) aren’t **cybercriminals’** allies, and d) are finite/very scarce)

A closer look at the macro picture and valuation dynamics:

On the heels of the election, initially stunned investors (a Hillary victory was considered a virtual certainty by the “establishment”) became increasingly convinced that **even stouter growth in federal spending**, and revitalized corporate profits, were in the offing. Specifically, considering that:

- The **federal debt** has been increasing by over **\$1trn p.a. on average** (true federal deficits have accordingly been of a similar magnitude), **or roughly twice nominal GDP growth**, since the beginning of the Obama administration
- Much bigger federal gov’t deficits are likely due to a **progressively weaker economy** (lower tax receipts & higher transfer payments) on the heels of the feeblest “recovery” on record featuring **plummeting productivity growth**

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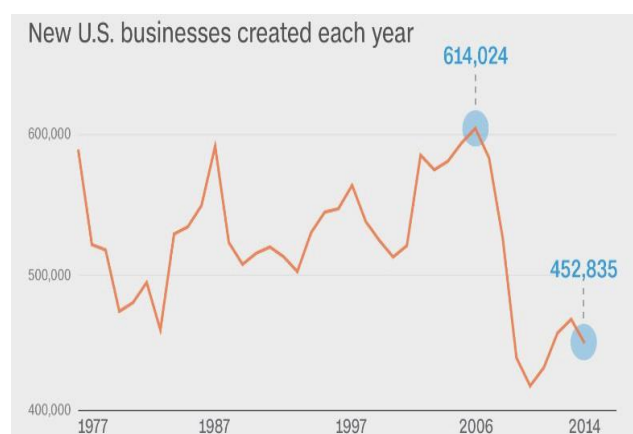


- President-elect Trump's apparently **prodigious fiscal (government spending) appetite** and Trump's avowed steep corporate tax rate reduction plans (from 35% to 15%), *if enacted*, would expand the federal deficit further still, yet would give, all else being equal, aftertax corporate earnings -- whatever their level -- a huge 31% boost
 - The Fed will have to monetize even more gaping federal deficits, especially given the **enormous Treasury bond exposure** of its own, highly-leveraged balance sheet -- and that of the Fed cabal member banks -- which in essence commits the Fed to a low interest rate status quo ("Translation:" look for record-breaking "QE" ahead)
 - Foreigners have become net sellers of **Treasuries**, which implies even greater Fed purchases of said and, should this continue, dollar weakness, which would further fan domestic monetary inflation risks
 - Additional money printing/Fed bond buying only adds to already unparalleled monetary inflation risks that can quickly metastasize if participants begin to experience sustained and rising dollar-based purchasing power erosion
 - Total US debt (\$18.1trn personal, \$5.8trn **corporate**, \$23.1trn government) is **\$47trn** and growing
 - A one percentage point higher 10-year Treasury yield will lead to about \$470bn higher interest expense in a relatively short period, which would offset fiscal stimulus while reducing consumer demand/hobbling GDP growth thanks to reduced financing access for mortgages, cars, and student loans (a double whammy!), ...
- ... investors sold bonds and, irrationally, in our mind, bought already very overvalued stocks. In the meantime, the **Fed's intention to keep raising the Fed Funds rate incrementally** has sent the dollar higher still and gold lower still, however strategically flawed.

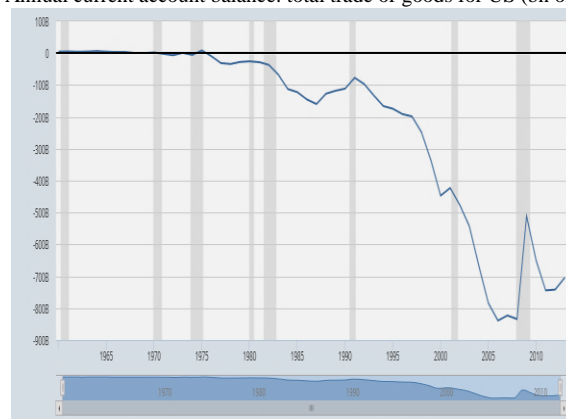
Frankly, to some it's beginning to look like "Reagan, revisited." But wait; not so fast. We beg to differ, from "A to Z." Both the **rule of law and property right protections** are much weaker today than they were in January of 1981; just consider the cumulative corrosive effect of **thousands of new, unconstitutional federal regulations** spit out by the executive branch, year after year, and piled on top of each other, for **decades**. Or consider that self-proclaimed king of debt, **taxpayer bailout supportive**, "eminent domain"-abusing, **litigious, crony capitalist extraordinaire Trump** revels in transferring Main Street's property rights to the "one percent."

To add insult to injury, instead of Trump "draining the (establishment) swamp," too many of his cabinet appointments, such as **Reince Preibus** (chief of staff), **Steven Mnuchin** (Secretary of the Treasury), **Mitch McConnell's wife Elaine Chao** (DOT head), and even **Rex Tillerson** (Secretary of State), are the very "swamp monster" RINOs, cronies, and statists that have driven policy further away from constitutional fidelity and private property right/liberty protections -- to the delight of Wall Street and K Street, and at the expense of the private sector, **free market capitalism, affordable power, coal miners**, and the **young generation**. Did anyone say "hello again, status quo?" (*Frankly, the positive implications of this on strategic PM prices could not be more favorable.*)

Is it any wonder, then, that vital (small) business formations, the engines of new job creation, inventions, and economic growth, have continued to wilt (related chart below)? This makes it harder to grow our way out of our overindebted state. Moreover, America's toxic regulatory, tax, and litigation environment has fueled a three decade-long erosion of its manufacturing prowess, a pivotal sector of high value-added output and **high paying jobs**, making it harder to "export" our way out of debt, a fact best underscored by multidecade growth in the US's trade deficit as aggregated in the annual current account balance position:



Annual current account balance: total trade of goods for US (bn of \$)



Sources: US Census, <https://fred.stlouisfed.org/series/BPBLTD01USA637S>, <https://fred.stlouisfed.org/series/IIPNETINA>

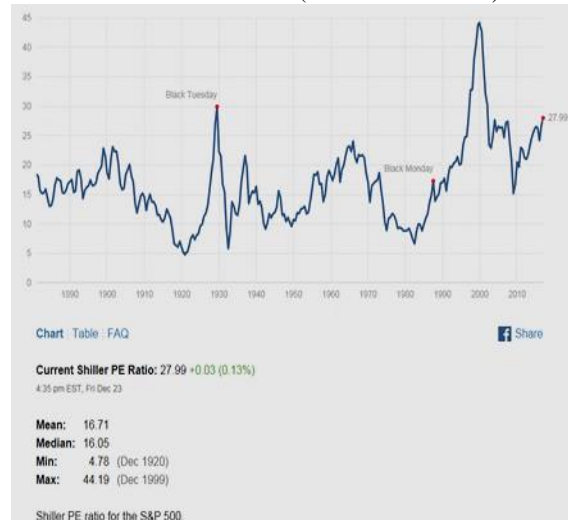
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Furthermore, **constitutionalist** Reagan at least attempted to return to federalism and to reduce the growth rate of non-defense-related federal spending (has anybody heard Trump speak about reducing the **growing spending/intrusiveness/cronyism of the US government**, or that “government IS the problem?”). Most importantly for investors weighing risks, Reagan began his first term in January 1981 with a 31% **federal government debt to GDP** and ran it up to 51%; Trump will be starting his first term at 105%. Reagan began with a **10.5% personal savings rate**; Trump will be starting at 5.5%. Reagan began with a **12.7% yield on a 10-year Treasury**; Trump will be starting with a **sub-3% Treasury** (based on current yield). Reagan inherited a **nearly 12% inflation rate** that had a long way to fall; Trump will be starting with “official,” **now heavily gimmicked**, consumer inflation at **1.7%** (current tally) with nearly nowhere to go but up -- i.e., if central bankers have their way, and history strongly suggests that it is “only a matter of time.”

