JUNE 9, 2023

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FFTT "Tree Rings": *The 10 Most Interesting Things We've Read Recently*

Here are this week's "Tree Rings". Have a great weekend! LG

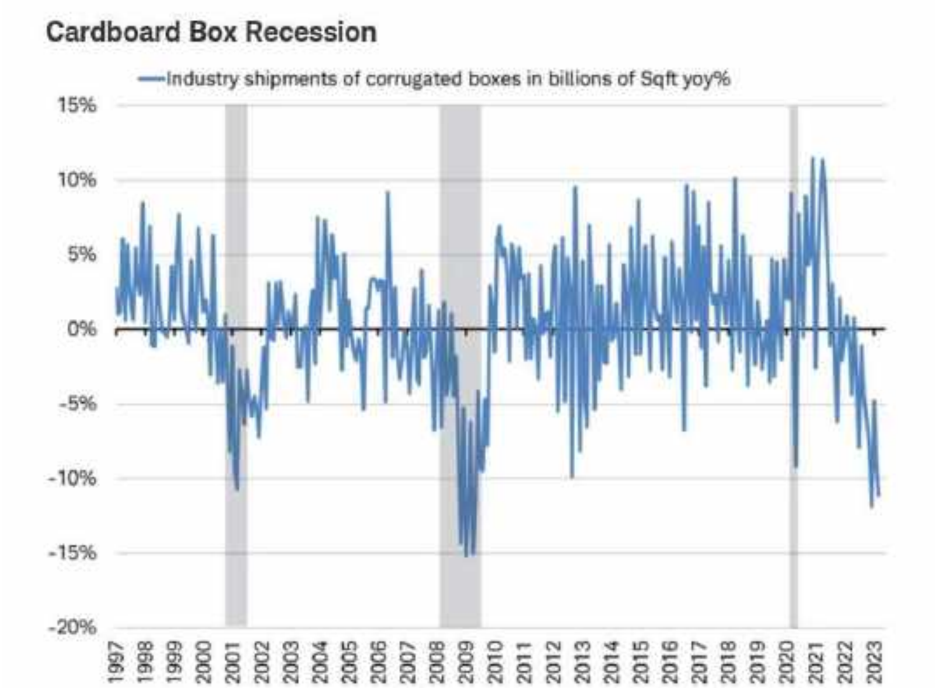
Luke Gromen, CFA
FFTT, LLC
Info@FFTT-LLC.com
www.FFTT-LLC.com
Follow us on Twitter:
@LukeGromen

“The US is in a ‘cardboard box’ recession”

Tree Ring: When we were doing channel check-driven, bottoms-up fundamental research in a former life, we loved unconventional economic indicators that punched above their weight in terms of macro indicators.

One such indicator was cardboard box volumes – this made sense because the US economy was 2/3 consumption and most consumer goods spent at least some time in a box at some point in their journey from factory to consumer.

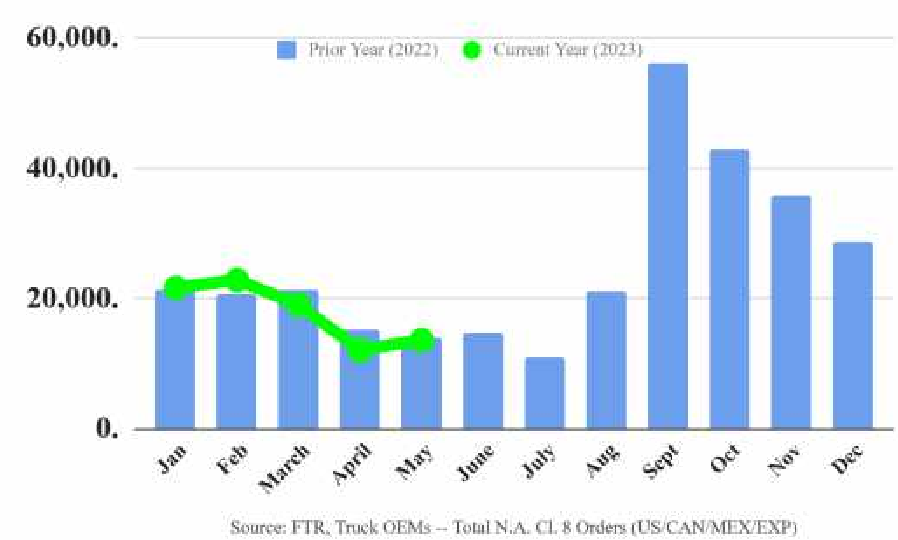
Arguably, the “Amazon effect” has likely only reinforced this dynamic, so the chart at right highlighted this week by Jeffrey Kleintop at Charles Schwab caught our attention. Fewer boxes = fewer goods shipped = slower growth = recession and less inflation in coming months.



Source: Jeffrey Kleintop, via Mid-Year Outlook: Global Stocks and Economy, Charles Schwab – 6/6/23
Mid-Year Outlook: Global Stocks and Economy | Charles Schwab

Cardboard boxes are not the only industrial indicator that punched above its weight from a macro perspective that is suggesting a recession is on its way or already here.

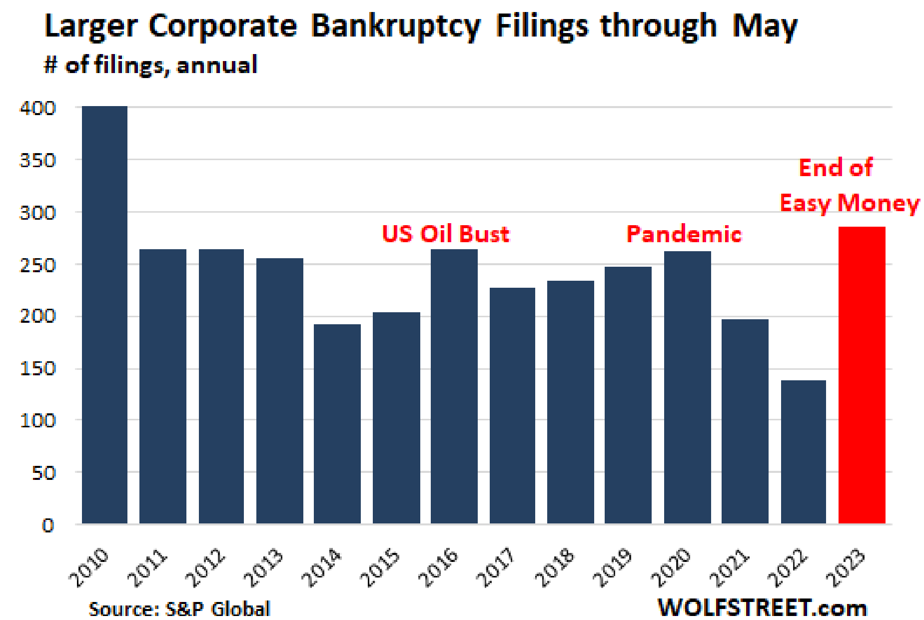
Heavy duty truck net orders have also softened notably and have historically been a good macro indicator because a majority of goods shipped in the US spend at least some time on a truck at some point:



Class 8 orders came in above expectations in May reversing the recent downward trend by rising nearly 9% from April levels to 13,600 units. This was relatively in line with the same time last year as orders were only off 2% year-over-year.

Source: Class 8 Truck Orders — FTR Orders & Indices (ftrintel.com)

There are other indicators with recessionary readings as well (right):



The recessionary indicators above suggest the US private sector is weakening, and may even be in a technical recession.

However, it is critical to remember that we are in a cycle unlike any other cycle in the past 40-60 years.

We have never had a US recession with US debt/GDP and deficits/GDP this high, or with US government spending as high a % of GDP as it is now.

Nor have we have ever had any of these factors occur in the past 50-60 years at a time when global Central Banks were no longer buying USTs on net (as has been the case since 2014).

The charts above point to lower coming inflation and weaker economic growth…but as we have showed repeatedly, the only thing that had been keeping the US from a fiscal crisis (i.e., US tax receipts above US government "true interest expense" (Entitlement Pay-Go's + Treasury Spending)) was the very inflation that is fading!

This sets up a unique scenario (for US investors at least – Emerging Market (EM) investors are more familiar with this setup) where higher rates drive higher government deficits, therefore supporting GDP and employment and inflation, even as private sector activity shrinks in response to higher rates. This suggests a scenario where "everything is fine, until it isn't".

The "everything is fine" portion of the movie will likely feature a stronger USD and pressure on EM currencies and economies. We suspect that the "until it isn't" portion will play out similarly to the bank strains we saw earlier this year – seemingly out of left field, and met quickly with incremental Fed liquidity in some manner (to relieve US banking system strains and/or maintain smooth UST market "functioning".)

As we see softening indicators and inflation, we continue to focus on the "big gears" of this cycle – by virtue of prior bursting bubbles having been kicked upstairs to the sovereign level via government backstops, the bubble is now in western sovereign debt and USTs. This means any softening in inflation or GDP will increase the stress on western sovereigns' fiscal situation, and in particular, the US government's fiscal position.

This will paradoxically support the USD early in this process as US deficits rise with rising rates and falling receipts, crowding out global USD markets, until the problem hits the US banking system and UST market functioning. Then the Fed will respond with more liquidity.

This process has been repeating in shorter and shorter intervals since 2019 (Sept-19 repo rate spike; Mar-2020 COVID crisis UST market crash; Sep-22 UST market functioning; Mar-23 bank strains)…we continue to play for the end game (an explicit version of US Yield Curve Control) by being overweight gold, gold miners, and BTC, while acknowledging likely increased volatility and strong USD near term by also being overweight USD cash and short-term USTs.

