ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

MAY 2023

There is no alternative

The death of the U.S. dollar's reserve currency status is greatly exaggerated

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Market Watch

Equity Market Indices[1]	3/31/23 Price	4/30/23 Price	MTD Change	YTD Change
MSCI All Country World	647	655	1.3%	8.2%
S&P 500	4109	4169	1.5%	8.6%
MSCI EAFE	2093	2144	2.4%	10.3%
Russell 2000®2	1802	1769	-1.9%	0.4%
NASDAQ	12222	12227	0.0%	16.8%
TOPIX	2004	2057	2.7%	8.8%
KOSPI	2477	2502	1.0%	11.9%
Emerging Markets	990	977	-1.3%	2.2%
Fixed Income				
2-Year U.S. Treasury Note	4.03%	4.01%	-2	-42
10-Year U.S. Treasury Note	3.47%	3.43%	-5	-45
BBG U.S. Agg Corp Spread	1.38%	1.36%	-2	6
BBG U.S. HY Corp Spread	4.55%	4.52%	-3	-17
Currencies				
Chinese Renminbi (CNY/$)	6.87	6.91	0.6%	0.2%
Brazilian Real (Real)	5.06	4.99	-1.5%	-5.5%
British Pound ($/GBP)	1.23	1.26	-1.8%	-3.9%
Euro ($/Euro)	1.08	1.10	-1.6%	-2.8%
Japanese Yen (Yen/$)	132.86	136.30	2.6%	4.0%
Korean Won (KRW/$)	1301.85	1338.50	2.8%	5.8%
U.S. Dollar Index (DXY)	102.51	101.66	-0.8%	-1.8%
Commodities				
Gold	1969	1990	1.1%	9.1%
Oil	75.7	76.8	1.5%	-4.3%
Natural Gas, Henry Hub	2.22	2.41	8.8%	-46.1%
Copper (cents/lb)	409	387	-5.5%	1.6%
CRB Index	268	268	0.2%	-3.5%
Baltic Dry Index	1389	1576	13.5%	4.0%

Source: Bloomberg

INTRODUCTION

April was a month of mixed data and market narratives as bulls and bears both cherry-picked figures to support their positions. The former can point to the surprisingly strong Empire State Manufacturing Survey and upside earnings surprises from bellwethers such as Visa, Microsoft, Alphabet, and Meta. The latter would argue that other regional Fed survey data were consistently in contraction territory, with some being shockingly weak. Various indicators have also shown U.S. banks becoming more risk-averse in extending credit, which will likely further pressure the U.S. economy. Adding to the confusion was the first quarter 2023 GDP data, which also offered something to both monetary hawks and doves with a higher-than-expected Core Personal Consumption Expenditures Price Index (4.9% annualized vs. 4.7% consensus) and weaker-than-expected real GDP growth (1.1% annualized vs. the 1.9% expectation).

While the debate on Fed policy and economic landing continued, the debt ceiling debacle loomed larger. Speaker Kevin McCarthy got the House to pass a bill to raise the debt ceiling by $1.5 trillion in exchange for spending restrictions, but the White House does not appear to have the urgency to start the negotiation. Let's hope it will wind up as mere political brinksmanship but not suicide, as the rest of the world is watching how dysfunctional our politics have become. Indeed, there have been growing calls among emerging market countries to move away from a U.S.-dollar centric global trade framework, and French President Emmanuel Macron was doing his best to undercut U.S. leadership of the free world.

Despite conflicting data and market narrative spins, leading economic indicators, which the Fed does not appear to be publicly focused on, are still pointing to a recession. Bulls will cheer the Fed's imminent move to wrap up its interest rate hiking cycle. However, based on history, if this pause is followed by pronounced deterioration in economic growth, risk assets will have some tough sledding ahead. Given the unprecedented amount of stimulus from 2020-21 followed by the worst inflation and most aggressive rate hikes in four decades, it would be a miracle for the Fed to stick an economic soft-landing.

