



April 10th
Market Briefing

kramer.

"Reversing trends"

Market briefing

- ➔ The world needs stability when it comes to choose its ruling currency.
- ➔ The market will automatically follow and praise the currency that covers its three basic needs.
- ➔ Despite whatever that can be said, the US dollar still holds the lead among worldwide currencies.

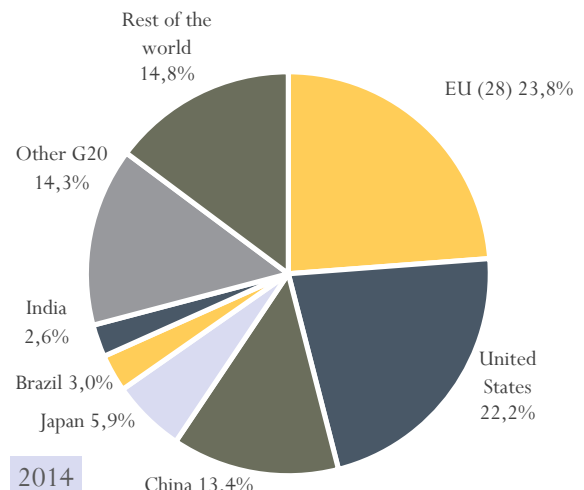
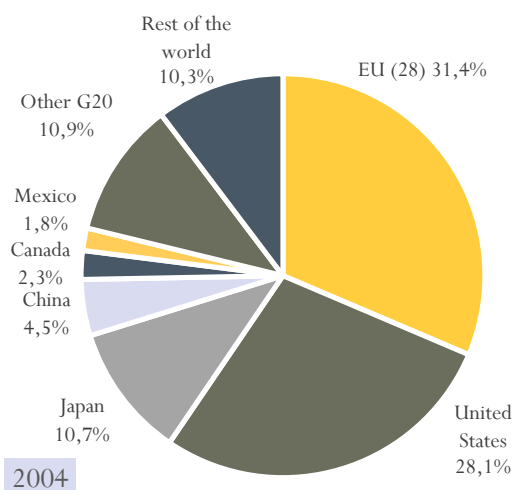
The US dollar can claim it has provided, for many years, the world with the necessary stability any currency of reference shall provide. World trade for goods, services and capital has benefited from the uniformity the US dollar represented to merchants and traders. However, in the last ten years, following the birth of the euro and the growing relevance of China in the world economy, more than one voice was raised claiming to a new era were the US currency would see its hegemony taken away. Truth is the US has seen how its share in the world trade for goods diminished year after year, and this has been the predominant argument used by those saying the US dollar dominance days were behind. But world trade has evolved and it certainly has changed in the last twenty years, and this evolution has implied that the core reasons for a currency to dominate the world has changed.

The Euro and the Yuan were once claimed to take over the US dollar's predominance.

Any currency must comply with three functions: To be a mean of payment, to allow for value to be stored, and to be useful as a unit of account. Starting with the last one, the fact that all commodities are traded in US dollars together with the predominance of the US dollar denominated assets in the world financial markets makes the US dollar a second-to-none unit of measure. Being a widely recognized unit of measure implies that trading will have a huge bias to happen in the same currency as the object of the trade is being valued. To be a way of storing value is maybe the currency function that the US dollar has complied less with. Since the beginning of 21st Century the US dollar has lost until April 2017 more than 43% of its purchasing power. The US currency certainly loses the battle against the euro which has a cumulative inflation slightly over 35% in the same period. Last but not least, the US dollar is a widely accepted way of settling down payments. US dollar denominated bank accounts are a certain option in all those economies with freedom of capital movements. Even considering cultural inertia, households in those economies with market controls tend to hold their savings in green currency notes. Therefore, despite the uprising relevance of alternatives the US dollar has coped very well to cover the basic functions any currency must cover.

The US dollar has been able to cover all the functions a reference currency needs.

Share of World GDP



In the previous graph (source: Eurostat) it can be seen how the EU and the US have lost weight in the world output, despite keeping the first and second place, respectively. However, if we look at the weight of the US dollar zone countries combined, the share of those goes up to 60% of the world output (source: BIS). The USD rules. Even the economic areas controlled by political power opposing the US view of the world order have relied on the US dollar for their economies to work. This is due to the dependency of those economies on commodities. We can't forget about those economies which have relied on the US dollar for pegging their domestic currencies in an attempt to signal stability. A currency pegged to the US dollar demands for huge reserves of the latest in order for the message to be credible. Also most governments opt for the US currency when issuing debt.

A currency is ultimately an asset and as such it has a price driven by the basic market forces of supply and demand. If demand is powered by reasons other than the standard ones then we can pump into the market more quantity of that asset while keeping the price high enough. Long story short this is what has happened with the US dollar for many years. But since the appearance of candidates to substitute, at least partially, the role of the US dollar in the world economy bets started to be made about how long the US dollar could last. That discussion, despite all the flaws of the US currency, is in our opinion no longer necessary. China, with its controls over the capital markets has dropped the Yuan out of the competition. The euro on its side could be the most reasonable alternative to the US dollar, however as long as its own existence is being questioned it will not succeed.

Even if the upcoming elections in the European Union fail to materialize the up rise of anti-European political parties the very own existence of the euro will still be questioned. Following Mr. Trump election as president of the United States six months ago the euro appreciated against the US dollar, reaching levels not seen in more than ten years. But since then the US dollar has appreciated more than 5% and everything points to a continuity in this trend. This recovery of the US dollar against the euro has happened even in a context within which the Euro Zone has shown clear signs of economic recovery. Even during the same period European stock markets have outperformed the stock markets on the other side of the Atlantic ocean. The most likely explanation is that fears about Mr. Trump presidency negative effects on the economy are fading out.

There is a clear reversing trend of the world economy to believing, beyond any doubt, that the US dollar will rule the world for the years to come. Each one for its very own reasons China and the European Union have failed in convincing the world that their respective currencies are a solid option to the US dollar.

Becoming a reference in any market not only relies in the characteristics of the product, but also on history. If a change takes place it does it at different speeds, depending on the industry. The inner mechanics of worldwide trade are extremely complex and its parts are deeply rooted. Changing that will need more than an attractive offer of an alternative.

In the absence of a major event, and we can't imagine an example of such, the US dollar will still rule and this condition will allow for its value to be boosted by factors different from any other currency. It is important to point that the prediction of a world dominated by the US dollar in the years to come has no direct link to its price. Leave aside predicting its value.

By controlling inflation and expanding its area of influence the ECB will prepare the ground for the euro, maybe, in many years to become an alternative (again). Obviously how attractive that alternative will be depends on what happens on the US side. Too many variables need to be considered for a grounded statement to be made today.

Any investment or corporate strategy today shall incorporate as a given factor that the US dollar will continue to be the predominant reference currency, serving the world to trade and value the goods and services exchanged every day. If it also serves as the best way to store value is something less clear but for sure is the alternative most of investors, from Mumbai to Buenos Aires, will take. The wisdom of the crowds will be tested by how well the US dollar performs.

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Contact

 info@kramer.co.nl

 + 31 3 6750 1715

 www.kramer.co.nl

 Markerkant 13-10, 1314AN Almere, Netherlands

kramer.