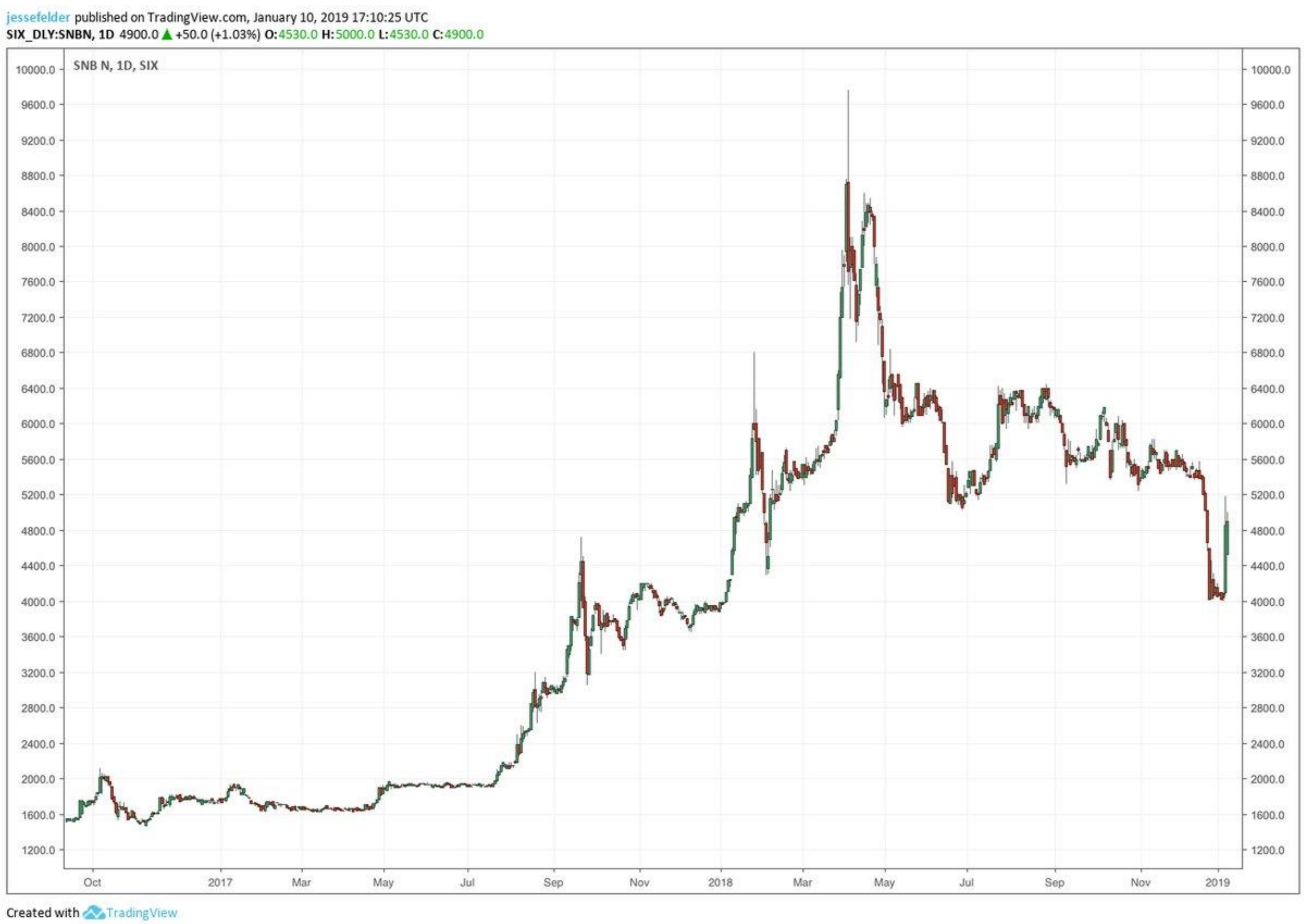
# Alps Precious Metals Group

## Monthly Commentary and Update

### January 2019

A) The Times they are a-changin'
B) Knut Wicksell and Misallocating Capital
C) Bear Markets and Gold Metrics

