

THE NINE MOST TERRIFYING WORDS IN THE ENGLISH LANGUAGE (PART 2)

Per my last commentary, the above phrase is from Ronald Reagan when he referred to the saying "I'm from the government and I'm here to help." [In that commentary](#) I dug into this concept of the government "helping." As many in the press have pointed out Biden seems to want to "help" more than any other President since Lyndon B. Johnson or Franklin D. Roosevelt. (A quick disclaimer that in today's hyper partisan political climate, I am NOT arguing that any policy is good or bad. I am simply trying to ascertain the outcome of those policies.) Let's also be clear that virtually all U.S. Presidents have overseen money printing during their term(s), so the above statement is referring to the magnitude of the government stimulus/spending which leads to the money printing, deficits and debt. There have also been times where an economic catastrophe has spawned the stimulus, which you could argue is a positive, leaving aside the fact that the catastrophe was probably the bursting of a Fed/government-driven bubble (FDR). There have been other times when the stimulus was justified by a desire to remake society (LBJ). Now Biden is saying both.

Let's go through some brief history with the disclaimer that all economic numbers are tough to attribute pure causation, because there are so many factors, but here goes.

When the Great Depression hit in 1929 or so, the reaction was to stimulate, meaning print money to help overcome the weakness in the private sector. From 1929 – 1932 U.S. Government spending was up 50% but the GDP was still shrinking by roughly 10%/year. FDR became President of the U.S. in 1933 and was in office until 1945. He took over after the Great Depression had begun so his "job," as he described it, was to get the population back to work and the U.S. economy growing again. In order to do this FDR pushed the spending and money printing a "tad" higher. (Spoiler alert, it worked.)

During FDR's first year in office the U.S. Government's outlays were \$4.6bb, roughly the same as the year before. In his last year the outlays were \$92.7bb. I'm not great at math but I think that equates to roughly "a sh*t ton." During his term the U.S. deficit averaged almost 100% of federal revenues (think about that) and when he left office in 1945 the federal debt equaled 112% of GDP (not far below today's levels), up from 34% when he took office. To be clear this included huge WWII spending. During FDR's time in office real GDP increased 9.3%. How about inflation, you ask? Just prior to FDR taking office U.S. CPI was -10.3%. The 1942 inflation was 10.9%. That is quite a swing. (P.S. for those "austerity can't happen" people, from 1945's peak spending of \$92.7bb it then fell to \$30bb in 1948 under then President Harry Truman. Again though, a bunch of this decline was due to WWII being over. And yes, over those three years real GDP fell by 9% in aggregate. That was also the last time our federal spending fell, other than a couple tiny drops in the mid '50s.)

How about LBJ, given his "Great Society" and "War on Poverty" spending initiatives? U.S. government spending the year before LBJ took office was roughly \$106bb. His last year the spending hit \$178bb. That's almost 70% in 6 years, which is.. not bad. What happened to GDP during that time (again, keep in mind this wasn't his primary objective)? GDP the year before he took office increased 2.6%. During his term it averaged 5.2%. Lastly, how about inflation? The year prior to LBJ taking office Inflation was 1.2%. His last year in office it hit 5.8%. Not as dramatic as FDR but quite the move.

Okay, back to the present.

Current U.S. Treasury Secretary, Janet Yellen, has been an interesting quote machine lately. I especially liked the following from an April 7th OpEd in the Wall Street Journal, "*We are going to stimulate our economy to grow as fast as China, focusing on rebuilding the U.S. middle and working classes and U.S. infrastructure.*" We haven't grown as fast as China in decades so the implication is there will be a lot more stimulus coming. She also said "*I urge major economies to ... strive to provide significant amounts of new fiscal support to secure a robust recovery.*" You can choose whether she was a) virtue signalling or b) trying to avoid cratering the U.S. dollar by asking other countries to ramp up their stimulus as well.



President Joe Biden said via Twitter on 4/5/21, *"Here's the deal: Wall Street didn't build this country – the great American middle class did. It's time we rebuild the middle class... This will be the largest mobilization of public investment in procurement infrastructure and R&D since World War Two."*

There are countless other quotes that I'm sure you have seen, but the key is HUGE spending coming to a) help the economy and b) build a better society (i.e., "Build Back Better").

