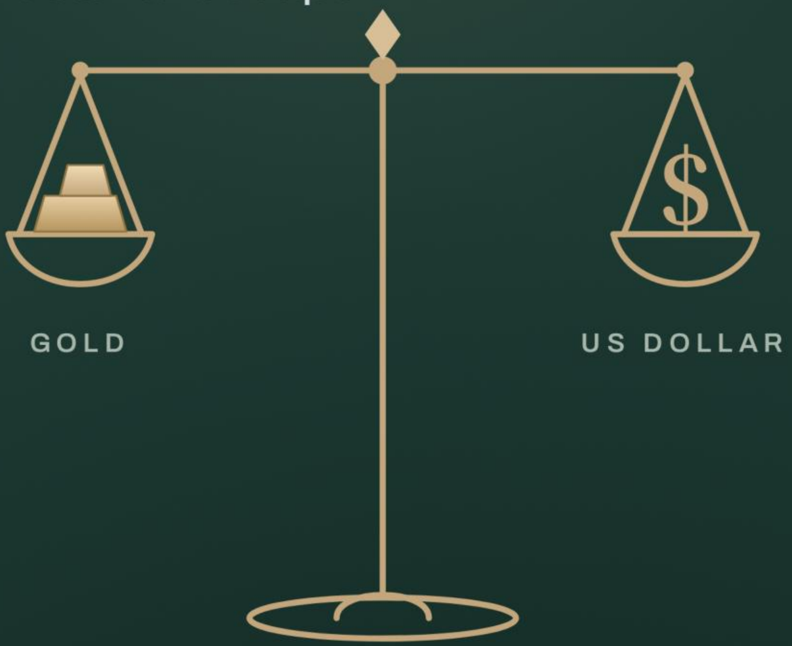
MACRO RESEARCH

Amidst a Regime Change

Gold, the US Dollar and the changing monetary–fiscal landscape.



PRAVIA
INVESTMENT ADVISORS

Amidst a Regime Change 08th Sep, 2026

Executive Summary

The Gold thesis can be divided into **two distinct phases**:

Regime 1: 2018-19

Gold was a contrarian trade because no market participant believed:

- **Past 30-40 years were ones of excessive financialization and borrowing**
- **Ever-expanding money supply would lead to any problems**
- **Declining interest rates inflating asset prices was an abnormal phenomena**
- **Increasing dependence on USD and Western financial system was sustainable**

The system had worked for so long that it created overconfidence among **politicians and investors who believed the increasing financialized system couldn't fail**. Afterall, the US was able to grow its way out of bubbles repeatedly (1999 Dot-com and 2008 GFC). Warning signs were emerging, but there was **little acknowledgement that the system itself could be vulnerable**. Policymakers continued to believe that:

- Monetary policy would be sufficient in managing economic downturns
- Liquidity could always be provided when markets came under stress

Nobody wanted to believe the system could fail despite multiple looming signs which were blatantly ignored by western politicians, investors and policymakers. **Short-term political incentives encouraged politicians to defer difficult long-term problems** rather than address them, allowing vulnerabilities to compound over time, gradually increasing distrust around the USD and the US economy. Simultaneously, the Federal Reserve **simply didn't accept the changing** of facts around them, causing them to fall behind the curve and not know it.

Deteriorating fundamentals for the USD combined with inaction of the Fed caused investors to believe no real problem existed – *made* Gold a contrarian trade with significant upside.

Regime 2: 2026 onwards

Central banks were among the first to recognise the changing environment and increase their gold purchases, followed by institutional and retail investors. Rising gold prices subsequently reinforced investor confidence, driving broader participation. **This turned gold into a consensus trade.**

However, Policymakers (the Fed), which were previously ignorant of the fact, may have become aware of the realities on ground.

We want to highlight parts of **Kevin Warsh's** Jackson Hole Symposium speech which lead us to this conclusion:

1. **Owning up to past mistakes**:

- "The Fed should be ***humble*** and never naïve."
- "It's ***wise to be modest about what we*** can and ***cannot know***."
- "The responsibility for 65 months of sustained, elevated inflation sits squarely with the central bank. ***And that is where it belongs***."

