Myrmikan Research

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Realpolitik

The long-awaited correction in the gold market arrived in March on the heels of unrest in the Middle East. Gold plunged 24.4% over three weeks, from a high of $5,420 on March 2 to a low of $4,099 on March 23. Standard explanations include: 1) the dollar rallied as a safe haven, 2) the dollar rallied because oil is priced in dollars, so demand for dollars spiked along with oil prices, 3) surging energy prices will boost inflation, which will cause the Fed to tighten (or, at least not to cut) short rates, 4) long rates are rising, making the dollar more attractive, 5) Arab states have a propensity to keep their savings in gold, so the loss of oil revenue cuts gold demand, 6) over-levered Arabs have to sell gold for liquidity reasons, 7) Iran, which has been using gold transfers for several years to avoid sanctions, is tapping gold for liquidity, 8) Japan imports most of its energy from the Middle East—soaring energy prices will stoke Japanese inflation, which will force its interest rates higher, which will end the carry trade, destroying global liquidity, 9) investment funds and speculators concerned about any one of these theses are front-running the decline in gold prices, 10) the declining price triggered stop loss selling especially for momentum speculators operating on margin.

That these factors, or some of them, or the perception of them, is influencing the gold price is clear from the fact that every major news item promising escalation of hostilities is met with plunging gold prices and vice-versa, exactly the opposite of what fundamentals would suggest. We observe that all ten factors listed above describe liquidity conditions; none address gold's value as measured by U.S. dollars, value which the war has undoubtedly increased.

Social conflict within America has intensified since our February letter, and the two incompatible narratives persist. The establishment continues to view the Iranian adventure as already successful in terms of realpolitik. Even if the U.S. is unable to achieve regime change, the military campaign has weakened Iran's leadership and military capacity. The closure of Hormuz affects America's main adversary most of all, while rising energy prices benefits American producers, especially since Ukraine has stepped up its drone attacks on Russian energy infrastructure. South Korea, Japan, and Europe are weakened, which also serves American interests in that they become more politically and economically subservient.

A different administration might conceal these strategic imperatives within flowery rhetoric: "making the world safe for democracy." Not Trump. In his recent speech he told allies directly: "So to those countries that can't get fuel, many of which refuse to get involved in the decapitation of Iran—we had to do it ourselves—I have a suggestion. No. 1, buy oil from the United States of America. We have plenty. We have so much. And No. 2, build up some delayed courage. Should have done it before. Should have done it with us as we asked. Go to the Strait and just take it, protect it, use it for yourselves."

The U.S. was always acting in its best interests, it's just that previously it had the capacity to subsidize the rest of the world to combat communism or prop up powers, no matter how unsavory, that opposed competitors to American power. Now the U.S. is limiting its scope of action to protect only its own interests while taking direct shots at its enemies' supply lines. If the rest of the world wants Iranian oil, the rest of the world can pay to get it.

On one hand, Trump is correct that: "when this conflict is over, the strait will open up naturally. It'll just open up naturally. They're going to want to be able to sell oil because that's all they have to try and rebuild. It will resume the flowing and the gas prices will rapidly come back down."

Except that, on the other hand, under this new, America-only paradigm, it really is not in America's interest to have Iranian oil flowing at all—which is why, "if there is no deal, we are going to hit each and every one of their electric generating plants very hard and probably simultaneously. We have not hit their oil, even though that's the easiest target of all, because it would not give them even a small chance of survival or rebuilding. But we could hit it, and it would be gone."

Gone as well would be the insane Green policies of Europe, Japanese reticence to restart nuclear power plants, and China's ambitions on Taiwan, three effects that are beneficial for the West. Trump could then impose export controls on U.S. energy, further splitting the world into friend and foe, with one price of energy for those inside the U.S. imperial system and a higher price for those within the competing Chinese Belt and Road Initiative. Imperial preference is, in fact, the normal state of affairs—it is the global free market of recent decades that is the anomaly. And as the world breaks into competing spheres of trade, the need for gold as a neutral reserve asset can only grow.

