The MoneyShow
Money, Metals and Mining Virtual Expo
Nathan Lewis, *The Polaris Letter*

April 6, 2022

Nathan Lewis, *The Polaris Letter*

Four books about monetary and economic topics, including the “gold standard trilogy.”

Gold: The Once and Future Money (2007)
Gold: The Monetary Polaris (2013)
Gold: The Final Standard (2017)

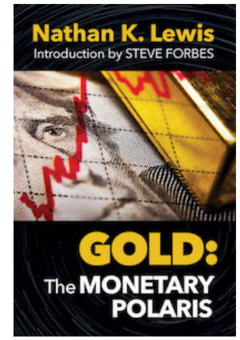
The Magic Formula (2019)

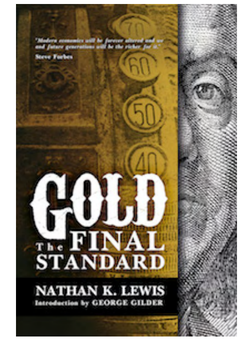
To be released April 2022: *Inflation*, with Steve Forbes and Elizabeth Ames

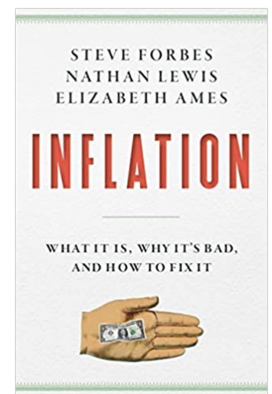
15+ years of institutional research and asset management experience.

Newworldeconomics.com

The Polaris Letter (polarisletter.substack.com)







An Asset-Allocation Approach

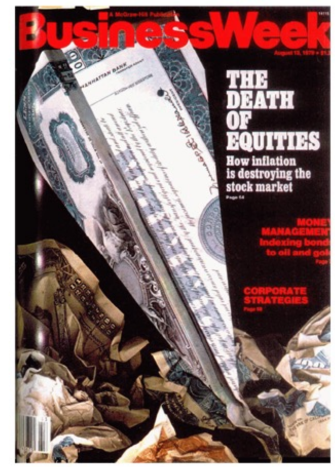
Most people don't have time (or expertise) to actively manage a portfolio of individual stocks or actively-traded positions.

Investing is a "zero-sum game."

This gives rise to a "passive investment" strategy, for example, 60% stocks, 40% bonds.

However, there are some times when stocks and bonds do very badly, and gold (or other alternatives) do very well.

A few good decisions can make a big difference.



Past episodes of currency decline have been bad for stocks, bonds and cash.

60:30:10 portfolios were mutilated.

Hard Assets were the big winners.

Playing the odds

Nobody knows what the next roll of the dice or turn of the cards will be. (i.e., short-term market moves are hard to predict)

But, *sometimes the odds are in your favor*, and *sometimes the odds are not in your favor*.

Today, ”the odds” favor gold and hard assets, over most stocks and bonds.

Nobody knows what the next cards will be, but all good gamblers know the odds.

If you don’t know the odds, you are probably going to be the sucker.

Like poker, investing is a “zero sum game.” All the investors always own all the assets.

We live in an environment of *floating fiat currencies.*

In the short term, the value of floating fiat currencies (USD, EUR, JPY, GBP, CAD, etc.) go up and down unpredictably.

In the long term, **they tend to go down, a lot.**

During these intermittent currency-decline events, the real values of stocks and bonds fall **a lot**, and gold is usually the big winner.

In the 1960s, a barrel of oil cost \$3. Now it is \$100+, and we are still driving gas-guzzlers.

Did the value of a barrel of oil go up? (Where are the superefficient cars?)

Or did the value of the dollar go down ***a lot?***

“Gold Is Money”

The primary characteristic of gold (as an investment asset) is that it is **reliably stable in value.**

This characteristic is why it served as the basis for monetary systems worldwide for most of the past 500 years (actually 5000 years), until 1971.

This is what people mean when they say “gold is money,” although it is rarely used in transactions today.

I think that gold retains this quality. It is still stable in value. The “volatility of the USD/gold price” is primarily an expression of the volatility of the floating fiat dollar, not gold.

Thus, you can think of gold as “a form of cash.”

When fiat currencies have one of their periodic episodes of decline, gold is usually among the best-performing assets.

But also, like USD cash, even if the “price of gold” doesn’t go up much, it can serve as a safe haven when stocks or bonds go down.

Occasionally, hoards of gold coins from Ancient Rome (circa 450 AD) are found in Italy.

Gold was money then too, and arguably, the value of the coins is about the same now as it was then.

Nothing else made it.

Since 1900 …

- The U.S. dollar’s value vs. gold declined by 90:1.
- The British pound’s value vs. gold declined by 324:1.
- The Italian lira’s value vs. gold declined by 28,000:1.
- Russia had hyperinflation in 1917-1921, and 1990-1995.
- China had hyperinflation in 1910-1912 and 1945-1950.
- Germany had hyperinflation in 1919-1923 and 1945-1949.
- Japan had hyperinflation in 1945-1949.
- All of Latin America had hyperinflation in the 1980s.
- All of Eastern Europe had hyperinflation in the 1920s and 1990s.
- It happens all the time.

1928

=

1x

U.S. $20 Saint-Gaudens coin from 1928, containing 0.97 troy oz. of gold.