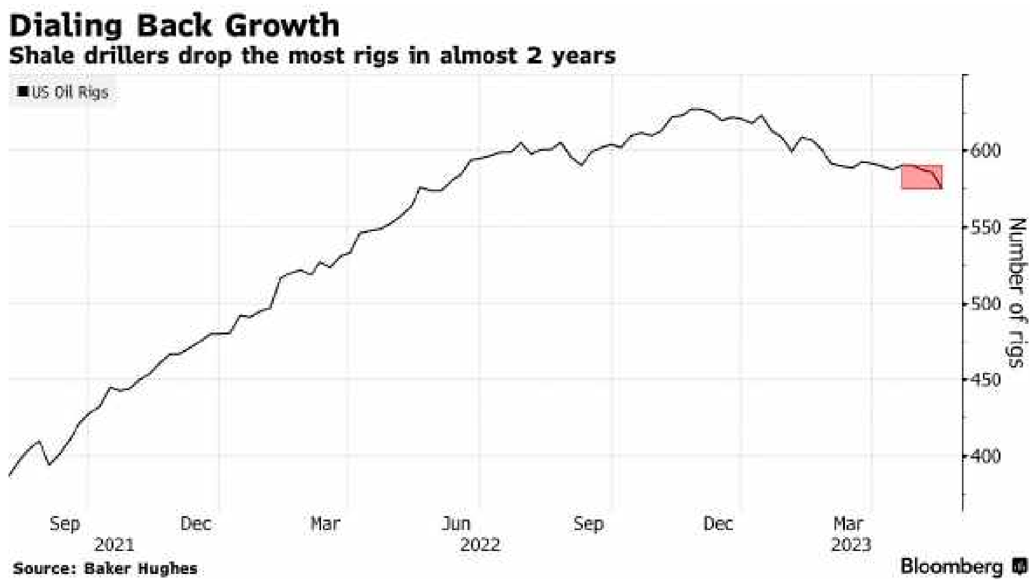
Let's watch.

<u>"Oil drilling plunges the most in two years as shale producers retreat"</u>

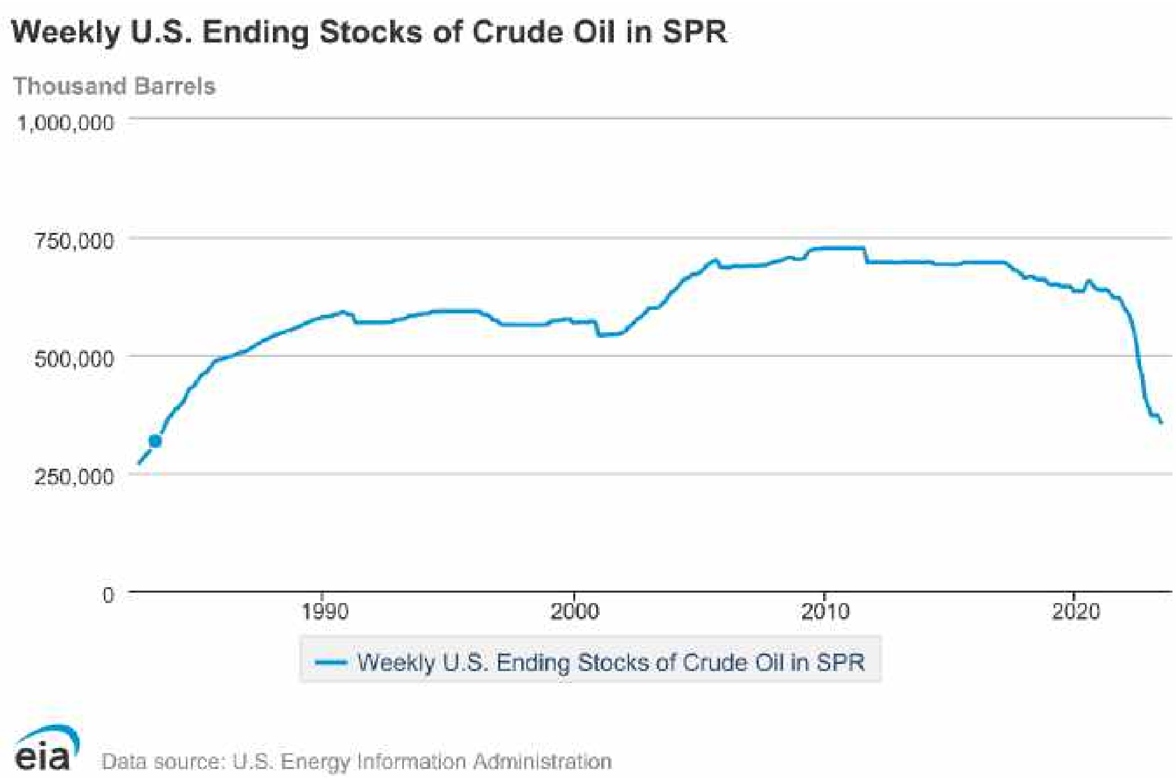
Oil drilling plunges the most in two years as shale producers retreat – 5/19/23
[Oil Drilling Plunges the Most in Two Years as Shale Producers Retreat - Bloomberg]

<u>Tree Ring</u>: Continuing the prior point theme of leading macro indicators, the Baker Hughes rig count has long correlated well with the US ISM Manufacturing index.

In the aftermath of the US shale renaissance, it has been highly correlated with the Manufacturing ISM, suggesting that this is another metric that is seeing recessionary impulses.



Paradoxically, the US reaction to last year's Russia-related oil spike is a key reason for the US rig count rolling over, as the US released Strategic Petroleum Reserve (SPR) oil inventories at the fastest pace in 40 years to reduce oil prices:



Not only is US rig count falling, but the “big 4” US shale basin legacy decline rates have accelerated in the past 9 months, going from 5.8% per month in August 2022…

Shale/LTO production m/m legacy decline rates		
Aug 2022 v. Jul 2022		
FFTT, LLC		
	Legacy Decline Rate (000's b/d)	**Aug-22 Total production (000's b/d)**
Bakken	47	1192
Eagle Ford	99	1205
Permian	303	5445
Niobrara	41	638
Total	490	8,480
Monthly depletion rate	***5.8%***	
Source: EIA, FFTT estimates		

…to 6.1% per month in January 2023…

Shale/LTO production m/m legacy decline rates		
Jan 2023 v. Dec 2022		
FFTT, LLC		
	Legacy Decline Rate (000's b/d)	**Jan-23 Total production (000's b/d)**
Bakken	50	1221
Eagle Ford	105	1241
Permian	333	5579
Niobrara	43	674
Total	531	8,715
Monthly depletion rate	***6.1%***	
Source: EIA, FFTT estimates		

…to 6.4% per month in June 2023:

Jun 2023 v. May 2023		
FFTT, LLC		
	Legacy Decline Rate (000's b/d)	**Jun-23 Total production (000's b/d)**
Bakken	55	1232
Eagle Ford	98	1108
Permian	360	5707
Niobrara	41	650
Total	554	8,697
Monthly depletion rate	***6.4%***	
Source: EIA, FFTT estimates		

The US’ move to weaken oil prices for geopolitical and inflation-fighting reasons was always a gambit with a finite life – the gambit was essentially “de-fund Russia’s war effort and get US inflation down before US shale rolled over”.

US shale now appears to be rolling over, which represents an important change in the global energy inflation picture and geopolitically for coming months. Here’s why (following page)…

With US shale representing ~90% of global oil supply growth over the past decade *(Source: Enverus, via Bloomberg),* once US shale rolls over, it will:

a) Effectively cede global oil markets back to OPEC and Russia, and

b) Leave "crashing the global economy" or "energy productivity miracle" or "energy price spike that re-accelerates US inflation" as the only ways to get oil prices back down as US shale supplies fall on global markets.

If the US cedes control of oil prices to OPEC+ as a result of US shale production rolling over, it means the US will also lose control of inflation and by extension, interest rates. Here's how:

- Since US shale production has been 90% of global oil production growth over the past decade, a shale production decline likely means a global oil supply problem.

- A global oil supply problem = global inflation problem.

- A global inflation problem = global bond market problem *(even in/especially in "risk free" western sovereign debt markets that underpin almost all other assets, due to high western sovereign debt loads.)*

- A bond market problem = a currency system problem *(because western sovereign debt loads are so high that resumed high inflation will likely force the Fed into the choice Dan Oliver highlighted several weeks ago – sacrifice the banking system or the currency. In our view, the Fed would sacrifice the currency and implement Yield Curve Control (YCC) if a global inflation problem takes bond yields to economically- and/or politically-unpalatable levels.)*

- A currency system problem = accelerated shift to a new global monetary system that already appears to be underway out of global necessity *(multi-currency oil pricing, with energy-related deficits settled in goods and net settled in gold.)*

As with much else in macro these days, the current oil supply situation is historically unique *(90% of global oil supply growth over the past 10 years has come from US shale, which is marginally high cost, with high and currently accelerating decline rates).*

We have found there is a high level of investor and economist complacency about the shale dynamics noted above (article at right and below from this week is an example).

The reverse OPEC maneuver – 6/8/23
The reverse OPEC maneuver - by Noah Smith - Noahpinion

The article above fails to note:

- How much of global production growth has come from US shale;

- That US shale production is rolling over;

- That US shale declines are far greater than global demand has ever fallen in any recession in the past 60 years;

- That Chinese and Indian per capita oil demand are a mere 1/5 and 1/15 of the US's, respectively.

In other words, many investors do not seem to realize how quickly the energy supply situation, and by extension, the outlook for inflation and US rates could go from "looking better" to "four alarm fire" again, except this time with the SPR already significantly drawn down and with US shale needing significantly higher oil prices to ramp back up. It has always been a question of "when." US shale production rolling over suggests we may soon be at that point.

The data above suggests we may be at peak complacency/bearishness on oil prices, and by extension, inflation and interest rates.

Let's watch.