Trump is a gangster, and his style is purposefully abrasive—but to accuse him of insanity ripe for 25th Amendment removal is as misguided as imagining that the Russian invasion of Ukraine was an idiosyncrasy of Putin, as opposed to an expression of long-held Russian national interest. We do not argue that Trump's strategy is in the best interest of the U.S. or the world; it hardly seems moral, but to call it crazy forecloses a sober conversation as to the relative merits of a republican versus an imperial form of government.

One the other side of the domestic dispute, populist anger has strengthened. In our October 2024 letter we ourselves explicitly endorsed Trump on the basis that he was only the second president since Herbert Hoover not to initiate military interventions abroad. Many MAGA voters view the Iranian conflict as a direct betrayal, not to mention as unconstitutional (only Congress has the authority to declare war).

In a March 30 interview, Secretary of State Rubio told *Al Jazeera*: "Imagine an Iranian regime who, instead of spending billions of dollars supporting terrorists groups and building up all of these weapons, had invested that money into Iran, for the people of Iran. . . .”—imagine that Trump had fulfilled his campaign promises to put America first, respond the MAGA influencers.

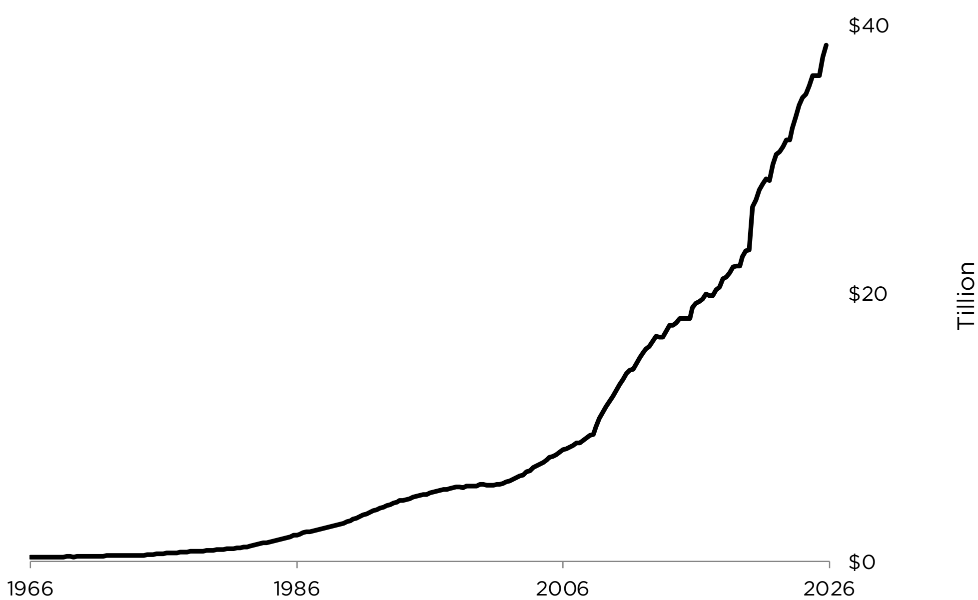
American aircraft carriers have been shown to be obsolete; stealth technology has been compromised by cheap, passive infrared systems; the U.S. will deploy ground troops into a morass involving devastating causalities; inevitable failure will leave Iran in direct control of Hormuz; Iran will allow shipments destined only for America’s enemies; by accepting only Chinese yuan in payment, Iran is ending the petrodollar scheme that has supported the U.S. dollar since 1973; regional powers will have no choice but to shift their alliances toward an Iran-China-Russia axis, turning Hormuz into America’s Suez; Trump is America’s Gorbachev, thrashing out militarily in a desperate attempt to delay the collapse of an economy corrupted over decades of mismanagement; the terms of the tenuous truce demonstrates complete failure, continues the dissident narrative.

In our role as gold investors, we need not commit to one of these opposing positions. If the dissidents are correct, the dollar will fall as the pound did following the demise of the British Empire—and, like Britain, the Left will sweep into power and destroy whatever remains of the economy and the currency and the culture. It will be worse, in fact, because Britain’s demise was driven by ideology, which could be corrected, not by imported, balkanized ethnic groups that compete for resources, often violently.

