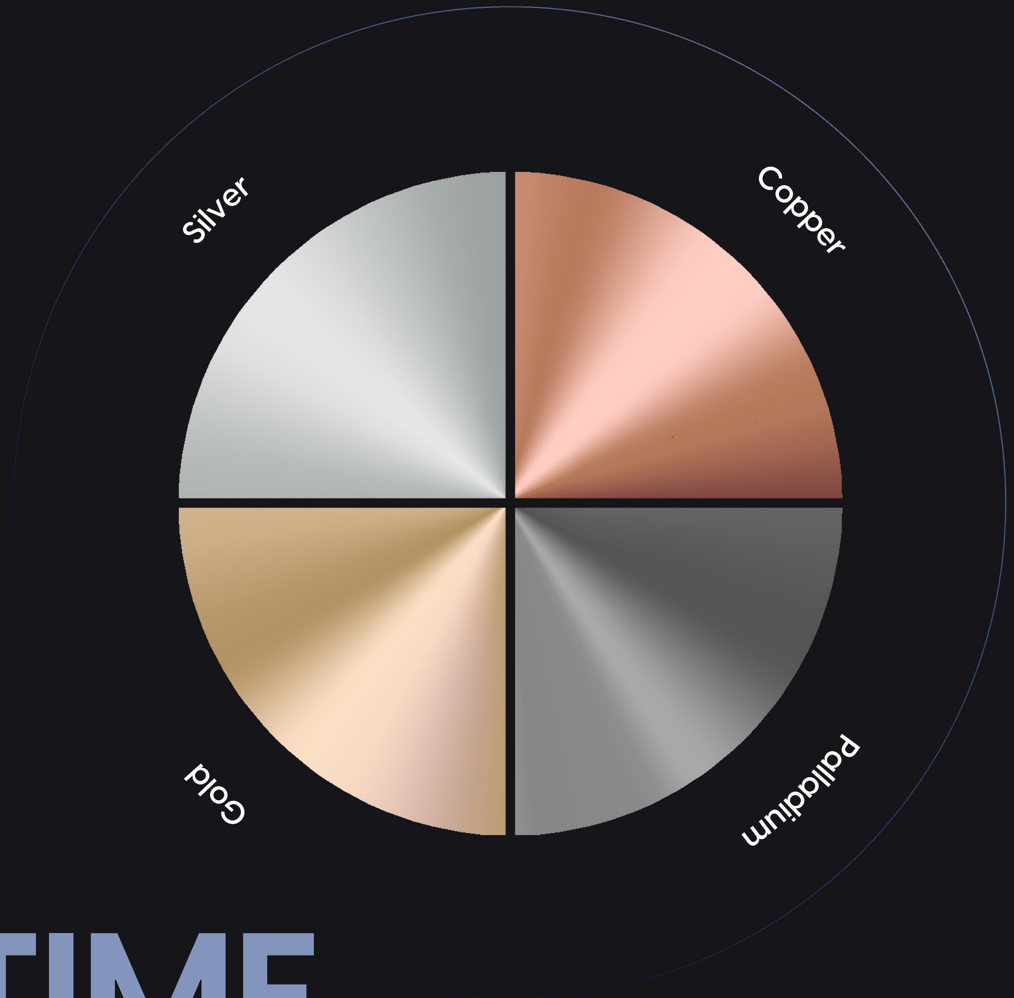


LIFETIME OPPORTUNITY

September 2024

Devaluation of the US Dollar: A Key Global Trend

Introduction

The ongoing devaluation of the US dollar is increasingly recognized as a critical theme with far-reaching implications for global markets. This trend is largely influenced by the strategic actions of the BRICS nations (Brazil, Russia, India, China, and South Africa), which are some of the largest emerging economies and key global oil producers. Their collective effort to reduce reliance on the US dollar in international transactions is a significant factor that could reshape global trade dynamics.

BRICS Payment System

In an unprecedented move, 159 countries are considering adopting the BRICS payment system, which allows them to bypass the US dollar in international trade. This shift would enable these countries to conduct trade more efficiently, using local currencies, thus reducing exchange rate risks and transaction costs.

Reduction in Dollar Dependency

The BRICS nations have actively sought to move away from using the US dollar in international transactions, opting instead to use local currencies. Presently, 20% of global oil payments are made in non-dollar currencies, and with 40 additional countries expected to join BRICS by 2025, this trend will likely accelerate. This shift marks the beginning of a more diversified global financial system where the US dollar's influence is steadily diminishing.

Impact of the Petrodollar's Decline

The recent dissolution of the longstanding petrodollar agreement between the US and Saudi Arabia is one of the most profound developments in recent history. Saudi Arabia, which produces around 10% of the world's oil, now has the freedom to sell oil in any currency, departing from the traditional practice of settling oil transactions exclusively in US dollars. This major shift weakens the dollar's dominance in the global oil market, further underscoring the BRICS nations' efforts to promote local currencies in international trade.

