# Myrmikan Research

*April 18, 2018*

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There is great consternation in the gold investing world as gold looks poised to break out and gold stocks remain moribund or even ready to break down. The chart below compares the performance of gold with the GDXJ Junior Miners ETF over the past seven years. It is not just that the GDXJ remains 76% lower compared to gold's 10% loss, but, as the arrows show, since the big bounce in 2016, gold has been trending higher and the gold stocks lower.


This is all the more disconcerting because gold stocks usually lead gold, as the left side of the chart exhibits: gold stocks broke down completely long before the bear market hit gold itself.

There do not seem to be any good explanations as to why gold stocks seem to perceive the future better than gold itself, though the two markets are inhabited by very different animals. Gold stocks, especially junior ones, are in large part owned by Australian and Canadian retail accounts, influenced by hysterical newsletter writers, unscrupulous promoters, venal brokers, and corrupt Canadian banks. The bullion market, on the other hand, is the purview of money center banks and sovereigns. The Director of Market Operations Department of the Banque de France, for example, admitted in 2013:

> We are still active in the gold market for our own account. We have a desk dedicated to FX activity, which is small, but now we are diversifying into gold, meaning that we are in the market nearly on a daily basis.... We do not communicate a lot around that, but central banks are a small community....[1]

1 Courtesy Gold Anti-Trust Action Committee: http://www.gata.org/files/BanqueDeFrance.pdf

It may just be that undercapitalized retail investors are far more sensitive to capital flows than the great banks and central banks and thus react first. Certainly the general pattern since the beginning of this credit cycle in 1980 has been central bank stimulus, nominal increases in gold but underperformance in real terms, central bank tightening, nominal decreases in gold but outperformance in real terms. If this pattern were to hold, then Federal Reserve tightening should squeeze retail holders first, prompting them to sell gold stocks, and hit gold only later.

This pattern may not hold. The reason these pages spend so much time looking at previous credit supercycles is because the dynamics of a collapsing credit bubble are very different than those in operation during the bubble. After the great crash of 1929, for example, Homestake Mining Company (one of the largest gold miners in the world) did indeed fall 22% in the three weeks following the crash, even as the demand for gold itself soared. Despite the fact that investors large and small were being wiped out, however, Homestake tripled by the time the stock market bottomed, and it nearly tripled again after Roosevelt devalued the currency.

The point is that gold stocks do not need capital inflows to make them go higher. Capital can flow the other way, in fact: gold mining margins explode in a true credit collapse, enabling self-funded expansion along with large dividends. Equity prices rise not because buyers increase their bids, but because sellers raise their asking prices.

Canadian and Australian retail investors are under large pressure currently. The real estate bubbles in those two countries are poised to collapse, and the hot money instead of going into junior gold projects has been consumed by crypto scams and marijuana projects, starving the junior gold mining sector of capital, which may account for some of the weakness in share prices. As soon as gold breaks out, however, the cash flow generation of the operating companies will make the industry as a whole self-funding, and there will be a scramble to acquire good development and exploration projects.

As Myrmikan's previous letter explained, Trump's recent tax cuts, combined with enormous spending increases, combined with Fed tightening, combined with a tottering pension fund universe, will likely bring this supercycle to a close in the near future. Recent developments that include the further entrenchment of the war party (which will require corresponding further spending increases) can only accelerate the process, as gold senses. It is certainly possible that, like Homestake, gold stocks will fall when the broader markets crash—and that is a good reason to avoid financial leverage and maintain proper position sizing—but the growth of our credit bubble has been the same as all of the others in history (except for its scale and longevity), and there is no reason to think that its collapse will be any different (except for its scale). Gold and gold mining stocks will remain the safe havens they have always been.

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