

The increasing “strength” of the US dollar will trigger its own destruction in favor of gold and silver!

Low or negative interest rates (unprecedented) are intended to make the currency less attractive and boost exports

Normally, central banks stimulate spending by lowering the real interest rate, nominal interest rate minus inflation. With inflation now close to zero or lower in many countries, because of lower overall demand, negative nominal rates are “needed” to make saving unattractive (so much for people that try to save for their pensions!). Who cares about the pension companies, those historically need a yearly actuarial yield of 8% to guarantee the pension payouts!

As the Economist wrote, “the best hope for success from negative interest rates lies in foreign-exchange markets” or (competitive) currency devaluations. Something Greece can’t do (yet) because it is still part of the Eurozone. The hope is that negative rates might send investors in search of better returns abroad, with the US dollar as the most favored currency, whilst leading to depreciation of their own currency. The idea is that a depreciated currency will raise the price of imports, helping to combat deflation and giving a growth-enhancing boost to exporters.

Sweden led the way below zero for a brief time in 2009 and 2010, followed by Denmark from 2012 to 2014. On September 6, 2011 the SNB warned that it would no longer allow one Swiss franc to be worth more than €0.83 – equivalent to SFr1.20 to the Euro – having watched the two currencies move closer to parity as Switzerland became a “safe haven” from the ravages of the Eurozone crisis because European savers lost confidence in the Euro. On January 15, 2015 in anticipation of the Eurozone QE the Swiss franc was unpegged.

Last year the European Central Bank introduced a negative interest rate. In June 2014 the European Central Bank (ECB) began charging 0.1% on deposits held in its vault, before lowering the rate further to -0.2% in September. Switzerland and Denmark have since, in order to prevent the strengthening of their currencies, both pushed their key policy rates to minus 0.75% whilst Sweden pushed it to minus 0.1%, unprecedented moves in modern times.

Currencies in general reflect a combination of the health of the economy, the current account surplus of a country and its interest rates. The current account is the sum of the trade balance (exports less imports), net income from abroad

(from corporates and individuals) and net current transfers (capital transfers); as the trade balance is generally the largest of these components, a current account surplus usually implies that the nation is a large exporter and has a positive trade balance. And since the currencies are the real yardstick of wealth and purchasing power investors prefer the safety of a strong or strengthening currency to preserve their wealth. Another important factor determining the current account unquestionably are the nominal (and real) interest rates which of course have to be considered in context with the fundamentals of and the outlook for the economy of the specific country.

Some German banks are now also charging for large deposits, and in the U.S., J.P. Morgan Chase will do the same, although in the US the Federal Reserve has stayed on the positive side of zero and even looks set to raise rates this year depending on the economic situation. About 16% of the world's government bonds now carry negative yields, meaning for safety reasons investors are willing to pay to lend to those governments. About \$3 trillion of assets in Europe and Japan, at maturities as long as 10 years (in the case of Swiss government bonds), now have negative interest rates! You have to ask yourself what does that tell you about the value of money and the conditions and strength of our economies!

Though the main question is: will it really work when everybody is following the same policy? Of course not! Next to that it causes huge currency movements.

