**Minutes of Advisory Board Meeting**

**Incrementum Inflation Diversifier**

**October 23rd, 2019**

# REPOS, QE4, AND THE FED'S FAILURE

## Highlights of the conversation:

**Special Guest – Dan Oliver Jr.:**

- Over the long-term all commodities depreciate against gold.
- Gold is an excellent way to increase your purchasing power over time.
- As technology advances, old mines become economically viable again.
- Every banking system starts with notes being backed by gold and/or commercial bills. But eventually the banks start creating credit, which leads to bubbles.
- An inverted credit pyramid is the best way to visualize a bubble, with cash at the apex (the bottom, since the pyramid is upside down) and mortgages, margin loans, derivatives, etc., at the top.
- Except in our system, the cash at the apex is really Federal Reserve credit, which is itself the top of an inverted pyramid that has gold at its apex.

**Jim Rickards:**

- The Fed doesn't own any gold, despite it being listed on their balance sheet. It's the Treasury that owns the gold.
- There is currently a global dollar shortage, which is the reason for the trouble in the repo market.
- The Fed has failed to normalize rates; they are not ready for the next recession.
- The Treasury could revalue upwards the gold they own, and tell the Fed to credit their account with the difference, instantly providing the Treasury with newly printed money.

**Heinz Blasnik:**

- As long as the annual growth rate of the total stock of gold is below the growth of economic productivity, the purchasing power of gold increases.
- If you own a large gold deposit your best bet might be to wait until better technology is available to mine it, or not mine it at all.
- There is a surplus of collateral now, and it is held by the primary dealers. They used to hold $75 billion in Treasuries and now they hold $300 billion.
- I am long gold stocks; I have been for a while and I don't see any reason to change that stance.

**Ronald Stöferle:**

- Our Incrementum Inflation Signal switched to full inflation recently.
- We have therefore become a bit more aggressive in our fund, allocating more to the silver and commodity space.
- There are moral consequences to the monetary insanity we are witnessing. People are becoming much more short-term oriented.

**Mark Valek:**

- It looks like we are in a new rate cut cycle.
- I think we will see a third cut by the Fed soon.
- The recent situation in the repo market suggests something is going on behind the curtains.

**Biography of our Special Guest – Daniel Oliver Jr.**

Daniel Oliver Jr. appears regularly as a guest on financial media outlets, lectures at monetary and investment conferences, and publishes articles on gold, interest rates, and the Federal Reserve.

He manages Myrmikan Capital, an advisory firm specializing in precious metals investments, and is president of the Committee for Monetary Research & Education, which was founded in 1970 by distinguished monetary scholars and financial professionals concerned by the threats to monetary stability introduced at Bretton Woods.

Mr. Oliver has a J.D from Columbia Law School and an M.B.A. from INSEAD. He is currently writing a book on the history of credit bubbles.

# Transcript of the conversation:

**Ronald Stöferle:**

Thank you for being with us gentlemen. It's a great pleasure to have Dan Oliver, a friend of ours, as the special guest this quarter. He manages Myrmikan Capital, an advisory firm specializing in precious metals investments, and is president of the Committee for Monetary Research & Education.

As always, let's start off with some housekeeping, and then we'll get into the discussion. We are currently finalizing the English version of our new book, which will be called "The Zero Interest Rate Trap", and it should be published in the next couple of weeks. And we are about to publish our new chart book on gold. Moreover, the great Mike Maloney and I did an in-depth discussion about our chartbook that already has more than 70,000 views on Youtube.

Moreover, **our proprietary Incrementum Inflation Signal switched to full inflation quite recently** and we therefore have become **a bit more aggressive in our fund, allocating more to the silver and commodity space.**

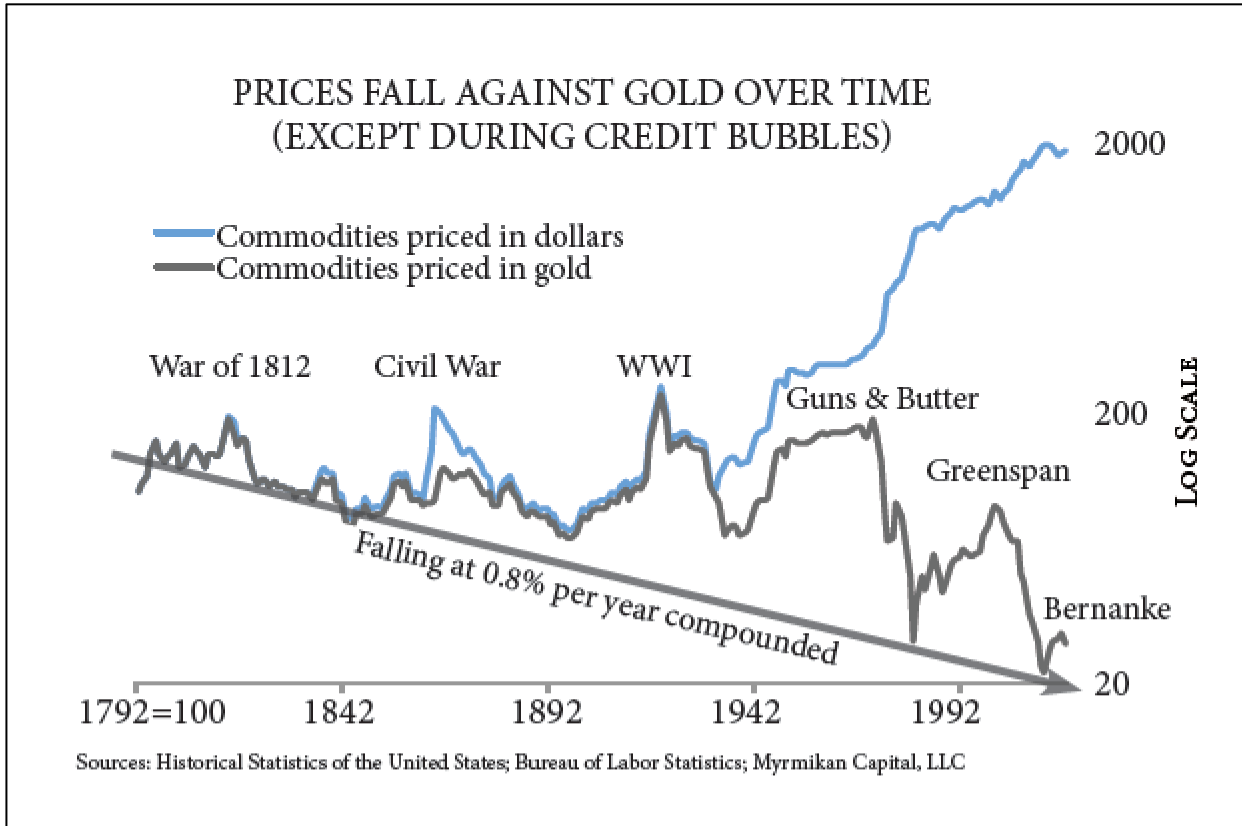
Dan sent over some interesting topics that he wanted to discuss so I suggest we start there. Dan, could you kick off the discussion by giving us an overview of your opinions on gold and the monetary system?

