THE HIGH-TECH STRATEGIST

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Sometimes, It's Just Not Easy

It's been a tough week. We have a lot of oak trees on our property here in Nashua, New Hampshire and there's always 'stuff' falling from them – sticks, branches, acorns (a record batch this year) and leaves. For more than 25 years we (mostly Kathy & I) have been picking them all up and disposing of them, but two years ago we decided to hire a service to take care of the fall leaf cleanup. Last year it took a team of six men with powerful blowers two hours to clear the lawn - and it was well worth the cost. We hired them again to come this week. However, winter storm Ezekiel came into view and the service was unable to accelerate their schedule (all booked up). There was no choice - we had to do it. If we didn't get the leaves picked up they could be buried by snow and we might not see them again until April - and that would be very bad for our lawn.

Over three days late last week I raked and dumped over 80 barrels of (mostly wet) leaves. In addition, Kathy and I disposed of a large number of tarps full of leaves (and acorns). But we got it all done before Ezekiel arrived on Sunday. The storm just ended (Tuesday afternoon as I write this). It was a whopper of a Nor'easter– two feet of snow - one of the biggest early snowstorms I've ever experienced. Normally, I'd be snowblowing – except this time the snowblower wouldn't start (hard as I tried). That means I've been shoveling the heavy snow (for two days) from our driveway and sidewalk. We have snowbanks as tall as Kathy. The city snowplow obliterated our mailbox (again). With all the leaf clearing and shoveling over the past six days, my 63-year old back is barking at me (shoulders too).

In the midst of all this craziness, I had to organize my notes and thoughts in preparation for this letter (a long process). Within ten minutes of starting to write this letter – the electrical power in the area went out. I believe I heard a transformer blow. So, I'm typing this with the help of a battery-powered flashlight and I can feel my feet getting cold (25 degrees outside). Thirty-two+ years of writing this letter every month under all conditions (including various illnesses) - but the show must go on. Sometimes, it's just not easy.

Similarly, it's not been an easy time for many investors (at least those with some gray in their hair). An inverted yield curve, corporate earnings declining year-over-year (an earnings recession), industrial production contracting – all over the world - including in the U.S. (four consecutive months of U.S. ISM manufacturing index declines), China's economy the weakest it's been in 30 years, Japan and German economies barely hovering above recession levels, Bank of Mexico lowering its country's GDP forecast last week to 0% growth while at the same time Canada reported a marked deceleration in Q3 GDP (to just 1% growth), international trade flows at the weakest level in ten years (per the World Trade Organization), slumping copper prices (Dr. Copper forecasting recession?), CEO confidence at its lowest level in a decade and the Conference Board reporting declining U.S. **consumer** confidence (four consecutive months through November) – so one would not expect the stock market to be setting record high after record high. But it has – at least up until this week.

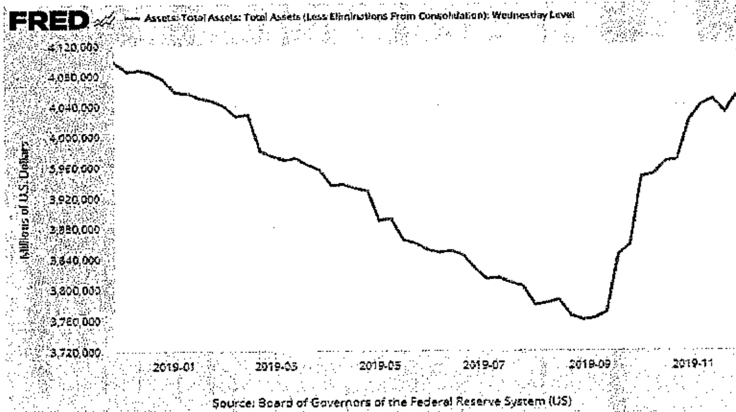
The soaring stock market has ignored other warning signs, including sentiment indicators showing excessive investor risk taking. Investors Intelligence reported its bull/bear gap is now 40 percentage points (bulls vastly outnumbering bears). Here are two recent financial media headlines: "Stocks Run Gauntlet of Bad News to Record Highs." "Bulletproof Stock Market Shakes Off Negative Trade Headlines and Keeps Marching to Records." Stock valuations are at extreme (historically dangerous) levels. Market Cap to GDP (Warren Buffett's favorite market indicator) recently hit 147.5% (second only to the 2000 Tech Bubble's 161%) and Market Cap to Sales reached 2.2 times (exceeding the prior record in 2000). Speculators are now so brazen, they recently drove their VIX (volatility) net speculative short positions to an off-the charts high. On two prior occasions (in 2018 and early 2019) with VIX speculative shorts at significantly lesser levels, stocks sold off violently (speculators' shorts squeezed). But today, they fear not.

The above conditions are a recipe for a U.S. bear market and a recession and both are overdue. Indeed, the U.S. economy is in its longest recovery without a recession in its history and stocks are similarly in the longest bull market in history. Bear markets and recessions have not been eliminated, even though many investors have come to believe that our (incompetent) central planners at the Fed have found some kind of magic formula (money printing).

