



**WALL STREET'S**  
**PROVING GROUND**



March 2021



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Spring is here and vaccines are being distributed.

The rate of COVID infections has fallen to its lowest level since October.

Things are opening back up.

A massive \$1.9 trillion stimulus package has been signed by the president and is set to deliver an economic booster shot of its own.

And the Federal Reserve has made clear it won't even think about raising rates or reining in monetary policy until employment reaches pre-pandemic levels.

Yet in the face of all this optimism, the market is sending mixed signals.

Both the Dow and the S&P 500 tanked hard at the start of the month, only to fight their way back up to where they ended February.

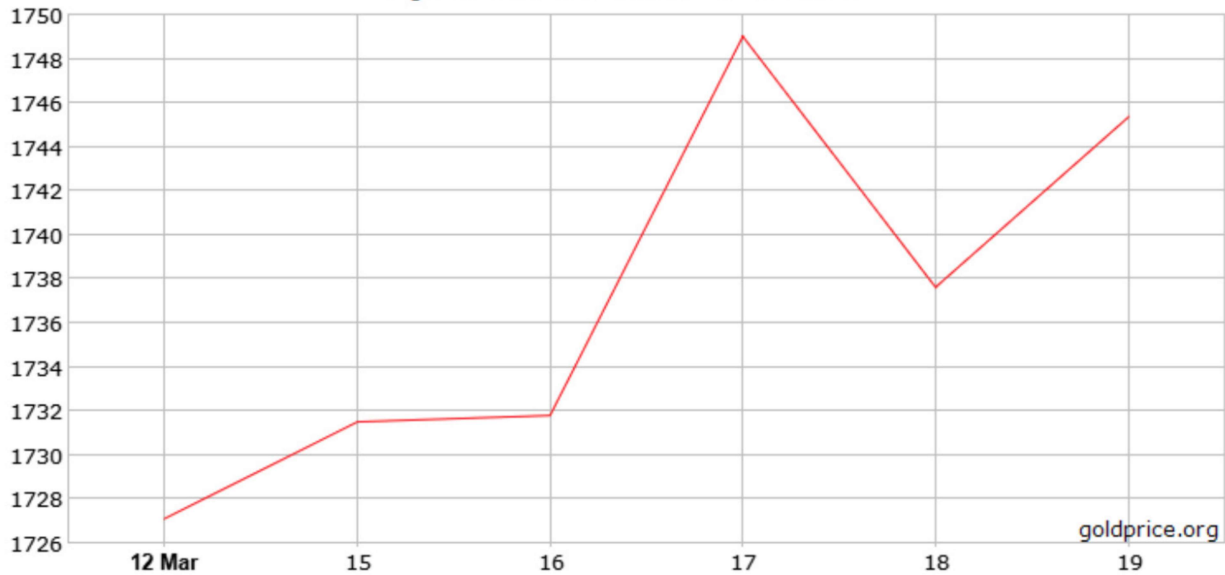
Gold prices, meanwhile, have been in a slump but recently managed to regain some of their momentum as well.



7 Day Gold Price in USD/oz

High: 1749.00 Low: 1727.09 ▲18.24 1.06%

Last Close: 1745.32



So what's to make of all of this?

Well, if you dig into the data, all of this volatility can be traced back to a single culprit...

The Fed.

Specifically, the Federal Reserve is lying about inflation.

It's not as subdued as Federal Reserve Chairman Jerome Powell would have you believe. Nor is it likely to stay restrained as the central bank focuses exclusively on job creation and the federal government rolls out another \$2 trillion in stimulus measures.

Some corners of the market have come to realize this.

Hence the rebound in gold prices and the sudden stock market panic.

That's my theory anyway.

Now let's see if I can prove it to you...



## **The Fed Is Lying About Inflation...**

And the Smart Money Knows It

Anyone who's followed [my work at \*The Outsider Club\*](#) knows how I feel about inflation.

To put it simply: It's way more prevalent than anyone is willing to admit. It's the elephant in the room that the Federal Reserve is telling everyone to ignore.