According to Axios on 3/24/21 Biden reportedly held a White House session to discuss how to "jam through once in a lifetime historic changes to America" since he has full party control of Congress. More specifically he asked "how big is too big?" and "how fast is too fast?" Add to this an article in Axios from 1/19/21 that said Biden's team doesn't care about deficits or debt if they are able to construct economic policy around issues like race, gender equality and climate change. Again, leaving aside political leanings, this has interesting economic implications.

If we go back a few years, here is another fun quote. This was from a NY Times OpEd on 8/28/14. Yes, it is old, but it is by Jared Bernstein, who is currently on Biden's council of economic advisors. At the time of the NY Times quote he was the Chief Economist to then current Vice President Biden. (Who knew the U.S. Vice President had/has their own economist on the payroll?) Based on his history we can probably assume he has some influence over our current President.

"There are few truisms about the world economy, but for decades, one has been the role of the United States dollar as the world's reserve currency. It's a core principle of American economic policy. After all, who wouldn't want their currency to be the one that foreign banks and governments want to hold in reserve?"

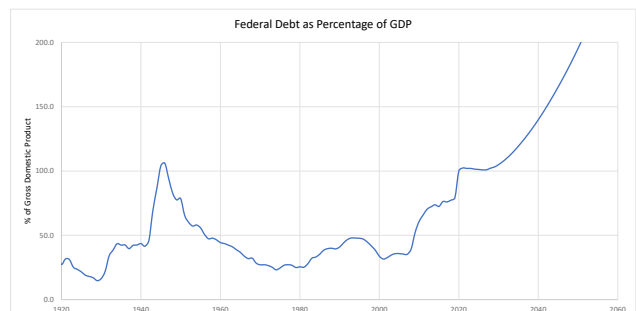
But new research reveals that what was once a privilege is now a burden, undermining job growth, pumping up budget and trade deficits and inflating financial bubbles. To get the American economy on track, the government needs to drop its commitment to maintaining the dollar's reserve-currency status...

Others worry that higher import prices (via weaker U.S.\$) would increase inflation. But consider the results when we "pay" to keep price growth so low through artificially cheap exports and large trade deficits: weakened manufacturing, wage stagnation (even with low inflation) and deficits and bubbles to offset the imbalanced trade.

But while more balanced trade might raise prices, there's no reason it should persistently increase the inflation rate...That's a price worth paying for more and higher-quality jobs, more stable recoveries and a revitalized manufacturing sector. The privilege of having the world's reserve currency is one America can no longer afford."

Relatedly, On November 30, 2020 The Brookings Institute (a Washington D.C. thinktank) published a paper by Jason Furman (Chairman of the Council of Economic Advisors under former President Obama), and Larry Summers (Director of the National Economic Council under former President Obama) titled *"A Reconsideration of Fiscal Policy in the Era of Low Interest Rates."* In it they described mathematically that as long as nominal interest rates remain below the nominal growth rate of GDP, then the present value of future nominal GDP is infinite and therefore we can't have a debt problem. Normally you don't print money like now and the debt increase is reasonably small and the economy does what it does. But instead of looking at the end result of all the inputs being GDP what if your inputs were interest rates (pegged low via YCC) and nominal GDP growth (juiced higher via money printing driven inflation)? Now the the offset or release valve is the Fed Balance Sheet, inflation and the declining value of the U.S. Dollar.

Here's another quote from a tangential character saying things to expand the Overton Window. Ex-U.S. Treasury economist, David Beckworth, has been writing about the need for "nominal GDP targeting." Further, the economist Paul Krugman has been writing a lot lately about how after WWII we didn't have to pay back the debt because we stoked inflation so nominal GDP grew faster than nominal rates on U.S. Treasuries. See the chart to the right. Technically, this is all correct. When you grow nominal GDP faster than interest rates (all else equal) then the debt/GDP ratio falls.