These are all conditions that should be conducive to short selling, but even though I had great success (eventually) shorting the stock manias in 2000 and again in 2008 (via put options), I've mostly stayed away from this one (and I'm very glad I did). As an aside, I'm also very happy the power's back on! There was no Quantitative Easing (QE) in 2000 and 2008 to forestall those crashes, but there is today. Former Fed chairman Bernanke started QE1 (supposedly "temporary" QE) in late-2008/early 2009 to combat a stock market crash and financial crisis. Today, QE4 is being used to push up stock prices to record after record in the longest bull market in history. See the chart below of the Fed's balance sheet. In just a little over two months, the Fed has reversed nearly all of the Quantitative Tapering (QT- or QE money printing reversal) that occurred over the first nine months of this year. The Fed has ginned up nearly $300 billion (using most of the proceeds to purchase T-bills). It is the steepest money printing ramp in the Fed's history.

Not much of that newly created money has gone into banks' "excess reserves" to help combat the ongoing overnight bank

lending problem (as the Fed intended), nor did it go into commercial and industrial loans (down $22B over the past two



months). It did, however, goose the U.S. money supply (now soaring at a 12% rate) and sent the stock market into orbit. On October 8, Fed chairman Powell announced the Fed would start expanding its balance sheet again "soon." That day, the Dow Jones Industrial Average (DJIA) closed at 26,164. By Thanksgiving Day (seven weeks later) the DJIA closed exactly 2,000 points higher at 28,164 (up 7.6%). The seven week rally was relentless.

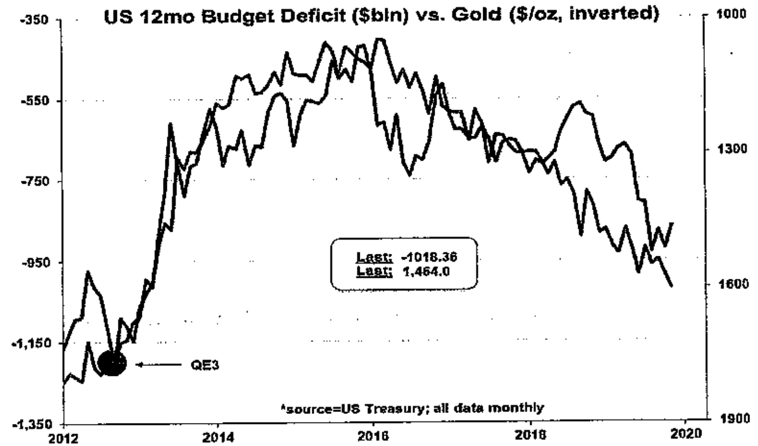
President Trump, who has hitched his reelection campaign wagon to the stock market, has contributed one optimistic China trade "deal" comment after the other - he stated a deal was "close" every month this year – except for December. In October, Trump announced a "phase one" trade deal agreement with China. With the latest tariff deadline approaching (December 15), we learned only today (from Commerce Secretary Wilbur Ross) there's no deal signing date planned, nor are there any ongoing high-level talks scheduled before the Dec. 15 deadline. This morning President Trump said the trade deal might be delayed until after the November 2020 election. Without the China trade deal Trump pump, stocks deflated 1% today after losing 1% on Monday (due to poor economic data). How long this trade deal disappointment selloff will last is anyone's guess. We are in unchartered territory. Never before has the Fed pumped in so much newly created money into the financial system so quickly.

One thing's certain – the continued trade uncertainty will not improve the sinking CEOs' confidence or their companies' already weakening capital spending plans. That bodes ill for IT (tech) spending. Moreover, at some point in the future, the Fed will lose control of this godawful mess they've created. Thoughtful investors are in a quandary. They can't hide in cash for very long (interest rates are abnormally low) because of the threat of Fed-caused inflation/dollar debasement (we don't know how many more QEs there will be). On the other hand, most stock prices are grossly overvalued in a sinking economy with falling earnings (year-over year) and could plummet at any time. For investors today, it certainly isn't easy.

The Best Alternative

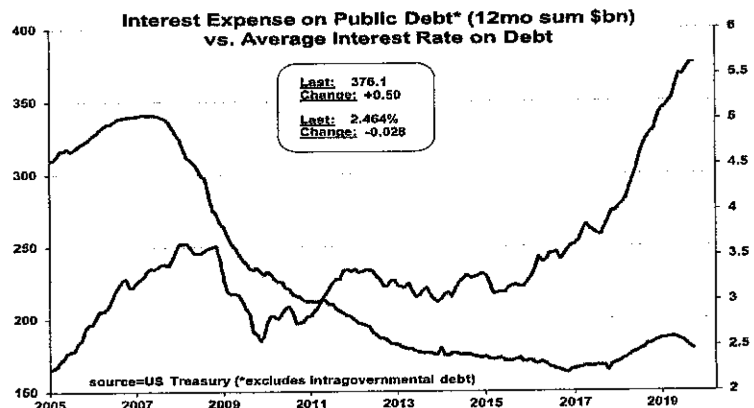
My solution has been to stay heavily long precious metals and mining stocks. I consider them to effectively be an alternative way to short the overall stock market because they typically do well when the stock market slumps and should also outperform in a monetary debasement period. The metals are relatively early in their bull markets (since 2016) and are under-owned by most investors (except for the biggest of the "smart money" types – Dalio, Tudor-Jones, Gundlach, Zell and many more). Following a metals correction that began in early September, investor sentiment is quite low (Daily Sentiment Index reading of just 25% bullishness last week).

