Myrmikan Research

May 14, 2015

Yellow shoots?

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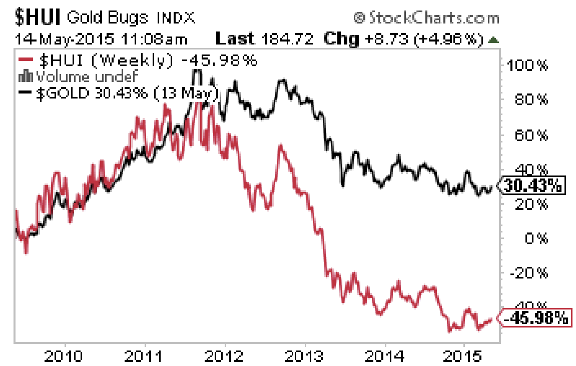
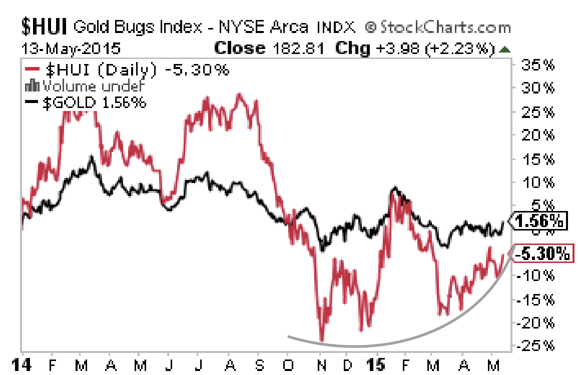
From the inception of Myrmikan Capital through April of 2011, gold mining stocks, in general, precisely tracked the movement of gold itself, as the top chart shows. Then a divergence began in which gold stocks would gain less than gold on rallies and lose more during declines.



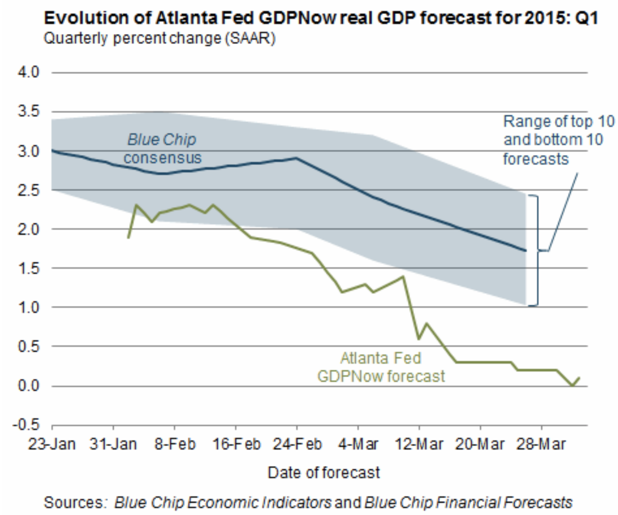
The second chart is the ratio between gold stocks and gold itself, which makes the divergence clearly visible. The trendline reveals that the *rate* of underperformance has now declined to zero, perhaps signalling an inflection point.

The third chart is the same as the first, only plotted from the beginning of 2014. It shows how jumpy gold stocks are right now compared with gold. During the two rally attempts in 2014, gold stocks shot higher, only to crash disproportionately again when gold softened.

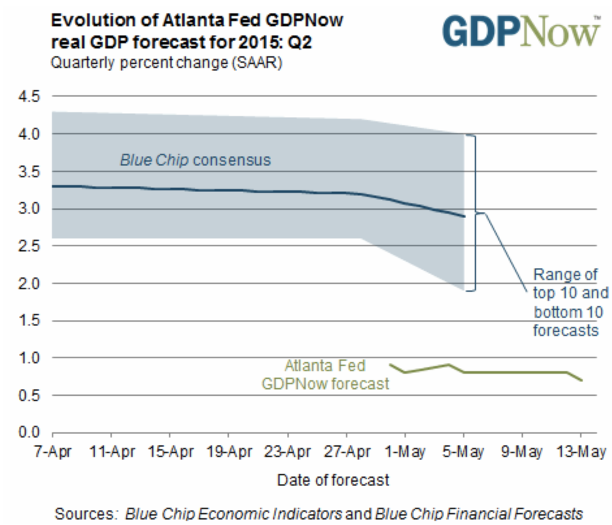


Curiously, gold remains near its cyclical low of $1180—there have only been a handful of trading days in which gold has traded below this—yet gold stocks have been in a visible uptrend since November of 2014.