## The Times they are a-changin'



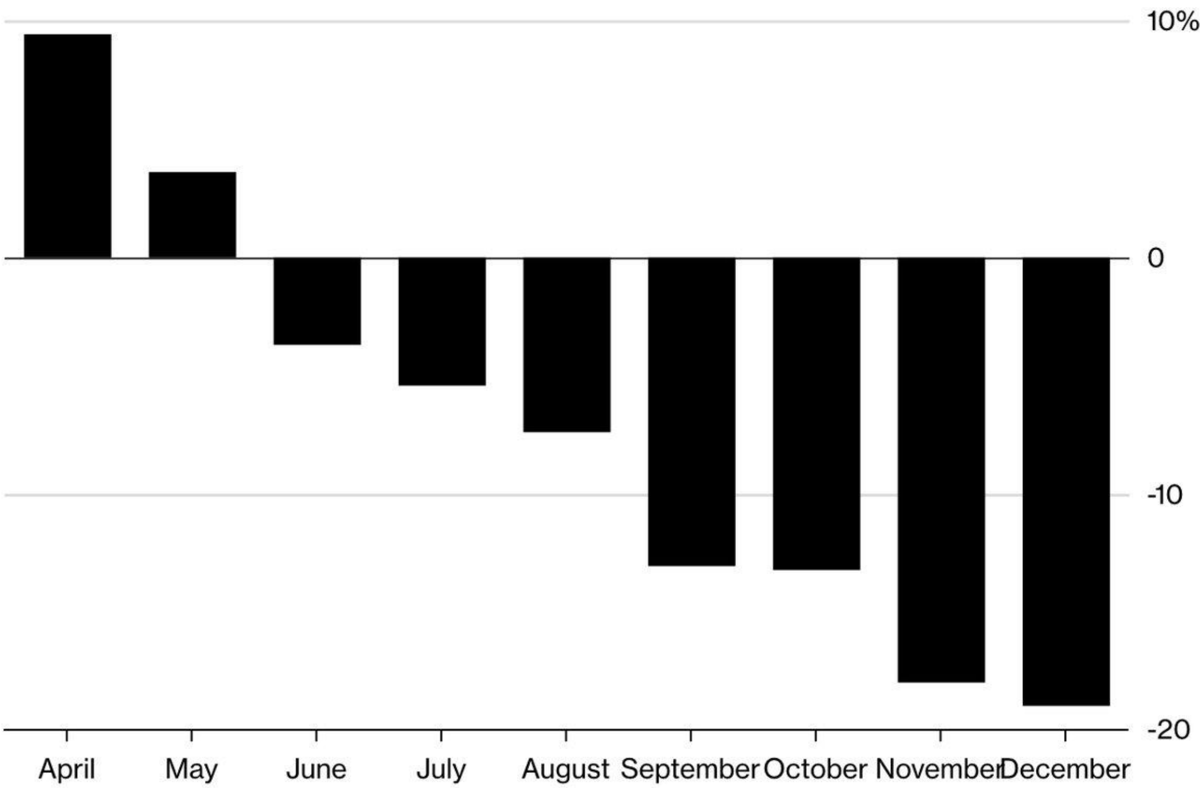

**Swiss National Bank stock chart – September 2017 through January 2019**
*(source: Jesse Felder twitter feed)*

Of the many distortions Central Banks have infected upon the markets, arguably one of the worst has been indiscriminate purchases of equities by these interconnected Government planners. Far removed from the mandated wisdom of holding only "near-cash convertible" securities as assets, the U.S. Fed, the ECB, the Bank of Japan and the highlighted Swiss National Bank ("SNB") have gone absolutely mad in waving in every sort of illiquid or way-down-the-capital-structure financial instrument. When financial assets are rallying, the strategy looks superb. But what happens when those same assets start to fall? The answer is, "No one knows" since this is all a nouveau experiment. As shown in the previous graph, the hyperbolic rise in the price of the Swiss National Bank was all the rage last year when it rose over 5-fold. However, what are the implications to the SNB, the global economy, and, more importantly, the Swiss people, when this bubble pops? Perhaps the world is about to discover the answer.

