ILLUMINATING GOLD

The perfect storm approaches

11 November 2020

Source: BGT

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RISK/REWARD FOR GOLD & SILVER IMPROVING

Investment case arguably better than it has been for years:

- Gold price drivers – dovetail with today's risks
- Deflation vs. inflation
- Debt cycles since the Industrial Revolution
- Gold has always outperformed in last phases of previous debt cycles
- Modification to Bretton Woods 1968-71 – is history repeating?
- Tragedy and hope in London's OTC gold market
- Inflationary mega-trends of the last millennium
- Finally: one way of looking at gold

GOLD PRICE DRIVERS

Dovetailing with today's risks:

- Loss of monetary & fiscal discipline… now exacerbated by Covid-19
- Debt bubble – gold is the only financial asset with *no counterparty risk*
- Global inventory of negative yielding debt has recently hit a new high at $17.05 trillion

Source: FT

- Only financial asset which *outperforms in both inflation & deflation* (cf. Roy Jastram: "The Golden Constant")

IT'S A WAR

We are stuck in a highly distorted final phase of the current debt cycle characterised by the conflict between the forces of:

Deflation *vs.* Inflation

Debt deflation inherent in this stage of a debt cycle

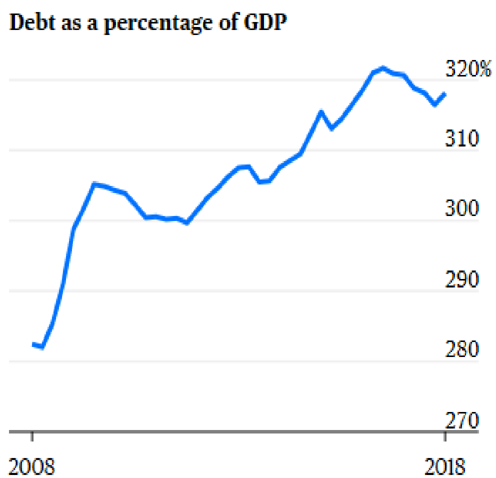
vs.

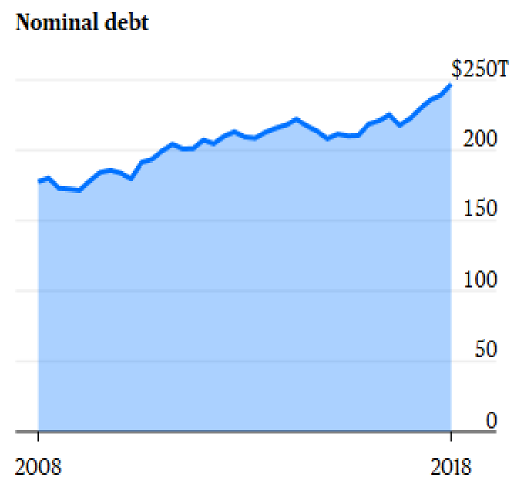
Inflationary / reflationary pushback by central banks

One will prevail…and either is positive for gold

DEFLATIONARY FORCE: GLOBAL DEBT BUBBLE

Global debt now more than $258.0 Trillion or 331% GDP *(IIF July 2020)*





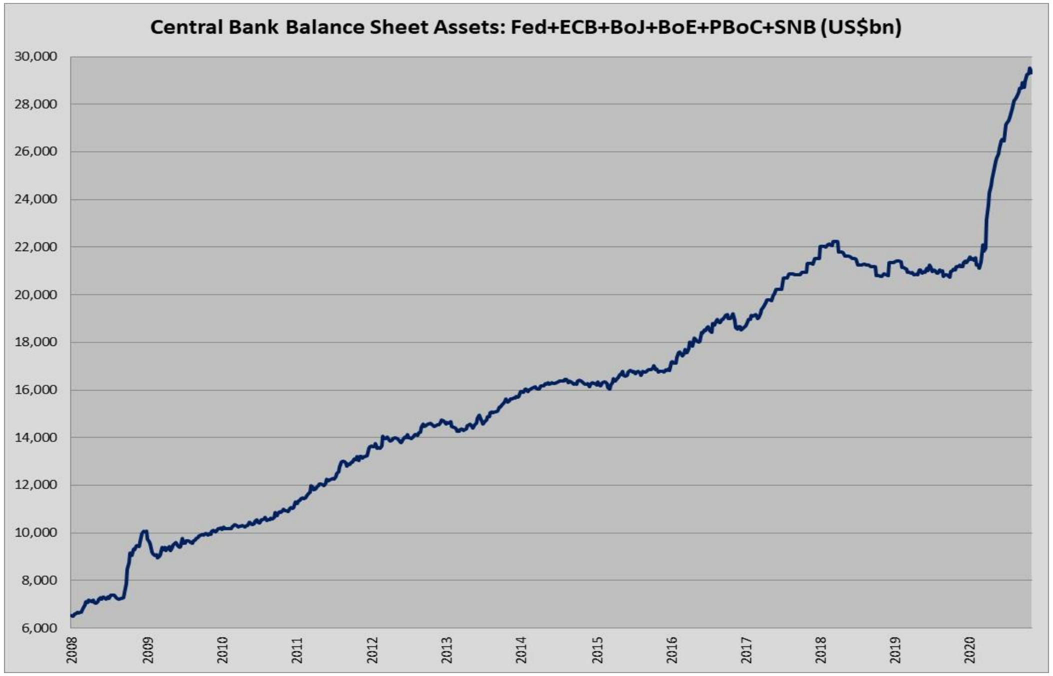
Source: IIF

- Debt has a “time function” – bringing forward *consumption* from the future into the present
- Debt “buys” time but becomes a *tax on future growth* as it increases
- We’ve bought A LOT of time

Central bankers never discuss the unprecedented volume of debt since they encouraged its accumulation

INFLATIONARY PUSH BACK: CENTRAL BANKS

- Heavy hand of hyper-interventionist central planning – the opposite of capitalism
- Since 2008 six central banks have created **$23 trillion** of credit out of thin air
- Re-inflating/extending debt cycle each time needs ever more stimulus



