THE National Investor

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A VICIOUS CIRCLE OF FACTORS COULD LEAD TO A U.S. DOLLAR SURGE, MARKET PLUNGE

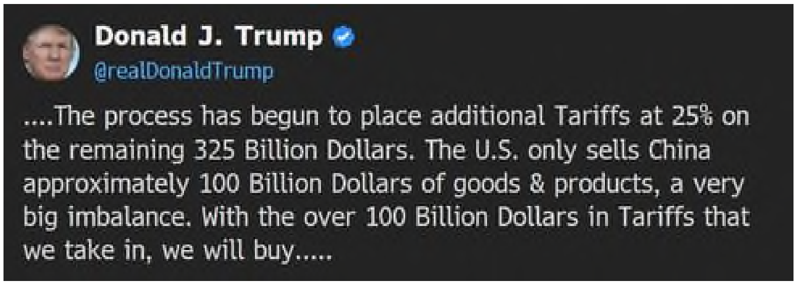
By Chris Temple – Editor/Publisher of *The National Investor*

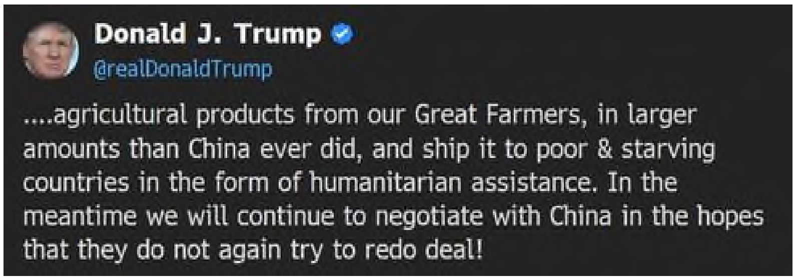
As I write this, what *had been* hopes for an imminent deal of some kind in the U.S.-China negotiations over trade issues (and a lot more) have been dashed. Nasty rhetoric, new tariffs and threats of more from both sides have been increased dramatically as we kick off the week of May 13, as this is written. A few more soothing and hopeful words are coming from both sides on Tuesday morning, for the moment arresting Monday's big market losses. Yet by most appearances, it will be all that the Chinese and American sides can do to get negotiations back on track in a positive way prior to the June month-end G-20 meeting in Japan, let alone have a "deal" for their respective presidents to sign.

As with so many issues in our world today, the masses get sound bites, superficial discussions of the issues and (these days) Tweets. Little of this is useful in understanding 1. What our legitimate issues with China are, 2. How we got into them and 3. How we get *out of them* and on to a better, fairer and more productive regimen for all. . .*if that is possible.* I've written and spoken a great deal on these issues and will continue to do so.

For present purposes, this development of a (for-now) ramped-up trade war *and more* with China is combining with other present/looming issues to increase a little-understood and under reported risk facing the markets: **a surprise and perhaps huge surge *higher* in the exchange value of the U.S. dollar.** Such an event would further devastate emerging markets, likely knock U.S. stocks down more as well, keep commodities in check generally and—all told—throw the world back into recession if it goes on.

CHINA -- "BEYOND A TRADE WAR"





Dueling sound bites—Partly for political reasons and partly, I still fear, out of his own lack of depth of understanding of the issues, President Trump continues to make this battle all about *mercantilism* generally (his prime motivation as I have explained since Day One) and merchandise trade specifically as evidenced by just a couple of his endless Tweets above.

China, on the other hand—in its own public post this (Tuesday) morning above (from the official WeChat post of the People's Daily)—is defending *far more* than Trump is generally wanting to admit. Translated, the above roughly reads, "Negotiate, sure!" "Fight, anytime!" "Bully us, wishful thinking!"

(For some little-understood background of how this all started, I refer you again to a GREAT work by Lewis Lehrman, entitled "China: American Financial Colony or Mercantilist Predator?" which you can read at https://spectator.org/china-american-financial-colony-or-mercantilist-predator/)

Though he has at times alluded to the fact that the long-running trade deficit with China was largely *Made in America*—enabled and profited from, largely, by U.S. banking and corporate interests in years past—President Trump publicly, at least, defines this deficit as the major issue *today*. **It is not.** Right or wrong, America's past leaders have created and enforced a U.S. economic and dollar-centric world where—BY DEFINITION, as the owner/manager of the globe's reserve currency—the U.S. MUST run trade imbalances with the rest of the world.

