

Weekly Market Summary

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Turning Bearish on America and the US Dollar? Better Wait to See if Kanye Runs for President!
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Latest Update on Coronavirus: Confirmed cases last at 12.42 million (from 11.02 million last week), with the death toll from the pandemic in excess of the 550,000 mark (558,092 last versus 524,743 deaths the week before). Japan is forging ahead with further steps to re-open the economy even as daily coronavirus cases continue to climb, whilst Hong Kong lately reported a resurgence of infections that is forcing the financial hub to reinstate restrictions that had been recently loosened, including the closing of schools. In the US, the coronavirus pandemic's merciless march through the Sun Belt (Arizona, Florida, Texas, California, ...) is killing record numbers of Americans there, overrunning hospitals and exhausting supplies!

Kanye West is an American rapper, singer, songwriter, record producer, composer, entrepreneur and fashion designer. His eccentric conduct at awards shows and on social media, coupled with his marriage to television personality and fashionista Kim Kardashian, have been a source of media attention in past years. Last Saturday, Kanye said he's running for President. Whilst it wasn't immediately clear whether the musician was serious, or if it was simply another publicity stunt for himself, his night Twitter post ("*We must now realize the promise of America by trusting God, unifying our vision and building our future. I am running for president of the United States!*") went immediately viral, with more than 100,000 retweets within the first hour (what is the world coming to?! 😞) "*Kanye*" also became the number one trending term on Twitter in the US, prompting Elon Musk – Tesla's boss – to proclaim his "full support" (when a Twitter user later pointed out to West's anti-abortion and anti-vaccination comments, Musk indicated he may be rethinking things!) Over the course of four rambling hours of interviews last Tuesday, the billionaire rapper also revealed that his 2020 presidential bid is for real, the campaign slogan is "YES!", his running mate is Michelle Tidball (an obscure preacher from Wyoming) and his party "the Birthday Party". And why the Birthday Party? "*Because when we win, its everybody's Birthday.*" 😊

On a more serious note, foreign exchange markets are well known for overshooting, both on the upside and downside. A currency that starts moving in a particular direction - as economic fundamentals improve or deteriorate - will often end up at a rate that cannot be justified by the data. This occurrence can easily be explained by the importance of technical, momentum and herd mentality trading. The latter refers to the tendency for individuals to mimic the actions (whether rational or irrational) of the larger trading community - either due to a lack of strong personal convictions on markets, the social pressure of conformity (rather than being branded as an outcast) or the common rationale that it is unlikely that such a large group of smart traders/hedge fund managers could be wrong - and usually leads to catastrophic financial events (take for example the bursting of the internet bubble in early 2000, where a powerful rally in US tech stocks between late 1998 and early 2000 was quickly followed by a 68% drop from the highs over the next 12 months, effectively wiping out the whole rally!). Therefore, trying to make sense of every move in the FX market (as well as changes in other asset classes), or even better trying to define fair values/ranges for particular currency pairs (an exercise I personally enjoyed performing in my early years of trading, before realizing the futility of concluded forecasts!) is akin to world leaders attempting to solve the root of the Middle East conflict!

Previously, it was always assumed that the United States remains the only economy that can absorb currency strength during periods of crisis. As Morgan Stanley's research had put it, the resilience of the US domestic economy was rooted in an internal rebalancing that most of the rest of the world has not yet completed. As such, US dollar strength would be

a reflection of the relative improvement in the US compared to the rest of the world, as well as a conduit for the US assisting the rest of the world in its rebalancing by importing global deflationary pressures.

Lately, however, things have drastically changed; First, it does not help the US dollar that traders have been scaling back their expectations for whether the US Federal Reserve will be able to raise interest rates again over the coming 2-3 years should economic growth improve / inflation surge; In fact, the futures rate market currently anticipates a small 50% chance of an upward 25 bps rate move by December-end 2023. Second, the US administration's failure to contain the Coronavirus pandemic (as well as Trump's dreadful handling of George Floyd death) – not to mention the administration's consistent failure to deliver on major foreign policy initiatives - will only have lasting damage to America's standing. *"You now have China on the list of countries that can enter the EU, and not the US!"*, said Ellie Geranmayeh, a senior policy fellow at the European Council on Foreign Relations. *"That speaks volumes symbolically. We're seeing the real-world consequences of US foreign policy over the last three years, what it has meant and the damage it has done."* The symbolism of such moments is simply inescapable! Last, the US economy is now expected to contract by almost 6% this year, whilst China is projected to witness a growth of almost 2% (still well below the 6.5% annual rate in previous years). That in turn, may further undercut a key source of America's influence, and the very idea at the heart of Trump's foreign policy approach: Using economic might as a weapon!

In a recent Bloomberg Opinion piece, Stephen Roach - a bright American economist currently serving as senior fellow at Yale University's Jackson Institute for Global Affairs and a senior lecturer at Yale School of Management (and a successful former Chairman of Morgan Stanley Asia!) - argues that the era of the US dollar's *"exorbitant privilege"* as the world's primary reserve currency is coming to an end! Already stressed by the impact of the Covid-19 pandemic, U.S. living standards are about to be squeezed as never before; At the same time, the world is having serious doubts about the once widely accepted presumption of American exceptionalism; And currencies set the equilibrium between these two forces - domestic economic fundamentals and foreign perceptions of a nation's strength or weakness. Since this balance is now clearly shifting, a crash in the dollar could well be in the offing. Roach adds that in the absence of domestic saving, and wanting to invest and grow, the U.S. had taken great advantage of the dollar's role as the world's primary reserve currency and drawn heavily on surplus savings from abroad to square the circle; But not without a price! In order to attract foreign capital, the U.S. has run a deficit in its current account (the broadest measure of trade because it includes investment) every year since 1982. Covid-19, and the economic crisis it has triggered, is stretching this tension between savings and the current-account to the breaking point. The culprit: Exploding government budget deficits (according to the bi-partisan Congressional Budget Office, the federal budget deficit is likely to soar to a peacetime record of 17.9% of gross domestic product in 2020 before hopefully receding to 9.8% in 2021)

And that is where the dollar fall will come into play. For the moment, the greenback is strong, benefiting from typical safe-haven demand - long evident during periods of crisis. Against a broad cross-section of U.S. trading partners, the dollar was up almost 7% over the January to April period in inflation-adjusted, trade-weighted terms to a level that stands fully 33% above its July 2011 low, Bank for International Settlements data show. However, since mid-May 2020, the dollar index (DXY) has been consistently losing ground (from 100.50 to 96.50, a 4% drop). The key question is what will spark further declines? According to Roach, as the economic crisis starts to stabilize - hopefully later this year or in early 2021 - realization of America's sharply diminished global leadership and domestic savings could easily result in the US dollar testing its July 2011 lows.

When that happens, one would hope being better diversified - with savings sitting in a multi-currency investment portfolio!

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