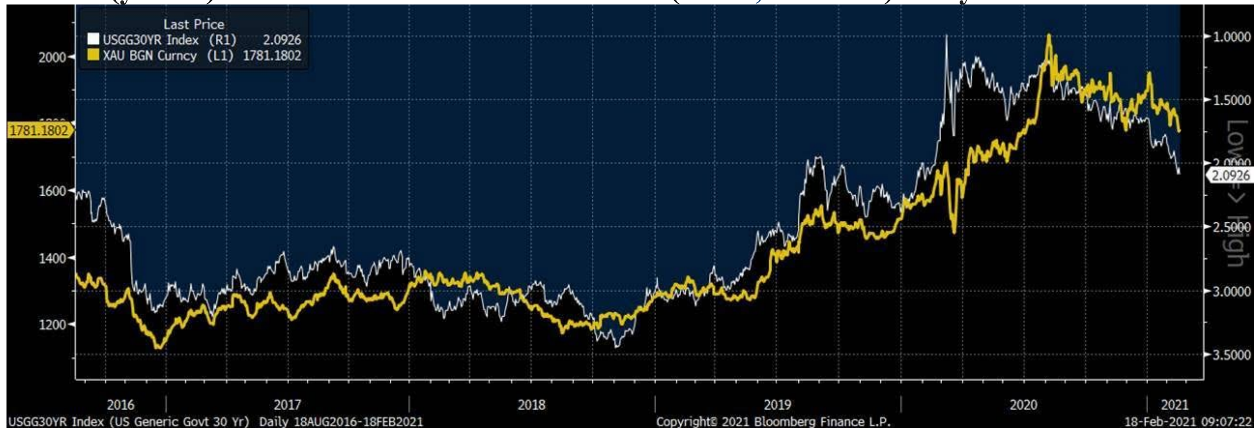
Classical Insights

Global Investment Analysis Based on the Classical Economic Model

Classical Insights bullet points - February 18, 2021

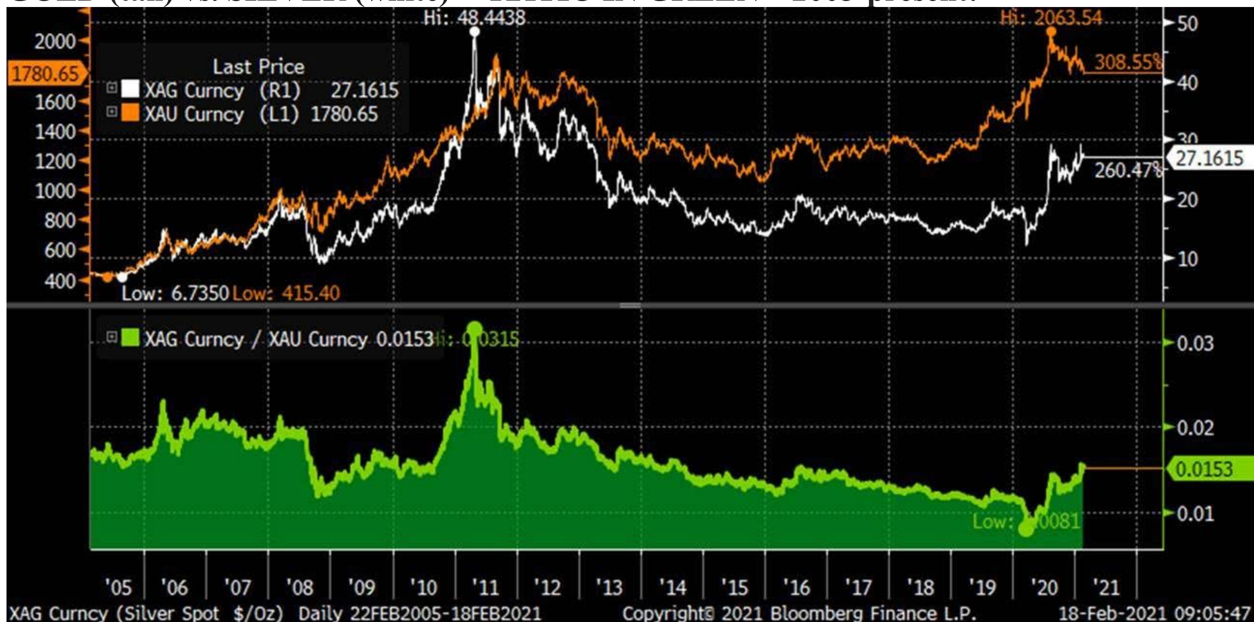
Gold is following the 30-year bond price lower. This has a certain canary-in-the-coal-mine feel to it, in the sense that gold has no utility and no hype. So there is no compelling *reason* to hold it (at the margin) as opportunity cost rises. It doesn't care that the Fed is promising to keep rates at zero for two years and it doesn't benefit from a hot economy. Gold looks far down the road.