In another stark change to a source of economic growth to which the global economy has grown accustomed, car sales in China have been plummeting of late. Should this data point from the world's 2nd largest economy be as reliable a future prognosticator as the same from the world's 1st largest economy, one should expect a global recession in our very near future:

**Reversing Fortunes**

Car sales in China are falling on economic slowdown, trade tensions




Source: China Passenger Car Association

As powerful as both the above vignettes are, the far larger change that may be making its way to the stage is a material restructuring of the general investment landscape upon which all investors have been making their decisions. Ben Hunt of Epsilon Theory refers to this far less sensational - yet far more drastic - upheaval as “The 4th Horse of the Apocalypse” of change to the status quo. The following succinct table describes the characteristics of what such a formidable change in the investment winds would resemble:

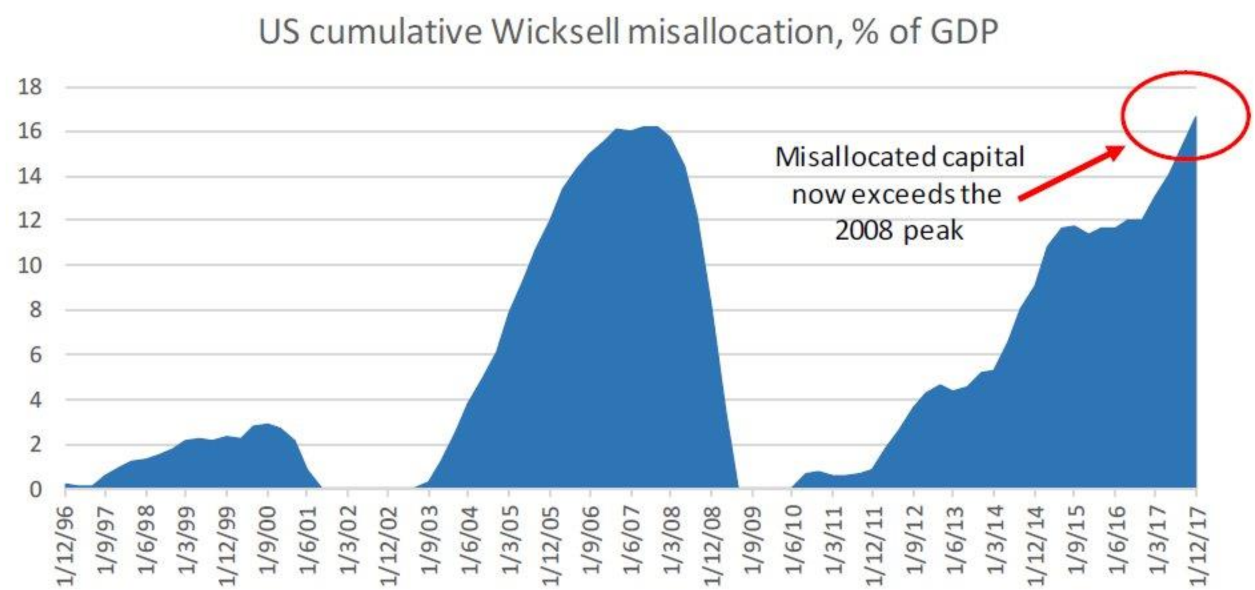
- **Deflationary expectations, now 40+ years old, are becoming inflationary expectations.**
- **Cooperative and multi-play games in both international politics and domestic politics, now 70+ years old, are becoming competitive and single-play games.**
- **Modern capital markets, now 150+ years old, are becoming political utilities.**

Our contention since the inception of our company remains: When a significant amount of major, global economic actors experience an erosion in confidence in the leadership and wisdom of the world’s foremost country, then the world enters a period of unknown duration where uncertainty reigns. If Mr. Hunt’s hypotheses above are in fact prescient, uncertainty in the U.S. Federal Reserve and the U.S. Government will be the norm. And when uncertainty is center stage, investors quickly become focused on assets which are tangible as opposed to intangible, liquid as opposed to illiquid and which have the most reliable historical performance during such times. As a result, our company is focused on Physical Precious Metals, as we believe they offer our clients and prospects the best opportunity for positive returns in the markets that lie before us.

## Knut Wicksell and Misallocating Capital

When the world was young and we were brand spankin’ new to the Investment world, the work of Knut Wicksell (pronounced “Noot Vick-sell”) hit our radar screen. A 19th Century Swedish economist, Wicksell had some very simple models and rules which arose from the largesse of his economic work. One such rule was that of the “Natural” rate of interest and its interrelationship with the market rate of interest. Wicksell concluded that to the extent that the Natural rate was below the market rate, the economy would regress and that market rates would eventually fall until the economy began to grow again. However, capital would be allocated very precisely in both states as the cost of interest would dictate that capital be allocated very carefully. Far more ominously was the reverse case, where the market rate fell below the natural rate because of some sort of artificial means (government mandate and/or manipulation as to interest rates, aka, the price of money/credit). In this instance, borrowers who would typically not have access to credit and/or capital are able to obtain it due to the distorted relationship between the market and natural rates of interest. Such access to credit leads to gross misallocation of capital into an artificial "boom" of investments that are ultimately unproductive – the unwinding of which leads to an extremely painful bust to unwind unwise investments and redeploy that capital into productive uses. This bust is far more difficult to endure than a typical ebbing and flowing of the market rate and natural rate absent artificial stimulation.