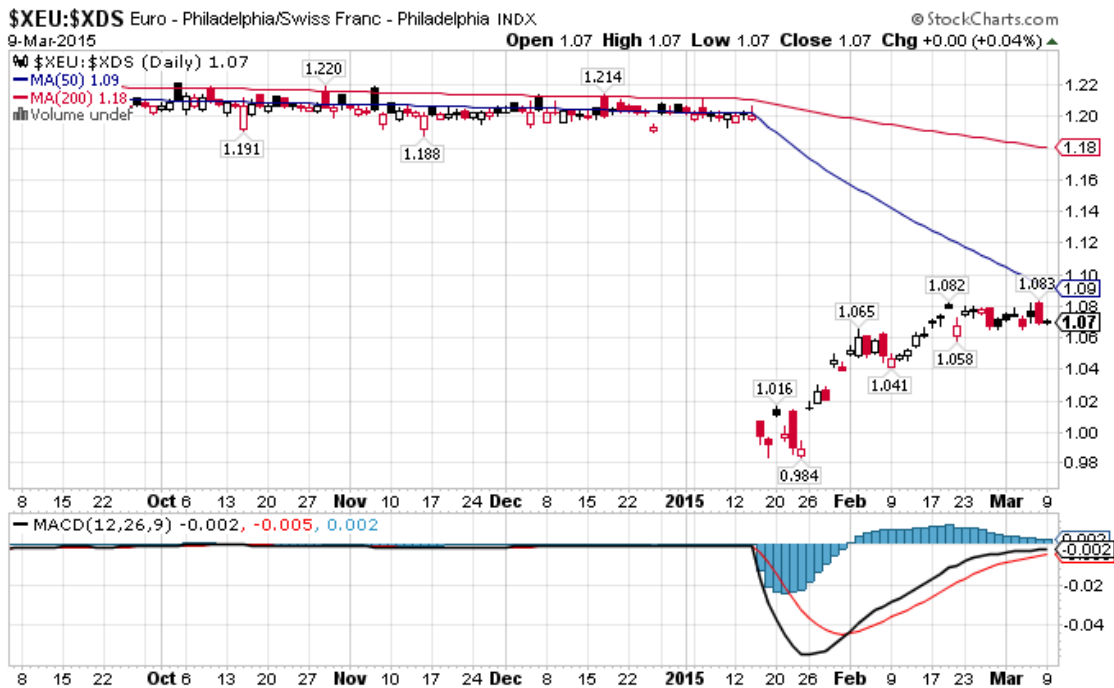
Central bankers hope that moving into negative territory will boost their economies by hopefully increasing the velocity of money and improving the country's export position through currency devaluation. Though the rest of the world is in a similar situation and the hope of kick starting the economy in a sustained fashion is therefore unrealistic in my point of view. If anything it will create a downward vortex of the value/purchasing power of the currencies: the competitive currency devaluations. If people didn't have confidence at historic low interest rates do you believe they will have more confidence when the interest rates are negative? Of course not, if anything it is a signal that things are not working and that the authorities are desperado. You can bring a horse to the water but you can't make it drink and especially not when the water is polluted!

I think if we are looking around the world we see that many economies are in similar positions and that as a result of the strong currency movements following QE in Japan and the Eurozone some major disruptions are taking place.

Since the ECB introduced negative deposit rates the Euro has fallen against the US dollar by more than 20%. In fact if we look at the USD index chart (see below) we see that against the most important world currencies (Euro, Yen, Sterling, Swiss franc etc.) the index has risen by 23% from 80 in July 2014 to 98.50 by March 10th 2015 a new 12 year high and the fastest surge since 1981.



When the Swiss abandoned the peg to the Euro the Swiss franc broke past parity against the Euro to trade from Euro/CHF 1.20 to 0.85 +29% before trimming those gains to trade 13% higher at Euro/CHF 1.04, the Swiss franc gained 25% against the U.S. dollar, before falling back to trade around 12% higher at USD/CHF 0.901.



These movements are huge considering the size of the foreign exchange markets and the specific currencies involved. Global daily foreign exchange transactions are estimated to amount to approximately \$5.3trn so imagine the size of the transactions that take place to move these currencies between 12% and 29%. In any case these movements could potentially create huge disruptions between countries, see below.

Anyway since most countries are trying to boost their exports following the same strategy by lowering the attractiveness of their currencies applying zero or negative interest rates it is unlikely to have any significant effect. If anything it will accelerate the deflationary forces in the system creating the opposite of the desired result.

The US dollar, the reserve currency, is rising by “default” because there are no alternatives to the devaluing currencies except gold and silver

The flipside of this flow of funds or carry trade is that investors direct their money from low yielding bonds (Yen JGB, Eurobonds) to higher yielding bonds (US treasuries) in concurrence with a “strong safe” currency: the US dollar, the reserve currency. It is mainly by lack of alternatives, and thus by default, that all the funds flow into the US dollar. Hence why we have witnessed the incredible rally in the US dollar up 23% since July last year. Though as we have mentioned here above these movements are very distorting and especially when it involves the two largest currencies in the world because of their impact.



According to this chart the surge into 2001 in hindsight was a 50% retracement of its 1984-1992 bear trend. The main question now is if the current move is another 50% or perhaps Fibonacci correction of the 2002-2008 bear trend or will we regain the 120 level?

The ramifications of the strong dollar

I want to stress here that the main reason we see the flight into the US dollar is the fact that most of the world is close to or experiencing deflation, i.e. more supply than demand of goods, services, commodities (see oil, iron ore, copper, lumber, Baltic dry index etc.), which resulted in reduced interest rates which in turn translated in the deflation/devaluation of the currencies. In other words we have to look at the current dollar strength being caused by default, because it is the reserve currency investors flee to, following the oversupply or deflationary situation in the global economy, and the lack of alternatives. It is all interrelated!

