

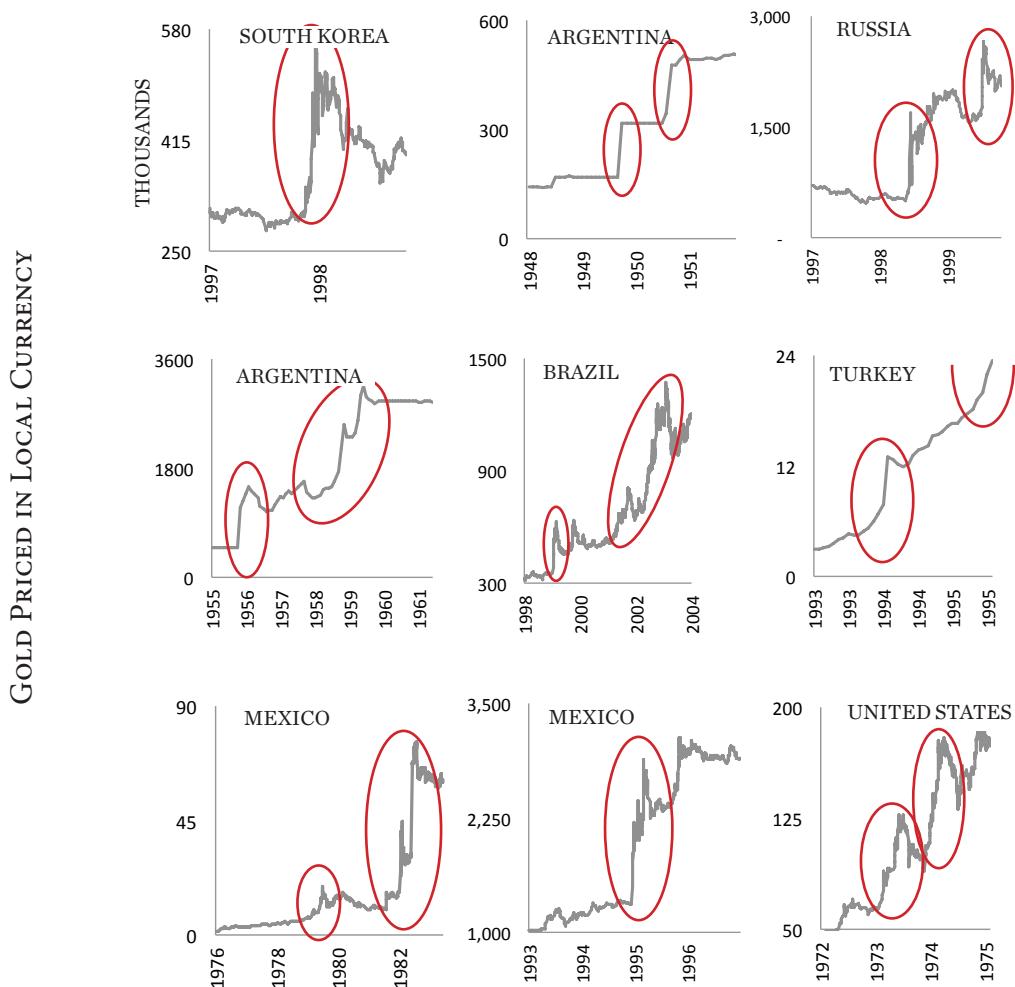
Myrmikan Research

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Just the Beginning

Currencies do not usually fade; they tend to collapse. The country is over-indebted, the citizens, the businesses, the government, all. Everyone takes on debt because they are crafty and anticipate a devaluation or because they must to meet living expenses. But the growing debt creates a growing demand for currency to pay interest. An uneasy equilibrium develops as the central bank tries to print enough to satisfy the interest payments but not so much as to crash the currency. There is a crisis, like 2008 or COVID or war; interest payments stutter; they stare into the deflationary abyss; they devalue suddenly, usually over a weekend.