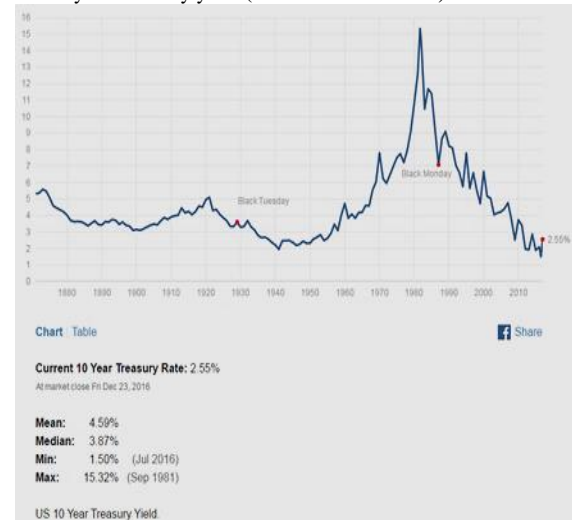
Moreover, and very decisive from equity return and capital preservation determinants, secular P/Es expand (the definition of a bull market) thanks to sustained reductions in interest and inflation rates, as has occurred since September 1981 when the 10-year Treasury yield reached 15.84%. The converse is also true: secular P/Es contract (the definition of a bear market) thanks to long-standing increases in interest and inflation rates; just consider the stagflationary ‘70s featuring high interest rates, high inflation rates, and low (and progressively lower) P/Es for reference directly below:

Shiller P/E ratio for the S&P 500 (**current value at risk**)



Source: www.multpl.com/shiller-pe/

US 10-year Treasury yield (**current value at risk**)



Source: www.multpl.com/10-year-treasury-rate

In other words, stock valuations or P/Es are largely determined by the discount rate used to derive the net present value (NPV) of estimated future earnings. The lower the discount rate (the 10-year Treasury yield plus a risk premium), the higher the NPV/stock valuation -- and vice versa. Thus, stock and bond valuations *are tied at the hip*, with stocks historically having to offer higher return prospects thanks to inherently less stable earnings and incurrence of losses; in contrast, bondholders' economic claims are senior to shareholders,' usually resulting in better nominal return and capital protection.

Taking into account both history and the fact that returns are largely determined by how much one pays for earnings, it doesn't look like stock market return nirvana is on the horizon. Specifically:

- The **historically lofty S&P 500 valuation** (28x average 10-year EPS & over 25x trailing 12-month GAAP EPS)
- The fact that EPS growth has been “topless” growth. **Real S&P 500 sales per share stripped of stock buybacks are down over 30% since Q3:2007!** This doesn't speak volumes about organic growth or sustained EPS growth
- The fact that S&P 500 EPS could easily implode by 50% or more from the 2014 peak if history is any guide (the strengthening dollar also threatens to trim near-term S&P 500 index EPS by a quite a few percentage points)
- The **uniquely leveraged, fiat money, fiat government, property rights-denuding nature of our national and global economy** (please see depiction below), which will ultimately “spell” higher risk premiums/even lower P/Es/even lower stock prices:

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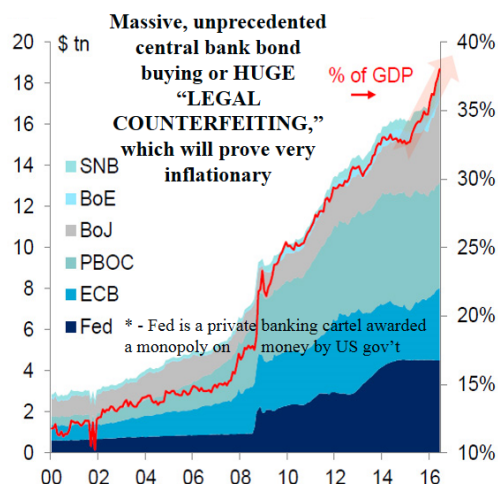
Central bankers/central planners: enablers of exploding debt, asset bubbles, ZIRP/NIRP, misallocations, weak growth, yield starvation, & toxic policies

Aggregate balance sheet of large central banks* in \$trn
(up 6-fold in 16 years – never, ever happened before!)

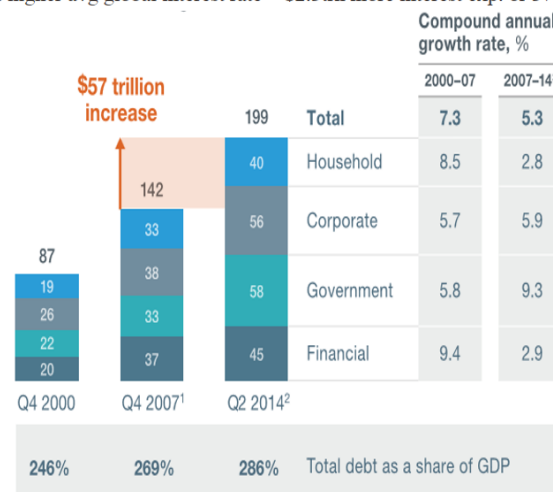
Global stock of debt outstanding in trn of \$ per Q2:2014

(2016 debt tally up by \$31trn to \$230trn, in excess of 300% of global GDP!)

1% higher avg global interest rate = \$2.3trn more interest exp. or 3% of GDP



Global central bank balance sheet CAGR: 12.2%, easily twice global nominal GDP growth p.a. over 16-yr period



Sources: Citi Research, Haver Analytics, www.mckinsey.com/global-themes/employment-and-growth/debt-and-not-much-deleveraging, www.valuewalk.com/2016/08/230-trillion-in-global-debt/

Yet despite rapidly rising central bank balance sheets, absolutely unequalled global debt/solvency risks, \$418trn of interest rate sensitive derivative risk exposure by money center banks and the associated counterparty contagion mega risks, flagging American and global economic growth, and fading global productivity growth (not typically mentioned in "white papers," but surely small US manufacturing firms' \$35K annual per employee compliance cost, and the fact that the American corporate sector spends over \$2trn a year to comply with regulations, weighs heavily on US productivity while pushing up costs, which is mirrored elsewhere, to varying degrees), we have global bond and stock bubbles!

