

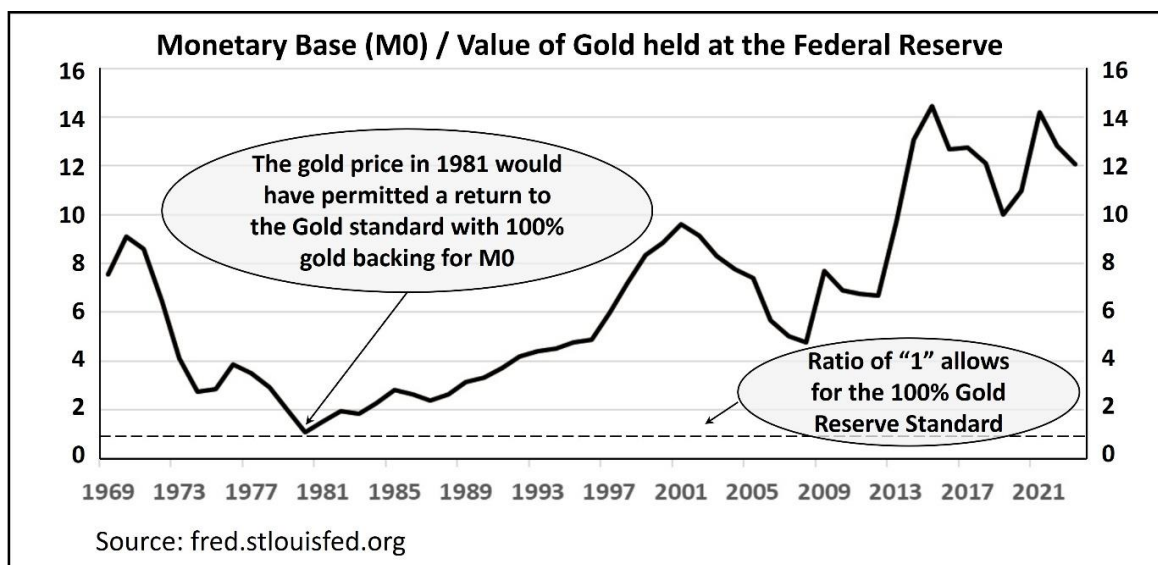
## Gold @ \$4,000/Oz – A Small Step for Gold; A Giant Blow to the Fiat Monetary System

There has been a relentless rise in gold prices over the last three years. From a bottom of around \$1640 in October 2022 to \$4000/oz today, Gold has delivered a 35% CAGR over the last three years.

Most analysts remain oblivious of the underlying causes and attribute the move in gold prices to economic uncertainty, geopolitics, Fed rate cuts, higher price inflation, Trump's tariffs, and other secondary factors. However, the Numero Uno factor is the return of Gold to the centre of the world's monetary system, and these are very early days as part of that transition. I would not be entirely surprised by an addition of "0" to the current gold price over the next 5 years.

### The Case for \$24,000/oz in the book "RIP USD: 1971-202X ...and the Way Forward"

The book laid out the base case for gold prices hitting \$24,000/oz by the end of the decade based on a return to "some form" of the Gold Standard by the US Fed. The \$24,000/oz number was based on a 100% backing for the M0 component of the then (Q1 2024) Money Supply and is shown below. The graph (reproduced from the book) indicates that at twelve times the then price of \$2000/oz, the Fed could have backed the base money (or "M0" component of the Money Supply) with its existing gold reserves.



