

GOLDS' RELATION TO INFLATION

by Mark Bentley, Executive Vice President, BTS Asset Management, Inc.



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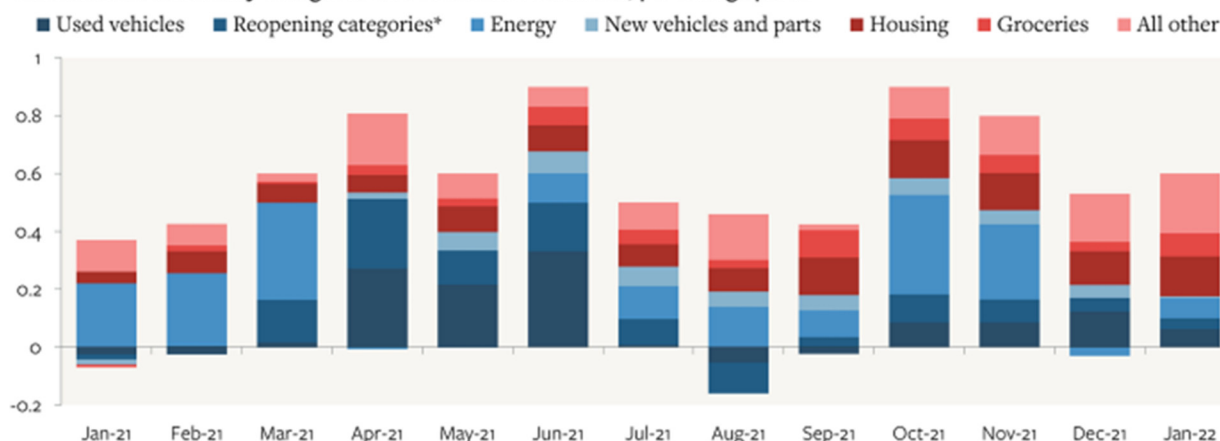
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The year-over-year change in Consumer Price Index (CPI) has reached another new recent high, coming in at 7.5% for January 2022. This now marks six straight months of increases, and you have to go all the way back to April 2021 to find a month in which the year-over-year increase was less than 5%. As these increases have compounded, the data releases each month have been marked by a wave of headlines pointing out that this number is the highest it's been in "x" years, with the most recent datapoint equaling the inflation last seen in the spring of 1982. But the inflation of 1982 was years in the making, and it has little in common with the inflation we are seeing today. Thus, investors may be better informed by looking a few years earlier to the inflation of the mid '70s when determining how to position their portfolios.

Today, inflation is on the rise. Back in 1982, it was in free-fall after Fed chairman Paul Volcker pursued an aggressive plan to crush inflation by raising the Federal Funds Rate to over 19%. He succeeded in curbing inflation but also contributed to the "double-dip recession" of the '80s. Historically, the Fed has been unable to push down inflation through interest rate hikes without causing a recession. Current Fed Chairman Jerome Powell is expected to follow through with a rate hike cycle this year, but with the Fed Funds Rate currently near zero, and with the lessons of the past in tow, it is reasonable to assume that his course of action will be less aggressive than Volcker's.

Inflationary pressures are still abundant in the economy. Global supply chains remain highly stressed while retail sales are soaring. Furthermore, when you break down the components of CPI changes, we have seen a recent shift that indicates inflation may be getting stickier. For most of 2021, monthly CPI changes were dominated by those categories most affected by the pandemic and subsequent reopenings, such as restaurants, hotels, airline fares, and others. But in the last couple of months, the CPI change drivers have shifted more towards all the other spending categories¹, which can't be so easily explained by a major exogenous shock such as a pandemic.