We also have a muscular dollar thanks to overt "QE" (money printing) cessation by the Fed and rising short term rates in the US while the European Central Bank (ECB), the Bank of Japan (BOJ), and the People's Bank of China (PBOC) print like mad dogs and dive into negative interest rate insanity (as regards the ECB and the BOJ). Clearly, predicated on an American economy continuing to lose vitality, and given the rising risks associated with falling bond prices, the Fed's monetary policy is completely unsustainable from both the rising Fed Funds rate and from "QE" cessation perspectives, assuming we carry forward our current "toxic policy stew" (the status quo). Nevertheless, very scarce silver and gold expressed in dollars have been correcting smartly. In short, the cost of "portfolio insurance" has been going down in price, not up, despite growing dollar-based, traditional asset valuation risks.

Drilling down into recent precious metals valuation developments

It's thus unlikely to be an accident that gold "downside" manipulation shifted into even higher than usual gear prior to the election, "greasing the lower PM prices skids" on the heels of an early Q4:16 PM price correction. For example, COMEX traders' open short gold interest (outstanding contracts to sell gold) rocketed 66% higher to 376,700,000 toz from October 18th to November 1st, exceeding registered (deliverable) inventory by over 200:1. To add insult to PM price injury, on the heels of the 2016 election, according to futures/precious metals (PM) expert, Rob Kirby, of Kirby Analytics, some 8,000 whopping metric tons (257m toz) of gold, or the rough equivalent of the "unaudited since Eisenhower" US gold horde, were sold at exchanges such as the LBMA and the COMEX within the first week after the election (in relative terms, similar silver price suppression has also been taking place). Contrasted with the tiny annual mined gold (\$106bn or 96m toz in 2015) and silver (about \$13bn or 887m toz in 2015) supply, which typically satisfies between 70% – 80% of global gold and silver demand, respectively, increasingly material, unbacked paper PM (precious metals) future sales dumped into the market can truly (continue to) decimate gold and silver prices.

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PM price pulverization can also crush “long positions.” This continues to cause investors huge and sustained losses while keeping PM artificially low. It is precisely this, and other criminal market-rigging in both the [silver](#) and the [gold](#) markets, which the fiat currency central banks’ [bullion bank cronies](#) have been engaging in for decades, [and increasingly more flagrantly so](#), as evidenced by unrivaled global fiat currency printing/debt creation and the associated need to suppress PM prices in order to offset incomparable global currency fraud. And, the final recent nail in the precious metals’ current coffin: a [Fed Funds rate](#) that rose another 0.25% to 0.66% with more (again largely empty?) promises of hikes next year. Never mind that historically, Fed Funds rate hikes’ (or reductions’) impact on the gold -- and, by extension, the silver -- price has shown no significant negative correlation (please see below). Besides, recall that as published/vastly [understated consumer inflation](#) rises from 1.7%, real short-term interest rates, already very negative ([the 3-month Treasury yield is 0.51%](#)), will likely become increasingly negative because the Fed will be hard pressed to sustain rate increases, which is very bullish for PM prices.

Gold price per troy ounce (white); Fed Funds rate (yellow) from 12/11/2000 to 12/8/2016



Source: Bloomberg. Noteworthy: latest 25 BP Fed Funds rate hike not “onboard”

More importantly, look for that PM coffin lid, and for gold and silver prices, to take flight as scarce physical precious metals are liberated from massive, naked paper short sales and criminal paper manipulation/rigging. As our fiat currency-based monetary/debt system comes unglued, investors will demand physical gold and silver instead of the paper gold and silver offered by the COMEX, the LBMA, and numerous ETFs. And recall that only a sliver of physical PM for each paper (futures) PM contract will be available, as precious metals delivery promises exceed the underlying physical stocks by 100-to-1 or more. A “meltdown” of our increasingly toxic and patently unsustainable (debt-based) fiat currency, fiat government system could occur anytime ([fiat currencies last 27 years on average](#), and the post gold dollar is over 45 years old). Countries such as Venezuela and India offer previews of possible spreading [hyperinflation](#), debt-induced deflation, and/or [cash banning, property rights eviscerating](#) attractions (ask the [Greeks](#) or the [Icelanders](#) if these are but remote, emerging nation happenings). There are plenty of potential “PM revaluation” time bombs and/or triggers. Below just a few:

- Global debt to global GDP is a historic 300% plus; “QE”-engineered over-indebtedness has never ended well.
- \$100s of trillions of off-balance sheet, [interest rate-sensitive derivative exposure](#) held by money center banks/hedge funds threaten systemic financial system insolvency if interest rates continue to rise.
- Nearly insolvent money center banks in Europe (and in the US, too, if we [had honest, mark-to-market accounting](#)).
- An ongoing and widening suspension of “[price discovery](#)”/free market capitalism in Japan thanks to the BOJ’s [most recent foray into nationalization of stocks](#), as it runs out of bonds to buy with counterfeit money and imposes NIRP (negative interest rate policy) on depositors. This comprises a secular, “Back in the USSR” misallocation/impoverishment trajectory for “99%” of the citizenry, which could be [overwhelmed/destabilized](#) by the [Japanese people taking money out of banks](#) while they still can, with potentially global implications.

