

The Healthy Skeptic.

with Jeff Sarti

WHAT GOLD IS REALLY TELLING US



DIVE INTO WHAT'S INSIDE:

- + Gold's surge may reflect the erosion of the dollar as the money supply continues to expand.
- + The hidden flaw in measuring wealth in dollars when the currency itself steadily loses purchasing power.
- + Why gold has remained a core portfolio allocation since 2015 as protection against rising debt and monetary expansion.

When currencies are printed without limit, the role of gold becomes simple: protect purchasing power.



GOLD HAS BEEN A CORE COMPONENT OF MORTON WEALTH PORTFOLIOS FOR MANY YEARS.

In fact, we instituted a gold allocation across our portfolios over a decade ago, in the summer of 2015. We stuck our neck out there as a firm by implementing this position. After all, we had already incorporated so many different alternative investments beyond stocks and bonds, why add another? And, even more of a head-scratcher, why add a position to the portfolio that can be volatile, has long periods of unpredictable and even disappointing performance, and distributes no cash flow whatsoever? What were we possibly thinking?

Quite simply, we felt risks were brewing that were wildly misunderstood by the larger investment community, and gold had unique attributes that could protect against those burgeoning hazards. We had no idea when that brew would lead to a violent boil, but we still persevered with this conviction. Our most important goal is to protect client portfolios, full stop! So, we were more than willing to veer from the status quo and engage in many passionate conversations with you, our clients, articulating our rationale.

While there are many reasons for owning gold, from protecting against uncertainty and geopolitical risk to its role as a diversifier from stocks and bonds in a balanced portfolio, for us there is a more basic rationale. As I laid out in my [white paper](#) in 2015, gold is a store of value, plain and simple.

This term “store of value” can be thrown around in a cliché fashion and is commonly misunderstood. But the beauty of this phrase is in its simplicity, which eloquently describes gold’s true purpose.

STORE OF VALUE

Perhaps a simple illustration will convey this definition of gold as a store of value. Imagine a game with the following components: 100 hungry individuals competing for 100 apples. It's a closed ecosystem where these numbers don't change. There are no births or deaths and there are always 100 apples in circulation. As soon as an apple is consumed, a new one is produced to replace it.

Also assume that each individual has two pieces of money: a single gold coin and a single dollar bill. So, this imaginary universe has 100 gold coins and 100 dollar bills. And each gold coin and dollar bill are interchangeable for the other, meaning they are of equal value.

Hungry individuals then start competing for these apples and are willing to pay a certain price for each apple. Let's assume this equilibrium resulted in an apple transacting at the value of either one dollar or one gold coin. Simple and clean.

Now, let's assume that one of the creative players in this game came up with a mind-blowing invention. He was an empath who wanted his 99 friends to be wealthier. So, he created a machine that magically created more dollars out of thin air. What a wonderful innovation! This magic money machine was able to create an additional 100 dollars before finally running out of steam. Suddenly, each individual had two dollars instead of one and felt immediately richer.

He tried to do something similar with gold and toiled day and night to create a magic gold machine that would double the supply of gold coins. But alas, gold exhibited unique properties, very different from paper dollars, whereby no new gold coins could be created.

But that was okay because, after all, the players in the game were still jazzed with their newfound dollar riches. After some time, however, something unexpected happened. Player behavior adjusted. Since players had more dollars than gold coins, they were willing to pay more dollars for the same apple. Slowly, but surely, the price of apples moved to \$2 as opposed to \$1. Similarly, while a single dollar had previously been equivalent to one gold coin, now a gold coin was worth \$2.



While the price of the apple doubled, from \$1 to \$2, was it actually more valuable? Of course not. Each apple was still ruby red, sweet, yet tart, and contained 95 calories. An apple is simply an apple and satisfies one's hunger the same way, whether it is priced at \$1 or \$2. Similarly, was the gold coin more valuable? After all, it previously could be exchanged for one dollar and now was worth two dollars. Nope! Just like the apple had a "value" inherent to its own properties, the gold coin's true value was unchanged. A coin is simply a coin and could purchase one apple, just as it did before.