The Fed's money printing episodes are encouraging government entities (and others including U.S. businesses and consumers) to pile up deficits and (record) amounts of debt – and that's great for gold. As you can see from the chart on the next page - sourced from Meridian Macro Research (info@meridianmacro.com), gold and U.S. federal budget deficits are highly correlated. In 2000-2001, when the U.S. government was running surpluses, gold hit rock bottom at around $250 oz. In 2009 to 2012 when the Fed was printing money (QEs 1-3), thereby monetizing the U.S. government's $1T annual deficits, gold skyrocketed to record highs (from $700 to over $1900). During the U.S. government's "sequester" spending limit years with falling deficits in 2013-2015, gold fell (see chart – gold is inverted). Budget deficits began rising again in 2016 and so did gold (beginning of the new gold bull market).



Two weeks ago, the U.S. Treasury Department announced a massive $134 billion budget deficit for October, bringing the 12-month deficit back over $1 trillion for the first time since February 2013. This occurred in peacetime and outside of a recession with unemployment near a fifty-year low (the first time that's ever happened). President Trump has sharply cut taxes and increased spending (especially on defense). He would like a big new infrastructure spending plan - as would the Democrats. Almost all of the Democrats running for President against Trump are promising all sorts of giveaways ("free" healthcare, "free" college tuitions, a universal basic income etc.). There's only one direction the budget deficit is heading – higher, much higher. Gold (and silver) should go with it.

The three biggest U.S. federal budget outlays are for Social Security, Medicare and defense. The first two are also heading sharply higher due to the ever-growing number of Baby Boomer retirees. The fourth largest budget item is now interest expense on the National Debt. Even with interest rates suppressed (by the Fed) at historically low levels, interest expense on the soaring National Debt (the National Debt is now over $23 trillion, having climbed $1.3 trillion in 12 months) is skyrocketing and within a few years will overtake defense spending. See the chart below - sourced from Meridian Macro Research (info@meridianmacro.com). Interest expense is heading in but one direction – straight up. Heaven help us if the Fed loses control and interest rates just "normalize" back to pre-2008 levels (around 5%).



Deficits typically soar during recessions and we're getting perilously close to the next one. There are virtually no U.S. politicians advocating belt-tightening any longer. They've become used to having the Fed monetize the debts. Last month it was reported that foreign holdings of U.S. government debt fell by the most since 2017. Many foreign governments have become much less interested in funding our growing deficits.

Instead, they're buying gold. Central banks around the world purchased 652 tons of gold in 2018 (up 74% year-over-year) and are expected to buy as much again in 2019 (a record 374 tons were purchased in the first half of this year). In addition to the huge gold buying central banks of Russia and China, smaller countries such as Serbia have begun to acquire gold. After Serbia bought nine tons of gold in October, bringing its gold holdings to 10% of its total foreign-exchange reserves, its President stated two weeks ago that the country needed to buy even more gold. "I think we'll continue doing that because of what we see and which direction the crisis in the world is moving," he said. Poland bought nearly 100 tons of gold this year, nearly doubling its holdings. Poland central bank governor Adam Glapinski: "The gold symbolizes the strength of the country."

It's not just the U.S. that's monetizing its rapidly growing deficits. The ECB (Europe), BOJ (Japan) and others are as well. The Institute of International Finance (IIF) recently reported that global debt has hit a record $250 trillion. That's up 45% (from $173 trillion) at the time of the 2008 financial crisis. Much of the increase is government debt. Major central banks decided to combat the 2008 debt crisis by encouraging the addition of massive amounts of new debt. What could go wrong?

"Risk Off" – Always Followed By "Risk On"

It's now Wednesday morning, the power's still on and the stock market is rallying - the Dow Jones Industrials are up over 200 points despite poor economic news. The ISM Non-Manufacturing (services) Index report for November was disappointing and the ADP payroll report was a huge miss (67,000 jobs added, the second lowest tally since 2010 versus the 140,000 consensus). Nevertheless, it's a "risk on" rally day as *Bloomberg* headlined this morning (at 4 AM): "U.S., China Move Closer to Trade Deal." The sources for this story were "people familiar with the talks" who "asked not to be identified." So, despite those very specific negative trade deal comments from Commerce Secretary Ross and President Trump yesterday, a leak (likely from the White House – desperate to keep the stock market up for reelection reasons) is enough to send stocks up again. That's the pattern that's continued almost all year long. Persistent evidence of a worsening U.S. (and global) economy - but a rumor over a trade deal that never gets done - is the excuse to rally stocks - over again and again. How does a sane, experienced investor navigate this nonsense? With great difficulty - it's just not easy.