"Inflation has been much lower and more stable over the past three decades than in earlier times," Fed Chairman Jerome Powell insists.

Any inflation we're seeing now is only "transitory" and the result of "base effects," he says.

And going forward, "it's more likely that what happens in the next year or so is going to amount to prices moving up but not staying up and certainly not staying up to the point where they would move inflation expectations materially above 2%."

Well, in my view, that's all bullshit.

It's flatly wrong.

Supermarket prices were 3.7% higher in January 2021 than they were in January 2020, which was before the pandemic. Prices for poultry, seafood, and dairy products increased between 4.4% (dairy products and other meats) and 9.6% (beef and veal), according to the USDA.

Home prices rose 10.4% in 2020, their fastest pace in seven years. And the National Association of Realtors says the median existing-home sale price rose 14.1% in January to \$303,900.

Lumber prices are up 140% in the past year, and copper is trading over \$4.00 per pound for the first time since September 2011.



Oil prices have staged a massive comeback and are now trading above \$65 per barrel — an 80% surge from their October lows.

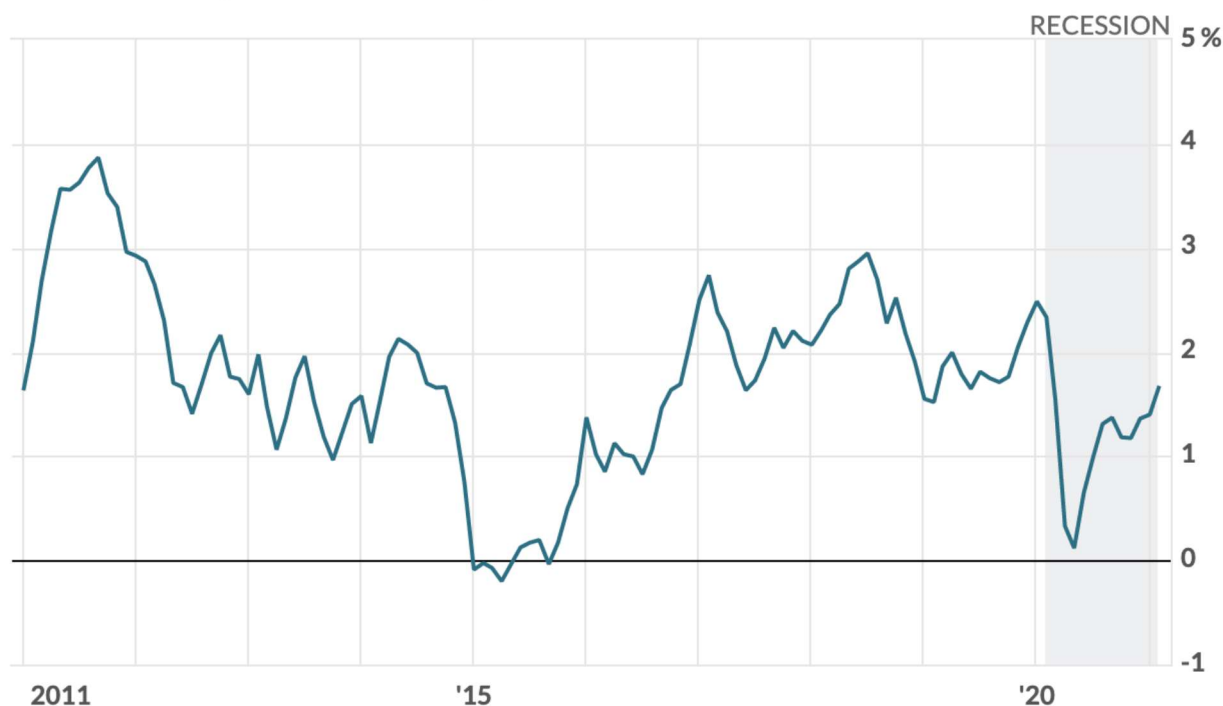
Of course, none of that counts, because the only thing that matters to the Fed is the CPI, which includes a plethora of goods and services ranging from men’s suits to dental services to taxi fares.

That’s been relatively subdued, but it’s also inching up.