Source: Bloomberg

Let's consider during previous debt cycles and the performance of gold…

DEBT CYCLES SINCE INDUSTRIAL REVOLUTION

- Fourth since Industrial Revolution and by far the longest

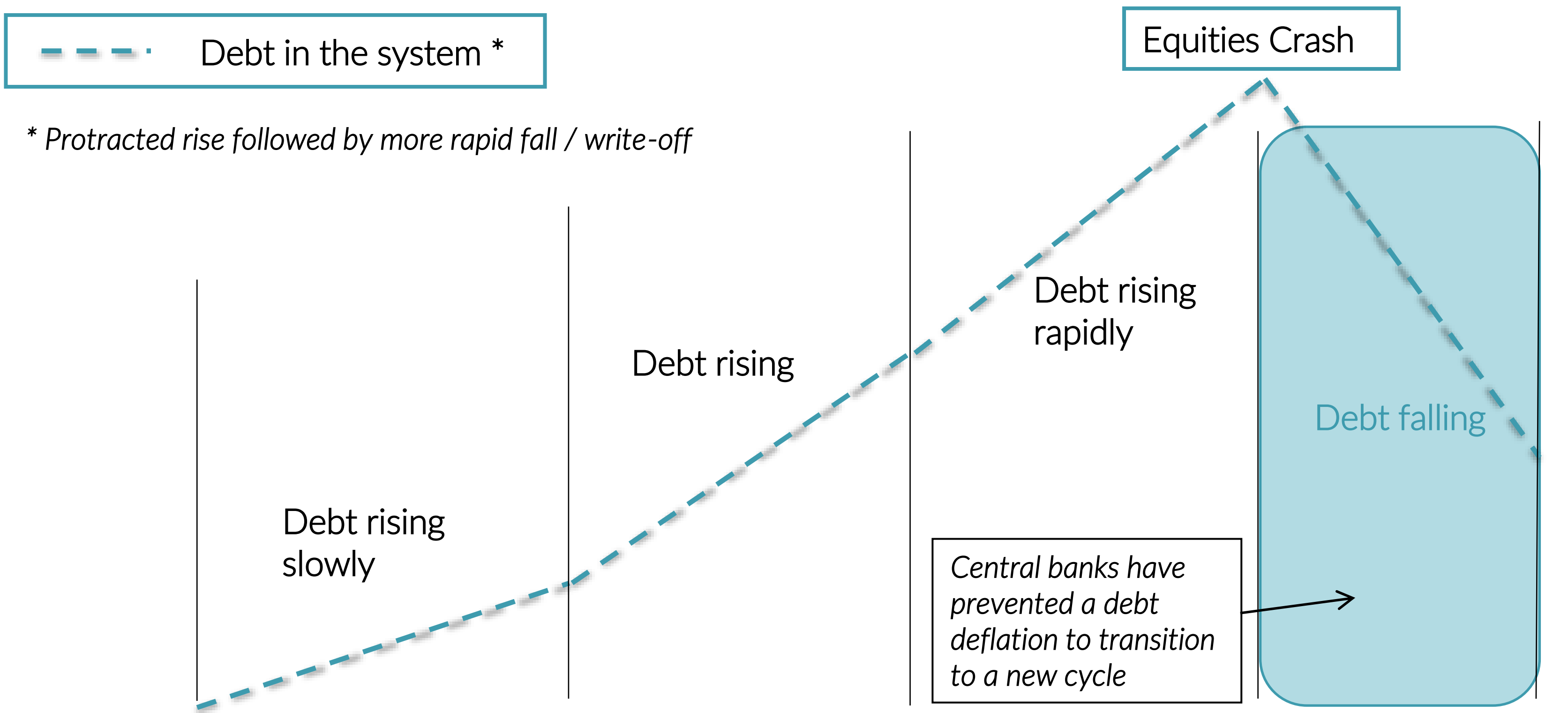
	Est. timing	Length (years)
First	1788 – 1843	56
Second	1844 – 1896	53
Third	1897 – 1933	37
Fourth	1934 -	87

- Protracted rise then more rapid fall in DEBT (other key variables = inflation/rates/GDP growth)
- First three cycles – major economies eventually overwhelmed by excessive debt
- Equity market crash brought on final phase which *(like Joyce's Finnegans Wake)* returns us to the beginning
- Final phase – debt deflation purged debt & asset bubbles… ***but it (really) is different this time***

Final phase of current cycle:

- Hyper-interventionist central banks utilising unlimited credit creation
- Distorted by monetary policy which avoids debt deflation at all costs *("Whatever it takes")*