In general when there is oversupply demand needs time to catch up to work off the oversupply though that is highly unlikely this time because of the overwhelming debt levels that are increasingly depressing demand (43% of Japanese tax revenues are used to just pay the interest on government bonds) and causing deflation and devaluation of the currencies.

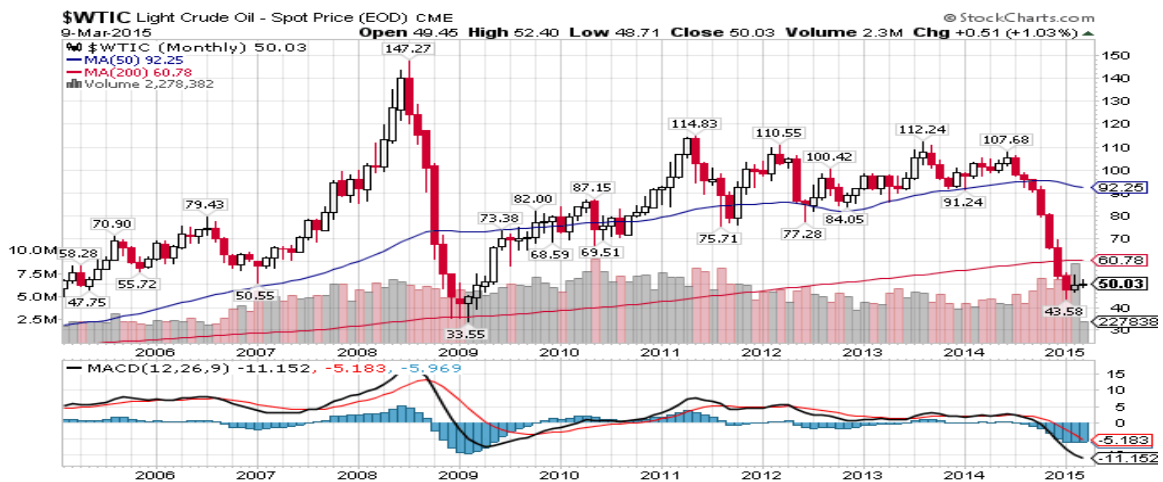
The effects of the sheer strengthening of the US dollar (a new 12 year high and the steepest surge since 1981, with especially the steepness that is difficult to hedge or adjust to) and its ramifications can in my point of view be summarized as follows:

1. **Inverse correlation with commodities:** Since all the commodities are expressed in US dollars, and thus are inversely correlated, they face price

pressures because a stronger dollar forces prices down. As a result we see resource (oil, hard commodities) currencies from countries such as Venezuela, Nigeria, Iran, Russia, Brazil, Australia, Canada, Chili really suffering from the much lower oil, copper, iron ore and coal prices.

Since the start of 2015 the Brazilian real has fallen by an astounding 14.5% to an 11-year low. The Brazilian real, one of several emerging market currencies to come under pressure in recent months from sliding commodity prices, a stronger US dollar and domestic economic weakness and rising political risk related to corruption at state oil producer Petrobras which could threaten President Dilma Rousseff's fiscal austerity plan. Things are often being pulled apart when the music stops.

Contrary to all other currencies like the Euro, Yen, and Swiss franc etc. only the US dollar has this dramatic effect on the earnings of companies and countries that are reliant on US dollar priced commodities. Hence why the fluctuations in the US dollar have such a dramatic impact compared to movements of other currencies.





2. **More expensive dollar loans for EM countries:** The prospect of rising U.S. yields is drawing funds away from emerging markets, causing strains from Brazil to Turkey. The Brazilian real led the rout, having fallen for the sixth straight session. The pressure also spread through Asia with the South Korean won hitting its lowest since late August 2013 and the Singapore dollar its lowest since 2010. Eastern Europe was also heavily in the red. Selling accelerated for Poland's zloty, Romania's leu and Hungary's forint and MSCI's main emerging market stock index. The MSCIEM fell 1%, down for its eighth day running.



