

# PALOS

## The Palos Perspective

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*A Macro Market View by Hubert Marleau*

## Return of the Gold Standard

John Maynard Keynes, the famous British economist, referred to the gold standard as a “barbarous relic.” He criticized its use because he believed it restricted governments’ ability to manage their economies, basing his attack on the thesis that once a country had joined it, it would rule out inflationary money printing, but would block governments from prescribing monetary and fiscal actions to offset downturns. Since he did not get his wish to create a global central bank to deal with persistent surplus and deficit countries to eliminate imbalance, the post-war Bretton Woods system was implemented as a sort of compromise: a scheme which made the dollar the undisputed global currency because the U.S. was the world’s largest debtor, running massive deficits to finance WWII, and agreeing to tie the greenback to gold at \$35 an ounce.

This standard lasted until August of 1971, when the U.S. was losing too much gold and decided to shut the "Gold Window" to stop the outflow of bullion. It helped the establishment of an independent monetary policy, where the Fed could set interest rates in consideration of the state of the domestic economy, reducing interest rates when it was stuttering and increasing them when it was overheating. This is how things are done when the currency is fiat. Unfortunately, it works relatively well only if fiscal policy is managed responsibly, which has not been the case through the piece, especially since the great financial recession.

The value of gold is a kind of market referendum on the world monetary order in a way that stocks are not. In this connection, key buyers of bullion, gold bugs, foreign investors, and central banks, have not hidden their feelings that fiscal and monetary discipline will be needed to prevent the worst: and that one way to accomplish this is with a return to the gold standard or some variance of it. If I’m correct in assuming that no remedy is in the offing, especially in western democracies, then the current bullion boom is not a cyclical phenomenon, but rather an omen of problems to come, unless the structural opposition to persistent and elevated government deficits and debt gets cured with a new world monetary order that would force a restoration of fiscal and monetary sanity. But does this

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seem likely? Certainly not, if one asks the aforesaid bullion buyers, who have opted to diversify their reserve assets in the case of the central banks; to hedge their investment position in the case of foreign investors; and to make big bets in the case of gold bugs, thinking that the de-dollarisation effort is an ongoing process. Indeed, Reuters reports that foreign banks now own more gold than U.S. Treasuries for the first time since 1966, while central banks' gold holdings are worth USD4.5 trillion versus USD 3.5 trillion of Treasuries. Treasury holdings are now down to 23% of foreign reserves versus Gold's 27%. Investors interested in hedging their portfolio with gold should note that central banks held a 75% share of central banks' reserve assets in the late 1970s.

While the above narrative is the fundamental reason behind the new demand reality for gold, its price hit a record high of \$3650 per ounce on Friday, mainly because recent employment data gave certainty that the Fed will cut interest rates on September 17, perhaps by as much as 50 bps. It begs the question whether this is an opportune moment to enter a gold position, acknowledging that gold often overshoots or undershoots elusive estimates of fair value. Being a non-productive store of value like fine wines, paintings and bitcoins, ascribing a value to it, however, is next to impossible.

According to DE Shaw, a very reputable \$55 billion hedge fund, gold value has something to do with global wealth. Currently, the S&P 500 is worth 1.81 times the price of gold: 2.29 times at the end of 2024, 2.42 at the end of 2023 and 2.07 at the end of 2022. So it feels pricey: but not that much in the perspective of time, its price has risen around 90% in the last 36 months compared to 70% for the S&P 500. Another way of looking at this is that since August 15, 1971 when President Nixon unlocked its \$35 price, gold (\$3642) is 105 x higher versus 65 for the S&P 500. Thus, it wouldn't be abnormal to see the gold price go higher.

With the U.S. at risk of losing its role as the sole center of the financial system, the over performance of gold is not exaggerated. Thus the inflow of new money into it is far from being a gold rush. According to BullionVault, inflows of new money are "being matched by existing investors choosing to sell at gold's new record high." Clearly it's about Asian demand, which is loading up with physical gold, making bargains for the gold stocks.

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I have no magic wand to predict gold performance, but do know that there is a correlation with the term premium component of real rates of long duration of U.S. government bonds, which are rising.

Meanwhile, Yardeni Research is sticking to their previous targets of gold hitting \$4000 an ounce by the end of this year and \$5000 by the end of 2026.

### **What Took Place in the Week ended September 5?**

After a day off for Labour Day, the S&P 500 fell by 0.7% to 6415 from trepidations that September is historically a bad month for stocks; also from bond market jitters stemming from nervousness over at a hugely consequential Federal Reserve meeting pending, along with the tariff question still unresolved, talk of an AI slowdown looming, a possible government shutdown, manufacturing activity bogging down, and key data on employment and inflation forthcoming - a lot of stuff to swallow in a short time frame.

On Wednesday, the S&P 500 ended higher, rising 0.5% to 6448 on a big tech bounce as Alphabet reacted positively to a Washington judgement that Google would not have to sell its Chrome browser in its antitrust case, boosting its stock by 9.0%, and a report that firms aren't hiring as many people anymore and laying off workers more than they use to, offering evidence to the Fed that there are now more people counted as officially jobless than there are open jobs. The weakening labour market gives the monetary authorities more reason to cut rates.

On Thursday, the S&P 500 scored a fresh record close, rising 0.8% to 6502 as ADP showed that privately-run businesses had created only 54K jobs in August - less than expected - while initial jobless claims had risen to the highest level since June. Meanwhile, the Challenger job cuts are up and the ISM Service Sector employment index is contracting, extending a string of poor employment reports that has raised alarms about the labour market - a situation that has built the case for an easier monetary stance that should spur the Fed one more time to cut its policy rate.

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On Friday, the NFP confirmed that the labour market is in trouble: hiring stalled as the economy added only 22k jobs in August and lost 13K in June. Given the anemic employment report, the S&P 500 slipped 0.3% to 6482.

### **The Near-Term Stock Market Outlook:**

I'm still of the opinion that we shall see 6600 on the S&P 500 soon, and I have 4 good reasons why I think the S&P 500 could melt up to 7000: low oil prices, easy money, productivity gains, and the AI capex boom being those ingredients that should keep the trajectory of the US economy positive. This is why the Atlanta Fed's NowCasting Model is presently tracking real growth of 3.0% in Q3 and why the NY Fed Staff Casting model is projecting 2.2% in Q4.

Incidentally, the payroll numbers were not as bad as many strategists have suggested. Forecasts for further increase in the unemployment rate may not materialize, because labour force growth is expected to be weak due to limited immigration and increasing deportations. In this regard, the "Sahm Rule" is not calling a recession because the labour is in balance.

Moreover, in a plethora of corporate surveys, a large number of companies surveyed have made plans to enact AI, trim their workforce and raise buybacks in the next 12 months, emulating what Wells Fargo, Bank of America, Amazon, and Microsoft have done to boost productivity, protect their profit margins and keep EPS guidance intact. This week, I re-bought NVDA.



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