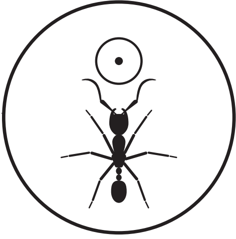

Myrmikan Research

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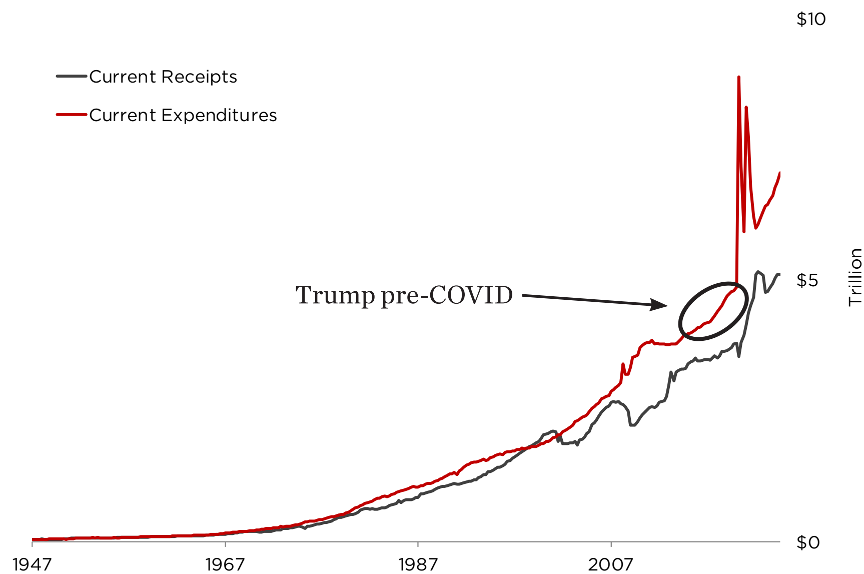
After Shock

Polsters and pundits assured the public that their new methodologies measured Trump's support accurately. Tight polls meant a close election that could go either way, and the superior Democrat ground game would tip it in Kamala's favor. They were wrong, again, the third time in a row.

We well remember the shock when Trump won in 2016. On the eve of that election, *The New York Times* gave Clinton an 85% chance of winning. Reuters said it was 90%. We were told that if Trump were to win, the dollar and the market would crash as the political order unraveled. That did happen, in fact, in overseas markets on election night, with gold $100/oz higher. But by morning the market had recovered, and gold was negative and kept going lower. The banks zoomed higher with the prospect of repealing Dodd-Frank; Copper rallied 24% with the promise of infrastructure spending; stocks loved Trump's promise to lower corporate tax rates and rallied hard.

Gold bottomed on December 12, a month following the election, down 13%, closing at $1,130/oz. It would turn out to be an important market bottom. While Trump's announced policies were credit friendly (and, therefore, gold unfriendly, for gold is the antithesis of credit), MAGA is not austerity, and debasement loomed.

FEDERAL RECEIPTS AND EXPENDITURES



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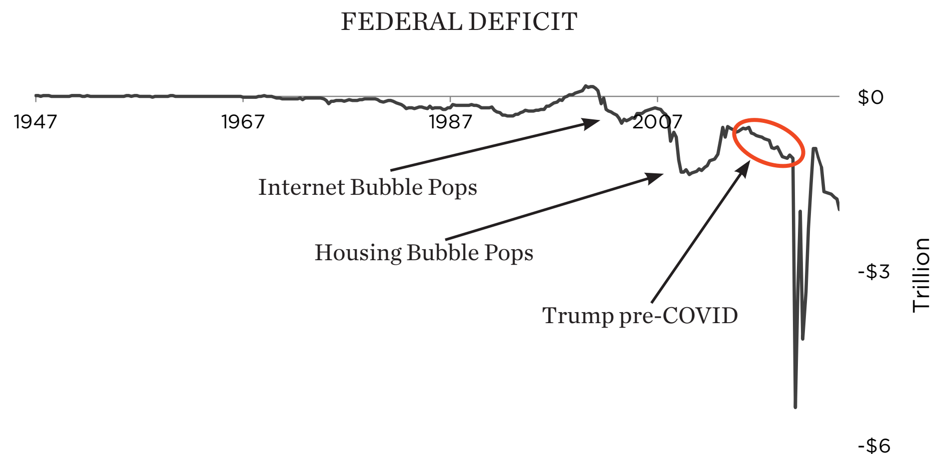
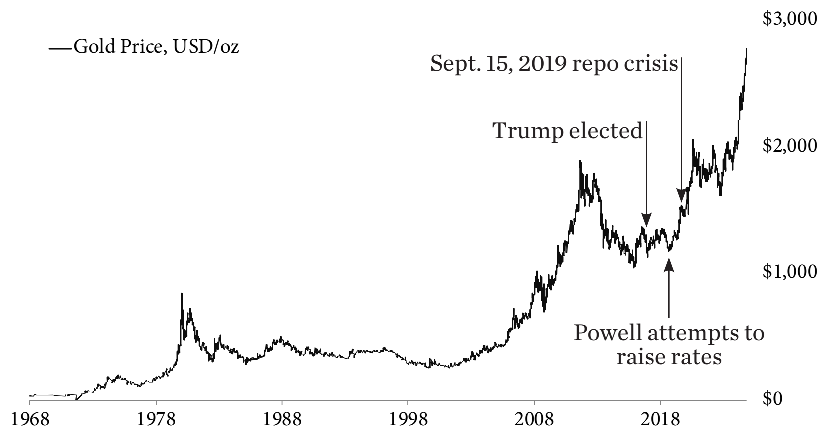
Right-wing pundits compared Trump's promises to Reagan, beefing up the military while cutting taxes and regulation. We commented then, however, that Reagan's economic success had come at a particular point in history: the trough of a credit cycle. Interest rates were at cycle highs, exceeding 20%, and the sum of government and private debt came to only 150% of GDP. The Federal Reserve's hoard of gold backed its liabilities by 92%. These were ideal conditions to commence a credit expansion, the longest and largest history has ever known.

