GOLD OUTLOOK 2023

MonetaryMetals®

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Gold Outlook Report 2023

Introduction

Welcome to the Seventh Annual Monetary Metals Gold Outlook Report. It's our tradition every year to survey the macroeconomic landscape and make our calls for the metals, and markets, in the coming year.

2023 begins with global markets on precarious footing. Last year the Federal Reserve raised interest rates faster, and higher, than at any point in recent history. And they aren't done yet. How much longer can they keep it up before markets start to buckle under the strain? What other major movements should investors be looking for in 2023? And how will the monetary metals fare? We tackle these questions and more in this year's report, but first, a review of our 2022 price calls.

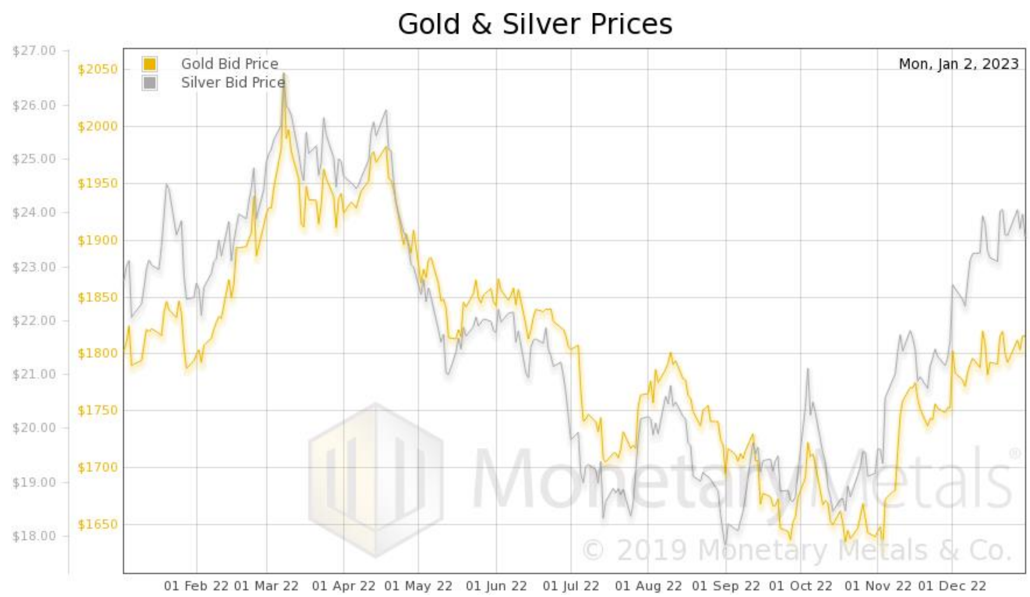
A Review of Our 2022 Call

Last year, we said that the markets are at a crossroads, waiting for a political (hence unpredictable) decision: whether the Fed will hike rates as they had been promising, or not. Well, they hiked. We said that in the hike scenario:

> "If asset prices go over the cliff as in 2008, then the price of gold will go down less. And stay down for a briefer moment."

Well, asset prices dropped if not necessarily fell off a cliff yet. And they have yet more to drop, especially likely in residential real estate. And what did gold do?

Its price went from $1,803 to $1,816. That is, it essentially did not change. At least by the end. It first rose to well over $2,000 before beginning a long drop to just over $1,600. And finally, a sharp rise back to even.



The price of gold, in dollars, is merely the mirror of the reality which is that the dollar has a value in gold (and when that value goes to zero, the dollar is done, like a steak kept under the broiler for three hours).

In other words, the dollar gyrated around wildly but held its value (because there are so many debtors, who owe so many dollars, desperately bidding on dollars to service their debts). The other currencies fared more poorly.

Anyways, back to our prediction a year ago. The price of gold held. Gold is largely unloved by the mainstream, and even much of the alternative-assets community. And last year was full of desperate scrambling for dollar liquidity. Yet something extraordinary happened.

The **selling** of gold by people desperate for cash to avoid defaulting when liquidity is declining was **matched** by the **buying** of people seeking a refuge from declining credit quality.

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We did not have the epic bull run that many in the gold community predicted. Nor a crash. We had some volatility, but the gold price held in the end.

Regarding silver, we said:

> "If the crisis metastasizes, there could be a big drop in the silver price. And a big rise in the gold-silver ratio. 120 is not out of the question."

Well, the crisis did not metastasize. So far, at least, the Fed has managed a so-called "soft landing", causing bond prices to drop and hence prices of other assets without a 2008-style crisis.

And the price of silver not only held up, but rose about a dollar an ounce.

We also said two interesting and controversial things. First, many people view gold as a hedge for *inflation*—rising consumer prices.

> "it is not necessarily true that the dollar price of gold keeps up with consumer prices."

As we have written (here, here, and here) there are many nonmonetary forces that push prices up. To name a few: regulations, lockdown and whiplash, green energy restrictions, trade war and tariffs, and Ukraine war. These do not necessarily affect gold.

And there is an empirical demonstration of this. As of the time of this writing, the Consumer Price Index for December is not out, but as of November, prices are up over 7% (we assume December won't change this much). If the gold price had moved up 7%, it would be about $1,930 at year's end.

Our second comment was:

> "There is not a direct correlation between the interest rate and the price of gold."

This is a link to a previous Outlook Report, showing the fact that the price of gold rose with the interest rate through 1980, then sagged during the falling rates of 1980's and 1990's, then skyrocketed during the falling interest rates of the 2000s, then fell with the falling rates of the 2010's.

Some gold permabulls want to convince you that rising rates are good for gold, and of course permabears portray it as bad for gold. And they're both wrong. There is little correlation over the long term.

And yes, we also looked at so-called *real* interest rates. Ironically, the actual rate at which actual lenders actually lend to actual borrowers is airily dismissed as the *nominal* rate. And a theoretical calculated rate—based on a consumer price index that even proponents dispute--is called the *real* rate. Economics is one helluva science! In what other field would such methodology be used? Anyways, so-called *real* rates don't correlate with the gold price either.

Macroeconomic Conditions for 2023

The Economic Outlook

Last year, we started our economic assessment with this gem:

> "One of the fundamental fallacies of socialism is that it does not admit **production is conditional**. In order for you to be able to buy goods, or get paid to do a job, many things have to occur first. An inventor needs to invent the product. An entrepreneur needs to organize a business. Then the business has to raise capital from investors, and later, lenders. It has to hire people (perhaps you). It has to produce the goods. Then distribute them. And finally, sell the goods to you."

How is an entrepreneur supposed to organize and plan a business—much less raise capital—when the central planner of credit, AKA the central bank, is busily trying to distort the value of the monetary unit? Much less when it is busily jacking up the costs of doing business, by hiking the cost of capital?

Well, the answer is often that he can't. Now we are seeing many startups laying off employees whom they had recently hired. Some are shutting their doors forever. Their cost of capital has skyrocketed—if they can raise any at all. Even large, established companies like Macy's recently announced store closures. They may be able to raise capital, or they may have cash on the balance sheet (Macy's had over $7B as of October). But why put it into a low-return business such as the marginal retail store when they could put it into T-Bills at nearly 5% with no risk and no headaches?

> ***Goods become scarcer, and society is generally impoverished.***

In 2022, it was not just central banks whose politicized decisions obliterated economic planning. For many years, Europe has been banning the use of energy sources that work, such as oil, coal, and nuclear. Instead, they have been pursuing energy sources that are unreliable such as wind and solar (solar is particularly questionable for extreme latitudes (Berlin is 52 degrees N Latitude).