2. **Reiterating the 2% target for inflation:**

- "The Fed's price-stability objective of 2 percent, as measured by the personal consumption expenditures (PCE) price index, ***is a firm, fixed target***."
- "Achieving both sides of our mandate over the medium term is ***not an either/or proposition***."

3. **Confident to achieve target inflation and not providing forward guidance:**

- "At the moment of truth, there are either reasons or ***results***."
- "I'm not alone in noticing that forward guidance in 2021, to cite one example, might well have ***slowed the policy response to high inflation***."
- "I believe when policymakers make quasi-commitments on interest rates through the cycle, we ***inhibit our own freedom to make the right calls*** when it's time to decide."

These remarks by Kevin Warsh show a **regime change**. Acknowledging 65 months of Fed incompetence, being humble, and not providing forward guidance – all make us believe that Warsh is ready to fight to restore the Fed's credibility, and with that, the dollar.

This ***makes*** the case for Gold to be a consensus trade:

- It is currently a crowded trade – limiting the case for a **linear** upside going forward. We cannot expect Gold in the future to rally the same way it did in the past.
- Short term path is uncertain as the likelihood for US to hike rates is higher now.

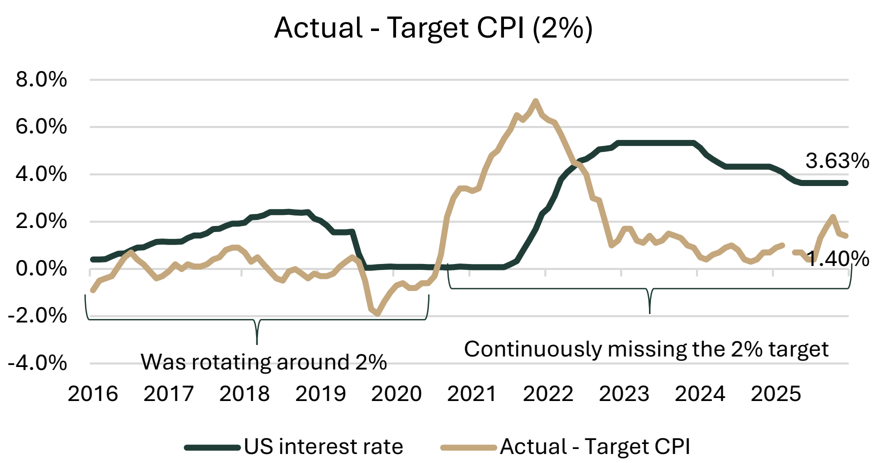
While we remain constructive on the long-term trajectory of gold, the short-term trajectory looks uncertain. We also believe Indian equity markets are well positioned going ahead, in continuation of our Nifty-to-Gold ratio note in Jan 2026. We are reiterating our "Hold" call on precious metals for portfolios with an existing commodities allocation, following our initial profit booking in silver in Jan 2026 and our subsequent "Hold" call in May 2026. Contrary to current consensus, we believe precious metals deserve a reasonable allocation in portfolios – *not overweight*.

Our view on Industrial metals however, is more positive. We believe decades of underinvestment, deteriorating ore grades and significant future demand can drive prices of industrial metals higher. We would like to allocate via Indian listed equities when our price arrives, and global mining companies – which offer relatively attractive valuations.

Detailed Note

Historical context

Ever since Covid, the Fed has been behind the curve. They have been slow to react to increasing inflation and essentially let go of their 2% inflation target. After interest rates bottoming in covid, inflation has increased significantly since.



Source: Investing.com

Pravia Insights

The brown line is the differential between actual inflation and target inflation:

Pre covid, this line was hovering around 0%, implying inflation was as close to target.

