

With a combined 50+ years of experience, 2X Wealth Group is committed to educating and empowering investors. We firmly believe financial literacy helps people make better decisions.

Regime Change

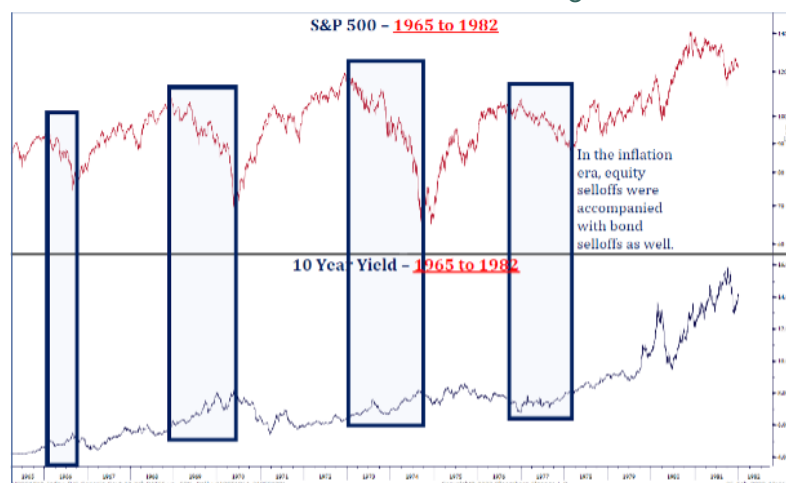
The four most dangerous words in investing are "this time is different". For the last 40 years, U.S. investors have become accustomed to declining interest rates and a rising stock market. The classic 60% equity/40% bond portfolio afforded stock market type returns with lower volatility, partly because bonds often provided a hedge during stock market downturns. As demonstrated by the chart below, bond yields are now *rising* at the same time as stock prices fall, removing their value as a hedge. (When bond yields *rise*, their prices *fall*.) This recent pattern of bonds and stocks going down at the same time typically occurs during inflationary periods.

In the QE Years, Bonds were a Hedge for Stocks... But Not This Time



Strategas Technical & Macro Research

In the Inflation Years, Stocks & Bonds Declined Together



Strategas Technical & Macro Research

While this time is *different* from the recent past, we have seen this movie before. As shown in the chart below, the last rising rate cycle was many years ago and before most professional wealth managers were in the business. Who would have known age would be an asset!

U.S. 10 Year Yield



To use a classic quote, 'history doesn't repeat itself, but it often rhymes.' The current environment may not look exactly like past times of inflationary pressure, but we expect similar economic and market outcomes. Ukraine is the fourth largest commodity producer in the world, and the Russian invasion exacerbates existing supply shortages and national security concerns. We believe the current cycle of rising commodity costs will last for years due to the combination of supply shortages, lack of investment in natural resource production and increased deglobalization.

As we write this, the Federal Reserve is reversing its course by raising interest rates and preparing to reduce their balance sheet in order to fight inflation. The effect on the market will be profound, reducing the price/earnings multiple investors are willing to pay for growth stocks and increasing the appeal of companies with current cash flow. We believe inflation will persist even if the Fed is successful in slowing the economy and higher prices create their own demand destruction. Fears of the Fed creating a recession and/or an economic slowdown in other parts of the world may lead investors to abandon commodity stocks, creating periodic buying opportunities.

As Bank of America opined in February, before the Ukrainian invasion took place, **"We are running out of... everything."**

"Not just Earth; Tech & Human Capital in severe scarcity

We have already reached peak youth, with grandparents outnumbering grandkids worldwide. Birth rates in the US and China are the lowest on record, exacerbated by an ageing population which intensifies health scarcity. We currently spend ~8 years of our life being ill but only 3% of global healthcare spend goes towards preventing diseases. Furthermore, skills scarcity costs us more than the GDP of Germany and Japan combined. And we need to power 1 trillion connected devices by 2035 but face a structural shortage in semi-chips. However, scarcity does not stop with tangible resources. By 2025 we will interact with a connected device every 18 seconds, and by 2030 we will spend more time in the Metaverse than the real world. Do we have enough time?

...We believe the current global resource supply vs. demand imbalance is underpinned by structural scarcity and will only get worse. While the global population grew more than 2x in the second half of the 20th century, food grain production grew 3x, energy consumption increased 4x and economic activity expanded 5x. It is fair to assume we will continue to live beyond our means. As a result, a transforming world needs transformative solutions – not just grow, mine or produce more...Since 1970 global resource extraction has more than tripled, 99% of everything we harvest, mine or process is trashed in six months, yet the share of recycling is 10x smaller than mining."