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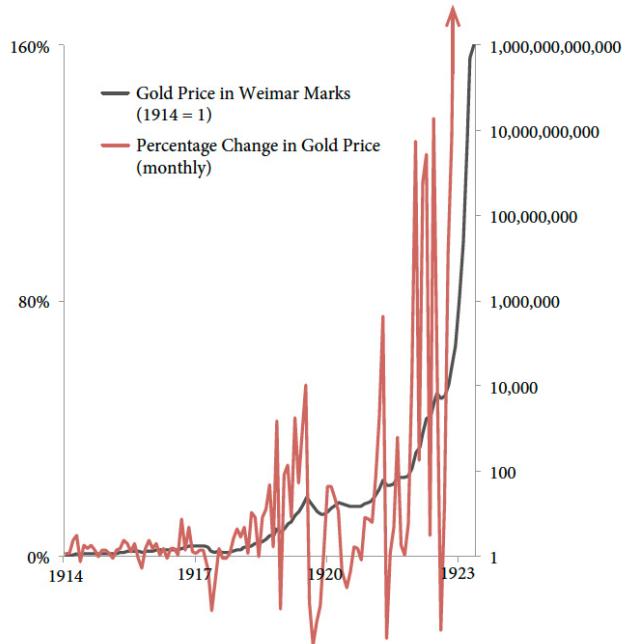
As soon as the currency stabilizes, everyone takes out more debt, anticipating the next devaluation. Save serious reform, the cycle repeats with gathering intensity. The market starts to guess how fast the debasement will be; then it starts to anticipate by how much the debasement will accelerate; then the acceleration of the acceleration, and so on. Once the market is betting on the third or fourth derivative, small deviations in the pace of the underlying issuances have increasingly jarring effects on the present value of the currency.

This is what Myrmikan's most publicized chart depicts: as the destruction of the German mark accelerated, its value as measured by gold became ever more volatile.

The present gold bull market is thus far a different phenomenon than that described above. As we have discussed in previous letters, this bull market began when Biden weaponized the U.S. dollar in February of 2022. No one wanted a panic, but central banks, sovereign wealth funds, international insurance companies, anyone with a balance sheet began to tip toe slowly out of the U.S. Treasury bond complex and other dollar-denominated assets and into gold, the only non-dollar market with sufficient liquidity to absorb very large capital flows.

The initial stages of this bull market were unseen to most. Two weeks after Biden froze Russia's dollar holdings, the Fed began raising rates, which should have sent the gold price lower. It did, at first, and then gold stabilized despite the higher rates. That anomaly was the beginning of the bull. As the more sophisticated players took positions, the nominal price began to reveal the growing demand. From the post-COVID bottom in November of 2022 to the end of January 2026, the price of gold in dollars formed a shapely parabola.

Thus far, however, there have been no large banks teetering, no mass bankruptcies are threatening the shadow banking system, there is no break in the Treasury bond complex, the central bank is not being forced to monetize an increasing percentage of the national debt, there are none of the normal crises that send a currency suddenly lower. They will come.



The US dollar has been the global reserve currency since at least Bretton Woods, arguably since World War I. It retains that position by default. But no one likes it: not the Russians, not China, not the rest of the BRICS, not even the Trump administration (to be more precise, the Trump administration wants the benefits of the dollar reserve status without bearing the costs). This phase of the gold bull represents the world searching for an alternate asset of final settlement to balance international trade, a crisis external to the domestic dollar system.

This international system is what had allowed the U.S. to live beyond its means since the 1960s, to run “a deficit without tears,” as Jacques Rueff complained. International capital flows are what enable U.S. financial institutions to carry insane amounts of debt. An external dollar crisis will translate into an internal crisis as foreign capital avoids the U.S. and funding costs explode. We expect private equity will be the epicenter, and the Fed does not have any tools to clean up the mess. But they will try.

Federal Reserve chairman-designate Kevin Warsh reportedly wants to lower interest rates to help fund Trump’s American reindustrialization and also wants to shrink the Fed’s balance sheet, the expansion of which, he argues, did nothing other than enrich Wall Street. We do not disagree with the latter point, and we think the former is a noble purpose; but we do not see how Warsh can achieve his dual goals.

