Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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War on Money: Why do markets largely ignore geopolitical risk?

Despite the escalating geopolitical risks and Iran's attack on Israel, there has been minimal market reaction. The S&P 500 rose 1.8% in the week of the attack and is up 2.7% in October (at the close of this article).

Oil, however, has had the most significant impact. Oversupply and monetary tightness drove oil prices (WTI) down 7% on the year only a week before the Iran attack.

Oil prices are now up 5.4% year-to-date, and the commodity cycle returns to a bullish trend where secular underinvestment meets a new geopolitical risk premium.

Geopolitical risk clearly impacts the global economy negatively. The global economy suffers from weaker trade, increased protectionism, and the impact of commodities on importers.

However, markets largely overlook these risks due to investors' obsession with money printing. It appears that the lack of concern stems from central banks' focus on money printing.

The US dollar continues to lose purchasing power

The evidence of monetary debasement is clear on gold and other commodities. Although oil is currently up 5.4%, this is merely a rebound following a negative year.

Gold is up 28.7% this year until the 11th of October. Copper is up 14.4%, aluminum is +10.4%, coffee is a whopping +33%, and nickel is a robust 7.6%.

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Therefore, the most significant driver is not oil’s geopolitical risk premium but the US dollar debasement.

All this is demonstrating to investors that the US dollar continues to lose its purchasing power, the Fed is in a panic, and the global demand for Treasury bonds has reached a new low in comparison to net issuances.

Investors ignore geopolitical risk because monetary destruction risk is more relevant. Rate cuts and money supply growth have been a significant driver of the bounce in commodities and the Global Food Price Index in the past two months.

Out-of-control fiscal irresponsibility

The global money supply has risen by $4.8 trillion since July, and the US and euro area money supply (M2) has bounced back fast since June.

Investors believe that the government's out-of-control fiscal irresponsibility compels central banks to return to easing measures. Central banks will prioritize disguising governments’ insolvency over price stability.

The Federal Reserve's decision to cut rates by fifty basis points was not the beginning of the process of easing monetary policy. Let us not forget that in June, the US central bank announced that it would reduce the pace of balance sheet reduction, a move that clearly indicated a much looser policy. In fact, in mid-September, the financial conditions index reached its most expansive level in more than a year.

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The decision to cut rates is not justified by the labor market or inflation. Unemployment is at 4.1%. The Federal Reserve knows that companies are not going to hire more workers to take on more debt, especially when household and business debt has risen significantly in the past year.

Core PPI prices (the producer price index) increased by 0.2% in September, and the annual core CPI inflation rate rebounded to 2.8% from 2.6%.

This means that the Fed’s favorite inflation indicator, the PCE deflator price measure, may have increased by 0.24% in September, which means an annualized 2.9%.

The latest US core inflation figure is 3.2%, and the headline CPI figure is 2.5%. The inflation rate for services and accommodation is over 4%.

Volatility will increase

Lowering rates so quickly was premature. The entire disinflation in the past few months was due to energy, and as previously mentioned, this item is rapidly rebounding.

Because the federal debt has increased to a record $35 trillion, the deficit will exceed $2 trillion, and the demand for Treasury securities by global investors is declining relative to net issuances, the Federal Reserve's objective is to cut rates and maintain elevated levels of net liquidity.

For investors, rate cuts mean two things. Central bank policy prioritizes liquidity over the fight against inflation, and this leads to asset price inflation.

The biggest war right now is the monetary battle of governments against their citizens’ wages and savings - Daniel Lacalle

However, central banks do not lower rates unless they perceive that the economy is weak. We should avoid complacency.

Markets are discounting central bank easing and disregarding geopolitical risks because the monetary environment is essential for equities’ multiple expansions and valuations.

An easing period is bullish for stocks, but volatility will likely increase, impacting those businesses that are more exposed to rising commodity prices, poor productive growth, and weaker trade.

Gold discounts the inevitable loss of purchasing power of the currency, while the weakness of the manufacturing sector and the most cyclical part of the economy tell us that we must invest to protect ourselves from inflationary pressures and monetary debasement.

Despite hotter inflation in September, the Fed will likely cut rates again, trying to disguise the government’s insolvency. However, long rates are signaling the opposite.

Bond investors are ignoring the Fed’s rate cut messages and demand a higher yield. Long-term yields have been rising since September 16th. The 30-year bond yield is at 4.4%, and the 10-year yield is at 4.2%, the highest levels since July. Doctor Treasury's yield warns of stagflation.

Financial repression is not even an option; it is a certainty, and it is worth protecting ourselves against the loss of purchasing power of currencies.

Despite signs of rising inflation and growing public spending, central banks are embarking on a joint path of rate cuts. No wonder investors are paying less attention to the risks created by war. The biggest war right now is the monetary battle of governments against their citizens’ wages and savings.