GOLD (yellow) vs. US 30-YEAR BOND YIELD (white, inverted) -- 5-year chart:



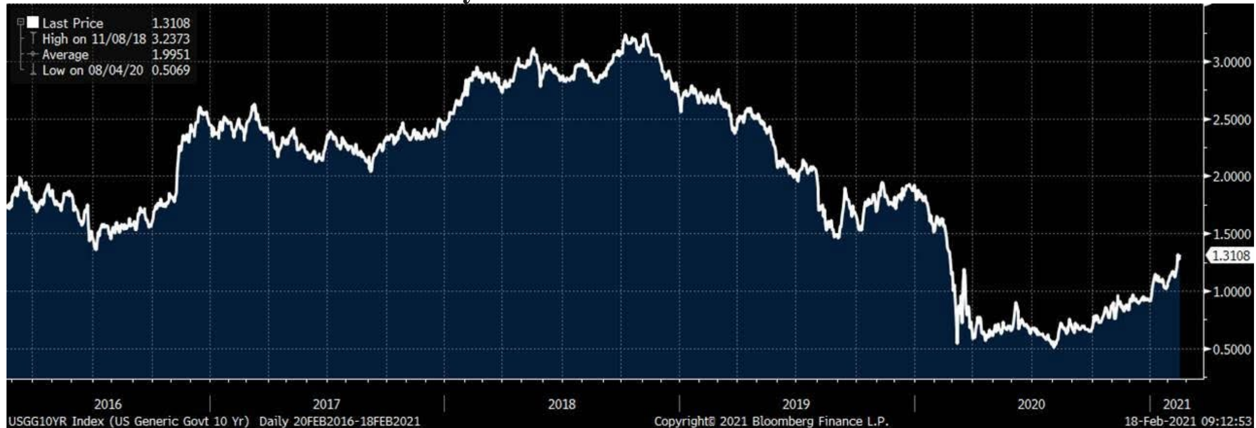
Silver is behaving a bit differently -- it is rising relative to gold. This makes sense as we are in a reflationary expansion and silver has some industrial utility. At a ratio of 0.0153, silver is back at its 2014 ratio with gold. This is helpful.

GOLD (tan) vs. SILVER (white) RATIO IN GREEN 2005-present:



The US 10-year yield is now up to 1.31%. Even though the Fed is signaling it won't move for 2-3 years, that still leaves another 7-8 years on a 10-year bond. The 10-year is starting to mirror the message of the 2028 Eurodollar future, which is at 2.50%. That's what the 10-year would be without the cement-shoes element on the front end of that 10-year period.

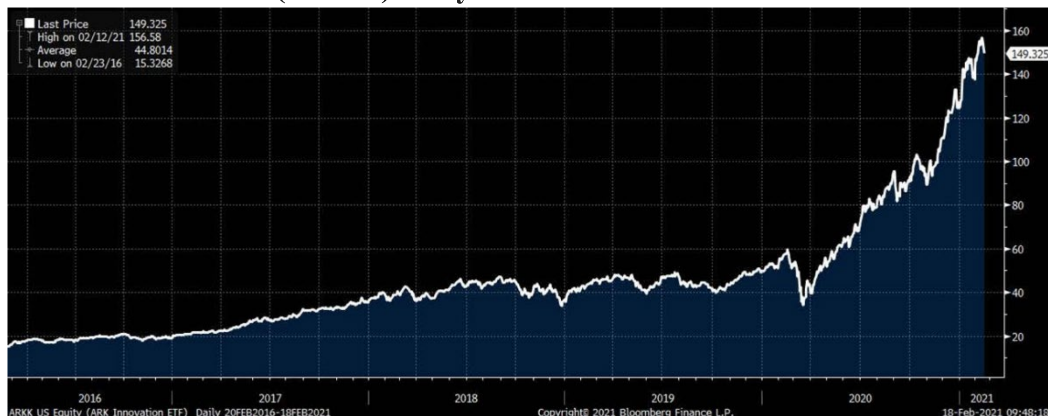
US 10-YEAR BOND YIELD -- 5-year chart:



At this point one has to start questioning how long the Fed is going to be able to keep up the zero-rate rhetoric. There comes a point where risk/reward flips. If you are an oligarch involved in a high-growth, high-PE sector, pretty soon you are going to start sending complaints up the food chain, which in turn will be relayed to the Fed. The US is a high-tech economy, not a growth economy, so it does better with strong currency and rock-bottom rates.

Here is the 5-year chart for the now-famous and enormous Ark Innovation ETF. It is 5% down from its recent peak, though it has still quadrupled off the COVID low from a year ago. Is this just minor noise -- or the start of a larger correction? I think one has to be on the lookout for the latter given the aggressiveness with which these long bond yields are moving.

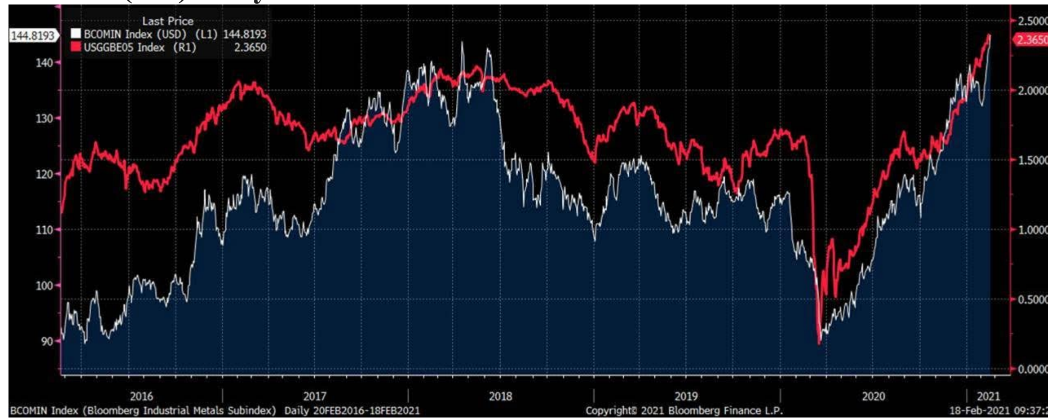
ARK INNOVATION ETF (ARKK) -- 5-year chart:



This raises the question of how the broader commodity universe will fare in a falling-gold / rising-rate environment. The really great corroborator for commodities is actually neither long bonds nor gold -- but simply the 5-year CPI breakevens, which capture the STANCE of monetary policy right now -- which is what commodities care about most. Right now, the Fed is

very easy. But again, the question is how long that's going to last. The subtle message of this chart is that commodity prices do not mess around: When they get a whiff of tighter policy, down they go.

BLOOMBERG INDUSTRIAL COMMODITY INDEX (white) vs. US 5-YEAR CPI BREAKEVEN (red) -- 5-year chart:



There are two ways the breakevens could top out: Either the 5-year yield starts to fall or the TIPS yields start to rise. In a sense it doesn't matter, and either or both are possible if the Fed decides to tighten up the rhetoric. Until it DOES that, I guess things just continue to run hot in the commodity sphere.

Addendum.

This is an informative discussion with a fairly normal-sounding dude, BlockFi's Zac Prince, who started off in peer-to-peer lending in 2009, became fascinated by Bitcoin a few years later, and then decided to put the two together and get into crypto-based lending. He's about 33 years old and seems to have spent his entire career wrestling with the issues of internet lending. That's 11 years of full-time cogitating without much distraction. From his perspective, one of the problems since the 2009 crash has been simply *access* to credit. Also he addresses how it's possible for investors to get 6-9% for just lending out Bitcoin and other crypto (including stablecoins).

Interesting WSJ video on Bitcoin mining. It turns out 70% of mining capacity is in China, where miners have access to the best new gear at cheap financing rates. The risk is that the Chinese government cracks down somehow on who can use it.

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