The consumer price index advanced 0.4% last month, while the annual rate of inflation rose to 1.7% from 1.4%.

## **Inflation in the U.S. is creeping higher**

12-month change in the consumer price index



Source: Labor Department via St. Louis Fed

That’s certainly nothing to scream about, but it’s also indicative of an upward trajectory that will likely carry inflation to its pre-pandemic pace of 2.3%(if not higher) in the next few months.

So while Powell wants to insist inflation is merely a mirage, it’s clearly real.

The question then becomes: How real will it get?

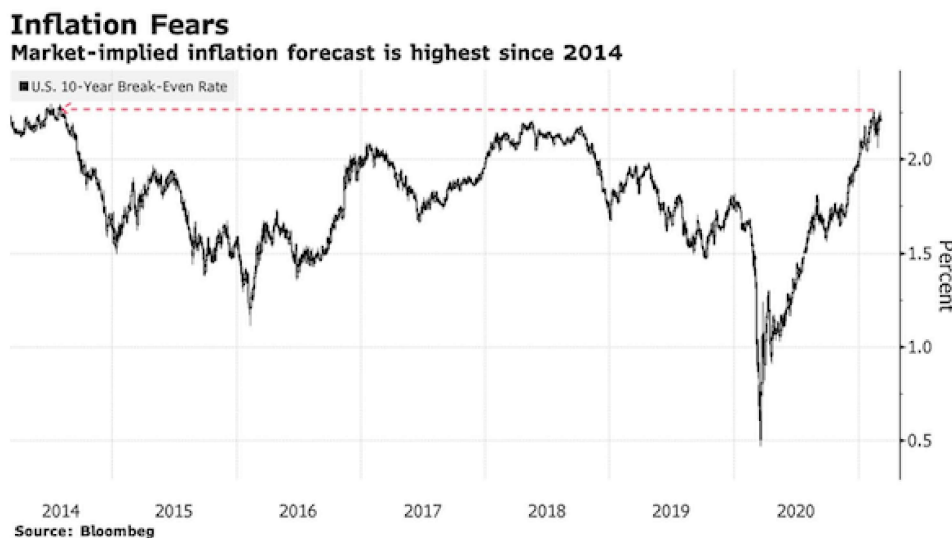
The market, as always, has some thoughts...

To gauge them, we have to look at the bond market.

Specifically, we can look at the 5-year “break-even” rate — the difference between the yields on 5-year Treasuries and 5-year Treasury inflation-protected securities (TIPS).

That’s now at 2.4%, its highest point since May 2011 and a strong suggestion that, in the market’s view, inflation is running *ahead* of the Fed’s old 2% target.

Same with the 10-year break-even rate...



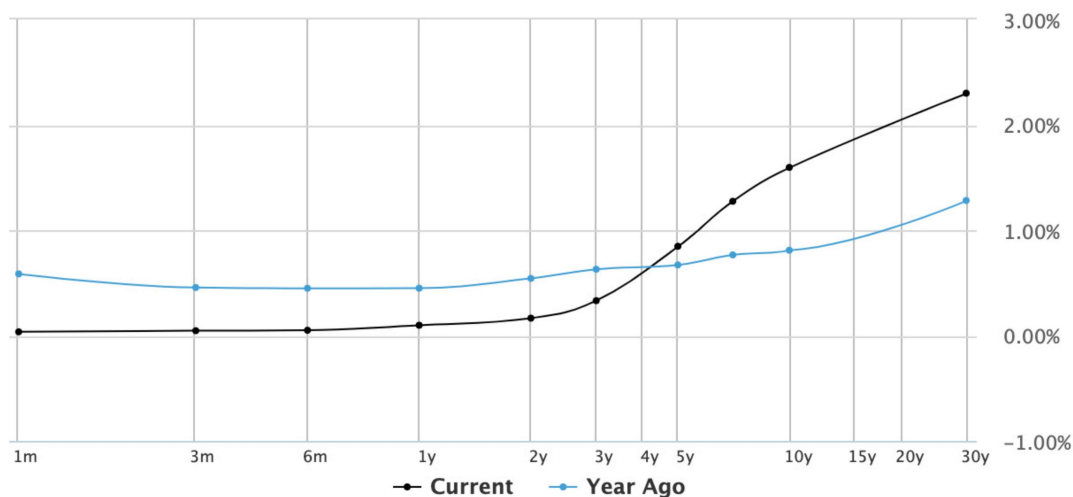
And that’s not all.