<u>"Conventional oil production has now unequivocally rolled over; 6 counties in West Texas are now 100% responsible for all global oil production growth."</u>

> *Conventional oil production has now unequivocally rolled over. Unconventional production, the only source of growth in global oil supply over the last 12 years, has also significantly slowed.*
>
> *The only growing non-OPEC basin is the Permian in West Texas. Never before has oil supply growth been so geographically concentrated. <u>Six counties in West Texas are now 100% responsible for all global production growth.</u>*
>
> *Conventional non-OPEC oil production peaked in 2007 at 46.2 mm b/d and now stands at 44.2 mm b/d – 4% below its peak. Including OPEC, conventional global output peaked in 2016 at 84.5 mm b/d and now stands at 81.3 m b/d – 5% below its peak. Even if OPEC has its alleged 4 mm b/d of unused production capacity (something we do not believe), conventional production would barely regain its 2016 peak.*
>
> *…However, the world has enjoyed a great luxury—it could ignore the problems firmly embedded in conventional oil production. Surging production from non-conventional oil sources more than offset these declines.*
>
> *Non-OPEC oil production between 2006 and 2015 grew by 8.6 mm b/d. Conventional oil supply contracted by 1.4 mm b/d. Unconventional oil supply more than offset these declines, surging by 10 mm b/d and broken down as follows: US shales grew by 6.8 mm b/d (65% of all growth), bio-fuels grew by 1.9 mm b/d (19% of the growth), and Canadian oil sands increased 1.4 mm b/d (14% of the growth). Please note that out of this 10 mm b/d growth figure, the Permian represents only 1.4 mm b/d or 14%.*
>
> *Between 2016 and 2023, unconventional production surged by another 7.4 mm b/d, representing all non-OPEC supply growth. US shales accounted for 85% of the increase. However, whereas all the major shale basins grew from 2006 to 2015, only the Permian grew afterward.*
>
> *The Bakken and Eagle Ford peaked at 1.5 mm b/d in 2015, and this year are each expected only to be between 900,000 and 1 mm b/d. Significant unconventional growth also came from natural gas liquids production in the liquids-rich Marcellus and Utica, which we estimate each added 1 m b/d. This source of production growth is now set to fade, while the plateauing of the Marcellus will turn into a decline.*
>
> *Between 2006 and 2015, the Permian represented only 14% of unconventional supply growth. Between 2015 and 2023, the Permian represented almost 75% of this growth.*
>
> ***"Hubbert's Peak is here": Goehring and Rozencwajg 1q23 market commentary – 5/31/23 (via DC)***
> *<u>2023.Q1 Goehring and Rozencwajg Market Commentary.pdf (hubspotusercontent-na1.net)</u>*

<u>Tree Ring:</u> Contrast the triumphal generalist economist view of energy (and general bearishness on energy) in the preceding point with the cold, hard data provided by Goehring and Rozencwajg above in their just-released 1q23 market commentary. The world's incremental oil supplies have come almost entirely from US shales that are now rolling over, at an accelerating rate. The data above suggests we are now in the calm before the storm on energy prices and inflation.

Many investors do not seem to realize how precarious the energy supply situation is and how quickly it is likely to change. As a result, the outlook for energy inflation and US rates could also change dramatically in coming months, from complacent energy bearishness to "four alarm fire" again, except this time with the SPR already significantly drawn down and with US shale needing significantly higher oil prices to ramp back up.

The data above suggests we may be at peak complacency/bearishness on oil prices, and by extension, inflation and interest rates. The data above is why we remain stubbornly bullish on energy-related commodities, EV-related commodities, and industrial equities. The generalists do not seem to realize how precarious the supply situation is. A stagflationary energy supply situation is also likely to be very good for gold, gold miners, and BTC, which is why we remain significantly overweight those assets. Let's watch.

<u>"OPEC+ sticks to 2023 production target, Saudi Arabia sets further voluntary cuts"</u>

OPEC+ sticks to 2023 production target, Saudi Arabia sets further voluntary cuts – 6/4/23
OPEC+ sticks to 2023 production target, Saudi Arabia sets further cuts (cnbc.com)

> *The influential Organization of the Petroleum Exporting Countries (OPEC) and its allies, known as OPEC+, on Sunday made no changes to its planned oil production cuts for this year, as coalition chair Saudi Arabia announced further voluntary declines.*
>
> *OPEC+ also announced in a statement that it will limit combined oil production to 40.463 million barrels per day over January-December 2024.*
>
> *Saudi Arabia's energy ministry said Riyadh will implement an additional voluntary one-month 1 million-barrel-per-day cut starting this July, which can be extended. This will bring the kingdom's total voluntary declines to 1.5 million barrels per day over the period, reining in its production to 9 million barrels.*

<u>Tree Ring:</u> In the near-term, we agree with the view that OPEC+ and Saudi in particular are attempting to defend the oil market from weaker demand. This point has been well-covered in our view. Beyond the near-term support of the oil market, we think the preceding Tree Ring points suggest Saudi's actions may be more strategic in nature:

We think Saudi is trying to be the adult in the room, essentially trying to help a US government that has spent the last 15 months managing oil markets to short-term political desires rather than secular strategic goals: i.e., Do whatever must be done to get oil down to reduce inflation, to help win an election, to reduce UST and bond market stress, to defeat Putin.

To be sure, in the short run, US policymakers have gotten oil prices down, which has reduced inflation, which ostensibly helped Democrats outperform expectations in 2022 mid-term elections, helped reduce UST and bond market stress (all else equal), and has increased economic stress on Putin and Russia.

However, these short-term US victories came at a steep strategic cost. As we showed earlier, US shale production appears to be rolling over. Given that US shale has been ~90% of global oil production growth over the past 10 years *(source: Bloomberg, citing Enverus data),* once US shale production rolls over, it will likely be off the table as a credible incremental source of major oil supplies for years, and maybe for good…and certainly not without much higher oil prices.

This would in turn cede control of the global oil market to OPEC+, for the foreseeable future. Were oil still only priced in USD globally, and the US still enjoying the unipolar power historical moment it enjoyed from 1989-2010, OPEC+ regaining control of the oil market would likely mean higher US oil imports, a weaker USD, and higher inflation *(most of which we would likely export to US foreign creditors (a la 2001-08))*, all of which would represent a cyclical shift, but little more.

<u>HOWEVER</u>: The US is no longer in the "unipolar historical moment." China is now the world's biggest oil importer, even as Chinese and Indian per capita oil consumption are still tiny fractions of the US's. There is now a credible non-USD energy pricing and settlement system in place that is gaining significant momentum globally. US debt/GDP and deficit/GDP are at post-war highs, and foreign Central Banks stopped financing US deficits (on net) nearly a decade ago.

These factors laid out above change <u>everything</u> regarding the financial implications of the US losing control of oil prices.

If the US loses control over oil pricing, it will mean not just a weaker USD, but a weaker USD <u>with</u> a reduced US ability to export weak USD inflation. This is due to multi-currency energy pricing as China in particular can/will use (is using) CNY-denominated oil pricing to send weak USD inflation back to the US, further pressuring a US fiscal and debt situation that is already stressed by secularly rising US debt and deficits against a backdrop of insufficient foreign UST demand.

If the US cedes control of oil prices to OPEC+ as a result of US shale production rolling over, it means the US will also lose control of inflation and by extension, interest rates. Here's how:

- Since US shale production has been 90% of global oil production growth over the past decade, a shale production decline likely means a global oil supply problem.
- A global oil supply problem = global inflation problem.
- A global inflation problem = global bond market problem *(even in/especially in "risk free" western sovereign debt markets that underpin almost all other assets, due to high western sovereign debt loads.)*
- A bond market problem = a currency system problem *(because western sovereign debt loads are so high that resumed high inflation will likely force the Fed into the choice Dan Oliver highlighted several weeks ago – sacrifice the banking system or the currency. In our view, the Fed would sacrifice the currency and implement Yield Curve Control (YCC) if a global inflation problem takes bond yields to economically- and/or politically-unpalatable levels.)*
- A currency system problem = accelerated shift to a new global monetary system that already appears to be underway out of global necessity *(multi-currency oil pricing, with energy-related deficits settled in goods and net settled in gold.)*

In our view, the Saudis are trying to be the adult in the room – i.e., better to pay $80-100 for oil today than to allow oil prices to fall to levels that take US shale production down dramatically, which then would either leave the world short of oil for the foreseeable future, driving oil prices to destabilizing levels such as $120 or $150 or higher, likely resuming the inflation and UST market dysfunction we saw in 2q-3q22 (i.e., a global debt market crisis.)

Or, the world's Central Banks could prevent a debt market crisis in case of an oil price spike in nominal terms by capping bond yields with explicit YCC…but this would likely only turbocharge oil prices and inflation even higher.

Alternatively, global Central Banks could decide to crash the global economy down to reduced oil supply levels…but as Myrmikan Capital's Dan Oliver (and FFTT) have noted, doing so would mean Central Banks would have to be willing to let the banking system and/or western sovereign debt markets fail…which they have already shown they will not allow.

In any of these cases above, gold, gold miners, and BTC (in our view) would likely do well, which is why we remain significantly overweight each of those assets. They are, at their core, plays on an energy supply situation that is far more dire than consensus realizes, into a global sovereign debt bubble that is far more fragile than consensus realizes.

The one potential "out" for global Central Banks is an energy productivity miracle (think commercialized nuclear fusion in the next 18-24 months – possible, but unlikely.)

The energy supply situation laid out on the prior pages suggests we are entering a period of time similar to that described below by Sir Winston Churchill:

> *"The era of procrastination, of half-measures, of soothing and baffling expedients, of delays is coming to its close. In its place we are entering a period of consequences."*

The US shale sector appears to have become a casualty of the US and the west's gambit to crush Russian oil and defeat inflation. We think things are soon about to get far more interesting on the energy price, commodity inflation, and volatility front than a seemingly-complacent consensus currently realizes.