By contrast, in 2016, rates were at cycle lows, the total debt-to-GDP ratio was recorded at 338%, and gold backed the Fed's liabilities by only 7.6%. Medicare, Medicaid, and Social Security consumed 10.4% of GDP, compared to 5.4% in 1980. If Trump wanted to stimulate the economy through tax cuts or spending, it would widen the deficit and, indeed, that is what happened.

FEDERAL DEFICIT



At least Bush and Obama had the excuse of the collapsed internet and housing bubbles to ramp up spending and could sell their stimuluses as temporary recovery measures. Trump had no such excuse. Yes, tax cuts benefit the economy (and are morally correct), but without spending cuts (spending increased, in fact), the deficit explodes, and taxes show up anyway in the form of inflation. Milton Friedman was correct when he said that the burden of government is not how much it taxes but how much it spends. Gold got the message: except for a brief period when Powell attempted to tighten monetary conditions, gold began a sustained uptrend.



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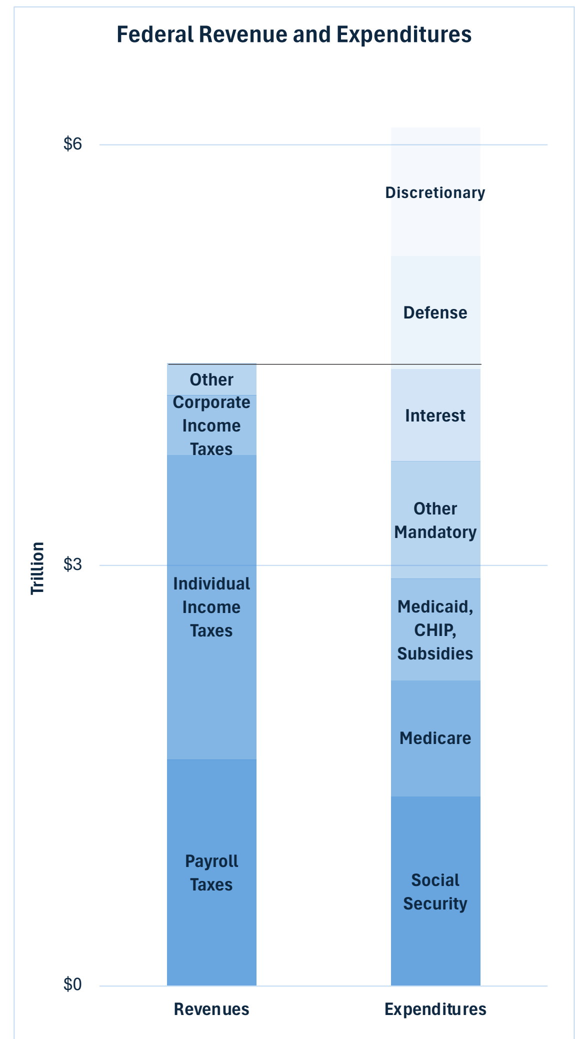
So what will Trump do now. A casual look at the first chart above shows the disaster that is the federal income statement. The deficit figure reveals the annual accumulation of debt—on top of the $36 trillion of existing debt that needs to be refinanced at higher interest rates, increasing the interest burden.

Mandatory outlays now comprise not 5.4%, not 10.4%, but 13.9% of GDP. In 2023, total federal revenue exceeded mandatory social spending plus interest expense by only $38 billion. Military spending came to $805 billion and discretionary spending was $917 billion. Plus, net interest spending has jumped by $233 billion in 2024.