The EM (Emerging Market) countries have large loans in US dollars because investors in general feel more comfortable to loan these countries in US dollars, the reserve currency, than the less secure local currency. As a result of the 20%+ stronger dollar these countries now see

the amount of their loans and the interest rates expressed in their local currency increase by 20%+. These are huge moves and bring these EM countries in a very vulnerable situation. According to the Bank of International Settlements in early December, at mid-2014 non-bank borrowers outside the US owed \$9 trillion of dollar denominated debt, a 50% increase since 2008. Of this \$9 trillion, \$5.7 trillion (split between \$3.1 trillion in bank loans and \$2.6 trillion in bonds) is in emerging markets, mainly in the form of corporate bonds and international bank loans to companies. This includes \$1.1 trillion of dollar debt in China, more than double its amount at the end of 2012. Most of emerging market dollar debt is corporate and not sovereign. There is the risk for a sell-off in emerging market bonds, leading to conditions like in 1997. The multi-trillion dollar carry trade may be on the verge of unwinding, meaning capital fleeing the periphery and rushing back to the US. Much of the debt was taken out at real interest rates of 1% on the implicit assumption that the Fed would continue to flood the world with liquidity for years to come. History suggests that severe accidents are more likely when the Fed is tightening, and the dollar is rising. Portfolio managers in the global bond market may dump EM debt very quickly as interest rates begin to rise, forcing some EM corporates to buy dollars to redeem maturing debt. This could push the dollar higher, tightening monetary conditions even more. It becomes a self-fulfilling prophecy.

- 3. Translation losses are mounting for US companies that have foreign income impacting EPS triggering more buybacks:** According to data from S&P S&P 500 companies get some 46.3% of sales overseas (Pfizer 62%, Wynn 72%, Applied Materials 78%) and with much of the rest of the world experiencing economic malaise or worse top-line and bottom-line growth will be very difficult to achieve in 2015. In the last earnings season, the strength of the dollar clearly had a negative impact on earnings guidance by a lot of companies.

The increased buybacks came as plunging oil and a strengthening dollar threatened to stall five years of earnings expansions. Buybacks will boost per-share earnings, with the potential of helping avoid the first back-to-back profit contractions since 2009, according to Yardeni Research Inc.

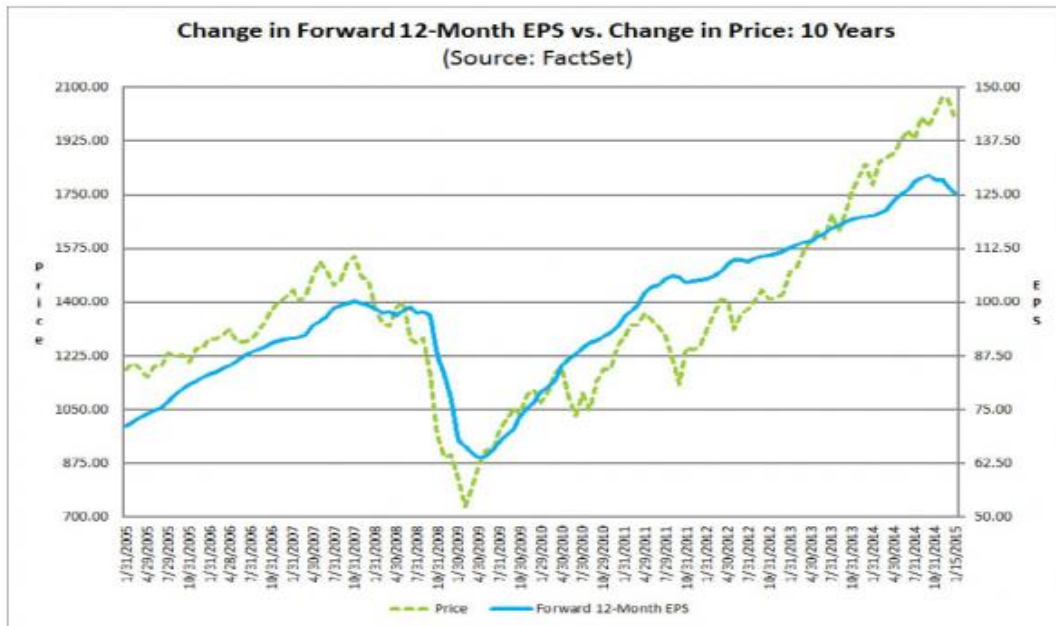
The reluctance of investors to pile into equities has left corporate America the larger source of cash throughout the bull market. Corporations and investors have switched positions as the bigger buyer of stocks whilst

normally when you have a bull market you see big money coming out of lifeboats and chasing yield, yet we haven't seen the mass money come in. Investors have pulled more than \$10 billion out of equity funds in January and February and sent \$38 billion to bonds -- even as companies announced \$132.7 billion more in buybacks. February's total of \$104.3 billion was the highest on record, according to TrimTabs Investment Research. For 2015, to mention a few companies, Ford announced \$5bn, Qualcomm \$15bn and Apple \$50bn.