Another bond market warning signal flashed bright red at the start of the month, when a Treasury auction failed to draw sufficient interest.

That is, a few weeks ago, demand for 5-year and 7-year Treasuries was so weak at a \$62 billion auction that the seven-year note sold at a 1.195% yield, or 0.043% higher than expected — a record gap for a 7-year note auction.



YIELD CURVE - US



Furthermore, the large financial firms that trade directly with the Fed and are *required* to bid at auctions were left with about 40% of the new notes — twice the recent average.

That's what drove Treasury yields on 10-year notes to 1.6% at the start of the month, instigating a wave of panic in the stock market.

Why is demand so low?

Well, why buy bonds for a rock-bottom interest rate if you think the Fed is going to have to raise rates in the short term?

Or just as crucially, why buy fixed-income assets at all if you think inflation is going to neutralize the gains?

It all adds up to one thing: The market doesn't believe the Fed is capable of keeping interest rates or inflation in check.

Bond traders are seeing the same rising prices I just enumerated, and they're acting in accordance with the reality of the market.

The Fed isn't. The Fed is lying, or at least hiding the truth, because frankly, it's more obsessed with the other end of its dual mandate, which is to promote employment.

Now, what does this all mean for gold?



## **Getting Back to Gold**

As I mentioned up top, gold prices have been laboring through a correction for the past several months.

There's a multitude of reasons why, but I just want to name a few...

There's a natural amount of profit-taking that occurs whenever an asset shoots up in price. And gold blasted past \$2,000 per ounce last year as the pandemic sent shock waves through the global economy and society as a whole.

But with multiple vaccines now being deployed, holiday spikes and a bleak winter behind us, and a massive amount of stimulus working its "magic," the sentiment has obviously shifted.

Simply put, there's been a race back into risk — what's often called "exuberance."

So it's not just gold that's suffering, it's all safe-haven assets.

Again, as we discussed, the bond market has gotten slammed these past few weeks with imploding prices and spiking yields.

That actually makes things doubly painful for gold because higher-yielding Treasuries are seen by many as a more appealing hedge than precious metals, which yield nothing.

All of that is understandable.

However, other shifts in the market have been far less justifiable.

The surge in cryptocurrencies, for example.

I've dabbled in Bitcoin in the past, but to be honest, I abandoned that game because the volatility proved to be too much.





Another example would be the vast amount of retail interest we've seen in stocks like GameStop.

Indeed, the Robinhood app has given rise to a vast new contingent of traders. But while the app trades, stocks, options, ETFs, and cryptocurrencies, it doesn't trade gold. So while virtually every other asset class has benefited from a broad new pool of capital, gold has been left out in the cold.

These are the things working against the yellow metal right now.

However, the stock market volatility and the creeping inflation that came in with the spring weather seems to have halted gold's decline.



We'll just have to wait and see how long this resurgence lasts.

It could be the sign of a new bull market or it could just be a temporary bounce.

Still, one thing is certain, which is that even with the Fed using its bullhorn to tamp down inflation and inflation expectations, the central bank won't be able to hide the truth forever.



Prices are going up. We've established that. And I'm not the only one murmuring about it.

Former New York Fed President Bill Dudley actually put a nice, fine point on this whole situation.

"They want the economy to overheat, and my personal opinion is, I wouldn't sell them short. I think they are going to be successful," Dudley recently told CNN Business. "The Fed has basically changed its regime from one where they would try to arrive on time to one where they're now going to arrive late."

That's really the crux of it.

The Fed isn't going to acknowledge inflation until it kicks down the door.

And as it happens, I have a theory on what that might look like...

