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We do not often write articles on the economy or markets, focusing insterad on inidividual securities on our recommended list. However, there's a question on the minds of all gold investors and we thought it should be addressed. That is, why has not gold responded more to the manic money printing and growing inflation? And when will it do so? (That's two questions, actually!)

WHO'S AFRAID OF THE BIG BAD FED? GOLD SHOULDN'T BE

The big question on gold investors' minds, and for good reason, is why gold is not higher given the unprecedented money printing and rising inflation. The second question is when will it change?

To some extent, gold has simply been in a long consolidation after the extraordinary move early last year, when gold jumped over 30% from its end-March low to early-August high. (The gold stocks more than doubled.) That kind of move—in four months—is extraordinary for an asset that is intended as a hedge and an insurance. Gold is not supposed to do that. Bitcoin...Tesla... perhaps, but not gold! It has been a long consolidation, as month-by-month more and more people give up, while natural gold buyers feel there is no rush to invest.

Gold always has deep mid-cycle corrections

Gold is down nearly 8% year to date, and was down again in September, which is disheartening. But we should put that in context: gold was up 25% last year, so the pullback is less than one-third of the previous year's move up. The current gold bull market started at the end of 2015, when gold hit \$1,051. Gold cycles, both up and down, tend to be long; indeed the shortest have been the last two, in the 1970s and from 2001 to 2011. And it is not unusual for gold to have mid-cycle corrections, often caused by an extraneous shock. In the 1970s, gold dropped over 40% in a correction lasting 20 months. In 2008's credit crisis, it fell nearly 30% in eight months. So far, this pullback has taken 15% off gold's peak price—a piker by historical standards—and has lasted just 13 months, well within norms for mid-cycle corrections. I would suggest that gold bottomed in March at \$1,685, meaning the correction lasted less than seven months.

Strength in the dollar and stock market are an anchor on gold

There have been fundamental factors holding back gold, and three are most important. One is the dollar, which has moved up over the past several months as the "cleanest shirt in the laundry basket". However low U.S. interest rates might be, they remain meaningfully higher than those offered by other major world currencies.

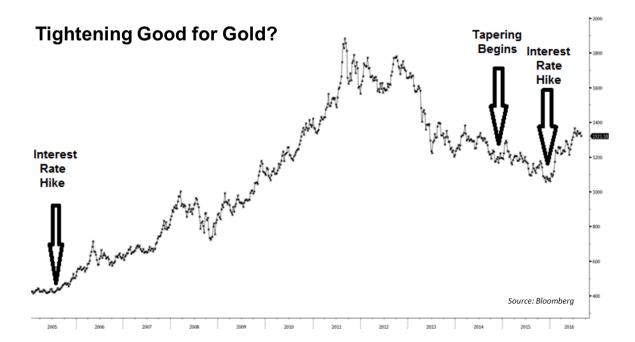
The second factor is that the stock market and other assets—including until recently cryptocurrencies—have been doing well. So long as the stock market moves up, investors believe that gold investments can wait.

The third major factor holding back gold is the Federal Reserve's constant threat to start tapering. The Fed has a history of talking more than doing, and, for reasons beyond me, the institution still has credibility. It is not only gold that has not responded to money printing and inflation, but other assets such as TIPs and bonds are also not acting the way one might expect, all seem to buy the Fed's narrative.

The Fed's bark is worse than its bite

Let's be clear about a couple of things. First, tapering is only reducing the pace of new purchases; it is not selling anything. So the Fed's balance sheet, which has continued to grow at an accelerating pace the last couple of months (24% in the last three months compared with 19% in the last 12 months) even as they discuss tapering, will still be larger a year from now than it is today. Second, as Powell himself made very clear in his Jackson Hole speech at the end of August, the Fed is separating tapering from raising interest rates. The Fed won't be raising rates any time soon.

It is going be a while—I think at least 2023—before the Fed increases rates, and even then, it will lag inflation. This is why Fed jawboning has more effect than action. The Fed threatening tightening makes investors nervous. Any cut back is, *per se*, a negative for the bond market, but not so for gold. Once they actually start tightening, the market sees that what the Fed is doing is never sufficient, and so rises.



The fact is that many times in the past gold moved down in advance of Federal Reserve tightening, responding to growing talk, but turned when it actually started to tighten. This is "buy the rumour, sell the news", only in reverse. Gold acts this way because all-too-often when the Fed does actually start to act, it is too little too late.

The Fed starting raising rates in August 2005, and again in December 2015, after months of discussion. In both cases, gold bottomed the same month rates started being hiked. Similarly in May 2013, when the Fed started talking about tapering, gold slid for the next several months. It was just before Christmas that we saw the first rate hike, and gold bottomed almost to the day. It rose over 16% in the next three months, and the stocks jumped by 32%.

The gold stocks are extraordinarily undervalued

The major miners (per the XAU) more-than-doubled in the end-March to early-August period last year, so they too have experienced a long consolidation. The stocks are now extraordinarily inexpensive, with the senior and intermediate gold companies trading in the lowest 25 percentile of their historical valuations, and more-or-less the lowest price-to-free cash flow ever. Given the price of gold...given the strong cash flows...given the improved balance sheets (the XAU is net cash positive today)...given the improved discipline among top mining companies, today's low valuations are a gift.

We all know that gold stocks are volatile. But that volatility works both ways, and once gold starts to move up convincingly, then the gold stocks will respond very strongly. It is worth noting that flows into gold ETFs and other investment vehicles are very procyclical, so we can expect flows to increase as the gold price moves up.

The recent action has been frustratingly modest and volatile. However, the longer gold meanders in its current trading range, the faster and stronger the eventual move will be. In the meantime, gold investors can accumulate at prices that will appear very good in a few years' time. They should not wait too long.

BEST BUYS NOW Osisko Gold (OR.NY, 11.65); **Wheaton Precious** (WPM.NY, 38.21); **Midland Exploration** (MD, Toronto, 0.62); **Lara Exploration** (LRA, Toronto, 0.54); **Royal Gold** (RGLD, Nasdaq. 94.07); **Fortuna Silver** (FSM.NY, 4.15); **Barrick Gold** (GOLD.NY, 18.52); and **Pan American** (PAAS, Nasdaq, 23.99).

QUOTE OF THE WEEK Chevron CEO Mike Wirth said he would not be investing in solar or wind power, which have low returns. "We'd rather dividend it back to shareholders and let them plant trees," he said.

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