Buybacks exceeded inflows by \$468 billion in 2014 when the S&P 500 climbed 11% and \$318 billion more in 2013, when the gauge had its biggest advance since 1997. Companies in the S&P 500 have spent more than \$2 trillion on their own stock since 2009, underpinning an equity rally in which the index has more than tripled. S&P 500 companies currently hold \$1.75 trillion in cash and marketable securities, data compiled by Bloomberg show. Instead of only looking at the asset side of the balance sheet I believe it is prudent to also look at the liability side, in other words what funded the cash, retained earnings or ultra cheap loans changing the debt/equity ratio!

Companies with the most buybacks are beating the market. The S&P 500 Buyback Index, which contains the 100 companies with the highest repurchase ratio, has climbed approximately 4% so far this year. Profits from S&P 500 members will decline at least 3.2% this quarter and next, according to analysts' estimates compiled by Bloomberg. For the full year, growth will be 2.3%, down from 5% in 2014.

In the end the only justification for doing the buy backs that holds water is that executives get a lot of their income from buybacks. Next to that buybacks can also be looked at as a lack of alternatives to responsibly invest companies' cash in. Companies are buying their own stock, by an astounding 6-to-1 margin!



4. **Deterioration of the trade balance and contractual disadvantage of US products buyers:** we also have to look at the trade imbalances the stronger US dollar causes because foreigners will source less American products and export more products to the US. At the same time Americans will import more foreign goods because they are cheaper and at the same time buy less American goods. In 2014 US exports were estimated to be some \$2.34trn or 13.2% of GDP whilst imports were forecast to be some \$2.74 or 15.5% of GDP of \$17.7trn. Economists summarize the overall impact of imports and exports on the U.S. economy through a measure called "net exports," the difference between exports and imports. Since exports fall and imports rise when the dollar strengthens, net exports -- and, therefore, demand for U.S. goods and services -- should fall. That's not good news for an economy that is already struggling to recover and is potentially facing interest hikes, which would further worsen the export position of the US economy and potentially implode the US economy. Undoubtedly interest hikes will finally prove the reliability/validity of the US statistical figures released by the Government.

And the stronger the dollar gets the more devastating the impact of the dollar strength will be creating a self fulfilling prophecy of the destruction of the US economy itself. Initially the ever-strengthening dollar will be negatively affecting countries whose fortunes are dependent on, the inverse correlation with the US dollar for commodity revenues, US dollar EM loans, larger foreign translation losses and lower exports. And as such the dollar is bearing the seeds of the US economy's own destruction (see points 1-4) because the economy is not as

strong in my point of view as is being portrayed by the bogus figures of the Government and the interpretation of the CNBCs of this world.