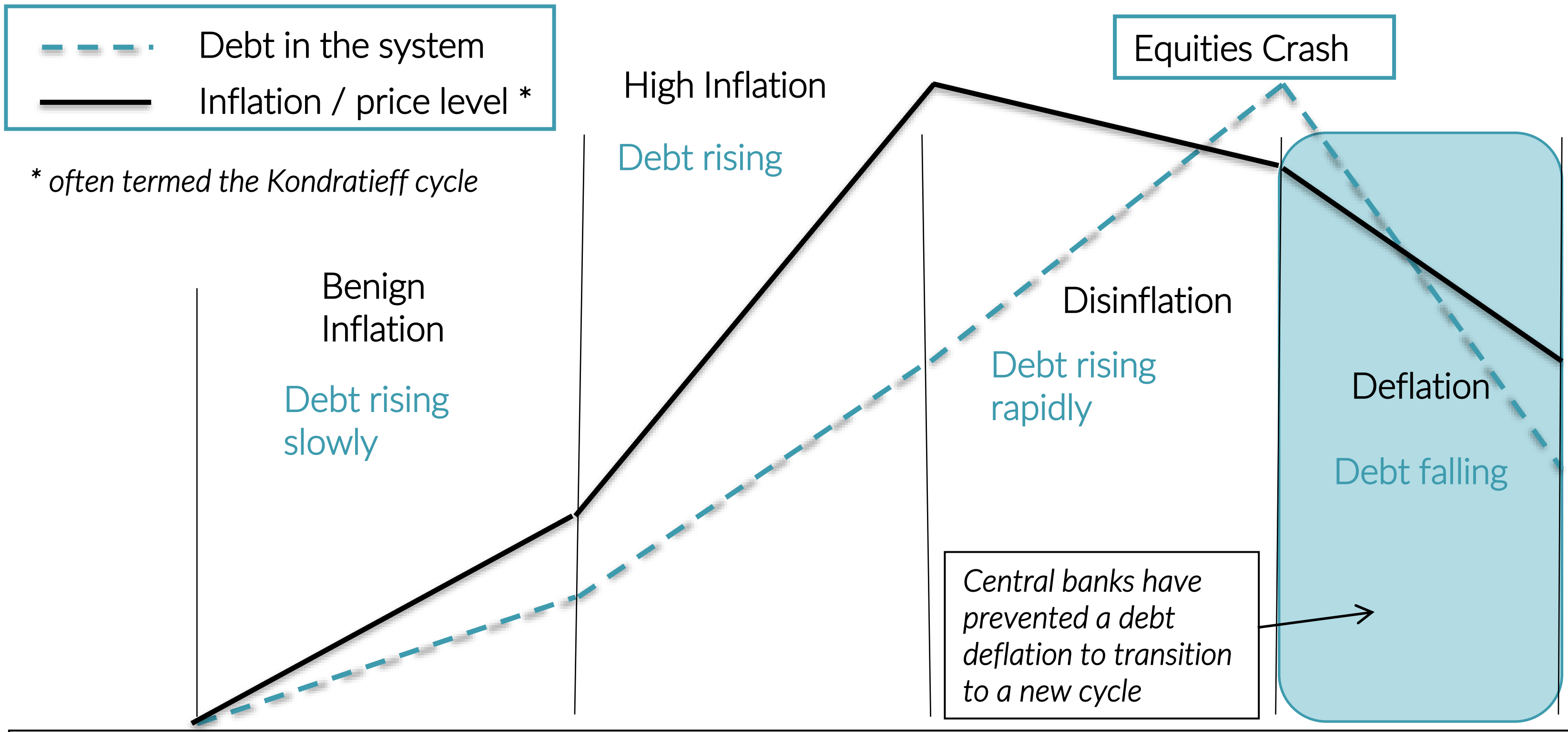
CLASSIC DEBT CYCLE: DEBT



Cycle 1	1788	1799	1814	1825	1843
Cycle 2	1844	1861	1865	1873	1896
Cycle 3	1897	1912	1921	1929	1933
Cycle 4	1934	1967	1981	2008	On hold

	SPRING	SUMMER	AUTUMN	WINTER
	(Rebirth)	*(Inflationary abundance)*	*(Feel good)*	*(Pay-back)*
	Economic recovery	Major war	Asset bubbles	Economic collapse
BUY:	Equities, Real Estate, Commodities	Gold, Commodities Real Estate	Equities, Bonds, Real Estate	Gold, Bonds
SELL:	Gold, Bonds	Equities, Bonds	Gold, Commodities	Eq, Commod, R. Est

CLASSIC DEBT CYCLE: DEBT & INFLATION / PRICE LEVEL



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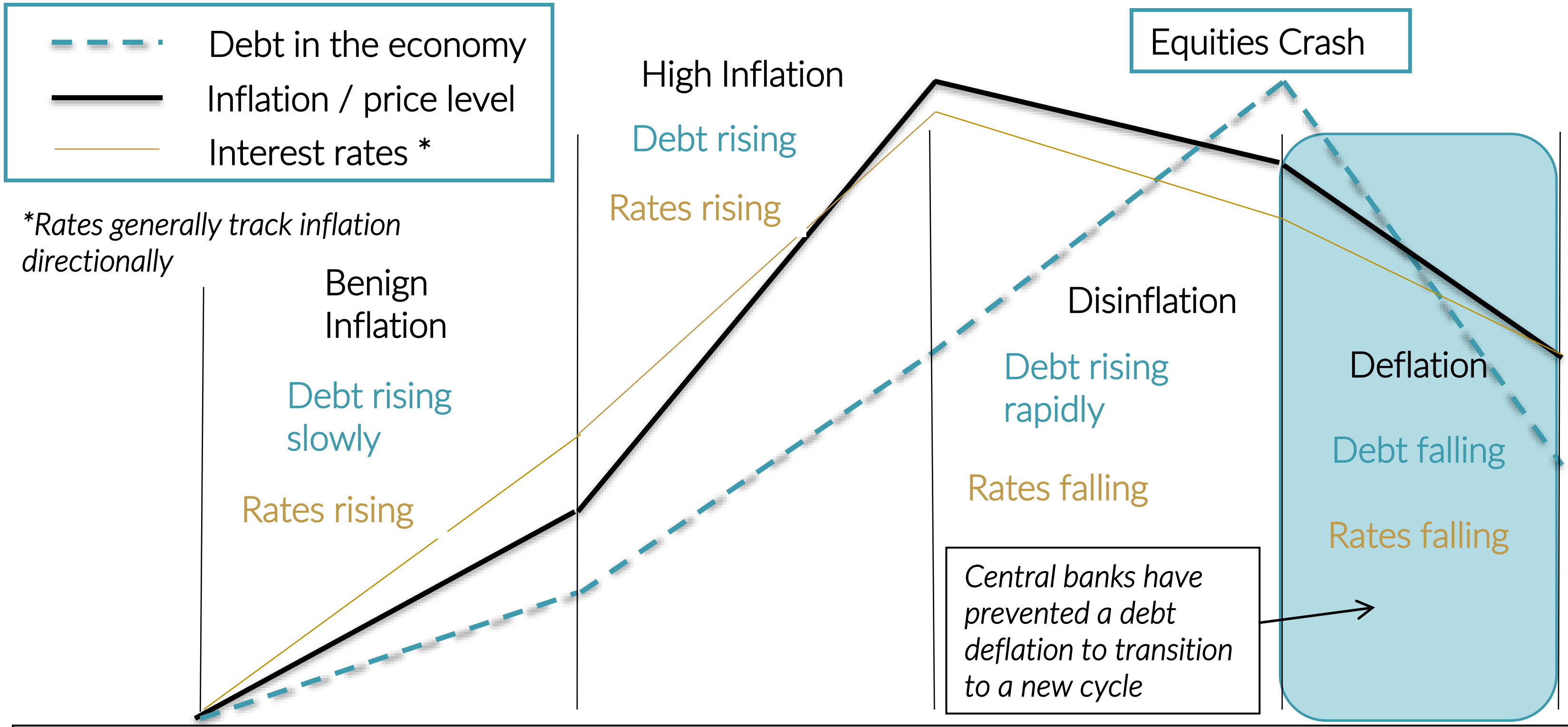
CLASSIC DEBT CYCLE: DEBT, INFLATION & INTEREST RATES