1x

U.S. $20 Federal Reserve Note from 1928.

2022

=

1x

90x

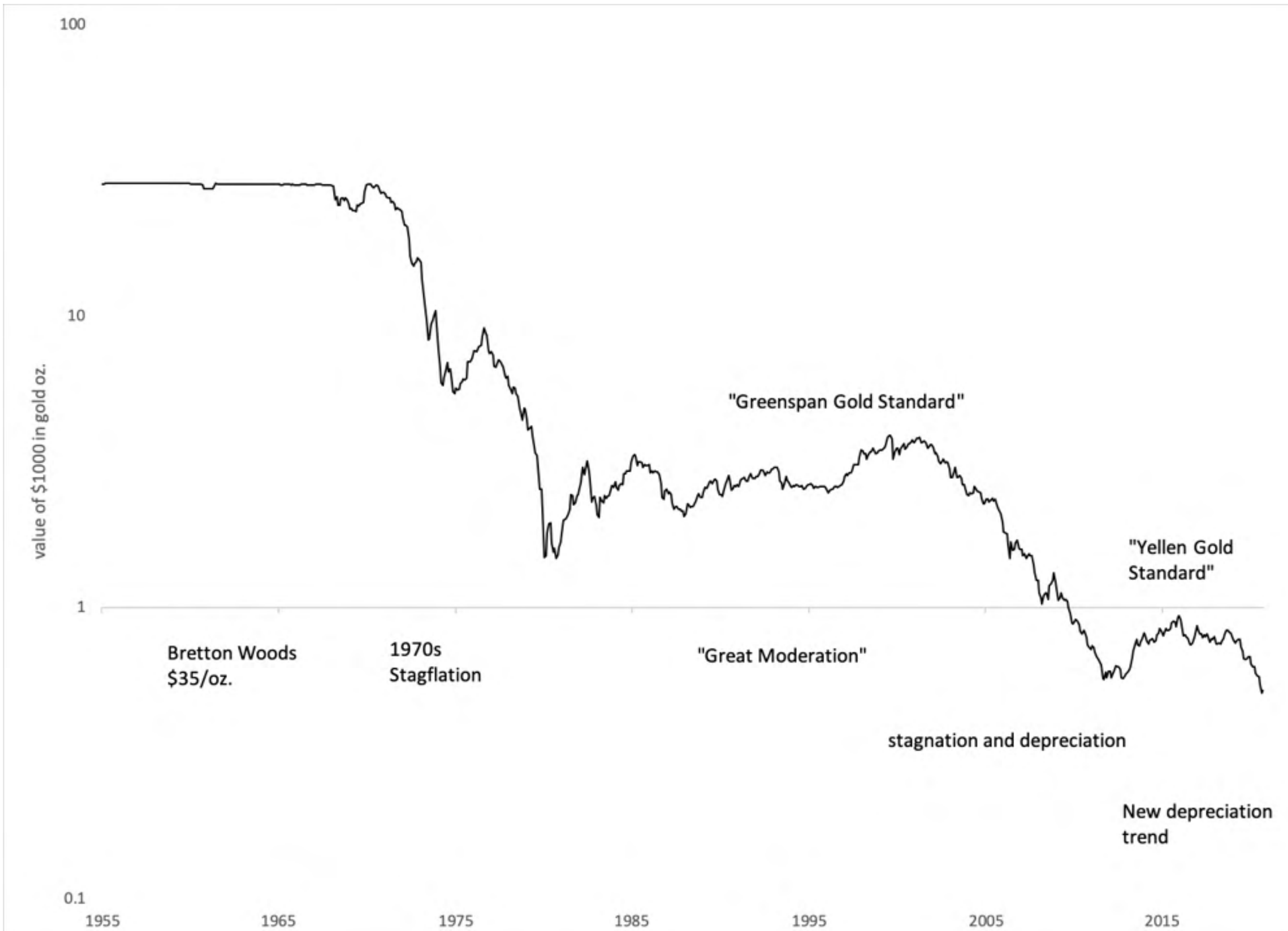
These events defined the macro conditions of the time.

Value of $1000 in gold oz, 1790-2020

The United States has had three major episodes of currency decline since 1900.

- A one-time "step" devaluation in 1933.
- The "stagflation" era of the 1970s, when the dollar's value vs. gold fell by about 10:1 over about 10 years. ($35/oz. in 1960s to $350/oz. average during 1980s-1990s.)
- The Bernanke depreciation of 2002-2011, a decline of about 4:1 over about 10 years. ($350/oz. average in 1990s to $1250/oz. average in 2013-2019.)
- These three events (about 21 years out of 120) account for the 90:1 decline in the value of the dollar since 1900.
- Each came about due to central bank/Treasury policy.
- We are probably now in a new period of global currency decline, which may eventually become the largest in American history since the hyperinflation of the 1780s. This period may last 5-10 years.
- Afterwards, it might be a great time to buy stocks and bonds again.

They created cycles of Hard Assets vs. Paper Assets



Gold as an “inflation hedge”

When the value of a currency goes down, but gold is stable in value, the “price of gold” in that currency ”goes up.”

This declining currency value leads to higher nominal prices, over an adjustment period that lasts years and even decades.

