2022: The year of rising Volatility.

At the start of the decade, we warned that there would be some powerful drivers that would influence the markets over the next 10 years. The primary theme would be a loss of confidence in the power of governments causing disruption in the markets. A secondary theme identified in February 2021 was food insecurity and rising prices - Food Insecurity and Prices - Canary Capital.

Canary Capital believe 2022 will be a year of rising volatility due to increasing uncertainty.

We live in a time of unrivalled easing of monetary policy, which has resulted in an increased appetite for both leverage and speculation. What has been unique to our time in history is the lack of inflation in the face of the persistent printing of money. We believe money printing will go into overdrive in the near future, however this time the signs are pointing to a corresponding rise in inflation. This will mean investors need to be both nimble and disciplined over the next few years. Rising inflation will also require that investors switch to physical investments that can protect capital and purchasing power.

The Bond Market

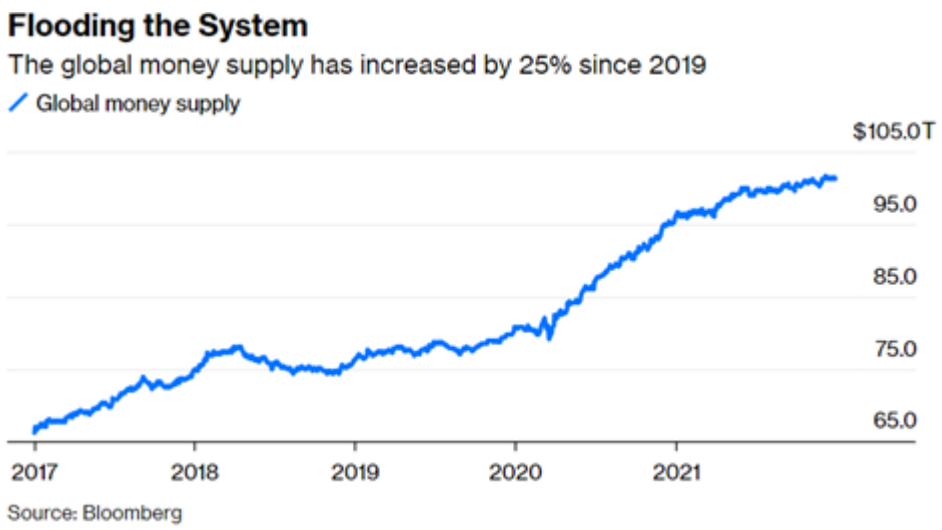
The bond market like the U.S. Fed is convinced inflation is transitory, with price increases being a direct result of supply chain bottlenecks caused by the Covid pandemic. The Fed believes that as the population get use to the new normal, as the economy opens the Fed will remain in control, interest rates will stay low, and prices will decline. At Canary Capital we are not so confident. In addition to this, the accumulation of debt by all governments is a topic that needs its own consideration.

International cooperation allowed the production process to be broken up across the world and to be performed at its cheapest location. Production was performed in low-cost Asian countries where efficient transportation delivered products cheaply and reliably to Western markets. Rising tensions between Western Europe and Russia, and China and US will result in a change in the production process. Germany cannot be reliant on the supply of gas from Russia to drive its manufacturing base. China has demonstrated that it will use its position in the supply chain as leverage to attain its nationalistic goals (2010 Japan-China fishing dispute). Covid has shown the importance of security in all aspects of the production process. There is now a move towards onshore manufacturing, which coupled with a shortage of skilled workers, has already resulted in higher wage demands and industrial action. In the US about 10,000 UAW members were on strike in October and they rejected a 10% wage rise.

The Federal Reserve

According to Jeff Gundlach the US Federal Reserve is presently acting in blatant non-compliance with the Federal Reserve Act of 1913 by buying US bonds. In the words of Jeff Gundlach (@TruthGundlach, CEO of DoubleLine) “An institution violating the rules of its own charter is de facto admitting that said institution has failed and is fundamentally broken.”

Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote the goals of maximum employment, stable prices, and moderate long term interest rates effectively". Recently the Fed has launched a new organisation, the Financial Stability Climate Committee (FSCC), which will stress-test US financial institutions against realistic scenarios for climate disruption. Banks will face questions about the share of their lending that goes toward carbon-intensive industries or lending that is secured by real estate in areas facing environmental disruption.



Producer Prices

A successful and quick shift to onshore manufacturing requires a heavy investment in carbon-intensive industries, just as bank lending decreases and regulation increases. This is not a driver for cost reduction in the short term.

Federal Reserve chairman Jerome Powell's term expires in 2022. The Fed chairman was reappointed prior to Christmas. Powell would only have been reappointed if he agreed to shepherd the agenda of the progressive left of the Democratic Party to enable safe passage of the Democratic infrastructure legislation. This can only result in the continuation of money printing and further underpin the rise in inflation.

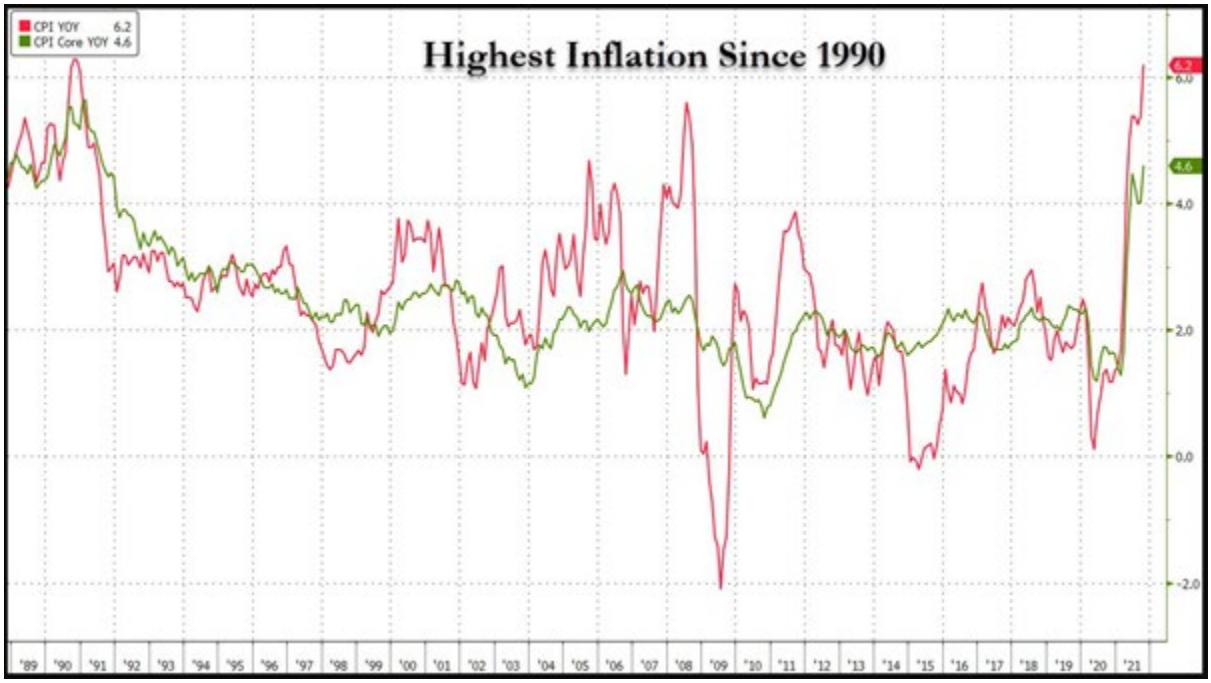
Government and currencies are both fiat (not backed by commodities such as gold and silver)—they require confidence and a widespread belief that overall things are fair and equitable.

