Weekly Market Summary

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What Do a Persisting USD Sell-off & Gold Rally Tell Us? Not a Positive Story if You Ask Me!

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Latest Update on Coronavirus: Confirmed cases last at 19.30 million, with the death toll from the pandemic at 718,290. India reported a record number of daily cases, pushing the total in the country to above two million. In Europe, British tourists face more disruption amid reports France may be next on the UK list of countries hit by travel restrictions. Germany's economy minister says a recent uptick in cases could threaten a nascent recovery, highlighting concerns about a resurgence of the virus. And negotiations on a new US relief bill edged toward the brink of collapse after a meeting between White House officials and top Congressional Democrats ended with each side accusing the other of being unwilling to compromise, whilst the biggest issues remain far from resolved!

In past weeks, market focus – and ours – has shifted to two major developing market trends, namely persisting US Dollar weakness as well as a relentless rally in gold prices. Indeed, as July drew to an end, a gauge of the dollar against its biggest peers dropped by 4.5% for the month – the worst rout in a decade. Gold prices, on the other hand, witnessed a $200/ounce (or 11%) surge during the same period, flirting with the $2,000 psychological level (closing the month at $1973. Last at $2,060!!). What makes the behavior of the US dollar particularly ominous this time around is that the world's key currency is sliding not only against commodity benchmarks – such as gold and silver – but also against other measures of value including different major currencies.

A general depreciation of the US dollar is usually rare and the message behind this latest dramatic move is very clear: The US economy (and to a lesser extent, the world economies) is somehow in big trouble and the supremacy of the greenback is now quite uncertain! That is a rapid reversal in fortune in a short period of time; Early on in the pandemic, the dollar was soaring after investors sought safety in US assets like T-bills and Treasuries!

To better comprehend the multiple forces at play, below is a recap of recent market contributors to the US Dollar / Gold rapid moves:

- **A Sharply Diminished Global Leadership:** The Trump administration's protectionist trade policies over the past few years - including the US withdrawal from the architectural pillars of globalization such as the Paris Climate Agreement, World Health Organization, Trans-Pacific Partnership and traditional Atlantic alliances – clearly implied that the era of the US dollar's privilege as the world's primary reserve currency would soon be coming to an end.

- **Poor Handling of the Covid-19 Pandemic:** "*The Trump administration has mismanaged its pandemic response effort from the start. From ignoring public health experts to misinforming the public about the virus to attempting to silence federal watchdogs*" - 06/08/2020, Accountable.US; "*You now have China on the list of countries that can enter the EU and not the US … That speaks volumes symbolically!*" – Ellie Geranmayeh, senior policy fellow at the European Council on Foreign Relations. The US failure to get the coronavirus under control is disconcerting and most experts worry that it will have a lasting damage to America's standing and become a burden for the US currency.

- **A Divided Nation and Fast Deteriorating Living Standards:** "*Donald Trump is the first US President in my lifetime who does not try to unite the American people – doesn't even pretend to try. Instead he tries to divide us*" - 03/06/2020, James Norman Mattis, former US Secretary of Defense. Additionally, US living standards are about

to get squeezed as never before; A profound shortfall in domestic US savings that was glaringly apparent before the pandemic, coupled with a Covid-19 induced recession (the world's biggest economy shrank at a record 32.9% annualized pace in the second quarter) and record job losses, means that citizens that were living paycheck to paycheck will simply not have financial cushion to absorb a shock of this magnitude. Further jobs' vulnerability will lead to reduced income, furloughs or renewed layoffs, potentially affecting up to one-third of the entire US workforce and necessitating immediate government assistance to pay the rent and put food on the table!

- **A Swift/Sharp Monetary Response from the Fed and Collapsing Real Yields:** In past months, the US Federal Reserve has responded aggressively to market strains and the sharp drop in the economy caused the coronavirus pandemic, cutting short-term rates nearly to zero, buying hundreds of billions of dollars of Treasuries, mortgage-backed securities and lately corporate bonds. As a result, US Treasury yields – both nominal and real - have fallen to close to record lows (US 10-year nominal / real yields last at +0.52% and -1.07% respectively!) That, coupled with exploding government budget deficits, has breathed new life into the search for an alternative store of stable value over the near & long term at a time the Fed is purchasing so much of the US government's record debt sales (effectively printing money, debasing the greenback and dimming its allure as a safe haven!)

- **A Successful EU Agreement on a Massive Stimulus Deal to Bind Continent Together**: European Union leaders lately agreed on an unprecedented stimulus package worth EUR 750 billion euros (US$ 860 billion) to pull their economies out of the worst recession in memory and more importantly tighten the financial bonds holding their 27 nations together. The latter is a strong display of European unity and serves as a validation that the EU bloc is now willing to offer meaningful solidarity to members in need. Over the medium term, it also marks a major step toward further economic integration and will be seen by markets as EUR positive (i.e. stronger Euro against the US Dollar, last at $1.1813, close to a 2-year high!)

- **Or Simply Coz Goldman Sachs Says So?!** Goldman Sachs' strategists have lately cautioned that US policy (repeated rounds of fiscal and monetary stimulus) is triggering currency "*debasement fears*" that could end the dollar's reign as the dominant force in global foreign-exchange markets. "*Gold is the currency of last resort, particularly in an environment like the current one where governments are debasing their fiat currencies and pushing real interest rates to all-time lows …. There is a greater likelihood that at some time in the future, after economic activity has normalized, there will be incentives for central banks and governments to allow inflation to drift higher to reduce the accumulated debt burden*," wrote Goldman strategists including Jeffrey Currie. They also noted that there are now "*real concerns around the longevity of the US dollar as a reserve currency*." (Always remember to never doubt Goldman, Bill Gates or Dr. Fauci !😊)

One would expect that the gold rally / US dollar sell-off will prevail over the coming months as government / central banks keep doing what they are doing, injecting additional liquidity to markets and squashing real yields even lower (Seth Klarman, a well-known American billionaire investor, hedge fund manager and author, lately suggested that "*investors are being infantilized by the relentless US Federal Reserve activity, as if the Fed considers them foolish children, unable to rationally set the prices of securities so it must intervene .. When the market has a tantrum, the benevolent Fed has a soothing yet enabling response*"!) Risks would only come in a change of central bank behavior, just as the last gold peak in September 2011 turned into a bear market once the Fed started to try to move away from its unlimited asset purchases in 2013. Nonetheless, such a shift looks less likely this time around. Gold does look expensive at current levels, but there is little reason to expect it to fall much anytime soon (outside a potential small technical correction as the relative strength indicator "RSI" signals extreme overbought conditions).

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