**Dan Oliver:**

Sure, and thank you for having me.

First, what people seem to often forget is that we shouldn't look at the value of gold in terms of dollars; it should be the other way around. We should understand that gold is stable, and the dollar is the asset that is moving around. Second, physical gold has a yield in terms of purchasing power. Buffett likes to remind us that a bar of gold just sits there and does nothing – but gold's purchasing power increases over time, and the reason for that is technology. Technology's function is to lower prices. Take iron ore for example: it's much cheaper to produce today than it was 50 years ago as a result of technological advancements. And industry is much more efficient at using it: in 1970 steel made up 87% of the average car versus 55% today. Gold resists this price decline because gold mining effects the above ground stock of gold to such a small degree – only about 1.5% of

gold is added to the above ground supply every year. And the falling price of mining gold doesn't really influence it**. Gold's value is therefore effectively constant, and everything else falls in purchasing power compared to gold.**




*Source: Myrmikan Capital*

But that's only half the story. The commodity value of consumer products has collapsed. **So, it's not just that gold buys you more commodities, but those commodities buy more consumer products in turn. Gold is therefore a great way to save in that it increases its purchasing power over time.**

Which leads me to another topic that very few people talk about, but that I saw Incrementum talked about a while back, and that is the moral implications of the inability of the common man to save. There are not a lot of places that people can place their money these days. If they put it in the bank they lose their purchasing power, given the low interest rates. If they put it in the stock market they get hit with hidden fees, and the volatility leads a lot of people to lose money. The essence of a bourgeois society is to save money and delay consumption, which creates an incentive to be conservative to support social stability so that the savings may be enjoy as consumption in the

future. But when you are penalized for saving, you instead consume straight away. Drug abuse is the ultimate form of immediate consumption, so the blame for the spreading epidemic lies squarely with the central banks. As financial repression and inflation ramps up you get more and more immorality in society; marriages collapse, Christianity collapses, and so on.

**Inflation is something that goes to the heart of society, not just the monetary system. And therefore, since gold can increase your purchasing power over time it's a way for average people to save for the future.**

But going back to a more market-oriented focus, the chart that shows commodity prices falling against gold is not steady, there are periods during which commodities shoot higher. It's no coincidence that those bubbles happened when the government increased spending. The way it works is that the central bank gives the banks more reserves, then those banks go out and make more loans based on those reserves, and the credit increases. That is how QE works. A lot of people incorrectly imagine Ben Bernanke in a helicopter dropping money onto the streets, but QE is simply an increase in bank reserves, which allows the banks to increase lending, primarily against assets, e.g. houses, new businesses, etc. These big projects require a lot of commodities, which temporarily boosts demand and prices. And that, according to the Austrian School Business Cycle Theory, leads to overcapacity and decreasing cash flows, which in turn leads projects to default, and as a result commodity prices collapse against gold.

This cycle has implications for investing in the gold mining space; I look mostly at the commodity-gold spread because gold miners are mainly a spread trade between the input costs of the mine, which are industrial commodities such as steel, rubber oil, etc., and the output, which is gold. **You therefore don't want to be in gold mining during a bubble because your margins will be squeezed; however, you do want to be in it during a bust.**

One last point is that on a long-term basis all the gold deposits in the world are getting slowly more valuable since commodity prices are falling against gold. You can see this in cutoff grades; a hundred years ago you needed an ounce per ton to make it profitable; you left behind any ore that had a lower grade than that. However, today the cutoff grade is a gram per ton, or lower depending on the deposit. **So as cut off grades fall, mines naturally replenish themselves because as technology advances these mines become productive again.**

**Ronald Stöferle:**

I couldn't agree more. I think it's important to talk about the financial consequences of this monetary insanity that we are witnessing, but also the moral consequences. In our recent book we explained that a lot of people these days are getting tattoos, i.e. their time preference is high. They want to consume and enjoy right now; they don't care too much about what will happen in five years. Such short-term thinking is dangerous for our financial system.

Mike Tyson has high time preference

Heinz, do you have any thoughts on this?

**Heinz Blasnik:**

I have also observed that the purchasing power of gold rises against commodities over the long-term. **As long as the amount of gold added to the total stock per year is lower than the increase in economic productivity, the purchasing power of gold will increase.** And this is proof that despite the demonetization of gold, the market still continues to regard gold as money. Gold is driven by monetary demand first and foremost, as opposed to its use in industrial applications or jewelry.

And I found Dan's point about gold in the ground very interesting, and I agree**. If you own a large gold deposit your best bet might be to wait until better technology is available to mine it, or not mine it at all.** The grades that are viable today are actually even lower than what Dan mentioned; in open pit mines a near surface deposit can be mined at 0.35 grams per ton. It's low, and it's getting lower. If you look at a company like Durban Deep, they have grades of 0.17 grams per ton and they mine them profitably (Durban Deep retreats old tailings left behind by gold mines in South Africa over the past century).