With China—as that cartoon on the first page shows—America has created one of the tightest symbiotic financial relationships of all time. For most of the duration of this "trade relationship," corporations set up shop in China. Costs for labor and raw materials alike were a fraction of what those cost in the U.S.; thus, profits *for those companies* (not merely "China") rose. **To a great extent, therefore, this "trade deficit" argument is a canard**: an argument over whether a company's profits should be in its left pants pocket (the U.S.) or right (China.)

And, of course, that buildup of dollars over time in that "right pants pocket" has resulted in a LOT of surplus U.S. currency to be recycled into U.S. dollar-denominated paper. **So let's also remove the veil from another canard**: shipping jobs and production to China was not just a sacrifice of American manufacturing power and American labor. It was yet another means for the U.S. government to *knowingly allow* those sacrifices in order to make servicing bloated debt levels that much easier.

The issue today where President Trump is concerned is a part-mercantilist and part-populist one of that simple MAGA concept. Reclaim American jobs and manufacturing, and all that. Bully. I'd like to see that as would the majority of Americans; one reason why Trump is *generally* receiving kudos for his hard line again. (That the president is silent on how such a thing would upend the post-War role of the U.S. dollar in the world, though, is something he never addresses; and a subject for another time.)

What has brought negotiations of recent months to a standstill, however, goes WAY beyond this. Those "hawks" on China I have long spoken of—and who have for now reclaimed Trump's attention and loyalty from the "doves" led by Treasury Secretary Mnuchin and most of Corporate America—seek among other things **to neutralize China** somewhat. Now that a few decades' worth of growing as that American colony has led to China being the second largest economy on the globe in its own right—*and* with aspirations of *at least regional* economic and military hegemony—it wants to march to its own tune (and maintain a VERY unfair playing field) without being lectured to.

Yesterday, one of the smartest people on geopolitics and China, John Rutledge, cut through the B.S. yet again, warning that **we have now moved on to something beyond a mere trade war with China**. (If you want to move past the oversimplified rhetoric and get a REAL education on the stakes here, listen to the interview with Rutledge at: https://www.youtube.com/watch?v=VZHBGfh7HoQ) That's ominous, with the "hawks" on China apparently back in charge.

To a disturbing extent (as always, the Deep State wants to have a conflict with a "monster" of its own past making) **they view China today as those who were in The Reagan Administration viewed the old Soviet Union a generation ago.** China is THE main economic and military rival, longer-term of America; and there are those who would be happy to *really* cripple China as a result of what, in a sense, are *still* misleadingly-termed "trade talks." A credit crisis, market plunge, economic disaster; all might be "tolerable" to these folks if it substantially delays China's long-run economic and military ambitions.

Yet again, as a result of the latest breakdown, an outcome *the opposite* of what both sides *should* want in solving a "trade dispute" is evident: **a renewed plunge in the Chinese yuan's value vs. the U.S. dollar, and with attendant renewed stress on its markets.** Having been one of a small minority of currencies to have previously *rallied* against the U.S. dollar in 2019, the yuan has swiftly given back those gains. If anything, this may even complicate talks with China, as Trump—rather than keeping his mouth shut for a bit and understanding that this is quite *involuntary* on China's part—will hector them further over what he'll term a more *deliberate* weakening of their currency to try to offset the effect of tariffs, export pressures, etc. The truth is that the yuan is weakening anew because many are again fleeing China due to fears that the U.S. hawks might just succeed in causing a crisis there; it's why the U.S. dollar remains high, Bitcoin is surging anew and even gold has kept a bid.

The net result of increased trade worries is that the resulting economic weakness and market drops will **chase people into the safe haven of the U.S. dollar** (and, to certain extents, the Japanese yen, Treasury securities *and even gold*, which will buck commodity weakness elsewhere.) The fate of the yuan will only be worse—and the U.S. dollar only move higher—if things aren't toned down sooner rather than later.

RENEWED EUROPEAN DONNYBROOK

The upcoming European Parliament elections *mere days away* may deliver markets generally and European politics particularly more than they bargained for; **and lead to renewed worries over the Eurozone generally that we haven't seen since 2010-2011.** One reason is that—though the British people voted back in 2016 to no longer be a vassal state of sorts to the E.U.—they will now be voting for their own representatives to go back to Brussels.