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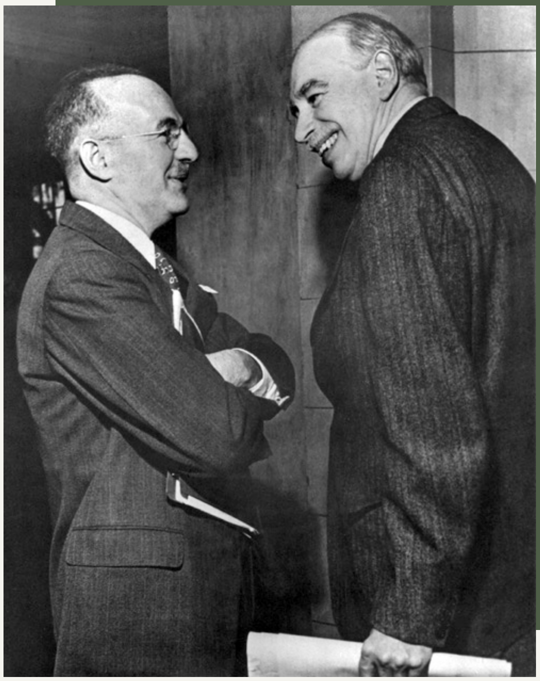
A Great Iconoclast

During his free-spirited youth, the prodigious firstborn of economist John Neville Keynes and social reformer Florence Ada Keynes had never planned to follow in his father's footsteps. In 1897 at age 14, Maynard, as he was known to friends and family, won a King's Scholarship to Eton College, a prestigious boarding school where he excelled in math, classics, and history. While at Eton, he came to taste a forbidden fruit when he met the first "love of his life," Daniel Macmillan, heir to the Macmillan Publishers fortune and the older brother to future Prime Minister Harold Macmillan. Homosexual activity was literally forbidden, as it was outlawed in the UK from 1885 to 1967.

In 1902, Maynard attended King's College at Cambridge studying mathematics and philosophy. He was so brilliant that Alfred Marshall, one of the greatest economists of the era and a founder of neoclassical economics, begged him to become an economist. Maynard received a bachelor's degree in mathematics in May 1904, then decided to stay on for a semester as a graduate student to further study philosophy and attend some economics lectures—his only formal education on the subject.

In 1906, Maynard scored second in His Majesty's Civil Service exam and accepted a clerk position in the India Office, which exposed him to the inner workings of India's economy and currency. He traveled extensively throughout the country and wrote a great deal about its economy, particularly the currency system. This experience laid the foundation for his later work as an economist, policymaker, and currency speculator.



John Maynard Keynes (right) with U.S. representative Harry White at the inaugural meeting of the International Monetary Fund in 1946.

Less than two years later, Maynard resigned from the India Office and returned to Cambridge, where Alfred Marshall and fellow economist Arthur Pigou personally funded a lectureship for him. He became a fellow of King's College a year later.

Maynard's return was driven by his nostalgia for the bohemian lifestyle that he and an eclectic group of friends had started several years earlier. These close-knit artists, writers, and intellectuals were united by their love of art and liberal attitudes towards religion, feminism, pacifism, and sexuality.

They started meeting regularly in 1905 with Maynard's college friend Thoby Stephen hosting a dinner at his London home every Thursday evening, followed by a Friday luncheon run by Thoby's artist sister Vanessa Bell. After Thoby's untimely death a year later, Vanessa and her sister, writer Virginia Woolf, carried on with the "Thursday Evenings" and "Friday Club" tradition. This group of avant-garde intellectuals would later be called the Bloomsbury Group, named after the district in the West End of London where most of them lived and gathered.

Members of the Bloomsbury Group included writers Lytton Strachey and E.M. Forster, artist Duncan Grant, art critic Clive Bell (who married Vanessa in 1907), writer and publisher David Garnett, and political theorist Leonard Woolf (who wedded Virginia in 1912). Maynard enjoyed not only intellectual and artistic stimulation with these talented individuals, but also uninhibited and entangled intimacy—Duncan Grant was the greatest male love of Maynard's life—and they both had relationships with the debonair David Garnett.

In 1913, at age 30, Maynard published his first book, *Indian Currency and Finance*. After WWI broke out the following year, the government sought his help on various issues and made him a Treasury official in early 1915.