**A Durban Deep open pit mine:**

*Source: greenarea.me*

**Dan Oliver:**

If I can add to one of your points; I looked at the volatility of oil prices since 1971 when Nixon took us off the gold standard, and what's interesting is that the 12-month rolling volatility of oil prices in dollar terms is 64%. But when you look at it in terms of gold it's only 40%, so it's not just that the oil price goes down compared to gold over time, but volatility does as well. And it's extraordinary that for 100 years economists have told us that gold isn't money – today it's almost dismissed as a joke – but yet as you point out the market treats gold as money anyway. The market can't be fooled.

**Heinz Blasnik:**

**There are places in the world where gold is used as a medium of exchange. In Vietnam properties are exchanged for gold.** I think that if we didn't have a central bank, and let the market decide what our money should be, it would choose gold.

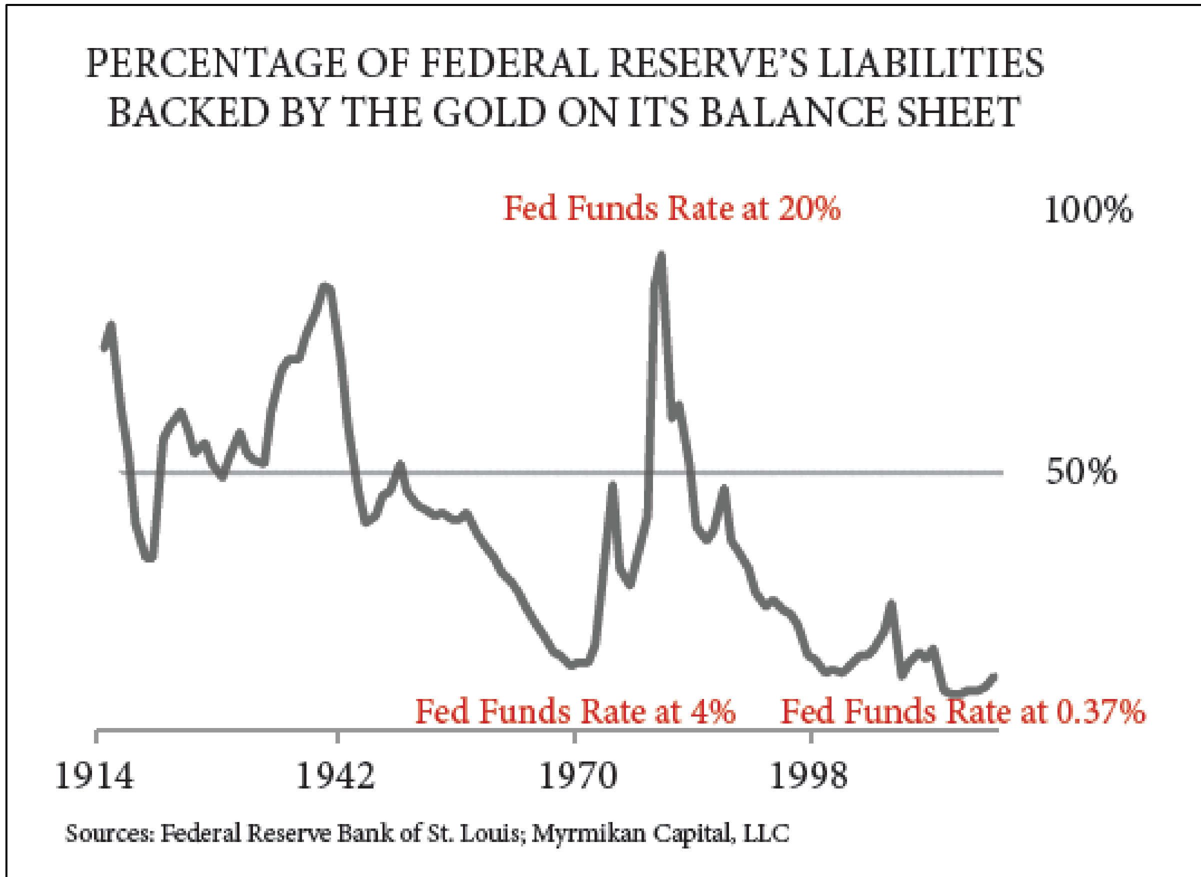
**Dan Oliver:**

That's a great segue into my next point; in low-trust societies you have to barter because when someone surrenders their goods, they want the good they are trading for immediately. But in high-trust societies people trust custodians. If you look back over the 19th century, the market allowed private banks to issue notes backed by up to 1/3 gold and 2/3 commercial bills. These commercial bills were short-term asset-backed commercial paper, effectively invoices – they were not working capital facilities. They were backed by goods that had already been sold, and the only thing

remaining was settlement. It was not an advance of credit, but an advance of liquidity, which is a small, but very important, distinction.

In any case, if we look back in history, we see that **every banking system starts with notes being backed by gold and/or commercial bills. Then you get legal tender laws and banks start to issue mortgages instead of bills; they create credit. Then they lower the discount rate, and malinvestment happens, and that's why we have bubbles.**

I sent around a chart showing the percentage of the Fed's liabilities backed by gold, and it was above 50% for most of the time between 1914 and 1942. What the chart does not show is that the balance during that time was mostly commercial bills, not government bonds. And then, when the Keynesians took over after World War 2, they tried to manage the economy and consequently started buying short-term government bonds. As a result, the percentage of liabilities backed by gold decreased because Europeans still had the right to withdraw their gold, which they did, and because the Fed was buying government bonds. The ratio fell to about 11% in 1969, which was the peak of the financial bubble of that period. An inverted credit pyramid is the best way to visualize a bubble, with cash at the apex (the bottom, since the pyramid is upside down) and mortgages, margin loans, derivatives, etc., at the top. Except in our system, the cash at the apex is really Federal Reserve credit, which is itself the top of an inverted pyramid that has gold at its apex.




*Source: Myrmikan Capital*

**Mark Valek:**

This is a perfect segue into a topic I wanted to talk about; the Fed performed an "insurance cut" in August, then one in September, and there will likely be a third cut soon. **It looks like we are in a new rate cut cycle**; this was not a surprise to us. The only surprise is probably that it started later than we expected. My question is if you think there will be more QE, or not? Jim, what are your thoughts; I'm sure you've looked into this, as well as the recent drama in the repo market?