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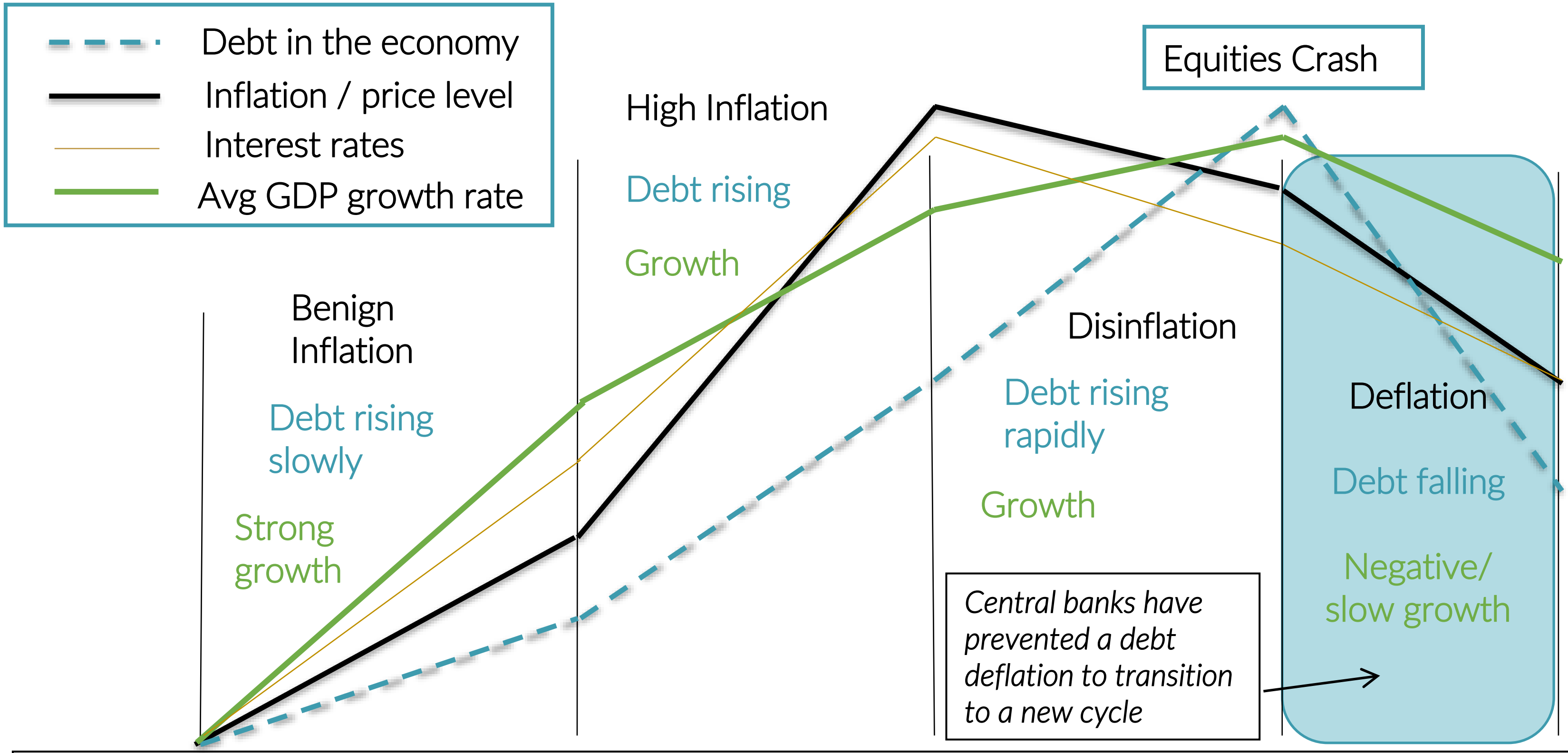
CLASSIC DEBT CYCLE: DEBT, INFLATION, INTEREST RATES & GDP GROWTH RATE



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GOLD AND DEBT CYCLES

Our position in the current global debt cycle is important because:

- Gold has performed strongly in the ***final stage of the 3 previous debt cycles*** since the Industrial Revolution

Gold vs. stocks, bonds & commodities in final stages of previous debt cycles

Debt cycle	“Winter” stage	Stocks	Commodities	Bonds*	Gold (actual)	Gold (real) #
1788-1843	1825-1843	-78%	-27%	3.54% to 3.17%	0%	+26%
1844-1896	1873-1896	-22%	-44%	5.49% to 3.61%	-10%	+20%
1897-1933	1929-1933	-89%	-46%	4.73% to 4.49%	+69%	+122%

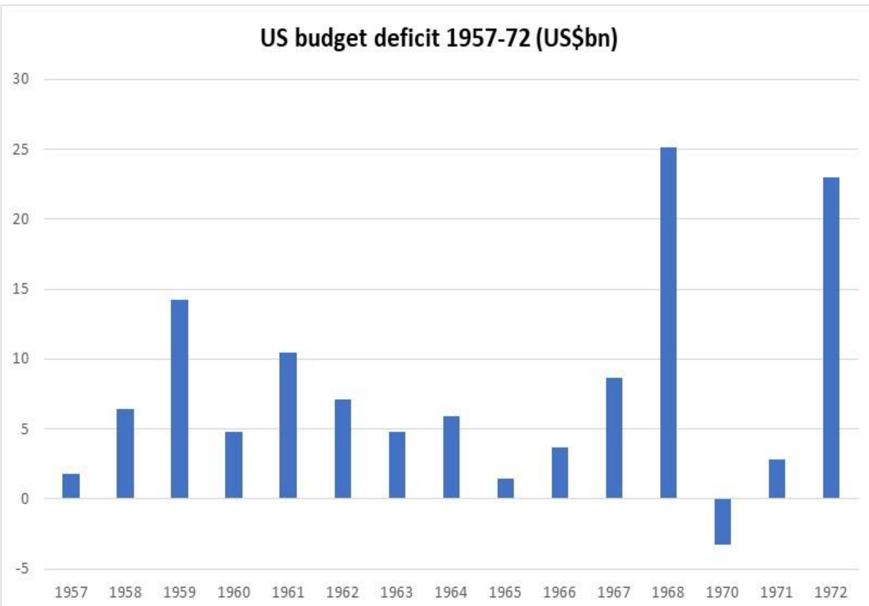
* change in long-term bond yield # change in gold price vs. CPI