One of John Maynard Keynes' responsibilities at the Treasury during WWI was to acquire foreign currencies to pay for imports. The Spanish peseta was especially difficult to accumulate due to hoarding by speculators. One day in 1918, the Secretary of the Treasury was pleased to learn that Keynes had acquired sufficient pesetas to meet near-term obligations. However, instead of the pesetas being handed over to the Treasury, Keynes had sold the Spanish currency in the foreign exchange (FX) market. When confronted by his horrified superiors, Keynes calmly said that he had sold them all to trigger a price decline in order to drive speculators to unload their positions. The daring move made Keynes a legend at the British Treasury as the strategy played out exactly as Keynes had anticipated.

Keynes was sent to the Paris Peace Conference in the spring of 1919 as the chief representative of the British Treasury. He argued that imposing exceedingly punitive reparations on Germany would ultimately backfire to hurt world trade and financial stability. When it became clear that the Treaty of Versailles was a "Carthaginian peace" to decimate the Central Powers, Keynes resigned in protest and approached his old flame Daniel Macmillan to publish his book *The Economic Consequence of the Peace*.

The book was an instant international best seller and greatly enhanced Keynes' reputation as a leading thinker. It was so influential in convincing the American public of the treaty's injustice that the U.S. Congress wound up rejecting President Wilson's proposal to join the League of Nations.

In 1921, Keynes surprised his friends when he confided that he had fallen in love with Lydia Lopokova, a famous Russian ballerina. In Keynes' eyes, Lopokova possessed a rare combination of beauty, grace, and intelligence. They married in 1925 with Duncan Grant, Keynes' former lover, as his best man. The marriage proved to be a happy union and provided Keynes with emotional stability as he juggled multiple positions as Chairman of UK's Economic Advisory Council, Director of the Bank of England, editor of the *Economic Journal*, fellow and the First Bursar of King's College, among others.

A GREAT ICONOCLAST

In the 1920s, Keynes believed that maintaining domestic price stability was the most important task in economic policymaking. During the Great Depression, Keynes evolved his views to advocate for government intervention to carry out countercyclical measures to spur aggregate demand—the crux of what became known as Keynesian economics and quite a departure from his mentor Alfred Marshall's trust in *laissez-faire*.

In 1936, Keynes published his magnum opus, *The General Theory of Employment, Interest and Money*. It was a seminal work that revolutionized economic theories and policymaking for the next four decades until supply-side economics gained popularity in the 1980s. In the wake of the Great Financial Crisis, Keynesian economics enjoyed a revival amongst progressive policymakers.

For his distinguished work in public service and academics, Keynes was rewarded with a hereditary peerage by King George VI. On July 7, 1942, Baron Keynes took his seat in the House of Lords at age 59. He was then tasked with the most difficult job of his life—negotiating with America, the world's new superpower, to design a post-war global monetary system.

Years of a workaholic and hedonistic lifestyle took a toll on Keynes' health by then. He suffered from high blood pressure, diabetes, heart issues, and complications from a broken pelvis. Gone were the free-spirited Bloomsbury days as several of his good friends had tragically passed away—Virginia Woolf drowned herself and a number of the artists passed away in their prime.

Keynes soldiered on with the idea of creating a global central bank and common world currency. However, with the British Empire worn down by two world wars and bloated withh debt, Keynes knew he did not hold many bargaining chips against his American counterpart, economist Harry Dexter White. To no one's surprise, America's design for the post-war international monetary and financial order had largely prevailed at the Bretton Woods Conference in July 1944. The U.S. dollar, backed by gold, was made the world's reserve currency with other currencies pegged to it at fixed exchange rates.

On the morning of April 21, 1946, two weeks after returning from an exhausting U.S. trip to negotiate issues related to the newly created IMF (International Monetary Fund) and the World Bank, the greatest economist of the 20th century suffered a heart attack at his country residence in Sussex. Baron Keynes' last words reportedly said to his loving wife Lydia Lopokova were, "I wish I'd drunk more champagne."

Bretton Woods Conference, July 1944. *UN Photo*

The Fiat Currency Era

Keynes never believed that Harry Dexter White's design for the post-WWII international monetary system would work out well. He was critical that the rest of the world would surrender the regulation of their price levels and management of credit cycles to the Federal Reserve, and that the U.S. dollar's peg to gold, a barbarous relic in his eyes, would limit policy flexibility. He was eventually proven right a quarter century later when President Nixon shocked the world by abruptly abandoning the gold standard in August 1971.