Europe has fallen, by default, into dependency on natural gas. And due to geopolitics, that natural gas came from Russia. Which they now cannot buy. Thus, the price of energy skyrocketed. And the prices of all things made from energy (if energy is even rationed to those manufacturers at all—a whole 'nother politicized decision-making process, by other central planners).

When you look at it this way, you can see why such price moves do not apply an upward force on the price of gold. The root is nonmonetary. It is a bunch of regulators spoking the wheels of those who would produce. Goods become scarcer, and society is generally impoverished.

The more government intrudes, and especially the more it does so unpredictably (or the consequences are unpredictable, or the lag of those consequences is unpredictable), the more difficult entrepreneurial planning becomes. And it can become impossible, where firms just throw their arms in the air and their spare capital (if they are so lucky to have any) into T-Bills.

The Fed is now ten months into a rate-hiking purge, which follows a zero-interest rate binge lasting well over a decade. It, along with its apologists and its critics alike, think that the result will be lower prices, because reduced quantity of *money*.

Does it work this way? Maybe, in the short term, there will be lower prices.

What was Macy's doing prior to closing its stores? Cutting prices, cutting hours of employees, cutting expenses. Its bid on everything from electricity to enterprise software was softened. Its employees, faced with reduced net pay, cut back on their purchases of clothing, cars, and cheese (well, probably not that last item).

Meanwhile, investors in the company suffer losses as the stock drops (so far, it's not down that much). Due to the reverse of the so-called "wealth effect", investors spend less on clothes, cars, and Cristal.

This affects the prices of those goods which were already produced. And those produced by capital assets which are already in place.

However, the economy is not a static snapshot. It is a dynamic system. Every day, economic actors make decisions based on the incentives offered to them by the market (or the central planners). Prices may soften in the short term. But then, something else happens.

Back to Macy's, what will happen as a result of their store closures (especially if other retailers are facing the same considerations and do the same thing)?

Obviously, the supply of goods offered at retail will be reduced. Less retail supply will mean higher prices for retail goods. Will there be less demand from the former workers who were laid off? Perhaps (though we have a vast and generous welfare state, so perhaps not that much less). More importantly, there are far more retail shoppers than laid-off retail workers. Therefore, supply is reduced much more than demand.

The Economic Consequences of Interest Rates

Rising rates causes higher consumer prices by two mechanisms. One, is that no entrepreneur will raise capital for a business that generates a lower return on capital, than the cost of that capital plus a spread. In other words, you cannot borrow at 10% to build a hamburger business that generates 5%.

The other, as hinted above, is that if a business (or anyone else) has capital, they can always put it into T-Bills. They will only choose to invest it in a business if that business generates a higher return.

When the Fed hikes rates, then the rate of profit inevitably must rise. It is easy to imagine that businesses can all just hike their prices, as the simple solution. But if they could do that, they would already have done it. No, it's more indirect than that.

> ***Hiking rates to fix inflation is monetary quackery, like the Medieval practice of bloodletting to help patients heal. The more blood they took, the more patients were weakened.***

Some businesses must go out of business first. The one which were already at the margin, even when rates were lower. And now, at the higher rate, they lose money and eventually run out of capital. Or, in our credit-driven economy, they run out of access to more credit.

With the supply of goods now reduced, the other sellers of those goods can raise their prices until demand comes down to match the reduced supply. This process iterates, until the remaining invested capital generates returns in excess of the rate of interest.

The Fed thinks to reduce demand—and demand is indeed reduced—but not via the mechanism that its theory supposes. The actual pathway is quite different. As we see here, a different path leads to the opposite outcome than the one predicted.

This was the mechanism in the 1960's and 1970's. We had rising interest rates and rising prices. At the end around 1981, American industry was gutted. But the quantity of dollars, not so much.

Hiking rates to fix inflation is monetary quackery, like the Medieval practice of bloodletting to help patients heal. The more blood they took, the more patients were weakened.

Say's Law explains why rate hikes cannot reduce prices. Jean-Baptiste Say observed that supply is demand. Each producer demands goods from his market, by supplying goods to the market.

In the light of Say, we can say that the Fed is trying to cut demand, by ruining suppliers.

If you see the picture that, when the interest goes up, then firms won't invest except at a higher rate of return on capital, then you get it. Regulations and taxes reduce the return on capital, so the gross margin must be even higher still. These things are the opposite of what one would want, if one's stated goal was lower consumer prices.

Economic Zombification

Speaking of ruin, we have written in the past about the so-called "zombie" corporations (heck, October was Zombie Month on the Gold Exchange Podcast)—companies whose interest expense is greater than their profits. In other words, they only exist by the mercy of lenders, plus dirt cheap interest rates. Well, even before the Fed's latest interest-hiking adventure, debt issued by zombies was approaching 20% of the total corporate debt outstanding. With each uptick in the rate, the next-marginal debtor finds itself below the new, higher margin. Higher interest rates breed more zombies.

The Fed has hiked quite a lot in this episode. The Fed Funds Rate has gone form essentially 0% to 4%. The yield on a 1-year Treasury has increased by over 4%. During this same time, the spread between junk bonds and Treasurys has increased by about 1.25%.[1]

The interest rate paid by the typical below-investment grade corporation went up by 5.25%.

That is a big change, moving the margin up a lot! And therefore lots more corporations—who were not zombies a year ago—now find themselves among the ranks of the undead. Or at least they will, as their old bonds mature and they must issue new ones at the new interest rate.

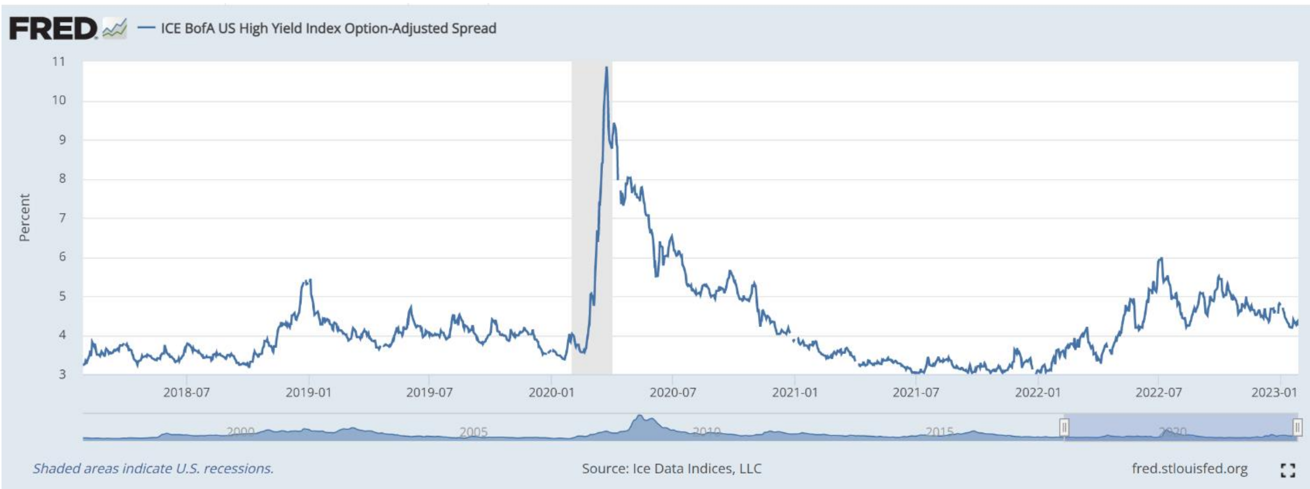
This, incidentally, is one of the reasons why there's a lag in the real-world effects of current monetary policy. A firm does not feel the squeeze of higher rates until it has to renew its

[1] The BofA US High Yield Option-Adjusted Spread

borrowing, roll over its bonds. When does that happen? Each firm would have different securities out there, each with its own maturity date.