Wealth was not created by this spontaneous printing of dollars. Once the euphoria wore off, the players realized that no true value was created. An apple was still an apple, a gold coin "stored its value" as a gold coin, and the value of each dollar was cut in half.


DOLLAR AS A MEASURING STICK

When most people think of their net worth, they think of it in dollar terms. However, the imaginary example above illustrates the flaw in measuring one's wealth with a measuring stick that is not fixed in nature.

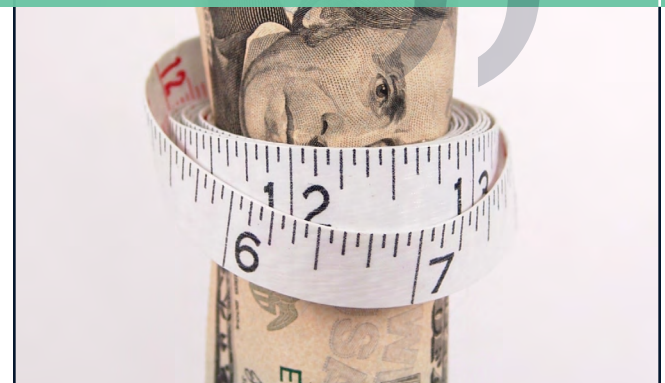
Let's assume that over time, your net worth in dollars doubles from \$1 million to \$2 million. The flaw with this methodology is that a dollar, the measuring stick we all use, is not fixed in nature. In fact, it moves over time. More specifically, it degrades over time. As the apple analogy shows, when more dollars enter the system, the value of each dollar erodes.

This is exactly what has happened across all global societies with each passing generation. Every country's printing press churns out more of their currency every year, and we have done the same with our American dollars.

There are many ways that this growth in supply of dollars can be measured. A standard measure is the M2 money supply, which includes cash in circulation, checking accounts, savings accounts, CDs and money market funds. The current amount of dollars under this M2 framework is \$22 trillion. It was \$11 trillion in 2014, meaning that the money supply doubled in 11 years. It was roughly \$5.5 trillion in 2002.



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In essence, the money supply doubles every 11–12 years, which means dollars are printed into existence at roughly a 6% rate each year. The more dollars in existence, the less dollars are worth over time and the more the price of apples (and everything else) goes up.

There are many ways to measure inflation; our government uses various methodologies with the Consumer Price Index (CPI) being the most widely accepted. CPI is a very complex measure of inflation (in contrast to the money supply calculation above) that is convoluted and, at the risk of opening up a can of worms, flawed in its construction.

That being said, CPI states that inflation over this 2002 to 2025 timeframe has averaged 2.6% per year. I don't know about you, but my gut tells me that prices have increased by more than 2.6% per year. Visits to the grocery store, healthcare costs or the price of concert tickets tell very different stories. Instead, I veer towards the more simple methodology of estimating inflation, namely the change in money supply over time. Simply put, my best estimate is that the value of our dollars degrades by roughly 6% each year. In stark contrast, gold has maintained its purchasing power over time.

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HAS GOLD GONE UP TOO MUCH?

While gold has passed the test as a store of value over the long term, over shorter-term periods gold can be volatile and underperform. For instance, during the decade of the 1980s, gold actually displayed modestly negative performance. On the other hand, since the summer of 2015, when we instituted our gold position, it has returned 13.8% per year annualized, outperforming other asset classes and surpassing its promise as a store of value.

AVERAGE ANNUAL TOTAL RETURN* (%)

OUNZ (Share Price)

1 YR

47.57

5 YR

20.56

10 YR

13.26

JUL/AUG 2015

13.84

So, the concern is, at least over the short term, has gold run up too much too fast, exceeding its store of value definition, and now is due for a breather? In other words, at roughly \$4,500 an ounce, does an ounce of gold actually have too much purchasing power, thereby outstripping its role as a store of value? The simple answer is “perhaps,” and the near-vertical move up in gold in the last year or two does give us pause. This is why we continue to maintain our discipline and rebalance our gold position in client portfolios (taking gains) to bring it back to our targeted levels.