The transition to the fiat currency era was quite difficult for the U.S. as inflation turned into a decade-plus long scourge while the U.S. Dollar Index (DXY) lost 27% from the "Nixon Shock" to the end of the 1970's. However, the U.S. dollar managed to keep its global reserve currency status to confer America with the so-called "exorbitant privilege" due to several factors: the rise of petrodollars, rapid growth of the euro-dollar market, and lack of a credible alternative.

The 1974 secret deal between Nixon and King Faisal of Saudi Arabia—having Saudi price crude oil in U.S. dollars (USD) and recycle its massive trade surplus to buy U.S. Treasuries in exchange for U.S. military protection—created a trifecta for America. It assured the U.S. a steady supply of the world's most precious commodity, created a reliable buyer of our debt, and "dollarized" the oil market so most nations would have to keep a substantial portion of their reserves in the greenback.

The eurodollar market came into existence with the Marshall Plan, which showered dollars around the globe to help our allies' post-WWII reconstruction efforts. These eurodollars—U.S. dollar-denominated deposits at banks outside the U.S.—facilitated global trade and financing, and grew into a huge, unregulated shadow banking system that made the greenback the preferred currency for investors around the world.

Of course, having the world's largest economy, rule of law, and strongest military also helped to prop up the U.S. dollar as the premier global reserve currency - a position that is now under increasing attack (refer to my August 2021 report, *Winning By Being Less Bad,* for more detail about the U.S. Dollar's evolution as the global reserve currency).

The French (Dis)connection

As much as the Brits disliked the U.S. hegemony and pressure put on them to dismantle their colonial empire, the UK has been a reliable U.S. ally through thick and thin due to the shared values between the two nations. On the other hand, the French have been treacherous to the U.S. despite all the blood the British and Americans spilled to liberate them from German occupation.

Charles de Gaulle had always harbored a paranoia that the Brits were colluding with Americans to prevent France from joining the ranks of the great powers. Towards the end of WWII, while he was still living off the largess provided by the Anglo-Saxon duo, he was already plotting to elbow out the UK to make France the "third force" countering the influence of America and the Soviet Union.

As the French President in 1964, de Gaulle was so petty that he refused to attend an international ceremony commemorating the 20th Anniversary of the D-Day Landings in Normandy; the ingrate was oblivious that without the Allies' sacrifices during D-Day, France would have remained occupied by either Nazi Germany or the Soviet Union.

The U.S. dollar's global reserve currency status was a thorn in de Gaulle's side; it was his Minister of Finance, Valéry Giscard d'Estaing, who coined the term "exorbitant privilege" in the 1960s. In 1965, de Gaulle proclaimed that the primacy of the dollar in international trade was over and advocated for other countries to ditch the greenback and return to the gold standard. He exploited a loophole in the Bretton Woods system—foreign central banks were allowed to exchange their holdings of the U.S. dollar to gold on demand—and dispatched the French Navy to the U.S. to exchange for gold, which accelerated the eventual collapse of the system.

A year later, to the shock of his North Atlantic Treaty Organization (NATO) allies, de Gaulle withdrew France from the organization's integrated military command structure - an entity initially designed to protect France and its allies from Soviet attacks. It forced NATO to pull its forces out from France and to relocate the headquarters from Paris to Brussels. It would not be until 43 years later in 2009 that France rejoined NATO's military operations—18 years after the end of the Cold War.

When the euro was launched with much fanfare on January 1, 1999, some of its proponents were hopeful that it would become a credible alternative to the U.S. dollar as a premier global reserve currency. By the end of 2009, the euro's share of global central banks' foreign exchange reserves increased from 18% to 28%.

This surge came at the expense of the U.S. as the greenback's share of global FX reserves dropped from 71% to 62% during this period. With the U.S. economy mired in the Great Recession at the time, many feared that the euro would continue to chip away at the greenback's share. However, 2009 turned out to be the peak of the euro's share as the subsequent European debt crisis and economic malaise dealt a blow to the currency's competitiveness and value.

History Rhymes

In recent months, the U.S. dollar's global reserve currency status has once again been called into question as emerging market countries, led by Russia and China, have accelerated the de-dollarization movement.