We suspect that lenders in this environment will be less indulgent than they were prior to rate hikes. Why would anyone lend to a junk credit which is heading to default for a mere 4.25% premium to Treasury bonds?

We believe this crisis is coming. It is not here yet, as this graph of the spread shows.



Ice Data Indices, LLC, ICE BofA US High Yield Index Option-Adjusted Spread [BAMLH0A0HYM2], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/BAMLH0A0HYM2, January 28, 2023.

What is the explanation? No doubt, part is that many or most of these zombies are not yet feeling the effects of higher rates, as their debts do not roll over until later this year, or in a future year. "It's not a problem, until it's a problem," is all too often a mantra.

Another contributory factor may be various ways the Fed and Treasury have to *nudge* market participants. If the Fed were buying junk bonds (which it has done), it might not need to buy that much in dollar terms in order to get everyone to buy. For years, people believed—rightly or wrongly—in a "Fed Put" under the ever-rising stock market.

The Elephant in the Macroeconomic Room

But the main reason is surely the elephant in the macroeconomic room. This is none other than the driver of four decades of falling interest rates. That is, marginal return on capital is less than the market interest rate. Put another way, there's trillions sloshing around desperately seeking a yield, but at the same time, businesses do not have much demand for more credit except on a downtick in rates. Just look at the continued offer of 0% finance on new cars (and Carvana still offers it on used cars), despite the massive increase in the cost of offering this subsidy. Sellers of cars know what will happen to sales volume if buyers must pay the market interest rate.

If you doubt this idea that investors are hungry for anything with a yield, put yourself in the shoes of an asset manager. Suppose you manage a few billion for a state government pension fund. The government folks say they need you to get them 7.5% annual returns and ask if you can do it. If you say "no", there are other firms who will happily take the

> *…it is possible to have both a falling interest rate trend and widening spreads for junk bonds. The question is when this will occur.*

business. Insurers are another category of investor who have enormous piles of cash and need returns.

Who can pay it to them? Who makes such a great return on capital, that they can borrow at rates over 5%? There is a tension between the credit-effluent pumped out by the Fed over several decades, and the corporations laboring under regulations that grew more restrictive (and much more expensive to comply with) over that same period.

Nonetheless, it is possible to have both a falling interest rate trend and widening spreads for junk bonds. The question is when this will occur.

What We Know, and What We Don't Know

We are not market timers. Economics can analyze root causes and predict their effects, but it is not a trading tool, to signal when to buy and when to sell. To time this, you would have to research corporate debt maturities (among other things).

Also, you would have to predict the Fed's (and the Treasury's) responses, which are not monetary science predictions but political predictions. Will the Fed buy more junk bonds? Will the Fed lend directly to smaller firms? Will the Treasury offer an implicit or explicit guarantee to bonds, and if so which ones?

We don't know the answer to that. But we do know certain things:

1. Ever-increasing mandatory Useless Ingredients make it harder and harder to get a return on capital
2. Falling interest rates incentivize borrowing for lower-and-lower return on capital projects
3. Even if Firm X does not heed the Siren Song of falling rates and borrow more, its competitors do, and Firm X suffers commensurate drop in return on its capital deployed
4. Falling rates is a process of overstimulating overproduction, hence soft consumer prices (not necessarily falling, due to increases in Useless Ingredients which compensate)
5. Return on capital is thereby pushed down, and stays below the ever-falling market interest rate
6. After decades, a huge proportion of corporations are zombies
7. Destroying the zombies will destroy the lenders (i.e. pensions, insurers, banks, etc.)
8. And also reduce supply of consumer goods, hence increase consumer prices
9. Whether the Fed is in the cutting-rates binge phase of its Bulimia Monetosa, or in the hiking-rates purge phase, it never corrects the damage it caused previously. It is

always doing more, like a wrecking ball when it's done with the north side of the street swinging to the south side to whack holes in more walls.

10. The present philosophy prevailing at all levels of government is to double down on more of the poison, hence we expect more bailouts, more stimulus, more backstops, and ultimately more Fed purchases of bad assets including bonds and eventually equities (plus more mandatory Useless Ingredients, more taxes on "windfall" profits, and more antitrust attacks)

It's a mess, and mainstream economics (much less political science) is not even talking about the roots of the problem (regulation and irredeemable currency). They are primarily interested in whether or not we are in, or will soon be in, a *recession*. The definition of which seems to be a Bad-Thing-That-Our-Gang-Can-Pin-On-The-Other-Gang. In other words, a political football that makes for lots of great grandstanding opportunities.

To properly understand *recession* in the late stages of the regime of irredeemable currency, one must keep firmly in mind that interest rates are falling pathologically. During the binge phase, rates are allowed to follow their (un)natural progression, which stimulates consumption via the so-called "wealth effect" and overstimulates overcapacity via the increasing subsidy of decreasing cost of capital. This is hailed by everyone as a *strong economy*. Eating the seed corn is lots of fun, and creates jobs besides.

Next, perhaps due to guilt or maybe even because the central planners become aware of the most excessive of the excesses that accumulate during the binge phase, they declare a purge. They push (short-term) rates up. This causes the yield curve to invert, which means banks are losing money on their loan book. It causes the cost of capital to rise, causing… well, all of the stuff we've described in this Report. If the aggregate level of pain rises above a threshold, then this is labelled *recession*, especially by whichever political party is out of power when it occurs.

Which, to most people, means the current president should lose the next election.

What Else Will Rate Hikes Do?

Back to the question: what else will rate hikes do? If the Fed persists, it will collapse the financial markets.

Compare the present era to the 1970's. Back in the 1970's, we had high and rising interest rates. But back then, corporations were on a footing for rising rates. Each uptick is an increased disincentive to borrow more. Though, perversely, when rates rise those who had borrowed earlier at lower rates are rewarded. It's good to be the lone restaurant which borrowed at 8% to expand, when competitors must pay 12% or not borrow at all.

Anyways, asset prices had not been driven up by four decades of falling rates. Hence leverage on those assets had not reached the unimaginable heights of today. Rising rates may have been gutting capital-intensive industries, but it did not destroy banks and other systemically important institutions.

Another difference today, is that after four decades of falling rates, everyone has been trained to borrow using short-term instruments. Even when financing long-term assets. The only discipline comes from occasional crises where debts cannot be rolled (e.g. 2008).

Rising rates did not collapse the financial world in the 1970's. By contrast, it would a big threat today.

Back in the 1970;s, there had been three decades of rising rates. That trains the opposite behavior: to match the duration of the liability to the duration of the asset. To borrow using instruments of the longest-term possible, because rates will only go up. You will be very happy to have a loan locked in at 10% for 30 years, when the rate is going up to 11%, then 12%, then 13%, etc.

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Dynamic Systems and Consequences

This discussion leads to another important point. The initial consequence of the Fed's rate hikes may be quite different than the consequences of the dynamic that rate hikes set in motion. Let's look at this.

Suppose you are a distributor of building supplies. You are used to carrying a certain level of inventory of, say, cinderblock. And manufacturers of cinderblocks have plants with a capacity to crank them out at a certain rate. Then rate hikes start to destroy home buying demand.

At first, the effect will be lower prices of bricks. Distributors have to keep turning their inventories. Rate hikes hit their income statement on both the revenue and expense lines. Revenue is down, due to lower demand. Expense is up, due to higher finance cost for inventory. They have to reduce inventory levels.

