

Can Gold and the US Dollar Continue to Rise in Tandem? For How Long?

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Theme: [Global Economy](#)

Can the dollar and gold continue to rise in tandem for long? The last three months have seen a very peculiar dollar/gold anomaly. Since mid November, gold (and silver) have "acted" very differently. We have seen "outside days" and even an outside week. Gold has moved nearly \$160 of its lows for a rise of nearly 15%. This has happened while the dollar has rallied furiously versus foreign currencies (with the exception of the franc). From a "textbook" sense, this should never happen. Actually, I am sure there are professors out there who would have argued "it cannot happen" ...but it has. Both the dollar and gold have rallied at the same time, so far gold outpacing the dollar. But why? Why has the tone for gold changed and why is it not "falling" versus a rising dollar?

This is a very important question because the answer may (probably does) hold the key to which will be the ultimate winner and which may lose and lose big. First, the explanations for a strong dollar are twofold, one mainstream and the other probably the real reason. Mainstream says the dollar is getting stronger because the world is a mess and the dollar is the "cleanest dirty shirt" of the bunch. It is said the U.S. economy is getting stronger and interest rates will be raised later this year which will give the dollar a strong yield advantage. Personally, I see this argument as hogwash, I see the economy as very weak and getting weaker while the overall financial system is fragile. The reported "strength" of the economy has been proven to be smoke and mirrors, this last quarter for example was revised higher because of Obamacare, even the lobotomized know this is fallacy. A higher "tax" is not now and never will be economic "output".

An increase in interest rates is almost a zero percent probability in my view with the exception of a forced raise to save a crashing dollar. I do not see the real economy nor financial system as having the ability to absorb higher interest rates of any sort. This is the current debate, "when will the Fed raise rates"? The answer in my opinion is they cannot, ever, until the markets force them to.

In my opinion, the dollar rally has been 100% synthetic and the result of a global margin call. Dollars on a global basis have been "purchased" to repay margin from busted carry trades. Fundamentally, less dollars are now required by the world to consummate trade. Less dollars will change hands on the oil trade simply because the price of oil has been halved. Less dollars will be required because nation after nation have cut deals and sworn off dollars in lieu of using local currencies. The list of countries is long and led by China who will transact trade using "non dollars".

My point is this, I believe we will soon see this first batch of margin calls met. Couple this with slowing dollar demand for trade and the dollar should run out of steam. Surely your next question is, "but what if margin calls actually increase again?". Aha! Good question

and one which in my opinion is a mathematical certainty. We will get another round of margin calls ...big ones! HUGE... because the recent volatility has created some dead financial bodies all over the world. I believe that as the bodies surface, more volatility will ensue. It will be at this point, panic will begin to set in and the margin clerks will be working 24/7. The opinion of Eric Sprott of this exact scenario can be found here <http://kingworldnews.com/billionaire-eric-sprott-entities-wiped-overnight-western-central-banks-near-total-surrender/> I believe this is well worth reading as his the arguments are well thought out.

This in my opinion will not create “net” synthetic demand because the question of “quality” will also factor in. To explain, yes there will be more demand for dollars to meet margin calls but when you add in the decline in demand for trade AND the flight from dollars as a credit consideration, then you will see a net weaker dollar. It is this scenario where I believe the rubber meets the road. The dollar will be viewed as a “credit”, in fact, I believe the dollar will then be viewed as the “credit” it is (or isn’t!).

The above needs to be put in simpler terms. Gold has outperformed the strongest paper currency over the last 2 1/2 months. The outperformance has surprised many, even those in the gold camp have been surprised. Had a 15%-20% higher dollar been suggested as fact three months ago, a flat gold price would probably have been the best forecast even by most gold advocates. In my opinion, physical demand is finally beginning to take over as the pricing mechanism. The danger of a “call” for real gold is preventing the paper markets from getting much downside action as the cost of production acts as barrier. I also believe increased global demand is a function of “credit considerations” by foreigners as they look at and view the dollar.

