July 10, 2020

War on the Coronavirus

Dear Investor:

A lot has happened since our last letter. Unfortunately, in the past three months we have seen the coronavirus do tremendous damage all around the world. There have been over 550,000 confirmed deaths from the virus. Confirmed cases are currently over 12 million, and we know both of these numbers are most likely higher. There have also been substantial financial losses at every level. It seems that everyone has been touched by this in one way or another. In the US, our first quarter GDP declined at an annualized rate of 5%. This was around $189 billion as our government began to issue "stay at home" orders in late March. That may not sound like much from an economy that was doing around $21.7 trillion at the end of 2019, but it puts us back to where we were at the end of Q3 2019, if you prefer to think along a timeline. Estimates for Q2 declines are much worse, as you would expect with most shutdowns in force during that time. They are in the range of $1.9 trillion, which would put us back to approximately where we were at the end of 2017. That's like losing three years of economic progress, if you want to look at it that way.

To help keep things going, we have had truly massive financial intervention by the Fed and the US Treasury. The US Federal Budget Deficit for this fiscal year was originally projected to be about $1.1 trillion dollars. That's a very large shortfall, and would have been over 5% of GDP. With all the relief packages now in place and with the loss of tax revenues, the Congressional Budget Office (CBO) is projecting that the deficit for this year will be $3.7 trillion. That's over 17% of GDP, and is unheard of in recent decades. The only other time in the last <u>100 years</u> our annual deficit was this high was from 1942–1945 during the years of World War II. In the Depression years of the 1930's, there were a handful of years in the range of 4.5% to 5%. Thus, you can see the $3.7 trillion is really a very big number, and they are estimating another $2.1 trillion in fiscal year 2021. The Federal Reserve has added another $3.1 trillion to their balance sheet by "printing" money to buy government bonds, corporate bonds, and to establish various lending programs. So, it's realistic to say that fighting the coronavirus has cost us $6 - $7 trillion thus far. That is an enormous amount of firepower and represents about a third of our GDP. I think you can plainly see that without these actions, we would be in a very deep depression by now.

We see that Gold is currently selling in the range of $1,800 an ounce. A year ago, the price was around $1,400 an ounce, so it's up over 28%. There is no free lunch, and some investors are worried about the value of the dollar, inflation, or both. Right now, there is clearly no sign of inflation, far from it. However, I have heard interviews by a few economists who think that could change in a year or two. They make some good points, but only time will tell if they are correct. The loss of value in the dollar is

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a very real concern. As I've illustrated, we are dealing with very large numbers, and the realistic chance of paying any of this money back is close to zero in my opinion. We will be rolling all these debts forward into the future. I don't believe in MMT, or Modern Monetary Theory, which teaches that debts don't matter as long as we have the ability to print our own currency. History is littered with currencies that have failed. During the Revolutionary War, one of the biggest problems Washington had was finding enough food to keep the army alive. One of the reasons was, the farmers did not want to accept Continentals (the paper money of the time) for payment. They wanted gold in exchange for their hard work raising the crops. Washington usually couldn't get his hands on any, so this was a constant struggle. Our currency has to be a store of value. Our debt is currently growing much faster than our GDP, which is not a sustainable situation. We should not think that we can borrow and "print" dollars forever with no consequences.

The unemployment numbers have also gone off the charts. As the shutdowns began, we saw millions of workers laid off every single week. By the end of April, the number was over 30 million. According to this week's report, more than 50 million new claims have been filed since mid-March. It's hard to comprehend that many people losing their jobs. Every one of those people has their own story. We know that some have made out well, with unemployment being higher than their regular income. Regardless of that, we know it has been a hardship for many others, and their future is uncertain as their old job has disappeared. In the case of many small businesses, their old employer has closed their doors and their job is gone, a very sad situation with high personal costs. Some others have been rehired due to reopened parts of the economy, but workers currently on claim with state and or federal programs number over 30 million. To add perspective, the number of unemployed in the Great Recession was 15.3 million.

While it looks like the economy has bottomed, it's not projected to reach the level of December 2019 until sometime in 2022. There's been a lot of damage, and I see new stories every day of financial losses that business and individuals are facing. In light of this, the government is working on another relief package.   We don't know what it will look like in the end, but it's a near certainty that it will be substantial. On the other hand, we do see that parts of the country seem to have found success with their reopening plans, and things are beginning to move forward. Some measure of positive GDP growth is expected in Q3 of this year and in future quarters.

This brings us to the obvious question of what's going on in the stock market? The apparent disconnect between the pace of recovery in the economy and this big move in the market is somewhat confusing. I hear people talking about it in interviews all the time. As I finish this letter, the market is very close to where we began the year. In January, the SP500 was expected to earn in the range of $175 to $180 this year. Current estimates for 2020 are now around $125 to $128, down over 28% from January before the virus hit. Expectations for 2021 are $163 to $165, still below this January. In light of this, why has the market come rocketing back to such a high point? There appears to be two factors in play here. The first is the enormous sea of liquidity the Fed has provided and their guarantee that rates will remain essentially at zero for as long as it takes. This has helped to drive P/E ratios to levels we haven't seen since the late 90's (and also 1929). Apparently, many investors are willing to pay very high prices for expected future earnings right now. A well-known saying on the Street is “Don’t fight the Fed”. Many are believing that the guarantee of rock bottom rates for as long as it takes will make earnings accelerate at a much faster rate than currently projected and essentially “catch up” to the high stock prices. This would bring the P/E into ranges we are more comfortable with. A second factor is that we have a situation in the SP500, where a small handful of stocks, such as Apple, Microsoft, Amazon, and others, have been rising like rockets and pulling all these numbers up, while the other 490+ stocks have been performing in a normal range, and many of them are still down for the year. I can’t tell you what the resolution of this will be. I will say, a small handful of superstar companies can’t go up forever. If we look at the rest of the market, we can see there’s a lot of work to do. It would not surprise me if we saw a correction, and it would have to be led by these high flyers.

We are in very difficult times and we will have to be patient. We have many high-quality companies in our portfolios, and they are not going to be going out of business.   I do believe that the worst is behind us. I expect the economy to continue to reopen at a gradual pace, and the economy will also reaccelerate as consumers start spending again. Most economists expect that unemployment will come down slowly as some jobs are gone for good, and some demand will probably not recover. At some point in time, the pharmaceutical industry is going to come up with the vaccines and other products we need to get this virus under control. That will usher in the final phase of reopening as people regain confidence to live as they always have. They are working at break neck speed, but we don’t know how long this will take. This is the reality of long-term investing. We need to stay committed to our plans and see that we have a level of risk that we can handle.

Please contact me anytime to discuss your portfolio. I hope you enjoy the rest of the summer.

Best Regards,

David

David E. Keim

Sections of this letter may include forward-looking statements. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. The precious metals, rare coin, and rare currency markets are speculative, unregulated, and volatile, and prices for these items may rise or fall over time. The commodities industries can be significantly affected by commodity prices, world events, import controls, worldwide competition, government regulations, and economic conditions. Past performance is no guarantee of future results.

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