Post covid, interest rates were kept too low, leading to high inflation. This led to inflation targets being missed for a period of over 5 years, as inflation is still not close to 2% for the US

Covid was the perfect time to be allocated towards the de-dollarization theme as the world believed Fed had the situation under control when, in reality, it didn't. Gold and Silver had 2 significant levers for price appreciation:

1. Bottoming interest rates (close to 0%) weakened the dollar and benefitted commodities
2. Fed's credibility was questioned, deteriorating trust as the earlier Fed governor stuck to his stance on interest rates ***even though it was not working.***

The 2nd point in particular was, at that time, hard to believe, which is why Gold and Silver were **relatively uncrowded trades** at that point in time. Today, this theme of de-dollarization is something most investors are aware of, and believe in, making it a **crowded trade**.

In the recent Jackson Hole symposium, Kevin Warsh showed humbleness, by admitting how the Fed had been behind the curve over the last 65 months, and simultaneously was confident that the Fed under his chairmanship ***will reach the 2% inflation target*** **–** a move which spiked the probability of a 25-bps Sept-26 rate hike from 35% to 70%. Higher interest rates can lead to:

- Sideways movement in Gold and Silver over the short term
- Strengthening of the US Dollar over the short term

Both of which are positives for the US. However, it will also lead to:

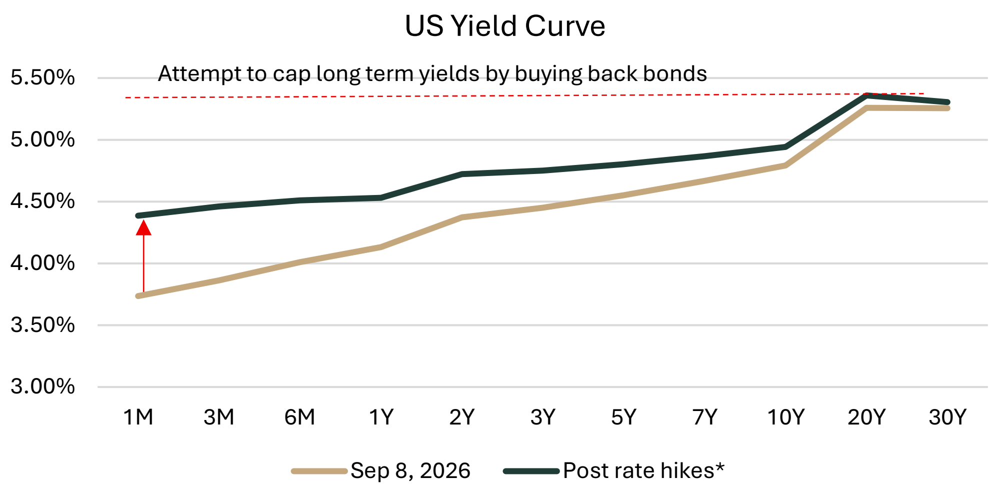
- Increased interest payments
- Halt/slow down re-industrialization of the US economy

Both of which will have negative medium-to-long term implications for the US economy.

<u>Current scenario</u>

There is now an intricate ongoing battle between the US Dollar and Gold, the outcome of which will create implications for the world. A number of recent policy actions can be interpreted through the lens of preserving dollar demand and maintaining Treasury-market stability. Multiple global events are leading us to believe that the US is not ready to let the dollar give up its reserve currency **<u>just yet</u>**:

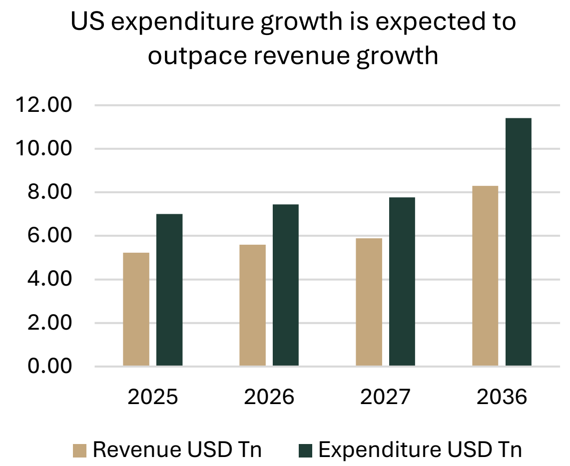
1. US intervened to buy Japanese Yen to help Japan maintain its currency level, and in the process **made sure Japanese Central Bank doesn't decrease its UST holdings aggressively.**
2. US intervened in its own bond markets by buying 30-year US government bonds to cap yields to contain interest payments.
3. Kevin Warsh in his Jackson Hole speech came across humble and acknowledged mistakes made by the Fed over the last 65 months and <u>confidently stated</u> that necessary steps will be taken to get inflation within control and that the target will be 2% inflation (July PCE was 3.7%) - ***Implying possibility of rate hikes. This can strengthen the USD but also increase interest payments.***