**Jim Rickards:**

Sure, I'm happy to talk about that. I just want to comment on what Dan said. I agree that you should look at gold in comparison to other commodities; and I don't think it should even be looked at as a commodity; it's money. It's actually the best form of money. However, in your analysis you seem to be merging the balance sheet of the Treasury and the Fed. At some level that is OK; I think it's what Modern Monetary Theorists do, but from a legal perspective I think it's important to separate them. **The Fed doesn't own any gold. They have not had any gold since 1933.** There was a legal requirement that the base money supply should not exceed certain percentages of the gold

held by the Treasury. That changed in 1945, and again in 1968. Today that has been completely abandoned. So, the Fed has not had any gold since 1933 and they have not had any constraints on base money since 1968.

I don't mean to nitpick, but I think it's important to get everything technically correct when talking about gold because a lot of mainstream economists and commentators are hostile towards the precious metal, and you don't want to be shot down on a technicality when your basic economic analysis is exactly correct.

**Dan Oliver:**
That is actually an area I'm not hundred percent clear on: if you look at the Fed's balance sheet it says they hold $11 billion of gold certificates, and they list it as an asset with no corresponding liabilities. And the physical gold is held by the Treasury. However, when Ron Paul asked Fed officials if it was their gold or the Treasury's gold, they said "ask the Treasury department". And when he asked the Treasury department they said "ask the Fed". Therefore, it's unclear to me who actually owns it.

**Jim Rickards:**
There are some case studies on this. I think there was a failure by Congress in 1953 or 1954 to raise the debt ceiling, and Congress adjourned without raising it. The White House then had to figure out how to pay its bills, and they found a way around it. At the time the size of the gold certificate was less than the gold held by the Treasury, and therefore the Treasury just gave the Fed a new gold certificate using up some of the unallocated gold (gold not previously represented by a gold certificate) and the Fed took it at the then price of $35 an ounce and credited the Treasury's account at the Fed with new money. So, the Treasury's account was replenished without the issuance of new debt. It's like buying a treasury note, except the bought a new gold certificate.

**Dwight Eisenhower warns Congress in 1953 that the federal debt ceiling will soon be reached:**

*Source: CNN*

**Dan Oliver:**
But does that not imply that the Fed has a claim to the Treasury's gold if they have a certificate?

**Jim Rickards:**
The gold certificate is not gold, and the Treasury owns the gold. That much is clear. **The Treasury could call the Fed today and say that they are revaluing the gold from $42.22 an ounce to $1,500 an ounce, and that the Fed should credit their account with the difference.** That would equal about $300 billion, which is about the difference between $42.22 and $1,500, given the 8,133 tons of gold they hold. That much is clear.

But here is what's not clear, and what I find intriguing; if you take the amount of the certificates and divide it by $42.22 you get almost exactly 8,100 tons, in other words the amount of gold held by the Treasury. In 1950 the Treasury had 20,000 tons of gold; by 1970 it was down to 9,000 tons and there was another 1,000 tons dumped on the market in the late '70s. But they haven't sold an ounce since 1980. It's almost as if the Treasury said to itself, based on behavior and logical inference, that it can't sell any more gold because it has to keep at least as much gold as the certificates

imply. So, it’s not the Fed’s gold, but the Treasury might be constrained to sell more gold for the fear of going below a certain level.

Therefore, after 1980 they suppressed the price of gold by getting the UK to dump 600 tons in the late ‘90s, by getting Switzerland to dump 1,000 tons in the early 2000s, and by getting the IMF to dump 400 tons in 2010. But since 2010 there has been no large-scale sale of gold by any developed market central bank. They have been net buyers ever since. I therefore think there is some linkage between the gold certificates and the physical gold, as demonstrated by the Treasury’s behavior. But legally they are separate.

**Central Banks’ sales and purchases of gold:**

Central bank demand in 2018 was the highest since Nixon closed the gold window

Tonnes

800
600
400
200
0
-200
-400
-600
-800

1971 1975 1979 1983 1987 1991 1995 1999 2003 2007 2011 2015

Net Sales Net purchases

Source: Source: Metals Focus, Refinitiv GFMS, World Gold Council

*Source: zerohedge.com*

**Dan Oliver:**

The chart above showing the percentage of the Fed's liabilities that is backed by gold is based on the balance sheet of the Fed as it is presented in its books, and I'm assuming the gold is there, and that they have access to it. And what I usually end on when I talk about this chart is that there hasn't been a physical audit of the Treasury's gold since the 1950s; nobody has actually seen it. So, if the gold is not there it implies that the dollar can collapse much further than the chart suggests. But the chart assumes there is gold there, and that at some level if the dollar collapses low enough the Treasury could buy back dollars using the gold and therefore stabilize the price. But if that is not the case, there really is no limit to how far the dollar could fall.

**Jim Rickards:**

The Treasury could sell gold if they wanted to, but the question is if that would push the amount of gold below the implied quantity on the Fed's balance sheet. The Fed has no claim on that gold, but there is something there. However, I can't say more than that, except for the fact that the Treasury has been dumping gold either through the redemption of dollars or through outright sales for 35 years.

**Dan Oliver:**

If we assume the gold is there the numbers are scary enough as they are. But if the gold is not there then the situation is much worse. **If the dollar was 100% backed by gold the price would be about $24,000 an ounce. That's to me the upper limit to the gold price today**, assuming the Fed doesn't expand their balance sheet, which is a very bad assumption. And it also assumes they have access to the gold; which you say they don't have. If you remove those assumptions gold can get to astronomical levels. But I don't think there's much point talking about gold at those price levels because you can lose credibility.

**Jim Rickards:**

I don't necessarily think you lose credibility. You just have to state your assumptions. When I calculate the implied non deflationary price of gold, I assume we have a gold backed money supply, which we actually don't, and I use M1 money supply and a 40% backing, which was the U.S. standard from 1913 to 1935. That gives a gold price of about $10,000. Alternatively, if you use M3 and 100% backing, you get a price of $50,000.

**Dan Oliver:**

I’m looking at M0, i.e. the actual notes in circulation, and a gold backing of 20%-40%, which was the level when the balance was 90 days commercial paper. However, today the balance is 30-year government bonds, and therefore I think the equilibrium level of gold-backing will be much higher than 20%-40% backing; during a crisis it can go to 100% and beyond. I think the gold price will eventually get to a point where it balances the Fed’s balance sheet; that’s its function. The lesson of history is that markets are stronger than the government and markets will revalue gold at some point. But the longer it goes, the worse this bubble gets.