Brick manufacturers are price-takers, they sell at whatever the bid price is. The bid, of course, is from distributors, who are now wary and reducing inventory levels. The brick makers react to the reduced demand from home builders, who are reacting to the reduced demand from homebuyers.

Can the Fed declare victory here? Can the Fed's court-economists and the Fed's most strident critics say that higher interest rates "worked"?

Not so fast.

It didn't really work. After a lag, something comes next. The marginal distributor and the marginal manufacturer go out of business. Reductions in supply must necessarily occur, until return on capital gets above the cost of capital, i.e. the interest rate. Bankruptcies must necessarily occur because the current production capacity was financed at much

> **Politics, not economics, determines what the Fed does.**

lower rates, and when rates rise businesses will not be able to afford the mortgage on unproductive plant.

What began as a drop in prices, even a sharp drop, as the Fed's hikes kill housing demand turns into a long-term trend of rising prices. Assuming the Fed sticks with it.

As hinted above, this path will lead to financial system collapse. So the Fed will likely abandon it. We say "likely" because the Fed is the politicization of credit decisions. Politics, not economics, determines what the Fed does.

We can envision scenarios in which those in power actually **want** the Fed to persist. This could be to achieve what they imagine it will achieve such as lower consumer prices. Or it could be vindictiveness against the other side, the way the deductibility of state and local taxes became so in 2017.

In contrast to monetary science, it is impossible to predict political outcomes.

What we can Predict

We feel pretty confident predicting one thing: continued non-monetary forces that push prices up. We refer specifically to mandatory Useless Ingredients, Green Energy Restrictions, Trade War and Economic Nationalism. Whiplash from lockdown and unlock will be shrinking in magnitude, going forward. As to war in Ukraine, we will stick to our swim lane, but economically the damage has mostly occurred already. Russian commodities go to non-Western markets, and commodities that would have gone to those buyers must come to Western markets via less efficient and more expensive channels. Makers of natural gas ships, among other niche markets, look to continue to do well, but everyone else is impoverished.

It is a perversity that, when a company fails to deliver the same quantity of goods, at the same price, and same quality as last year, then politicians spring into action. Often, they are just preening for the cameras. But too often, they do something. And that something is to make it harder and more expensive for the goose to lay golden eggs.

For example, the [Ticketmaster servers crashed, when millions of fans tried to buy tickets for Taylor Swift] (2 million actually got tickets). So naturally, the company faces an antitrust investigation. Even the Wall Street Journal offers that, "it's possible more competition would have encouraged more investment in digital infrastructure." We would suggest that a company facing the threat of annihilation is not in a position to make any capital investments, nor even strategic plans. Its management team's time and energy must go into defending against the existential threat, and it has no idea if it will have the capital to invest after the billions in fines it may be forced to pay. Not to mention to even have the right to own and operate an enhanced server system, if the company is busted up.

A similar populist attack has been waged against oil companies. The proposed solution, all around the world, seems to be to charge oil companies extra taxes. According to the magical thinking of the politicians and their voters who want to impose such taxes, it will make the oil companies lower the price of oil. But in reality, it will deprive these firms of the capital to invest in future projects. It will also raise the hurdle rate of return that they must get over, to justify the investment. The end result is less supply, hence higher prices.

There are calls for similar attacks against egg producers, due to the temporary rise in egg prices occurring as we write this Report. And probably many other products.

We think that the average person has **no idea** how extensive and expensive the compliance burden has become for productive enterprises. And it occurs in so many areas, from licenses, to employment, to product-specific regulations… to antitrust.

We think the economic nationalism trend has legs. We will see more "re-shoring" of manufacturing that moved offshore for cost reasons decades ago. Will this create net jobs at home? No, because producing the same goods requires more resources on-shore (which is why it moved offshore in the first place). The net result is everyone is impoverished, which is Bastiat's Unseen (though the Seen may be some jobs making certain products).

Green Energy Restrictions is a wildcard. On the one hand, a majority of the people believe that CO2 should be reduced. On the other, Europeans and Brits had a close brush with freezing this winter. And the threat of freezing next winter is greater, not to mention the skyrocketing prices of food due to the shortages of natural gas. Will the people revolt and demand a rollback of these restrictions? Will the UK allow the reopening of coal and oil plants (the ones which still survive after 6 years), and allow domestic hydrofracking? If not, we are confident that this non-monetary force can cause more skyrocketing of prices of energy, and those goods made and distributed with energy-using processes (i.e. nearly all goods and services).

If peace breaks out in Ukraine, and people demand an end to Green Energy Restrictions, then perhaps the balance of non-monetary forces may hit an equilibrium. The upward forces of Useless Ingredients and economic nationalism might be balanced against the downward forces of more energy and commodity production coming back to the market.

We are not especially hopeful of this outcome.

> ***We feel pretty confident predicting one thing: continued non-monetary forces that push prices up.***

Bitcoin and Cryptocurrencies

We are not going to reiterate our previous discussions of the economic, social, and technical problems of Bitcoin. Interested readers can click here to visit our repository of articles over the years.

…we can say with certainty, the sheen is off crypto as an asset class.

We will mention just one new thing. Keith has been saying since 2012 that no one can borrow Bitcoin. To do so is to have the value of one's debt go up a thousand times (proponents certainly promote price targets higher than that, even). Imagine your monthly home mortgage payment going up from $1,500 to $1,500,000. You would be ruined.

Then so-called "yield farming" came to the market. Smug Bitcoin advocates said "See! See!" What they missed, is now obvious. These schemes did not make their yields (or alleged yields) by financing any productive enterprise. They were self-fulfilling, self-referential schemes that basically amounted to borrowing to lever up to buy more crypto. When the price of crypto coins fell, these schemes blew up.

The crypto space is pervaded by a get-rich-quick mentality. But, while the retail speculators—and some prominent institutions—were betting they'd get rich, they ignored something. The firms formed to exploit the demand for all things crypto also held the same ethos.

When a financial institution is formed to get-rich-quick, too often it looks like FTX. This firm had no internal systems, much less controls. Who cares about such things when you're becoming a billionaire overnight?

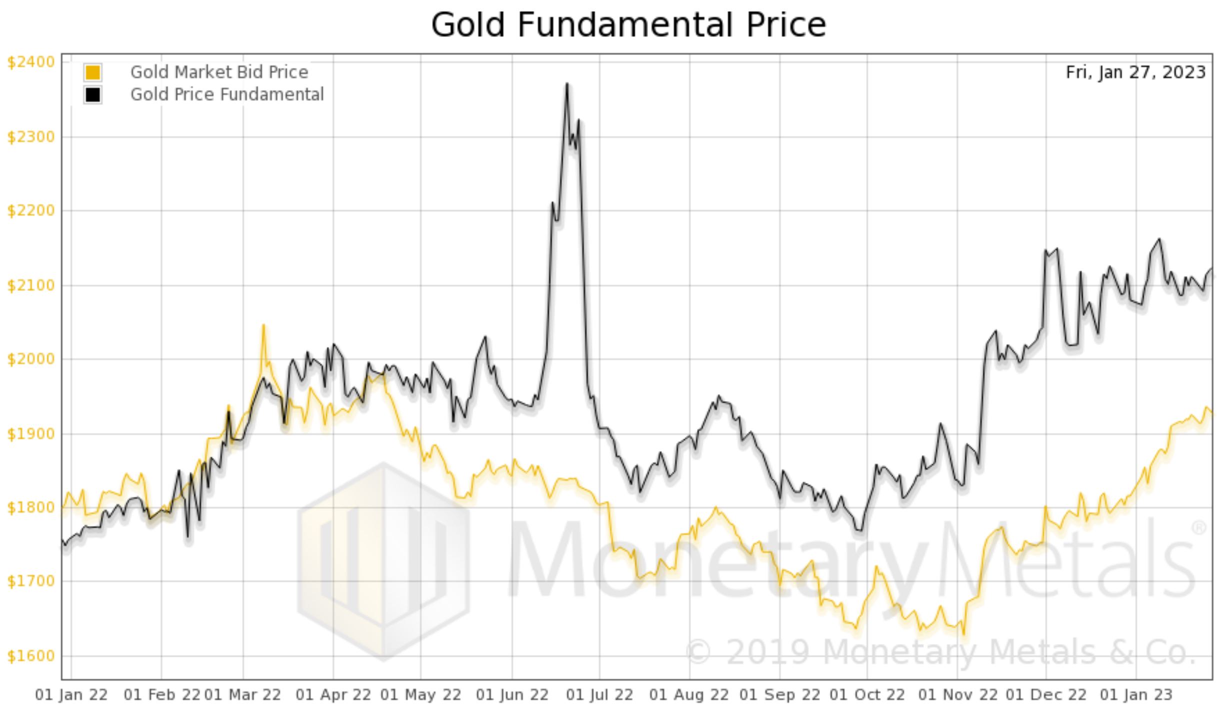
We certainly would not bet that there is not another (or several runs up in prices). But we can say with certainty, the sheen is off crypto as an asset class.