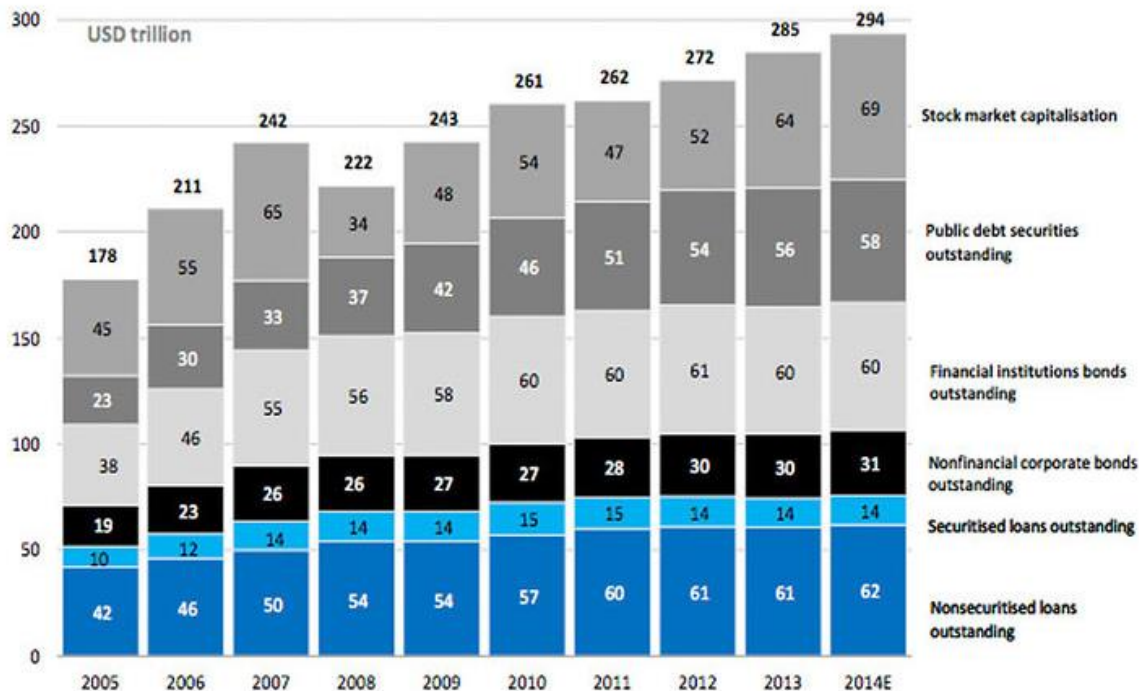
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- The announcement of a record-sized round of currency printing of some sort in the US (instead of more Fed Funds rate rises), which may cause an accelerated sale of USD assets by the ROW, repricing the dollar and USD assets.
- Growing fears about [deeply underfunded, defined benefit pension plans](#) and pensioners requesting lump sum pension plan payouts (taking their money out of de facto Ponzi schemes) [could prove to be highly destabilizing](#).
- A loss of confidence in either the “greater fool” theory (“someone will take me out at an even higher price”) or in central banks’ efficacy in propping up absurdly valued bonds and stocks against a backdrop of weakening solvency and growth, respectively. Shifts in perception can come quickly; they are unannounced. No specific catalyst is required. It can be the proverbial straw that breaks the camel’s back.
- A major war.

In the meantime, there are some seriously price constructive PM demand and supply constraint drivers:

- As mined supply only accounts for 70% – 80% of demand and as scrap sales are winding down, continued stout physical PM demand will eventually result in a higher equilibrium price (“the demand curve shifts up”).
- Population dominating eastern nations, such as [Russia](#), [China](#), [Turkey](#), [India](#), and Indonesia, which distrust paper currencies for historical reasons, continue to increase physical precious metals holdings, taking PM “off the table.”
- Arbitrage: opened for trading on [April 19th, 2016](#), the [Shanghai Gold Exchange](#) (SGE) is a physical exchange. Physical gold prices and silver prices at the Shanghai Gold Exchange have sprouted a [\\$20 - \\$40 premium in gold per toz](#) and between \$1 - \$2 in silver per toz to COMEX and LBMA-based “paper” gold and silver prices ([SGE physical prices converted from grams to toz and from the yuan to dollars](#)). Investor PM purchases at the COMEX or the LBMA and sales to the SGE will require the western exchanges to procure the very PM they have so little of, forcing them to source additional physical supplies, thus driving PM prices up (from “paper” to “physical”).
- [1.6bn new potential Muslim physical gold buyers](#) have been added to the “demand column.”
- A potential reallocation toward PM by fund managers; with roughly \$300trn in investable funds (please see illustration below), [of which less significantly less than 0.5% are committed to PM](#) (mostly gold), just a slight allocation increase, say to 0.8%, would vastly overwhelm mining supply -- [which appears to be peaking](#) -- for well over a decade, implying much higher PM equilibrium prices.



Sources: McKinsey Global Institute, Haver, BIS, Deutsche Bank estimates, author Wallace Witkowski

- Both businesses and the general public may increase their appetite for holding physical precious metals if currency debasement (“QE”) is continued, especially if technology/the Internet allows for [physical gold based savings and checking accounts](#). (The author of this post has zero financial interest of any kind in [www.goldmoney.com](#).)

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Risks:

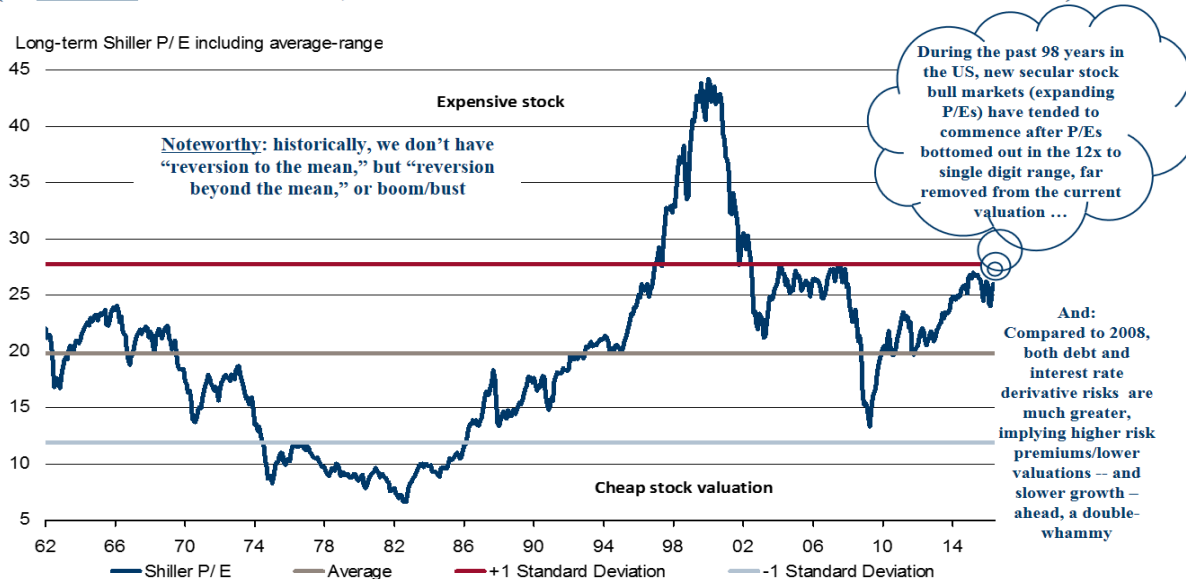
“Markets can stay irrational longer than you can stay solvent,” as Keynes correctly professed (little did he realize to what extent technology, “a digital printing press,” and cronyism would conspire to manipulate asset prices/extend bubbles or to sustain select repression of asset values). We’ve been moving away from private market participant-based asset values (price discovery) for a long time. The fiat dollar is long in the tooth at more than 45 years old. And even though we’ve never, ever had the entire world engaged in legal counterfeiting (currency printing out of thin air), and even though creditors have never, ever suffered the perversion of negative interest rates, [which reached \\$12.2trn worth of global debt in June](#) (and declined to \$8.7trn after Trump’s win), and even though we’ve never, ever had such global debt mountains, determining **when** price discovery once again overwhelms the machinations of central bankers/central planners is as difficult to ascertain as it is easy to say that all manipulations eventually end.