**Mark Valek:**

This is a very interesting discussion, thank you for that. I think we should go to the repo question now; I think it’s a big topic for market participants these days because it suggests something is going on behind the curtains.

**Jim Rickards:**

One big question that has been hanging over the markets for the last 11-12 years is: how can the Fed reduce the money supply, and increase rates, without getting into a recession? They had to print almost $4 trillion of base money, and take rates to zero, to truncate the crisis and muddle through the longest but also weakest expansion in U.S. history. Why would the Fed raise rates, which they started doing in 2015, and why would they do Quantitative Tightening, which they started doing in 2017, in a weak economy? That is unprecedented. Normally the Fed doesn’t lead the economy, it follows it. So, why are they trying to lead it now? The answer is that Bernanke’s policies were so extreme that they left the Fed unprepared for the next recession, and they therefore had to raise rates, and reduce the balance sheet, in order to be able to respond to the next recession. I.e. when the next recession hits they can reduce rates again, and increase the money supply again.

But the problem is that you can’t raise rates, and reduce the money supply, in a weak economy because you will cause a recession. And that’s why they threw in the towel in December 2018. We were on the brink of a recession at that point. The Fed decided they would not raise rates further. Then by spring Powell said they would cut rates, which they did on July 31st. And then again in mid-September. He also said there would be an early termination of the QT program, which happened early July.

So, they stopped raising rates, and then they cut rates, and then they stopped the QT program. What was the missing piece after that? QE4. And sure enough, by August and into September we had the makings of a very severe liquidity crisis, which was shown in overnight repo rates.

**US overnight repo rate:**

*Source: zerohedge.com*

There are lots of reasons for that; people say the Chinese are dumping Treasuries because they are trying to hurt the U.S. and raise interest rates. It's true that China is dumping Treasuries, but they are doing it because they need the money, not because they want to raise rates. **The actual cause of the problem is that there is a global dollar shortage**, which people find unbelievable because the Fed printed $4 trillion. How could there be a dollar shortage if they printed so much money? It's because while the Fed printed $4 trillion, the world created $100 trillion of debt, a 25:1 ratio. And when there is a demand for redemption of that debt, but debtors can't roll it over, and they can't expand their balance sheets, a liquidity crisis occurs. There wasn't enough money to go around, and there was a shortage of good collateral. For example, hedge funds and other non-bank institutions (i.e. the shadow banking system) were pledging decent, but not great collateral,

such as mortgage backed securities, in order to finance the purchase of more mortgage backed securities. All of a sudden, those reverse repo counterparties, like J.P. Morgan and Goldman Sachs, were calling for more, or better, collateral.

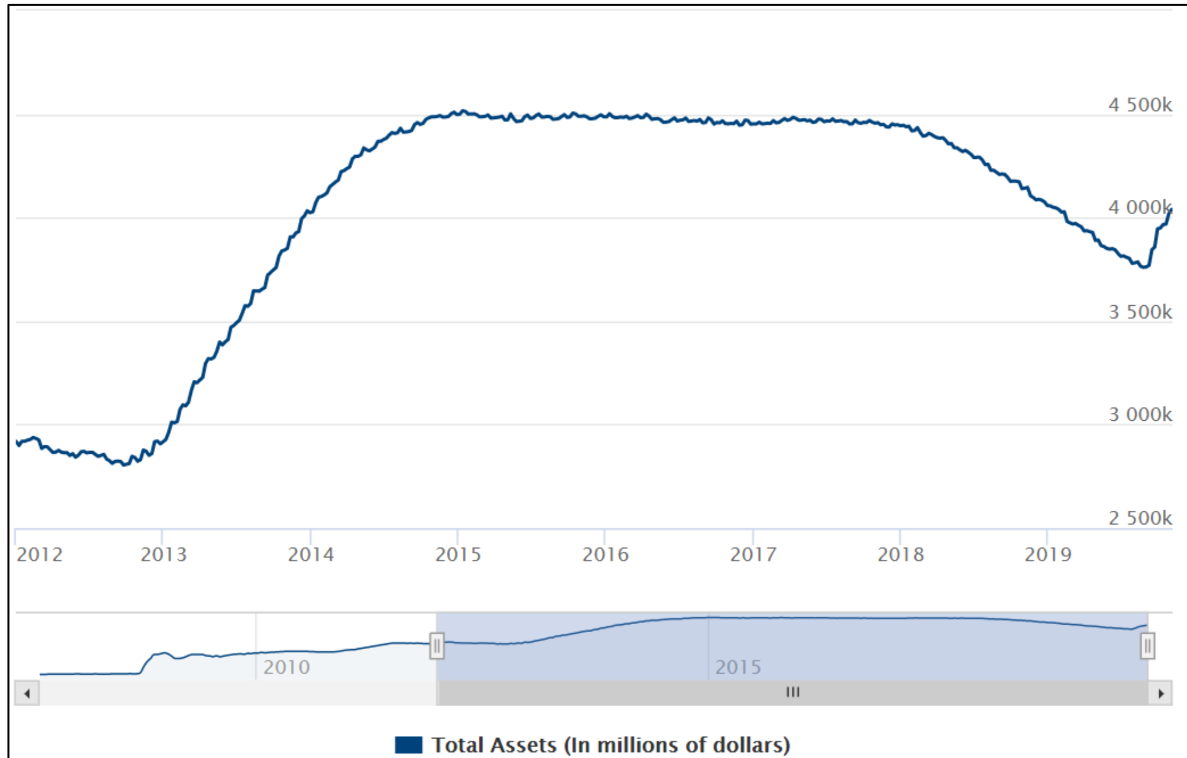
And this liquidity crisis was rippling through the shadow banking system, which increased the demand for Treasuries because they could pledge it to their counterparties and keep their lines of credit open. Yet, at the same time the Fed was buying Treasuries, making them scarcer. And as the situation became more acute the Fed did some reverse repos; they started at $75 billion per day, and said they would do it for a week. But that wasn't enough so they increased it to $100 billion per day and said they would extend it to mid-October. And then most recently they said they would make them term repos, not overnight repos. And Jay Powell said "please don't call it QE4", but **what they are now doing is to effectively tip toe up to QE4**. They increased the amount and duration of the purchases, and made it open ended. The reason why is because they learned the hard way between QE2 and QE3 that by pre-announcing the timeline, and the amount they would print, the market would discount it straight away. Therefore, when it came to QE3 they made it completely open ended; they did not announce a termination date, and they made it unlimited. They reserved the right to keep the program going for as long as they wanted, and to increase or decrease the amount per month as they saw fit. As such, the market could not discount what the Fed would be doing.