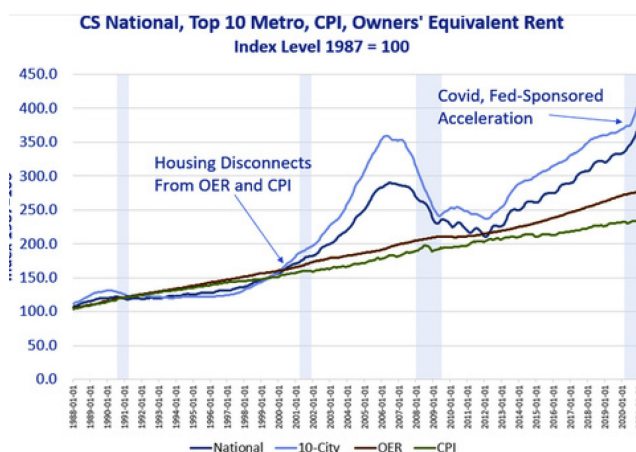
Whether this is/was a good idea or not isn't the point. This seems to be the unstated policy goal. During the period in the chart where debt/GDP fell (1946 – 1974) total government debt was up 77% (2%/yr). However, nominal GDP was up 578% (6.9%/yr) and real GDP was up 175% (3.2%), hence the ratio of debt/GDP fell. But... During that period our annual real GDP grew much faster than now and the annual budget deficit was VERY small. The release valve back then, like now, was inflation which averaged 3.6% for those 29 years. Lastly, it is interesting that the last time this started our total debt/GDP was similar to now. During those 29 years the S&P returned 4.9%/year, but keep in mind that was nominal (ie, post inflation). Given inflation was 3.6%, that leaves a poor real return left over.

Let's piece all this together.

We have the Global Financial Crisis. The official policy response is to launch massive Quantitative Easing (QE). In other words, the Fed printed money in order to buy back bonds, which was meant to lower interest rates to help stimulate the economy and create a wealth effect via a higher stock market. Since 2009 real U.S. GDP growth has averaged 2.3% and yet we felt the need to continue stimulating so QE went until 2018. Then we tried to reverse the QE briefly in late 2018 (quantitative tightening) before deciding it was too painful since the stock market quickly fell 17.5% over three months in late 2018.

After the huge drop in economic activity due to the Covid-led pandemic and lockdowns it was decided we needed to keep stimulating. So QE continues on with no reduction in sight.

The question of why we didn't see inflation from QE has been asked for years. **We have.** It just isn't reflected in CPI. Bond prices? Stock prices? Art? Collector cars? Bitcoin? Gold? Real Estate? Etc. Yes to all. Assets, including real estate, for the most part, are not captured in CPI. Within the CPI calculation we butcher the price mechanism for real estate to measure a made-up number of "owners equivalent rent" (OER) as opposed to housing prices. Prior to 2000, home prices, OER and the Case Shiller national home price index all moved in lockstep. See the chart to the right. Now? Not so much. The fact that OER now makes up just over 24% of CPI seems okay in capturing housing's importance until you realize that the number used to approximate housing costs in CPI is ridiculous.

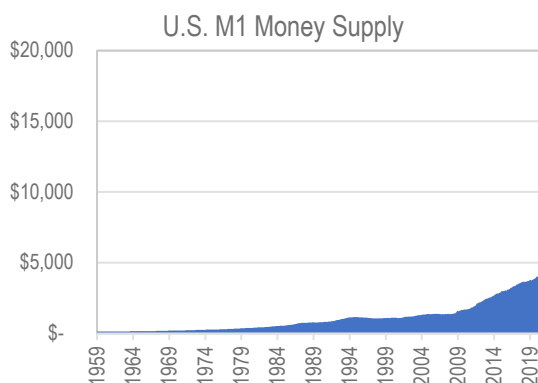


OER for the trailing twelve months is 2.1% according to the government and this leads to an overall TTM CPI number of 4.2%.

But, to say the U.S. housing market is running hot would be a vast understatement. If you used the most recent national housing price increase (+11.2% year over year according to Case Shiller) instead of OER then the overall CPI goes to 6.4%. Quite a difference. This still leaves the other assets not reflected in CPI, let alone the many other perversions of CPI which overtly try to keep stated CPI lower than it actually is. I have written before about the government's not so subtle methodology changes to reduce stated CPI. They are well documented on www.shadowstats.com. Based on their data, the most recent 4.2% CPI TTM print would have been 7.5% based on the methodology they used in 1990 and 11.2% with the methodology they used in 1980. That is how much the way you calculate CPI matters.