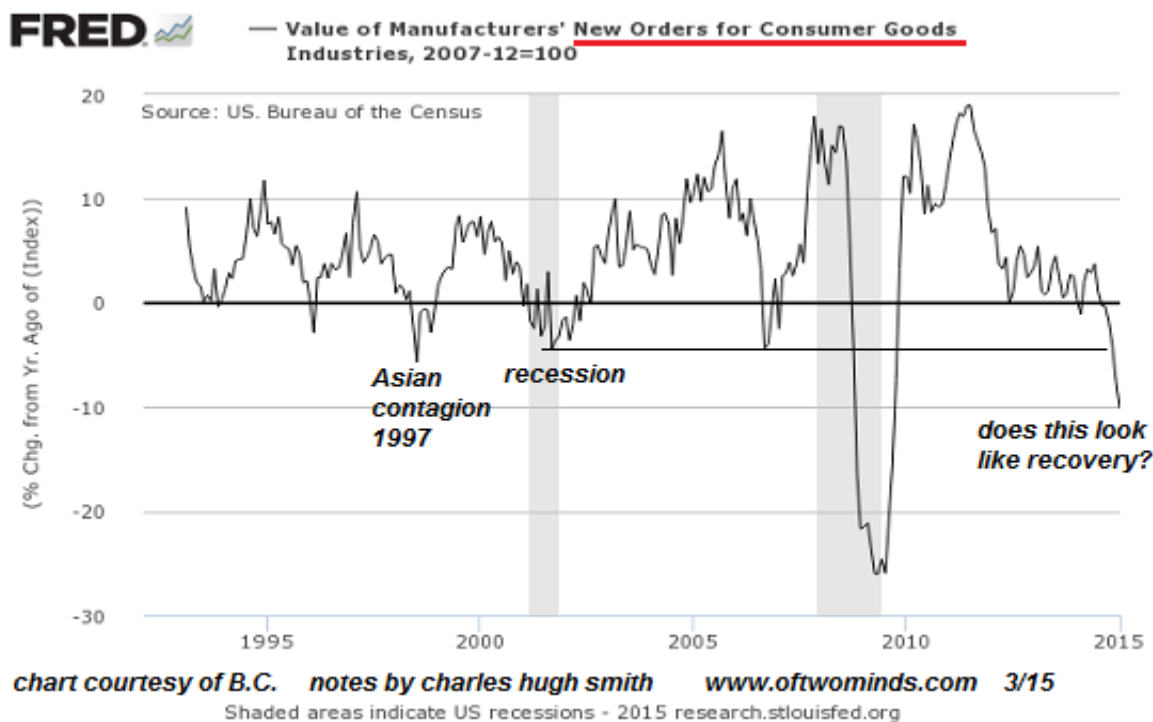
Conclusion: QE has not worked anywhere, not in the US (mainly part-time jobs were created and 4Q14 GDP growth was only 2.2%!), not in Japan (BOJ is buying all bond issues, it takes 43% of the government's tax revenue to just pay interest on its government debt!) and it will not work in Europe (negative interest rates are an indication how "well" the QE is being anticipated to work) and as a result it is now inflating (blowing up to unsustainable levels) the US dollar which will ultimately lead to a major correction (50%+) in the markets and wipe out all the QE "achievements".

In short, every crisis since 2000 has been "rescued" by lower interest rates instead of addressing the real underlying problems and implementing structural changes. With lower interest rates not doing the trick any longer QEs were employed to try and boost the markets to install confidence in the consumer with the aim to stimulate economic growth. Subsequently the Japanese, that experienced deflation since 1989, were "convinced" to implement QE or "Abenomics" followed by the Eurozone QE starting this month.

As a direct result we have seen a carry trades away from the low interest falling currencies (German 10y bunds now yielding 0.19%!!) into the higher interest bearing US dollar (10y treasury 2.13%). Next to that we shouldn't forget that at these low interest levels positions are leveraged many times over to maximize returns and therefore the sudden unwinding of these positions can be quite brutal and can invoke quite some damage. Let alone the hundreds of trillions of derivatives that are based on the underlying bonds and which value is very sensitive to the steepness of the movements in the interest rates.

Anyway the flight into the US dollar in my point of view is a flight to safety and not a move into the US dollar because the fundamentals are so fantastic or improving so much. It is a flight by default because there is no other currency that offers the same liquidity and because the Fed is "not" continuing QE at the moment hence why the interest rates are relatively higher. Though if you sincerely believe that the fundamentals in the US are really so great first check the statistics and analyze them properly, put them into context with other information you have and ask yourself if the figures makes sense with approx. 50m Americans on food stamps, 100m Americans out of a job, the labor force participation rate at a 37-year low and part-time jobs included in new job

creation figures as if they were full time jobs giving a false impression of the real improvement of the labor market.



Don't only read what you want to read that is benefitting Wall Street or your positions because one day you will be presented with the bill and you won't believe your eyes or understand what is happening!