Historically, the size of the Fed’s balance sheet was a function of its interest rate policy: banks traded reserves among themselves at an interest rate that was determined by bank reserve scarcity, called the federal funds rate, and then lent out money to the broader economy at a spread to that rate. If the Fed wanted rates lower, it bought bonds to add reserves to the banking system, which would lower the federal funds rate, and competition among banks would lower rates generally; the Fed’s balance sheet expanded as a by-product. It hiked rates by selling bonds, thereby shrinking its balance sheet.

When the 2008 financial crisis threatened the banks’ solvency and broke the relationship between the rate at which banks borrowed and the rates at which they lent, Bernanke bought bonds *en masse* to jam bond prices higher and lower rates throughout the economy, as opposed to relying on banks to be intermediaries. A side effect of QE was to flood the banks with reserves: bank reserves jumped from \$45 billion in January 2008 to \$1.2 trillion by February 2010, to \$2.8 trillion in 2014, to \$4.1 trillion in 2021.

Given that reserves were no longer scarce, the Fed had to come up with a new way to control interest rates: they decided to begin paying interest on bank reserves. The idea was that a bank would never lend to another institution at a rate less than what it could earn risk-free at the Fed, so, by paying interest, the Fed could put a floor under rates—it could raise rates without making reserves scarce (the reverse repo facility soaked up money from non-bank institutions). In theory, rates could also never go above the Interest on Bank Reserves (IORB) rate because, to the extent it did, banks would withdraw their excess funds from the Fed and lend them into the financial system until market interest rates returned to the IORB rate.

This system worked more or less for the past decade. Because the size of the Fed’s balance sheet was separated from the mechanism by which the Fed manipulates rates, it appears conceptually possible for Warsh to achieve his seemingly inconsistent policy goals of lowering rates and the size of the Fed’s balance sheet at the same time.

There are two problems. First, using IORB to create a floor on interest rates requires the Fed to print money to pay the banks. The assets the Fed purchased to implement QE at least purported to have value; the governors could at least pretend that the value of their assets continued to match that of their liabilities, that they were only adding liquidity. IORB is different in that it creates immediate losses, since the rate the Fed is paying out is far higher than the interest it receives on the bonds it holds, mostly bought during COVID. The Fed has reported \$245 billion in operating losses since 2022, money that it transferred to the banks. The whole mechanism requires accelerating money printing and deeper losses at the central bank that issues the nation's currency.

The problem with using IORB as a ceiling is, first, the mechanism to keep rates low involves funds leaving the sterilized confines of the Fed and entering into the banking system, where the fractional reserve mechanism can multiply it, and, second, the mechanism assumes that the banks have excess reserves to lend into the market to keep market rates tied to IORB. Reserves still stand at \$3 trillion, which seems like a lot compared with pre-2008 levels. But, first, regulations now require banks to keep much more cash on hand than before the 2008 crisis and, second, reserves are not evenly distributed: the money center banks hold the lion's share. Even the Fed does not know what the level of reserves are necessary to keep the banking system functioning, but they can back into whether reserves are scarce by looking at repo market prices and the spread between the IORB rate (the rate the Fed pays) and the SOFR rate (the wholesale rate the market charges). If the market is functioning well, the spread between IORB and SOFR should be tight and stable.

These rates began signaling reserve scarcity last autumn—this is why the Fed announced on December 10, 2025: “The Committee judges that reserve balances have declined to ample levels and will initiate purchases of shorter-term Treasury securities as needed to maintain an ample supply of reserves on an ongoing basis.” “Declined to ample levels” is bureaucrat-speak for “only just ample,” or “just above distress.” From the New York Fed that same day “The Desk plans to release the first schedule on December 11, 2025, with a total amount of RMPs of approximately \$40 billion in Treasury bills; purchases will start on December 12, 2025.” RMPs stands for “reserve management purchases”—just don’t call it QE.

So the Fed just restarted QE two months ago to keep the banking system liquid. And now Warsh is going to stop it? And make the Fed’s balance sheet smaller? Does he know that \$10 trillion in Treasury bonds mature over the next twelve months?