Even if you are not of the economic mindset that money printing must lead to inflation, it is hard to imagine our M1 (currency + bank deposits held by central bank + demand deposits, traveler's checks and other checkable deposits) can do the following without some impact. Since it is hard to tell exactly from the chart U.S. M1 was roughly \$4tt at the end of 2019. At the end of February, 2021 it is at \$18.299tt. Wow.

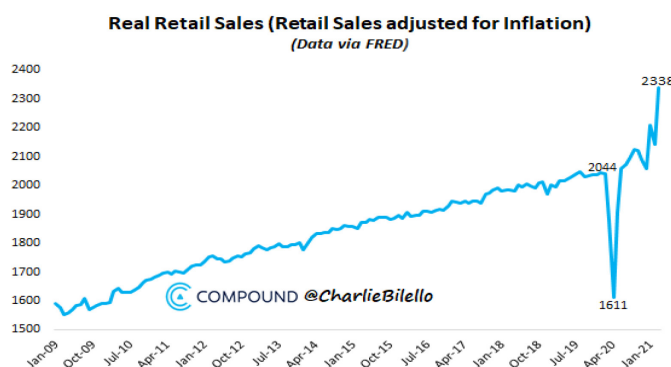
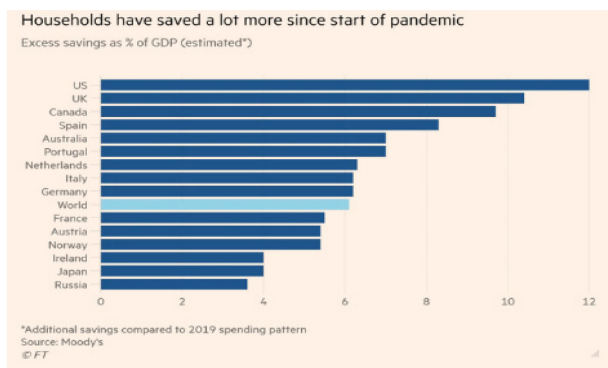
If we can agree that QE has caused asset inflation, but is not generally reflected in CPI, then can we also agree that asset inflation creates wealth inequality since it is the wealthy that tend to own real estate, stocks, bonds, art, etc. (Keep in mind the government knows this as one of the rationales given for QE was to create a wealth effect. ie, create asset inflation and then





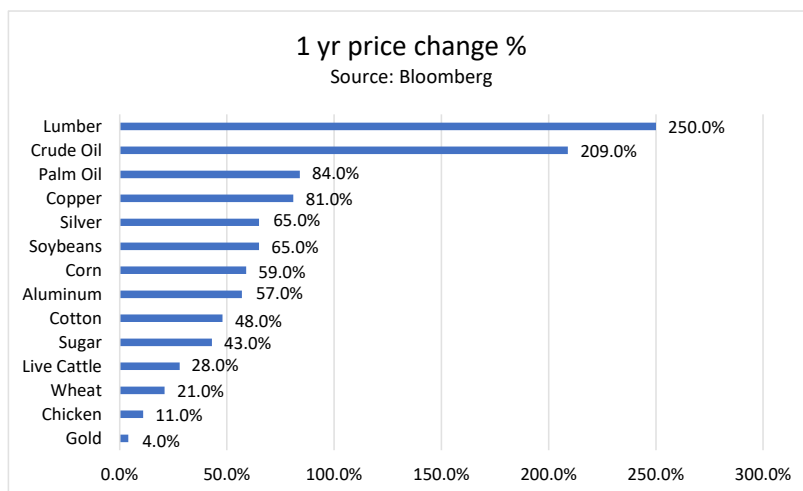
the increased value would be monetized and that additional money would be spent in the economy spurring GDP growth.) So now that this has all happened, the government is “shocked” at the level of wealth and income inequality and they must act to help the non-wealthy. How to “help”? Money printing for projects and direct payments to individuals, and funding other political wish list items. Call that enhanced unemployment insurance help, Universal Basic Income, elimination of student loan debt, one-time payments, helping the needy, reparations, etc. The point is, more printing and sending money directly to people. This reminds me of a scene in the Netflix show “Narcos” which is about Pablo Escobar and the drug trade between Columbia and the U.S. Pablo decides he would like to be seen as more legitimate, thus he should run for office. Since he was “a man of the people” he literally handed out cash when giving political speeches.