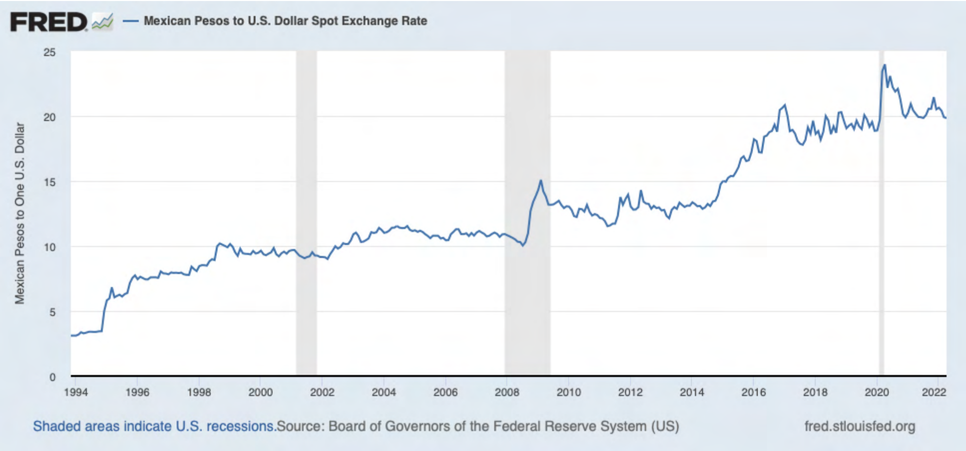
The “rise in the price of gold” during a currency decline event is your “inflation hedge.”

It has little to do with the CPI.

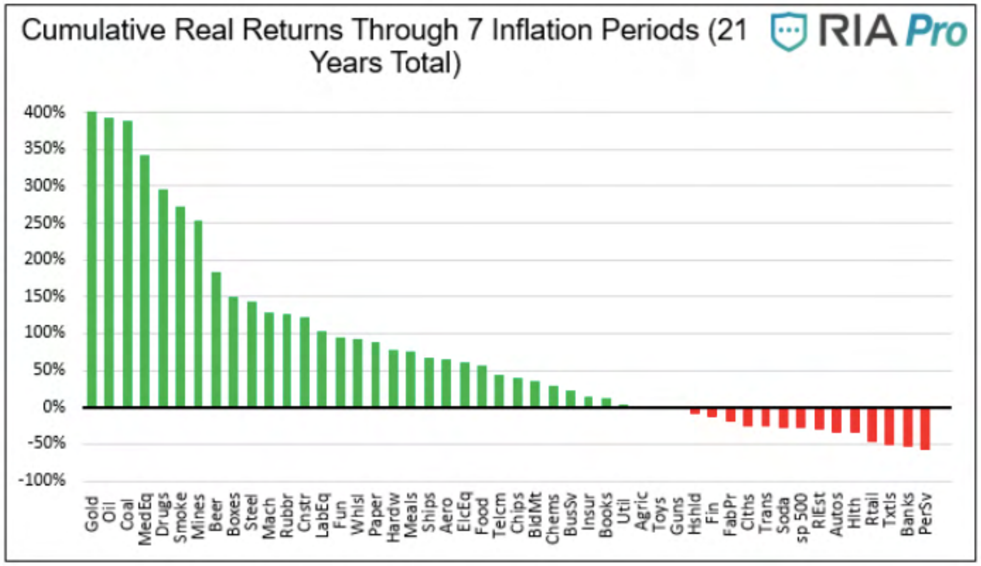
It’s really obvious when it happens to someone else (like Mexico).

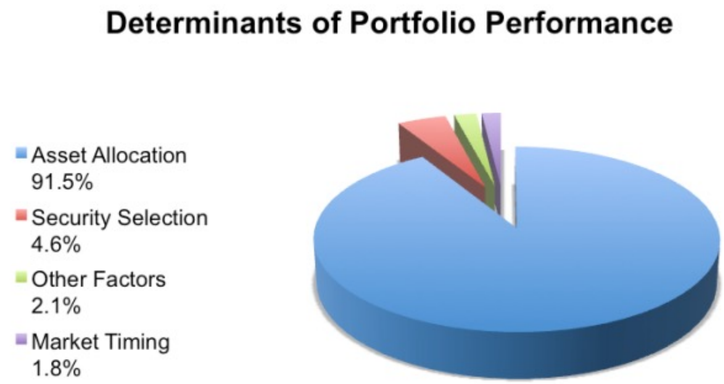
When it happens to us, everyone is confused.

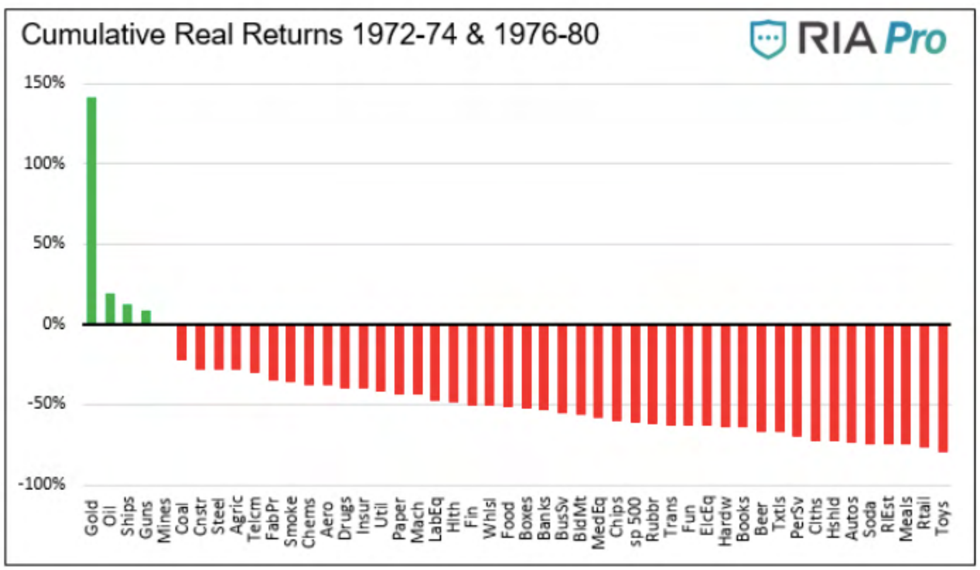
This is known as the “money illusion.”