But putting our long-term hat back on, our thesis has not changed, and we believe gold is still warranted as a store of value in client portfolios. Here are a few data points that illustrate why gold still has potential upside from here: Gold’s previous peak in January of 1980 was \$850 an ounce and then in the ensuing years it retreated to the \$300–400 range. So, depending on your timeframe, gold, at roughly \$4,500 an ounce, has gone up from roughly 5 to 15 times since the 1980s.

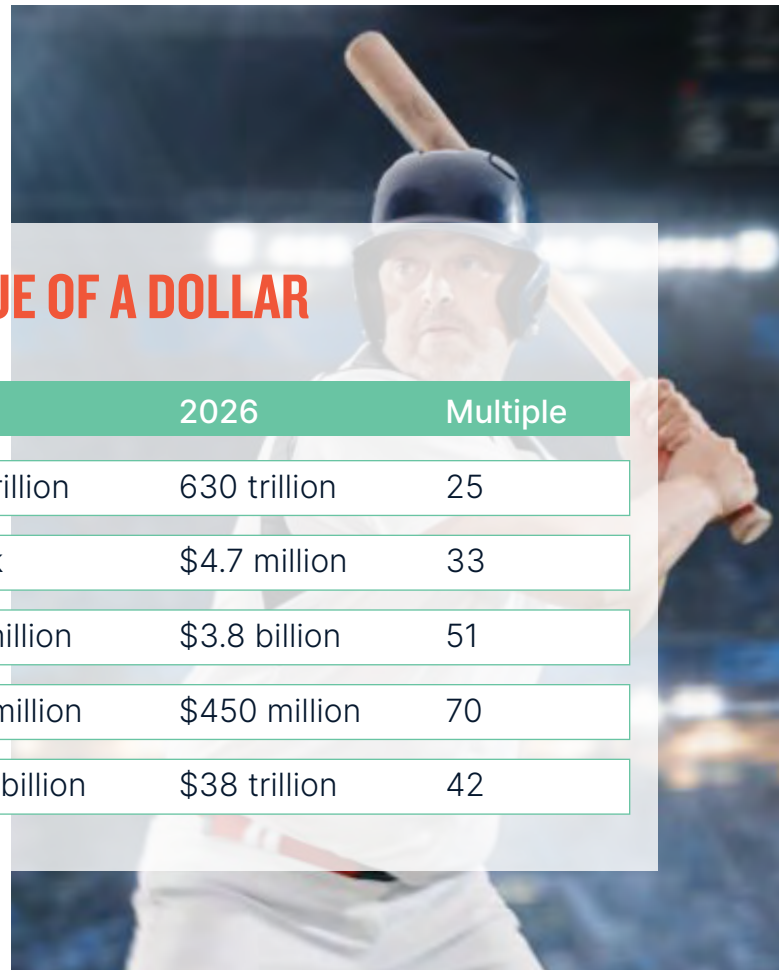
Let’s look at how much other things have gone up in dollar terms since 1980:

The price of goods and services, as measured by CPI, simply does not tell the whole story of inflation and degradation of the dollar. The asset prices and other metrics below clearly illustrate how vulnerable the value of your dollar has been over the long run. Also, when looking at these numbers, the recent rise in gold’s price suddenly does not seem as frothy and illustrates the fact that gold may have more upside from here. Even at \$4,500 an ounce, gold has not appreciated as much as the items in the table below.

You may notice that the last item on the list—federal debt—doesn’t quite fit with the others. After all, it’s not a price or asset value but instead a liability. The reason for including this number is that I believe it is the most concerning factor related to the continued debasement of our dollar over the long run. I’ve hit on this point ad nauseum over the years, but it’s worth repeating. Our debt levels are utterly out of control, and I believe we are past

THE ERODING VALUE OF A DOLLAR

	1980	2026	Multiple
Global Financial Assets	\$25 trillion	630 trillion	25
Avg MLB Salary	\$143k	\$4.7 million	33
Forbes 400 Wealthiest Entry Point	\$75 million	\$3.8 billion	51
Highest Priced Painting	\$6.4 million	\$450 million	70
Federal Debt	\$900 billion	\$38 trillion	42