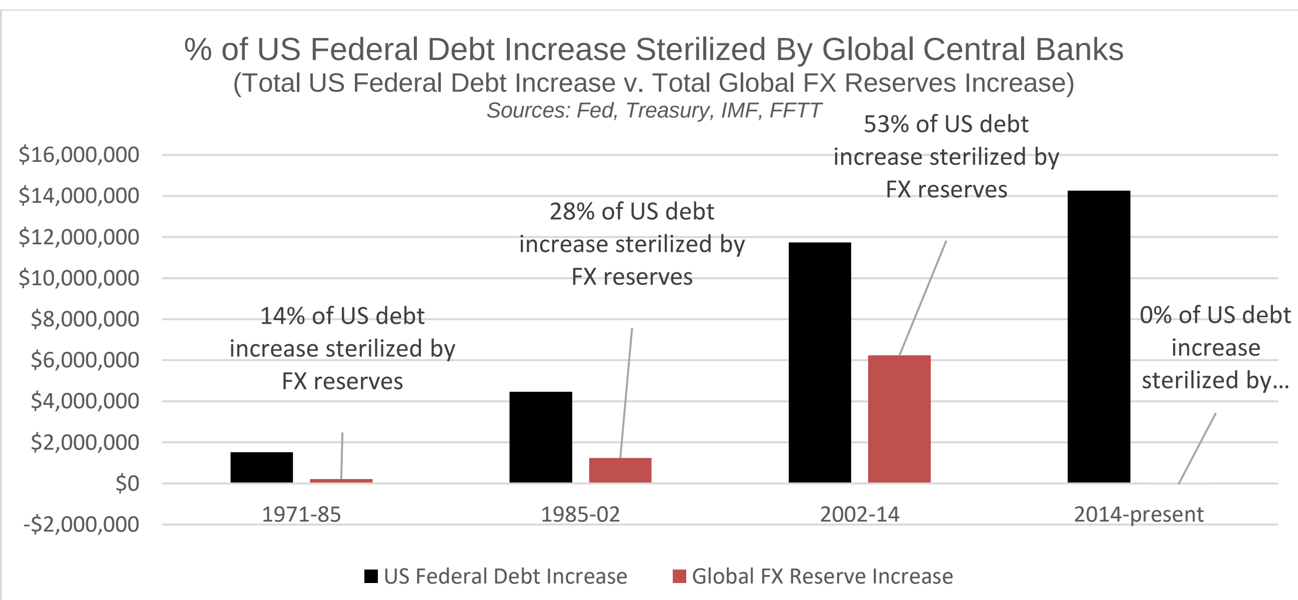
Let's watch.

“Every other commodity bear market ended with a shift in the global monetary system and a devaluation in the dollar that stimulated resources.”

> *Every other commodity bear market ended with a shift in the global monetary system and a devaluation in the dollar that stimulated resources. The implications will be profound for many asset classes. However, history suggests the biggest beneficiaries will be commodities and their various producers.*
>
> ***“Hubbert’s Peak is here”: Goehring and Rozencwajg 1q23 market commentary – 5/31/23 (via DC)***
> *2023.Q1 Goehring and Rozencwajg Market Commentary.pdf (hubspotusercontent-na1.net)*

Tree Ring: Goehring and Rozencwajg’s publicly-available 1q23 market commentary was one of only a few reports we have seen make the linkage between commodities and monetary system changes:

> *The only missing element has been a shift in the global monetary system. The final piece may be coming into place: the US dollar might be on the verge of losing its reserve currency status. A change in the dollar’s reserve currency status would be the most impactful market shock of the last forty years.*
>
> *According to our analysis, it would also most likely correspond with a period of robust commodity performance. The monetary regime changes in 1930, 1968, and 1998 were hugely stimulative for commodity prices, and we believe the monetary regime change that will take place this decade will be no different.*
>
> *Following the Bretton Woods Agreement in 1944, the US has enjoyed a unique advantage: nearly 90% of global trade has been settled in US dollars. When Australia sells coal to China, they pay in dollars. The result has been a persistent demand for dollars outside the US to facilitate global trade settlement. US dollars are recycled into Treasuries, allowing the US to run persistent deficits.*
>
> *Critics have called the current system unsustainable for years and warned that a change is near. Luke Gromen of Forest For The Trees has written about the end of the US dollar reserve status for nearly a decade.* [FFTT: Minor correction: We’ve been writing about change in USD reserve status, not the end of it.]
>
> *We were never convinced a change was imminent, given we saw no actual evidence countries were moving away from the dollar. While the arguments made sense, China continued buying Australian coal in dollars, and foreign Central Bank Treasury holdings remained elevated.* [FFTT: Foreign CB’s stopped buying USTs in 2014 on net (below); given time and ongoing increases US debt and deficits, that is more than enough to force a change to the USDs reserve status structure.]



The US reserve currency status may have been unsustainable, but at the time, it appeared intact. We believe this is starting to change. The past twelve months have seen a spate of announcements of countries looking to settle trade in currencies other than the dollar.

Although details remain scarce, Saudi Arabia has discussed settling its oil sales in renminbi. All sanctioned Russian oil sales have been paid for in renminbi to avoid the SWIFT banking system necessary for US dollar settlement. In April 2023, the Brazilian government announced intentions to set up the infrastructure to settle trade in renminbi.

In the strongest rebuke of the current US dollar reserve currency system, Brazilian President Lula rhetorically asked before a group in China: "[…] why all countries have to base their trade on the dollar. Why can't we do trade based on our currencies? […] Who decided that the dollar was the currency after the disappearance of the gold standard?" Even in Europe, the sentiment appears to be changing: TotalEnergies agreed to sell LNG into China and settled in renminbi.

Zoltan Pozsar, Louis Gave, and Luke Gromen have written some of the best research on the changes now affecting the global monetary order. Some analysts believe fifteen years of excess money printing is to blame, while others cite the "weaponization" of the dollar or the ongoing political dysfunction in Washington. To some extent, the causes are unimportant.

What matters is that the move away from the dollar has started. If this trend continues, it would represent the end of the US dollar as the global reserve currency. The writing has been on the wall for a long time, but the change is only occurring now. That is what matters. Every other period of commodity undervaluation culminated with a shift in global monetary regimes. This time will likely not be different.

Proponents of the US dollar argue that no other currency can meet the requirements of a reserve currency. While much talk has centered on the renminbi, China maintains a mostly closed capital account -- a clear impediment to a reserve currency. As commodity exporters amass renminbi, there is no apparent outlet for them to convert their capital. Of course, Chinese goods remain a strong export market; however, these are not enough to balance the trade with commodity producers.

While Louis Gave correctly points out that China is building a robust Chinese Government Bond market, this only pushes the problem into the future when the bonds mature. Indeed, commerce covets the US dollar because it is a unit of exchange accepted as collateral worldwide. CGBs do not hold the same appeal.

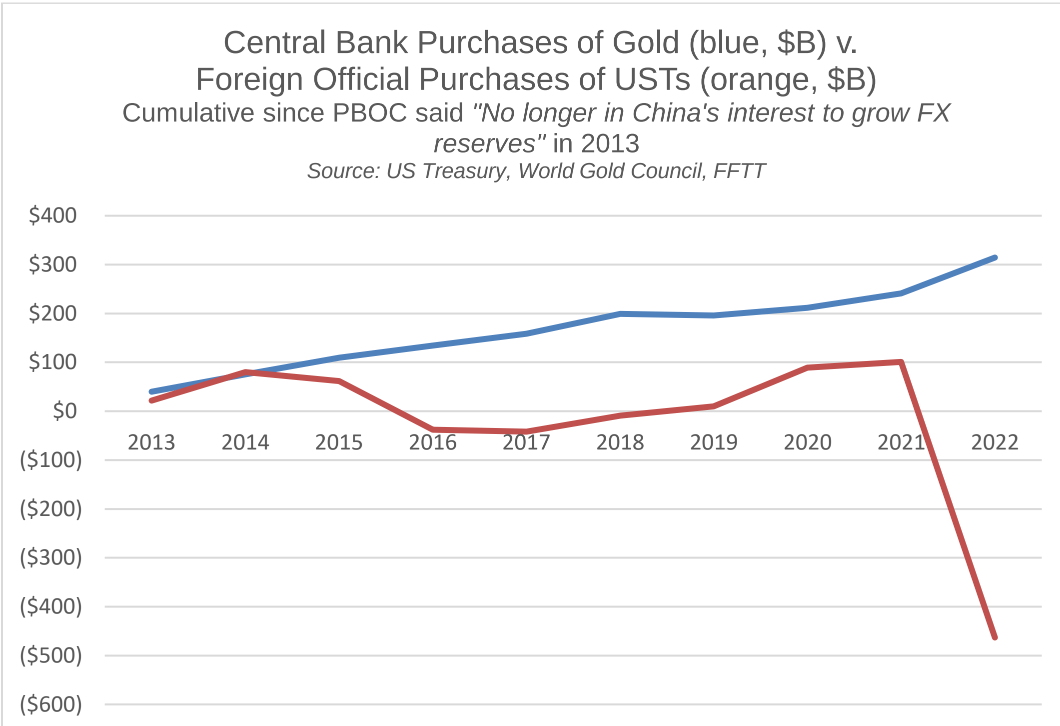
Any move by China to displace the US dollar as a reserve currency must include some degree of gold convertibility. Foreign holders could then convert some portion of their trade surplus from renminbi into gold via the Shanghai gold exchange. China has accumulated vast amounts of gold in recent quarters, making such an outcome more plausible.

[FFTT: China is not using its gold to settle deficits; gold in Mainland China cannot leave. By virtue of doing this but still making CNY convertible to gold in Shanghai, HK, London, and Dubai, it effectively means China is using UK and US gold to internationalize the CNY – if a CNY holder wants to convert CNY into gold, it will pull from UK and US vaults, not Mainland China vaults. This fixes the errors in the US Bretton Woods system (USD pegged to gold and US used its gold to redeem USDs.)]

If this were to happen in earnest, commodities would go from radically undervalued to radically overvalued -- likely led by gold. Every other commodity bear market ended with a shift in the global monetary system and a devaluation in the dollar that stimulated resources. The implications will be profound for many asset classes. However, history suggests the biggest beneficiaries will be commodities and their various producers. Investors must be aware and seek to protect themselves.

"Hubbert's Peak is here": Goehring and Rozencwajg 1q23 market commentary – 5/31/23 (via DC)
[2023.Q1 Goehring and Rozencwajg Market Commentary.pdf (hubspotusercontent-na1.net)]

To summarize GoRozen's points above: Peak Cheap Oil is forcing a monetary system change. As marginal oil costs rise secularly, Central Banks are shifting FX reserves to gold (a 0% yielding bond with a floating face value and which has infinite duration and finite issuance), from USTs (a low-yielding, fixed face value bond with finite duration and effectively infinite issuance), as you can see below.