If you are unemployed, then the federal government will give you a bunch of money to augment the state unemployment insurance money. We are now on our third “one time” payment to all Americans, other than the top 5% or so, just because. We didn’t get inflation from the original QE, because the assets that went up are not reflected in CPI. Now, we are starting to see it directly since we are paying people directly to buy stuff. Note, when you give money to people, one way or another, and the savings rate goes up, when the economy opens up you better believe we will get a huge demand response.



The Fed continues to refer to whatever inflation is out there as “temporary,” but with literally everything surging in recent months, it’s risky for investors to ignore the possibility that this may be a more permanent upward shift in price (see below). Let’s also remember that the Federal Reserve said the mortgage crisis in the early days of subprime was “temporary.” On the right above is a chart of U.S. retail sales. If you want to argue that the money printing didn’t go to inflation since it effectively was stuffed into the banks, I addressed that above but clearly based on retail sales the newest “help” from the government is going into buying stuff which is and will continue to be inflationary.

The problem is that in free markets higher inflation generally means higher interest rates. Higher interest rates means more interest costs for the government. With the amount of debt that the U.S., let alone Japan and pretty much all the EU, has higher interest costs are untenable. Hence some form of Yield Curve Control is coming. To be clear QE is a non rate-specific target form of YCC. The developed world has had that for years. The only thing left is to target a specific yield on a certain maturity (0% in Japan, .3% in Australia, etc.) It seems clear that it’s coming here too. Speaking of this, the U.S. Government has stated their current run-rate purchases are \$120bb/mo in bonds (\$80bb in U.S. Treasuries and \$40bb in mortgages) every month. However, the last few months the Fed has bought back well in excess of this amount and last week alone they bought back \$84bb. It’s funny how their purchases expanded as the yield on the 10-year bond went from 0.5% to 1.74% and now back down to 1.58%. How





much worse would the yield rise have been without this buying? How much more buying will the Fed need to do? It is hard to imagine it ending. Sure, we haven't kept yields at .5% (for now) but we spent more to keep them from rising further. This is all on the path of full YCC.

If we can also agree that the government can't afford to let yields go to where the market would set them because it would essentially create a death spiral where the deficit is super high because of interest costs, then the government has to print to pay for the borrowing to pay the deficit which creates more inflation, etc. This is exactly why companies in dire straights that issue payment in kind ("PIK") bonds are frequently referred to as death spiral bonds. If you know you can't continue with too much debt forever, what to do? You can't default. You can't stomach austerity (i.e., cut spending dramatically). This has proven to be virtually impossible politically because it directly negatively affects economic growth.) So that leaves option three; create inflation to devalue the debt, but fudge the inflation numbers so it doesn't look so bad. It is hard to know when the problem will be evident, but the U.S. and the rest of the developed world has become addicted to debt. As with all addictions, the only cure is going through the pain of withdrawal, but in our "I want everything now" societies, pain is no longer acceptable. Sooner or later, the day of reckoning will come due and the longer we postpone it, the more vicious the final collapse will be.

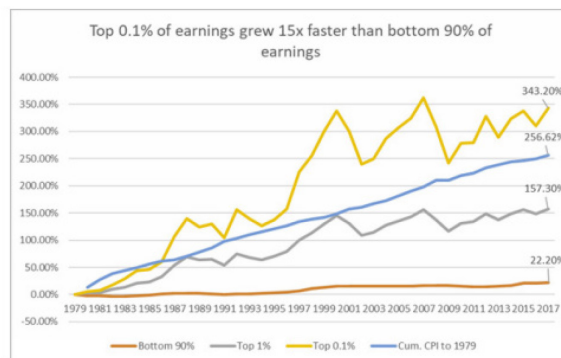
When is anyone's guess but we have allowed markets to become extremely fragile. Fragility is a treacherous concept: for a long time nothing seems to happen and prudence resembles stupidity, until suddenly, apparently out of the blue, all hell breaks loose. But rest assured, the need for inflation to reduce the real value of the debt is why the government (and the Federal Reserve, even though they are officially independent) continues to talk about the virtues of inflation.

The problem is that there is no societal virtue in inflation. Period.