Gold tends to be the best-performing asset.







In these situations, if you get a few asset allocation decisions right, the gains are gigantic.

Hard Assets have had gigantic outperformance in periods of declining currency value.

"Gold is money. Everything else is credit."-- J.P. Morgan

1970-1980 total return:
S&P500: +134%
Cash: +108%
Gold: +1,581%

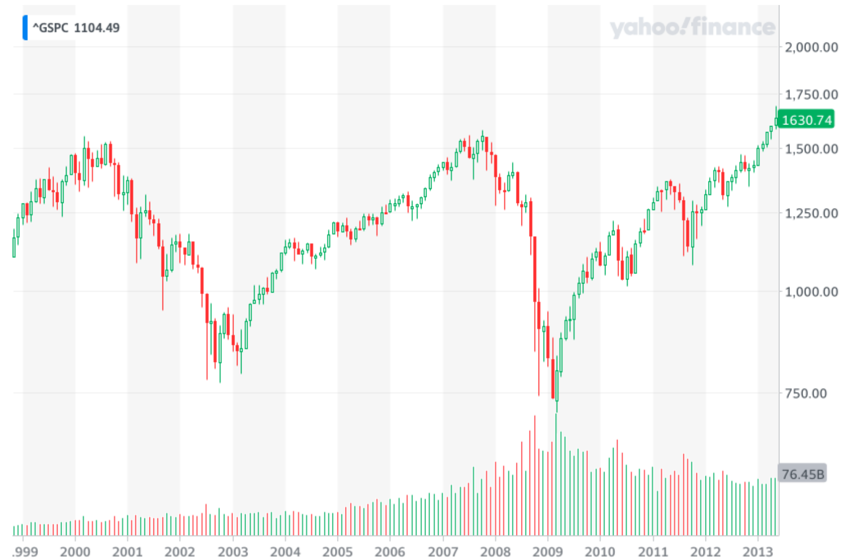
2001-2011 total return:
S&P500: +17%
Cash: +24%
Gold: +508%

Using full year results.

SP500:Gold ratio. Gold was a huge winner in 1970-1980, 2001-2011.

For centuries, gold served as a "stable standard of value," the basis of monetary systems worldwide. Many hard asset investors believe that gold still serves this role. This is often expressed as: "Gold is money." When currencies decline in value vs. gold, it indicates that the real monetary value of the currency is probably declining.

The “Hard Asset” phases tend to have stagnant equities.



While nominal prices are stagnant, real values have a huge decline, and valuations come down.

Wall Street tends to belittle/ignore hard asset investors, even when they are massively outperforming, because it makes what they are selling -- stocks and bonds – look bad. Most investors will be stuck in Wall Street’s “stay the course” stock and bond strategies throughout the entire “hard asset” episode. Ouch!

The World Gold Council has recommended a 5%-10% portfolio allocation to gold.

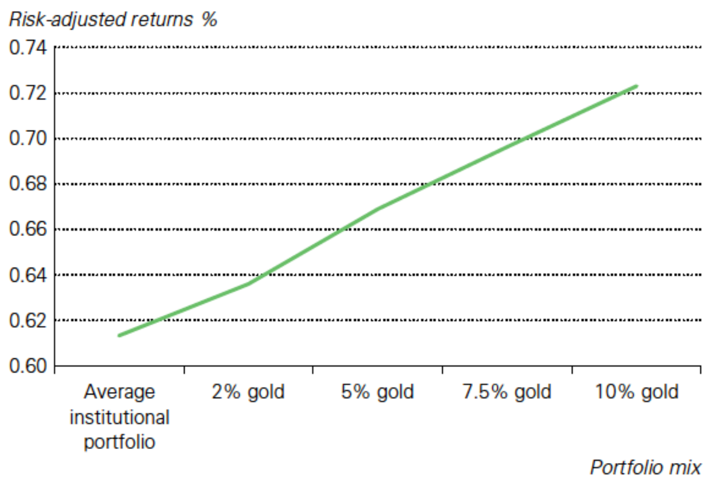
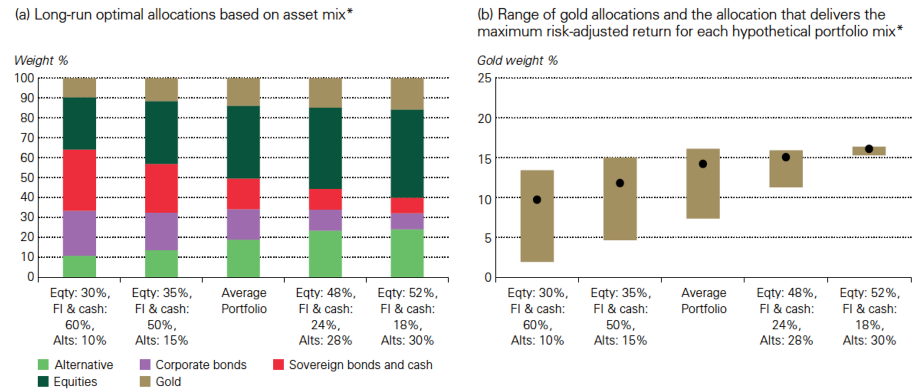