But none of this will matter. Powell was famously against QE when he was a Fed governor in 2012: “First, the question, why stop at \$4 trillion? The market in most cases will cheer us for doing more. It will never be enough for the market. Our models will always tell us that we are helping the economy.... Meanwhile, we look like we are blowing a fixed-income duration bubble right across the credit spectrum that will result in big losses when rates come up down the road.” But then the market stuttered in 2019 and he began printing, and then he went crazy when COVID came.

Warsh supported QE but was so against QE II that he resigned his post as Fed governor in protest. But, like Powell, when the existential crisis lands on his shoulders, when the private equity and private debt markets blow up, he will print. Whatever Warsh’s stated intentions, he will have no choice but to renew the expansion of the Fed’s balance sheet at an accelerating rate.

The difference, however, is that during previous episodes, the QE money was dispersed throughout the globe, sparing the U.S. the full brunt of the inflationary effects. If gold is replacing the USD as the international settlement asset, which seems to be ongoing, then the new QE money will mostly stay right here in the U.S. As inflation kicks up again, and bond investors begin demanding a yield premium to protect against inflation, the Fed will find it has to buy ever more bonds to affect interest rates.

This will be the second phase of the gold bull market, a move that has not yet begun, the move to reflect the market realization that the Fed is powerless to save private equity or control interest rates without buying the entire bond market.

The third phase will be when the higher rates create a government bond death spiral: the higher the interest rates rise, the larger the interest payments go, the worse the deficits, the greater the supply of treasuries, and the higher rates will rise. This is the rapidly intensifying government crisis: either the government defaults or it orders the central bank to buy any and all Treasuries, destroying the currency. This has always been the end game. *There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.*

We do not know how high gold should trade in this current, initial phase of the bull market. We can deduce from the price action on January 29 and since that the laminar phase is over, and the market is now entering something more turbulent. We point out that chaos is not credit-friendly, and gold is ultimately a bet against credit.

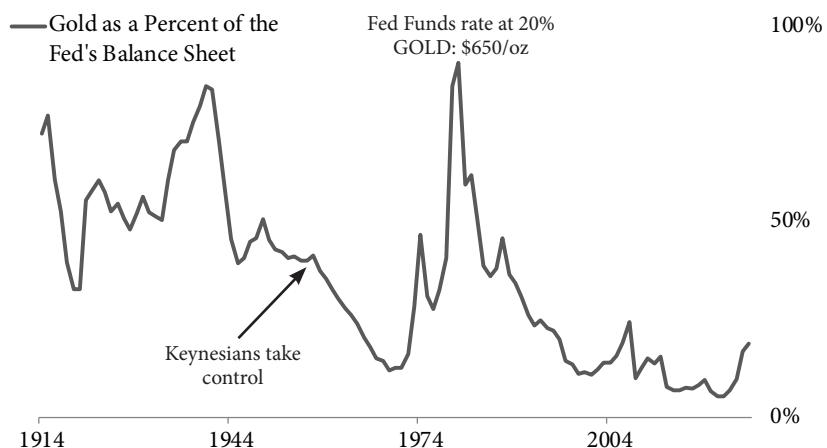
The turbulence is disrupting the plumbing of the trading system. Metal traders and smelters, for example, hold large amount of physical gold as well as contracts for future delivery. They sell short in the paper markets to balance their exposure. Increasing prices and, now, increasing volatility have nervous banks cutting credit lines and issuing margin calls: even though the traders and smelters have no underlying business exposure to the metal prices, they must post collateral or curtail their operations, which creates a bottleneck for new supply of metal to reach the market.

We are agnostic on the question as to whether phase one will roll right into phase two, or if there will be a jarring market break first: we are confident that the U.S. financial system cannot continue to function as currently designed, and we do have a decent idea as to where the gold price should be in the second phase.

Gold is free market money and, therefore, its end goal is to balance balance sheets. We do not subscribe to the claim that the Fed's balance sheet should be 100% gold, which would currently imply a price of \$25,190/oz. Historically, the market forced central banks to maintain gold reserves of between a third and a half, which would currently imply a price of between \$8,395/oz and \$12,595/oz.