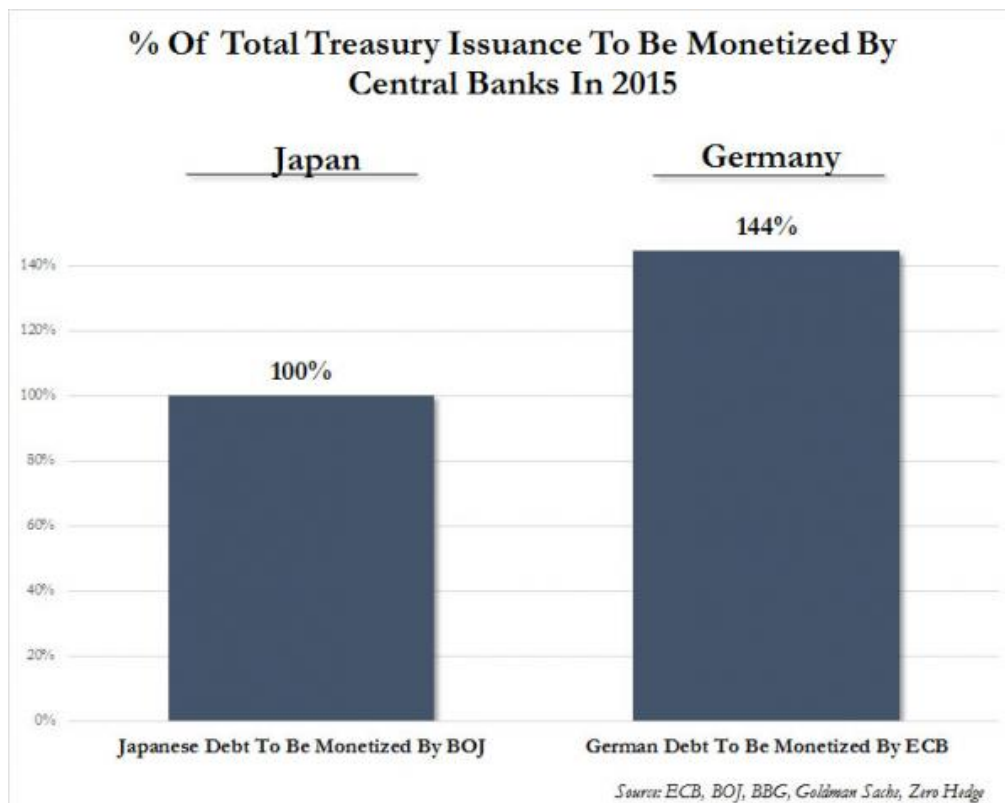
In 2008 when the real estate market tanked the mortgages kept their fixed nominal debt levels whilst the underlying collateral fell in value destabilizing the economy and causing the 2008 recession. In my point of view a kind of similar situation, fixed nominal debt/falling collateral/falling underlying value, is happening now but on a much larger scale whereby the ever growing \$200-300trn worldwide debt is nominally fixed whilst the economies are shrinking following the deflationary trend that is taking hold. The deteriorating and deflationary situation affecting assets and the growth of the economy is getting more out of balance resulting in more volatile moves of the currencies, bonds or equity markets, currently at historic peak levels, which will have an increasingly destabilizing effect.

And we see the first effects of all these deflationary QE measures potentially coming to the surface in Japan. Recently Bank of Japan (BOJ) policy board member Takahide Kiuchi expressed his skepticism about the ability of further

asset purchases to boost inflation and even went so far as to suggest that the BOJ's prediction of 2% inflation by mid-2016 is nothing more than a fairytale!



Economist (and former BOJ member) Yuri Okina has become concerned about the destabilization of the government bond market occasioned by Japan's move to monetize all of JGB gross issuance. At issue is a lack of liquidity, which in turn limits price transparency and promotes volatility. Liquidity represents the ease with which investors can buy or sell bonds when needed and when that ceases to exist there is a risk interest rates will rise sharply if some incident or event happens. Next to that many analysts are wondering what will happen if the BoJ finds that it is unable to buy all the bonds it wants, thus exposing the limits of its "quantitative and qualitative easing" program. It would show the inability to achieve its goals, which would undermine the trust of investors. BoJ's net bond buying this year is due to top Y80trn (\$683bn), up from Y60trn last year. As it stands now the ECB and the Bank of Japan intend to buy more than all gross German and Japanese issuance for the next 12 months