## **Hot Summer Prices**

Like I said, the annual rate of inflation is likely to shoot past 2% in the next few months.

It pretty much has too.

Commodity prices have been surging for months, along with the costs of food and shelter.

Monetary and fiscal stimulus are pouring out of the spigot.

And on top of it all, a huge wave of consumers is set to reenter the market as vaccinations scale up and COVID cases retreat.

It's basically the perfect storm for higher prices.



And as those prices rise they're going to start getting a lot more attention.

As I said, inflation hawks are already squawking. What's really missing, though, is consumer awareness.

That is, inflation moving up by 1–2% over a year doesn't really shake the average American. They might *feel* like prices are getting higher in certain respects, but it's not enough to blow their minds.

However, I think this summer will be a massive wake-up call for a lot of people.

And I think one place where inflation will be particularly acute — and especially obvious — will be in gas prices.

Already coasting higher on the rebound in oil prices, gas prices are poised to surge over \$3.00 and perhaps even test the record highs set back in 2008.

Consider that the average price of a gallon of gas has already edged back up to \$2.826, according to the AAA fuel gauge. That's up from \$2.491 a month ago and \$2.345 a year ago.

	Regular	Mid-Grade	Premium	Diesel	E85
Current Avg.	\$2.826	\$3.138	\$3.407	\$3.045	\$2.439
Yesterday Avg.	\$2.815	\$3.124	\$3.393	\$3.034	\$2.433
Week Ago Avg.	\$2.745	\$3.058	\$3.327	\$2.963	\$2.389
Month Ago Avg.	\$2.491	\$2.813	\$3.079	\$2.727	\$2.181
Year Ago Avg.	\$2.345	\$2.702	\$2.964	\$2.795	\$2.065

And we haven't even yet seen the return to car travel — commutes and vacations — that is likely to spike this summer.

Make no mistake, people are going to be anxious to get out of the house after a long year of wilting indoors like Boo Radley.



And trust me, people know when gas prices are going up. The prices blare from roadside signs and cause eyes to bulge from the pump.

They're also something of a political cudgel.

You might remember the last time this happened, during the Obama presidency when oil prices surged over \$120 per barrel, sending gas over \$4.00 per gallon.

A parade of Republican politicians were quick to pounce.

Newt Gingrich warned Obama's "anti-American energy government" would lead to "\$10-a-gallon gasoline."

Mike Lee, the tea-partying senator from Utah, cautioned that if Obama got reelected, gas prices would reach \$5.45 a gallon by the start of 2015. (Regular retail gasoline prices averaged \$2.43 per gallon that year.)

Mitch McConnell commented that the soaring prices were "the painful effects of President Obama's energy policy."

And according to Mitt Romney, "the doubling of gasoline prices obviously follows a presidential policy" and Obama was to blame "for what's happened to gasoline prices under his watch."

You can bet Republicans will make sure Americans know who to blame for their \$40 fill-ups this summer, too.

And it won't be hard to tie the surge back to Biden's massive stimulus, either.

Indeed, that package, viewed by many as sensible today, could come to be viewed as a costly, inflation-sparking boondoggle in a few months.

At that point, the rising costs of food, shelter, and medicine that I've been bemoaning for the past year will suddenly find new purchase.



And the establishment and the public will suddenly, and somewhat ironically, have a new infatuation with inflation.

Combine that with more market volatility in stocks and bonds, and gold could be in for a monster rebound.

And that's why we doubled down on our main gold holding, Perpetua Resources (NASDAQ: PPTA).

## **Gold and Perpetua Resources**

On March 11, we doubled down on **Perpetua Resources (NASDAQ: PPTA)**.

As it currently stands, our official buy-in price is down from \$11.80 to \$9.04.

By way of explanation, I launched *Wall Street's Proving Ground* near the height of gold's epic 2020 run.

I knew valuations were frothy at the time, but there was no way I could omit Perpetua from our launch portfolio — it's simply too good a company. (We are talking about the largest potential gold mine in the U.S., after all.)

So I had to bite the bullet and get in at the top.

This happens in investing; you rarely get in at the bottom.

But the remedy is never to abandon a good company with scores of potential.