The main culprit, according to many pundits, is that the U.S. government's frequent use of financial sanctions and the freezing of Russian central bank's assets have driven foreign central banks to look for alternatives. The West's trade embargoes against Russia have also forced the world's largest commodity exporter to settle trades in the Chinese yuan, United Arab Emirates dirham, and Russian ruble.

China, as the world's biggest commodity purchaser and the West's strategic competitor, was only too happy to seize on this opportunity to chip away at America's economic and geopolitical influence.

On the diplomatic front, Chairman Xi Jinping leveraged China's position as the largest trading partner with Iran and Saudi Arabia to broker the resumption of diplomatic ties between the two embittered Gulf states. It is widely believed that Saudi Arabia will soon announce sales of crude oil to China priced in yuan, an important milestone in the ascendancy of the petroyuan. Chairman Xi then parlayed his success in the Middle East to score a win in our own backyard. Brazilian President Lula da Silva—favored by Western progressives for being the opposite of his rightwing but pro-America predecessor, Jair Bolsonaro—signed a deal with China to settle bilateral trades in the two countries' respective currencies, thereby ditching the U.S. dollar as an intermediary. During his mid-April visit to China, Lula publicly said, "Every night I ask myself why all countries have to base their trade on the dollar; why can't we do trade based in our own currencies?"

If Lula's increasingly anti-American antics were a slap in the face to his supporters in the White House, French President Macron's betrayal must have felt like a sucker punch. Two days after House Speaker Kevin McCarthy met with Taiwanese President Tsai Ing-wen at the Ronald Reagan President Library to express U.S. support for the island state, Macron led a large group of French business executives to pay respect to Chairman Xi in China and threw the U.S. and Taiwan under the bus. The meeting took place just a few days after French energy company, TotalEnergies, transacted its first-ever renminbi-based liquified natural gas (LNG) deal with China.

HISTORY RHYMES

Macron made some calculated remarks which called into question the West's unity in the face of the clear and present threats by Russia and China. Speaking as if he represented Europe, Macron said Europe risks getting "caught up in crises that are not ours, which prevents it from building strategic autonomy." He argued that Europe should not pick sides on the Taiwan issue. Macron also urged Europe to reduce its dependence on the "extraterritoriality of the U.S. dollar" and avoid becoming a "vassal."

It's clear that, while Macron is seven-inches shorter than de Gaulle, he harbors the same lofty vision, or perhaps delusion of grandeur at the expense of France's real allies and benefactors. It appears that France's national motto "*Liberté, égalité, fraternité*" (liberty, equality, fraternity)—does not amount to a hill of beans when it comes to its leader's drive for strategic autonomy and profitable deals with authoritarian regimes. There may be an element of truth in the joke about French army officers wearing brown pants after all.

THE GREATLY EXAGGERATED

Death of the U.S. Dollar

These recent developments coupled with the U.S. Dollar Index's 11% decline from last September's cycle peak have led Chicken Littles and crypto bros to pontificate about the U.S. dollar's imminent demise. Financial press and social media were busy rolling out clickbait headlines such as "Could the U.S. Dollar Collapse?" and "De-dollarization: World faces threat of economic catastrophe." It's suddenly fashionable to discuss the implications of a post-dollar world.

Before we think about what attire to wear to the King Dollar's funeral, let's get some facts straight:

- The USD is still by far the most widely held currency in central bank FX reserves around the globe—it has a 58% market share with the euro's 20.5% at a distant second at the end of 2022. The Chinese renminbi accounts for just 2.7% of the world's FX reserves and ranks fifth behind the Japanese yen (5.5%) and British pound (5%).

- According to the Bank for International Settlements (BIS), the USD was involved in nearly 90% of global FX transactions in 2022. The renminbi was at 7%.

- The BIS estimates that roughly half of all international debt securities and cross-border loans issued in offshore funding markets were denominated in USD during the second quarter of 2022. This is the aforementioned eurodollar market outside the purview of U.S. regulators. 88% of eurodollar debt and 65% of eurodollar bank loans do not even involve a U.S. resident, i.e., many foreign lenders and investors prefer to transact in USD without prodding from any U.S. entities. Furthermore, there are tens of trillions of dollars of financial derivatives tied to the eurodollar market, which means that market forces will keep the USD as the preeminent currency for decades to come.