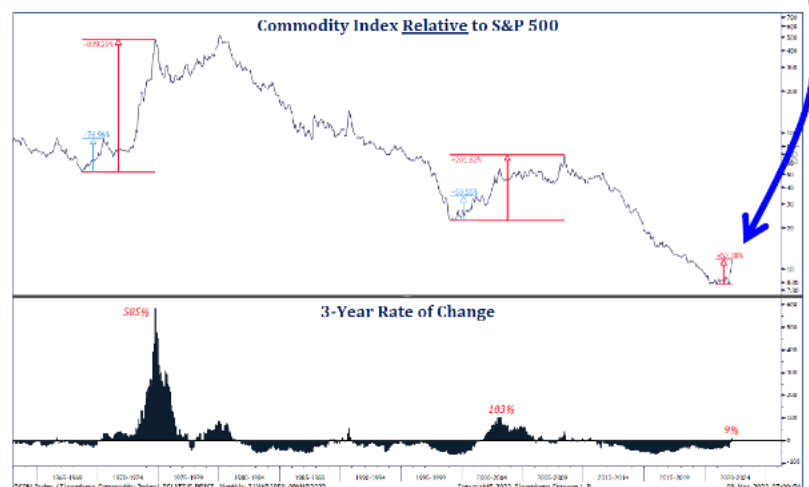
B of A Global Research, Thematic Investing, The World Is Not Enough – Scarcity Primer, 23 February 2022.

We Incorporate Our Point of View into Our Investment Management Practice

It was quite lonely when we first started talking about our inflationary concerns and commodities as an investment solution. Now, our point of view is becoming more consensus, but other managers are not putting their money where their mouth is, so to speak. The energy sector's average weighting over the last 50 years has been 11%. Even though the sector has doubled since we started buying energy stocks 18 months ago, the energy sector only represents about 4% of the S&P 500 today, less than the valuation of either Apple or Microsoft. For perspective, in 1980, the energy sector was 27% of the index.

If other inflationary periods are our guide, we are just getting started. The chart below provides a historical perspective on the length of commodity cycles.

Again, Certainly Overbought Today... But Structurally Not So Much



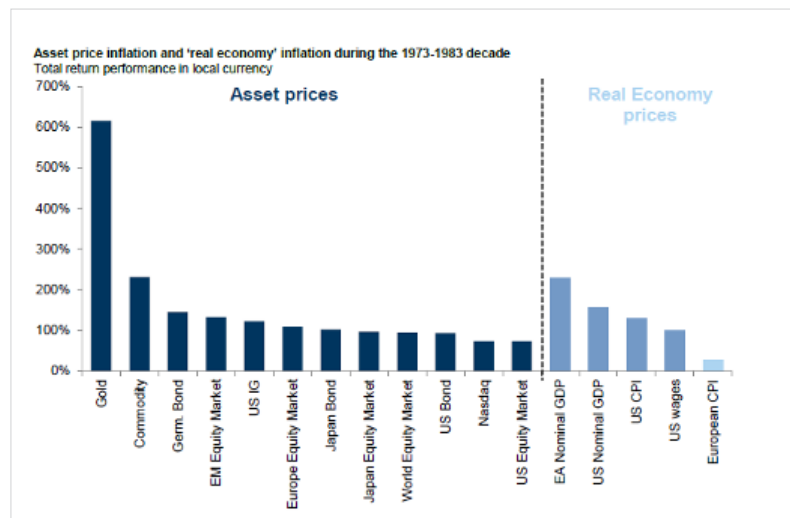
Strategas Technical & Macro Research

Although commodities have rallied about 50% versus the S&P 500 during the current cycle, history shows there is likely more to go. In the 1970s, the commodity index relative to the S&P 500 went up 839%. From 2002 to 2007/08 it was up 202%. In addition to energy, we like other materials including copper, uranium and agricultural commodities, and we continue to add equity exposure to these sectors.

Because commodity companies have dramatically underperformed in the last 10 years, they are very small percentages of equity market indices. To move the needle in a portfolio, you can't just buy the S&P 500 index, you must add exposure directly to these sectors through

individual stocks and ETFs. Just as 40 is the new 30, we argue commodities are the new technology. As you can see in the chart below, commodities outperformed other asset classes during a prior inflationary environment.