The fact that the United Kingdom is even taking part in them is a victory of sorts in one battle that has been "won" by the plutocracy in Brussels, with an important assist from Prime Minister Theresa May. *Yet it could prove to have been a Pyrrhic victory to have kept the British as a part of this whole exercise.* If the election outcome delivers back to the parliament a reinvigorated and reengaged Brexit Party leader Nigel Farage (at his best recently at https://www.youtube.com/watch?v=YshD3VZuLrU) the outcome of this cohabitation-while-divorcing could end up looking like the classic dark comedy *War of the Roses*, with Michael Douglas and Kathleen Turner.

With the part-traitorous and part-hapless P.M. May now a pariah and lame duck in her increasingly lonely abode at "No. 10," Farage has stormed into the void *and now leads the adrift Tories in polls ahead of those parliamentary elections*. In a recent campaign rally, Farage—who would have been a part of history in the rear view mirror were it not for May's betrayal of the Brexit cause—showed again how he has risen almost as a Phoenix and overnight has become a swing factor with his new party (having previously resigned from what was left of U.K.I.P.) *His message even resonates with many who were not that thrilled about leaving the E.U., but who have had a bad taste left in their mouths by the May government's part-betrayal and part-haplessness.* "This fight now is about far more than just leaving the European Union," he told cheering supporters. "This is a full-on battle against the establishment."

And a hostile U.K. contingent in the next parliament is far from the only looming headache for the E.U.'s leaders as Election Day nears in two dozen-plus member states. It is pretty much a foregone conclusion that, *generally*, establishment and "center" parties pretty much Europe-wide are going to come out on the short end of the stick as an assortment of euro skeptic, nationalist and anti-immigration forces add to their presence in the E.P.

Most ominously for the powers that be, **new polls show that the so-called "far right" Rassemblement National (RN)—formerly the National Front—headed up by Marine Le Pen has pulled in front of President Macron's REM Party**. From the yellow vest protests, to Macron's "partnership" with German Chancellor Merkel in turning lose a foreign invasion on Europe to a host of other issues, Macron's popularity, as May's, continues to plunge. If his party indeed does come in second to Le Pen's, it will even further upend domestic politics *and more*.

All this renewed political angst is likely to add to the *downside* case for the euro in the months—even years—ahead. It's notable that the common currency has continued to slowly erode in 2019 *despite* the Fed's about-face as to its own policy intentions. As I have pointed out numerous times, this is due to America's *relatively* healthier economy, and relatively FAR healthier banking system.

Economics and politics alike—especially with increased wrangling within a more fragmented E.U. as to all manner of priorities—are most likely to lead to even more work on the part of the European Central Bank to keep all these political, economic and financial messes heavily papered over. The new makeup of the E.P. will also contribute to what has already become a free-for-all of jockeying in the quest (WHY anyone would want the job is beyond me!) to replace E.C.B. President Mario Draghi when his tenure is up at Summer's end.

Not that long ago it appeared that Germany's Jens Weidmann (right) —Bundesbank President, Chairman of the Bank for International Settlements and a member of the E.C.B.'s governing council—would next have his "turn" at the helm in Frankfurt. But in the context of a euro zone that, if anything, will need *massive NEW monetary easing* just to hold everything (and everyone) together, most have already lost their stomach for a man who would come in very much like the U.S. Fed's Paul Volcker initially did here in 1979 (for one view of how the Establishment sees Weidmann, check out https://foreignpolicy.com/2018/03/08/the-most-dangerous-man-in-europe-is-jens-weidmann/)

So adding all the above together, expect more tension. . .jockeying among "doves" to replace Draghi. . .perhaps some renewed, credible threats to leave the euro zone. . .and more, all of which will lead to a marked drop in the euro versus the dollar, all else being equal. **As tensions increase, I have no doubt that whoever runs the E.C.B. next will double down on Draghi's past "Whatever it takes"**

promise to keep this whole scheme alive, even if in the process the euro increasingly begins to resemble the Venezuelan and other rickety currencies. Already, Italy has proven that the E.C.B. specifically and Europe's leaders generally can be shaken down, extracting numerous concessions in papering over its world-leading mess of a banking system and more as the price for remaining in the euro zone. *Others will soon be extracting the same*.

At its zenith in the middle of the last decade, the euro traded at $1.60 to the dollar. *My firm belief is that it will continue its trip since back down to the all-time lows plumbed just after its launch*. What I and others have called the "Japanification of Europe" will intensify.

