
A MACRO DISCUSSION ON FLOATERS, GOLD AND THE DOLLAR

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05/01/2018

On last week's "Behind the Markets" podcast, I had a [macro](#)-focused show spotlighting the geopolitical situation and developments in Asia, fixed income, floaters, the dollar and gold with two interesting guests: Peter Tchir, macro strategist at Academy Securities, and Brent Johnson, CEO of Santiago Capital.

Academy Securities is a broker-dealer, owned by disabled veterans and staffed 40% by veterans, with a social mission to help those who served in the military. Academy Securities also has an advisory committee (composed of 10 retired admirals and generals) that shares insights on geopolitics with institutions and registered investment advisors (RIAs)/family offices alike—and this made for a timely discussion with the geopolitical developments in Asia. Santiago's Johnson believes we are going to have a strong dollar environment for which the monetary system isn't prepared, and he believes this could create a crisis that ultimately leads to a parabolic move in gold.

Some of the highlights of the conversation included the following:

Peter Tchir, Macro Strategist at Academy Securities

- **On the Trade War:** Tchir commented that we have been in a trade war for the last 10 years, but only one side has been firing bullets. Therefore, Trump's focus on reciprocity in trading relationships could be a winning argument when it comes to opening foreign markets to our goods or intellectual property rights in China.
- **Wary Outlook:** Tchir is cautious on equities in the very short run because he believes we will see another flare-up in trade tensions—that China will try to support its technology firms on the global stage. Until the market gets past that or feels we are going to come to a good deal with China, Tchir believes it will be hard to see strong gains.
- **Is the [Federal Reserve \(Fed\)](#) Too Aggressive and Slowing Consumer Spending?** Tchir believes the Fed is at risk of slowing down the economy too much with the [2-Year Treasury](#) having risen from 1.25% last year to 2.5% now. This is making cars and homes more expensive, and Tchir sees some slowdowns in large-ticket items, such as auto sales and furniture, that are worrying.

- **Fixed Income or Floaters?** Tchir prefers [floating rate](#) instruments for derisking portfolios. He suggests one could take risk off the table by shifting out of long-date bonds and [high-yield](#) investments to favor floaters. We spent some time discussing floating rate Treasuries as the new anchor for U.S. government “risk-free” floating rates, whereas investors used to have to take [credit risk](#) in either leveraged loan or non-investment-grade credit rates tied to . LIBOR spreads have increased from 10 to 15 [basis points \(bps\)](#) to 40 bps, and Tchir finds that attractive given structural changes to money market funds that he thinks are causing these spread increases.
- **Chinese Yuan Bonds:** Tchir likes a global exposure in both emerging markets as well as Chinese specific assets, with the view that China is, for the long run, going to continue to support a stronger currency to support consumption.

Brent Johnson, CEO of Santiago Capital, on Gold and the Dollar

- **Beginnings:** Johnson had his start in traditional wealth management at Donaldson, Lufkin & Jenrette and Credit Suisse before he brought his wealth management practice to join an independent RIA, Baker Avenue Asset Management. In 2012, he set up Santiago Capital as a precious metals solution for its wealth management clients.
- **Permanent Portfolio:** I probed Johnson about how investors should think about alternatives to the traditional [60/40](#) equity/bond mix, something he views to be at risk in the current market environment with extended [duration](#) and lack of yield in traditional fixed income. His current portfolio allocations for clients continue to shorten duration. He sees the risk-reward and relative safety of bonds to be nowhere near where it was over the last 40 years. The problem for Johnson is that he sees limited opportunities elsewhere, with all assets at their all-time highs.
- **Got Gold?** Johnson believes everyone should have some gold in their portfolio. This permanent portfolio, which has roots back to 1970s, has 25% allocated to each of four groups: equities, fixed income, real estate and gold. Johnson thinks this is a great place to start—with returns that would have only lost money in three years over the last 40 years, and the three years that were down were modest. Shifting this permanent portfolio more tactically for today’s environment, Johnson would be under-weight in bonds and over-weight in equities and cash.
- **Owning Physical Bars:** Johnson set up his fund so that he can own physical bars, be able to [hedge](#) his positions and also have the flexibility to invest directly in mining companies. Right now, Johnson is not in the miners because he thinks he will get a better opportunity ahead.
- **Why a Stronger Dollar Could Lead to a Gold Spike:** Johnson believes the monetary system was set up for a weak dollar environment and that problems a strong dollar environment can cause will create chaos that ultimately leads to sharp moves higher in gold. Johnson has a base case of \$5,000 in the next four to five years.
- **Digital Gold (aka Bitcoin) versus Actual Gold?** I probed Johnson if Bitcoin has the potential to steal some of the “alt-currency” demand from gold, and Johnson thought it wasn’t an either-or proposition; instead, he believes gold’s legacy as an anchor in central bank reserve portfolios throughout time makes it a more reasonable “safe haven” asset. Johnson sees four or five digital currencies ultimately will wind up helping change the world, while the other hundreds if not thousands of digital currencies will end up like the dot-com crash.

- **Dollar Weakness or Euro Strength?** Johnson ascribes some of the weakness in the dollar to a view that the Fed eventually could cause a [recession](#) by [hiking rates](#) at the same time Europe would be ending its bond purchase programs. Yet European data has rolled over from strength and Mario Draghi (president of the European Central Bank) has backed off some of the [taper](#) talk. Furthermore, Johnson sees the Fed to be in a stronger position from continuing its tightening regime today compared with when it started hiking. Many were worried we'd taper and cause a recession or hike and cause a recession, but we've hiked rates five times without any problems and the dollar is 10% weaker than when the Fed started hiking, with financial conditions arguably in better shape today.
- **Supply/Demand Imbalance of Dollars:** Ultimately, Johnson describes dollar strength he sees as coming from the largest buyer in the world (the Fed) buying back dollars (removing dollar supply) as the Fed engages on [quantitative tightening](#) regime and also having the [Treasury](#) ramping up debt issuance crowding out dollars from the system. Johnson believes the dwindling supply of dollars will cause a spike in the dollar's price, something he sees as a large global risk factor.

With everything in the markets today being very macro and geopolitics driven, this was a great conversation that you can listen to in full below.

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DEFINITIONS

Macro: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

2-Year Treasury: a debt obligation of the U.S. government with an original maturity of two years.

Floating Rate Treasury Note: a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

High Yield: Sometimes referred to as “junk bonds,” these securities have a higher risk of default than investment-grade securities.

Credit risk: The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

Basis point: 1/100th of 1 percent.

60/40 Portfolio: A portfolio of 60% equities and 40% fixed income.

Duration: A measure of a bond’s sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Tapering: A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Quantitative Tightening: Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Treasury: Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.