The gap between the reality of a deteriorating global economy nearing recession with corporate earnings falling year-over-year and a stock market propelled to record after record on trade deal "hopes" just keeps getting wider and wider. Stock prices at these lofty (and historically dangerous) levels are not sustainable unless an economic recovery magically appears and there are no signs of that happening. Even if there is a "phase one" agreement with China, it is likely to be very limited in scope - China buys soybeans it would obtain anyways (because they need them) and Trump defers the latest tariff increase threat or does a minor tariff roll-back, leaving all of the contentious issues unaddressed. Underlying all this is the continuing fire hose of Fed (and other central bank) liquidity spewing into the markets every day. It's distorting markets terribly and it will eventually end very badly. When? No one knows for sure. As I said before, we are in uncharted territory.

The Skunk at the Party

As we saw in the past stock manias, tech stocks are favored investments for bubbleheads willing to believe. That puts The High-Tech Strategist letter in a difficult position – join the wilding herd buying ever more overpriced stocks with deteriorating fundamentals, or get left behind. Once again, I choose to stay behind. Thankfully, precious metals offer a safe (and profitable) port in this storm. This year continues to be my portfolio's best year ever (in dollar terms) and with my portfolio at record highs, it makes this maddening situation (barely) tolerable. As for tech, all I can do is be the skunk at the party - pointing out that the realities in the tech world do not justify the euphoria.

The Tech Spending Downturn Accelerates

While the first month of each quarter always is heaviest with the largest number of tech earnings reports, the second month (this time November) offers up quarterly earnings from many of the largest and most important enterprise tech companies – Cisco Systems, Dell, Hewlett-Packard Enterprises (HPE) and HP Inc. These tech giants' reports were overall very ugly and the stocks fell hard, at least initially. Last week both Dell and HPE reported. Dell's stock slumped 10% for the week and HPE slid 7.5% due mostly to very disappointing current quarter guidance. Meanwhile, their suppliers – including semiconductor stocks such as Intel, Nvidia and Micron Tech. continued to rally. Little makes sense in this market.

I'll start with Cisco Systems (CSCO), as they reported earlier in November. Cisco, the largest network equipment supplier with $52 billion in annual sales, disappointed investors with current quarter guidance calling for the biggest sequential revenue decline in a decade (since the global financial crisis). Orders for the quarter ended in October fell 4%, the steepest decline in nearly three years. Analysts had expected Cisco's revenues to increase 2.4% in the current quarter, but the company dashed those hopes with a forecast of -3% to -5%.

CSCO CEO Chuck Robbins on the conference call described a broadening global economic downturn. "Over the last year, many of you have heard me talk about the resilience of the global macro environment. However, on our last earnings call, we indicated that we had begun to see some weakness and that weakness continued throughout Q1 and was more broad-based. While the main challenge continues to be in service provider (telecom carriers) in emerging markets, this quarter we also saw relative weakness in enterprise and commercial."

When asked by an analyst what they were hearing from their customers, Robbins responded, "It feels like there's a bit of a pause. We saw things like conversion rates on our (deal) pipeline were lower than normal, which says that things didn't close the way we've historically seen it. We didn't see any incremental (share) loss ratios. It was really just stuff slipping. We saw some large deals get done – but done smaller."

Robbins tried to explain the causes for the relatively sudden order and revenue deterioration: "if you just go around the world right now and you look at what's happening in Hong Kong, you look at the China/U.S. trade situation, you look at what's going on in (Washington) D.C. You've got Brexit. And you've got uncertainty in Latin America." "And then obviously, we have elections coming in the next year that we have to see how they work." "Business confidence just suffers when there's a lack of clarity. And there's been a lack of clarity for so long that I think it's finally just come into play."

When asked about the commercial order rate deterioration, Robbins explained, "That's a good question. That was one of the big signals to us that this thing is...that there's definitely something going on because the commercial business is usually fairly resilient. And it (the deterioration in Cisco's commerical business) was broad-based across the globe in each of our regions. I think all three (Americas, EMEA and Asia) were negative."

Kelly Kramer, CSCO's CFO on the orders deterioration throughout the quarter: "In terms of orders in (fiscal) Q1, total product orders were down 4%. Looking at the geographies, Americas and EMEA (Europe, Middle East and Africa) were each down 3% and APAC (Asia-Pacific, Japan and China) was down 5%. Total emerging markets were down 13% with the BRICS plus Mexico down 26%. In our customer segments, public sector (government spending) was up 6%, enterprise and

commercial were each down 5% and service provider was down 13%." Cisco's order downturn just can't get much broader than that.