There has been a marked increase in producer prices across the world resulting in a change in consumer expectations. Once consumers expect inflation, they change their behaviour and bring purchasing decisions forward as well as demand an increase in wages. Inputs both soft and hard have been in a steady uptrend, further cementing price rises in the real cost of production.

Food

We have been predicting the rising food prices for over a year. Supply chain disruptions, lower inventory, higher transportation and fuel costs, and labour shortages have all contributed to rising food costs. Some of the highest inflation in decades is crushing the budgets of working-class Americans and as a result they can barely afford to survive. Such pain in the wallet is making them angry, especially after coming off a demoralising pandemic. Covid has closed abattoirs resulting in farmers slaughtering their herds at a loss. High gas prices have caused chicken and pig farms to close because of increased costs. Gas is one of the primary inputs in the production of fertiliser. Fertiliser prices have doubled in the last 12 months. China, which currently supplies 37% of the world fertiliser, recently banned exports completely.

Natural gas is needed to produce ammonia and energy from fossil fuels to mine for phosphate. Ammonia and phosphate are the raw materials to make fertilizer. You need fertilizer to grow food at scale and you need food to keep the peace. Food price increases cannot be hidden with adjustments to the CPI.



The oldest and most fatal ailment of all republics is a gap between the rich and the poor. ~ Plutarch

“The middle class and lower classes are taking a beating. History shows a vast wealth gap always leads to problems; wealth inequality always ends in unrest. Amazon may get the retail customer but cannot absorb the unemployed. The Zoom economy, in conjunction with social unrest and soaring prices, is emptying the cities measurably. It may eventually lead to a more efficient economy and even a better world, eventually, but the transition and fundamental reorganization of the cities will be unpredictable. The current societal bargain presumes the vaccines will work and those lost jobs will reappear or be replaced. A change is coming, but it is hard to envision when and how.”[i] David Collum

High-cost local production in America has been replaced with risk by relying on what is now their primary economic adversary—China. Both sides now look to be locked into a trading war (with security overtones) and appear determined to win every dispute with little trade off. Humans have been fighting to the death for resources for centuries. The West has bought products from the East resulting in a transfer of capital. The East has used this capital to build its productive capacity and buy physical assets in the West. The control of physical assets is a superior bargaining position if it ever comes to an arm wrestle.

There appears to be a two-pronged attack on the American–Western hegemony. China and Russia are attacking distinct parts of the world order. The Chinese population has been promised a rise to its rightful place in the world order by President Xi, a commitment he cannot afford to lose. Russia is using its control of energy to pressure Europe into accepting its strategic security goals. India and China have had repeated clashes on the border in the Himalayas. Whilst there have been many wars and conflict over time, the power of the nations involved in current posturing has never been so great. One of these clashes can create instability that will be hard to contain. The recent instability in Kazakhstan is capable of getting out of control quickly. Russia cannot afford to give up control of Kazakhstan, a situation that does not leave a lot of room for compromise.

These and other trends will rise and fall during the next few years. Volatility requires both discipline and diversification. The one asset which we believe is cheap and underrepresented in most investment accounts is gold. An increased allocation to this asset will reduce risk in portfolios when volatility rises. It will also protect accounts if an unforeseen shock were to arrive over the horizon. Joe Biden's nominee to run the Office of the Comptroller of the Currency (OCC) Saule Omarova, was recently quoted, "There will be no more private bank deposit accounts, and all of the deposit accounts will be held directly at the fed". She ultimately withdrew her nomination for the post.

Diversification is a survival strategy particularly after a sufficient asset base has been created. It can be a saviour in uncertain and volatile times.

Canary Capital's recommendation in the gold sector is Nexus Minerals (ASX: NXM). see Nexus Minerals Limited - Canary Capital The company is due to release drilling results from DDH-5 later in January, which had a 30m intercept containing visible gold. Three reverse circulation and two diamond drill rigs are going to be working on the Wallbrook project from January 2022 so there will be results every couple of weeks this year.

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[i] 2021 Year in Review: Crisis of Authority and the Age of Narratives | Peak Prosperity