In terms of measuring the "Natural" rate of interest, the consensus seems to gravitate around the long-term GDP growth rate (e.g., https://realinvestmentadvice.com/wicksells-elegant-model/). By comparing the Natural rate to the Market rate of interest (e.g., the real rate on Baa/BBB rated bonds; see - http://web.gavekal.com/article/four-quadrants-wicksellian-analysis), one can derive a graph of an approximation of how well allocated or MIS-allocated investments are at any given time. The last 2 decades of results are graphically depicted here:




*(Source: J. Brett Freeze Twitter Post, 1/9/2019; Jesse Felder)*

Wicksell's work preceded by approximately a century the current experimentation of today's Central bankers. Essentially, what has been done by the denizens of the Mariner Eccles building and their global compatriots is to prove Professor Wicksell correct. The problem is that we have only seen the "boom" side of the equation, while the "bust" side awaits. On the prior two occasions over the last 20 years when the Wicksell misallocation corrected, precious metals investments spectacularly outperformed nearly all other alternatives.

## **Bear Markets and Gold Metrics**

After the carnage that was the 4th quarter of 2018, the minds of most investors are focused on the following question: Are we in a Bear market, or is this simply a correction in a still raging Bull? The answer to this question is crucial for those considering an allocation to Physical Precious Metals. A few snapshots may provide some guidance to answering the query.

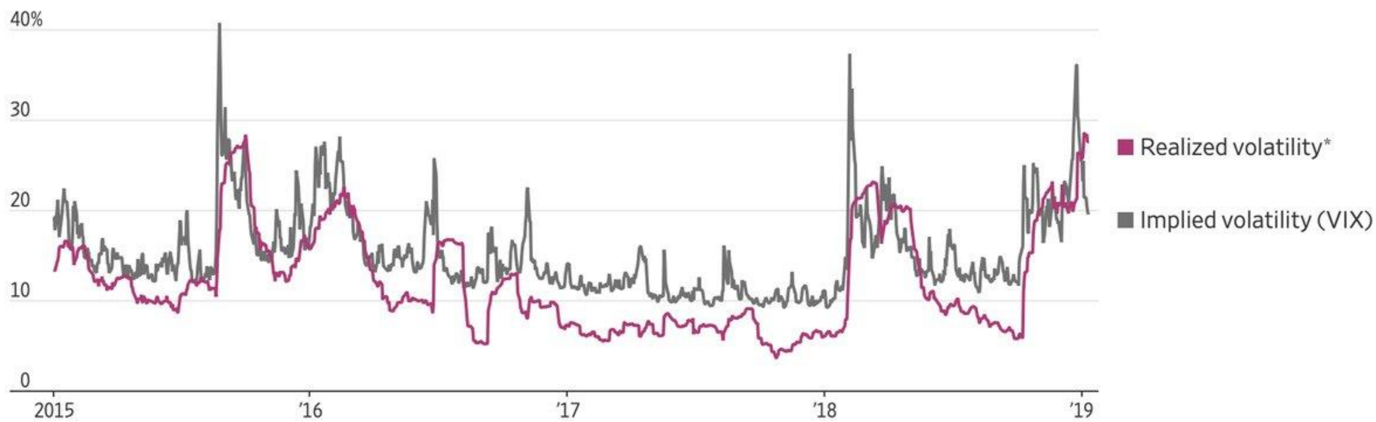
First, Sotheby's has generally been a decent canary in the coalmine. When "BID" falls from a steep rise, that has typically meant that a Bear market is afoot. Currently, the bird doesn't look so great:


*(Source: Bloomberg)*

Second, Volatility has returned in realized form, but not in implied. Typically, when these volatility measurements get disconnected in this manner, they reconnect when implied Vol heads higher toward realized Vol. If that comes to pass, we have some "interesting" days of trading ahead of us in the next year or so:

**Swing Time**

Periods when expected volatility is lower than realized volatility in the S&P 500 are rare, and mean that buying protection looks cheap.