It's all over but the crying.

Our Price Calls for 2023

Last year, we had the great uncertainty of whether the Fed would follow through on its mad promises to hike rates. We got clarity on this (they did). Now we face somewhat lesser uncertainty on when they will abandon hiking, and then return to zero interest rate policy and beyond.

Let's first look at the current fundamentals, to see if we can glean a likely direction, before we look at the macro longer-term drivers.

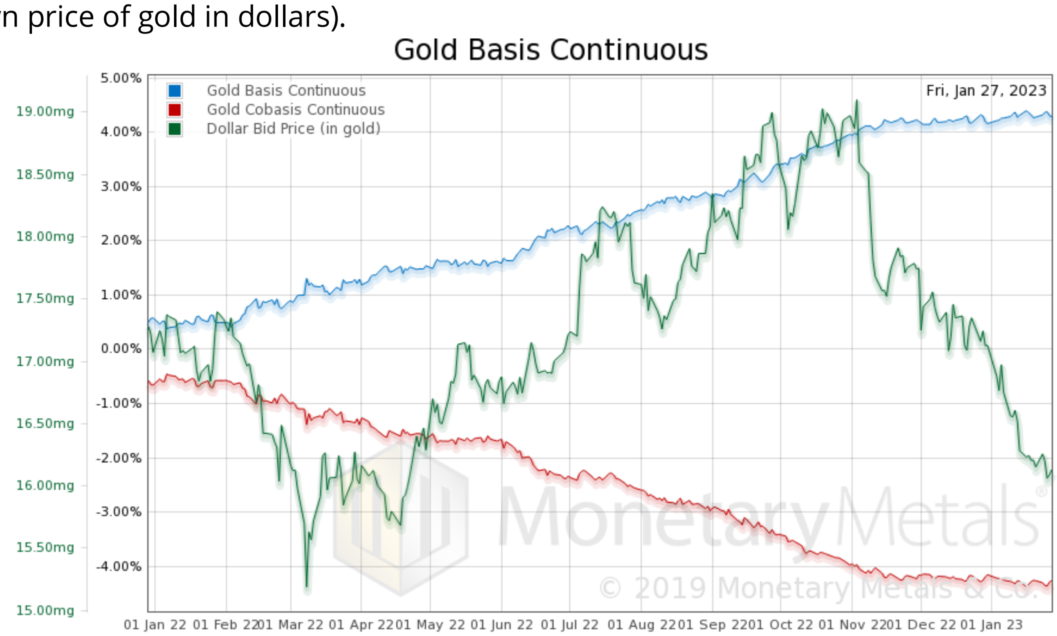


This chart shows the market price of gold overlaid with our calculated fundamental price. The fundamental is generated by our proprietary model. It is our answer to the question "what would the price be, if we backed out the effects of the speculators?" As you can see, sometimes the speculators are pushing the price down (as now), and at other times they're pulling it up (which occurs to a small degree a year ago).

As of the end of January, the fundamentals of gold put it a bit over $2,100. But bearish sentiment has traders pushing it down (via shorting the futures market).

Perhaps more interesting, the fundamental has been rising for four months.

Here is a chart of the gold basis and cobasis (our indicators of abundance and scarcity of gold to the market), overlaid with the price of the dollar in gold (inverse to the commonly-shown price of gold in dollars).



As the price of the dollar falls (i.e. the price of gold, in dollars, rises), we would expect gold to become more abundant to the market. Higher prices attract more metal. However, in that epic move from around 19mg to 16mg per dollar (i.e. $1,628 to $1,927), abundance does not seem to want to increase much, and scarcity does not want to decrease.

This is doubly interesting, as the Fed has been pushing up interest rates for nearly a year. Normally, the basis tends to stay close to the interest rate (due to arbitrage, see our [other commentaries](#)).

The gold lease rate is calculated as LIBOR – GOFO. LIBOR is a short-term unsecured interest rate. GOFO is closely related to the basis. Here is a graph.

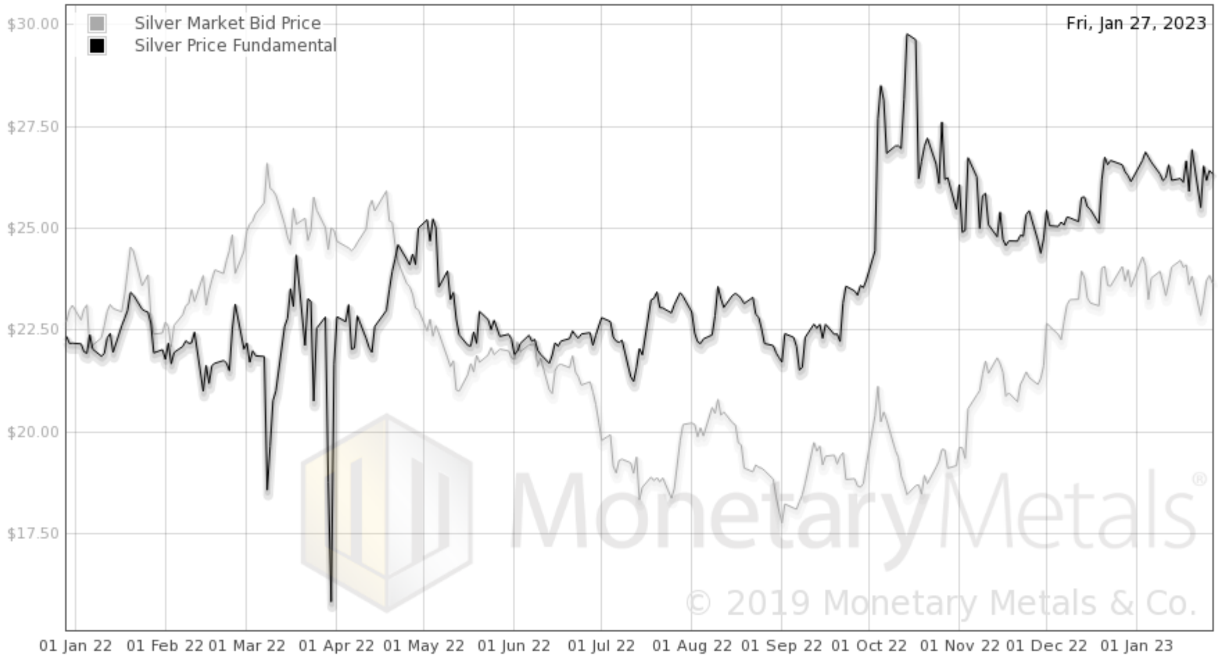
It's been rising since last year, though softening slightly in recent months. For the lease rate to rise, it means interest rates are rising faster than the gold basis. And this move has been occurring amidst rising gold prices.