The charts themselves cannot tell us whether the incipient rally will sustain or crash again like the other recent attempts. But the macro environment remains highly favorable for gold.



Myrmikan recently highlighted the Atlanta Fed's new GDPNow tool which predicted Q1 GDP at 0.1% growth while the Blue Chip consensus was above 1.5% (top chart). The actual number came in at 0.2%.



Fancy Wall Street economists have been applauding the outsourcing of blue-collar jobs for decades—will they be as sanguine about their own replacement by algorithms?

But, channelling Scarlett O'Hara, tomorrow is another quarter. The lower chart shows that the divergence between man and machine is of sufficient magnitude to retest the hypothesis that economists have no clue about the economy.

Economists do understand politics and policy, however, and they are scared. Trade balance numbers announced since the initial Q1 GDP print have made implied Q1 GDP negative. If the Atlanta Fed is right about Q2, the recovery is over, and that is dire. HSBC Chief Economist Stephen King recently explained why:

> If another recession hits, it could be a truly titanic struggle for policymakers. ... Remarkably enough, it's six years since the last recession, suggesting the next one may not be too far away, yet there is a total absence of traditional policy ammunition.

True, but there remains untraditional policy. Janet Yellen has said that she, like Bernanke before her, will not be the Fed Chairman to preside over the unwinding of the banking system and the next great depression.

According to McKinsey, global debt has increased by more than a quarter since 2007, meaning the Fed response to the next crisis will have to be proportionally greater than in 2008. Let us not forget that last time the Fed was able to drop rates first, and their guarantee of $16 trillion of debt and printing a few trillion was only the residual action.

This time, that first step is unavailable: Yellen will move straight to guarantees (contingent printing) and actual printing to prevent the debt pyramid from swallowing the economy, and on a scale that far exceeds 2007. As Paul Krugman wrote: central banks must "credibly promise to be irresponsible." Hey, it worked last time.

The aptly-named Stephen King responds:

> If, however, the benefits of this policy are so blindingly obvious, why has no government or central bank so far fully gone down this "irresponsible" path? The answer is simple. Monetized deficit financing can all too quickly lead to a loss of faith in the integrity of a country's monetary and financial institutions. The risk is a mixture of currency collapse on the foreign exchanges and, eventually, a revulsion towards money that would create a world of hyperinflation.

Hyperinflation! With $2.6 trillion in assets, HSBC is largest bank in the world—let us ignore China Construction Bank Corporation and Industrial & Commercial Bank of China, which purport to have more assets, since the value of most Chinese assets are imaginary—and its chief economist published the word "hyperinflation."

Anyone who understands banking knows that the final decision the Fed will make will be either to let the banks and the markets and the government collapse or else hyperinflate. Yet, it is just surprising to see even a hint of this inevitable future outside of fringe blogs.

The Fed will not willingly hyperinflate. The taper is real. They probably believe they can normalize policy. And how far will they let the system fall before hitting the print button in panic? It is unknowable.

For gold investors, it doesn't matter. The phoney war between inflation and deflation is nearing completion. Gold measures not just the outcome, but the intensity of the struggle. Gold rises in real terms, in terms of purchasing power, whichever side is victorious.

Gold has been on a tear since the beginning of May, for no obvious reason, following the gold mining stocks' lead. Perhaps it is signaling that one of the manifold risks details in these pages over the last few years is about to detonate.