The MBridge Project and Digital Currencies

Saudi Arabia's involvement in the MBridge project, alongside 20 commercial banks from China, the UAE, Hong Kong, and Thailand, reflects a growing interest in using blockchain technology and Central Bank Digital Currencies (CBDCs) to facilitate cross-border payments. This initiative aims to reduce transaction costs and increase the speed and security of international payments, further lessening dependence on the US dollar.

TURNOVER OF FOREIGN EXCHANGE INSTRUMENTS, BY CURRENCY ▾

Source: BIS

CURRENCY	2001	2004	2007	2010	2013	2016	2019	2022
BRL:Brazilian real	0%	0%	0%	1%	1%	1%	1%	1%
JPY:Yen	24%	31%	17%	19%	23%	22%	17%	17%
CHF:Swiss franc	6%	6%	7%	6%	5%	5%	5%	5%
RUB:Russian rouble	1%	1%	1%	1%	2%	1%	1%	0%
USD:US dollar	90%	88%	86%	85%	87%	88%	88%	88%
CNY:Renminbi	0%	0%	0%	1%	2%	4%	4%	7%
INR:Indian rupee	0%	0%	1%	1%	1%	1%	2%	2%
EUR:Euro	38%	37%	37%	39%	33%	31%	32%	31%

Devaluation of the US Dollar: A Key Global Trend

BRICS' Strategic Currency Swap Agreements

BRICS countries, particularly China, have been actively pursuing currency swap agreements with developing nations. These agreements allow countries to trade using local currencies, bypassing the US dollar altogether. The cumulative value of these swaps stands at USD 553.49 billion, covering 29 developing nations. This initiative enables more direct, cost-effective transactions and provides stability for national currencies.

By removing exchange rate fees and lowering transaction costs, these agreements foster economic independence for developing nations and bolster their financial systems against global market volatility.

China, as the leader in this initiative, is expanding its reach through the swap agreements, offering nations the opportunity to reduce their reliance on the dollar. This could lead to long-term shifts in global trade flows, further undermining the US dollar's role as the dominant reserve currency.

A Growing Threat to the US Dollar's Dominance

The International Monetary Fund (IMF) has acknowledged that the de-dollarization trend led by BRICS is a growing concern for the US dollar's status as the global reserve currency. While the dollar remains the primary currency for global trade, particularly in commodities, it is increasingly under threat.

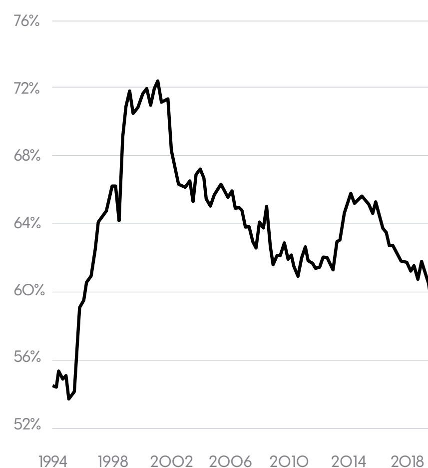
Furthermore, if Saudi Arabia, one of the world's top oil producers, joins BRICS, it could accelerate the use of local currencies in global oil transactions. This would be a significant blow to the US dollar, as BRICS nations already control 43% of the global oil supply.

The declining value of the US dollar presents an opportunity for investors to diversify their portfolios by incorporating commodities and other hard assets. As central banks reduce their exposure to US Treasuries and move towards physical assets like gold and oil, investors should follow suit to hedge against currency risks.

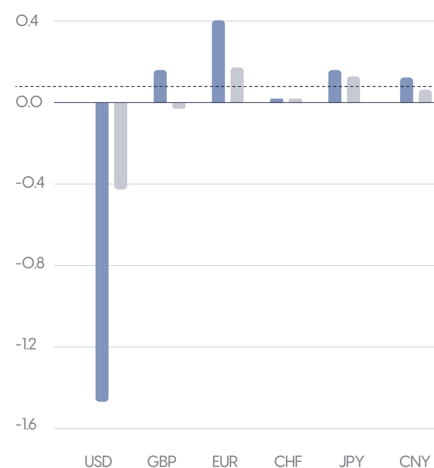
DOLLAR SHARE FELL TO ITS LOWEST LEVEL SINCE 1995 ▼

While Dollar's share of global reserves initially increased at start of pandemic, it has since decreased & now stands at just 59%–1.5pp decline QoQ & lowest since 1995. Part of decline due to depreciation, but also due to active USD selling.

USD Share of Allocated Reserves



Change in Share of Global FX Reserves, Q4 2020



Change in Reported Share
Change in FX Valuation-Adjusted Share

Sources: IMF, Bloomberg, Goldman Sachs Global Investment Research

Rate Cuts and Inflation Trends

Global Inflation

As inflation trends shift globally, central banks are taking decisive actions to either control inflation or stimulate growth. Many are considering or have already implemented interest rate cuts to boost their economies. These monetary policy shifts have profound implications for commodities markets, particularly those that act as stores of value like gold and oil.