Switching gears to “out of control” geopolitics, Greece just voted in the non austerity party. Within 24 hours of taking power, Greece is already turning away from the West. They are simply calling a spade a spade when they say they “cannot pay”. No matter how much they cut their budgets, interest and principal alone cannot be paid ...and this is on money ALREADY borrowed. Greece is simply suggesting they “un” borrow it and receive writedowns on what is owed, and this is the central core problem!. This is not just a Greek problem, it is a Western world problem, only Greece hit the wall first! They cannot pay, they don’t have the revenue, they don’t have the money, nor do they have the production capacity under any scenario. Greece will fail, the only thing in question is how it is handled.

A very good read on the situation can be read here <http://www.theautomaticearth.com/its-not-the-greeks-who-failed-its-the-eu/> .

I would go even one step further than this piece does and say “It’s not the world who failed, it’s the Western financial system who failed”. I also believe the result for the rest of the Western world will be similar to what Greece is facing now. Do they continue the game (can they continue?) or do they “switch sides” so to speak? In my opinion, this is an easy question and one the Swiss have already begun to answer. They were the latest in a string of nations announcing currency hubs, Britain, Germany and Australia being notable predecessors. The West will one by one turn East.

The reasoning behind my writing this missive is simple. The thought process out there in “gold land” has just at the wrong time shifted to “but why can’t they just keep papering things over indefinitely?”. The answer is just as simple and if you stand back and put your “common sense goggles” on, you can see it. Our financial system is simply untenable.

All collateral has already been margined. We arrived (in 2007-08) at the point in time where collective credit cards could only be paid by “balance transferring” to another card. New debt has needed to be issued just to service existing debt. Now, this is true even for sovereigns.

The comedy of course is the Fed. Everyone hangs on every word they speak. Everyone is hoping to hear “we will kick the can”. Let me help you stand back for a moment to see the forest. It has now been five years, since 2009, that we have heard the word “recovery” and the Fed will begin to tighten. Every year, every quarter and every Fed meeting we have heard the meme “the Fed will begin to tighten later this year or early next year”. Do you see my point? Nothing has changed since 2008, the only thing that has changed is the world is now further in debt, gobs of currency issued, yet consumption nor production are higher. The bad situation we were in is only bigger while the amounts of unencumbered collateral underlying it all are much smaller. In understandable terms, systemic RISK has never been higher!

Getting back to Greece for a moment, why should they matter? They are a very small and peripheral country in the EU. I am here to tell you they do matter for two reasons. First, financially, let’s call them a \$350 billion burr under the system’s saddle. Looking at the sovereign debt market, rounded off, the sovereign debt market is \$100 trillion so \$350 billion is not very significant. You would be correct IF much of this debt was not carried with such huge leverage. If you consider the CDS “overwritten” and derivatives on this \$350 billion, now you’re talking about real money! Maybe \$3 trillion? Or even \$5 trillion? More? Could the system collectively come up with a \$trillion or two to paper this over? Maybe? The answer is yes they can, but with one very large caveat. Whatever salve to sooth the wound they come up with will be 100% printed because there is nothing left to “lever” off of. Think of it this way, Greece will be the “Lehman moment” with all the same potential dominos “plus two”. The extra dominos are the fact that Greece is a sovereign AND the thread that if pulled on will unravel Europe itself.

Digging even deeper and assuming Greece itself doesn’t set off a chain reaction, though the world ignored what Iceland did in 2009, I don’t think they can or will ignore it with Greece. Even if Greece were to get their requested debt reductions, they would soon be followed by the other “lazy” southern Europeans. Country after country would line up and ask for reductions. Should Greece come right out and say “we cannot pay”, or worse, defiantly say “we WON’T pay”, the same thing will happen. Other cash strapped countries will “follow the leader” and default.

To finish, it is important you understand that now is no time to “let your guard down” and fall into the “they can do this forever camp”. They mathematically cannot and as the math takes over, sentiment will follow ...very quickly! I would like to add, the above has not been lost on China nor Russia. They fully understand it all and have been preparing for and waging a financial war, the U.S. being the ultimate target. Do they want to harm the U.S. population? I don’t believe so and is not their intent. But harm they will and the unsuspecting will be nothing more than collateral damage. The East only wants one thing, “true and fair settlement” of trade. They want “something in return for something”. Can you blame them?

The reason the can will not be kicked down the road any further is because the rest of the world, led by China and backed up by Russia will not allow it much longer. The alternative of course is unthinkable and has happened many times throughout history, real and bloody

war. I pray the end of our current financial system is bloodless, the odds of this however are probably near zero.

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Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.

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