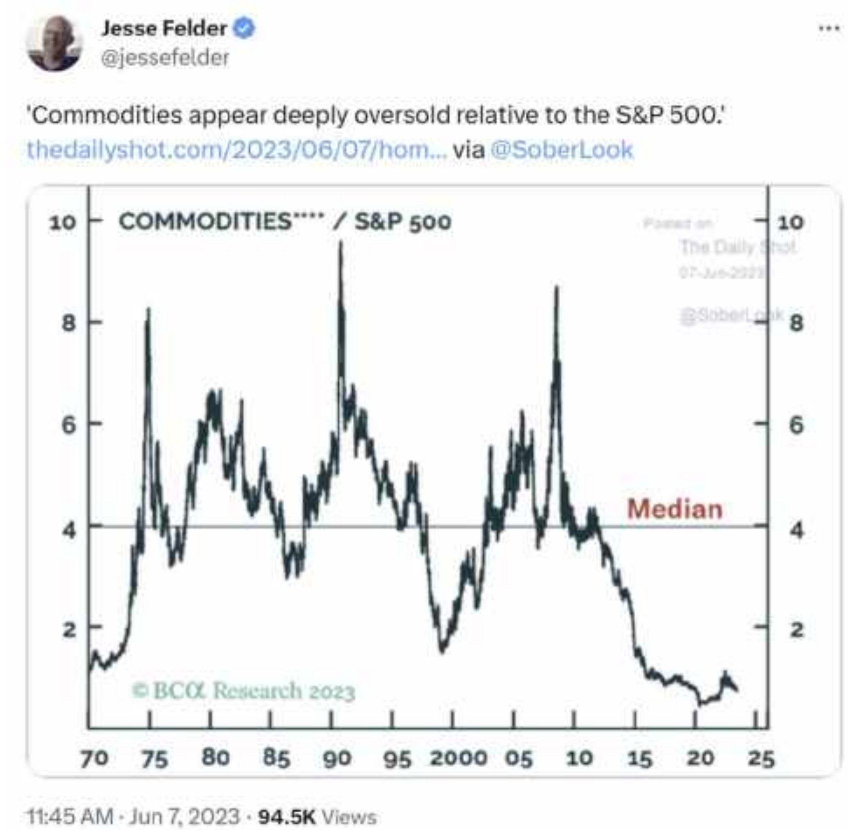
This is happening because gold can, has, and will preserve purchasing power in oil terms, while USTs cannot credibly do so once US shale production rolls over.

Looked at through this lens, both rising US shale production since 2010 and US SPR releases since 2022 have been de facto moves to defend the UST market and by extension, the USD. If shale production is rolling over, it is likely to be secularly negative for the UST market (on a real basis) and the USD over time, unless a new energy source is found and commercialized, ASAP.

Let's watch.

<u>"Commodities appear deeply oversold relative to the S&P 500"</u>

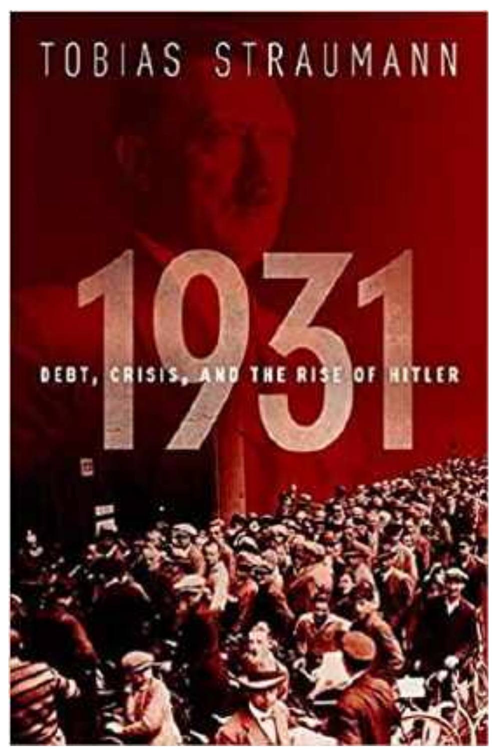
<u>Tree Ring:</u> When we marry what GoRozen wrote above about commodity bear markets ending with shifts in the monetary system with the chart at right, we can see the table has been set for monetary system change for the better part of the past decade.



Dalio's point below has been and is continuing to serve as an accelerant to those changes:

> ***Ray Dalio says US at beginning of "Late, Big-Cycle Debt Crisis" – 6/7/23***
> *[Ray Dalio Says US at Beginning of 'Late, Big-Cycle Debt Crisis' - Bloomberg]*
>
> *"We are at the beginning of a late, big-cycle debt crisis when you are producing too much debt and have a shortage of buyers," Dalio said Wednesday at the Bloomberg Invest conference in New York.*
>
> *He said while interest rates won't go much higher, the economy will get worse, and that could cause more internal strife if the US continues to have political fragmentation.*

Dalio's point on this being the beginning of a late, big-cycle debt crisis combined with GoRozen's view of commodity bear markets being ended with monetary system changes reminded us of the following section of an excellent book about the beginning of the last bursting global sovereign debt bubble (debt crisis): *"1931: Debt, Crisis, and the Rise of Hitler",* by Tobias Straumann (right).



Here are a few key excerpts for our purposes today:

> **<u>Page 4</u>:** *Why was Somary so pessimistic? To him these two bank failures were not isolated events, but symptoms of a fundamental international imbalances that were about to unwind in a chaotic way.*
>
> *After the Great War, the Allied Powers had decided to uphold the war debt claims against each other and to punish Germany with a high reparations bill. According to Somary, this agreement was a recipe for disaster. "What drives us into the crisis, there is an enormous amount of insoluble debt."*

FFTT: As then, so now do we also have an "enormous amount of insoluble debt."

Page 8: *By the early 1930s, it was obvious there were huge international imbalances (right). The United States was the biggest creditor, Germany the biggest debtor.*

Belgium, France, Great Britain, and Italy had more-or-less even foreign debt balances, but their accounts depended on Germany's willingness and capacity to pay reparations to them.

The Allied powers and Germany formed a chain, tied together by "a colossal structure of inter-Governmental obligations" as The Economist observed.

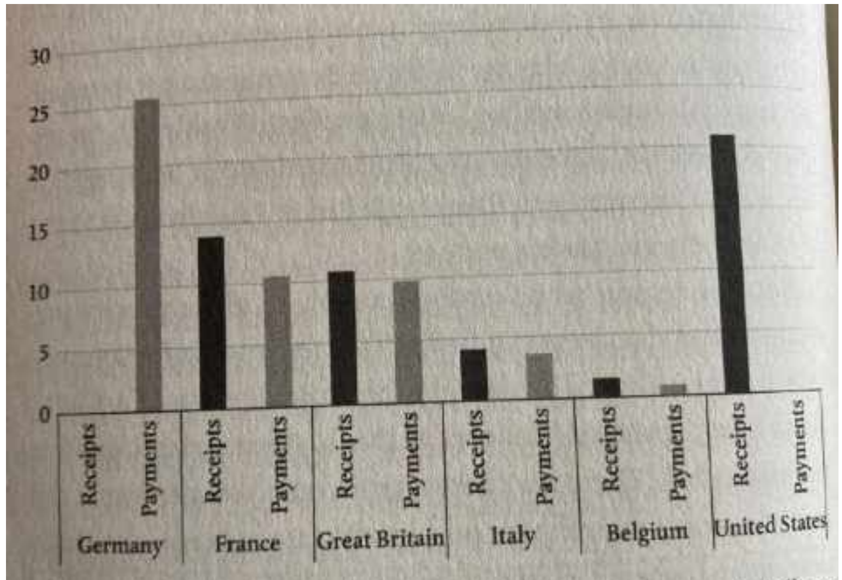
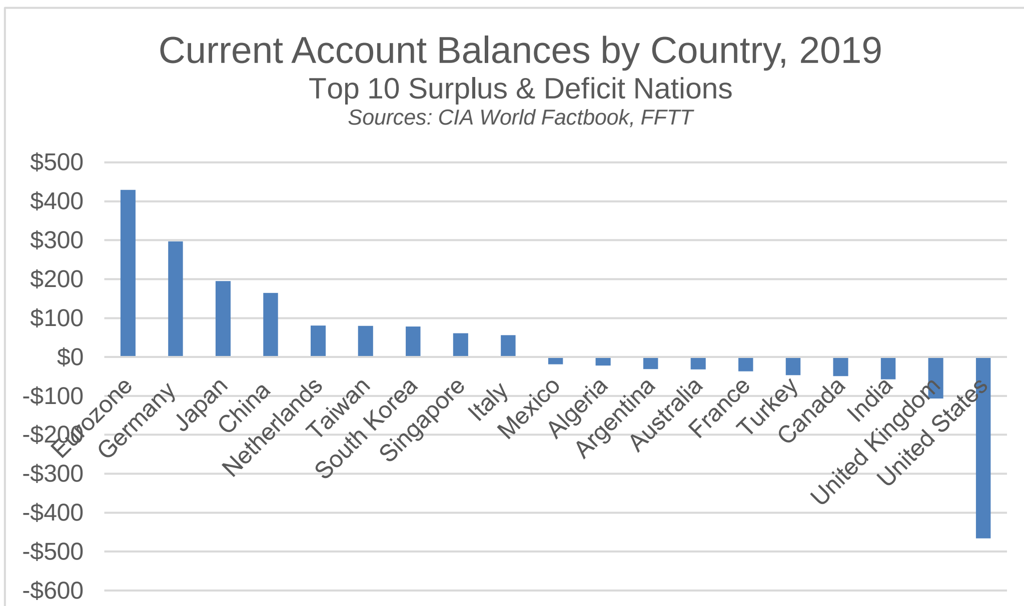


Fig. 1.1 All inter-governmental debts outstanding on 1 July 1931 (in billions of US dollars)

FFTT: A version of the 1931 chart above, updated for 2019…this time, the Eurozone, Japan, and China are the creditors, while the US occupies the role of 1931 Germany (while having the global reserve currency like 1931 UK):



Here's another way history echoes with the points made by GoRozen and Dalio:

Page 113: *To Somary, there were only two measures that would alter the situation radically. The first was a readjustment of the International price structure. Prices of finished goods had to be lowered, those of raw materials increased.*

This readjustment would allow the periphery to gain more purchasing power and the rich countries to increase their exports. Somary was thinking of temporary government purchases of raw materials to revive demand and destroy numerous cartels and syndicates, those "parasites of our economic life", he said, and a lowering of industrial wages to enable cuts in the prices of finished goods.