However, as discussed in previous letters, historically central banks held commercial bills with durations less than 90 days and short-term government bonds of solvent countries. We don't claim that U.S. Treasuries are worthless, but they are certainly worth less than where the Fed-manipulated market prices them, and

the longer-term bonds that the Fed owns are severely impaired, meaning that in a cleansing, gold as a percentage of the balance sheet must trade a lot higher than a third. As the chart shows, a panic can take gold up toward 100%, at least briefly.



Plus there is also the stark reality that the Fed's balance sheet will grow, not shrink as Warsh intends. This will push the cleansing price of gold higher. Finally, the numbers presented above are best-case for the dollar because the Fed does not actually own the gold, the Treasury does. As discussed in Myrmikan's February 11, 2025 letter, the government could use this power for good, by abolishing the Fed and reissuing gold-backed treasury notes, or for ill, by demanding a revaluation of the Treasury's gold and spending the dollars created thereby into the economy. Most likely in a panic they will choose the latter first and the former in the end.

We are not traders. We have little ability to forecast what the price of gold will be next week or even next year. What we are confident about is that the macro forces propelling the gold price higher are still very much in place, and over time the gold price will trade significantly higher with increasing volatility.

We are also confident that mining companies retain good value: even though share prices have increased dramatically, the development companies we follow have seen their market caps-to-NPV ratios *decline*, from 0.2x when gold was trading at \$1,800/oz to 0.17x assuming gold at \$4,000/oz.

This unexpected result mirrors what we see in the gold mining ETFs. The way ETFs work, in theory, is that if someone buys shares, he either are buying from another holder that is selling, or, if the price strays above NAV because there are no sellers at that price, the ETF will issue new shares, sell them into the market, take the capital generated from the sale, and buy the underlying securities. Conversely, a sell order is filled either by a corresponding buy order or by the ETF itself, which must then sell underlying positions to fund the repurchase of the shares being sold. Therefore, the change in the number of shares outstanding reveals whether net capital is flowing into the ETF or out of it (which is distinct from whether the NAV is increasing or decreasing due to changes in the prices of the underlying securities).

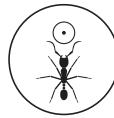
From the beginning of 2024 to 2026, the number of shares outstanding for the GDXJ ETF has fallen by roughly a third. GDX ETF shares outstanding have declined by about the same proportion. In other words, even as gold mining shares have soared

in price, gold mining instruments have seen net capital outflows. This lack of interest suggests we are at the very beginning of the bull market.

Looking forward, as the gold price moves ever further away from the production cost per ounce, the marginal gold move has less effect on NPV. To illustrate, if a gold mine has a cost of \$1,900/oz, and the gold price moves from \$2,000/oz to \$3,000/oz, a 50% increase, the profit margin would increase 11x, from \$100 to \$1,100. If the gold price moves another \$1,000, margin increases by only 91%. Even if it moves by another 50% to \$4,500, margin increases by only 3x, not 11x.

With the gold price now so far above the cost of production, we expect the next wave of returns to come from multiple expansion. M&A over the past few years for development companies has been at levels around 0.4x NPV. Most juniors trade well below that level at current prices, often substantially lower. Not only do we expect company valuations to converge the higher the gold price goes, we also expect that M&A multiples will also increase: we could see the average multiple going to 1x in a mania. Combing multiple expansion with NPV leverage to gold prices suggests that gold mining stock can have explosive returns from here, despite doubling or tripling or more over the past two years.

We think the bull market in gold mining stocks remains young. The forces identified in this letter should drive gold much higher. The metal is still massively underowned by professionals and domestic institutions. The miners will continue to get a boost from the rising gold price, but the real fireworks will begin when the market starts repricing multiples. The senior miners will do well as capital panics into the space. The juniors should do better as their projects become too compelling to ignore. For the first time since starting Myrmikan sixteen years ago, we've seen juniors turning down financing deals. Anyone who wants to play will have to pay up.



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