

Weekly Market Insights

August 17, 2020

The dollar, gold and the economy

Markets

U.S. equity markets continued to advance these past two weeks. Investors appear, at the moment, to want to put more emphasis in the good or neutral news rather than the bad. The Dow was up 1.81%, the S&P 500 gained 0.64% and the NASDAQ was up 0.08%.

The Economy

There have been a number of very interesting things occurring in the global financial markets during the past few weeks. Gold, of course, has risen to record levels, the U.S. dollar has fallen, the Euro has gained and the developed foreign markets have outpaced the U.S. markets. It is an interesting confluence of events, but all are in some way related. Answering the question about why the powerful advance in gold is a good start.

Gold has always held a great fascination for investors. Typically, gold market activity has been dominated by consumer and central bank demand originating in Asia. The following article from the Official Monetary and Financial Institutions Forum (OMFIF) provides more detail for those interested.

<https://www.omfif.org/2020/08/arbitrage-and-reflation-in-the-gold-market/>

Lately, there have been three important trends. The first has to do with the pandemic. Many trades are done on the futures exchange. When the pandemic struck, severe travel restrictions became the norm, and mines shut down production. This frightened traders, and they scrambled to buy gold because

they feared they could not make delivery. This is most likely a unique occurrence.

The second, is fear that inflation will get out of control. We have written about this threat in the recent past. Nothing has changed. There certainly has been an explosion in the growth of global money supply, but, as we wrote earlier, that alone will not cause inflation. An important monetary statistic to follow is the money multiplier. This statistic measures the turnover of money supply. In other words, it is a very accurate measure of demand. This statistic has been falling, indicating a lack of demand. Under these circumstances inflation is not a threat. Can it become so? Yes! The Federal Reserve has shown its wisdom in the past, and it will be their job to start to withdraw money from the system as monetary turnover begins to accelerate, which we have confidence they will do. As in the famous words of William McChesney Martin, former chair of the Federal Reserve Bank, "The Federal Reserve ... is in the position of the chaperone who has ordered the punch bowl removed just when the party was warming up." Although an excess of money supply is an important criteria for inflation, demand is an equal part of the inflation equation.

The third is far more interesting and unlikely but deserves to be addressed. It is the fear for the future of the U.S. dollar. Will the dollar lose its status as the world's most important reserve currency? This fear is generated by the people who have always turned to gold. The United States currently has a high debt to GDP ratio and an

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exceptionally divisive political situation. During these times, people throughout history have turned to gold. Dickens talks about the debased French currency in *A Tale of Two Cities*, and in 1928 George Bernard Shaw wrote in *The Intelligent Women's Guide to Capitalism and Socialism*, "You have to choose between trusting to the natural stability of gold and the natural stability of the honesty and intelligence of the members of the government, ... I advise ... vote for gold."

We include this because it is amusing and accurately describes the views of many gold bugs. But, this is very unlikely to happen. The United States has the most respected politically independent central bank in the world. The country

continues to have the strongest economy that publishes accurate and timely economic data. There is just no competitor.

At least for the foreseeable future, the United States will remain the most important reserve currency in the world.

As an interesting aside, the World Trade Organization (WTO) is going to elect a new president very shortly. The two front-runners, Ngozi Okonjo-Iweala, from Nigeria, and Amina Mohamed, from Kenya, both agree with the United States' view that the WTO direction must change. If either is chosen, it could be quite positive for both U.S. trade and employment.

Michael Olin Clark moclark@1919ic.com | Ryan Schutte rschutte@1919ic.com

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