Declining Inflation in Europe

Inflation in major European economies, such as France, Spain, Germany, and Italy, has dropped to its lowest levels in three years. In response, the European Central Bank (ECB) is contemplating interest rate cuts to further stimulate economic activity. Historically, lower interest rates tend to increase demand for hard assets such as commodities. When real returns on bonds decline, investors often flock to gold and other tangible assets as safe havens.

US Inflation and the Federal Reserve's Approach

In the United States, inflation is slowly trending towards the Federal Reserve's 2% target. However, real estate inflation tends to lag behind by roughly six months, which could influence the Fed's future decisions. With unemployment rates remaining stable, the Fed's strategy for interest rate cuts will play a crucial role in shaping demand for commodities, particularly gold and oil, which are considered stores of value in uncertain times.

Global Economic Trends

Global economic recovery, especially in commodity-producing nations, is boosting optimism for the commodities market. The strong performance of commodities in 2022 highlights their resilience in inflationary environments. This trend is likely to continue, driven by inflation and the global business cycle.

China and other major commodity exporters are leading this resurgence, signaling growing demand for industrial commodities. As these economies expand, commodity demand will rise, supporting higher prices and sector growth, with China remaining a key player due to its manufacturing strength and infrastructure projects.

US - REAL INTEREST RATE VS. GOLD PRICE ▼

Source: MacroMicro

Geopolitical Risk and its impact on commodities

Iran and Israel

The escalation of military tensions between Iran and Israel, particularly following recent airstrikes, has led to heightened fears of supply disruptions in global oil markets. Iran, a major oil producer, holds a critical position in the geopolitical landscape, and any threat to its oil production can send shockwaves through energy markets.

Following the airstrike in Damascus, attributed to Israel, which resulted in the death of key figures within the Iranian Revolutionary Guard, Iran has vowed retaliation. The risk of further military engagement between these two nations puts pressure on the stability of oil supplies from the region, driving up oil prices.

Major countries have already issued warnings to their citizens to leave Lebanon due to the risk of escalating conflicts. As tensions rise, the potential for broader regional conflicts could lead to significant disruptions in oil supply, pushing prices higher.

Ukraine and NATO: Russia's Aggression

The ongoing conflict in Ukraine and its bid to join NATO have heightened tensions with Russia, with potential repercussions for energy and commodity markets. NATO's support for Ukraine remains defensive, but the prospect of Ukraine's induction into the alliance could escalate the conflict further.

The REPO Act, passed by the U.S. House, could allow the Biden administration to seize over USD 300 billion in frozen Russian assets for Ukraine's reconstruction, straining relations between the West and Russia.

Despite military support from Europe and the U.S., Ukraine continues to face territorial losses, and the war shows no signs of ending soon. Ukraine's recent receipt of F-16 jets suggests a protracted conflict. The country has lowered the minimum recruitment age from 27 to 23 and has reportedly gained control of 1000 square kilometers of territory, including a key bridge at Kyersk. Kyiv had also considered a shock strike to change the war's course.

Meanwhile, Germany plans to reduce its military funding for Ukraine, potentially affecting future defense capabilities.

Dylan Figueiredo
Head of Multi-Asset Management at Haute Capital Partners

«Europe and the US can supply Ukraine with all the weapons they want, but they can't provide soldiers. If they do, it risks a WW3 with Russia and opens the door for China to invade Taiwan. Now, for the first time, Ukraine can negotiate with something Russia wants – its territory – rather than just asking for peace. This marks a major shift, as Russia has held the upper hand in the war for much of the year».

Central Banks and Their Gold Buying Spree

Central Banks' Flight from US Treasuries

As global financial systems shift, central banks and investors alike are turning towards commodities, especially gold, as a hedge against dollar volatility.

Countries like China, India, and Russia are significantly reducing their holdings of US Treasuries. Instead of relying on dollar-denominated assets, they are shifting their reserves to commodities and other physical assets. This strategy not only helps them mitigate the risks associated with the dollar's devaluation but also increases their protection against market fluctuations.