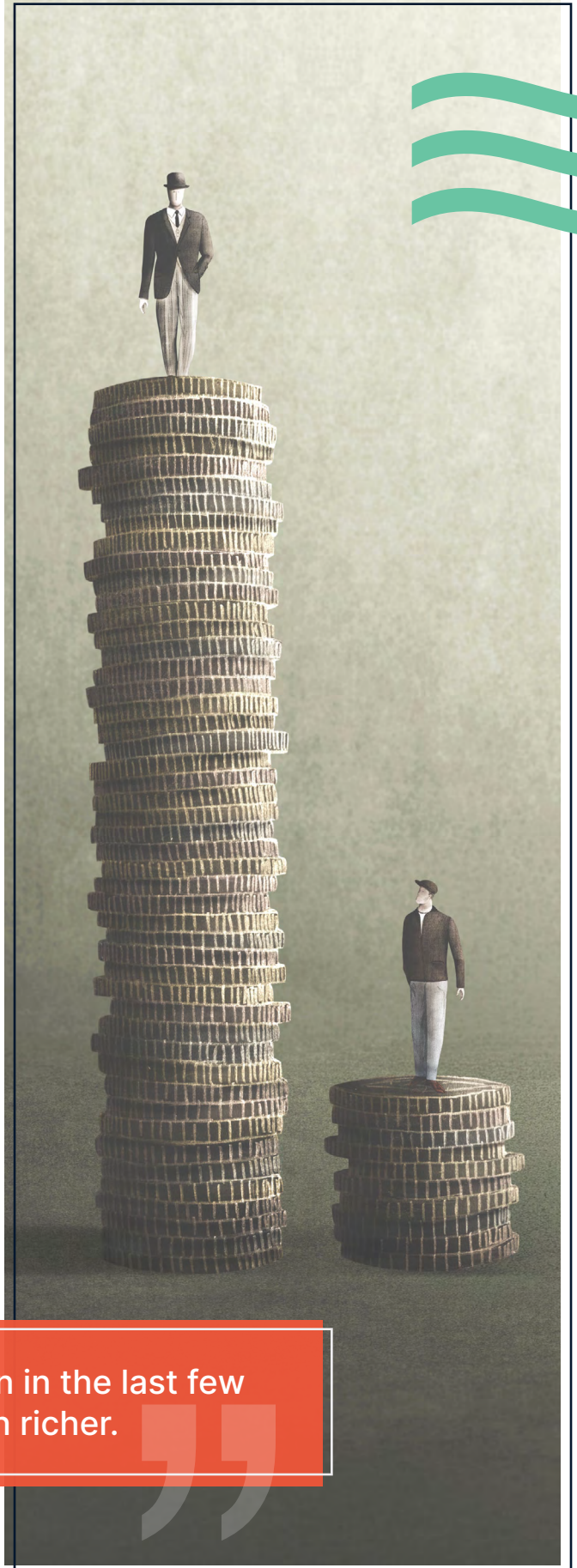
the point of no return regarding solutions to pay off these debts. I laid this argument out in my [Healthy Skeptic newsletter in May of 2024](#). The punchline of that letter is that the path of least resistance to pay off these debts is to weaken the currency over time through a combination of money printing and interest rate manipulation, thereby weakening the dollar. It's much easier to kick the can down the road and pay off your debts with cheaper dollars in the distant future as opposed to making more sound, but hard, decisions to right this sinking ship. Gold, with its role as a store of value, serves as the anti-dollar to this ongoing risk.

WEALTH INEQUALITY

You may notice that some of the line items in the chart above correspond to factors that only impact ultra-wealthy individuals. The topic of wealth inequality is a subject I discussed in my most recent [Healthy Skeptic letter](#) and my presentation on the American Dream at our recent [Investor Symposium](#).

The focus of those pieces was on the imbalances and challenges that most Americans face as a result of this bifurcation of wealth. However, I'd like to shift my focus to the ultra-wealthy and their potential impact on gold prices. With the tremendous wealth creation in the last few decades, the rich have simply gotten richer. They've been spoiled by an economic backdrop of geopolitical harmony, low interest rates and inflation, and stimulatory policies that continually pushed up asset prices. They have increased their wealth on a scale that is eye-popping.