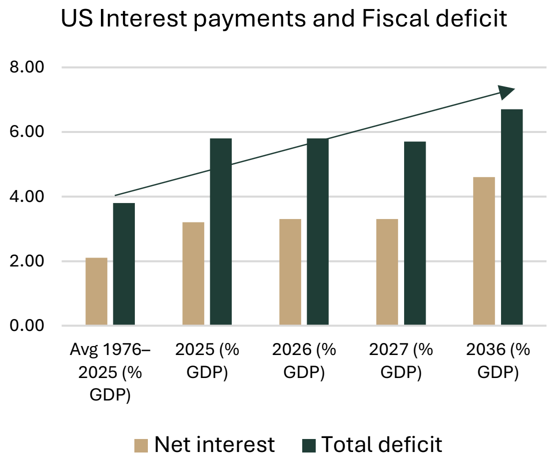


**Post rate hikes are purely illustrative and potential in nature*

However, the US has multiple ***structural*** problems which aren't acknowledged:

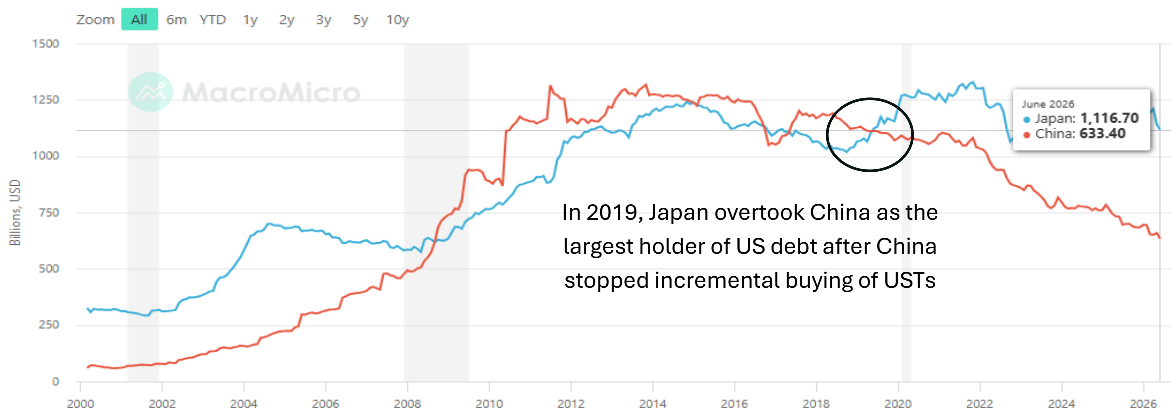
- US government spends much more than it makes – Expenditure is $1.85 Trn **more than revenue** in 2026, and expected to be $3.12 Trn more than revenue by 2036. They tried to cut unnecessary expenditure via the DOGE, which ultimately failed.
- Trump is trying to bridge this gap by increasing short-term revenues **from Tariffs**, a decision which has consistently gotten contested and worsens relationships with its trading partners – leading to de-globalization and each country reshoring manufacturing.