Rise of Gold and Commodities as Strategic Reserves

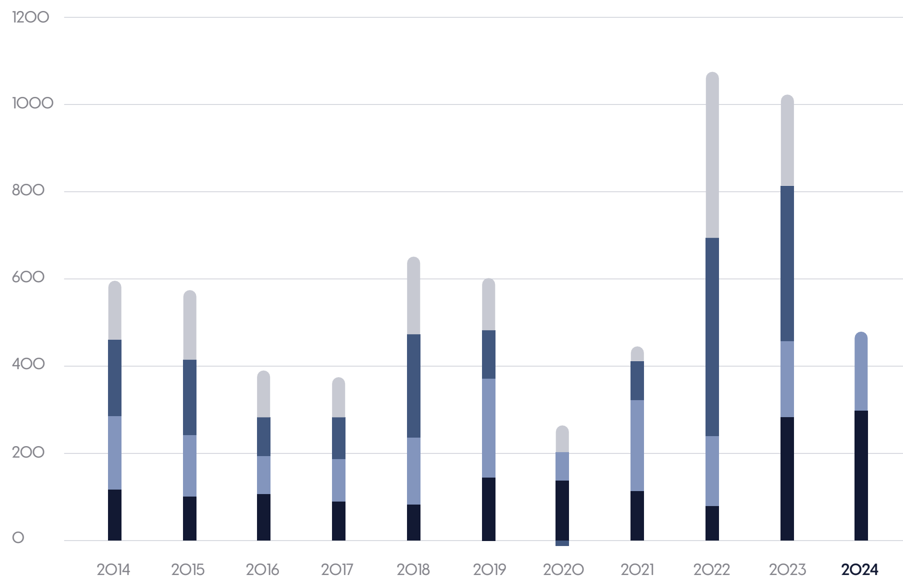
The move toward commodities reflects a broader strategy among central banks to protect their reserves from the ongoing depreciation of the dollar. For investors, this is a clear signal that commodities, particularly gold, represent a solid hedge against currency risk.

1. **Jewellery demand and portfolio hedging:** Jewellery demand remains a significant driver of gold consumption. However, gold is also increasingly being utilized in portfolios as a hedge against market volatility and inflation.
2. **Gold as a diversifier:** Gold outperforms bonds about half the time when stocks decline, making it an essential tool for portfolio diversification. Despite this, many investors still overlook gold as a strategic asset.
3. **Tail-risk hedge:** Gold is an excellent tail-risk hedge in both high and low inflation environments, as well as during periods of geopolitical uncertainty.

Given these factors, gold and other commodities are likely to be underpriced in aggregate.

CENTRAL BANK GOLD DEMAND IN H1 WAS THE HIGHEST ON RECORD ▶

- Q1
- Q2
- Q3
- Q4



Sources: Metals Focus, World Gold Council; Disclaimer

*Data as of 30 June 2024.

Central Banks and Their Gold Buying Spree

China, India, and Poland Lead the Way

China and India have been at the forefront of the gold buying surge. China, in particular, has dramatically increased its gold purchases, outperforming European markets. This is largely driven by inflationary concerns and geopolitical risks, which have led many in the region to view gold as a more reliable store of value than their local currencies.

Poland has also ramped up its gold reserves, signaling a broader trend across both developed and emerging economies to protect themselves from the devaluation of major currencies.

Asian Gold Flows Surpass European Flows

Asian markets have been outperforming their Western counterparts in terms of gold flows, reflecting a regional understanding of the role that gold plays in times of financial instability.

1. **Emerging economies and wealth protection:** People in emerging economies, particularly in Asia, have historically experienced significant drawdowns in their financial asset wealth due to inflation or geopolitical conflicts. For them, gold is seen as the base currency, while their paper currencies are considered risky. This reality has made gold a cornerstone of wealth protection across much of Asia.

2. **Chinese demand as a gold price driver:** China's massive demand for gold is a critical driver of global gold prices. This demand is fueled not only by inflationary pressures but also by domestic challenges such as capital controls, poor performance in local real estate and stock markets, and restrictions on alternative investments like Bitcoin.

China's Deflationary Depression and Currency Devaluation

China is in a deflationary depression, with limited policy tools to address economic challenges. Currency devaluation seems the most viable solution, especially with projected US interest rate cuts and a weaker dollar, which provide room for the PBoC to devalue the yuan. Devaluing the currency relative to hard assets like gold is one way China could manage this situation.

Chinese citizens face restricted investment choices due to capital controls, limiting their ability to move money abroad. With real estate values dropping by over 34% and stocks underperforming, physical gold and jewelry have become the preferred means of wealth preservation. This shift has significantly driven up demand for gold, as it offers a stable store of value in the current economic environment.

The Unique Nature of Gold: Physical vs. Financial Demand

Finance vs Indutry

Gold is unique in that its price is driven more by supply and demand dynamics than by the fundamentals that drive equities or bonds. There are two types of demand for gold: physical and financial.

1. **Physical demand:** This includes demand from central banks, jewelry buyers, and purchasers of gold bars.
2. **Financial demand:** Financial demand comes primarily through exchange-traded funds (ETFs) like GLD. Interestingly, while physical demand remains robust, financial demand has shown signs of weakness in Western markets, as ETFs have experienced outflows despite rising gold prices.

This divergence between physical and financial demand creates a complex dynamic in the gold market. The correlations between gold and other asset markets have flipped since the pandemic, making gold a challenging asset to trade but an attractive one to hold.

East Meets West: A Tale of Two Markets

The surge in gold prices is being driven by contrasting financial climates in the East and the West. In the East, depreciation pressures on the Chinese Yuan have sparked a significant demand for gold, with domestic gold ETFs trading at a 30% premium over the Shanghai premium. Meanwhile, in Western markets, the GLD ETF has seen negative flows, indicating a selloff despite rising gold prices.