Instead, the best move is to lower your entry cost by adding more shares.

That's what corrections are for.



And that's why I officially doubled down and added new shares to our portfolio.

To be clear, this shouldn't have affected you at all.

The stock is still rated as a "Buy" and it's an important part of our portfolio.

Furthermore, I would recommend that anyone who's underwater on their own Perpetua holding do the same.

As I just explained in detail, I believe that gold prices could be turning a serious corner, so I wanted to act.

There's not much more to report on the company since it changed its name and up-listed to the Nasdaq in February, but I'll keep you posted.

In the meantime, let's get caught up elsewhere.

Let's first look at some earnings.

## **Easterly Earnings**

**Easterly Government Properties (NYSE: DEA)** has been relatively flat since we introduced our portfolio.

But that's OK.

We're not into the stock for its lofty capital gains potential (though there certainly is some there).

We're in it for the near-5% dividend yield it churns out.

See, a bank rates below 1%, or even the Treasury inflation-protected securities (TIPS) I mentioned earlier won't do anything to shield your money from inflation, which is currently rising faster than their yields.

But Easterly's current 4.78% yield is more than enough to compensate investors for the value their money loses simply by existing. Yet, as a government client, it offers the same level of safety.

Here's how the company performed last year...

For the fourth quarter, DEA reported net income of \$2.6 million, or \$0.03 per share on a fully diluted basis. That compares with \$1.6 million, or \$0.02 in the fourth quarter of 2019.

Easterly's funds from operations (FFO), a REIT's key metric, came in at \$29.7 million, or \$0.32 per share on a fully diluted basis, up from \$25.3 million, or \$0.30 per share a year prior.

And adjusted FFO reached \$27.4 million, up from \$25.9 million.

For the full year, Easterly reported net income of \$13.5 million, or \$0.15 per share on a fully diluted basis (a growth of 50% year over year); FFO of \$111.3 million, or \$1.26 per share on a fully diluted basis FFO; and adjusted FFO of \$106.1 million, or \$1.20 per share on a fully diluted basis.

"In a year that saw a contraction of 3.5% in real GDP and where many real estate sectors faced challenged fundamentals, Easterly was able to deliver 5% growth year over year in FFO per share on a fully diluted basis," said William C. Trimble III, Easterly's chief executive officer. "The company remains committed to growth through its ever-increasing sustainable cash flows derived from the full faith and credit of the U.S. government."

To that end, the company also made numerous acquisitions that will increase cash flow over the long term.

Those include:

- A 97,718-square-foot Department of Veterans Affairs (VA) Consolidated Mail Outpatient Pharmacy in North Charleston, South Carolina (“VA - Charleston”).
- A 27,596-square-foot Health Resources and Services Administration (HRSA) facility in Baton Rouge, Louisiana (“HRSA - Baton Rouge”).
- A 149,110-square-foot U.S. Department of the Interior (DOI) Regional Office and warehouse facility in Billings, Montana (“DOI — Billings”).
- And a 73,397-square foot U.S. district courthouse in Jackson, Tennessee (“JUD — Jackson”).

In all, Easterly added nine properties totaling 7.3 million square feet to its portfolio and now has 79 total properties.

Of course, acquisitions like that take capital, which was in part paid for by the disposition of one former DEA facility in San Diego, California.

However, to make up the rest it had to issue 6,996,824 shares of common stock. Those shares were weighted at a net average price of \$22.93 per share, raising net proceeds of approximately \$160.4 million.

Furthermore, Easterly expects to raise approximately \$105.4 million from the sale of more than 4 million shares of common stock that have not yet been settled.

It's also now carrying \$983.4 million in debt.

Guidance for 2021 FFO per share on a fully diluted basis is projected to be in a range of \$1.28–\$1.30. That would represent growth between 1.5% and 3%.

	Low	High
Net income (loss) per share – fully diluted basis	\$ 0.28	0.30
Plus: real estate depreciation and amortization	\$ 1.00	1.00
FFO per share – fully diluted basis	\$ 1.28	1.30





## Green Brick Earnings

Meanwhile, **Green Brick Partners (NASDAQ: GRBK)** followed up its preliminary earnings release from last month with its official report.