Trump advisor Elon Musk cut 90% of Twitter's workforce with no perceivable change in the product's output. But even if Trump and Musk cut 100% of discretionary spending plus all military spending, the deficit would persist and grow (and Trump has promised to cut all manner of taxes). The alternative is that Trump will try to cut mandatory spending, the only real way out of the debt trap; but that would require unlikely Congressional action and ensure that Trump's presidential term is the last Republican, perhaps forever.

And what if Trump does somehow miraculously slash spending—we may applaud from a political and cultural perspective, but the immediate impact would be a painful recession as those who survive on government expenditures (and those who rely on those people) are thrown out of work, cut spending, and default on their debts. Tax revenue would fall even while Keynesian automatic stabilizers would increase government expenditures. In 2009, economists defended QE-sponsored deficit spending on the grounds that it brought economic activity forward, from a time when the economy was likely to be stronger to a time when the economy was weak. The reverse must equally be true.

While gold's 8% decline from $2,800/oz to $2,585/oz in the wake of Trump's election has been unpleasant, it does nothing to change the underlying gold thesis: the U.S. and, indeed, the world reside in the largest credit bubble man has ever constructed: the total debt-to-GDP ratio in the U.S. is now 365%. Even at $2,585/oz, gold backs Fed liabilities by only 9.4% (less than the 12% backing at $35/oz in 1969). Credit bubbles resolve in only two ways: widespread default or debasement, often both. The economic crisis, so feared and so pervasive through economic history, is nothing more than the balancing of balance sheets. Under a gold standard, the crisis lowers nominal prices until they rebalance with gold prices. In a fiat currency regime, the price of gold must rise to match nominal prices. Either way, those holding gold when the crisis comes see large increases in their purchasing power.

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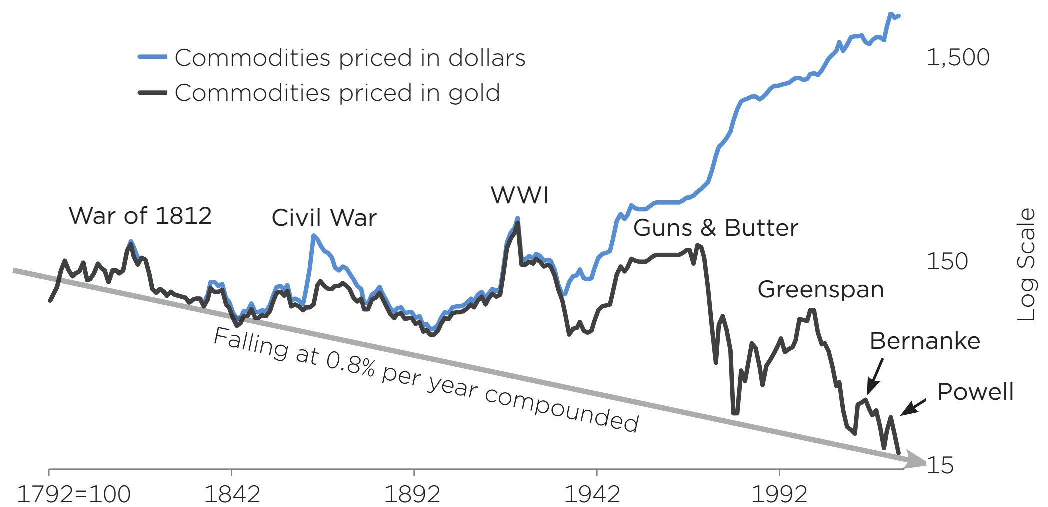
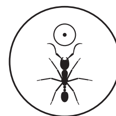
This phenomenon also applies to the gold miners. The chart below is the guiding star for Myrmikan's investment thesis. It shows that commodities fall against gold over long periods of time as technology lowers the costs of production. It shows also that commodities rally against gold during credit bubbles and plunge during credit busts. Since gold mining margins are determined by the spread between input costs (which are comprised mostly of industrial commodities) and the price of gold, gold mining margins are highly anti-cyclical.

The Powell COVID mini-credit bubble is rolling over. Given the imbalances cited above, not to mention the dismal state of the Federal Reserve's balance sheet, there is little that the incoming Trump administration can do to induce a credit mania. If Trump convinces Powell to continue lowering rates, the dollar will get hit in international markets. If Powell raises rates or even keeps them steady, then interest payments on the federal debt will swallow the rest of the budget.



Gold stocks have plunged along with gold since the election, just as they did in 2016. We expect this rout to be temporary, as it was in 2016. The difference is that the fiscal and monetary balances are much worse eight years later as is American's geopolitical standing, and we expect those forces to wrest control of gold from the traders currently selling it. The gold miners—which were just starting to break out—will follow.



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