An analyst on the call (trying to minimize the damage) asked Robbins if the downturn might be similar to the last slowdown Cisco experienced in 2017 (a midyear "pause before recovery"). "Is there anything different about it this time?" he asked. Robbins didn't bite: "First of all, I think that given the broad-based (nature) and the rapid change that we saw, I don't believe it's anything like white box (one segment with troubles in 2017) or anything like that. It's broad across the portfolio. It's broad across geographies. And as Kelly said, obviously it's in the second half." There was just no way to spin Cisco's bad news positively.

There was one bit of good news (for Cisco, but not DRAM makers such as Micron Tech.). Kelly Kramer: "And then of course, we are still benefitting from the DRAM price decreases related to the server market that we started to feel the benefit of a couple of quarters ago. It's a very large impact this quarter – favorable to us – that I expect will continue next quarter."

Less than two weeks prior to CSCO's report, a major competitor to Cisco, Arista Networks (ANET), foreshadowed trouble after its sales forecast missed analysts' lowest projections. ANET's high-priced stock immediately plunged 29% when it opened the next day. ANET forecast Q4 revenues to be more than $135 million less (20%) than the average of analysts' estimates ($686 million). Arista does a heavy amount of business with the hyperscale cloud vendors (Amazon Web Services, Microsoft's Azure, etc.). ANET CEO Jayshree Ullal: "In Q3, the cloud titan vertical segment remained our largest one. The modern enterprise segment is now consistently our second largest, with financials in third place and service provider and tier-2 specialty cloud providers coming in at fourth and fifth place."

Ullal: "I would like to offer some further color on Q4 2019 guidance, given our significant drop. After we experienced the pause of a specific cloud titan's orders in Q2 2019 (Microsoft), we were expecting a recovery in the second half of 2019 for cloud titan spending. In fact, Q3 2019 is good evidence of that. However, we were recently informed of a shift in procurement strategy with a material reduction in demand from a second cloud titan (thought to be Facebook, which had lowered its 2019 capital spending forecast just a few days earlier), reducing their forecasts dramatically from original projections for both Q4 2019 and for calendar 2020." "Naturally, this type of volatility brings a sudden and severe impact to our Q4 guidance. Given this tepid forecast and volatility of this cloud segment, we believe the cloud titan forecast should be modeled as flat to down in calendar 2020."

Most of the "Unicorn" startup companies' (WeWork, Uber etc.) stocks/private valuations have suffered huge declines in recent months. Now these massive money losers (and big users of cloud services – most don't have their own computer equipment) are pulling back on their spending out of necessity as funding sources have dried up. According to a *Wall Street Journal* story last week titled: "Silicon Valley Adjusts to New Reality as $100 Billion Evaporates," these (malinvestment companies) "have collectively lost about $100 billion in value this year, prompting some startup executives to talk up profitability over growth as venture-capital investors grow more cautious about spending." The *Wall Street Journal* quoted a venture capitalist: "We've been in the middle of a rollicking party that's gone on for five years and someone has snapped on the light switch." WeWork announced it is cutting about 17% of its workforce (2,400 jobs). It was reported last month that Uber is laying off about 350 of its employees. The wild spending for "growth" (at any cost) is over and the *Wall Street Journal* published another story last month titled: "Silicon Valley Is Trying Out a New Mantra: Make a Profit." This is an important change because for the past few years the cloud titans were reliably the biggest spenders on IT equipment.

Back to the Arista conference call comments. Jayshree Ullal: "Well, as I was trying to explain, our Q4 forecast is actually quite consistent with many of the cloud capex (spending forecasts) reported in recent calls, which is overall flat to down." "If you look at the two reasons why we believe it will slow down – also in 2020, it's because **many** of the cloud titan customers are extending their use of (computer) server assets and delaying their network purchases longer." "We have three types of cloud titans – some large ones that will remain flat (spending), some that will go down and some that will go up – and the aggregate of that is flat to down."

The slowdown in orders is not just from the cloud "titans." Ullal: "The new tier-2 companies – specialty cloud companies that started growing very well for us in 2017 and 2018 are now having to review their investments and decide from a matter of economics which ones make more sense – do they rely on their own cloud or go to the public cloud titan. And some of the tier-2 companies are finding it difficult to compete." Arista also saw weakness from service providers – as so many others have.

Computer industry giant Dell ($92 billion in annual sales) missed revenue estimates for the quarter ended on November 1, as its server and networking unit revenues plunged 16% (to $4.24 billion) "due to a soft market, particularly in China and in large enterprise customers in the U.S. and Europe," Dell CFO Thomas Sweet explained on the conference call. Partially offsetting this weakness was strength in commercial PC sales (double-digit growth in commercial desktops and workstations).