Chairman Xi and his anti-USD buddies may not realize that there are immense responsibilities that come with the global reserve currency status. For the renminbi to become a credible and major reserve currency, China will need to do the following:

- Offer a large, deep, transparent, and stable financial market as well as the rule of law to assure foreign investors of liquidity, stability, transparency, and safety. Currently, China still has a closed capital account as its citizens and companies cannot freely move money in and out of the country. I doubt that China would relax its capital control as it will likely result in rampant capital flight—one has to wonder why foreigners would want to hold the renminbi while many Chinese nationals can't wait to get their capital out. As for China's commitment to the rule of law, well, just ask Hong Kong students how the Sino-British Joint Declaration on Hong Kong's "one country, two systems" has fared in recent years.

- Give up its export-driven mercantilist economic model and run up trade deficits to absorb its trading partners' surpluses as well as global excess savings. This is the flip side of the "exorbitant privilege" that comes with the global reserve currency status, and it is partially responsible for the hollowing out of the American middle class over the past decades. Given China's long-time embrace of protectionism, it is unlikely to adopt policies that would sacrifice Chinese jobs and exports.

THE GREATLY EXAGGERATED DEATH OF THE U.S. DOLLAR

As for Lula's question about why countries cannot trade in their own currencies, the answer is that Brazil is free to ditch the dollar to the delight of his kindred spirits in Venezuela, Cuba, and Iran, etc. However, he needs to understand that Brazilian companies raise a lot of capital from the international market, especially the eurodollar market. As such, it behooves them to transact in USD in order to match their debt obligations. It is easy for foreign politicians to talk a big game about de-dollarization—Lula is so keen on ditching the USD that he even proposed a currency union with Argentina, a serial defaulter and poster child for economic malpractice that just posted greater than 100% inflation in March—but they still need to go to the eurodollar market hat in hand to get financing. Simply put, it is not that easy under the existing international financial framework to circumvent the U.S. dollar.

Investors need to realize that it's one thing for China and its trading partners to bypass the USD in bilateral trades, but more consequential is the decision on what to do with their trade surpluses. An upcoming case study will likely be Saudi Arabia's handling of the petroyuan.

The U.S. shale energy revolution has materially reduced our import of crude oil from Saudi Arabia, and the kingdom's exports to China now dwarf what it sells to the U.S. three-to-one ($66 billion vs. $23 billion in 2022). As such, it should not be a surprise for Saudi Arabia to sell oil to its largest customer in renminbi. However, what will the kingdom do with its yuan-denominated trade surplus? In 2022, Saudi's trade surplus with China was $26 billion, or roughly 180 billion yuan. With the kingdom's currency, the Saudi Riyal, having been pegged to the U.S. dollar at 3.75 SR per USD since 1986, it makes far more economic sense for the Saudi central bank to invest most of the 180 billion yuan in U.S. Treasuries rather than Chinese bonds.

In conclusion, countries bypassing the USD for international trade will not do much damage to the dollar's preeminent reserve currency position. What really matters in the end are two things: where most of the world's trade surpluses and excess savings will wind up, and what currencies international lenders prefer to get paid in. Currently, China has neither the capacity nor the market structure to absorb global excess savings. In the foreseeable future, I believe most FX reserves will still wind up in Western currencies, with the U.S. taking the lion's share.

The deep and liquid eurodollar market will entice emerging market borrowers to keep on raising money in USD. In short, don't let fear mongers drag you down with the USD doomsday narrative. The U.S. has many problems, but the dollar's reserve currency status is not high on that list yet.

Defending the King Dollar

While the greenback will retain its global reserve currency status for the foreseeable future, its market share will decline over time. The gradual erosion of the U.S. dollar's global reserve currency status may be a blessing in disguise as it will force America to slowly wean off foreign capital that has eroded our fiscal probity and export competitiveness for decades.

In the meantime, there are several things within America's control to support the U.S. dollar.

The first is to return to old-fashioned financial discipline—fiscal and monetary saneness, aka reducing fiscal deficits and avoiding unconventional monetary policies. The sad reality is that our political dysfunction and extreme wokeness can inflict more damage than foreign countries' de-dollarization efforts.