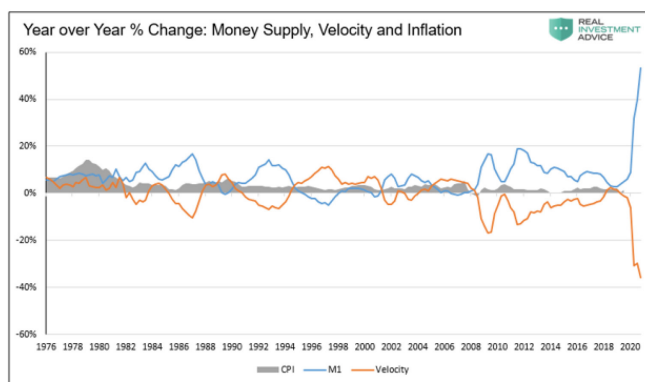
Inflation is an insidious tax on everybody, with the sad irony in a world of income and wealth inequality that inflation hits the poorest the hardest, by far. I used the chart on the right in a previous commentary but it makes this point perfectly. The real living standards of everybody but the super wealthy are going down but since the people want to believe the government is here to "help" them they don't see it.

From an Austrian economics point of view, inflation is the direct outcome of money printing. Econ1 teaches you that when supply is up, assuming demand is flat, then prices go down. In this example, the price is of money, not goods and services. When the value of money falls, the price of everything relative to money rises. The common retort to this is if monetary velocity falls that can offset the increase in money supply so as to not cause inflation. The issue is velocity is virtually impossible to calculate from economic data, just like general inflation. CPI fails to capture asset price changes, and velocity is the same. For the past ten plus years money was printed and it directly bought bonds. All else equal bond prices rose and yields fell. But so far the government is not buying new issuance bonds. They are buying from the open market, so whoever is selling gets that newly printed government money. That transaction is not counted in velocity. What the recipients will do with that money is unclear. Again, since the wealthy are the primary owners of assets, including bonds, maybe they stuffed the money under their mattress so to speak. Temporarily the velocity in the consumer CPI point of view is down, but will it always be? Clearly no. They will spend it or invest it, or even if deposited it in a bank, it will be lent out and spent. (That is what banks do.)

If you are still not convinced velocity is a B.S. plug number that doesn't capture everything, look at this chart on the right. Velocity is essentially the exact inverse from M1 money supply. That is an



Source: Social Security Administration wage statistics





amazing coincidence if velocity is truly an independent variable. Like all economics formulas there is logic to $MV = PQ$. But it doesn't quite work when the methodology of calculating it is a plug in the formula.

Since asset inflation, and the corresponding velocity is NOT captured in CPI it **appears** as though we have very low CPI inflation. However, hopefully it is clear that CPI, as it is calculated, isn't the appropriate measure of inflation. Yet, it is what we use. Back to the point of inflation vs deflation. Of all the widely held but patently false economic beliefs/narratives is the absurd notion that falling consumer prices are bad for the economy and something must be done about them.

Given the big push by the government to generate inflation, it is interesting to read a governmentally-driven study that goes the other way. A case in point is a March 2020 Bank for International Settlement (BIS) study, *Costs of Deflations: A Historical Perspective*. It showed what should be obvious; that the fear of deflation is foolish. The study says:

"Once we control for persistent asset price deflations and country-specific average changes in growth rates over the sample periods, persistent goods and services (CPI) deflations do not appear to be linked in a statistically significant way with slower growth even in the interwar period. They are uniformly statistically insignificant except for the first post-peak year during the postwar era – where, however, deflation appears to usher in stronger output growth." The study concludes with "Deflation may actually boost output. Lower prices increase real incomes and wealth. And they may also make export goods more competitive."

So if deflation isn't necessarily bad, the "need" for inflation is all a lie by our government. Back to a quote from my last commentary from the U.S. Economist Walter Williams, *"Politicians exploit economic illiteracy."* In this case the government does "need" inflation, just not for the reasons they tell us. There are many news articles/opinion pieces that ask the question if the Fed understands the potential negative consequences of what they are doing. Of course they do. Sadly I will always take the cynical point of view that anybody in the government or reliant on the government for their livelihood will do whatever sounds good in order to get re-elected / keep their job.