This divergence signals broader market implications and sets the stage for a potential short squeeze in the gold market, which could drive prices even higher. With robust demand from China and declining ETF demand in the West, upward pressure on gold prices is expected to intensify.

COMMODITY PRICES HAVE SURGED SINCE 2020 LOW ▸

BofA strategists say a secular bull market is just getting started

Source: Bloomberg

Silver: Dual Demand

Introduction

Silver holds a unique position as both an industrial metal and a safe-haven asset. Its versatility and increasing demand, driven by industrial applications and investor interest, make it a commodity with significant market potential.

The Photovoltaic Boom

Silver is a critical component in photovoltaic cells used in solar panels. With the global shift towards renewable energy, demand for silver in this sector is expected to rise significantly. China, a leader in solar panel production, is driving much of this demand, accumulating 71'000 metric tons of silver. This surge has pushed silver prices higher on the Shanghai Metals Exchange, far outpacing Western markets.

India, another major player, has also increased its silver imports, further intensifying global demand. As the world continues its transition to cleaner energy sources, silver's role in renewable technologies, particularly solar energy, solidifies its importance as an industrial metal.

Silver vs. Gold Ratio

The gold-to-silver ratio is a critical metric that many investors watch closely. Historically, this ratio has fluctuated, and any significant deviations often present trading opportunities. Currently, silver is trading at a lower value compared to gold, which could suggest an underappreciated investment opportunity.

Limited supply, combined with rising demand, could trigger a "silver squeeze," where prices rise sharply due to supply shortages. The growing demand in China and India is already creating upward pressure, and any disruptions in supply could further exacerbate the situation.

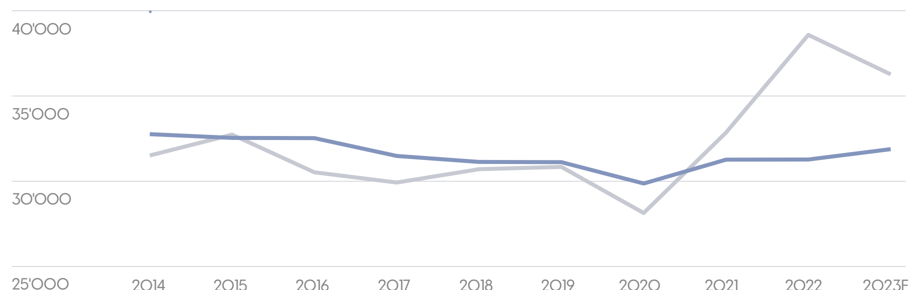
Lastly, the global demand for silver is soaring. The industrial use of silver in sectors like solar panels and AI chip production, coupled with its traditional role as a safe-haven asset, makes silver an essential commodity to watch.

The Ripple Effect on Precious Metals

Historically, bull markets in gold often attract generalist investment first, but attention eventually shifts to silver. As the more accessible counterpart to gold, silver has begun to attract interest as a cost-effective alternative amidst rising gold prices and currency fluctuations.

According to the World Gold Council, demand for gold coins and bars surged nearly 58% from 2022 to 2023, indicating that investors are increasingly viewing silver as the next logical step in their precious metals portfolios. This shift is especially true for large institutional investors looking to diversify in a period of global economic uncertainty.

SILVER DEMAND GROWING FASTER THAN SUPPLY, TONS ▸



Source: Bloomberg

Copper: The Essential Industrial Metal

Rising Global Demand

Copper is indispensable to the global economy, particularly in the renewable energy and electric vehicle (EV) sectors, where it plays a key role in electrical conductivity, energy efficiency, and infrastructure development. Despite recent market corrections, the long-term outlook for copper remains robust, driven by its essential role in emerging green technologies and infrastructure.

Demand Growth in Green Technologies

Global copper demand is projected to grow by 3.5% in 2024, primarily fueled by its increasing use in renewable energy systems and electric vehicles. According to the International Copper Study Group (ICSG), global refined copper consumption is set to outstrip supply in the coming years, driven by:

1. **Electric vehicles:** EVs require approximately 3 to 4 times more copper than traditional internal combustion engine vehicles. Each EV contains roughly 83 kg of copper, used in batteries, motors, wiring, and charging stations.
2. **Renewable energy systems:** Solar panels, wind turbines, and energy storage systems all rely on copper for their efficiency and reliability. For instance, copper accounts for about 25% of the total mass in wind turbines, playing a vital role in the generation of clean energy.