However, the strength in commercial PC sales seen over the past few quarters (across the industry) will not continue for much longer. Research house IDC last week slightly raised its PC sales outlook for 2019 due to the continuing strength in this segment. Jitesh Ubrani, research manager for IDC's Worldwide Mobile Device Trackers: "The upcoming end of support for Windows 7 (in mid-January) has been a boon for the industry as commercial organizations around the globe have been pursuing hardware upgrades in 2019." "However, 2020 will remain challenged as the runway for OS (operating system) driven hardware purchases shortens." Dell's CFO estimated the Windows 10 refresh is "roughly two-thirds through." IDC expects PC and tablet shipments to decline from 407.7 million in 2019 to 366.7 million in 2023 (a drop of 10%). Gartner expects global PC shipments to decline 2% in 2020 as consumers use their PCs for a longer period and corporate demand slips due to the completion of the Windows 10 operating system upgrade for business PCs.

Dell's CFO offered weaker than expected guidance for fiscal 2021 growth. "We continue to monitor the macroeconomic and IT spending environments as well as the ongoing trade discussions between the U.S. and China. As Jeff (Clarke, Dell's VP of Products and Operations) mentioned earlier, we do see continued softness at large enterprise customers and in China." Clarke: "The caution that we're seeing with our large customers is certainly being seen in our ability to close transactions and how long it's taking to get that order closed would be another piece of color that I would add."

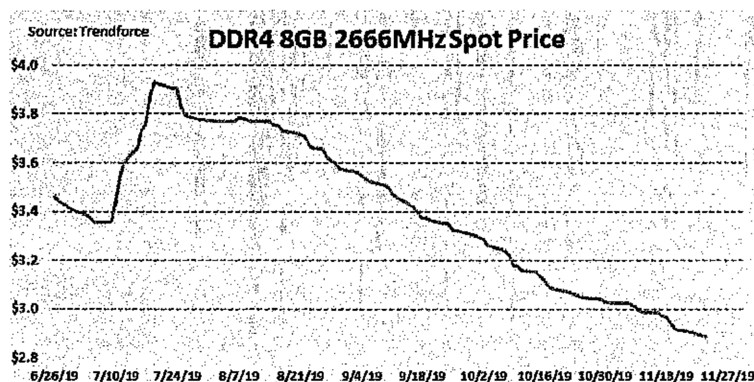
HP Inc. ($58 billion in sales annually and the number two maker of PCs to Lenovo) slightly bested revenue estimates for the quarter ended in October due to a 4% year-over-year increase in PC sales (again the Windows 10 refresh drove corporate sales). That tailwind couldn't help HP's printer business, which saw its revenues decline 6% year-over-year. Xerox (with prodding from activist investor Carl Icahn) recently made a hostile bid to acquire HP (a much larger company). HP's board rejected the offer. HP will be under pressure to show better bottom line numbers and has begun a restructuring plan that is expected to eliminate around 7,000 to 8,000 jobs (nearly 15% of the workforce).

Dell's primary competitor in computer servers, Hewlett Packard Enterprise (HPE, $29 billion in annual sales) missed revenue estimates (by $200 million) for the quarter ended in October. HPE CEO Antonio Neri cited "elongated sales cycles," "the tariff situation with the global trade" and "geopolitical uncertainty" for the shortfall. HPE CFO Tarek Robbiati added that Trump's corporate tax cuts also have had an effect on the industry (positive at first and then negative later). Robbiati: "We've done a fair bit of work on this internally and there is no doubt that the fiscal year 2018 was propelled by the benefits from tax reform, i.e. there was more

disposable income for large corporations worldwide to be spent on infrastructure and that has happened – that carried on pretty nicely all the way to the first quarter of fiscal year 2019." "Beyond that point, there was a drop due to macroeconomic factors, but also we do believe that there is an element where the spending that was taking place in fiscal year 2019 has to be digested by the companies moving forward." In other words, President Trump created a temporary 'sugar high' and now comes the hangover (excess capacity digestion).

Semiconductor Industry Tailwinds Become Headwinds

In addition to the tax-driven, enterprise IT excess capacity digestion, the coming 2020 slowdown in corporate PC sales as the Windows 10 refresh cycle ends, the worsening global economic environment (a likely recession), the slowdown in startup company spending (forced to tighten), and the excess capacities at the tier-1 and tier-2 cloud suppliers; semiconductor companies also face headwinds as some of their customers have pulled forward demand for semiconductors and other tech products due to the trade war turmoil. Today, *Bloomberg* published a story: "China Stockpiles US Chips as 'Silicon Curtain' Descends." This was not news to me, as I've known the trade wars have caused semiconductor demand pull-ins for several quarters now. Bloomberg noted that Huawei, China's giant communications equipment leader, "has built up inventory from around 2018 and continued to do so in 2019 in anticipation of losing access to U.S. tech." Huawei was not alone in doing so.



The demand tailwinds in 2019 (trade-related pull-ins and corporate PC sales growth) have not kept DRAM semiconductor prices from plunging virtually all year long (down nearly 60% year-over-year). As you can see from the chart above, there was a temporary blip-up in DRAM prices mid-year due to supply fears caused by the Japan/Korea trade war (Japan restricted certain key component materials from Korean DRAM makers for a time) and an outage at a Toshiba memory fab in mid-June. Those fears soon dissipated and DRAM prices resumed their plunge (as I've said – declining nearly every day). There simply is too much capacity and more is coming on in 2020 (including at industry giant Samsung's new memory fabs in Pyeongtaek (Phase 2 in Korea) and Xian (Phase 2 in China). I'm told that DRAM deals are currently being done (directly with the memory manufacturers) at prices significantly below published spot prices.