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That being said, they are utterly exposed to the various risks that I've laid out, since their wealth is primarily in assets priced in, and dependent on, the U.S. dollar. If they shift their mindset to one of protecting their wealth as opposed to a continued bet on outsized asset price appreciation, then gold will likely be their asset of choice. During times of uncertainty and market dislocations, this is exactly what happens—investor focus shifts from speculation to protection and living to fight another day. Vulnerable assets that are more exposed to dollar debasement may be sold (taking profits off the table) and shifted into gold.

ROLE IN PORTFOLIO

What are our return expectations for gold going forward? The answer is simple. As a store of value, gold's return should be such that it maintains purchasing power over time, no more or less. So, its appreciation in dollar terms should be the inverse of how much the dollar's purchasing power erodes over time. In other words, if the dollar's purchasing power erodes by the rate of reported inflation, 2–3%

per year, then gold should be expected to make about 2–3% per year to combat the erosion of the dollar.

As I stated above, I believe that inflation, as reported by CPI, is understated and the more accurate figure is the 6% growth of dollars we have experienced. If the supply of dollars continues to grow at that rate, then we would assume an annual return of roughly 6% going forward.

Why allocate to an investment where our return targets are so modest? It comes down to gold's purpose in the portfolio, namely as an insurance policy against dollar debasement.

These returns are obviously lackluster. It's important to illustrate that even though gold has outperformed stocks since we initiated this allocation in 2015 (13.8% annualized for gold compared to 13.1% for the S&P 500 over the same time period), we do not believe that gold should outperform stocks over the long term. Stocks are a productive asset, and the point of productive assets is that they should appreciate by more than inflation over time.

Why allocate to an investment where our return targets are so modest? It comes down to gold's purpose in the portfolio, namely as an insurance policy against dollar debasement. With any insurance, do you want the payoff to be large or small? Of course, the answer is "small to none" since insurance only pays when an unfortunate event occurs. Accordingly, if you asked what we hope for with our




gold performance, our answer would be a declarative “poor!” This may sound strange, but if gold generates poor performance going forward, the implication is that the value of the dollar has not deteriorated and your purchasing power has remained intact. In that scenario, most of your other investments have likely done well and exceeded the pace of inflation. If, on the other hand, we continue (or even accelerate) the reckless policies that print money and binge on federal debt at ever-increasing levels, then gold will likely do well and protect your portfolio, just like any good insurance policy should. Other

traditional assets in your portfolio will likely be challenged, but hopefully gold will be a bright spot to help protect your wealth.

UPSIDE POTENTIAL

While my argument above is designed to subdue one’s return expectations for gold going forward, I also acknowledge that meaningful upside potential still exists. Gold’s outsized return in the last decade exceeded its store of value definition and outperformed most productive assets. This was because gold was out of favor. Few investors felt the



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need for an insurance policy against dollar debasement. Therefore, the cost of insurance, as reflected by gold's price, was cheap. We took advantage of that mispricing when we entered this position in 2015.

With gold's tremendous run in recent years, the implication is that investors have embraced our view of the world and see the need to protect portfolios against dollar debasement. As a result, the cost of insurance, or the price of gold, has gone up. However, the actual data runs counter to this argument. Yes, gold is being bought

by central banks around the globe and by investors in the East. But investors in the West, and particularly in America, remain largely uninterested.

Western investors mainly purchase gold through exchange-traded funds (ETFs) and the number of shares outstanding in these gold-linked ETFs is still below its all-time high from five years ago. In other words, there were more holders of gold ETFs when the gold price was \$2,000 as compared to today, when gold is hovering around \$4,500. The Western investor remains largely uninterested. So, while our base case is that gold should generate mid-single-digit returns, there is the potential that the average investor demands an asset that protects their purchasing power and flees to gold, thereby pushing up its price in an accelerated fashion.

Whatever the future holds, we continue to believe a core gold position is necessary to protect against our country's undisciplined dollar-related policies. While we, of course, strive to find diversifying assets that can generate attractive returns in excess of inflation, we are hyper-focused on protecting portfolios as well. Protection takes many forms and includes many of the uncorrelated assets we target in the private credit space that are designed to perform well in most economic environments. But even beyond these cash-flowing private credit investments, we believe that bearing the cost of portfolio insurance, through gold, is essential to constructing resilient portfolios.



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