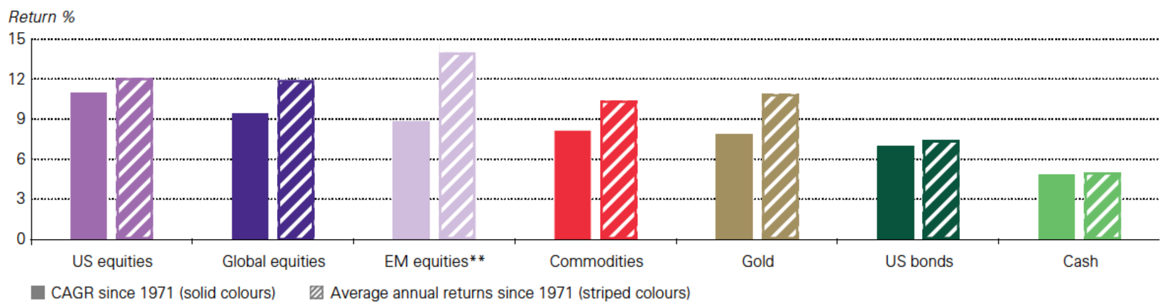
Chart 9: Gold can significantly improve risk-adjusted returns of hypothetical portfolios across various levels of risk



These numbers seem to have been massaged – not to make gold look better – but to make it look worse. (For example, the 1970s were omitted, with the sample beginning in 1986.) Basically, they needed a result that made sense in terms of “career risk” – mainstream institutional investors can’t justify a gold holding above about 10%.

Asset Class performance during the Floating Fiat Era

Chart 22: Gold returns have been on par with equities and above bonds since the end of the gold standard
Compounded annual growth rate (CAGR) and average annual returns for major asset classes*



* Data from 1 January 1971 to 31 December 2021. Return computations in US dollars for 'cash': ICE 3-month Treasury; 'US bonds': Bloomberg Barclays US Bond Aggregate, 'US equities': MSCI Daily TR Gross USA USD; 'Global equities': MSCI World Net Total Return; 'EM equities': MSCI Daily TR Gross EM USD; 'commodities': Bloomberg Commodity Index; 'gold': LBMA Gold Price PM. CAGR is defined by the price of the asset at the ending period, divided by the beginning price value raised to the (1/n) years minus 1. Average annual returns are calculated as the arithmetic mean of y-o-y returns over the time horizon.

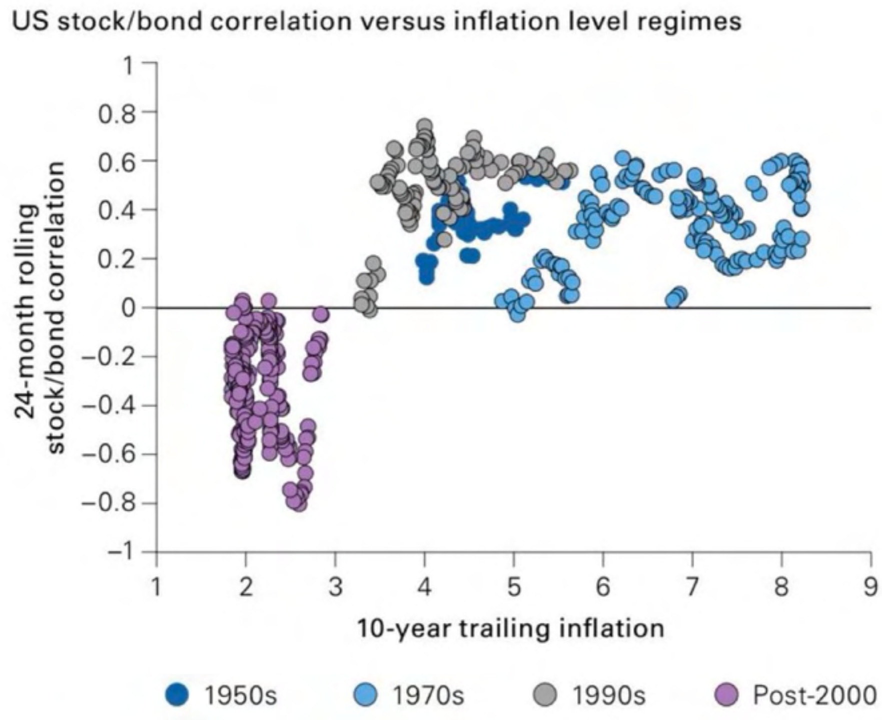
** Emerging market returns based on available data beginning in January 1988.