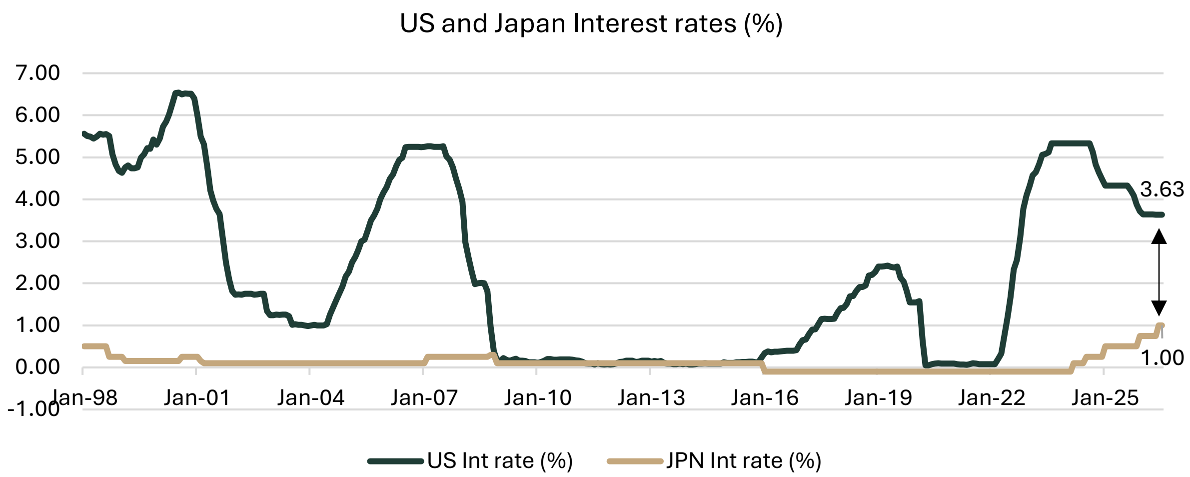


2027 and 2036 figures are projections. Source: Congressional Budget Office

The excess expenditure has to be funded by debt, and for US to be able to raise large amounts of debt, it needs to have major international institutions (other countries) *wanting* to buy its debt.



Since there are very few countries capable of holding $1+ Tn of US debt, US cannot have a situation where its largest international debt holder is forced to decrease the US bond allocation in its portfolio – leading to interventions in the currency markets.



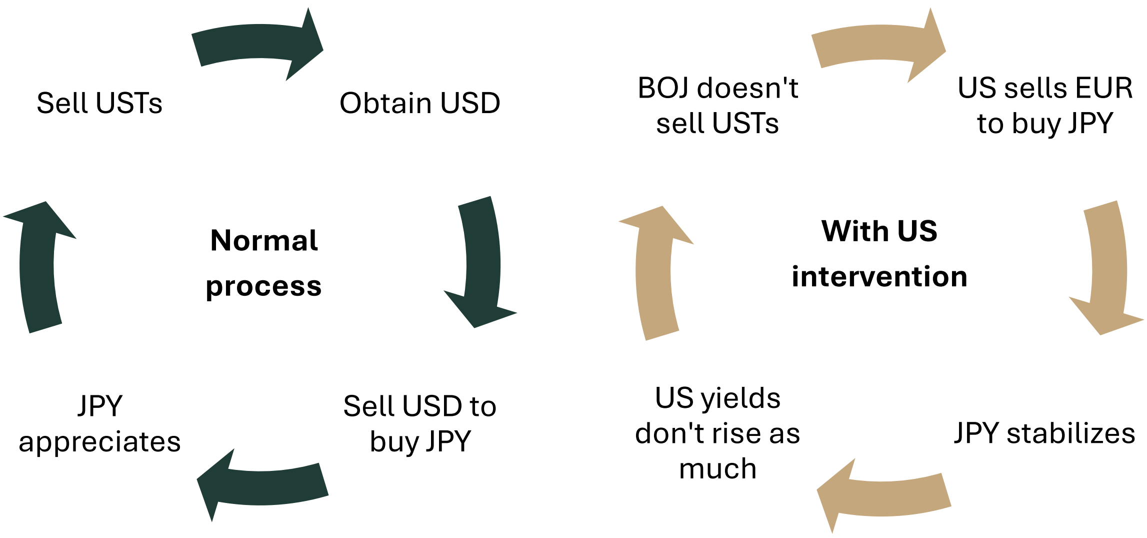
<u>US was involved in 2 major interventions in the past month:</u>