Contributions to monthly changes in U.S. Consumer Price Index, percentage points



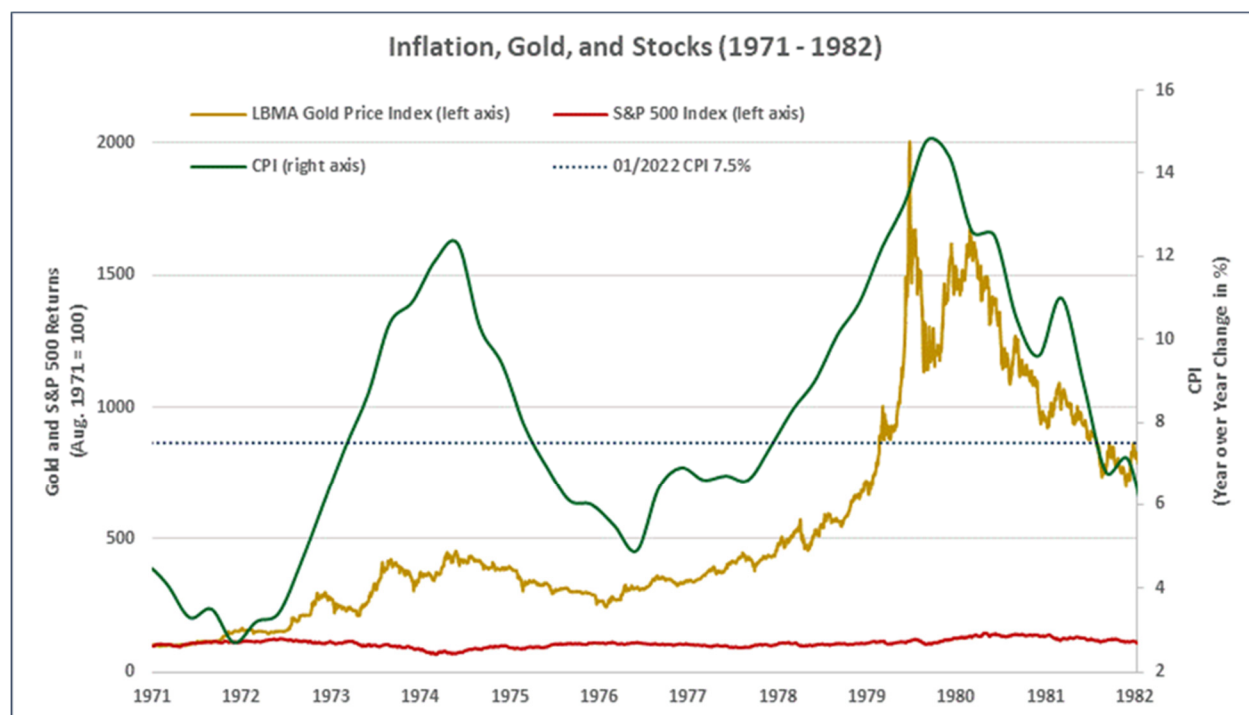
*Reopening categories are restaurants, hotels, airline fares, recreation services, personal services, club memberships, live events, school tuition and fees, childcare, personal care services, and motor vehicle insurance, rentals, and other fees

Source: Bureau of Labor Statistics, Matthew Klein's calculations

Source:

Matthew Klein, *The Overshoot*²

In the chart below, the horizontal dotted line represents our most recent year-over-year CPI % change of 7.5%. The last times that we saw inflation at this level and rising were 1973 and 1978. If the pattern going forward resembles the trend in those years, investors may want to shift away from traditional asset classes like equities, which were essentially flat from 1971-1982, to more nontraditional asset classes such as gold.



Source: Bloomberg

Gold investors were likely disappointed with the asset class's returns in the second half of 2021. Inflation was dominating the headlines, which often drives investors towards safe haven asset classes such as gold, but returns in the space were muted. However, when you look at past inflationary cycles, including the one of the 1970's, gold may be following a familiar trend.

When inflation begins to pick up in the economy, it is typically viewed as a temporary blip that will be easily weathered. It may even give the initial impression of growth and increased well-being. The Fed often further placates investors by using verbiage such as "transitory", like they did repeatedly throughout 2021 before dropping the word from their statement in December. This early indifference towards inflation often leads gold to underperform other commodities, as was the case in late 2021. However, when it becomes evident that inflation is more than a passing concern, it becomes a race for protection, and in this second half of the inflationary cycle, gold tends to be an outperformer. In just over three years, from 12/31/1976 to 1/21/1980, as CPI was on a second upswing, the LBMA Gold Price Index increased 531%.

Mark Twain once said that "History doesn't repeat itself, but it often rhymes." While the outsized gold returns seen in the late 1970s-early 1980s are unlikely to recur, it's important to remember that gold and inflation don't move in tandem. Widespread portfolio shifts to safe haven assets like gold are typically driven by behavioral finance, and it isn't until inflation has become firmly entrenched in the economy that investors begin to panic. In our view, the possibility of this trend repeating make gold an attractive asset class for 2022, while the volatile nature of gold makes it important to consider tactical strategies that can move to cash when appropriate. In any event, investors should look beyond the headlines to truly find which lessons of the past may be applied to today.

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¹<https://www.bls.gov/news.release/cpi.t06.htm>

²https://theovershoot.co/p/is-us-inflation-getting-worse?utm_source=url

The S&P 500 includes 500 leading companies in leading industries of the US economy and is a proxy for the total stock market.

Consumer Price Index is a measure of the average change over time in the prices paid by urban consumers for a market of consumer goods and services.

The LBMA Gold Price Index is the London Bullion Market Association (LBMA), a London-based international trade association that represents the wholesale over-the-counter gold and silver market in London. The LBMA Gold Price PM is set in the London gold market at 15:00 GMT, in U.S. dollars, serving as a benchmark for pricing gold. It is widely used by producers, consumers, investors, and central banks.

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BTS:

- Seeks to defend capital
 - Aims to offer upside potential
 - Strives to reduce volatility while delivering consistent long-term returns
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