There's definitely some buying of physical metal going on. And by "some", we mean lots.

Now let's look at silver.

There's definitely some buying of physical metal going on. And by "some", we mean lots.

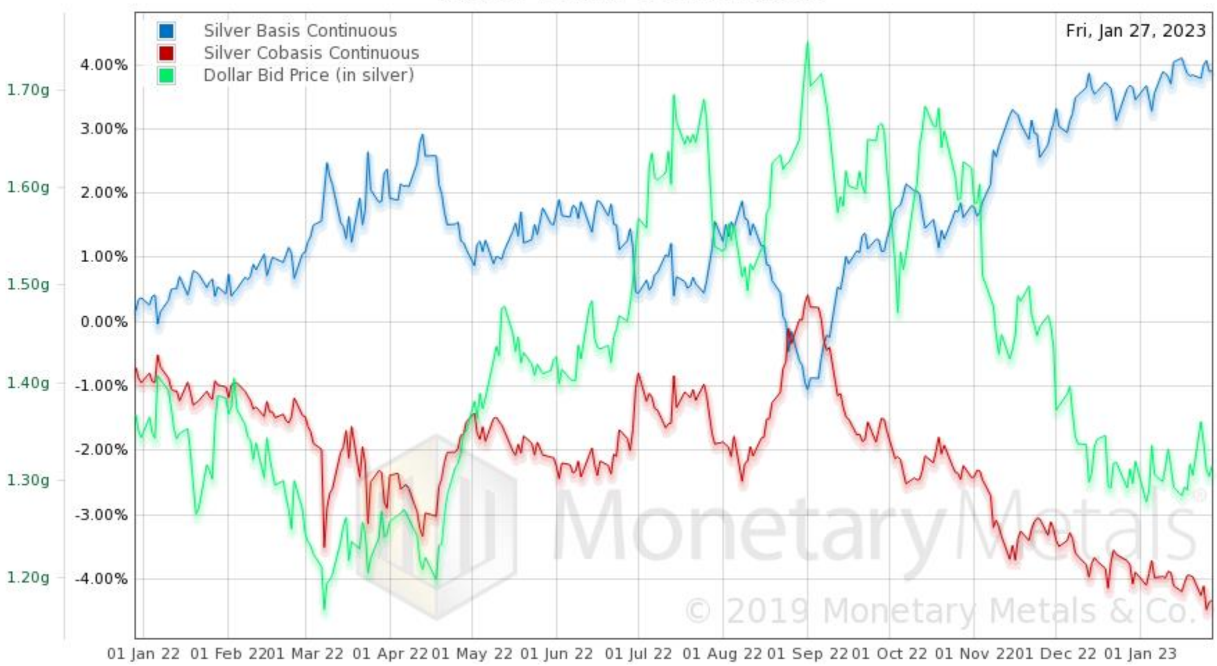
Silver Fundamental Price



The silver fundamental price is a bit over $26. It has been in a generally rising trend since June, though with a dip and spike in August through October.

Here is the silver basis.

Silver Basis Continuous



Here we see the basis moving more as we would expect with a big dollar price move down from 1.65 to 1.3 grams of silver (i.e. $17.76 to $23.65 per ounce). Silver is indeed more abundant around $24 than it was around $18.

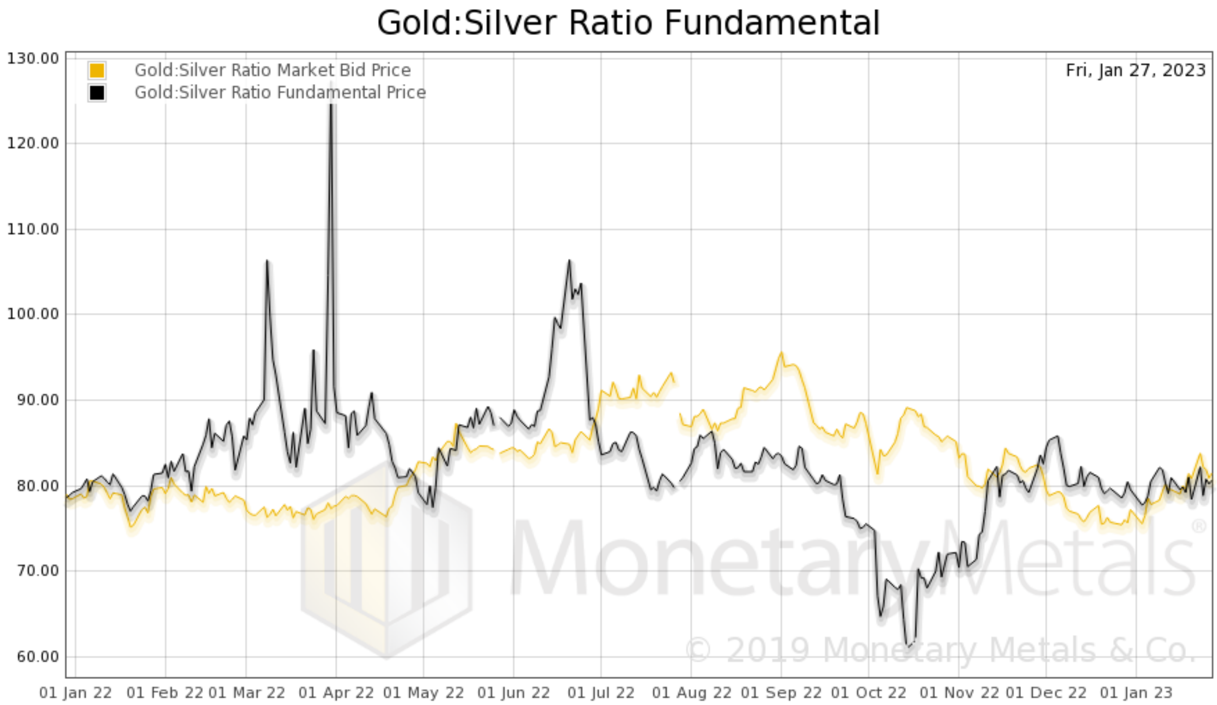
Here is the silver lease rate.

It's the same pattern as gold, but with greater magnitude of the moves. Rising through the price low of September 1, then falling. The silver lease rate is still a bit higher than the gold lease rate. I.e. silver is a bit scarcer.

A word about these lease rates: these are calculated as the rate at which a bank would breakeven in the following trade: borrow dollars at LIBOR, buy metal, sell it forward, and lease the metal for the duration (in this case six months). No bank would actually do it for this rate, because the bullion desk pays above LIBOR, plus it has its own costs, plus it needs to make a profit, plus every borrower has a risk premium.

This lease rate has nothing to do with the rate Monetary Metals charges to lease metal to bullion dealer or refiner. That lease rate is based on the time preference of the holders of metal, i.e. it's a free market in interest, unlike any dollar rate.

Let's look at a graph of the fundamental gold-silver ratio.



Well, isn't that interesting. The market ratio is almost bang on the fundamental ratio. The fundamentals are not currently calling for silver outperformance.