The DRAM (and NAND) memory price declines have sunk Micron Technology's (MU) earnings this year. Micron's most recent quarterly report in September (for the quarter ended in August – note those results included the benefit from the mid-year short-term price increases) was dreadful – an 87% year-over-year plunge in net income and a 91.5% collapse in adjusted free cash flow. Analysts are currently expecting another 84% year-over-year drop in earnings for the quarter just ended in November – and that's including an estimated $80 million reduction in depreciation expense (lowers MU's cost of goods sold and increases gross margins) in the quarter due to an accounting change (increasing the depreciable life of MU's NAND equipment from five to seven years).

The bigger trouble will be when MU gives current quarter guidance (for the period December through February) in two weeks (Wednesday December 18). Given the steep price declines and the fact that the seasonal weak demand period has begun (year-end PC inventory builds have already occurred), the guidance ought to be a doozy. Analysts currently estimate about 45 cents in earnings per share, down only slightly from the 48 cents estimated for the November-ended quarter. I believe there's ZERO chance of Micron coming anywhere close to that number.

Last month at the Bernstein 6th annual Tech Summit, Micron's CFO, David Zinser recited a long list of problems to a very friendly Bernstein analyst (who on 10/22 reiterated Micron as one of his "Top Picks"). The analyst had expected a faster than expected memory recovery (ha!). The Bernstein analyst started out the "fireside chat" with MU's CFO by describing Micron as "One of the hottest stocks out there." Amazingly, despite the near-total collapse in its results, Micron's stock is currently UP 45.9% year-to-date. I doubt that performance can hold up much longer given my expectation of further steep declines in guidance. As I've said before, I believe Micron could be losing money next year.

Some of the litany of "constraints" that Zinser enumerated: "Limited upside in demand," "Q2, a seasonally weak quarter" (current fiscal quarter), "some of the demand we've gotten was inventory build in China" (see the related Bloomberg story above), cost declines won't be significant "until the second half of the year," "underutilization at the Lehigh fab," mix shift to NAND memory "pressing on gross margins," DRAM market still remaining "competitive," and less interest income than analysts have forecast. The CFO essentially guided down for the first half of fiscal year 2020. The analyst noted, "You were adamant" (in previous conversations), that "free cash flow wouldn't go below zero." "Is it fair to say that you're likely to have lower free cash flow?" Zinser's answer: "We're doing everything we can to keep those (cash flows) positive. Even if it does go negative, it will be for a short time."

I'm assuming that Micron's 'teflon' stock won't be able to withstand the guidance gutting that's coming. Once the stock starts falling, the momentum players will (try to) pile out. Unlike most major semiconductor companies, Micron pays no dividend. There's chatter (heard very recently) that Micron has begun to hint to analysts that their estimates are too high. Therefore, I expect Micron's stock to weaken into the quarterly report on December 18.

Strategy/Positioning

As we've seen – especially in recent weeks - it's extremely difficult to sell short or buy put options in a money printing environment. Moreover, this money printing episode is more intense than any other. If I can't win with my Micron put options, given Micron's dire circumstances noted above, I don't think I can win with any other short. Therefore, Micron remains my only put position (April expirations) – until it becomes clearer others might work.

I'll have to remain content with my "synthetic short" – precious metals. My precious metals positions are my largest positions, by far. My largest miner positions are Agnico-Eagle Mines (AEM), Newmont Goldcorp (NEM), Alamos Gold (AGI), Kirkland Lake (KL), Barrick (GOLD) NovaGold Resources (NG) and Pan American Silver (PAAS) – not in that order. The Pan American Silver position now falls into the "large" category mostly due to its strong stock gains over the past seven weeks (up over 30%). That's an impressive performance during the precious metals (gold and silver) correction.

Last month PAAS reported very strong Q3 results and the numbers would have been even better if approximately $17.8 million of revenue hadn't pushed out into Q4 due to "timing of shipments." "We expect the revenue associated with that metal inventory will be realized during Q4," said PAAS CEO, Michael Steinmann. In late October, PAAS issued some tremendous drill results for its skarn discovery at its La Colorada property. On the conference call, Steinmann characterized those results as "some of the best drill intercepts I have seen in my career." PAAS said it would issue a maiden

resource estimate for this asset later this month following the results from 50,000 meters of drilling.

I used to own Detour Lake Gold's stock a few years back. Detour is a large, long-life, low-grade open pit mine located in Ontario, Canada I sold the stock after multiple execution problems at the mine. However, I never stopped following it. I reviewed its reports and conference calls every quarter and I was impressed with the progress made by the new management team. Detour was considered to be a prime takeover target. Recently, I had relooked at Detour with the possibility of buying back in.