In the current cycle, the Bretton Woods currency system needed modification…

BRETTON WOODS MODIFICATION 1968-71

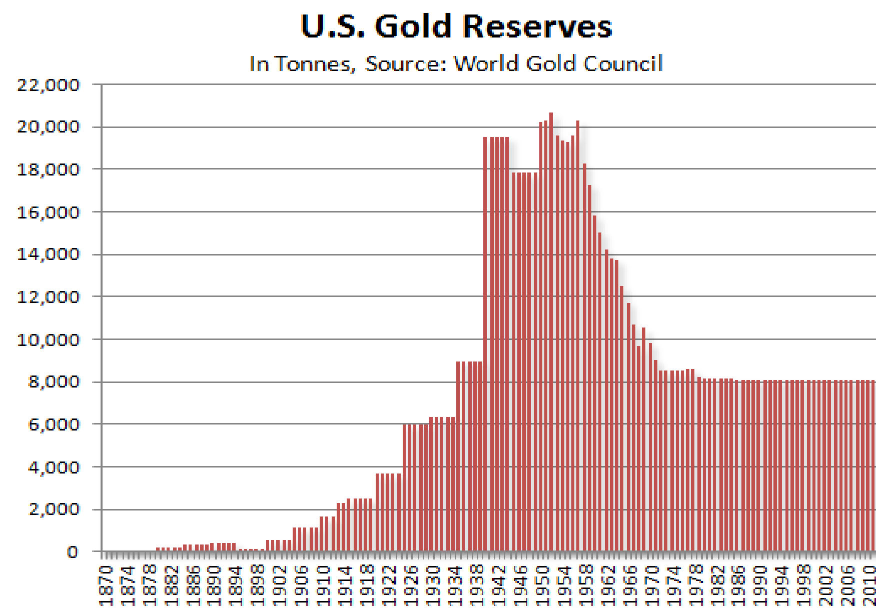
Preceded by a two-stage loss in US monetary discipline…

Firstly in late 1950s/early 60s & secondly in late 1960s



Source: US Treasury

London Gold Pool formed in 1961, failed in 1968



Source: WGC

- Waves of gold buying broke BW as gold price freed from $35/oz cap in 1968
- Shift to new system of un-backed fiat belatedly confirmed by Jamaica Accords

Fast forward to 2008's GFC…

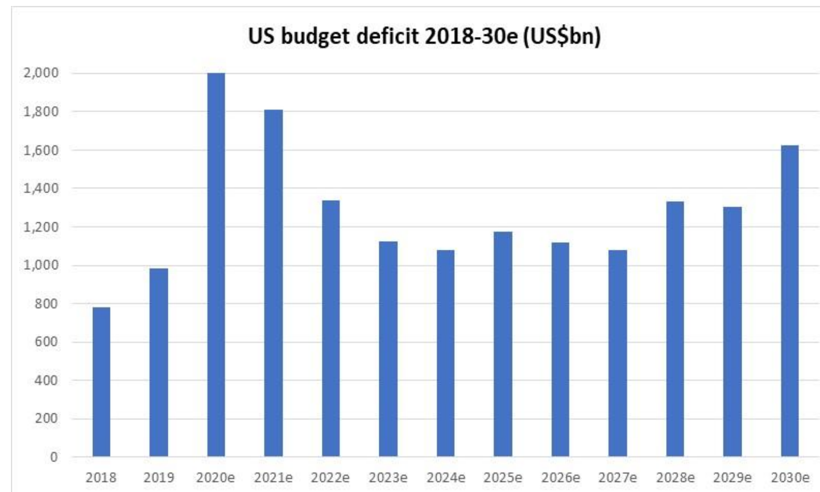
HISTORY REPEATING

First stage 2008-15 with ZIRP & QE1, QE2 , QE3…second stage began in late 2018

December 2018 – capitulation in "hawkish" Fed policy

Source: Federal Reserve

Perpetual trillion dollar deficits now in prospect



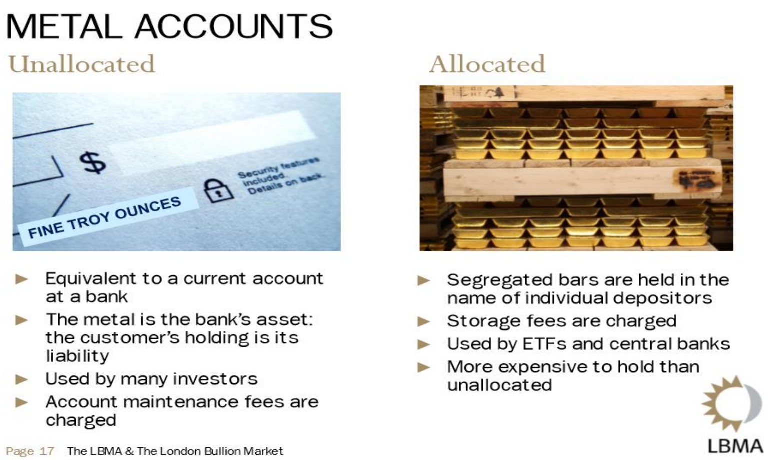
Source: CBO

- We are moving *inexorably* towards a systemic monetary crisis
- Unlike previous debt cycles, this one is characterised by *unlimited credit creation by central banks*
- Inflation is the likely endgame (there will be deflation in terms of gold)

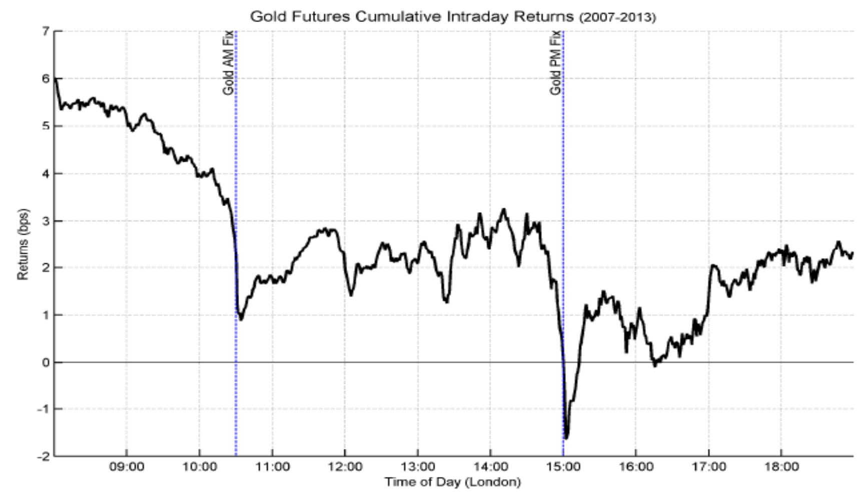
TRAGEDY: LONDON OTC GOLD MARKET

Physical gold almost eliminated from price setting and no "random walk"