Whither Gold and Silver in 2023?

It is tempting to do a linear extrapolation of both metals' fundamental prices out a year. This would give you $3,000 and $36.80. Or, if the gold-silver ratio holds at 80, then $37.50.

But put away your straightedge. That is not generally going to give an accurate prediction.

To look to the longer term, we must analyze the likely macroeconomic trends as they bear on the metals. The current fundamentals may reflect the current macro state (or market participants' estimations of that state). But not usually how those trends are going to play out.

Anecdotally, we see another one of those sea changes underway. In discussions with more than a few clients, they report their friends and business associates saying things that show they are perceiving gold differently than they had. It is one thing for us to observe the latest madness from central banks, and think that more market participants will see it too and respond by buying gold. It is quite another to hear them saying it in their own words. This is hardly scientific observation, and data is not the plural of anecdote. So take it for what it's worth: gold people being sensitive to changes in sentiment.

Most people believe two things: (1) that the Fed should hike rates to address inflation, and (2) that gold and silver are inflation hedges, whose prices should respond to inflation and/or inflation expectations. As described extensively above, we reject proposition #1.

Proposition #2 is, at best, oversimplification. In a cycle of rising consumer prices and interest rates, the driver of higher price is monetary. Then, the prices of the metals respond. This is because they are measuring the dollar itself.

But in a falling interest rate trend, which is still ongoing—notwithstanding the current correction—the monetary force is pushing prices downward. At the same time, there are nonmonetary forces pushing consumer prices upward.

Gold and silver prices are not driven by lockdown and whiplash, economic nationalism and trade war and tariffs, Green Energy Restrictions, mandatory Useless Ingredients, or Ukraine. The price of energy could explode 10 or 100 times higher, which would drive up everything from food to utility bills to transportation. It would not affect gold and silver.

So what **does** affect the prices of gold and silver? Everything we described in the macroeconomics section above argues that owning shares, properties, and bonds (other than Treasurys) will be less attractive as we go forward. It will be harder to earn a margin. While rates are being pushed up, then those diminishing future cash flows will be worth even less. When rates turn the other way, it will be because even the Fed wakes up and smells the defaults and (layoffs).

We are not merely arguing that gold and silver are attractive to own. That does not explain change at the margin. We are arguing that more people will see gold and silver becoming more attractive (or other assets become less attractive). And then, one holds *money* to avoid the losses of holding those other assets.

And when (not if) the Fed reverses and begins slashing rates (or slams them to zero), we think it will likely spur another period like 2009-2011. Speculators might jump into ordinary commodities, thinking lower rates will drive higher *inflation*. But that would be an error (though Green Restrictions could cause higher commodity prices). They will also jump into gold and silver, perhaps many of them holding that same reason. But others will see the macro picture we've been painting (or parts of it). They will be seeking a safe haven from madness, dishonesty—such as the trillion-dollar platinum coin that the socialists love so much—souring investment backdrop, and monetary debasement.

Our prediction is that metal prices continue to be robust and likely rising, until the Fed pivot. Then, a different kind of bull market erupts.

But we cannot predict when the Fed will change course.

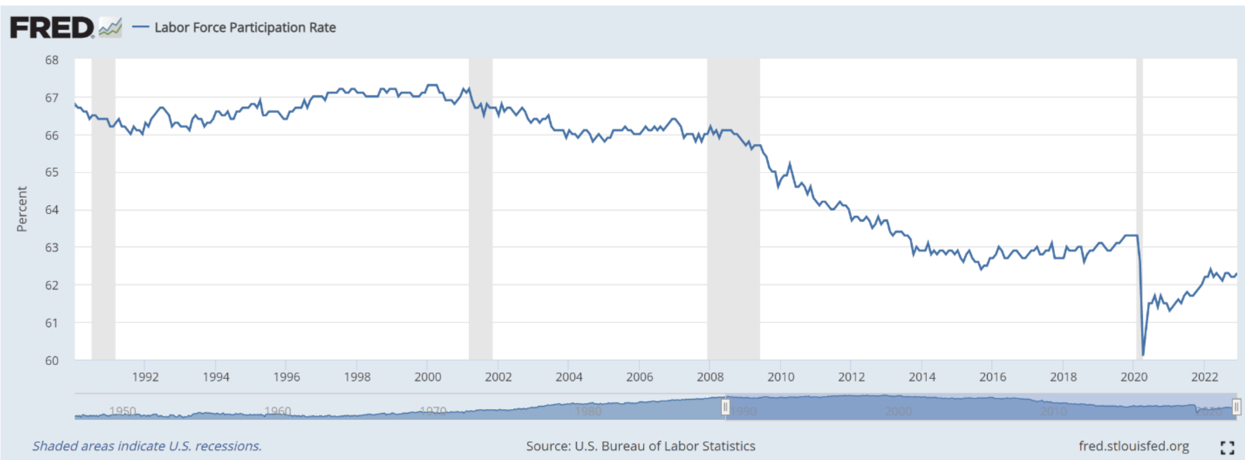
We do not have a strong opinion on the gold-silver ratio right now. There is a nonobvious difference between the metals. Because of its higher value, gold has always been a capital asset owned by the asset-owning class. Gold is more often purchased with the proceeds from selling another capital asset, such as shares, properties, and bonds (plus antique cares and works of art). Most wage-earners (especially globally) don't have $2,000 to plunk down for a one-ounce coin. There are smaller bullion products, but they are more expensive on a per-ounce basis. And also less satisfying to hold. Think of holding a gram of gold (which, due to gold's incredibly high density is very small) vs three silver coins. No contest.

Silver has always been the savings of workers, who can put 10% of their weekly wages into silver. And, during retirement, sell silver to buy groceries. Of course, the asset-owning class can also choose to buy silver, if for example, they think silver offers the better deal.

So the question of whither silver depends on the outlook for the labor market. On the one hand, the Fed is targeting labor specifically in its rate-hikes-to-reduce-demand policy. In addition, the Fed's attempts to paper over the massive losses realized in the last two crises of 2008 and 2020 also deliver sucker punches to labor.

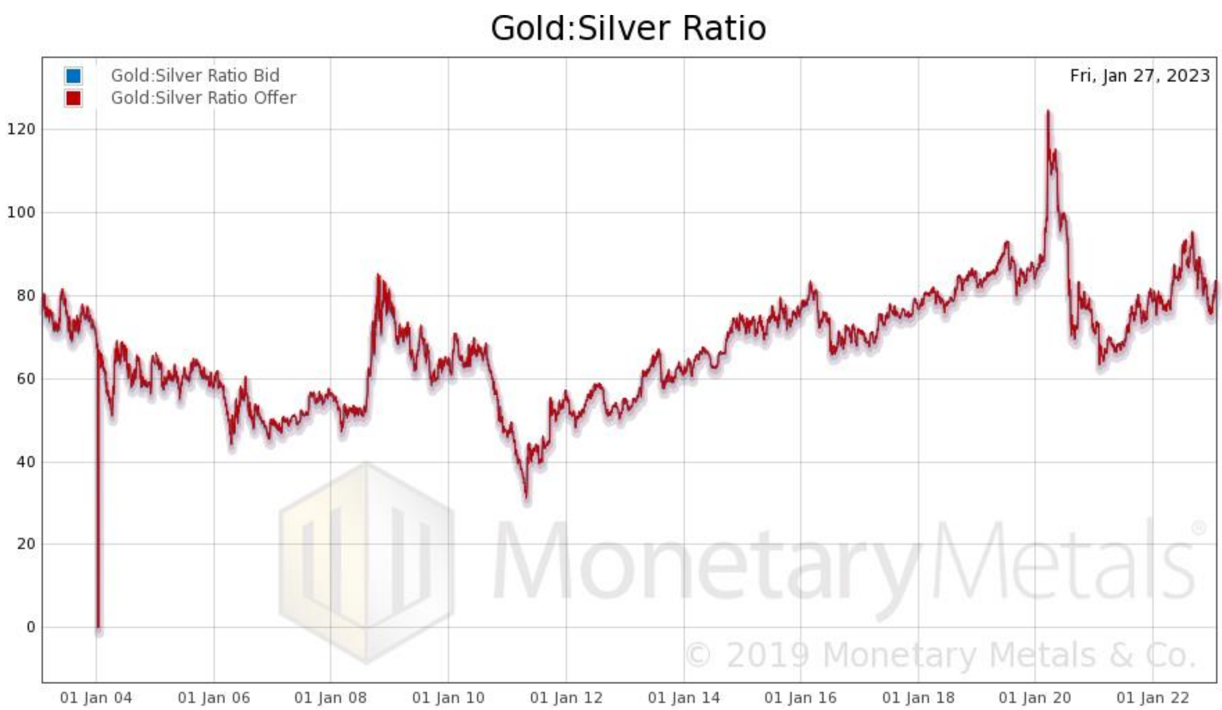
Here is a graph of the labor force participation rate, which measures the percentage of the working-age population who are working or seeking work. It excludes those who have given up, taken early retirement, started collecting disability, or gone on welfare.