Fourth-quarter highlights included the following:

- EPS of \$0.58, a 81.3% increase compared with EPS of \$0.32 for the three months ended December 31, 2019.
- Net income of \$29.3 million, an increase of 84.1% from \$15.9 million.
- Total revenues of \$254.1 million, an increase of 10.4% from \$230.1 million; and gross profit of \$63.9 million, an increase of 31.1% from \$48.7 million.

Here's a larger snapshot...

	Three Months Ended		Twelve Months Ended	
	December 31,		December 31,	
	2020	2019	2020	2019
Residential units revenue	\$ 246,437	\$ 223,270	\$ 930,176	\$ 759,830
Land and lots revenue	7,663	6,852	45,845	31,830
<b>Total revenues</b>	<b>254,100</b>	<b>230,122</b>	<b>976,021</b>	<b>791,660</b>
Cost of residential units	184,534	176,221	705,866	597,884
Cost of land and lots	5,712	5,191	35,551	24,694
<b>Total cost of revenues</b>	<b>190,246</b>	<b>181,412</b>	<b>741,417</b>	<b>622,578</b>
<b>Total gross profit</b>	<b>63,854</b>	<b>48,710</b>	<b>234,604</b>	<b>169,082</b>
Selling, general and administrative expenses	(30,416)	(27,191)	(112,134)	(97,775)
Change in fair value of contingent consideration	(158)	(3,157)	(368)	(4,906)
Equity in income of unconsolidated entities	3,616	2,244	16,654	9,809
Other income, net	1,053	1,976	4,057	8,119
<b>Income before income taxes</b>	<b>37,949</b>	<b>22,582</b>	<b>142,813</b>	<b>84,329</b>
Income tax expense	7,659	5,034	25,016	20,027
Net income	30,290	17,548	117,797	64,302
Less: Net income attributable to noncontrolling interests	980	1,628	4,104	5,646
Net income attributable to Green Brick Partners, Inc.	\$ 29,310	\$ 15,920	\$ 113,693	\$ 58,656



“Green Brick’s robust growth and financial success reached new highs this year,” said Chief Executive Officer Jim Brickman. “The company achieved a record diluted EPS of \$2.24, up 93% year over year, representing a 34% compounded annual growth rate from our FY 2015 results. Demand for our homes has been tremendous at all price points and continues to climb with net new orders in January and February 2021 up 80% year over year, well above the 63% year-over-year increase seen in the last half of 2020.”

Green Brick Chief Financial Officer Rick Costello had an interesting note on the earnings calls, as well.

“During the fourth quarter of 2020 and continuing into March 2021, we have raised home prices more aggressively to further increase margins and attempt to slow down our sales pace,” he said. “The company intends for this increase in pricing to lead to lower new order levels, but higher profits, prospectively.”

Indeed, demand for Green Brick properties is so hot they’re raising prices to try to tamp down excessive demand and increase profit margins.

That’s a good problem to have.

## **Speed Kills for Lockheed Martin**

While the F-35 has been a headline-grabbing cash cow, my chief interest in Lockheed Martin has long been tied to [its massive edge in hypersonic weapons development](#).

We saw another example of why earlier this month, when the company landed a \$1.53 billion deal to develop a hypersonic missile for the U.S. Navy.

The contract, from the Pentagon’s Strategic Systems Programs office in Washington, D.C., covers “the design, development, build, and integration of equipment for missile flight test demonstrations and fielding” of the Navy Intermediate Range Conventional Prompt Strike Weapon System.



It's slated to be finished in early 2024.

The U.S. Navy first chose Lockheed Martin as the lead contractor for the prompt strike weapons system program in 2018. This latest deal brings the total value of contracts related to the new weapons system to \$2.83 billion.

Yet it's just one small part of a larger Pentagon effort to develop precision ballistic missiles carrying non-nuclear explosives at more than five times the speed of sound.

Traveling at Mach 5 means the missiles can fly more than 60 miles per minute, giving the military the ability to strike targets thousands of miles away with little or no warning.