On Goldhub.com see: **Gold returns**.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

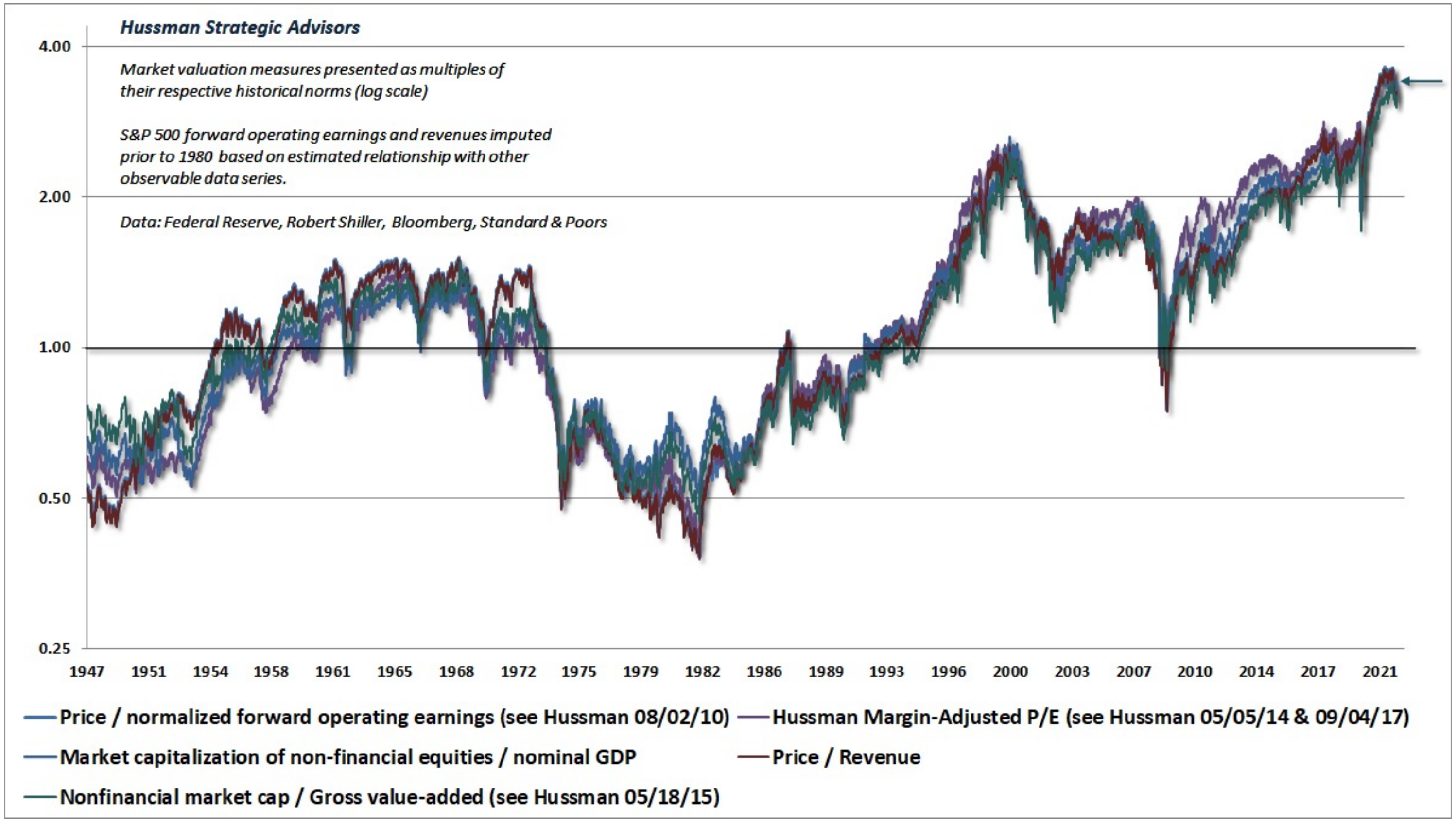
The "Pet Rock" has outperformed bonds and cash during the Floating Fiat Era, while adding a nice element of negative correlation. Equities have outperformed gold, but US equities are, by some measures, about 200% above their long-term valuation averages. If US equities had an average valuation, how would things look then?

Positive Correlation During Inflationary Periods



"Equity and bond correlations become positive in high-inflation regimes" = both stocks and bonds go down together. Gold is the refuge of choice.