Today most politicians seem to fancy the theories of the English economist, John Maynard Keynes. He was the godfather of modern day economic planning. In his 1919 work, *The Economic Consequences of the Peace*, he wrote:

"By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. The sight of this arbitrary rearrangement of riches strikes not only at security but [also] at confidence in the equity of the existing distribution of wealth..."

"As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery."

Does that sound like today?

If you don't recall, former Fed Chairman Alan Greenspan was a gold=money guy pre-Fed, but when he was appointed to the Fed he became very negative on gold's prospects, and now that he is retired, he is frequently quoted as again very positive about gold. If you still aren't sure if the Fed knows what it is doing, how about this quote? In September 1979, former Fed Chairman Arthur Burns said the following in a speech entitled "The Anguish of Central Banking."

"Viewed in the abstract, the Federal Reserve System had the power to abort the inflation at its incipient stage fifteen years ago or at any later point, and it has the power to end it today. At any time within that period, it could have restricted the money supply and created sufficient strains in financial and industrial markets to terminate inflation with little delay. It did not do so because the Federal Reserve was itself caught up in the philosophic and political currents that were transforming American life and culture."

Those currents he was speaking about were specifically full employment via economic growth. More importantly, he was being politically correct to say the Fed was "caught up" in whatever when the truth was they did what the government wanted. In other words, to end



inflation would have temporarily hurt the economy and employment, which no politician wanted. That said, it had to get to a point of maximum pain, which it did after which the next Fed Chairman Paul Volker raised rates dramatically and killed it.

Going back to money printing leading to inflation, these days other than the almost mythical Weimar Germany people associate hyperinflation with poorly run/corrupt emerging markets like Zimbabwe, Venezuela or Brazil. In simple terms all these countries ran up too much debt via overspending with no way to collect enough from the population so they resorted to printing money, which led to the collapse of the value of their currency and rampant inflation. We all know that story, but those countries were always a mess to start with right so maybe they shouldn't count as examples?

Another interesting book on this topic, but not focused on the above obviously poorly run countries is the 1982 book by Thomas Sargent, *The Ends of Four Big Inflations*. He goes into the history of Austria, Hungary, Poland and Weimar Germany. I won't bore you with a book report, but can quickly summarize that when faced with social spending commitments / war spending / war reparations with no available money, they borrowed and the only answer on how to fund the debt was to pump the monetary printing presses. All had REALLY poor outcomes. As this book demonstrates, the correlation between currency printing and inflation is undeniable and the causal relationship seems hard to prove but obvious. For more recent examples look no further than the currencies and economies of Turkey and Lebanon today. Yet MMT proponents continue to contest this. Sir Winston Churchill once said "*however beautiful the strategy, you should occasionally look at the results.*"

Another good book on this topic is *1931 – Debt, Crisis, and the Rise of Hitler* by Tobias Straumann, written in 2020. In that book he quotes the German Chancellor Heinrich Brüning who says in an internal government meeting "Our strategy is going to be to tell the external creditors, particularly as it relates to the war reparations, that we're going to keep paying the war reparations. While at the same time, we're going to tell the domestic audience that is sick of the austerity that we keep putting on them so that we can repay the war reparations, that we're not going to repay the war reparations."

As the author says "If he (Brüning) supported the abolishment of reparations, he would unsettle foreign investors. If he fought against the popular campaign for an end of reparations, he was sure to lose the domestic elections."

Again, doesn't sound too different from today.

Allow me a quick political (cynical) comment. Factually, since MMT was more broadly discussed, it has been widely panned by economists. A recent University of Chicago Booth Business School Forum survey of 50 of the most respected academic economists (both Democrats and Republicans) found that not a single respondent agreed with the central claims of MMT regarding deficits, currency production, or inflation. So how does this nonsense continue on? Money and a nice story.

Just like politicians are bought by money, so are academics that need research grants. As an example, billionaire investors Leon Levy and Warren Mosler, who for some reason are believers in MMT, funded the economics departments of Bard College and the University of Missouri – Kansas City. Neither school is especially well known nationally, but when you look at much of the research on MMT, the bulk of it comes from those two colleges. Shocker. That said, Stephanie Kelton from Stony Brook University is a better marketer so she gets the headlines.

After money comes the story. The story is obvious. We can print money and fund everything we want with no negative consequences. What better story could a politician have, when their only goal is to get re-elected and maintain their power?