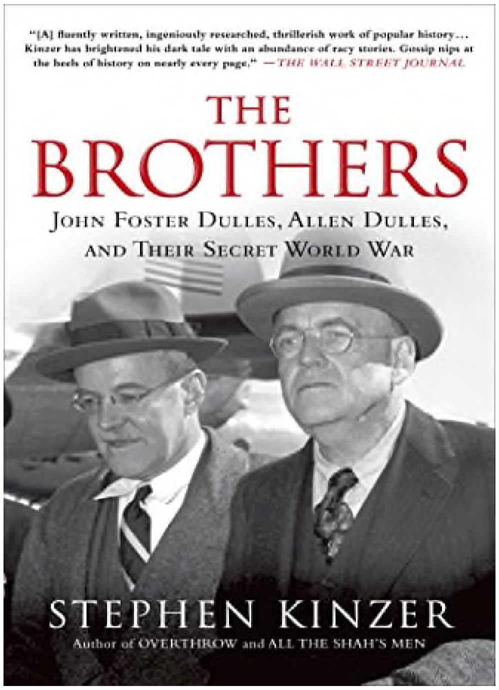
If that's not enough to undermine the euro and put more steam in the dollar, a weakening euro will **exacerbate trade tensions between the E.U. and China**. The world's two major exporting titans have already had their own intensifying issues with one another, though they have been overshadowed by the marquee U.S.-China spat (more fun, etc. for media coverage.) Here again, as this other trade war heats up, Europe and China can be counted on to increase their own *currency war*.

RENEWED GEOPOLITICAL WORRIES

The above core economic issues we face today are already enough in themselves to make the risk of a major dollar move being one to the up side higher than most understand. But what could *really* send a rising dollar (and plunging assets most everywhere else) into overdrive would be a greater threat—or God forbid, the reality—of WAR.

To me, the most disappointing thing about the Trump presidency thus far is that *Candidate* Trump—who correctly railed against America's military adventurism the world over, with its attendant loss of trillions of dollars and countless lives—has allowed himself to be completely neutered. **Now-*President* Trump has given the Military-Industrial complex, war mongers and interventionists a pretty free hand**. He brags of presiding over record military budgets. He wants N.A.T.O. expanded, as opposed to his (correct, I.M.O.) calls as a candidate for that body's long-overdue dismantling.

No Trump appointee more epitomizes his 180-degree turn than National Security Adviser John Bolton. As I have quipped, Trump might just as well have had Melisandre from *Game of Thrones* fame raise the maniacal John McCain from the dead and let *him* run American foreign policy. There would be no discernable difference.



As with the hawks on China policy that are willing to risk pushing China *too far*, Bolton is a dedicated advocate of American Empire; he's very much following the example first set by the Dulles brothers in the wake of World War 2. **To that end (among other things) he is dusting off one of the top priorities of the neocon cabal in Washington of recent years: the overthrow of Iran's government, if not all-out war if that isn't accomplished**. With those not to America's liking once again running the country, Bolton seeks to repeat what the Dulles brothers accomplished back in the early 1950's (at that time, the overthrow of Mohammed Mossadegh.)

With markets both overpriced and vulnerable, even an "accident" of some kind in the Middle East (*Bolton* is the one who claims to have ordered a carrier group and Patriot missile battery nearer Iran) could topple things. With upward pressure *already* on the greenback due just to what we pretty much know, this unknown "Black Swan" event—if it materialized—would send market moves into overdrive: Treasuries (and other major sovereign debt) would soar higher in price. . .the U.S. Dollar Index would surge back well into triple-digit territory. . .emerging market paper of all kinds would get pounded. . .industrial commodities would get set back further . . .etc.

CONCLUSION

In putting together a portfolio strategy, one must sort through and handicap numerous probabilities and scenarios. The preceding is by NO means a recommendation that one *completely* gird their portfolio—yet—for that "Going to the mattresses" mode I've quipped about previously. Indeed, though I have just advocated that Members increase a few positions in our short ETF's as a portfolio "counterweight" and trade, *we remain net long of stocks, as well as of gold-related ETFs and companies*.

All the above is, instead, food for thought: and an explanation I hope I have made sufficiently well that the risk of a U.S. Dollar move that would surprise everyone were it to come about has not been taken nearly seriously enough. And don't forget that—in addition to all these factors I've discussed that could give rise to that—currency traders will be only too happy to ride and then exacerbate such a move as I discuss, with a lot more of this, at http://www.kereport.com/2019/05/13/trade-war-escalation-shift-money-to-the-risk-off-assets/