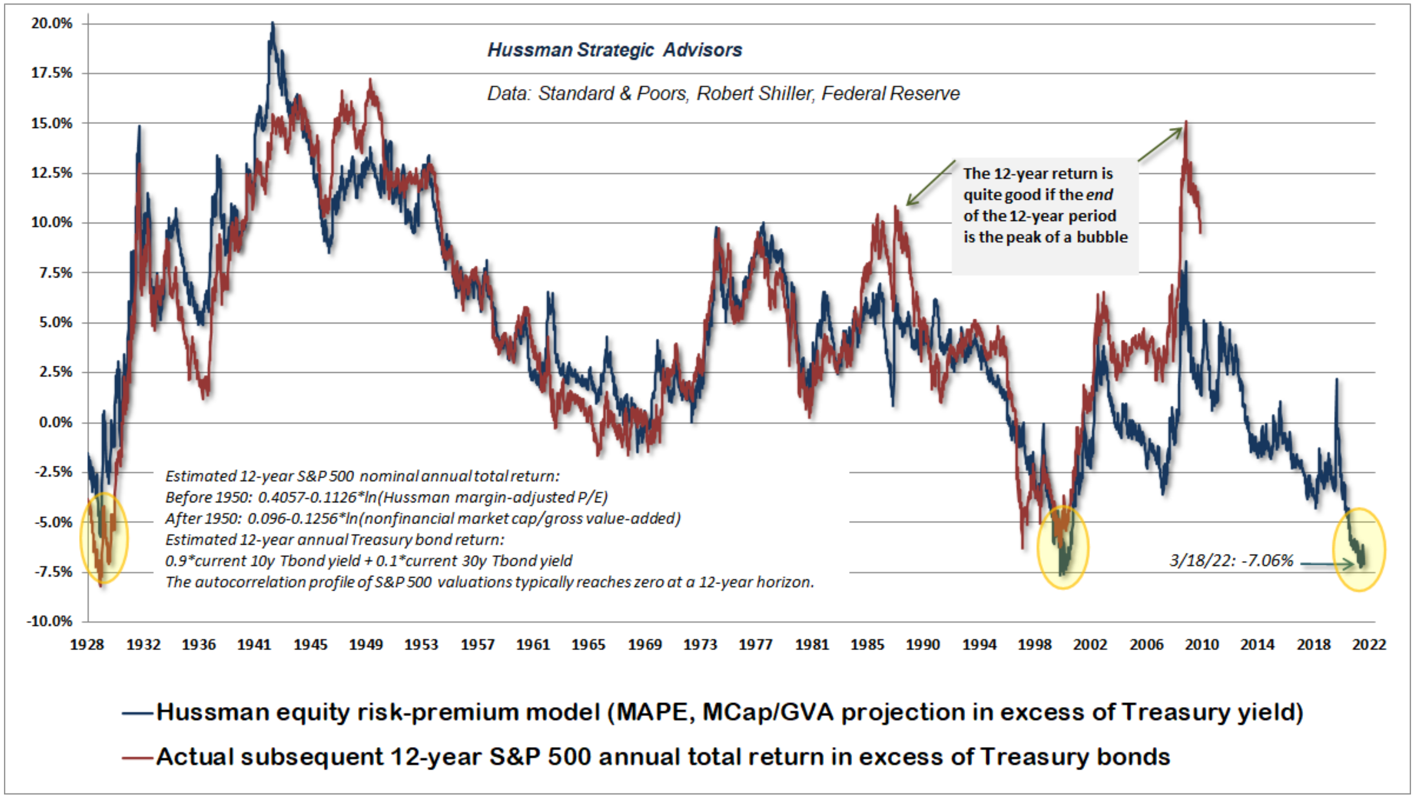
Equities and Bonds are very, very expensive.



John Hussman (hussmanfunds.com) does meticulous work on market valuation. Today's US equity valuations are near the highest in US history, even after the recent selloff.

To return just to average (=1.0) valuation would mean a valuation decline of about 70%.

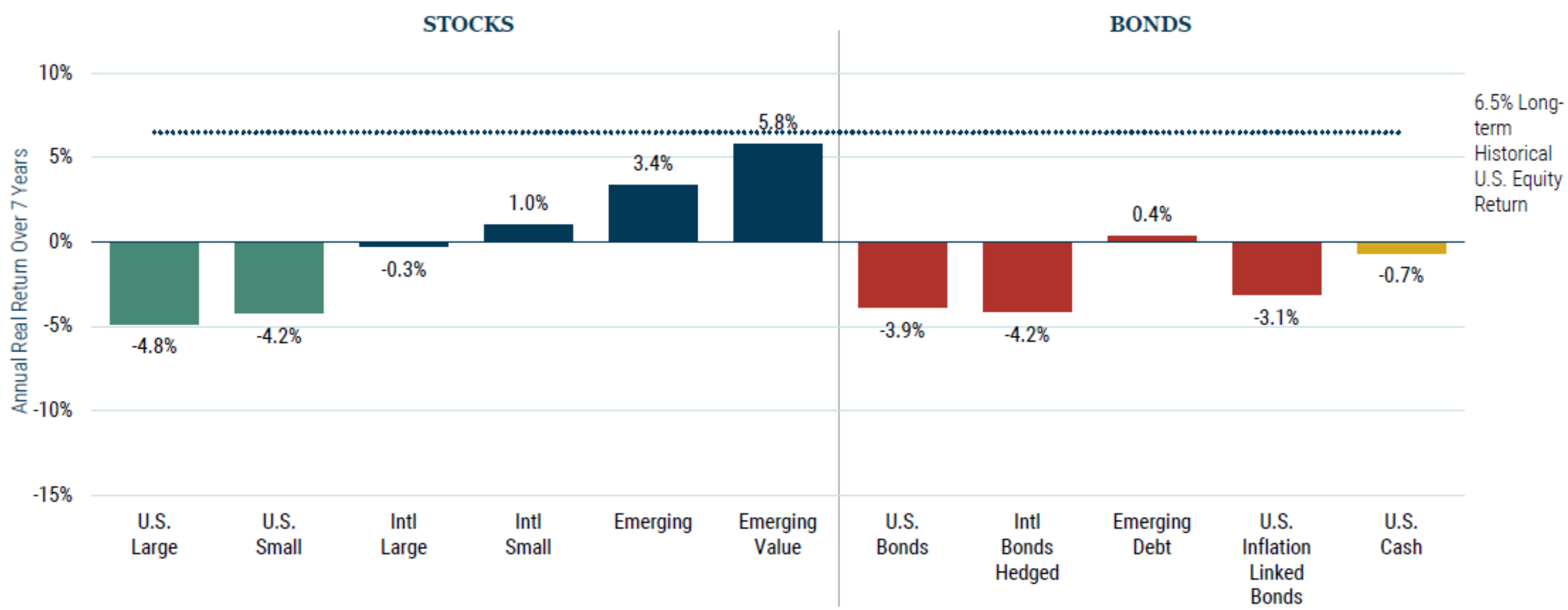
”The odds” are very, very bad.



