May 31, 2022

**Goldman Sachs: Doing The Opposite Of What It Tells Clients Again?**

*"Always remember, markets take people out. That' s one of the glories of capitalism."* – Darla Moore

Taking a page from Darla Moore, one of our generation's most successful investment bankers and a classic American Horatio Alger story, allow us to posit that perhaps the greatest glory of finance is that unlike other industries, the smallest player can go toe to toe with the industry's goliath – all that matters in finance is the quality of the idea.

In that vein, this month Goldman Sachs, one of Wall Street's goliaths, doubled down on its recommendation to clients, proudly saying that 0% gold in portfolios was their recommended allocation.

Like other wirehouses who guide clients in a similar manner, Goldman's perspective was disingenuous at best. In this case their words were reminiscent of Jeremy Siegel's biased hit job on gold. Readers of Siegel's *Stocks for the Long Run* may recall that Siegel chose to only consider U.S. stocks in his comparison of equities vs. gold, ignoring the returns of overly indebted nations, a huge flaw as he cherry-picked the U.S. bourse when it was the world's dominant exchange. At the same time, Siegel never mentioned that gold's price was fixed for more than 70% of his study. Calling the world's most dominant exchange as a "proxy" for stocks vs. an asset that was fixed in price – what could be less fair?

Goldman's note this month may have been the most disingenuous review of gold since Siegel's study in 1994. Specifically, Goldman built its argument on the following points, advising investors maintain 0% allocations to physical gold:

1) Gold traded notably lower between 1980 and 2002

While it is obvious to anyone who can look at a chart this is true, Goldman fails to mention to its clients that the period they cited was the most atypical in American rate history. Without coincidence that period is the worst backdrop gold has endured since the nation's founding and the best backdrop for their recommended stocks and real estate. Even more relevantly, Goldman chose not to broach that the period is largely the mirror opposite of today's markets. Why?

Goldman knows 1980 represented the inflation peak in the US when rates hit 20%. Goldman also chose to end its study close to the inflationary low (excepting for recent QE distortions) as inflation bottomed in the early 2000's. By doing so Goldman held up the period investors should use as a framework for the future as one when rates moved from the 20% level and fell by 15%. To repeat that environment looking forward long end rates would have to fall to *negative* 15%. I would ask Goldman's clients - do you really think that is going to happen? We do not.

Perhaps most ironically, Goldman doesn't even mention that at the end of the period it held up for investors, the US government had stopped issuing bonds with U.S. debts at the level they were. The mega-trend behind Goldman's base case for investors was a backdrop that was rocket fuel for the valuations of stocks and real estate, the two assets Goldman suggests are the best hedges vs inflation. Conversely while this trend was in place it makes the need for gold, other than as an insurance allocation, insignificant.

What may be more likely?

Per our prior report ***Once In A Generation*** we believe we saw the trough in inflation in March 2020 and that we have entered a generational turn where inflation will remain a headwind for stocks and real estate.

Using Truflation as a more accurate gauge of inflation than the continually manipulated CPI measure, U.S. inflation is currently 12%.

This suggests that if the Fed really wanted to battle inflation, rates would need to rise towards the mid-teens to encourage investors to shift from spending money to saving it. Do you think your financial institution is going to pay savers ~15% anytime soon? If so, please let us know where you bank. The 1980-2002 period Goldman quotes simply could not be more inappropriate as a guide for looking ahead.

2) Goldman suggests that gold's past strength has been largely confined to periods awash in "inflation fears" such as in the early 1980s and soon after the financial crisis of 2008.

True to form, Goldman's carefully chosen verbiage tries to link gold to "fears" rather than track record. Why not compare gold's performance to stocks during real inflationary periods and not just when "fears" about potential inflation existed?

Goldman should have noted for its clients that if today's inflation persists, gold has consistently performed very differently in preserving wealth vs. financial assets than in the period Goldman highlighted. Specifically in the 1970's, when America's inflation was strongest and gold was trading freely, gold increased more than 15x while equities languished over the decade, not even doubling.

To further underscore how different gold's performance is during inflationary periods than what Goldman represented, if one considers the five most inflationary years over the last century, gold's average *annual* outperformance was 8x that of equities.

3) Goldman then switches timeframes and looks at the period from c. 1992 – 2021 and tells clients that equities and real estate have the highest likelihood of outperforming inflation "over time" while gold and commodities have not offered consistent protection against inflation.