1. Co-ordinate with BOJ to buy JPY in order to stop US yields from increasing further:

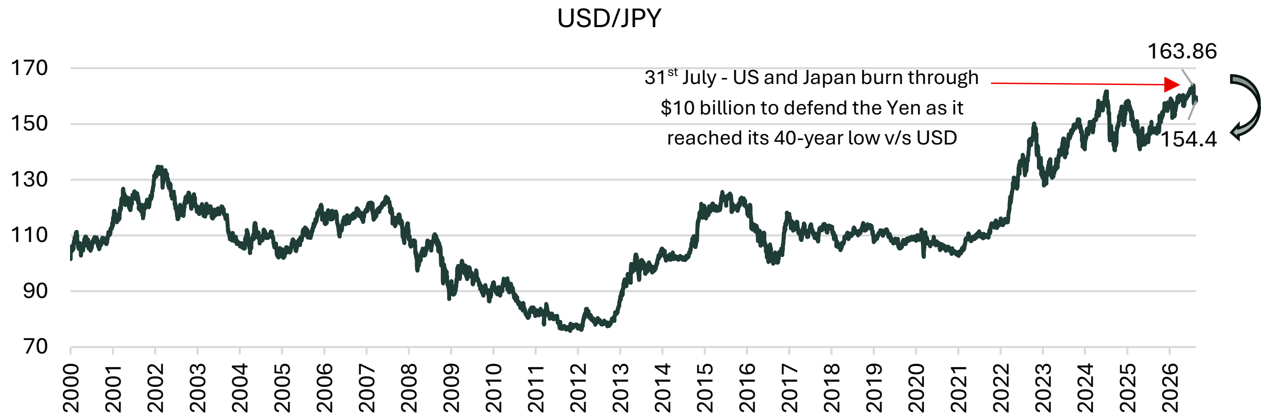
Currently, Bank of Japan (BOJ) is stuck between 2 very difficult choices:

A. **Increasing interest rates** – which it cannot afford as it will mean making higher interest payments on its ~$9 Trn debt.
B. **Keeping rates as is** – which will lead to its currency depreciating significantly as interest rates aren't high enough (relative to the US) to entice purchase of JPY. Recently, **JPY reached its 40-year low** vs USD due to the high differential between USA and JPN interest rates.

The yen hit around **¥164/$**, **<u>a four-decade low</u>**. Japan had to intervene as a weak yen was raising import costs and inflation. Normally, to buy yen, Japan would sell USTs to fund the JPY purchase. However, with UST yields increasing, the path taken was a different one – US bought JPY by selling EUR.



JPY: Japanese Yen, USD: US Dollar; BOJ: Bank of Japan

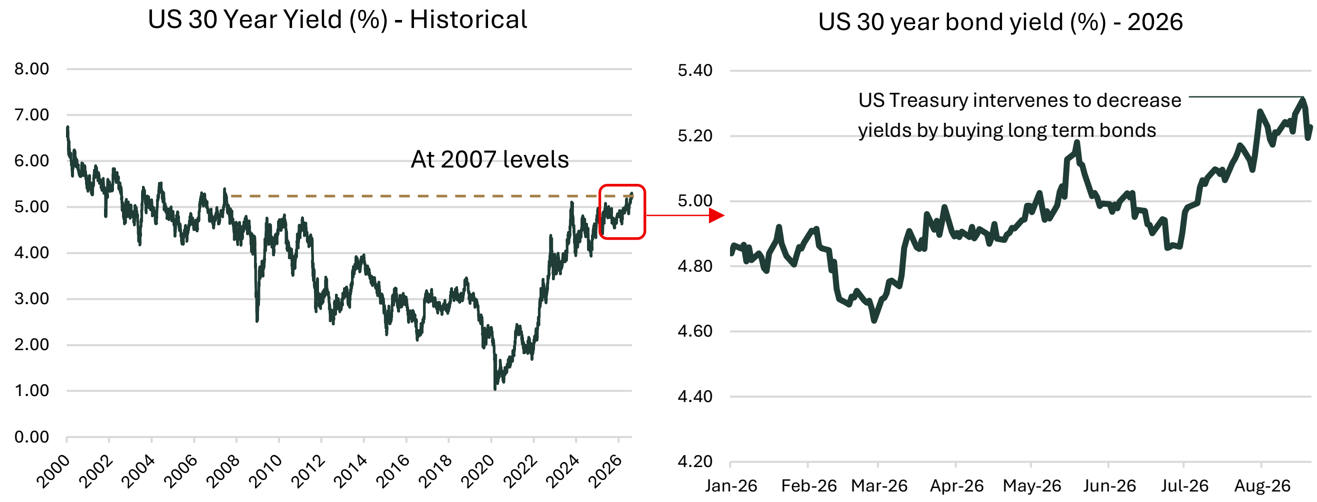


Source: Investing.com

2. US intervenes in the bond market to control yields by buying long term bonds and selling short term bonds to control long term bond yields