PM paper supply manipulation/price suppression can keep occurring even as physical PM prices rise above paper PM prices on [vibrant demand](#); we see no bankers going to jail for massive market rigging [of any sort, including LIBOR, the short-term benchmark for about \\$800trn worth of financial instruments!](#) We just see banks hit with “tiny” fines (\$50m - \$150m) compared to their “manipulation profits” (collectively, likely in the multi-billion or trillion-dollar range). Upshot: paper-based gold and silver prices may remain under pressure, but a growing premium for physical PM delivery suggests investors may begin to take their PM valuation queues not from the COMEX or the LBMA, but from Shanghai.

In a somewhat similar vein, but considered from the asset bubble instead of the price suppression perspective, traditional asset levitation can also continue, especially because it is in the cronies’ interest to sustain traditional asset bubbles. But asset valuation manipulations, including our “[mother of all manipulations](#)” current status quo, are not eternal. For those that remain invested in traditional asset (bonds and stocks) bubbles, they may well realize additional nominal “irrational” returns, but their downside valuation risk is incomparably larger, in our view.

In addition, and *most germane*, asset prices don’t tend to revert to mean valuations, they tend to revert BEYOND the mean; boom and bust valuations result. An S&P 500 P/E of 25x trailing 12-month GAAP earnings, or 28x 10-year average earnings (the Shiller P/E), can become an S&P 500 with a P/E of 12 or less in a hurry:

Stock market is a QE/ZIRP bubble, especially as recession “overdue” (If [current](#) EPS fell 50%, 25 P/E would be 50 P/E at current S&P 500 level)



Sources: Robert J. Shiller, Credit Suisse, <http://us.spindices.com/indices/equity/sp-500>

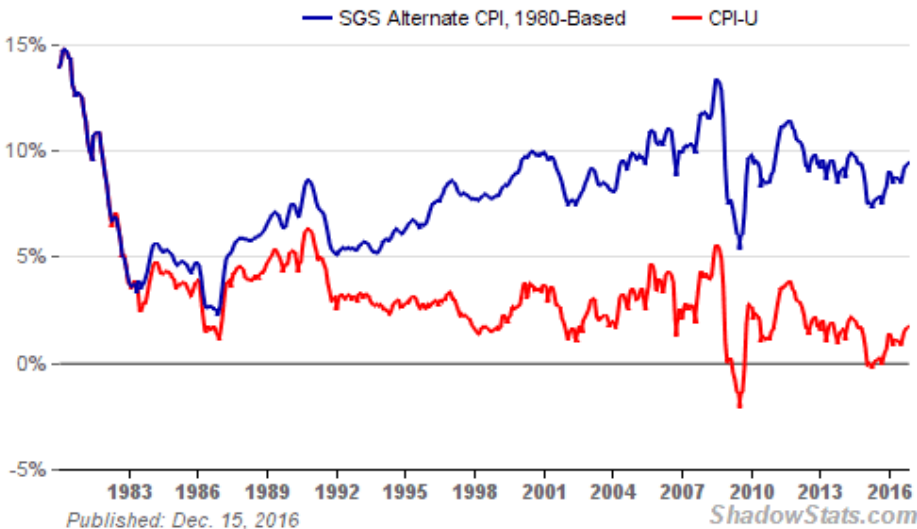
The ten-year Treasury currently [yielding 2.5%](#) could again yield 9.5%, if not more. And, in our frank opinion, it should, when taking into account real world inflation in the 9 -10% range (please see below) combined with [huge solvency](#) and [monetary inflation exposure](#) risks associated with holding these assets.

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Consumer Inflation - Official vs ShadowStats (1980-Based) Alternate

Year to Year Change. Through Nov. 2016. (BLS, SGS)



Source: www.shadowstats.com/alternate_data/inflation-charts

A yield spike from 2.5% to 9.5% would result in that very 10-year Treasury *losing 45% of its value* (simple bond calculation). Related to same, perhaps the recent, **swift** 85% surge in the 10-year Treasury yield from 1.37% on 7/5/2016 to 2.54% (intraday yield on 12/26/17) is the beginning of the end of 35-year old bond bull market? Takeshi Yamada, chief Japan FX strategist at BofA, thinks so; we are also convinced that this is imminent in the not too distant future:



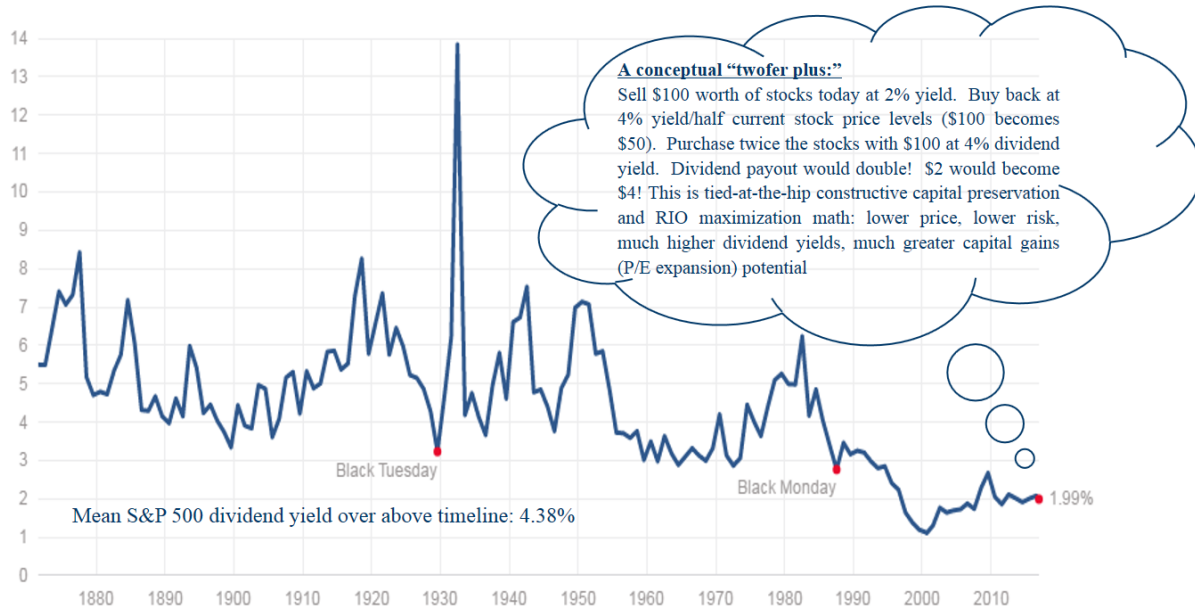
In the interim, the ultra-long duration S&P 500's NPV or market cap -- without any EPS reduction "dialed in" -- would crater by 47% if the 10-year Treasury yielded 9.5% versus 2.5% (based on the author's debt-adjusted NPV calculation), which would also bring us back to a more equity market conform dividend yield of 3.49%, rather than the current 1.99%. Our larger point: the damage such a revaluation would have on portfolio values determined mainly

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by bond and stock exposure will prove very significant, and should be avoided. That avoidance comprises **the key** strategic capital preservation, better yield-enabling, and stout capital gains opportunity of the future:

Value at risk: S&P 500 dividend yield history is closer to 4% than 2%!