Second, regain the political common sense to responsibly maximize the production of our abundant natural resources such as fossil fuels, agricultural products, and minerals of strategic value. Imagine the precarious geopolitical and economic situation we would be in had the U.S. shale revolution not taken place.

The third initiative is to contain and even weaken the authoritarian axis that has been actively undermining the world order built on liberal democratic values. At the core of this axis is, of course, the Sino-Russian alliance that has become stronger in the wake of the Ukrainian war.

Some argue that we should stop aiding Ukraine's resistance to Russian invasion, as if that would convince Putin to play nice. On the contrary, turning our back on Ukraine at this point will seriously damage America's credibility in the eyes of our allies and embolden our foes. It will send the message that the U.S. can no longer be trusted as an ally, and more countries will seek to curry favor with Russia and China, which will in turn accelerate the decline of U.S. influence on all fronts.

On the other hand, if the West's support of Ukraine winds up diminishing Putin's ability to carry out further aggression, it will set the stage for a potentially favorable geopolitical realignment in the post-Putin era. Indeed, some leaked Pentagon documents revealed that Putin may have been receiving chemotherapy and some of his generals were trying to undermine him. Once Putin is out of the picture, the odds of a rapprochement between Russia and the West will rise materially.

DEFENDING THE KING DOLLAR

It will eventually weaken the Sino-Russia alliance, which is a mere marriage of convenience with mistrust on both sides. Most Russians are suspicious of China's ambitions—turning the ailing Russia into China's vassal and "gas station" as the Middle Kingdom becomes stronger—and have more affinity with Western culture and institutions. Without Russia's staunch support—especially in military and natural resources—the Chinese Communist Party (CCP) will find it more difficult to sustain its strategic rivalry with the U.S. Many of China's fair-weather friends will then pivot away from the CCP's sphere of influence and renminbi-centric economic framework. That is, the global reserve currency status ultimately rests upon raw geopolitical power.

Lastly, the U.S. needs to tread very carefully with the rollout of a Central Bank Digital Currency (CBDC), which can be used as a trojan horse to undermine the USD's reserve currency status. As money becomes programmable, it will be easier for the International Monetary Fund (IMF) or another international entity to implement Keynes' vision of a new common world currency which he named bancor. That will be his ultimate revenge against the USD-centric global financial framework.

Favoring Treasuries Over Stocks for Now

Although I am confident that the U.S. dollar will remain the dominant global reserve currency, the value of the dollar will continue to fluctuate against other fiat currencies, and it may move materially lower in the coming years.

Prior to the Fed embarking on the most aggressive tightening cycle in four decades, the U.S. Dollar Index (DXY) has traded in a range of 90 to 100 from 2015 to April 2022. The Fed's surprisingly hawkish rate hikes then lifted the DXY to as high 114 by September 2022. Now, with the Fed close to wrapping up the rate hike cycle, the DXY has weakened to around 102. While the dollar could potentially gain in value during a recession due to its safe haven status, as well as a potential shortage triggered by deleveraging in the eurodollar market, I suspect the next major move for DXY will likely be a slide back to the 90 to 100 range in the next few years. A weaker U.S. dollar will be supportive to our exports and lessen the debt service pressure on foreign entities that have USD-denominated debt.

Assuming that the historical inverse relationship between precious metals and the USD holds, gold may finally break out to new all-time highs.

FAVORING TREASURIES OVER STOCKS FOR NOW

Of course, it's easier to predict the currency movement than to get it right. Currency values are notoriously difficult to forecast because everything is relative to other countries' developments. Even Keynes, who was widely sought out as the foremost expert on international trade and currency issues, experienced a stretch of significant losses in currency trading, which nearly bankrupted him if it hadn't been for the financial lifelines from his friends and family. That may have been the genesis of the adage, "The market can remain irrational longer than you can stay solvent."

U.S. Treasury yields will likely move lower across the curve during the next recession, and I would take advantage of the periodic back up in yields to extend the duration. Then, in the depths of the next recession, equities will likely go through their bottoming process to create more attractive investment opportunities. In the meantime, investors should remain focused on quality and avoid the urge to chase market rallies in an environment of decelerating growth and still-elevated valuations. Keynes had cautioned, "The markets are moved by animal spirits, and not by reason." However, in the long run, it is fundamentals that will prevail.

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