The 1970s saw a very different outcome for asset performance



Goldman Sachs Global Investment Research, Strategy Outlook for 2022: Getting Real

What about Gold?

Gold is an inflation hedge during periods of high inflation

If higher inflation is with us for an extended period, it is helpful to look at the 1970's when U.S. inflation became de-anchored. In 1973, after the oil price shock, inflation fears led to higher gold prices as stock and bond market volatility created a search for capital preservation. Déjà vu?

Gold rallies during rate hikes

We and others have pointed out the strong negative correlation between gold and U.S. 10-year real interest rates over the last several years. (See our blog, ["Why Gold Often Glitters"](#))

However, in periods when the Fed is raising interest rates, especially when U.S. growth begins to decelerate and emerging market currencies remain stable, this negative correlation breaks down. Under these circumstances, gold can rise as real interest rates increase.

Gold is a geopolitical hedge

Although gold doesn't always go up in price during times of geopolitical tensions, it did rally following 9/11, the 2003 Gulf War, and in March of this year. After the Ukraine invasion, with severe economic sanctions placed on Russia, the Russian government experienced firsthand what it was like to have a currency that no one would accept. Is this lesson lost on other central banks? Although the dollar losing reserve currency status is probably not imminent, China and Russia have already started trading energy in local currencies and not exclusively dollars. And just today, Saudi Arabia is considering pricing its oil sales to China in yuan.¹

1. A brief history lesson. In 1944, 44 nations agreed to use a gold standard to create a fixed currency exchange rate under the Bretton Woods Agreement. The gold-backed U.S. dollar became the global reserve currency, and the IMF was established. At the end of WWII, with huge wartime debts, dollars for gold became unsustainable. In 1971, Nixon took the U.S. dollar off the gold standard and currencies began to float in relation to the dollar and in 1973 the entire system collapsed. With the collapse of Bretton Woods, and the destruction of the international gold standard, Nixon was worried about the demand for the dollar. He sent Henry Kissinger to Saudi Arabia where Kissinger made an agreement with the Saudi royal family. In exchange for the U.S. providing Saudi Arabia with weapons and guaranteed protection from Israel, the Saudis agreed to price all of their oil sales in U.S. dollars only and to be open to investing surplus oil proceeds in U.S. debt securities. The petrodollar was born and by 1975 all of the oil-producing OPEC nations agreed to price their oil sales in dollars. The petrodollar replaced the gold backed dollar and with it, the demand for dollars and the dollar's role as the global reserve currency continued.

The Elephant in the Room.... Cryptocurrency

We understand the appeal of cryptocurrency given its openness and liquidity. Further, crypto could take monetary management decisions, and the power to abuse them, away from any single country. But...Bitcoin is a risk-on hedge and gold is a risk-off hedge.

Risk-aversion is a major driver of investment interest in gold versus assets such as equities or cryptocurrencies. During an inflationary environment, we believe owning gold will help investors hedge their portfolios from risks of a growth-slowdown, falling valuations, and increasing volatility.

"Further, despite the rise in total market capitalization and liquidity, Bitcoin's volatility has shown no downward trend, with cryptocurrencies severely underperforming other asset classes last year on a risk-adjusted basis (despite high nominal returns). As we have often said, we believe this is driven by crypto's lack of use beyond a digital store of value, indicating to us that it is still too early for crypto to compete with gold or the dollar for defensive asset investment flows."

Goldman Sachs, "Gold: Time to buy the defensive real asset 26 January 2022

And we leave you with this thought from Strategas Securities...

Give Me the Hard Stuff²

It has been fashionable over the last decade to favor digital currency over what Keynes referred to as the 'barbarous relic' that is gold. Whether it was Justin Trudeau's decision to freeze certain bank accounts and the use of cryptocurrency in Canada or the recent tragic events in Ukraine, there are more relatively or recently wealthy people wondering just what constitutes money today than perhaps at any time in the past 75 years. There are reports that Russian citizens are desperately trying to use their rubles to buy luxury watches and handbags as some sort of physical store of wealth. Gold itself has a 5,000-year brand, while Bitcoin, the first decentralized cryptocurrency, was first created in 2009... Central banks and national Treasuries are loath to give up the power of seignorage. We expect SEC Commissioner Gensler to become a far more muscular presence with regard to cryptocurrencies in 2022.

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Hard stuff and hard decisions abound. We are here to help. If you want to start a conversation, you can reach us [here](#).

2. Jason De Sena Trennert, Strategas Securities, LLC

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