The projected total return (!) of the S&P500 is -7.06% nominal over the next twelve years.

The correlation of actual returns and projected returns based on valuation is very high (80%+).

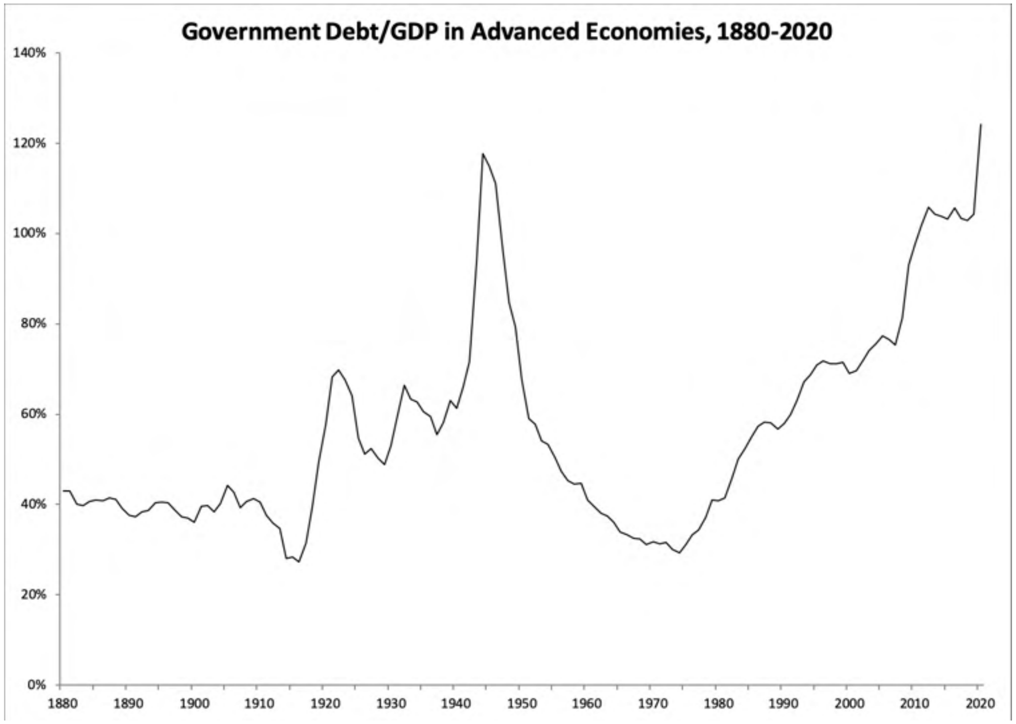
Including bonds and international equities.



Big institutional money manager GMO (gmo.com) finds that most major asset classes have negative projected returns due to high present valuations.

Cash is one of the best options.

The next decade might be the end of the "fiat currency experiment."



High debt loads, legacy commitments, wanton abandonment of all fiscal discipline, and active central bank financing of governments are coming together worldwide.

The euro and yen have already made new lows vs. gold.

Central banks are talking "tough on inflation" now, but will they go back to "easy money" again in the next recession? Markets say yes!

Japan has been the leader in this process.

Thank you

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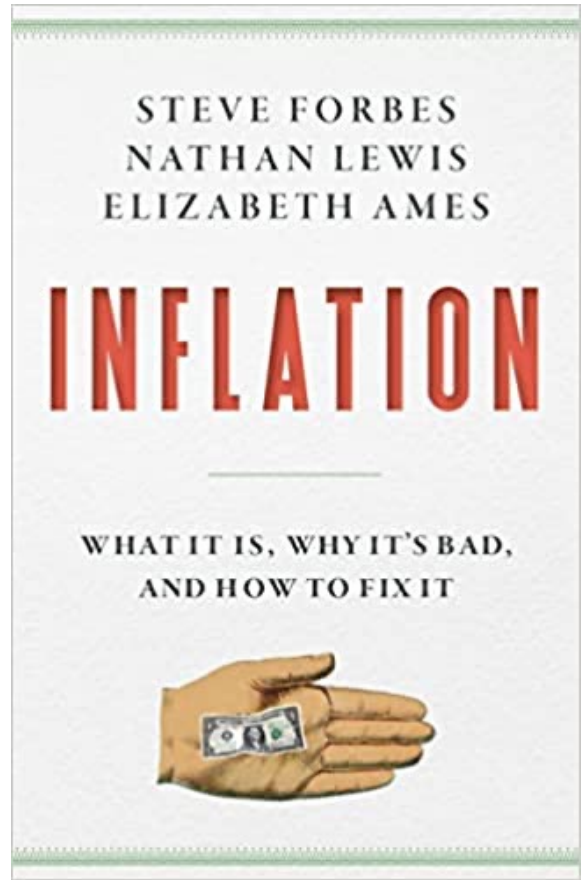

Available April 19, 2022