It's an ugly-looking chart.



U.S. Bureau of Labor Statistics, Labor Force Participation Rate [CIVPART], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CIVPART, January 30, 2023

Now let's look at the gold-silver ratio.



> ***We expect there's a high correlation between those who prefer work over welfare, and those who stack silver.***

Ignoring the glitch in 2004, it is falling until we get to the crisis of 2008. This is where the labor force participation drops. Then we have a big drop in the ratio, from the start of stimulus and bailouts through 2011. We would not expect the crazy silver price action of 2011 to recur, as that was due to bullion bank duration-mismatch in their silver book more than merely silver sentiment.

On the other hand, there are secular trends that may cause robust wages for those dwindling numbers of people who want to work. Generous subsidies to drop out of the workforce is one of them. Another is the re-shoring trend caused by economic nationalism and trade war. Businesses may be less profitable, but many may be forced to hire more people just to get the same job done (a socialist's dream in all senses of the word, it sounds good to them but it leads not to a workers' paradise but to general impoverishment).

We expect there's a high correlation between those who prefer work over welfare, and those who stack silver.

So we do not make a prediction for the gold-silver ratio this year. We simply think the price of silver is likely to follow the price of gold.

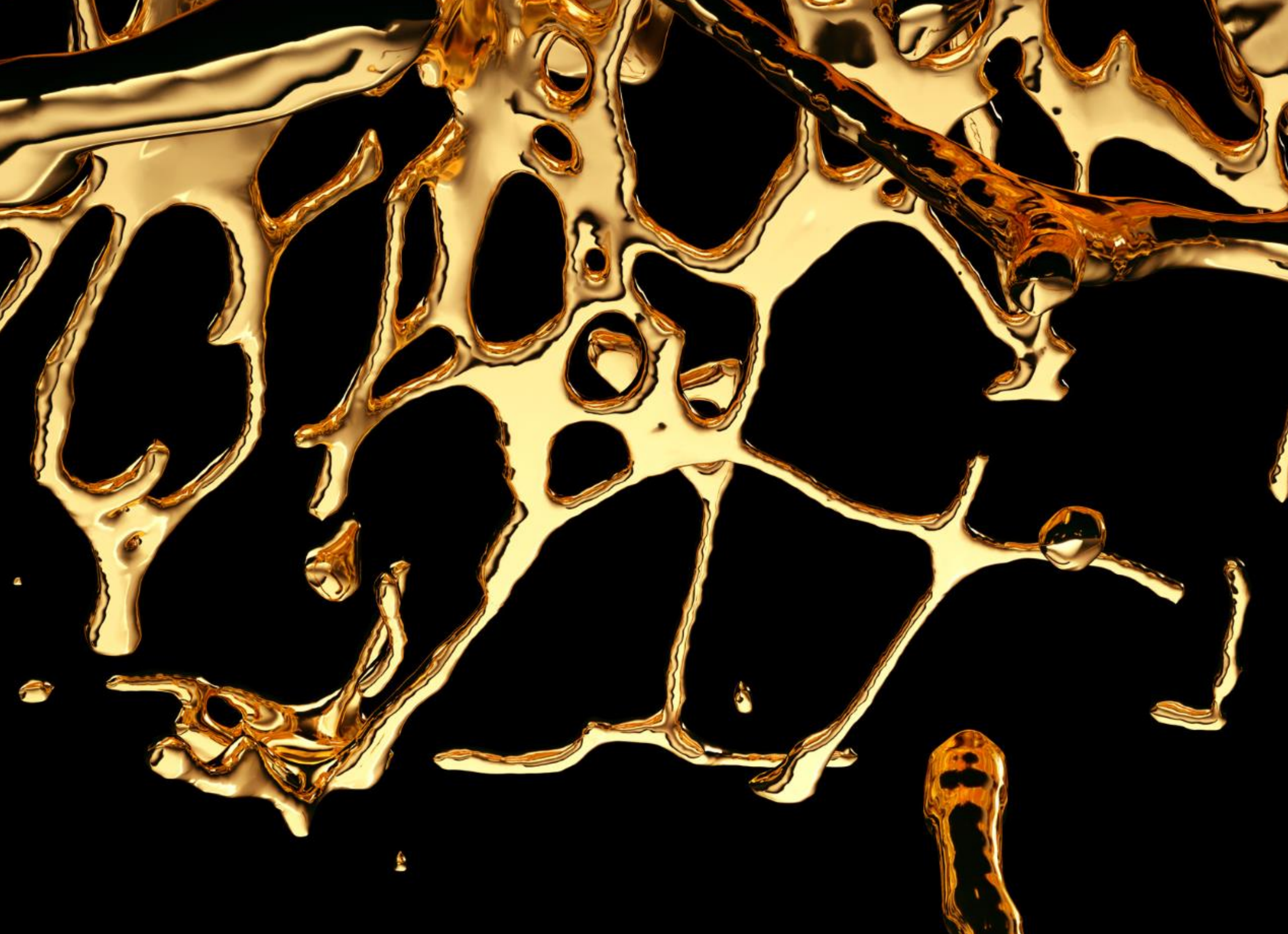
The Monetary Metals Alternative

We don't trade metal money for dollar-denominated profits (i.e. more government IOU's). We do something more exciting: generate a yield on gold. But we have developed the most sophisticated model and software platform to analyze the structure of the gold and silver markets. We publish original research that you won't find anywhere else (here).

Many professional traders and other industry professionals use our research to trade and conduct business. Notably, the London Bullion Market Association stopped publishing the Gold Forward Rate in 2015. This deprived the industrial users, such as refiners, of information they need to hedge and finance their businesses. We produced our own MM GOFO™ Gold Forward Rate, with over 99.9% accuracy to the LBMA's historical rates, and 60-odd other graphs, that we update every market day.

This data and our unique approach to analysis gives us insight into supply and demand conditions. And hence a view on the likely direction of the gold and silver prices. For more information on how we do it, go here.

Of course, there are plenty of *wrong* ways to analyze gold and silver markets. For those who want to avoid the most common pitfalls, we have a forthcoming standalone resource for investors, How NOT to Think About Gold.



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