Let's bring all this back around to what seems like the obvious political playbook.

- 1) Initiate massive government spending to goose the economy which stokes inflation (in process).
- 2) Print the money needed and have the Fed monetize (ie, buy) whatever portion of the fiscal deficits necessary to keep financial market stability.
- 3) Manipulate the numbers to under-report inflation (we have been doing this for years and yet the problem still worsens) and call whatever inflation we do report as "temporary". Further, keep telling the markets inflation is not an issue and the Fed can control it whenever they want.
- 4) The end game: create nominal GDP growth (via inflation), underreport CPI AND cap interest rates so the nominal GDP is far higher than the short term funding rates.



Real GDP is nominal GDP less inflation (CPI), so creating inflation equals higher nominal GDP and underreporting inflation gives you a magically higher real GDP. Politically, higher GDP looks better. The Government continues to tell us that some inflation, but not too much, looks better. Good so far, right? The problem that we addressed earlier is that inflation sends interest rates higher, which is bad. The answer is to suppress rates. The final result (ASSUMING you can convince the population that the government is acting in a beneficial manner) is that you then get massively negative real rates, which ultimately devalues the debt directly.

Yield Curve Control seems extreme, but keep in mind that we have done it before. In 1942 the Fed and Treasury internally agreed that the Fed would cap the Treasury's borrowing costs by buying any government bond that yielded above .5% on 3-month T bills and 2.5% on longer bonds. What is interesting is that until 1947, when we officially abandoned the policy, the Fed maintained these pegs without having to buy large amounts of bonds. The fact that the government said they would keep rates pegged there was enough to convince people so the government didn't actually have to buy much. Today, Japan has an overt YCC policy to keep 10 year bond rates at 0%. It took a few years of heavy spending but the Japanese public has seemingly learned the same lesson that the U.S. saw at the end of its YCC experiment and the last 3 years those purchases have slowed dramatically. Interesting.

Since I like quoting movies but haven't yet in this piece, here goes. In the 2004 Will Smith movie *iRobot* the biggest corporation is U.S. Robotics (USR), which makes human assisting robots. In its headquarters the central artificial intelligence computer, VIKI, "learns" (this movie is almost 20 years old but predicts the impacts that artificial intelligence will have on us) that humans at times make poor decisions and USR's robots need to take over. When asked about why the robots that are supposed to help humans are taking over, VIKI, says *"you cannot be trusted with your own survival... To ensure your future some freedoms must be surrendered. We robots will ensure mankind's continued existence. You are so like children. We must save you from yourselves. Don't you understand? My logic is undeniable."* Substitute "the U.S. Government" for "robots" and here we are. I especially like the *"My logic is undeniable"* part. Isn't that essentially what we get from the government? This is the right answer and how dare you question it.

I apologize for the macro commentary, but if we are truly on the verge of finally seeing CPI reflected in the data more than "temporarily" as the government claims, maybe more people will realize the importance of it and think about its impact on their investment portfolio. As for Kopernik, as we tell all our clients we are 100% bottom-up focused in terms of picking stocks. That said, we, of course, have to consider the macro scenario to understand the risks. We are not specifically looking for inflation protected businesses, but we do consider it given the current scenario we are in.

Maybe with stated inflation rising, let alone true inflation much higher than stated, the stock market and all other assets will continue to move higher, but maybe this steady rise will have hiccups. When 96.4% of stocks in the S&P 500 are above their 200-day moving average, the highest % ever (Bloomberg), we are fearful. Perhaps we will be wrong but we prefer to look at cheaper alternatives overseas. To the extent it is difficult to find true value stocks, then the byproduct of not finding enough cheap stocks is that our portfolio weighting of cash increases. Some will say we should be fully invested at all times, but we view our mandate as to find and buy businesses that are undervalued. Period. Not undervalued relative to something else, but undervalued in an absolute sense. We are also believers in the great Warren Buffett quote *"The beauty of stocks is that they do sell at silly prices from time to time. But you have got to wait. That's how Charlie and I have gotten rich."* Lastly, in an up market cash is certainly a drag on performance, but in a volatile or down market it provides fantastic optionality. Like any option when interest rates and volatility are both very low, like now, this optionality is even more valuable. We view this as a big advantage.

Thanks again for your support.

Mark McKinney

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