1) This writer always puts the physical gold/digital gold discussion as the last bullet point. However, given what has happened over the weekend and on Friday, it is important to commence with this subject. The pullback in GLD on Friday clearly related to the choice of Kevin Warsh as Fed Chair, alleviating much deserved fears that a successor to Powell would simply be a mouthpiece for the Administration. Warsh is clearly in favor of a shrinkage of the Fed balance sheet which will be a most provocative juxtaposition with the Administration's desire for lower rates. Moreover, the steepening of the yield difference between the 2 year and 30 year Treasuries, to its highest level since 2021, would appear to be telling investors that, yes, the Fed is still going to cut rates but one needs a higher premium for the 30 year in view of continuing deficits and the still-to-be realized inflation target.

    a. Another factor that may have impacted GLD was the revelation that central bank buying unexpectedly declined approximately 20% last year, creating concern that funds and private investors have increasingly become the key driver of bullion's record breaking rally. According to the World Gold Council, purchases by central banks and sovereign wealth funds declined to 863.3 tons last year, while investment demand surged 84%. In 2022-2024, central banks and sovereign wealth funds purchased well over 1,000 tons annually. Central banks do have target allocations for gold, so the massive price increase in 2025 may have led to a reduction in purchases to keep those allocations balanced. The World Gold Council's data does not include activity by China which is unreported. Poland was the largest buyer of gold for the 2nd consecutive year, with Singapore, Russia and Jordan being the largest sellers. Perhaps Putin "needed" fiat currency to fund the War? Gold investors should also note that Tether is the largest holder of gold outside of the central banks given the necessity of having gold and/or Treasuries underlying the amount of stablecoins issued and that fundamental demand should continue.

    b. As for digital gold, the collapse over the past 3 days is a shock to believers in this asset class. Digital gold thrives on liquidity and a perceived reduction of systemic liquidity is the basis for selling. The thesis revolves around the unwinding of the carry trade, in which crypto investors borrowed low-yielding yen to invest in crypto. Given the gyrations now in the currency market, investors, out of fear, have clearly been unwinding that trade putting significant downside pressure on bitcoin. Moreover, at best, the amount of money involved in the carry trade is opaque making this level of uncertainly even more disturbing.

c. As for the impact of the gyrations in the yen on the carry trade, the fashionable term has become "dollar debasement"—selling the US$ for other fiat currencies, gold, crypto, etc. The DXY closed the week at 97.15 down from a year-end close of 98.28 but traded as low as 95.55 earlier in the week. This writer believes the BoJ will attempt to keep the Yen in an 152-159 range trying to limit any extreme movements given the bold plans announced by Takaichi (aka Mrs. Thatcher) including the snap election on February 8th as well as her plan for a two-year suspension of the 8% consumption tax on food, a proposal extremely popular with the Japanese electorate. As for the Euro, one would expect the high of 120.24 this week to represent an extreme, and given the economic outlook for most of Europe—the Federal Ministry for Economics lowered growth estimates for Germany this week to 1% in 2026 and 1.3% in 2027—a further strengthening in the Euro is certainly not in the best interests of the EU. The point of the matter is stabilization in the currency markets is of significant importance to digital gold.

d. Further impacting digital gold, about which this writer commented last week, was any positive momentum for crypto was abruptly halted when the Senate cancelled a vote on a major cryptocurrency bill due to intense lobbying by the CEO of Coinbase. Given what has occurred since on both the price of Coinbase stock and of crypto overall, perhaps Mr. Armstrong might intensely work on a compromise plan.

2) Returning to the theme of the impact of the fixed income market on equities, Paul Shea (Miller Tabak Economist) continues to espouse views that are non-consensus but which have been uncannily accurate in the past. In his piece this week entitled "The Fed is Guilty of Wishful Thinking on the Labor Market" (your inbox late Thursday evening US/early Friday UK/EU), Shea states that Powell's claim that the labor market is showing "some signs of stabilization" is "puzzling." The U-6 data suggests otherwise, and, according to the latest readings of the Conference Board, households are reporting that it is harder to find a job and are starting to accumulate more debt. Household debt service is now 11.3% of disposable income, the highest level post-pandemic. This indicates to Shea that GDP, especially consumption, will slow to match a weaker labor market. Shea is maintaining his view that the yield on the 10 year will decline to

3.75% by Christmas, 2026, clearly non-consensus and the lowest on the Street. Such a decline can be interpreted by equity investors in different manners.

3) Readers of these Sunday pieces know that my most important indicator for equities for reasons stated on numerous occasions remains HYG. Despite gyrations in the currency and other segments of the fixed income markets, HYG was essentially unchanged on the week, comfortably above both its 50 and 200 day upward sloping moving averages. HYG continues to act as a balm for equity investors' nerves.

4) This writer will continue, every Sunday going forward, to harp on the fact that the average intra-year drawdown during the midterm election years is 18%. Therefore, expect a nasty equity correction at some point this year, with the 3rd qtr being favored. Consensus is that it is highly unlikely for the current Administration to keep control of the House. Even Ronald Reagan, after winning 49 states in his 1984 election triumph, lost 5 House seats in the 1986 midterms.

5) As this writer has noted, the action in the VIX is a sign that equity investors have become more immune to sudden policy shifts by the Administration which are quickly reversed when the equity markets swoon. Put this indicator in the bullish camp rather than suggesting too much complacency.

6) Unfortunately for long-suffering small cap investors, who had experienced moments of optimism over the last several weeks, the Russell notably underperformed this week. Bulls on the small caps will attribute this to mere profit-taking and mean reversion after an extended out-performance. The bears will suggest a movement back to more glamorous names, given some of the earnings posted in tech, and therefore the performance of the SMH.

7) Relative to the SMH, which many investors including this writer believe to be the most important etf in the equity market, it closed at an all-time high at week's end, despite a noticeable pullback on Friday. Investors will be keenly watching the 420.60 number and the 396.22 figure, representing the highs and lows for the week as to next meaningful move in this etf.

8) This writer has been noting since early December that the Transpos, after lagging badly for most of 2025 , began displaying positive relative performance across all industry sectors that are components of the Index, which has continued y/t/d. One can surely make the argument that the Transpos are a beneficiary of higher capex due to accelerated depreciation feature of the Big Beautiful Bill as well as a US economy that has been stronger that most observers have been predicting.

9) While energy has been about the strongest component of the S+P sectors y/t/d, please note WTI has risen for 6 straight weeks from $56.66 to $65.21 in that timeframe. Might some sort of pullback be anticipated ?

Jeff
Have a productive week.