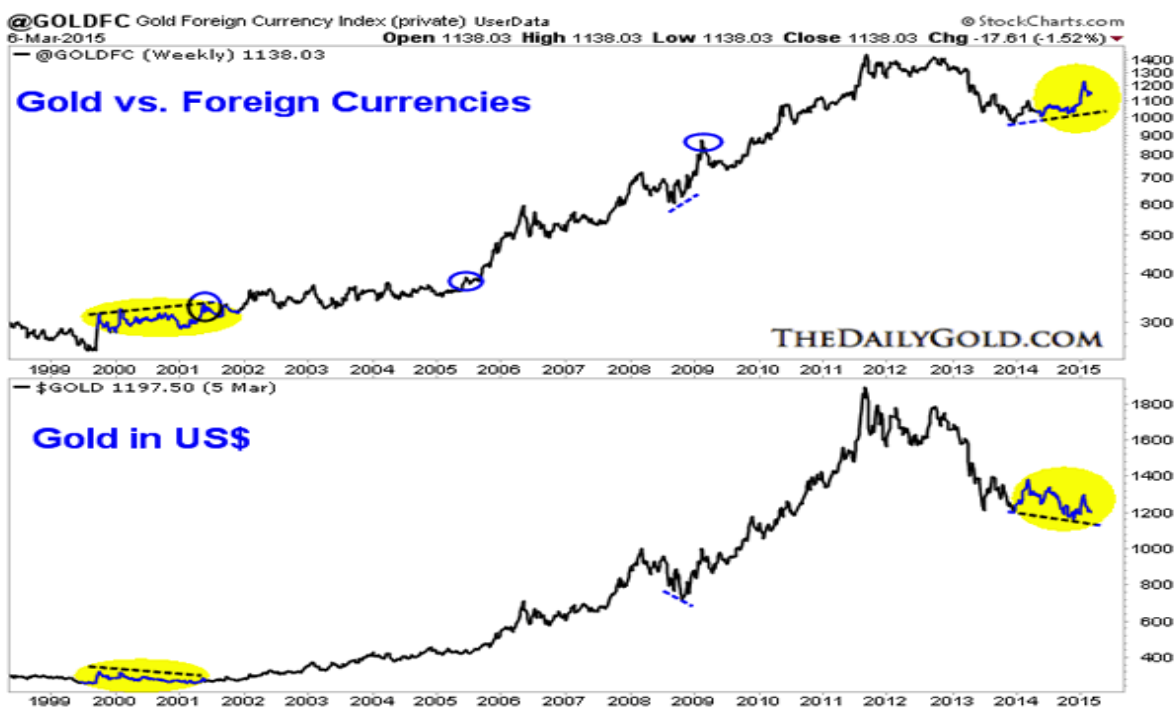
Assuming that all the new JGB issuance from the finance ministry — about ¥40tn — finds its way to the BoJ via intermediaries, the bank will still have to find another ¥40tn or so. But the big banks, which account for more than a third of the total JGBs outstanding, show every sign of wanting to hold on to what they have.

Japan is probably the country most vulnerable to violent swings in government bond yields. In general the adagio goes “the more you control the less you are in control”! If yields on JGBs become increasingly unwieldy because either traders lose confidence in the central bank’s ability to manage the Ponzi scheme or a lack of liquidity triggers excessive volatility (or both), it’s game over. Japan is probably an even more controlled market than the US markets.

In my point of view the Fed is set in their mind to increase interest rates in order to regain some monetary leverage because with near zero interest rates and having unsuccessfully applied QE several times (how many times can you cry wolf with investors still giving you credibility) there are hardly any options left. Last Friday the U.S. currency rose against most major peers after the employment data, the unemployment rate dropped to its lowest in almost seven years, cutting the appeal of gold and silver bullion as an alternative asset. While the Fed has said it will be “patient” on increasing borrowing costs, Chair Janet Yellen last week said the timing will depend on economic data. How much

more economic data do you need if the employment data is so-called so strong?
I am of course facetious.

If the Fed increases interest rates the economy is most likely to implode (it has been on life support since 2009) the carry trade will be unwound and risk premiums will go up with foreign investors selling US dollar treasuries. The dollar, which has become a very one-sided trade, as the “last conventional safe haven”, will tank because all the tools in the toolbox will be exhausted. There will be nothing left to keep the US dollar underpinned. Subsequently following the weakening of the US dollar and its inverse relationship gold and silver will reclaim their position as the ultimate currencies!! I believe that in the sequence of events first the reserve currency must be exhausted before gold and silver can really shine to preserve wealth against a massive devaluation (loss of purchasing power) of the paper currencies. When a currency gets in trouble the price of gold in terms of that currency rises. Measured in terms of Euros, so far this year gold has already jumped (10.75/9.9) +8.6%.



And with the gold and silver exchanges changing away from the naked futures not being backed by allocated physical gold and silver to an allocated physical backing of all futures paper contracts a tectonic change is taking place finally forcing real price setting. Next to that the bullion banks which until now where in the know which parties had which stop losses at which levels will no longer have this knowledge and therefore won't be able to any longer manipulate price

movements. It looks like things are finally clearing up in this field so that we get a much more realistic price setting for the precious metals!

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