Long term yields are however, driven by concerns over fiscal spending. Currently, for the US, fiscal uncertainty is increasing as the **national debt has crossed $40 Tn.**

The US faces limited scope to meaningfully reduce its debt burden without significant fiscal adjustments. Politicians are likely to continue to be focused on their objectives and short-term goals, while delaying solutions for long-term problems for their successor. Total interest payments have already crossed total defence budget for the US, and is likely to cross healthcare and social security budgets as well. **It is stuck in a situation where it cannot lower rates due to high inflation, but has to cut rates to lower interest payments.**



Source: Fed StLouis, Investing.com

The US treasury has announced that it will at least double its liquidity-supporting buyback operations to $4 bn for Treasury instruments having a maturity of at least 10 years. Buying back longer term bonds to contain yields seems like a short term fix to a structural problem.

Options for the US going forward:

Both the measures taken **do not address the structural underlying problem of ever-increasing spending.** To solve this $40 Tn+ debt problem, the US may have to:

- **Try to grow its nominal GDP faster than its debt –** US will try and increase economic productivity using AI, but outgrowing debt can result in inflation to be higher for longer.
- **Continue using tariffs as a continuous source of revenue -** Which can be lucrative for the short term but will be counter-intuitive in the long term.
- **Leverage geopolitics for acquiring commodities/real assets –** US is likely to use its geopolitical position to secure access to key commodities – ***as proven in the recent oil deal with Venezuela.***

Market Vulnerabilities – lessons from 1929

Sooner or later, US' intensifying sovereign debt crisis is likely to set off a serious bout of stock market volatility. The current environment in equity markets looks very similar to the lead up to the great depression in the 1920s:

Metric	1920s	2020s
Leverage	Speculative leverage	Margin debt, options & leveraged products
Concentrated market rally	Radio, Auto, telecom	AI and related infrastructure
Tarrifs	Smooth-Hawley tariff act in 1930 post 1929 crash	Renewed tariff regime
Narrative	Rising belief in a "new era" of permanently higher productivity and profits	Rising belief that AI will permanently transform productivity and corporate earnings

The parallels extend beyond the headline similarities. In 1929, economist Roger Babson warned that excessive borrowing and speculation had made the market vulnerable, even as a small group of stocks continued to rise while broader market participation weakened. Today, leverage through margin debt, options and leveraged products, combined with increasing concentration in AI-related stocks, creates a similar vulnerability.

The technology narrative also bears similarities. Radio was the defining technology of the 1920s, with Radio Corporation of America (RCA) emerging as the era's glamour stock as ***investors priced in virtually unlimited future growth***. RCA went from $1.5 per share in 1921 to $115 in 1929, ***only for it to decline back to $2.5 in 1932*** (source: 13D research). Today, AI occupies a similar role, with a small group of companies and the infrastructure supporting them accounting for a disproportionate share of market enthusiasm. **The technology itself can be transformative** *while the valuations attached to its perceived winners can still become excessive*.

The sequence around tariffs is also instructive. The Smoot-Hawley Tariff Act of 1930 sharply raised US import tariffs in an effort to protect domestic industries, ***triggering retaliatory tariffs*** and contributing to a contraction in global trade. Today's renewed use of tariffs similarly introduces uncertainty around trade, investment, supply chains and corporate margins.