Supply-Side Challenges

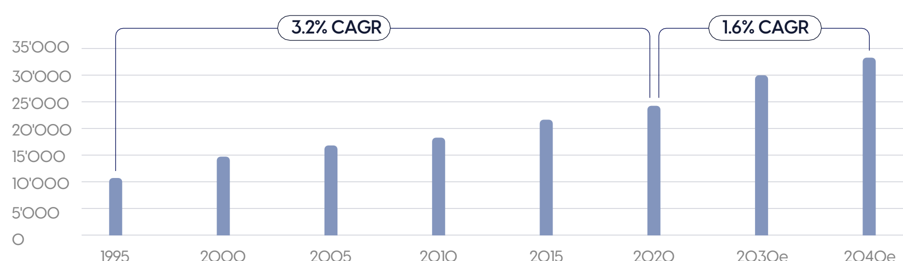
While demand continues to rise, the copper supply is facing significant challenges. Ore grades at many of the world's major copper mines are declining, leading to higher production costs and lower yields. Additionally, investment in copper exploration has plummeted, with exploration spending dropping by nearly 50% since 2013.

Major copper-producing regions such as Chile and Peru are grappling with declining ore grades. In Chile, the world's largest copper producer, average ore grades have decreased from 1.5% in 2000 to around 0.7% today. This trend is expected to continue, which will raise costs and limit output.

Furthermore, the lack of significant investment in copper exploration over the past decade is further exacerbating potential supply shortfalls. The industry has been slow to invest in new discoveries, resulting in fewer high-grade deposits being brought into production.

With supply constrained and demand growing, the copper market is at risk of entering a prolonged deficit, similar to silver. A report from S&P Global estimates that by 2030, the world could face a 6.5 million metric ton copper deficit if new mining projects aren't developed to meet demand.

COPPER MARKET
1995-2040 ▸



Sources: USGS & IEA

Palladium: A Key Player in the Automotive Industry

Introduction

Palladium plays a crucial role in the automotive industry, particularly as a key component in catalytic converters used in hybrid vehicles. These converters help reduce harmful emissions by converting toxic gases such as carbon monoxide and nitrogen oxides into less harmful substances. As hybrid vehicles become more popular due to their dual capability of efficient long-range travel and eco-friendly city driving, the demand for palladium is on a steep upward trajectory.

The Hybrid Vehicle Market

The global hybrid vehicle market has seen explosive growth in recent years. In the United States alone, hybrid vehicle sales surged by 53% from 2022 to 2023, according to the Electric Drive Transportation Association (EDTA). This increase reflects a broader global shift toward more sustainable vehicle options, driven by rising fuel prices, tightening emissions regulations, and increasing environmental awareness.

Worldwide, hybrid vehicle sales reached approximately 5.5 million units in 2023, up from 3.5 million units in 2020, representing a compound annual growth rate of over 15%. Key markets such as China, Japan, and Europe have been instrumental in driving this trend, with hybrid vehicles accounting for a growing share of total automotive sales.

Palladium's Critical Role in Emission Reduction

Palladium's unique catalytic properties make it indispensable in the production of catalytic converters, which are essential for reducing emissions in hybrid and traditional gasoline-powered vehicles. Palladium's efficiency in converting harmful pollutants into less toxic byproducts has solidified its position as a critical material in meeting stricter global emissions standards.

Governments across the globe are imposing stricter emissions regulations to combat air pollution and climate change. The European Union, for example, has implemented its Euro 7 standard, which mandates lower emissions from vehicles, driving further demand for palladium in catalytic converter production.

Hybrid vehicles require catalytic converters that contain a higher percentage of palladium compared to traditional gasoline vehicles, due to the need to manage both fuel combustion and electric power. As a result, palladium is experiencing sustained demand growth, particularly in regions like North America, China, and Europe, where hybrid adoption is accelerating.

Palladium: A Key Player in the Automotive Industry

Supply Constraints and Price Pressures

While demand for palladium is surging, supply remains constrained. Palladium is primarily mined in just two countries, Russia and South Africa, making its supply highly concentrated and vulnerable to geopolitical and logistical disruptions.

In 2023, Russia accounted for approximately 40% of global palladium production. However, geopolitical tensions and sanctions have raised concerns over future supply stability. South Africa, another major producer, faces challenges such as labor strikes, power shortages, and aging infrastructure, further exacerbating supply constraints.

Palladium prices have remained elevated in recent years due to the combination of high demand and limited supply. As of late 2023, palladium was trading at around USD 1300 per ounce, down from its peak of over USD 3000 per ounce in 2021 but still significantly higher than historical averages.