### Ratio of the Monetary base M0 to the value of Gold (at a price of \$2000/oz)

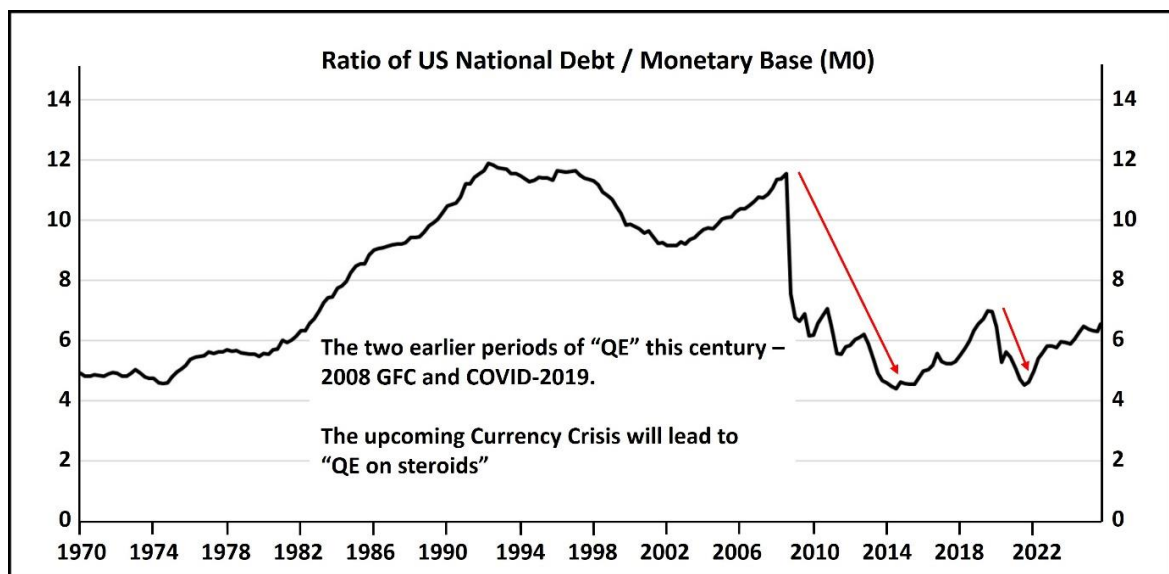
- i. A 100% gold backed standard can be implemented when this ratio is 1. The markets in 1981 had priced gold at a level that would have permitted a return to the Gold Standard.

What has happened since the book was published in June 2024? The one change is the election of Trump as President of the US, effective January 2025. Unquestionably, Trump inherited a horrendous fiscal situation. However, despite his pre-election promises to balance the budget and pay down the debt, he has only exacerbated the problem. Consequently, it is time to upgrade the targets, and as explained below, \$40,000/oz does indeed seem to be a reasonable projection.

### Funding the National Debt

The growth in the National Debt for FY2025, ending September 30, has been \$2.1 trillion and this is in line with the trend of the previous 5 years. However, the “Big Beautiful Bill” of Trump is expected to add at least \$3 trillion per year to the National debt – a near 50% increase from the recent trends of \$2 trillion annualized additions to the debt. FY2025 might well be the last year in which the annual additions to the national debt had a “2” handle.

Additionally, approximately \$7 trillion of the existing debt is maturing over each of the next three years. The implication is that nearly \$30 trillion of US debt will need to be sold over the next three years. What will that do to the Monetary Base?



The graph above indicates the external leverage that the US Government was able to get through the US Federal Reserve, financing a portion of the National debt. At its peak, between 1990 and 2007, for every \$1 of the Monetary Base, the US Government was able to sell (or more correctly, borrow) up to 12 times in international markets. When the Fed monetizes the deficit, it does so by buying Treasury securities (typically long-dated) by creating new currency, which increases the Monetary base. When there is a massive expansion of the deficits, a

significantly large portion of the US National Debt must be financed by the US Federal Reserve, which increases the monetary base. This causes the ratio to decline, as we witnessed during the 2008 GFC as well as during the COVID-19 pandemic. From these lows, the ratio has increased to 6+ as indeed it has today.

So, merely retesting the two immediate prior lows (at around 4) of the National debt-to-M0 ratio could send Gold's target to \$40,000 in the QE tsunami that is just ahead. A strong case can be made for why this 4 is a high number, given the bankrupt nature of US finances today, and that we should expect to see much lower levels in the years ahead. Even if the ratio doesn't drop much below 4, the National debt itself is expected to witness a steep increase in the years ahead, leading to a significantly higher monetary base. But we will leave that argument for another day. \$40,000/oz is good for now.