Derivative-*ised* – 95% of trading is unallocated "paper" gold

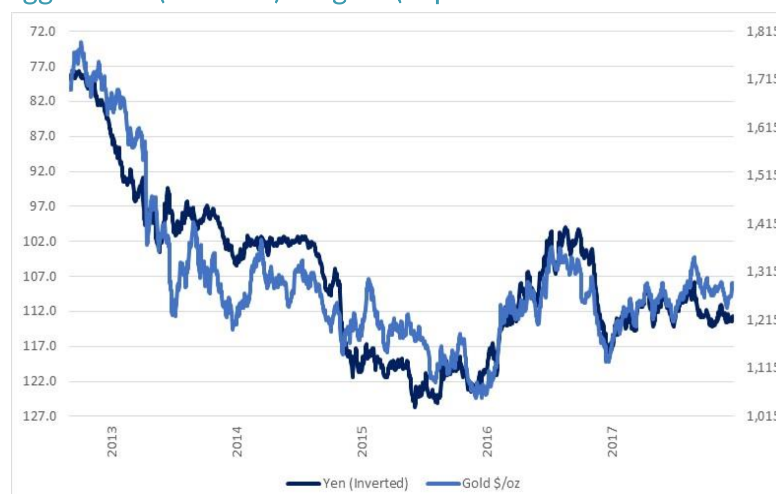


Gold price: average intra-day pattern 2007-12



Gold price algorithms in action

Pegged: Yen (Inverted) vs. gold (September 2012-December 2017)



Sources: Bloomberg. LBMA, Kitco, goldchartsrus

TRAGEDY: BANKS' ABUSES HIGHLIGHTED

Frustrated gold's ability to signal an overstretched global financial system

Michael Nowak, head of precious metals trading, was charged on Monday along with two colleagues, Gregg Smith and Christopher Jordan, on federal racketeering charges normally used to take down organised crime syndicates.

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Finance & economics

Oct 3rd 2020 edition ›

Spoof proof

JPMorgan Chase faces a fine of $920m for market manipulation

BANKS DECEMBER 2, 2016 / 9:45 PM / UPDATED 4 YEARS AGO

Deutsche Bank to pay $60 million to settle U.S. gold price-fixing case

By Jonathan Stempel

2 MIN READ

Gold price manipulation is real; JPMorgan's spoofing case explained

David Lin

Friday October 02, 2020 09:05

Kitco News

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Deutsche Bank Spoofer Claims Gold Manipulation Is Taught By Superiors

Last Updated: September 18, 2020 / Daniel Plainview

January 29, 2018

CFTC Orders UBS to Pay $15 Million Penalty for Attempted Manipulation and Spoofing In the Precious Metals Futures Markets

UBS's Penalty Was Substantially Reduced in Recognition of Its Self-Reporting, Cooperation and Remediation

The bull market in gold will accelerate when gold bullion settlement becomes problematic…

HOPE: GOING FORWARD

It's not the amount of gold bullion in London vault that's critical, but the "float"

- Excluding "encumbered" gold, the vaults appears to be relatively depleted at ca.600 tonnes

Current estimate for gold "float" in London (tonnes)	
Total gold in London vaults (Sep'20)	9,068.9
Less:	
Official gold (95% x gold in BoE – Sep'20)	-5,168.5
Less:	
ETF gold held in London (Oct'20)	-2,982.0
Less:	
Est. held by institutions (incl. SWFs) and HNWs	-300.0
Equals	
Gold float supporting London OTC trading	618.4

Source: LBMA, BoE, World Gold Council

- Official LBMA trade data (excl. non-LBMA members) shows daily trading of 1,000 tonnes/day

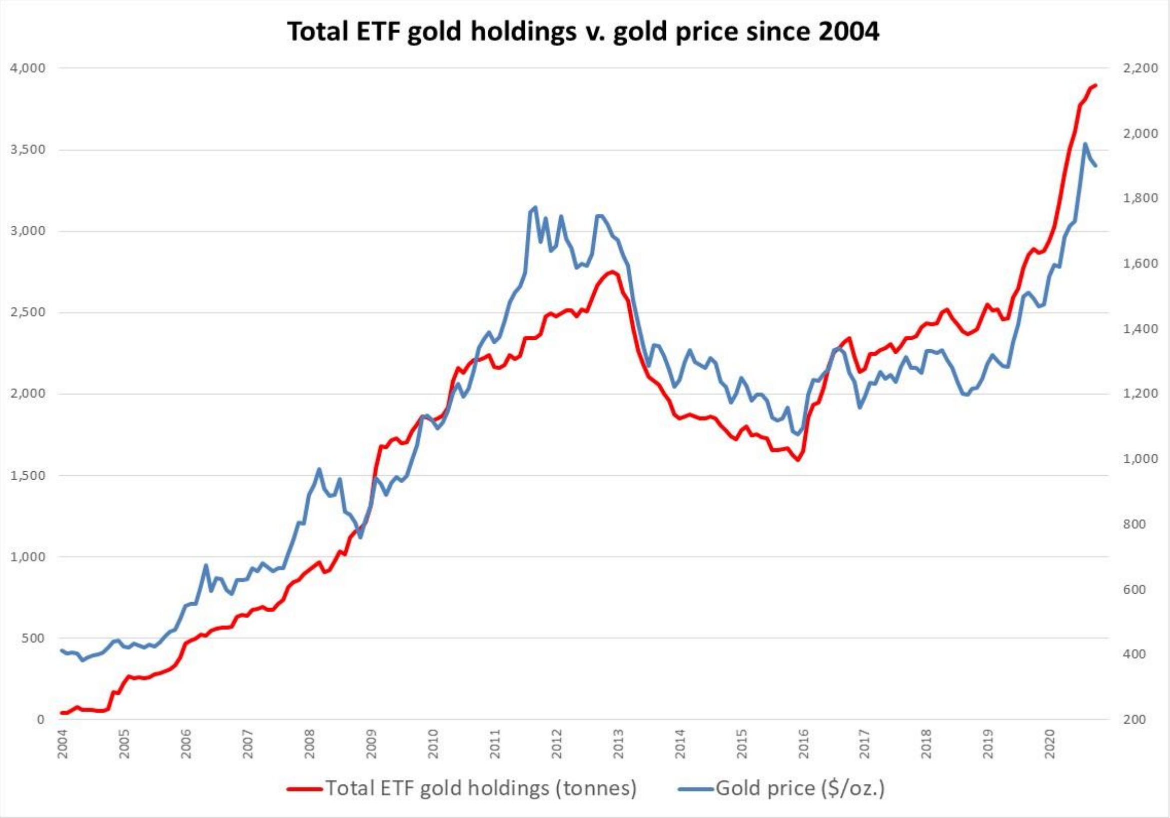
- Can London withstand a sustained wave of gold buying?