Goldman chooses not to mention a truth that it knows all too well – that the rear-view mirror performance of equities and real estate that it is touting has been dramatically distorted and elevated by QE.

Earlier this year equity valuations were 30% above the richest bubble previously seen in the U.S., namely the dotcom mania. Even today equities are still above that bubble level despite the market correction that has begun. How early are we in the corrective process? Consider for all of the market's angst, the Fed has not even raised rates by 1% and QT is just now going to begin.

In many parts of the world bonds traded to illogical negative yields for the first time in 5,000 years of financial records spurred higher by central banks spending. On the heels of this bond bubble, real estate also benefitted from QE during the period Goldman highlighted. How significant has the Fed distortion been?

The Fed has bought nearly $3 trillion in real estate assets. Does anything else need to be said about potential risks to real estate with such publicly available data? The Fed's Esther George admitted:

*"Our presence in financial markets muddies price signals, encourages excessive risk-taking, and can foster financial instability."*

Said differently, with $1 trillion in incremental real estate purchases in less than two years from the Fed, what would investors think has been the cause of the real estate's price appreciation?

Year-to-date these same Fed assets have already lost approximately $500 billion … all stemming from a minuscule and entirely insufficient increase in rates.

Ironically despite Goldman's doubling down on its 0% gold allocation through April last month, it should be noted that gold has outperformed equities over one year, three years, twenty years, this century, and since gold began trading freely in America. It is only if one considers the five year and ten-year performance of gold vs equities that equities have outperformed the metal. Recognize again that each of those periods where equities have outperformed have been totally dominated by QE. And that should not come as a surprise. After all that was the entire point of QE - artificial government interference in free market pricing designed to elevate equities, bonds, and real estate. QE also artificially reduces the price of inversely correlated gold which investors should see as an attractive subsidy for their investment in metals. Even so, that is not bad relative performance at all for an asset with gold's risk profile.

**What Goldman Should Have Told Its Clients**

With approximately $225 trillion in global financial assets, gold investments including mining equities constitute approximately 1% of global wealth. If one were to consider the performance of gold during the most notable periods of market stress such as the great depression, the bursting of the dotcom bubble, the 2008 real estate crisis, etc. generally 10% allocations to gold protect imploding portfolio assets. In other words, in such periods investors with 10% allocations to gold emerge from the crisis with their net wealth intact.

Think about what that means for gold in today's environment. If investors choose to increase their gold allocations to just 5% of their wealth, the low bound of a gold allocation recommendation from many of our generation's most successful buy-side managers, that would require $11.25 trillion in gold investments. Unfortunately, even at that low percentage, it would require investors purchase ***more than four times the gold that exists in the world today***.

**What could push investors to want a 5% allocation to gold?**

This month investors observed the completion of a trend not seen in at least 100 years including the great depression: eight consecutive down weeks of the Dow Jones industrial average. In 2018 the Fed also spoke of raising rates and moving to tightening instead of printing. Markets crashed and at the time the press blamed President Trump for the financial pain. But without Trump to

blame this time is there any doubt the cause has been the dawning recognition among markets that if the Fed is no longer going to artificially elevate markets … markets will probably reprice lower?

2022's equity pain has a similar backdrop as 2018 - QT is just now going to begin, interest rates are far below inflation, negative real yields are back towards all-time highs and the markets are reeling. What do investors think will happen if we were to come close to nominal rates near inflation?

What is shaping up as potentially tragic, based on the recommendations financial advisors are making, is that investors don't need to sell everything and bunker down in nothing but gold. What history suggests is that it is very prudent to have some gold as a hedge against today's environment. As we have shown in past work, even during the QE goldilocks period for paper assets, having some gold exposure mixed in with equities and bonds has not been a material negative. On the flip side, having some gold during periods of inflation has been like having a financial life preserver. Below is a snapshot showing the trend of gold's inverse correlation to risk assets continues with golds performance versus equity year to date.