Perhaps the most striking parallel is the disconnect between warning signs and market confidence. In 1929, economist Babson warned that excessive borrowing and speculation were building systemic risk, while prominent economist Irving Fisher argued that stocks had reached a "permanently high plateau." The market continued higher before ultimately collapsing. Eventually, concerns around fiscal deficits, rising debt-service costs and elevated equity valuations can overpower the strong optimism around AI-driven growth, ***which would completely flip the narrative towards pessimism.***

Our View on Precious metals:

Gold in 2018 was an under-allocated asset class, and recommending it was a contrarian call. Today, we are in a very different environment. Gold has moved from being contrarian to consensus, as central banks, pension funds and emerging-market investors all becoming significant buyers.

More importantly, **the Fed itself has undergone a regime change under Kevin Warsh.** The ignorance that characterised the previous cycle looks unlikely to be repeated. Warsh has been clear that the Fed must take responsibility for inflation and cannot afford to repeat the policy mistakes of the past. ***This makes it unlikely that the Fed's actions will simply allow gold to continue its linear rise alongside a weakening USD***. As the world's most powerful monetary authority, the Fed has both the incentive and the tools to push back through tighter policy and stronger financial conditions.

This creates an important distinction between the **short-term and long-term outlook for gold**. In the short term, the ***Fed's changed reaction function can create meaningful headwinds for precious metals***. Gold is no longer moving in an environment where policymakers can remain ignorant while inflation, currency weakness and financial excesses build. We should therefore expect greater volatility and periods of consolidation rather than extrapolating the recent pace of gold's rise.

Our long-term thesis, however, remains intact. The underlying fiscal position of the US has deteriorated significantly, and some of these problems **may already be difficult to reverse. For the USD to regain the strength it enjoyed over previous decades** would require more than a change in monetary policy **– it would require a sustained change in fiscal discipline** and, importantly, **a change in the behaviour of politicians**.

For the US to solve the fiscal problem, there are 2 steps that have to be taken – acknowledgement and action. Kevin Warsh has **partially acknowledged the problem**, come across humble and showed willingness to make the difficult calls – which makes us conscious and watchful in our approach at this point in time.

Recommendation

We would therefore maintain our existing precious metals allocation at a reasonable level of around 5-10% of the total portfolio depending on clients' risk appetites, rather than increasing exposure or moving overweight at this stage.

For portfolios with no existing allocation, we would recommend gradually building exposure through monthly purchases over the next 12 months.

Our view on Industrial Metals:

We believe industrial metals might do well ***despite*** the prospect of higher interest rates. Conventional logic says higher rates hurt metals – a stronger dollar, higher carrying costs, slower demand – but that holds only when demand is driven by the business cycle. Here it is **driven by policy and security**: mandated, funded, and largely **indifferent to the cost of capital**.

- **Re-industrialisation and reshoring** – new factories, and above all the grid and power infrastructure – are copper and aluminium intensive, and are being built to strategic timelines, not to the cost of capital.
- **Defence rearmament** – a structural, multi-year upcycle in military spending across the West and Asia – is metals-heavy and funded from national-security budgets.
- **The physical AI build-out** – data centres and the electricity to feed them – is emerging as one of the largest new sources of copper and power demand of the decade, and it is being funded regardless of rates.
- **The scramble for critical minerals** – as nations race to secure supply chains, they no longer trust – adds a layer of strategic, non-economic buying on top of ordinary industrial demand.

Crucially, this demand meets a supply base that is left:

- Structurally tight by a decade of under-investment,
- Declining ore grades, and
- Amidst resource nationalism, with new mines taking the better part of a decade to come online.

Recommendation

We suggest adding copper miners as the first step towards building our global equity allocation. We will be releasing a detailed initiating investment note on the same, covering the underlying demand drivers, constrained supply outlook and the investment case.

We believe an allocation to industrial metals is becoming increasingly important for client portfolios. The demand outlook is supported by multiple structural trends, including electrification, energy transition, data centres and AI infrastructure, defence spending and broader infrastructure investment. At the same time, copper supply faces increasing constraints from declining ore grades, long project development timelines and limited new mine investment.

This creates a favourable long-term supply-demand backdrop for copper and, by extension, high-quality copper miners. We therefore see copper miners as an attractive way to initiate global equity exposure while gaining participation in a structural industrial metals opportunity.

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