- The *vast pools of western capital* still hold a minimal amount of gold bullion and are typically wrong-footed in the early stages of gold bull markets…

…this is changing

GLOBAL GOLD ETFs vs. GOLD PRICE

- Non-official, i.e. private sector, accumulation of gold seems to be driving the gold price



Source: Bloomberg

Meanwhile you may not have appreciated the scale of the current inflationary mega-trend

INFLATIONARY MEGA TRENDS

The four “Great Inflations” of the last millennium

1st Great Inflation	1180 - 1317
2nd Great inflation	1496 - 1650
3rd Great inflation	1733 - 1814
4th Great inflation	1897 - ?

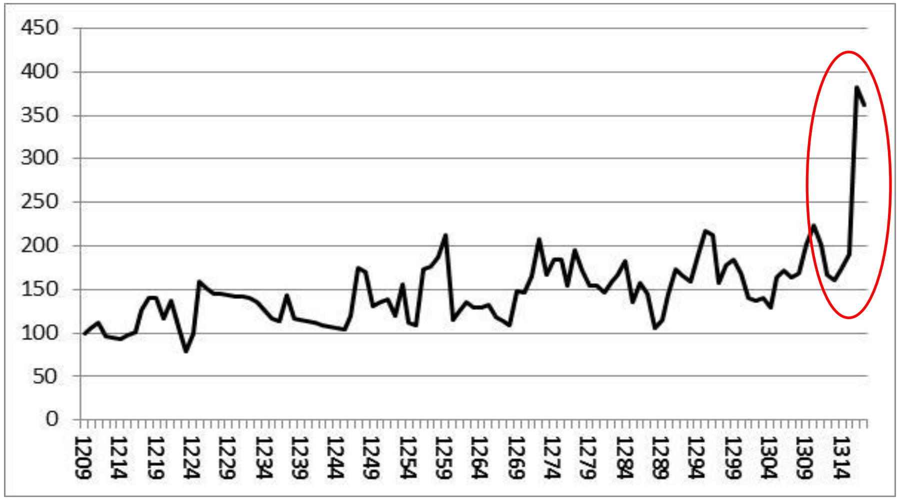
The driving forces for these inflations were similar in each case:

- Population growth – increasing pressure on available resources;
- Governments/kings – excessive spending (e.g. wars)

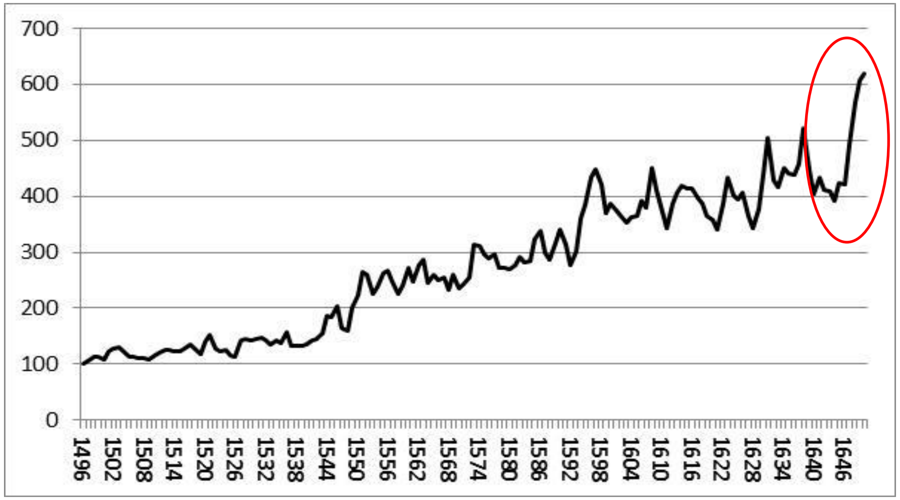
Now watch what happened in the late stages of the first three Great Inflations…