Simply put, they're the future of warfare. However, China and Russia actually lead the United States in this category. Hence a massive infusion of Pentagon money as the U.S. military races to catch up.

To that end, Lockheed Martin is working hypersonic missiles for the U.S. Air Force and U.S. Army as well as the Navy.

The demand for hypersonic weapons and their development was also a key motivating factor in the defense giant's bid for Aerojet Rocketdyne.

## **VSBLTY's Blockbuster**

Finally, I've saved the best news for last, and it involves the hottest stock in our portfolio — **VSBLTY (CSE: VSBY; OTC: VSBGF)**.

Essentially, VSBLTY, Grupo Modelo, and Retailgent Media have entered into a joint venture that will install and manage an international in-store media network in up to 50,000 Modelorama stores and independent neighborhood bodegas across Latin America by the end of 2024.

The initiative is projected to generate at least \$200 million in profit for VSBLTY in its first five years.

However, this deal isn't just notable for its size (which is exceptional for a small cap company) but because it's a milestone for the broader industry.

Remember, VSBLTY is, at its heart, a data company. Yes, it provides security, but it also gathers oodles of information on things like foot traffic, digital ad effectiveness, and consumer behavior.

This is a product that produces digital ad displays that companies and brands pay to exploit.

But in addition to the base-level advertisement, they get measurable, quantifiable information on the effectiveness of those displays (i.e., how many people looked at the ad and for how long, their age, their gender, etc.).

And the stores and retail outlets get real time security that scans for shoplifters and weapons.

With that, this deal creates the largest digital network yet deployed in the world.

Again, when I've talked about VSBLTY in the past I've been at pains to explain just how nascent the market is for digital ads and in-store data collection.

At \$300 million–\$400 million, it is tiny compared with other multibillion-dollar industries.

So a deal that's expected to generate at least \$200 million in five years' time is more than significant — it's groundbreaking.



Furthermore, Intel, one of the world's largest software companies, has long been a key partner in VSBLTY's growth and development. But now it has another massive global partner in Anheuser-Busch InBev.

This new marriage will be fully consummate as AB InBev will gain the right to acquire 15.5 million common share purchase warrants. Each warrant will be exercisable to acquire one common share of VSBLTY for a period of five years from the date of issuance at an exercise price of at C\$0.84 per share.

To be clear, VSBLTY is currently trading at \$0.78 per share, which means those share purchases, if they were to take place today, would come at a premium to the current market price.

Better still, VSBLTY has tied the distribution of those warrants to the project's deployment.

That is...

- 15% of the warrants will vest immediately as a result of execution of the agreement.
- 15% of the warrants will vest upon execution of the definitive agreements for the joint venture.
- 20% of the warrants will vest upon the joint venture having been installed and operating in at least 1,500 locations.
- 20% of the warrants will vest upon the joint venture having been installed and operating in at least 5,000 locations.
- 15% of the warrants will vest upon the joint venture having been installed and operating in at least 20,000 locations.
- 15% of the warrants will vest upon the joint venture having been installed and operating in at least 30,000 locations.

So AB InBev increases its stake in VSBLTY only as the deal/deployment scales up.

And the fact that the company is willing to pay \$0.84 per share suggests it sees the same strong growth potential that we do.

The bottom line: This is a whale of a deal for VSBLTY.

## **Conclusion**

Things are heating up as we head into the spring.

That includes the economy and inflation.

Prices for homes and commodities are positively scorching. And a fresh round of stimulus from Congress and loose monetary policy from the Fed will further fuel the fire.

Increasingly, the market has gotten more volatile as investors try to parse through the data.

That means we could be in for a bit of a roller coaster ride going forward.

So while I'm bullish on our holdings, I think it's important to maintain a hedge via gold, and specifically Perpetua.

That's what we're doing.

In any case, the long, cold winter is over. I hope you get a chance to enjoy this warm weather and maybe even get out from under the thumb of this pandemic after a long year.

Fight on,



Jason Simpkins

Editor, *Wall Street's Proving Ground*



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