Source: www.multpl.com/s-p-500-dividend-yield/

Tying it all together:

We are going to continue to argue that traditional asset (bonds and stocks) perception and valuation is “way out in front of economic reality” (thank you, central bankers, for the overvaluation gift, which we should “cash in”). Or, as famous, hugely successful, progressively more **crony investor Warren Buffett** said decades ago: “near term, markets are voting machines; long term, they are weighing machines.” Returns will again matter. You read it here first ...

Put differently, we think both stocks and the buck will be going on a “reality 101 diet” together with bonds sooner rather than later. Commensurately, we view this is another strategic reallocation opportunity away from overvalued traditional assets and into secure cash (Treasury Bills, which won’t go down in value when interest rates go up), into **scarce real assets**, and especially into physical precious metals (to reiterate, you may want to consider this cash and gold “twofer”: www.goldmoney.com) which, once our unrivalled asset valuation bubbles and debt mountains begin to implode, will prove to be key pillars of capital and purchasing power protection.

*Plus, when considering the long-standing and material manipulation of PM prices to the downside, physical PM metals prices should explode to the upside. A PM price explosion would reflect liberation from paper gold rigging on the one hand, and a pell-mell repricing to the upside reflecting physical PM availability scarcity on the other hand. That “repricing” will, to repeat, be thanks to a very material historical, global investable portfolio under-allocation to PM at well under 0.5% (in the stagflation ‘70s, **PM allocation reached 1.6%**). It will also be thanks to what we perceive will be a growing insistence on verifiable physical gold ownership over paper gold promises, of which there are “100 plus” for every toz of deliverable physical gold. This is bullish for leading PM mining equities, for physical PM ETFs with verifiably adequate PM inventory (fund managers can only buy “securitized” PM), and, by extension, for bullion prices, which would likely be “arbitraged up” by both central banks and retail investors.*

(In a related manner, and for “graphic scarcity perspective,” according to 2011 Deutsche Bank statistics updated for four additional years of 3,000MT of annual gold extraction, all the gold ever mined would represent a 21m by 21m by 21m cube containing 178MT of gold. That “cube” would be worth some \$6.5trn at today’s paper gold per toz prices.)

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Against a dimming Q4:16 precious metals shine, the “negative free cash flow” buck, trading at a near 14-year high versus a basket of major currencies (please see below), is the fiat currency of last resort as all other, flawed fiat currencies buckle first. The US dollar is not strong for stout economic growth reasons, rather despite them and because of a constructive, albeit likely transient, short-term interest rate differential. Concretely, because dollar-based markets are the deepest/most liquid. “Translation:” there is unparalleled dollar debt, and Treasuries are considered “must have ‘reserve assets.’” Stated differently, and perhaps perversely, huge (and liquid) indebtedness can be a virtue in troubled times!

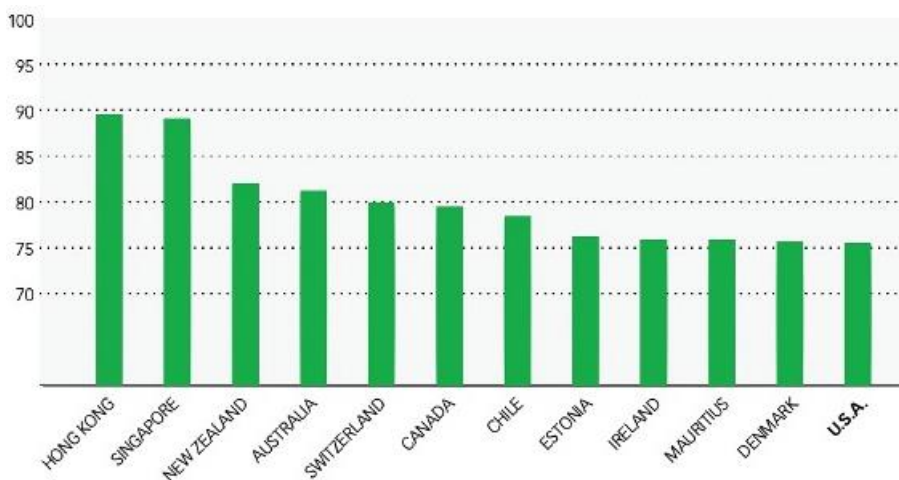
Trade-weighted US dollar index: major currencies



Source: <https://fred.stlouisfed.org/series/DTWEXM>

As physical gold and silver (real money) priced in dollars are inversely correlated to the US currency, their dollar-based rally will resume when the buck resumes its fundamentally-driven, multi-decade devaluation trend in large part precipitated by an increasingly economic freedom-robbing (please see depiction below), [US toxic public policy stew](#). We state this notwithstanding massive EM dollar debt ([\\$3.2trn in non-bank borrowing](#)) and [increasingly difficult, \\$340bn huge, EM dollar refinancing issues](#) associated with a brawny buck and weakening EM economies.

Economic freedom score



Source: 2015 www.heritage.org/index/ranking

The likely weaker dollar catalyst: what we are convinced will be unprecedented currency printing (“QE4”) by the Fed to “rescue” a faltering economy, shrinking profits, and a sinking stock market -- think “2008/2009, revisited.” This will also ease EM dollar refinancing as their currencies strengthen against a debasing dollar. Coupled with the global economic and financial mess we’re in, this should ignite dollar-based precious metals prices while pressuring the dollar thanks to sustained excess dollar (Treasury) sales by the rest of the world ([the ROW allegedly holds \\$16trn](#)) to