His second idea was to take steps to reduce the imbalance between France and Germany in the hope of restoring political confidence in Europe. "As long as France hoards and Germany invests her savings outside her own borders, a recovery on the continent is impossible. Europa has no lack of capital, what she needs is confidence.

I am convinced that France and Germany, working separately, will not find a way out; England must bring them together a second time. If Great Britain has neither the will nor the strength to do so then the present crisis will be but a prelude to a dark period to which the historian of the future will give the name 'Between Two Wars.'"

FFTT: Somary, "the Raven of Zurich", prescribed a significant restructuring of the currency system and widespread currency devaluations to prevent a political catastrophe. He was right, but he was ignored.

We once thought that 2020 may have convinced western policymakers that a restructuring of the currency system and widespread devaluations were preferable to a far more catastrophic political outcome; in 2022, Fed rate hikes and US SPR releases to weaken oil prices have taken things in the opposite direction.

We can see history rhyming; from here, there seems to be a few ways events can go:

1. Monetary system shift featuring a major devaluation of the USD and all fiat currencies v. gold and commodities.
2. Conflict, up to and including war, between the US and China and their respective emerging economic blocs.
3. Energy productivity miracle.

Under the first two options, gold, gold miners, BTC, USD and short-term USTs, and energy related commodities and industrial capacity (esp. electrical infrastructure) should all do well. Under the third scenario, we would expect growth stocks, bonds, the USD, and especially big tech to outperform.

Let's watch.

"A Hard Break from China"

Tree Ring: This week, conservative thinktank American Compass released a white paper advocating a "hard break from China":

> ***A Hard Break from China – 6/8/23***
> *[A Hard Break from China - American Compass]*
>
> *Executive Summary*
>
> *The dream of a liberal, democratic China is decidedly dead, and U.S. policymakers are finally beginning to grapple with the reality of having an authoritarian adversary as a global peer. But this thinking remains dangerously underdeveloped and naïve, as reflected in recent speeches by Secretary of the Treasury Janet Yellen and National Security Advisor Jake Sullivan, in which they emphasize narrow concerns about military technology while expressing optimism that our two nations can remain integrated economically. Yellen still envisions "a growing China that plays by the rules" and fosters "rising demand for U.S. products and services and more dynamic U.S. industries," while Sullivan advocated a policy of "de-risking and diversifying, not decoupling."*
>
> *The China challenge is not only, or even primarily, one of national security. It is that too, to be sure. But the fundamental problem is that America's free market economy is incompatible with China's state-controlled one, and American liberty and democracy are incompatible with Chinese communism. America must sever its economic relationship with China to protect its market from subversion by the Chinese Communist Party (CCP). Disentangling our economies will be costly, but the alternative of accepting CCP control of our assets and investments, dominance in our supply chains, and influence over our institutions will cost far more. This paper demonstrates how integration with China undermines American economic sovereignty across three critical dimensions and describes the unprecedented policy response necessary.*
>
> ***I. Investment***
>
> *American capital flowing into China implicates American investors in the People's Republic of China's (PRC) human rights abuses, subsidizes development of its military capabilities, and subjects retirees and other savers to the risks of a poorly regulated and CCP-dominated market. When American firms invest directly in China, typically through state-mandated and -subsidized joint ventures, they transfer jobs and technology across the Pacific. In both cases, the PRC actively distorts market incentives to attract investment and then uses its leverage over the investors to force support for CCP priorities and propaganda. Flowing in the other direction, PRC-based capital is taking control of American corporations and real estate, establishing a foothold in the American market that current U.S. law is incapable of managing.*
>
> *The United States should:*
>
> - *Prohibit PRC-based entities from acquiring and operating in the American market, participating in American funds, and holding American real estate;*
> - *Prohibit American firms from forming joint ventures in or transferring technology to China and American investors from providing capital to PRC-based firms; and*
> - *Reject the premise of a bilateral investment treaty with China or any request for assistance to American firms in the Chinese legal system.*
>
> ***II. Supply Chains***
>
> *The PRC has adopted an explicit economic agenda of government subsidies, market access restrictions, and intellectual property theft intended to establish technological superiority and secure control of key supply chains. It complements this approach by suppressing worker power and consumer demand, generating an enormous trade surplus with the United States that has hollowed out American productive capacity and led to the transfer of trillions of dollars in assets. Basic trade in goods and services can still benefit both countries so long as it occurs in a balanced manner, the American market is insulated from PRC distortions, and resilient supply chains operate beyond PRC control.*

The United States should:

- *Revoke China's Most-Favored-Nation status and impose tariffs to disfavor Chinese supply chains in the American market;*
- *Develop the state capacity to monitor supply chain resilience and create industrial policies that rebuild American capabilities in critical sectors; and*
- *Foster economic conditions that channel capital toward the major long-term investments necessary to support domestic industry.*

III. Institutions

The CCP uses its economic leverage in financial markets and supply chains to corrupt American institutions and undermine democratic norms. Capitalism encourages whatever activities will produce the greatest profit and, in America's current relationship with China, the pursuit of profit often calls for kowtowing to the CCP. As a result, American movie studios and sports leagues self-censor in keeping with the CCP's preferences, American universities partner with affiliates of the Chinese military, and American business leaders fall over themselves apologizing for any possible slight. Preventing such subversion in a free society is not easy. Steps to limit economic interaction with China and thus the incentive for such behavior are most important. But policymakers can also act in some instances to interdict the influence directly.

The United States should:

- *Ensure research integrity and security by prohibiting flows of funds between American institutions and PRC-based ones;*
- *Limit PRC-based tuition revenue to universities and access of Chinese nationals to American graduate programs in sensitive fields of study; and*
- *Renormalize free speech through cultural export controls that eliminate incentives for placating the CCP and public forums that reward honest discussion of its true nature.*

The policies advocated for above would be massively inflationary, leading to pressure on the global bond market and overall asset prices, increasing the current trend of falling US government tax revenues and rising US government borrowing costs, deficits, and therefore inflation.

The changes advocated above needed to be implemented in 2001-06 to have been able to be implemented without pushing the US economy toward a stagflationary outcome…

…and yet we continue to read from Harald Malmgren and others in a position to know that such policies are being implemented, at least directionally (right):

Sequoia Capital's split-off of China business spurred by Sino-US rift – 6/8/23
[*Sequoia Capital's split-off of China business spurred by Sino-U.S. rift - Nikkei Asia*]()

> *"To deliver on our mission, we have decided to fully embrace our local-first approach," Sequoia said Tuesday in a joint statement from the three heads of its U.S. and Europe, China and India businesses. The three funds will be split up and independently operated by March 2024. Sequoia Capital India also handles investments in Southeast Asia.*

The post-1971 structure of USD reserve status requires that the US maintain an open capital account, free from capital controls, to allow USD deficits to be recycled back into US markets. And yet, what American Compass advocates and what Malmgren says has begun happening amount to US capital controls on Chinese investment – a de facto US-led reform of the post-1971 USD reserve status structure…or, as GoRozen and we put it earlier, "a monetary system shift".

Why would the US do this? Legendary monetary economist Robert Mundell gave us a possible reason why 26 years ago:

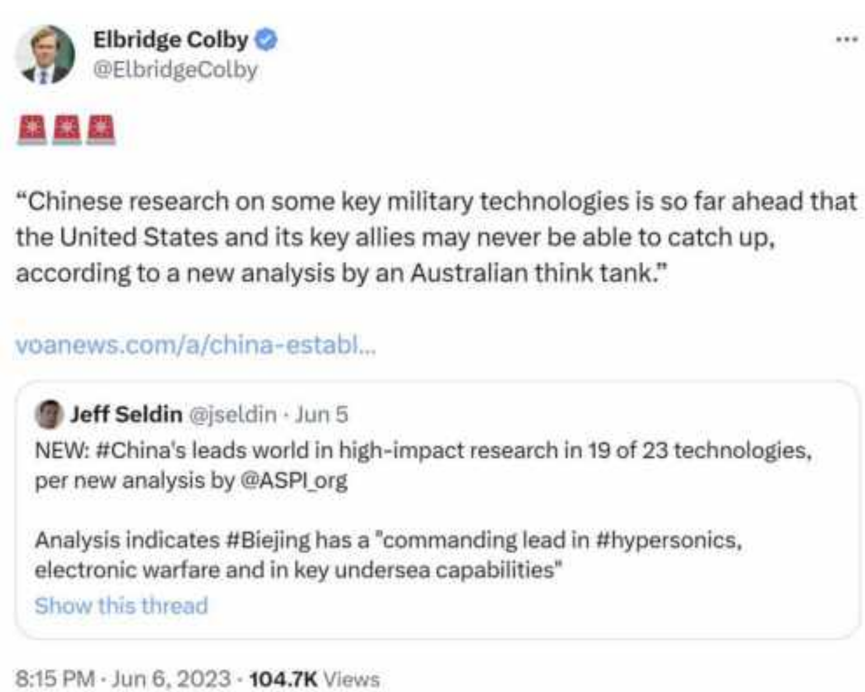
> *"The United States would not talk about international monetary reform … because a superpower never pushes international monetary reform unless it sees reform as a chance to break up a threat to its own hegemony."*
>
> **-Nobel Memorial Prize Winner Robert Mundell 1997, via DP**

What threats to the US' own hegemony is the US attempting to break-up? The threat we have long been highlighting in these pages – in essence, that "borrowing money from China to build weapons to face down China using Chinese components is not a sustainable strategy" – continues to become more and more acute. For example, from this week alone:

Here's David P. Goldman replying to American Compass' tweet highlighting their policy paper above…

Serious policy analysts such as Elbridge Colby and Jeff Seldin are highlighting another aspect of the "threat to the US's own hegemony" that at its core is driven by the USD's post-71 reserve status structure that requires the US' role in the global economy to be essentially to run the deficits to supply China with the USDs it needs to buy up global commodity supplies and build out its military:

> ***China establishing "commanding lead" with key military technologies – 6/5/23***
>
> [China Establishing 'Commanding Lead' with Key Military Technologies (voanews.com)]



Here are three more examples of the “supplying China the USDs to buy up the world’s commodity supplies” portion of the point above, also just from the last two weeks:

China’s EV domination echoes Japan in the 1970s: Niall Ferguson – 6/2/23
https://www.bloomberg.com/opinion/articles/2023-06-04/china-s-ev-domination-echoes-japan-in-the-70s-niall-ferguson

> *In the past two years, according to the Wall Street Journal, Chinese companies have spent $4.5 billion acquiring stakes in nearly 20 lithium mines, most of them in Latin America (for example, Bolivia) or Africa (Zimbabwe). If the International Energy Agency is right that global lithium demand will grow by 13% per year from 2020 to 2030 and 8% per year from 2030 to 2040, we are going to be reading a lot more about the “Lithium Triangle” — the arid, high-altitude patch of land that connects Argentina, Bolivia and Chile — which holds more than 60% of the world’s lithium.*
>
> *If lithium is the new oil, in other words, there will be a familiar struggle between the governments that have ultimate control of the mineral rights and the companies that want to exploit them. Indeed, that struggle has already begun.*
>
> *A similar scramble is unfolding for nickel, of which Indonesia has abundant reserves, and cobalt (bad news: there’s a lot in the war-torn Democratic Republic of Congo). In each of these markets, there seems little doubt that Chinese companies are ahead of the competition. If the West intends to challenge China’s dominance of the EV battery market, it apparently aspires to be the tortoise to China’s hare.*

Your next electric vehicle could be made in China – 5/24/23
Your Next Electric Vehicle Could Be Made in China - WSJ

We take all of the above as evidence of a continuing and accelerating restructuring of the global monetary system, or if you prefer, a “monetary system shift.” Such shifts are rarely deflationary overall, and we do not think this one will be either.

However, they also feature elevated geopolitical and asset volatility. This is why we continue to deploy our own assets in the barbell strategy we have been describing.

Let’s watch.

<u>"Chinese trade with BRI and ASEAN nations is now ahead of the EU and USA as trade partners."</u>

<u>Tree Ring:</u> China appears to be shifting its trade patterns to more trade in the region, as advocated by PLA General Qiao Liang in a speech to CCP leaders in 2015:


S.L. Kanthan
@Kanthan2030

Trump famously said about China, "They need us more than we need them!"

Well, China's trade with Belt and Road countries are much larger than the trade with the US now.

BRI and ASEAN are ahead of the EU and the USA as trade partners.

Jan-May 2023 data.

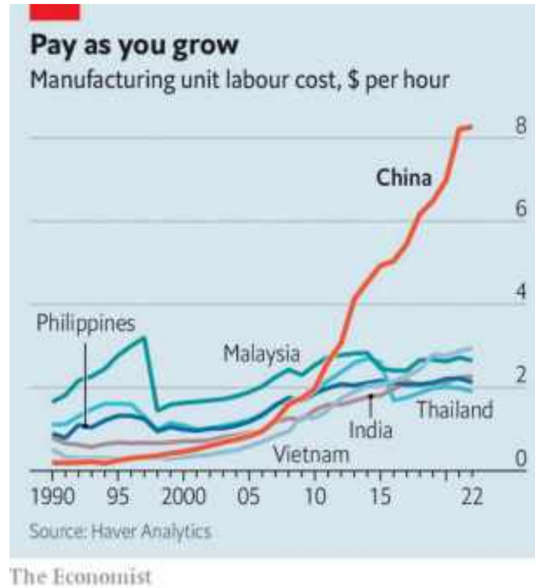
10:35 AM · Jun 8, 2023 · **2,300** Views

> *China's "One Belt, One Road" is not simply to join the global economic system, which is a globalization under the U.S. dollar.*
>
> *As a rising superpower, the "One Belt, One Road" strategy is the beginning of China's own globalization. It is a necessary globalization process that a superpower must have during the phase of its rise.*
>
> *"One Belt, One Road" is the best superpower strategy that China can bring up at this moment, because it is a counter measure to the U.S. strategy of shifting focus to the East.*
>
> *Someone may ask: "A counter measure should be in the opposite direction of the force coming toward you. How can you turn your back on the U.S.?" (The U.S. is pressing China from the east over the Pacific Ocean, but China turns its back on the pressure and moves to the west.)*
>
> *That's right. The "One Belt, One Road" strategy is China's indirect counter to the U.S. shift to the East. China turns its back on the U.S. [to avoid direct confrontation]. You pressure me [from the east], I walk to the west, not because I want to avoid you, nor because I am afraid of you, but rather because this is a smart move to defuse the pressure you bring to me.*
>
> *The "One Belt, One Road" strategy does not require the two paths happen in parallel. It should have priorities. Sea power is still China's weakness, so we can focus on the land path first. The "One Belt" is the primary direction. This also means that we need to revisit the importance of the army.*

PLA Strategist: The US uses its dollar to dominate the world – 4/15/15
PLA Strategist: The U.S. Uses Its Dollar to Dominate the World – Chinascope

More trade in the SE Asia region and across Eurasia (prior page) is occurring despite/alongside rising Chinese incomes (right)…

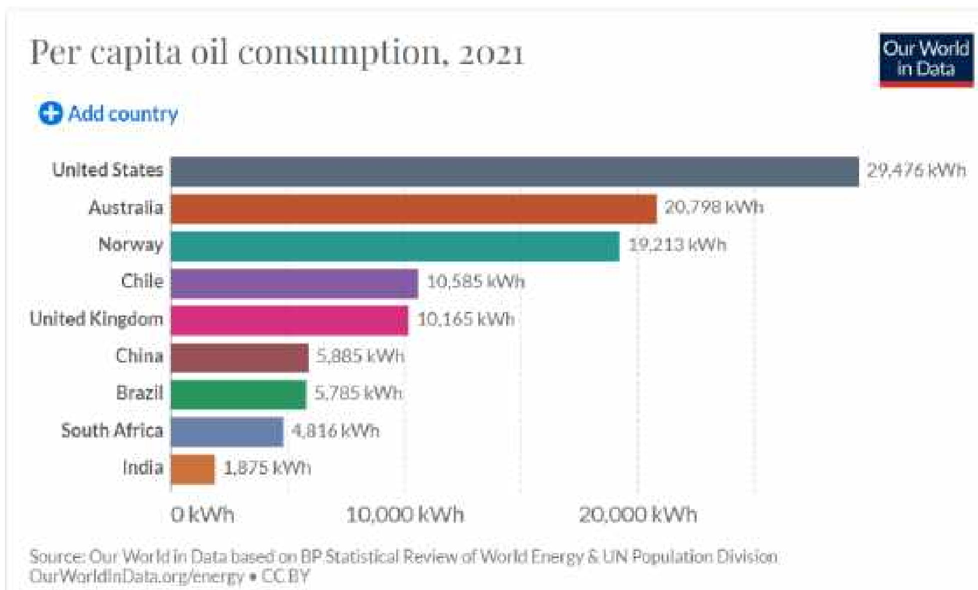
This is a formula for rising per capita energy consumption in China and across SE Asia and Eurasia over time…



…and yet, Chinese per capita oil consumption is still only a tiny fraction of the US (right)…

…with an ongoing and accelerating monetary system shift that allows China to “print currency for oil” like the US (by using net gold settlement) that we have been describing ad nauseum.

This is why we remain secularly bullish on energy and EV and EV-related metals and electrical infrastructure-related equities, alongside gold, gold miners, and BTC.



In our view, they are, at their core, plays on an energy supply situation that is far more dire than consensus realizes, with an energy demand picture that is far more bullish than consensus realizes *(because consensus does not understand how China is using gold to gain the ability to “print CNY for oil”, which could lead to a nonlinear shift higher in Chinese and Eurasian oil demand),* into a global sovereign debt bubble that is far more fragile than consensus realizes.

As China continues to ramp up its ability to “print CNY for oil”, China’s per capita oil usage should continue to rise (look at what “printing USD for energy” did to US per capita oil usage, above), and gold should rise in both barrels of oil terms and in USD terms, along with energy prices in USD terms.

Let’s watch.