FOUR GREAT INFLATIONS

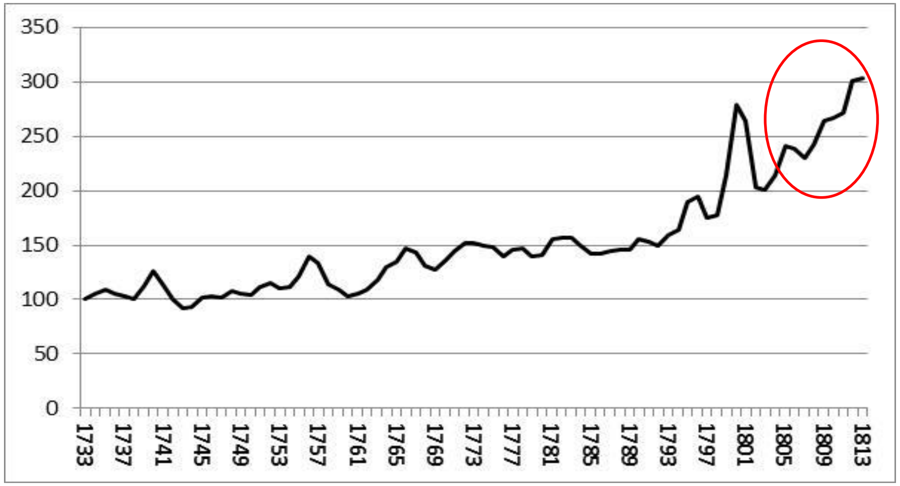
1st Great Inflation 1209 - 1317



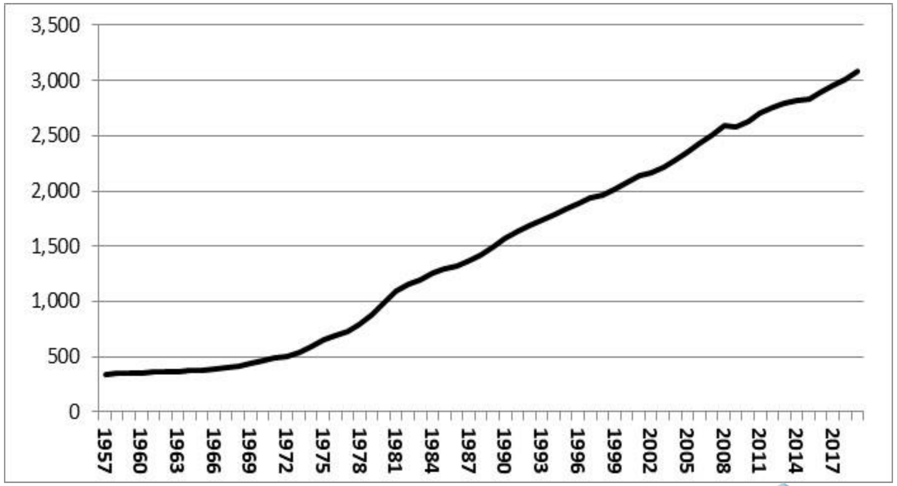
2nd Great Inflation 1496 - 1650



3rd Great Inflation 1733 - 1813

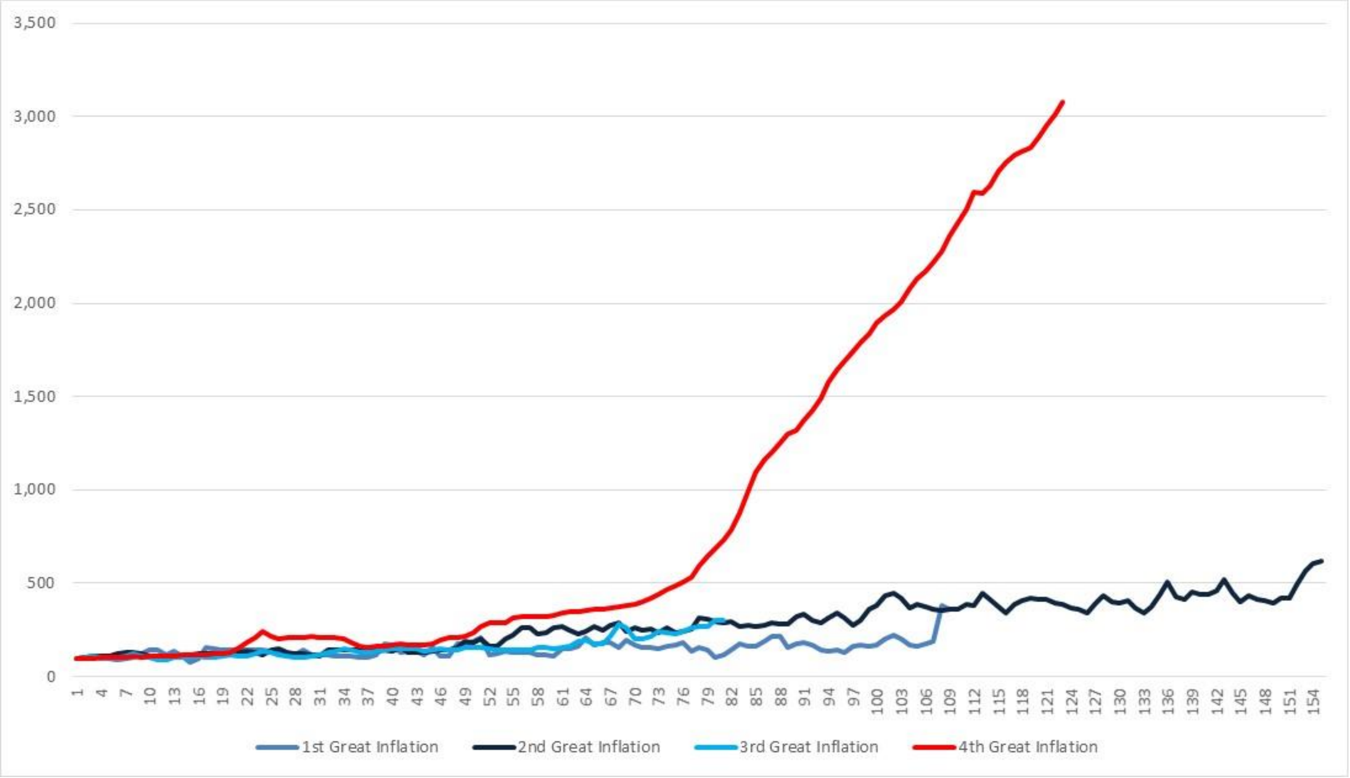


4th Great Inflation 1897 - ?



FOUR GREAT INFLATIONS *(same chart)*

Four Great Inflations: *X-axis = no. of years, Y-axis = price index (year 1 = 100)*



- The **red line** by deduction = a modern central banker's definition of "low inflation"

You might want to look away before the next slide…

HOW THE FIRST THREE ENDED

1st Great Inflation — Banking collapse followed by "Black Death" (world population reduced by an estimated 20%)

2nd Great Inflation — Plague and wars – population reduction *again* – and decline in silver supply (then the world's money)

3rd Great Inflation — "Great Re-coinage of 1816" and Britain adopted the Gold Standard

Note: in all three, food prices increased faster than the general price level in the latter stages

We can only speculate…

4th Great Inflation

- Inflation / currency crisis is probably inevitable
- Modification to system – new Bretton Woods?
- World Economic Forum's "The Great Reset" of 2021 is food for thought

One more thing…

FINALLY: ONE WAY OF LOOKING AT GOLD

Gold vs. S&P 500 since 1971

Source: Bloomberg

THANK YOU

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Source of charts: Bloomberg, Reuters