*Looking at daily moves over the past 30 days
Source: FactSet

In regards to volatility, massive swings in market performance have typically been an indicator for Bear markets. The following chart chronicles the schizophrenic behavior of the markets during the last two sobering market phases; and the recent vertigo looks all too familiar in comparison:

**DROPS AND POPS DURING THE 2000 and 2007 BEAR MARKETS**
EVERY SINGLE TRADING DAY IS ACCOUNTED FOR BELOW
Close-to-Close (not intraday), "days" are trading days

**2007 - 2009 Crash**
Dropped -18.5% in 101 days
Then Popped +12.0% in 49 days
Then Dropped -40.5% in 112 days
Then Popped +18.5% in 6 days
Then Dropped -25.2% in 12 days
Then Popped +24.2% in 30 days
Then Dropped -27.0% in 40 days

**2000 - 2002 Crash**
Dropped -11.2% in 15 days
Then Popped +12.1% in 97 days
Then Dropped -27.5% in 147 days
Then Popped +19.0% in 32 days
Then Dropped -26.5% in 82 days
Then Popped +21.5% in 72 days
Then Dropped -32.0% in 137 days
Then Popped +20.7% in 22 days
Then Dropped -19.3% in 33 days
@OddStats January 11, 2019

If a Bear market, a recession or BOTH are upon us, here are two scorecards on how various assets have performed during such periods:

| | Start | End | S&P 500 index | U.S. Treasuries | Gold |
|---|---|---|---|---|---|
| 1987 crash | 8/25/87 | 10/19/87 | -33.2% | -2.6% | 5.0% |
| Iraq invades Kuwait | 7/17/90 | 10/12/90 | -17.6% | 0.8% | 7.6% |
| Asia crisis | 10/7/97 | 10/28/97 | -6.2% | 0.0% | -4.6% |
| Russia/Long-Term Capital Management crisis | 7/20/98 | 10/8/98 | -18.7% | 5.3% | 1.2% |
| September 11, 2001 | 9/10/01 | 10/11/02 | -22.3% | 11.2% | 16.6% |
| Global financial crisis | 10/11/07 | 3/6/09 | -54.5% | 15.8% | 25.6% |
| 2010 Euro zone crisis and flash crash | 4/20/10 | 7/1/10 | -14.5% | 4.5% | 5.1% |
| U.S. sovereign debt downgrade | 7/25/11 | 8/9/11 | -12.3% | 3.6% | 7.8% |
| Taper tantrum | 5/22/13 | 6/24/13 | -4.8% | -2.0% | -6.4% |
| China worries | 8/18/15 | 2/11/16 | -11.8% | 3.5% | 11.5% |
| Fed rate increases & U.S.-China trade war | 9/20/18 | 12/24/18 | -17.9% | 2.5% | 5.1% |
| | | | | | |
| Average | | | -19.4% | 3.9% | 6.8% |

*(Source: Bloomberg; Tocqueville Asset Management)*

During six recessions since the 1970s, gold increased on average 20.8%:

| Decade | Gold Start (USD/oz) | Gold End (USD/oz) | Change (%) |
|---|---|---|---|
| 11/1973 – 03/1975 | 100 | 178 | 78.0 |
| 01/1980 – 07/1980 | 512 | 614 | 20.0 |
| 07/1981 – 11/1982 | 422 | 436 | 3.3 |
| 07/1990 – 03/1991 | 352 | 356 | 1.0 |
| 03/2001 – 11/2001 | 266 | 275 | 3.5 |
| 12/2007 – 06/2009 | 783 | 930 | 18.8 |
| Mean | | | 20.8 |

*(Source: Incrementum AG, Deutsche Bank)*

If we are in a Bear market, the historical evidence is crystal-clear that Precious Metals are an imperative allocation for one's portfolio. The current price action in PPMs would suggest that the "Buy the Dip" strategy has jumped to a new asset class.

## Alps and Liechtenstein Precious Metals

Alps Precious Metals Group via our partnership with Liechtenstein Precious Metals Group is dedicated to providing the global standard for the finest and most secure storage and trading of Physical Precious Metals. Our Vault is constructed to the highest security standard in the world ("Class 10") and, via our relationship with Lloyd's of London, insures each client's specie at 100% of its market value. Our trading desk provides liquidity on each and every business day with as little as next day settlement. All of these benefits are enjoyed while simultaneously being freed from the status quo global financial system. Contact us (www.alpspmg.com) to discuss how APM/LPM can become a trusted partner in the creation, protection and utilization of the hard money portion of your portfolio.

James P. Hunter
Managing Partner
Alps Precious Metals Group