We are currently seeing a re-enactment of that strategy; reserving the right to change the amount as they see fit, and also keeping it open ended. Therefore, the Fed has now fully reversed course; they are cutting rates instead of raising them, and they are increasing the money supply instead of decreasing it. **In other words, their efforts to normalize failed, and that is a big deal. If you can't normalize, you are not ready for the next recession.**

But the most interesting question to me is: what was causing the liquidity crisis to begin with? Why was there a shortage of good collateral? A good way to explain it is if you take a patient's temperature, and you see that they are ill, you might not know the cause of the fever, but you know it's a sick patient; something is wrong. And the Fed was seeing that there was something wrong in the market. Someone might have gone broke; there was speculation it was WeWork. Somebody somewhere was short of good collateral, or cash. And when the Fed started these reverse repos, taking in Treasury bills and putting cash in the system, two things were happening: (1) the Fed took good collateral out of the system by buying Treasuries, exacerbating the shortage of good collateral, and (2) the banks were not lending the money that the Fed gave them; they turned

around and put it on deposit with the Fed. So, the Fed did not get the positive outcome they were looking for, which is why they extended the termination date of the program, and increased the amount.

**The Fed balance sheet:**




*Source: federalreserve.gov*

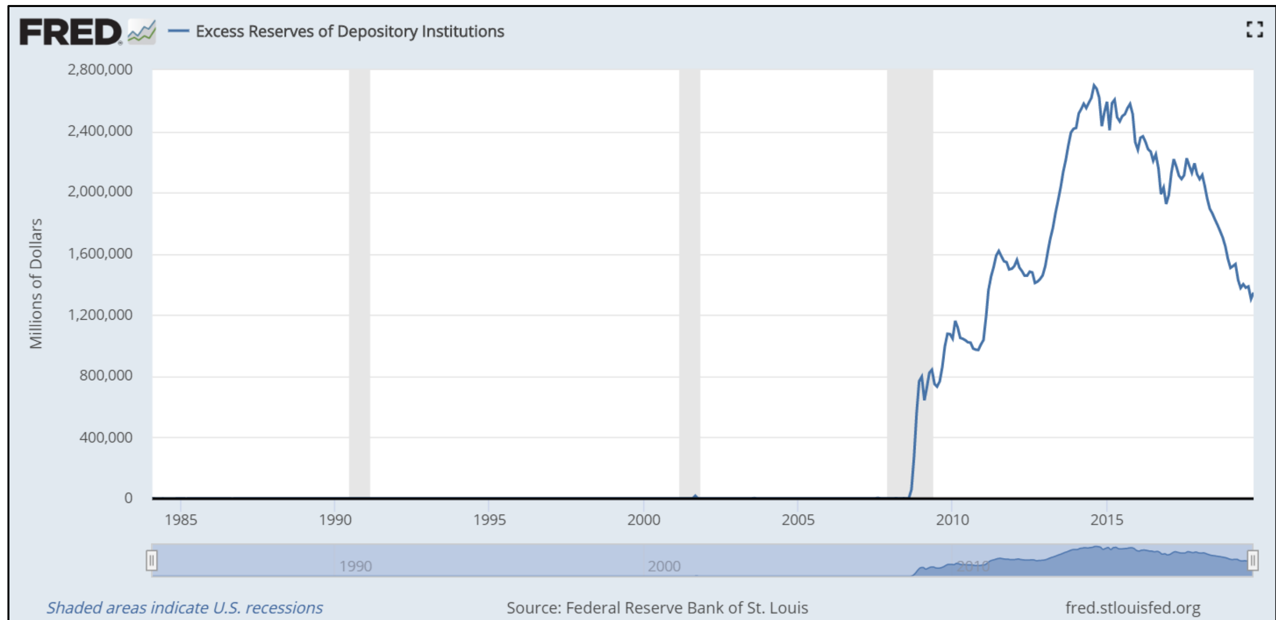
**In summary, something is going on. The Fed has shown an inability to normalize its balance sheet or get away from the drug of injecting QE doses into the market.** They have put out the fire for now, but I don't think it's a permanent solution. There is a dollar shortage, and there seems to be a player out there who is in distress. And the banks are receiving more reserves, but they are not lending the money. The Fed doesn't really know what it's doing, and they are just feeling in the dark.

**Dan Oliver:**

Jim, I'd like to get your take on something; I've been reading that as the Fed was engaging in QT, and the excess reserves were shrinking, I believe, from around $2.7 to $1.4 trillion, there was the idea that there existed $1.4 trillion of excess money sitting there waiting to capture the spread in the repo market. But that didn't happen. The repo went to a 7% premium, but the banks just sat on

their hands. The theory that I have read is that the banks need to be able to wrap up their operations within 30 days, according to their living wills. And they need actual cash at the Fed to do that, and therefore the excess reserves are not actually excess, they are reserves needed for regulatory purposes.

**Excess reserves of depository institutions:**




*Source: fred.stlouisfed.org*

When a repo borrower shows up at market, they usually tender MBSs or Treasury bonds, and if you look at the Fed's repo operations, which was designed to step in to the shoes of the big banks, most of the assets they are accepting in these repos are Treasuries. And I've heard that the Fed is hoovering up Treasuries, but there are not enough Treasuries out there. And yet when the shadow borrowers are in trouble they seem to have plenty of Treasuries to pledge to the Fed in return for cash. My view is that the amount of Treasury bonds has exploded since the debt ceiling was renegotiated. When I look at the numbers there seems to be too many Treasuries compared to the amount of cash that the banks are able to lend into it, on a regulatory basis. But the theory that there is no excess cash seems to have some weight to it, and I'd like to hear your thoughts on it.