### **Wall Street Portfolio Allocation: A Paradigm Shift from 60/40 to 60/20/20**

For decades, Wall Street's traditional portfolio allocation rule has been 60/40, meaning 60% in stocks and 40% in bonds. Gold has been completely ignored, despite outperforming the DJIA for the past 25 years. The DJIA-Gold ratio has declined from 40+ at the start of the century to less than 12 today. In other words, excluding dividends, the DJIA, when priced in terms of gold rather than the US Dollar, has lost about 70% of its value in the last 25 years. The nominal gains are merely an illusion of monetary inflation!

Morgan Stanley recently changed its allocation from 60/40 to 60/20/20, i.e., 60% stocks, 20% in bonds, and 20% in gold. Almost equally interesting is the fact that they have recommended allocating the bond portfolio to shorter-duration income securities, indicating that they expect an increase in long-term interest rates. Finally, Wall Street is waking up from its apathy towards gold and recognizing the reality ahead.

***Now that Wall Street has recognized gold, does it signal the end of the bull market?*** Not in the least. Bonds are the quintessential antithesis of gold, and Wall Street recommending equal weightage to both signifies a very queer position indeed. Bonds today, especially long-dated bonds, are still the largest bubble in history, many times the combined size of the current HB2.0 and AI bubbles. The worst part is that any attempt to reinflate the other bubbles after they burst in the form of QE will deflate the bond bubble even more. Or in other words, the QE ahead will cause bond prices to plunge, and bonds (especially the long-maturity ones) will be the worst-performing asset category by a distance.

*"Not worth a Continental"* is a phrase that refers to the Continental Dollar, which became completely worthless in a few short years between 1776 and 1779. The 30-year treasury might well meet the fate of the Continental, and the US Treasury would be forced to discontinue the issuance/sale of these bonds. The US 30-Year Treasury is going to be the new Continental.

The end of the gold rally will occur when Wall Street assigns **zero** weightage to bonds in its model portfolio. Wall Street has taken decades to shift from a 60/40 to a 60/20/20 allocation, following 25 years of gold's outperformance compared to stocks and bonds. The next overhaul of the model portfolio will not take decades and will occur within this decade. The eventual model allocation by the time the gold bull market ends could well be 50/0/50.

### **Central Banks Gravitating Towards Gold OR Gold Price Gravitating towards a Monetary Status? - A Precursor to the Coming Gold Standard.**

By 1981, the value of Gold as a % of central banks' international reserves had climbed to 75%. The primary reason was not the increased gold buying by central banks, but rather the market revalued gold's price to reflect its monetary role during the previous decade, increasing it by over 25 times from \$35/oz in 1971 to over \$800/oz in 1981. Over the subsequent 3 decades, the dollar and other fiat currencies gained in perception to the detriment of gold. From a high of 75%, gold's value in the central bank balance sheets declined to just 10%.



Although it is still far from the 75% it should be at, an important milestone was achieved earlier this year. For the first time this century, the value of gold held by the central banks surpassed the holdings of US treasuries. The US has not exactly endeared itself to the other countries by its outrageous foreign policy, tariff tantrums, and, not to mention, the ballooning trade deficits.

Yet again, it is not the increasing gold holdings that are causing this, but the market revaluation of gold that is the primary factor. The gold holdings of central banks are estimated to be around 40,000 tonnes, while the annual mine supply is approximately 3,500 tonnes. The yearly purchases of central banks over the last few years have been around 1,000 tonnes, and even if they “double down”, this would increase gold holdings by only about 5%.

The above picture, indicating that gold is now the largest reserve holding of central banks, is a clear vote of no confidence in the US Dollar. However, the fatal blow to the fiat monetary system is still a while away, and the first cracks in the central banking system's sandcastle will appear when the central bank's holdings of gold exceed 50% of its reserves.

That scenario is not too far away. Within 1 to 2 years would be my guess.

### **About the Author**

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