If the establishment strategy prevails, America will restore its imperial dominance, the costs of empire will fall more explicitly on client states, and the gains of energy dominance will reinvigorate industrial development. These trends can support the dollar, though even they would serve merely to slow its demise. We need observe only two charts to see why.

The first shows the galloping increase in federal debt (note the inflection in 2008).

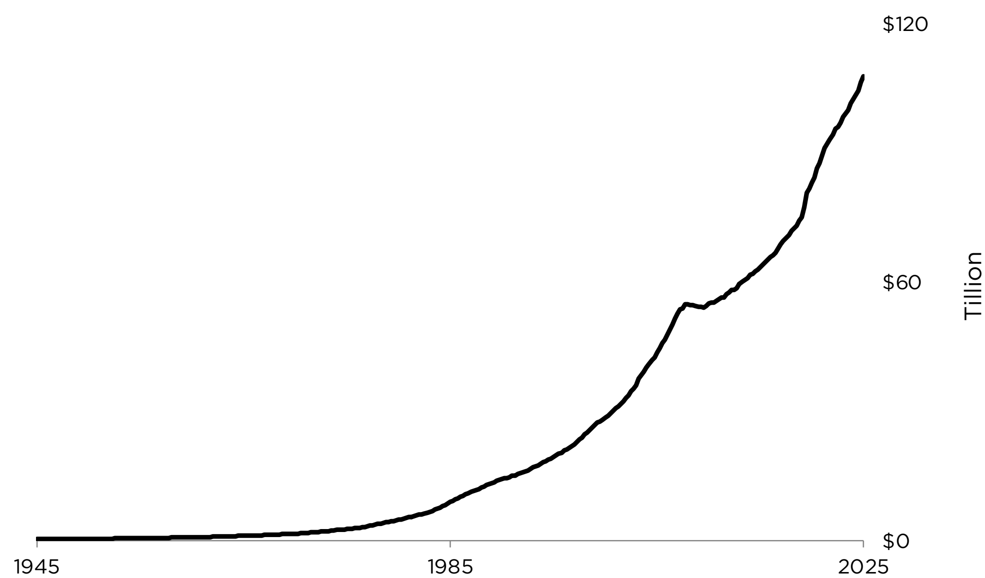
TOTAL PUBLIC DEBT



War is expensive, but even more so are all of the metastasizing social programs, especially when abused by certain Democrat-run states for the benefit of favored ethnic groups. Trump's efforts to stamp out corruption, through DOGE and deporting notorious immigrant operators, have failed. The people as income beneficiaries are always more powerful than the same people as concerned citizens. Some oilmen getting rich and building out infrastructure cannot reverse catastrophic deficits.

This second chart demonstrates that the government is not the only one feeding at the debt trough.

DEBT SECURITIES AND LOANS, ALL SECTORS



The causes of this vertical movement in debt levels are many: governments, including state and local, to live beyond their means; institutions, like schools, to fund competitive infrastructure; consumers, unable to meet living expenses; home buyers, who cannot afford a place to raise their families without submitting to a crushing mortgage; companies, to fund expansion at ever rising prices; the private equity industry, which buys companies using the target company's own assets to collateralize the enormous amounts of debt necessary to fund the acquisition. All of these groups have within them speculators who maximize debt in assured reliance of the accelerating devaluation of the dollar against real assets.

At this point the causes are less important than the effects of that debt liquidating, be it slowly or suddenly. Suddenly would be better, as the country could restart with a clean slate, assets moving from the reckless and profligate to the prudent and frugal. A slow liquidation would cause a long depression, as businesses and consumers are slowly starved of credit.

The Federal Reserve was founded to prevent any such liquidations. And even if Trump's strategic vision prevails, spiking energy prices must impact the economy severely for months, even years, even if the conflict ends tomorrow, and at a time when debt-ladened companies are already straining to survive, when private credit firms are gating their investors as panicky redemption orders flood in.