**Jim Rickards:**

You're right that the number of Treasuries is going up; we are now back to trillion dollar a year deficits, which were last seen in 2011/2012. But I don't think you can look at Treasuries in isolation, and I don't think the ratio of Treasuries to excess reserves is that meaningful. The only way to think

about whether there are enough Treasuries or not is to ask yourself how much debt those Treasuries are supporting. The non-bank lenders (e.g. hedge funds, mutual funds etc.), i.e. the shadow banking system, does not have access to the Fed so they have to go through real banks. The real banks are therefore the intermediaries. And I don't think it's possible to think about a shortage or surplus of Treasury securities unless you compare it to the amount of debt that those Treasuries are being asked to support. So, there are more Treasuries in the market, and the ratio of Treasuries compared to reserves is going up, but I'm not sure those things are meaningful.

My question would be: what is the amount of Treasury debt, which is the best collateral in the world, available to be pledged for other forms of debt? But we don't know what the other forms of debt are because there is no transparent reporting mechanism. Each bank knows its counterparties, and each participant knows their balance sheet, but nobody knows the big picture, including the Treasury and the Fed. I'm therefore not comfortable saying there are too many, or too few, Treasuries, but based on what happened in the repo market it seems like there are too few. The conundrum is that the Fed can print all the money they want, but to do so they have to take in Treasuries, which reduces the supply of Treasuries that are available for pledging to support debt. And the new money that is created doesn't do any good because the banks are not lending it.

As far as the reason why the repo rate went up, the explanation you read about regulatory capital could be an answer, but it's the third explanation I have heard. When it all started, they said that it's because the Treasury gets a lot of tax revenue in October when people file their tax revenues, and therefore that account was depleted in September. Then there was a second reason saying that it was third quarter window dressing. And now there's this third reason that it's because of capital regulations. I think they are all plausible. But it reminds me of the period from 2015 to 2017 when inflation was declining and Yellen was raising rates because she was afraid of inflation. Everyone said there was no inflation, but Yellen said these factors leading to low inflation were transitory. Every quarter there was a different factor; first it was that cell phone charges were going down because there was a price war, then it was healthcare costs going down, and so on and so forth. There was always a new explanation, but the transitory factors turned out to be permanent.

Therefore, when I hear now that there are three separate explanations for why repo rates are high, I get the feeling they are not transitory, but permanent. The bigger picture is that the Fed is between a rock and a hard place, they are creating money, but it's not doing any good and they are exacerbating the situation by removing good collateral from the market.

**Dan Oliver:**

I think it could be a combination of those three things, and a need for liquidity**. If you think about it in the context of the Austrian Business Cycle Theory, what happens at the end of a bubble is that there is an enormous need for liquidity.** These three factors might be reducing the amount of dollars available at a time when there is an increasing demand for liquidity. And the only thing the Fed can do is to print more money because they don't want a replay of 2008.

**Heinz Blasnik:**

**There is a surplus of collateral now, and much of it is held by the primary dealers. They used to hold $75 billion in Treasuries and now they hold $300 billion.** And it is true that the regulatory requirement for the living will is that the banks must pre-fund their liquidity needs every day in the morning instead of having the latitude to comply with the liquidity coverage ratio in the afternoon or evening and that is one of the reasons for the current repo market situation.

**Ronald Stöferle:**

Gentlemen, I'd like to switch the topic of the conversation a bit.

Dan, I was wondering if you could tell us a bit about your investment process, seeing as it is quite unique? I understand you invest a lot in small caps in the gold mining space, and do a lot of options and warrants.

**Dan Oliver:**

Sure, we began the conversation talking about the gold to commodity ratio, and that margins at gold mining companies can be squeezed during a boom because their costs go up relative to their output. And during a bust it's the opposite. I found that marginal players have a lot of operational leverage, and they have enormous upside during bubble times. And marginal assets are not "crappy" assets, they are just marginal. And they can come in the form of lower grade, more risky jurisdictions etc. The thesis is therefore that these companies are essentially call options that don't expire; however, they do decay because they are constantly raising money, which dilutes existing shareholders. If you own these companies when gold goes up a lot, which it does during crises, these companies can go up 20-30x.

One important part of my strategy is that I take my positions through private placements, and I therefore get a discount. The other thing is that these companies often don't have debt because people don't want to lend money to them, which means they are surprisingly resilient when the gold

price goes down because they don't have debt to service, and they can simply furlough their operations. The share price does collapse in such a situation, but the company can sit on the asset, and as a shareholder you won't lose your ownership stake to debt holders, or through massive dilution. And when the gold price recovers, the company comes right back. My example is that I was down more than 80% from 2011-2015, it was very unpleasant. But then I was up 400% in the first six months of 2016. But that does not happen with the majors because they are empire building and take on huge amounts of debt at the top of the cycle to buy huge assets; when the price reverses, they are stuck paying the debt off with reduced cash flows. Consequently, they sell off their assets at the bottom to survive. The small companies don't have the ability to take on debt, so they don't fall into that trap.

I market my strategy as a form of insurance. It makes sense to have a little bit of your capital in it, like an insurance premium. And I look at companies that have real gold, and real projects, in other words, not greenfields. These companies can make money at a gold price of $1,250, even if they are not that robust. But at a gold price of $1,500 the IRRs are 60%, 70%, or 80%. And what's extraordinary is that capital has not found its way into the sector yet, partially because a lot of the Canadian banks that used to look at this sector are out of the business, and all the promoters are doing marijuana stocks now. The major gold companies that should be acquiring these small companies are not doing it yet because they are trying to fix the previous mistakes they made, as well as merging with each other and selling off mines they don't want. So, there's a market dynamic where the value is already there, but the market has not recognized it yet.

**Ronald Stöferle:**
Thank you, Dan. I think we all agree with you, and I really like your approach. And I love studying your research, which people can subscribe to for free.

Just one quick question to everyone before we conclude the call: what is your top trade idea for the rest of this year?