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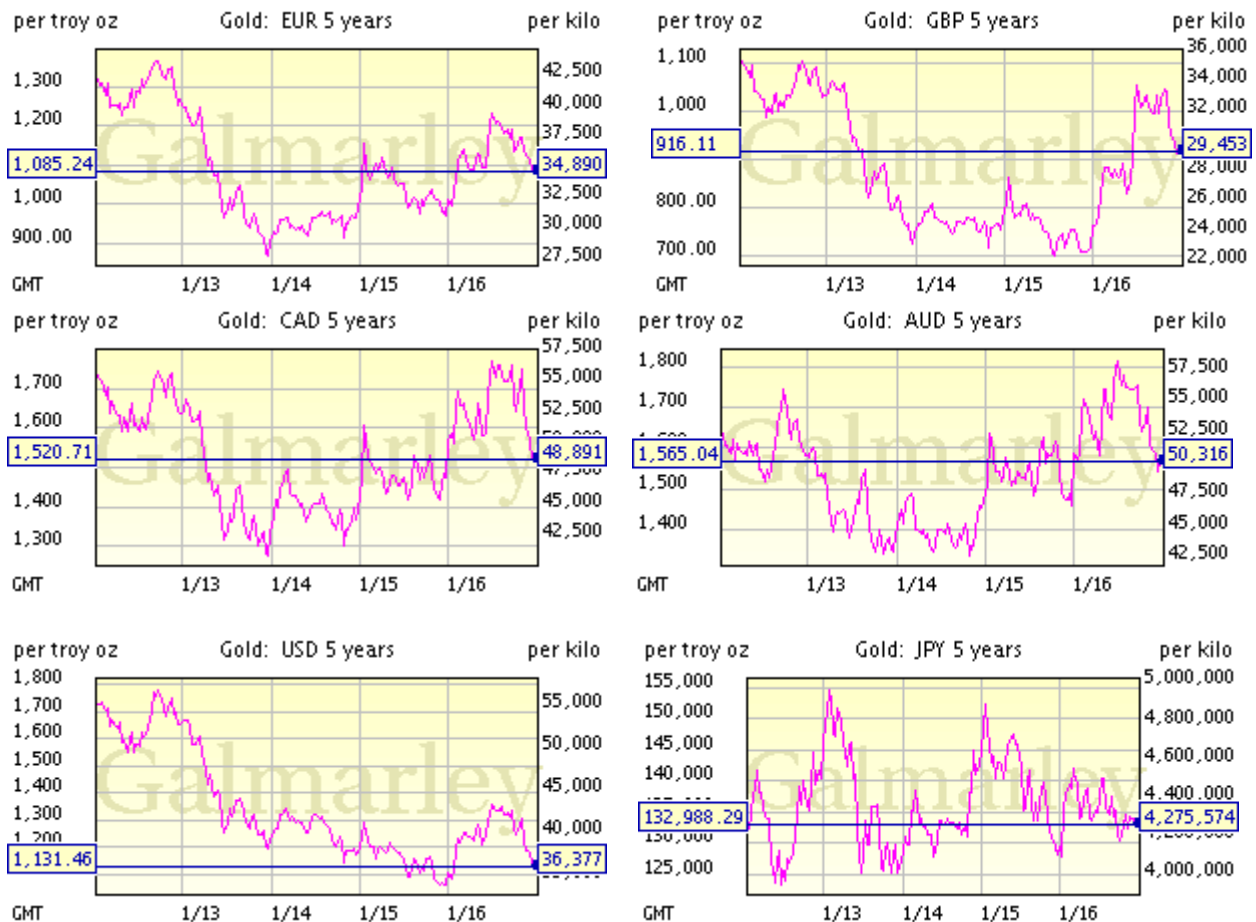
a) pay domestic bills and to b) shift to other trading currencies, including by OPEC nations, i.e., most pointedly if the US loses progressively more influence in, and control of, the Middle East to nations such as Russia and China:

US Treasuries held in custody for international accounts



Source: <https://fred.stlouisfed.org/series/WMTSECL1>

Said differently, the gold rally already occurring in most other (troubled) fiat currencies other than the dollar will engulf the most flawed major currency of all (America's \$7.4trn net debtor tally, which is expanding by roughly \$500bn p.a., is the largest ever in recorded history), the greenback:



Source: <http://www.usagold.com/gold-price-forex.html>

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When the dollar gold rally returns, it will unleash the “great asset valuation reset.” Specifically, a weakening dollar and progressively higher 10-year Treasury yields (**the** global benchmark interest rate off which virtually all long-term assets are priced), which will conspire to pressure long duration asset values. Meanwhile, domestic inflation rates will eventually surge due to higher borrowing costs in a very indebted economy and thanks to a globally depreciating dollar, thereby unleashing an even stouter bond bear market while further punishing stocks’ net present value.

“Bond vigilantes” of historically peerless “firepower” will trump central bank machinations. With some \$300trn in global investable assets, of which roughly 75% is comprised of bonds, central bank currency printing efforts in the few trillion-dollar range to underpin asset bubbles in bonds and stocks will be swamped, and heightened gold and silver allocations will surely be sought, reinforcing the “great reset.” Gold and silver are not barbarous relics, they are reliable stores of wealth. The reasons: the yellow metal has no counterparty risks, it is nobody’s liability, it is the ultimate liquid asset, and because it anticipates “Mad Max” money printing, i.e., the historical response to debt-induced deflation. The true barbarous relics are debt-based fiat currencies, which can be printed in infinite amounts, **right into worthlessness on average in under three decades**, as history has shown again and again.

In the interim, both gold and silver prices, historical beneficiaries of pronounced **monetary inflation risks** and **debt-based deflation risks** alike (they are actually tied at the hip, as hyperinflation is characteristically the “progeny” of central bank-induced debt mountains, as implied above), have been in retreat since the beginning of the fourth quarter.

Conclusion -- and will very volatile silver, the people’s money, be “gold on steroids?”

Given increasingly dicey global fiat money regimes bent on **eliminating cash** from Australia to India to Scandinavia, thereby corraling savers into digital “**bail-in**” pens, seeking refuge in physical gold and silver as stout portfolio insurance/diversification (up to 10% of current investable portfolio wealth with the intention of PM exposure offsetting traditional asset valuation declines and possibly “then some”) seems to be an eminently sane endeavor. This is even more sensible when considering a) increasingly attractive fiat currency-based PM valuations, b) the global precious metals allocation “rounding error sliver,” and c) the limited physical PM supply.

Ultimately, fiat currency implosions revert back to the **discipline, stability, prosperity/productivity-enabling, property rights-protecting nature of gold and silver-backed money**; why should it be any different this time around? The world, until now, has never been 100% fiat currency-based. **PM have historically anchored nations’ currencies**, very much including the **freshly constructed, constitutional, federalist American republic**, in which it was illegal for states to use anything but gold and silver coins to settle debts at a time when the federal government was a miniscule operation that lacked taxation powers beyond tariffs.

If the US dollar again needed to be backed by gold -- let’s leave silver out for the moment -- and assuming the US truly has 8,133MT of gold, and knowing that it currently has an overt monetary base of **\$3.6trn**, then covering that monetary base with gold would result in a \$13,800 gold price per toz. Back to silver: the white metal has historically been the **preeminent monetary metal used in daily transactions**. Additionally, silver was a monetary metal in the US from 1787 until 1964, and **dollar silver certificates (please see below) could be redeemed for silver bullion until 1968**.



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In earlier times, silver was mined at about 15:1 to gold, a fact which the Congress's "15:1" [1792 Coinage Act](#) reflected. That ratio is closer to 10 toz of silver to 1 toz of gold currently, and would theoretically imply a \$1,380 silver price per toz if America's monetary base became gold-backed, and silver was "remonetized" domestically.