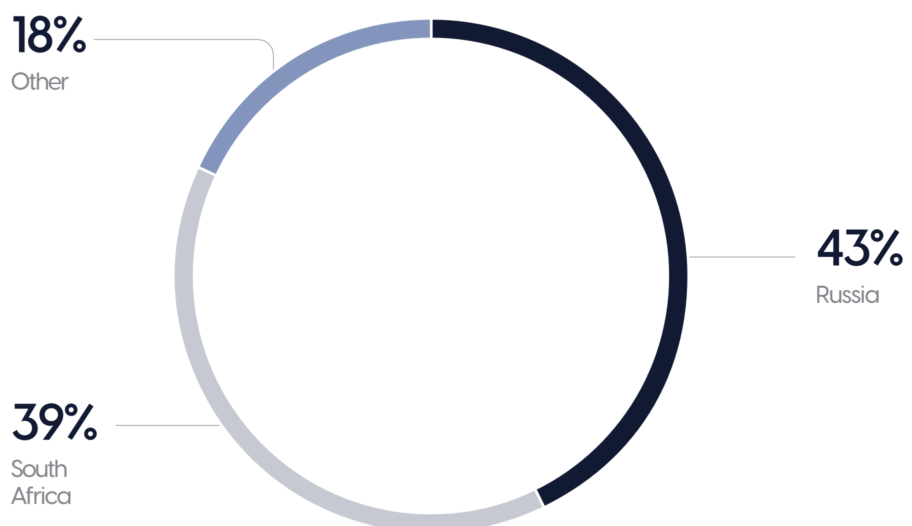
Investment Opportunities

Again, the unique supply-demand dynamics of palladium present compelling investment opportunities. We are closely watching the palladium market as both hybrid vehicle sales and emission regulations drive demand higher, while supply remains constrained.

The automotive industry accounts for more than 80% of palladium demand, making it a key driver of price movements. As the transition to hybrid and electric vehicles accelerates, the demand for palladium is expected to grow in tandem, creating long-term price support for the metal.

Although there have been attempts to substitute palladium with platinum in catalytic converters, the switch has proven to be technologically challenging and costly. As a result, palladium continues to dominate the market for gasoline-powered and hybrid vehicles, ensuring its relevance for the foreseeable future.

RUSSIA SUPPLIES >40% OF PALLADIUM ▸



Sources: Johnson Matthey & UBS

Rethinking the 60/40 Portfolio

Role in a 60/40 Portfolio

For decades, the 60/40 portfolio strategy, investing 60% of a portfolio in stocks and 40% in bonds, has been a cornerstone of traditional investment approaches. However, in the face of prolonged inflation, volatile markets, and shifting economic dynamics, many investors are questioning the continued viability of bonds as the "40" in this equation. What if we replace bonds with commodities, particularly gold, in a modern 60/40 portfolio?

Commodities in a High-Inflation Environment

Commodities, unlike bonds, tend to perform well in inflationary environments. The 2020s have seen a resurgence in inflationary pressures driven by factors such as massive global debt, aging demographics, de-globalization trends, and the transition to net-zero carbon policies. This environment makes commodities a stronger hedge against inflation compared to bonds, which have delivered negative returns in recent years.

Over the past four years, 30-year US Treasuries have handed investors losses of nearly 40%. Rising interest rates, driven by central banks' efforts to combat inflation, have severely diminished the appeal of long-term bonds. In contrast, commodities have delivered annualized returns of around 10% to 14% since the start of the decade.

We can argue that "the commodity bull market is just starting" signalling that commodities are likely to outperform bonds in the years to come. We see commodities, including gold, as a more effective "40" in the 60/40 portfolio for the 2020s, particularly as the world faces structural inflationary pressures.

PORTFOLIO GROWTH (INFLATION ADJUSTED)

● Portfolio 1:
60% US Stock Market
40% Total US Bond Market

CAGR	6.57%
Sharpe Ratio	0.52

● Portfolio 2:
60% US Stock Market
40% Gold

CAGR	8.69%
Sharpe Ratio	0.62

Source: Author

Rethinking the 60/40 Portfolio

Gold: The Ideal Bond Replacement?

Traditionally viewed as a hedge against both inflation and market volatility, gold provides protection in uncertain times while offering the potential for capital appreciation.

While bonds offer fixed-income returns, they are increasingly vulnerable to interest rate fluctuations and inflationary pressures. Gold, on the other hand, has historically been a store of value in times of economic distress, making it an ideal asset in periods of rising inflation and declining bond yields.

Since the beginning of the decade, gold has delivered competitive returns, averaging around 10% annually, compared to the significant losses in long-term bonds. As global economic growth remains uncertain, and inflation continues to exert pressure, gold's appeal as a safe-haven asset is only likely to increase.

A New Secular Bull Market for Commodities

We suggest that commodities are at the start of a new secular bull market, driven by several structural factors:

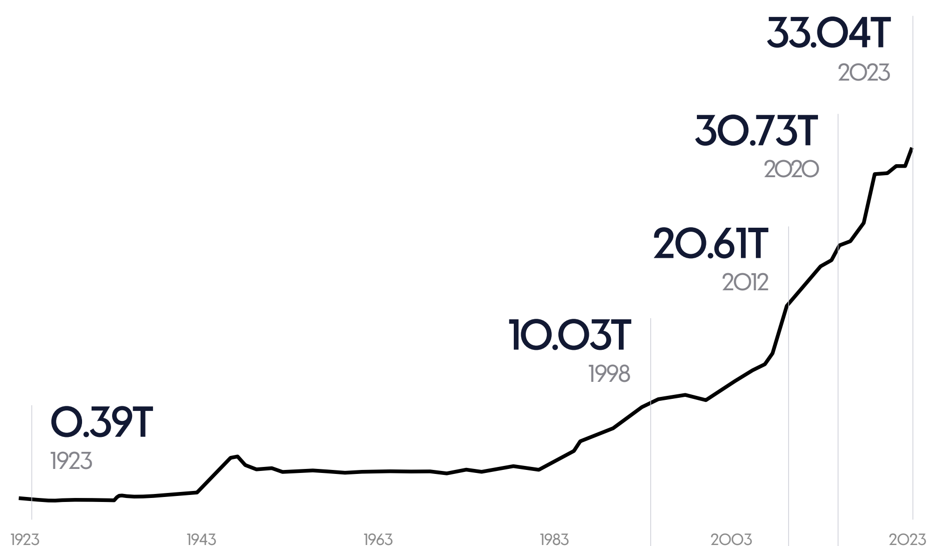
1. **Debt and deficits:** Global debt levels are at all-time highs, leading to higher inflation as governments continue to fund deficits through expansionary fiscal policies. Commodities, particularly gold, benefit from these inflationary environments.
2. **Demographics and de-globalization:** Aging populations in developed economies are placing pressure on labor markets and public finances. At the same time, the reversal of globalization trends is increasing production costs, further driving up commodity prices.
3. **Technological shifts and net zero:** The global transition to net-zero carbon emissions is driving significant demand for metals like copper, silver, and palladium, which are essential for renewable energy technologies. Commodities linked to the green transition will continue to benefit from this structural demand.

HOW US NATIONAL DEBT HAS GROWN ▸

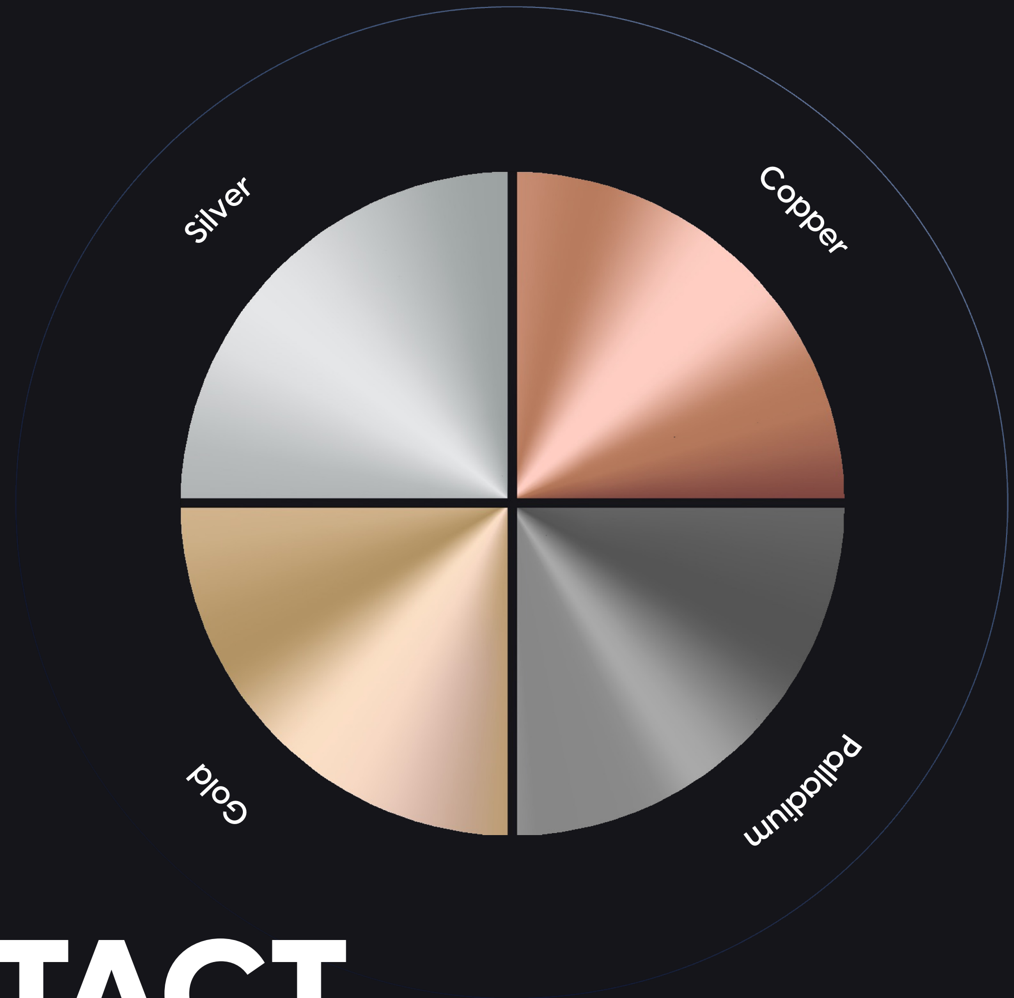
It has grown by 84 times in 100 years.

In 1923*, the national debt was $390 billion, but has now topped $33 trillion.

*Inflation-adjusted national debt



Source: US Department of the Treasury



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