**Jim Rickards:**
10-year Treasury notes.

**Ronald Stöferle:**
Excellent. What about you, Heinz?

**Heinz Blasnik:**

**Long gold stocks; I have been long for a while now, and I don't see any reason to change that stance.** And I also have a few options betting on a market correction, but it's not a big position. I am careful at the moment with regards to shorting. And by the way, I would love to get a list of Dan's favorite juniors!

**Dan Oliver:**

We can definitely have a chat off line. But I will say that a portfolio approach is very important because the volatility of the individual juniors is huge.

**Ronald Stöferle:**

Gentlemen, thank you very much for participating in this call, we will end it there. Have a good day and see you next time.

## Appendix: Permanent Members of our Advisory Board

**Zac Bharucha**

Zac began his career in finance at the investment bank Kleinwort Benson and later became an equity portfolio manager at Philipps and Drew Fund Management. He then moved to AMP Asset Management where he was responsible for managing more than GBP 1bn of institutional assets. Afterwards, he moved to M&G in London. Since 1998, he has developed absolute return strategies and specialized in equities and commodities. After 25 years in asset management, he retired from professional life in 2011 and wrote his first book about market timing.

**Heinz Blasnik**

Heinz is an independent trader and market analyst for the consulting firm Hedgefund Consultants Ltd, as well as an author on Austrian economic theory for the independent research house Asianomics in Hong Kong. Heinz also publishes the blog www.acting-man.com, on which he analyses developments in the financial markets and the economy from an Austrian School perspective.

**James G. Rickards**

Jim is the author of the international bestsellers *Currency Wars* and *The Death of Money: The coming collapse of the international monetary system*. He is portfolio manager at the West Shore Fund. During his career, Jim has held senior positions at Citibank, Long Term Capital Management and Caxton Associates.

**Dr. Frank Shostak**

Frank is chief economist at AAS Economics. He has over 35 years of experience as a market economist and central bank analyst. He holds a PhD, MA and BA honours from South African universities. He was professor of economics at the Witwatersrand University in Johannesburg. He is one of the world leaders in applied Austrian School of Economics and an adjunct scholar at the Mises Institute in the US.

**Rahim Taghizadegan**

Rahim is the founder and director of the institute for value based economics, an independent research institute in economical and philosophical issues in Vienna. He is bestselling author and a popular speaker internationally. Rahim studied Physics, Economics and Sociology in Vienna and Lausanne. He has worked in the fields of economics, space research and journalism. He has also taught at the University of Liechtenstein, the Vienna University of Economics and Business Administration and the Universität Halle an der Saale.

**Ronald-Peter Stöferle, CMT**

Ronni is partner of Incrementum AG and responsible for Research and Portfolio Management.

He studied Business Administration and Finance in the USA and at the Vienna University of Economics and Business Administration, and also gained work experience at the trading desk of a bank during his studies. Upon graduation, he joined the Research department of Erste Group, where he published his first “In Gold We Trust” report in 2007. Over the years, the Gold Report became one of the benchmark publications on gold, money, and inflation.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the book “Austrian School for Investors” and in 2019 “Die Nullzinsfalle” (The Zero Interest Rate Trap). Moreover, he is an advisor for Tudor Gold Corp. (TUD), a significant explorer in British Columbia’s Golden Triangle and a member of the advisory board at Affinity Metals (AFF).

**Mark J. Valek, CAIA**

Mark is partner of Incrementum AG and responsible for Portfolio Management and Research.

While working full time, Mark studied Business Administration at the Vienna University of Business Administration and has continuously worked in financial markets and asset management since 1999. Prior to the establishment of Incrementum AG, he was with Raiffeisen Capital Management for ten years, most recently as fund manager in the area of inflation protection and alternative investments. He gained entrepreneurial experience as co-founder of Philoro Edelmetalle GmbH.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the book “Austrian School for Investors”.

**About Incrementum AG**

Incrementum AG is an independent investment and asset management company based in Liechtenstein. Independence and self-reliance are the cornerstones of our philosophy, which is why the four managing partners own 100% of the company. Prior to setting up Incrementum, we all worked in the investment and finance industry for years in places like Frankfurt, Madrid, Toronto, Geneva, Zurich, and Vienna.

We are very concerned about the economic developments in recent years, especially with respect to the global rise in debt and extreme monetary measures taken by central banks. We are reluctant to believe that the basis of today's economy, i.e. the uncovered credit money system, is sustainable. This means that particularly when it comes to investments, acting parties should look beyond the horizon of the current monetary system.

## Cautionary note regarding forward-looking statements

THE INFORMATION CONTAINED IN THIS DOCUMENT HAS NOT BEEN INDEPENDENTLY VERIFIED AND NO REPRESENTATION OR WARRANTY EXPRESSED OR IMPLIED IS MADE AS TO, AND NO RELIANCE SHOULD BE PLACED ON, THE FAIRNESS, ACCURACY, COMPLETENESS OR CORRECTNESS OF THIS INFORMATION OR OPINIONS CONTAINED HEREIN.

CERTAIN STATEMENTS CONTAINED IN THIS DOCUMENT MAY BE STATEMENTS OF FUTURE EXPECTATIONS AND OTHER FORWARD-LOOKING STATEMENTS THAT ARE BASED ON MANAGEMENT'S CURRENT VIEWS AND ASSUMPTIONS AND INVOLVE KNOWN AND UNKNOWN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS, PERFORMANCE OR EVENTS TO DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED IN SUCH STATEMENTS.

NONE OF INCREMENTUM AG OR ANY OF ITS AFFILIATES, ADVISORS OR REPRESENTATIVES SHALL HAVE ANY LIABILITY WHATSOEVER (IN NEGLIGENCE OR OTHERWISE) FOR ANY LOSS HOWSOEVER ARISING FROM ANY USE OF THIS DOCUMENT OR ITS CONTENT OR OTHERWISE ARISING IN CONNECTION WITH THIS DOCUMENT.

THIS DOCUMENT DOES NOT CONSTITUTE AN OFFER OR INVITATION TO PURCHASE OR SUBSCRIBE FOR ANY SHARES AND NEITHER IT NOR ANY PART OF IT SHALLFORM THE BASIS OF OR BE RELIED UPON IN CONNECTION WITH ANY CONTRACT OR COMMITMENT WHATSOEVER.