Apollo is the latest to tell investors they can't have their money, after receiving withdrawal requests equal to 11.2% of its $15 billion private credit fund. Ares, Blue Owl, BlackRock, and Morgan Stanley have all told investors who want their money back to wait in line.

To paraphrase George Bailey: You're thinking of this place all wrong. As if I had the money back in the safe. The money's not here. Your money is in a dermatology roll-up, where they've slashed costs by replacing physicians with nurse practitioners. And your money's in a dentist roll-up, where they're pushing unnecessary procedures such as baby root canals to drive up revenue. And your money is in HVAC and mobile home park roll-ups, where they took out all of the local competition and jacked up prices. Why, you're lending them the money to loot consumers before the economy collapses, and then, they're going to pay you back as best they can, but only if the Fed does QE and lowers rates—and then you won't even want your money back.

The Fed will have to lower rates to bailout the snowballing private credit disaster right as energy is already leading to a significant jump in wholesale prices, and this even assuming success in Iran—strategic failure in Iran may mean having all of the dollars housed abroad being dumped suddenly into the domestic market.

The March correction in the gold price conspired with the surge in energy prices to send gold mining shares tumbling: the HUI Gold Miners Index plunged 20%. We observed little dispersion among stocks in this drawdown, suggesting general liquidity conditions rather than investors assessing geopolitical impacts on individual projects. We suspect, however, that the market will begin to focus on such distinctions.

Australia, for example, holds diesel reserves of thirty days and is already reporting localized shortages. Australian gold mines are typically open-pit, with a high relative input of diesel, making those producers particularly exposed not just to cost increases but to risk of shut down.

Africa has a diversity of reliance on imported fuel—some jurisdictions, such as Malawi and Nigeria, have seen sharp increases in fuel prices, whereas prices in countries such as Ghana and Côte d'Ivoire have been more stable.

The Western hemisphere is awash in oil. Canada, the U.S., and Mexico all have large, developed oil reserves, and Central and South America export 1.34 billion barrels of oil compared to imports of only 230 million barrels.[1]

While it hasn't yet, we suspect that if the conflict continues, the market will begin to discriminate against miners that have projects in energy and security-deprived jurisdictions. Barrick Mining, for example, has been developing a huge copper-gold project in Pakistan, relying on an end-of-history thesis that security concerns are secondary, an odd position for a gold mining company to adopt. On April 2, the company announced "it was reviewing all aspects of the project in light of the escalation of security risks and increased security incidents." There will be more such announcements in other jurisdictions.

We expect that the global energy shortage will not be permanent. North America in particular is expanding capacity aggressively. For example, the EIA estimates that American natural gas production will grow from 103 billion cubic feet per day in 2024 to 112.6 billion by 2027. The EIA forecasts that domestic consumption will increase

1 https://www.iea.org/regions/central-south-america/oil

only 2.5 Bcf/d , the balance to be exported. Canada is currently developing 6.5 Bcf/d of export capacity and has the ability to increase capacity further. U.S. shale has become the global swing producer, the U.S. now controls the heavy oil in Venezuela, and the Canadian oil sands offer unlimited oil at the right price, putting a hard ceiling on long-term oil prices.

The Trump administration is also fast tracking the development of small modular nuclear reactors, as is China. While large-scale deployment remains years away, the prospect of a vast new source of energy entices those with hydrocarbon reserves to develop them more quickly while energy scarcity remains acute.

In short, we expect either that there will be a resolution of the conflict, and energy prices will resume their gradual decline (in real terms), helping miners globally, or that the world will fracture into competing spheres with energy prices lowest in the Western hemisphere. If the latter happens, the transition will be messy and prices will be volatile as infrastructure needs to be retooled to accommodate new trade flows. When the dust settles, lower energy prices will be good for Western primary manufacturers, though the consumer will be hit with massive inflation as currently-cheap foreign products either become much more expensive or are choked off completely.

The Fed needs to start printing no matter what happens in Iran to bail out the private credit players and the banks that funded them. If the global economy fractures and inflation hits hard, the Fed will have no choice but to cut rates and print money to support the banks regardless of the inflation that will result. Gold will sniff it out first.