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CMEFS WEEKLY INVESTMENT NEWS

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Hello and welcome to this week's edition of Investment News.

Before we go into this week's discussion, let's see how the CMEFS Flexible fund has done for the year thus far as compared to the All Share Index (ALSI)

Fund	Last week Thursday	This week Thursday
ALSI	+1.56%	+0.58%
CMEFS Flexible Fund	+0.28%	+0.25%

I spoke last week about the US Federal Reserve printing money and how this was destroying the value of US$ over time.

This, however, is not the end of the story.

This gradual devaluation of the value of the US$ has a great many other repercussions on the rest of the world economy, on the wealth of individual nations as well as on the value of stock markets worldwide.

It remains as true today as it was 30 years ago that when the US sneezes, the rest of the world catches a cold.

This is why it is so much more important to follow what is going on in the US than in any other country in the world, including China.

The US is still a global giant from an economic point of view and as such, it casts a long shadow over the rest of the world's economies.

Let's look at these one at a time.

Repercussions on the world economy.

The US remains a nation of consumers and it buys much of its goods and services from the rest of the world, much, but by no means all of it from China.

A weakening US$ has the effect of pushing up the cost of buying these goods and services abroad, whilst at the same time making US exports cheaper.

Let’s do some basic math to illustrate this point

Imagine we produce a widget (widget = whatchamacallit, thingummy, doodab, etc.) in SA for sale in the US for R1 000

At an exchange rate of 17/1, and ignoring all other inputs for the sake of simplicity, this widget will cost the US consumer US$58.82.

Now there will be a finite number of US consumers who will be both willing and able to purchase this widget at this price.

Now imagine the US$ weakens to an exchange rate of 15/1

Using exactly the same math, the price in US$ of this widget rises to US$66.66.

Clearly, the finite number of US consumers who would be both willing and able to purchase this widget at this now higher price will be lesser than those who are able to purchase it at US$58.82

This dynamic results in lesser exports to the US than would otherwise have been the case, resulting in a slowing down of business done with the US in so far as the export of widgets to the US is concerned.

This again in turn results in a general slowdown in global economic growth, which is not so great when you’re emerging from a global pandemic and need all the growth you can get in order to get back up on your feet.

Now let’s look at what effect a depreciating US$ has on the wealth of individual nations.

Our Reserve Bank, along with virtually all other Central Banks worldwide carry a reserve of US$ on their books, as well as varying amounts of gold as a “just in case” measure.

The reason they carry this US$ reserve, usually equal to 6 months’ worth of imports is that all international trade is still conducted in US$.

That is to say, countries around the world conduct all of their international trade in US$, not only because it is a plentiful currency, but also because it continues to be seen as a “strong” currency hence a “currency of last resort”.

It is because all international trade happens in US$ that Central Banks worldwide hold US$ reserves.

This way, if their currency “blows-out”, as is happening right now with the Argentinian Peso at 27.24/1 in June of 2018 and now at 72.52/1 in June of 2020 (I have no doubt the recent external debt default of US$300 billion had something to do with this) they (theoretically at least) hold sufficient US$ to import some essentials like energy, food, and medicine whilst they sort things out.

Note that they just would not be able to import anything using the Argentinian Peso as frankly, no one would want to touch their Peso with a 10-foot pole at this point.

But getting back to the value of these US$ reserves.

If one held US$1 000 000 at an exchange rate of 17/1, the Rand value of these reserves would be R17 000 000.

At an exchange rate of 15/1 (a weaker US$) the Rand value of these reserves drops to R15 000 000.

So when measured in the local currency, we a poorer to the extent of R2 000 000 as a result of this weaker US$.

And now to the value of stock markets globally.

Firstly it is necessary to understand that in the event of a market collapse in the US, you will not find any other market either holding their value or moving higher.

They WILL fall roughly in line with the US markets.

This is not true the other way around.

For example, if the German, Japanese or even Chinese markets collapsed, the US stock market might not necessarily be affected to the same extent and may well even head off in the other direction.

The value of the US Stock market therefore by and large determines what is going to happen, or is happening on other stock markets around the world.

And we all know that right now, despite the mess that the US is in from virtually every standpoint, the S&P500 today is only 0.38% off the highest point it reached in pre-Covid-19 days.

Why?

Well there are many reasons for this, some psychological (let's show the virus a thing or two), some political (Trump will do anything prior to election date to prop up the value of the US markets as his re-election depends in large part upon this – and he has great influence over the Federal Reserve), some as a result of the shift over to passive trading strategies which are gaining more and more momentum, but mainly as a result of the markets being flooded with cheap money with nowhere else to go.

So here we have the US market valuations being artificially inflated to unbelievable highs as a result of this cheap money being printed with the rest of the world following suit for fear of missing out.

And not because the markets are actually offering any value, but just because there is almost no other choice, as the bond markets are either sitting at zero with some even being negative and cash offering very little at all.

So we have a massive build-up of pressure in the markets without a release valve at this point, as every time the pressure builds to a point where it needs to be released, the Fed simply print more money to keep the illusion of wealth creation going with all of the consequent knock-on effects mentioned above.

In the “good old days” one bought and sold a share on market fundamentals, such as whether the share was fairly valued taking into account all possible variables.

There was no interference (or very little back then) in the markets and one could make certain calls about whether certain prices and indeed companies, were sustainable over the medium to longer-term with a fair degree of confidence.

This is not the case anymore.

Now, all one has to try and do is guess at what “the Fed” is going to do next. And as long as “the Fed” continue with their money printing program the markets will continue to rise (market price inflation) with many zombie (walking dead) companies simply remaining in business because they are “too big to fail” and “we can’t afford the job losses that will follow”.

So reality is ignored and will continue to be for as long as they (the Fed) can afford to do so.

For my part, I have to wonder just for how long this will be?

We will just have to wait and see, I guess.

I hope you enjoyed the read.

Until next time then, do take good care of yourselves.

Kind regards, Nine, Charles, and all of us at CMEFS.