| Ticker | Last Pri | DAY CHG | DAY % | MTD % | QTD % | YTD % |
|---|---|---|---|---|---|---|
| DOW JONES | s32899.7( | -348.58 | -1.05% | -.27% | -5.13% | -9.46% |
| S&P 500 | 4108.54c | -68.28 | -1.63% | -.57% | -9.31% | -13.80% |
| S&P 100 | 1860.19c | -34.89 | -1.84% | -.61% | -10.81% | -15.24% |
| NASDAQ | 12012.73 | -304.17 | -2.47% | -.57% | -15.53% | -23.22% |
| NASDAQ 100 | 12548.03 | -344.86 | -2.67% | -.74% | -15.44% | -23.11% |
| RUSSELL 2000 | d 1883.053 | -14.621 | -.77% | +1.02% | -9.04% | -16.13% |
| RUSSELL 1000 GROWTH INDX | d 2384.811 | -57.355 | -2.35% | -.37% | -14.57% | -22.44% |
| GOLD SPOT $/OZ | 1851.19y | -17.39 | -.93% | +.75% | -4.45% | +1.20% |

Another analogy for investors would be this:

Imagine you are on a cruise liner at sea and there are menacing icebergs around you, the size of which have never been recorded before. The ship is supplied with one life vest for each passenger. Despite the danger around, instead of putting your life vest on which would be painless and historically has been notable protection, the ship's captain shouts over the loudspeaker:

***Don't' worry about the icebergs around you. Look at our wake – we didn't hit an iceberg yet. Throw your life vest overboard!***

If a financial iceberg hits like occurred in 1929, the 1970's, 1987, 2000, 2008, etc. investors need to recall that gold showed itself to be buoyant when stocks tanked.

Best case, investors know the markets are overpriced yet they believe they will be able to exit their risky exposure flawlessly so that they will not have any regrets of missed opportunities they

perceive in risky assets. If an investor were to have a 20% allocation to gold, he would still have upside exposure, via other assets, if the Fed is able to engineer further levitation. But if history matters, investors should have their life vests on. Gold's returns are even more admirable when properly compared to other currencies.

It should be noted that just since QE began in 2008, the Bureau of Labor Statistics states that 37% more dollars are needed to purchase what one dollar bought just 14 years ago. Little wonder that workers who save in dollars have been so devasted by policy errors. In contrast, currency diversifier gold has more than doubled in price during the same time.

Switching from the highly likely to conjecture we have a closing prediction. The need to include gold in a portfolio is so obvious we expect that as time unfolds, it will be revealed that Goldman's senior executives and the firm owned gold with their own capital. Reminiscent of when Goldman shorted sub-prime real estate with the firm's money while recommending its clients buy the same products that were about to be obliterated, if we are right about this, the impact is far more egregious. In 2008 only those who took Goldman's advice and bought sub-prime real estate exposure while Goldman shorted it were hurt. The number of Goldman clients who did so were limited in quantity. Goldman clients, and wirehouse clients more broadly, who do not have gold are far greater in number and the impact of Goldman's mistake will be borne by those investors sitting on sizeable paper currencies such as dollars and no gold exposure.

DO YOU HAVE A LARGE LIFE INSURANCE POLICY?

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We submit 20% allocations to physical precious metals is a baseline case today. We expect the historical 10% allocation will be seen as too paltry in retrospect given the previously unexperienced debt levels we have today here in the US and globally where for the first time in

history we have a synchronized debt crisis brewing as the issuers of each of the world's major currencies (Yuan, Euro, Yen, Sterling as well as the dollar) are overly indebted.

We expect the returns of various gold allocations will diverge widely. We suggest caution is warranted around paper gold solutions such as GLD. Conversations we have with investors who have piled $64 billion into the GLD suggest a lack of understanding about the limitations of GLD relative to the physical. This reality became more apparent last month with GLD's 8K which stated:

"we shall not be obliged to effect any requested delivery" … [if] "delivery is impracticable for any reason".

We call out to the army of financial advisors across the nation who have negative views on gold that your stance is indefensible based on history. You have a moral, if not fiduciary, obligation to do what is in your clients' best interests, not just what is in your firm's interests. I speak from experience having been at the vortex of the last financial crisis as a Lehman employee: You do not want the regrets of not having followed your conscience. As advisors you also do not want the anger and bitterness clients may harbor against you for not protecting their wealth when it was so easy to do so.

We work with financial advisors from around the nation and stand ready to have three-way conversations with investors and their advisors to drill more deeply into the details about customized gold solutions and how to execute those solutions in tandem with advisors and existing portfolios. We make the process easy and efficient for both investors and their advisors.

We expect time will show that the size of one's gold allocation within a portfolio was a fundamental driver as to one's success in the years ahead. The goliath Goldman's advice of 0% gold allocations could prove deadly to your net worth that you have worked your whole life to accumulate. Let us show you how to allocate to gold safely, easily, and efficiently in your IRA or for taxable accounts.