Before that could happen, Kirkland Lake swooped in and acquired Detour in an all-stock transaction early last week. I've written that I thought Kirkland would soon make some acquisitions but I was surprised that it targeted Detour. I was hoping it would buy Osisko Mining or Bonterra Resources, in which Kirkland already owns significant stakes. I still believe there's a good chance that will happen in the future.

Kirkland's stock immediately sank 16% on the news. There was the usual merger arbitrage that typically hurts the acquirer's stock, but in addition to that, there was investor disappointment. When I made Kirkland Lake one of my largest positions a little over two years ago at around \$6.50 a share, it was a little-known stock. Two year's later, KL was up more than 7x (KL peaked at \$51) and had become a momentum investor darling. It had attracted gold investors and general market investors alike. As you know, I had significantly reduced my KL position, mostly because it had become so large, but also because of some concern over the fact KL had delayed issuing drill results for its Fosterville mine in Australia. Some were worried those drill results would turn out to be disappointing. Nevertheless, KL remains one of my largest positions (just not extraordinarily so).

When Kirkland bid for Detour, it added to those Fosterville concerns. On the conference call, KL's CEO tried to address the issue by saying that things were going well there and "exploration is progressing **fairly** well." This week KL released the drill results and they were **fairly** good. The Swan Zone (where there are obscenely high grades) was extended by 80 meters down plunge. There were other very good intercepts, but at Harrier South, "We have not yet seen the ultra-high grades you get at Swan, but it is early days and we remain optimistic," CEO Tony Makuch said. That's a bit of a disappointment to some.

As I look at the new Kirkland/Detour combination, I still like it as an investment even though it will not be the kind of moonshot it had been for me over the past couple of years. It will be too big (a "senior" gold producer), but it will also be more stable. Now that the momentum investors have exited, KL's stock is finding its level and should be less volatile. I expect KL's stock to do very well in this current gold bull market. Detour will be accretive to KL's results. KL will generate a lot of cash, continue to repurchase shares (buybacks were halted last quarter due to the pending deal decision) and increase its dividend. KL announced a 50% dividend hike last month. KL insiders showed confidence in the soon-to-be-merged company with several of them buying shares on the open market at the end of November (including CEO Tony Makuch, who purchased over 8,000 shares). If I didn't already have a large position, I'd buy this stock at these reduced levels.

After adding to my small Hecla position in October, I increased my position again in early November after seeing HL's full Q3 results. Hecla's stock intially fell on the report as computers/algos sold on a "headline" earnings miss. I immediately bought a truckload of HL's stock on the decline (as the computers sold) because I knew (by reading the whole earnings release) that Hecla would have actually handily exceeded analysts' estimates if not for a \$20.1 million "weather delayed" shipment for which the company had received payment in the quarter, but could not recognize revenue. The sale will show up in fourth quarter results. Additionally the (stupid) headline-reading algos missed another key development disclosed deeper in the release – a tentative labor agreement with the Lucky Friday mine's union negotiating committee (subject to member ratification). Lucky Friday had been Hecla's second largest producing mine but had been shut down due to a strike lasting over two years. A couple of years back, I had sold all my Hecla stock position (after accumulating huge gains) because I expected the strike to be long lasting. I stated I would revisit that decision at the first signs the strike may be ending.

I couldn't believe Hecla's stock was down 6% pre-market on the report and I just kept buying and buying that morning, at one point increasing my position by 10x. It turned out to be a great opportunity because over the last three weeks, Hecla's stock has soared over 35%. I have since sold most of those additional shares (booking some significant gains), though I still have a larger position than I did a month earlier. If there's any pullback, I'll likely buy more. That morning on Twitter, I tweeted (in detail) about the error the computer/algos had made.

I own physical gold. I also hold a sizable call option position in the iShares Silver ETF (SLV) with expirations in January 2021. I added more SLV calls last month. I have medium-sized positions in Wesdome (WDO, WDOFF), Hecla Mining (HL), New Gold (NGD) and Osisko Mining (OBNNF, OSK), and smaller sized positions in Bonterra Resources (BONXF, BTR) Franco Nevada (FNV), and Pure Gold (PGM, LRTNF). In next month's letter, I expect to cover my mining positions' Q3 reports.

I continue to hold plenty of cash - largest cash reserves in several years. Some of my cash reserves are in short-term Treasuries and the rest are in low interest-bearing money market accounts. I'm looking to put some of that cash to work, as I believe the gold correction may have ended. The correction lasted 13 weeks (long enough), investor sentiment became negative enough, and the "hot money" Managed Money speculators have lowered their futures contracts positions (by approximately one-third). That should be enough too. Seasonality is very favorable.

In case anyone's feeling sorry for me due to my recent misfortunes – don't be. I'll be in sunny, warm Costa Rica in a few days…unless the flight's cancelled. Here's hoping everyone has a Merry Christmas, Happy Hanukkah and a Happy New Year!

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