<u>"Saudi signs MOU with Swiss gold refiner Valcambi to establish a 250-tonne/year gold and platinum group metals refinery in Saudi's special economic zone"</u>

Saudi GACA signs MOU with Swiss-Saudi precious metals refining JV (via BullionStar & EF) – 5/30/23
Saudi GACA signs MoU with Swiss-Saudi precious metals refining JV (zawya.com)

> *Saudi Arabia's General Authority of Civil Aviation (GACA) has signed a memorandum of understanding (MoU) with a joint venture between Switzerland-based Valcambi Suisse and Riyadh-headquartered Ajlan & Bros to establish a collection, distribution and recycling centre in the Integrated Logistics Bonded Zone (ILBZ) in Riyadh.*
>
> *The special economic zone, launched in October 2022, is located near King Khalid International Airport in Riyadh.*
>
> *Valcambi and Ajlan & Bros Mining is building a state-of-the-art refining facility in Saudi Arabia for precious metals and Platinum Group Metals (platinum, palladium, rhodium and iridium) with capacity of 250 tonnes per annum.*
>
> *In July 2022, Arab News had reported that the $2 billion refinery would be built in phases. The first phase, worth $300 million, is scheduled to be fully operational by the end of 2024. The statement said the authority also signed an MoU with Chinese security technology giant HIKVISION to set up a light assembly facility for the region in ILBZ.*

<u>Tree Ring:</u> A sizable gold and precious metals collection, distribution, recycling and refining center in the special economic zone located near the international airport in Riyadh (with Swiss and Chinese involvement) announced six months after this:

China's Xi calls for oil trade in CNY at Gulf summit in Riyadh – 12/10/22
China's Xi calls for oil trade in yuan at Gulf summit in Riyadh | Reuters

> *President Xi Jinping told Gulf Arab leaders on Friday that China would work to buy oil and gas in yuan, a move that would support Beijing's goal to establish its <u>currency</u> internationally and weaken the U.S. dollar's grip on world trade.*
>
> *Xi was speaking in Saudi Arabia where Crown Prince Mohammed bin Salman <u>hosted</u> two "milestone" Arab summits with the Chinese leader which showcased the powerful prince's regional heft as he courts partnerships beyond close historic ties with the West.*

Making the above even more interesting (especially on the heels of the Iraq gold buys we wrote about last week) was the article below that hit this week:

Saudi crown prince threatened economic pain on US during oil standoff – 6/8/23
Saudi Crown prince threatened economic pain on U.S. during oil standoff - The Washington Post

> *Last fall, President Biden vowed to impose "consequences" on Saudi Arabia for its decision to slash oil production amid high energy prices and fast-approaching elections in the United States.*
>
> *In public, the Saudi government defended its actions politely via diplomatic statements. But in private, Crown Prince Mohammed bin Salman threatened to fundamentally alter the decades-old U.S.-Saudi relationship and impose significant economic costs on the United States if it retaliated against the oil cuts, according to a classified document obtained by The Washington Post.*
>
> *The crown prince claimed "he will not deal with the U.S. administration anymore," the document says, promising "major economic consequences for Washington."*
>
> *Eight months later, Biden has yet to impose consequences on the Arab country and Mohammed has continued to engage with top U.S. officials, as he did with Secretary of State Antony Blinken in the seaside Saudi city of Jiddah this week.*

Most investors continue to misunderstand that Peak Cheap Oil requires a monetary system shift. Said differently:

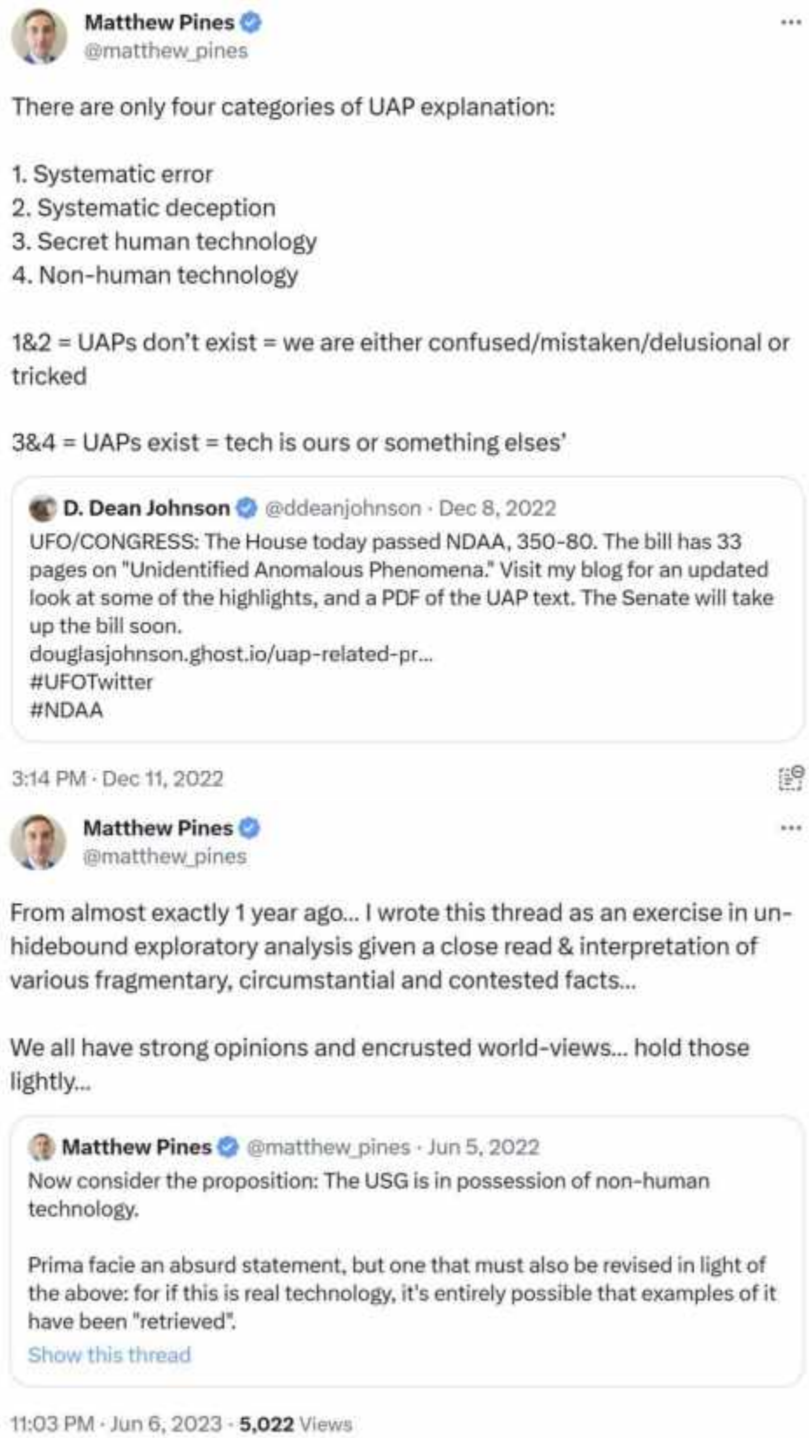
China is not doing this from an offensive perspective, but out of defensive necessity – if they do not buy oil in CNY and net settle in gold that floats in CNY, in an energy price spike, China will run out of USDs to buy energy and then quickly suffer a 1997 SE Asia currency, economic, and political crisis. This is not politically-palatable for China and as such, will not be allowed to occur, in our view.

We continue to believe gold is moving and will continue to move back into the system as a neutral reserve asset to settle energy-related net deficits in CNY and other non-USD currencies. As it does so, it should continue to be good for gold, measured both in barrels of oil (gold/oil ratio has already risen from 8x to 27x in the past 15 years) and in USDs and all currencies.

Let’s watch.

“NASA group studying UFOs stresses need for better data in first public meeting”

NASA group studying UFOs stresses need for better data in first public meeting – 5/31/23
[NASA group studying UFOs stresses need for better data in first public meeting - CBS News](#)


Matthew Pines
@matthew_pines

There are only four categories of UAP explanation:

1. Systematic error
2. Systematic deception
3. Secret human technology
4. Non-human technology

1&2 = UAPs don't exist = we are either confused/mistaken/delusional or tricked

3&4 = UAPs exist = tech is ours or something elses'

D. Dean Johnson @ddeanjohnson · Dec 8, 2022
UFO/CONGRESS: The House today passed NDAA, 350-80. The bill has 33 pages on "Unidentified Anomalous Phenomena." Visit my blog for an updated look at some of the highlights, and a PDF of the UAP text. The Senate will take up the bill soon.
douglasjohnson.ghost.io/uap-related-pr...
#UFOTwitter
#NDAA

3:14 PM · Dec 11, 2022

Matthew Pines
@matthew_pines

From almost exactly 1 year ago... I wrote this thread as an exercise in un-hidebound exploratory analysis given a close read & interpretation of various fragmentary, circumstantial and contested facts...

We all have strong opinions and encrusted world-views... hold those lightly...

Matthew Pines @matthew_pines · Jun 5, 2022
Now consider the proposition: The USG is in possession of non-human technology.

Prima facie an absurd statement, but one that must also be revised in light of the above: for if this is real technology, it's entirely possible that examples of it have been "retrieved".
Show this thread

11:03 PM · Jun 6, 2023 · **5,022** Views

Tree Ring: We have written before in these pages about UFOs. We have repeatedly written in these pages that an “energy productivity miracle” is a way out of the seemingly intractable debt conundrum the US and the global economy find themselves in.

In the past, we have written that our views around the UFO phenomenon are one of two things:

1. A psy-op designed to keep US adversaries on their heels at a time when those adversaries have, in some defense technology areas, reached near-peer or even peer status with us.

2. A warning to US adversaries that we have defense technology capabilities that they can only dream of, so do not act unilaterally to implement a military or economic attack on the US or else we will unleash these technologies on them.

These views are reflected in the list at top right compiled by our friend Matthew Pines.

We are now adding a third possibility to our thinking on UFO’s – perhaps they are an “invitation” of sorts to US allies and potential allies:

“We have these emergent energy technologies, but they will only be available to those who go with the US and USD economic bloc; not those who go with the China/Russia/BRICS bloc”, a view reflected at right by Pines.

We have no strong views on the subject, other than this: *This could be exactly the type of “energy productivity miracle” we have been discussing, so we must pay attention.*

If it is an energy productivity miracle, it would force us to completely change our investment view and geopolitical view. It would likely be massively bullish for US big tech (who would likely be early to benefit from such technology), US defense stocks, US equities more broadly, the USD, USTs. It would likely be bad for China, oil, gas, and other fossil fuels.

It is difficult to imagine all the potential implications for the global economy and macro that such an energy productivity miracle would entail, and some of it would depend on geopolitical and domestic political moves after the fact. What might it mean for our gold and BTC positions if it ends Peak Cheap Oil and Gas worries (a key underpinning of our gold and BTC positions)?

While on first blush we would think it might be negative for gold and BTC, upon further consideration, we think gold and BTC would probably do well – the energy productivity miracle would make consumer debt (broadly defined) more sustainable in real terms, but it would make existing energy related debt and its derivatives more unpayable, and in a globally-connected system with high debt levels, a problem or big deflationary shift anywhere would likely quickly morph into a problem everywhere that would still require a systemic restructuring that required a neutral reserve asset with a much higher price (to deflate global debt against.)

Let’s watch.

Thank you for reading this edition of Tree Rings. Have a great weekend! LG

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