Needless to say, we don't anticipate that \$1,134 gold will become \$13,800 gold, or that \$15.79 silver will become \$1,380 silver. However, we would like to highlight how very undervalued, expressed in ever more prevalent fiat currency terms, both gold and silver currently are. And because gold currently trades at over 71x silver's price per toz, instead of at the "10:1" -- or even the "9:1" -- rate that it is mined at, much more supply constrained, extremely volatile silver offers "gold on steroids" capital gains potential, meaning silver's valuation gap should shrink markedly from 71:1 in the direction of 10:1 over time. Silver's relative "above ground supply" scarcity to gold is because of [silver's historical and increasing industrial usage](#), and because of how difficult/costly it is to "recycle" based on its above ground dispersion (such as in iPhones, in other electronic devices, in electric devices, in brazing alloys, in photography, in photovoltaic cells, etc., all of which tend to contain smidgens of expensive-to-access silver). This means less scrap silver is available to satisfy demand, which is significant as scrap supplies only about 20% of total silver supply, versus about 30% for gold. Moreover, silver supply ([mined supply appears to be peaking](#)) has trended toward a growing physical deficit when compared to expanding demand:

World silver supply and demand

(million ounces)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Supply										
Mine Production	643.4	667.7	684.7	717.3	753.0	757.6	790.8	823.7	868.3	886.7
Net Government Sales	76.5	42.5	30.5	15.6	44.2	12.0	7.4	7.9	-	-
Scrap	207.1	204.2	202.0	201.2	227.5	261.5	255.5	192.1	168.3	146.1
Net Hedging Supply	-11.6	-24.1	-8.7	-17.4	50.4	12.2	-47.1	-34.8	16.8	7.8
Total Supply	917.3	890.3	908.6	915.7	1,075.2	1,043.3	1,006.6	988.9	1,053.3	1,040.6
Demand										
Jewelry	174.5	182.3	177.6	176.9	190.0	187.9	185.4	217.8	224.0	226.5
Coins & Bars	50.7	56.1	192.3	91.6	144.4	210.4	160.5	242.1	236.1	292.3
Silverware	62.1	60.2	58.4	53.2	51.6	42.2	43.7	58.8	60.7	62.9
Industrial Fabrication	648.9	661.0	656.8	542.6	650.3	676.3	615.0	618.1	611.2	588.7
...of which Electrical & Electronics	242.3	262.5	271.7	227.4	301.2	290.8	266.7	266.0	263.4	246.7
...of which Brazing Alloys & Solders	54.7	58.3	61.6	53.6	60.9	62.7	60.6	63.2	66.1	61.1
...of which Photography	142.2	117.0	98.2	76.4	67.5	61.2	54.2	50.5	48.5	46.7
...of which Photovoltaic*	-	-	-	-	-	75.8	62.9	62.5	63.2	77.6
...of which Ethylene Oxide	6.6	7.9	7.4	4.8	8.7	6.2	4.7	7.7	5.0	10.2
...of which Other Industrial*	203.1	275.3	217.9	180.4	212.1	179.4	165.8	168.3	165.1	146.4
Physical Demand	936.3	959.6	1,085.1	864.2	1,036.4	1,121.8	1,004.6	1,137.9	1,131.9	1,170.5
Physical Surplus/Deficit	-19.0	-69.3	-176.6	52.5	38.8	-78.5	2.0	-149.0	-78.6	-129.8
ETP Inventory Build	126.8	54.8	101.3	156.9	129.5	-24.0	55.3	2.5	1.5	-17.7
Exchange Inventory Build	-9.0	21.5	-7.1	-15.3	-7.4	12.2	62.2	8.8	-8.8	0.3
Net Balance	-136.8	-145.5	-270.7	-89.2	-83.3	-66.7	-115.5	-160.2	-71.3	-112.5
Silver Price, \$ per oz.	11.55	13.38	14.99	14.67	20.19	35.12	31.15	23.79	19.08	15.68

* Photovoltaic demand included in "Other Industrial" prior to 2011
© GFMS, Thomson Reuters / The Silver Institute

Silver price; NY close



Sources: www.silverinstitute.org/site/wp-content/uploads/2011/07/WSS2016MarketTable.jpg; www.kitco.com/charts.html

Soaring bond yields and a weakening global economy beleaguered by a toxic public policy stew, an aging business cycle, and low-quality earnings in retreat will coalesce to prick [equity market valuation bubbles](#). Neither central banks' balance sheets nor troubled money center banks' balance sheets nor extremely leveraged global economies can handle rising interest rates and falling bond and equity markets, especially not with recession-induced expansion of government deficits around the corner (we think the US fiscal deficit could easily eclipse \$2trn within a year or two). Global money printing ("QE") will be doubled-down on to sustain the unsustainable; ill-fated monetary Keynesianism will "ride to the rescue," yet again. We expect the 800-lb Fed gorilla to launch the biggest overt asset purchase scheme ("QE4") the world has ever seen. It will surely be echoed "in spades" around an over-indebted, weak-GDP-growth world increasingly engaged in "beggar thy neighbor" currency wars, and possibly even in trade wars ("The Donald?"), which would be an unmitigated disaster.

Thus, position your portfolio for more status quo monetary "dysfunctionalism." "The Fed has your back again" ("QE4" and a declining Fed Funds rate from a measly 0.66%) bond yields will probably stabilize, or even fall fleetingly, thereby putting a cursory floor under bond and stock prices. For the swift, this could constitute an attractive tactical (trading) opportunity. Yet at the same time, renewed, vigorous Fed money printing will worsen strategic return, solvency, and inflation risks associated with those disturbingly overvalued paper assets that have no legitimate claims on scarce real assets (which can't be printed) or on productivity improvement (true wealth creation).

Predicated on the bitter, nearly decade-old financial repression harvest also known as [yield deprivation](#), weak real economic growth, tumbling productivity amidst an explosion of debt, and [perpetually weaker property rights](#), we

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believe investors will lose confidence in central bank “puts” (promises to support asset prices). This will have them sell the traditional assets (especially bonds) central banks buy. A trickle can quickly turn into a gusher. As stated above, [when considering the extreme financialization of America’s](#) and the globe’s GDP, central banks’ asset purchases could easily be overwhelmed by a stampede of sell orders, which would send traditional asset prices tumbling, whether those sell orders are computer-based or fund manager-based, whether they are “technically-based” or fundamentally-based, or whether it ends up being a combination of the above factors.

After paper (fiat) money has been serially abused long enough, distrust in “Potemkin village” paper assets, which are not “money good,” always results. [This has always pushed people into physical precious metals insurance for wealth preservation.](#) We are closer than ever to a complete loss of confidence in our current fiat money-based system, yet the price of physical precious metals insurance is not reflecting the financial implosion just out of eyesight. That implosion is depicted by the upside-down pyramid below, whose top-to-bottom compression will be ignited by failing derivatives performance. That’s spelled “strategic PM opportunity,” especially when it is complimented by sales of currently overvalued bonds and stocks -- stocks that investors may well be able to repurchase at 50% or more fire sale prices prior to the Fed (and likely the Treasury) convincing shareholders, time and time again with progressively more dollar debasement, as in 2008/2009, that it once again “has their back.”



We (my talented webmaster, other global contributors to the site, and yours truly) wish you a Happy, Healthy, and Wealthy New Year dead ahead!

Sincerely,

Dan Kurz, CFA (dan@dkanalytics.com)

DK Analytics (www.dkanalytics.com)