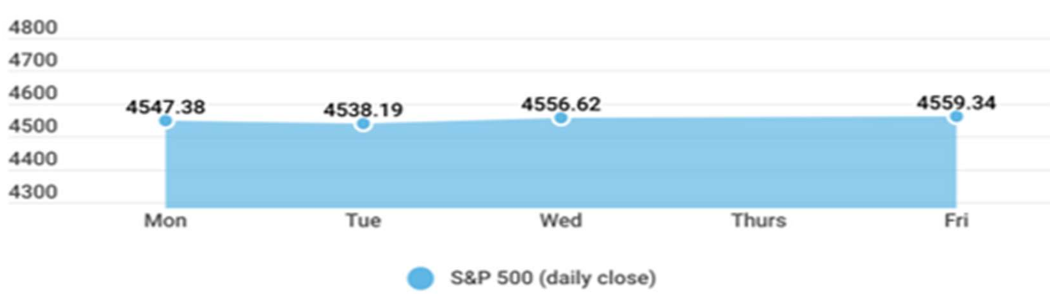
WEEKLY ECONOMIC UPDATE NOV. 27, 2023

Investor enthusiasm for stocks remained strong last week, buoyed by declining bond yields in a holiday-abbreviated trading week.

The Dow Jones Industrial Average picked up 1.27%, while the Standard & Poor's 500 gained 1.00%. The Nasdaq Composite index rose 0.89% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, was flat (+0.03%).[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	35,390.15	+1.27%	+6.77%
NASDAQ	14,250.85	+0.89%	+36.16%
MSCI-EAFE	2,101.43	+0.03%	+8.10%
S&P 500	4,559.34	+1.00%	+18.75%



	Treasury	Close	Week	Y-T-D
	10-Year Note	4.47%	+0.04%	+0.60%

Sources: The Wall Street Journal, November 24, 2023; Treasury.gov, November 24, 2023
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, November 17, to Friday, November 24 close. Weekly performance for the MSCI-EAFE is measured from Friday, November 17 open to Thursday, November 23 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Falling Yields Lift Stocks

The stock market continued to look toward the bond market for direction, responding positively to bond yields that fell steadily for much of the week. A successful 20-year Treasury notes auction on Monday triggered a decline in bond yields. The release of the minutes from the Fed's last meeting buoyed investor optimism that the potential for further rate hikes was diminishing.

Investor sentiment was also lifted by the earnings results from a leading mega-cap, AI-enable chipmaker that topped analysts' expectations, bolstering the narrative of AI's potential to help corporate profits. Despite a higher turn in bond yields on the final half-day of trading, stocks retained the week's gains.

Fed Minutes

Minutes from the October 31–November 1 meeting of the Federal Open Market Committee were released last week, providing insight into its decision not to raise rates and its thinking on the future direction of interest rates.

The minutes reflected concerns by committee members that inflation remained stubborn and may move higher. The minutes also reaffirmed the messaging of many Fed officials, including Fed Chair Powell, that monetary policy must remain restrictive until they are convinced inflation will be on track for the Fed's two percent target. They further said that future rate decisions will be based on fresh economic data, offering no indication that a rate cut was forthcoming, as many analysts are increasingly anticipating for 2024.

This Week: Key Economic Data

Monday: New Home Sales.

Tuesday: Consumer Confidence.

Wednesday: Gross Domestic Product (GDP).

Thursday: Personal Income and Outlays. Jobless Claims.

Friday: Institute for Supply Management (ISM) Manufacturing Index.

Quote of the Week

"The means of defense against foreign danger have been always the instruments of tyranny at home."

– James Madison

Of Note

The dollar has been extremely strong over the past two years. This persistent dollar strength has been a mystery to many. After all, the dollar's problems are well known.

The ratio of government debt to GDP for the United States is at a record high approaching 130% (a prudent level is considered 30%, and anything over 90% is a headwind to any economic growth at all).
The U.S. is running multitrillion-dollar deficits year after year. The Congress and White House seem in the grip of Modern Monetary Theory, which claims that the U.S. can run unlimited deficits and accumulate unlimited debt without economic harm because it can print money in unlimited quantities to finance the debt and spending.

Meanwhile, projected annualized interest payments on the U.S. national debt exceeded $1 trillion for the first time at the end of October. The cost of debt service has doubled in the past 19 months as interest rates have risen. This fiscal profligacy comes against a backdrop of social unrest and political dysfunction. We're facing a presidential election next year in which one candidate is senile and the other candidate may be behind bars on Election Day. Take your pick. But the dollar keeps on chugging along. How can the dollar be so strong against such a dismal landscape?

There are two answers to this question.

Answer No. 1: The first is that the dollar has its problems, but other currencies are in even worse shape. For example, the Chinese yuan is on the brink of collapse being held aloft by non-sustainable intervention by Chinese banks. The Japanese yen is joined at the hip with the yuan because of the extent of Japanese investment in China financed by Japanese banks. With the yuan going down, the yen will go down in sync. So that's two major currencies with problems.

Meanwhile, Europe and the U.K. have deindustrialized under the sway of the greeniacs pushing the Green New Scam policies. Now Europe faces a winter of freezing in the dark if cold weather is extreme and Russia decides to turn off the energy taps. Germany, the largest economy in the eurozone, is heading for recession if it isn't already in one, and the same is true for the U.K. That's two more major currencies are facing troubles. So yes, the dollar has its problems, but as an investor do you really prefer sterling, euros, yen or yuan?

Answer No. 2: The second reason for the dollar's strength is much more technical and not well understood, but it's critical to grasp. You don't need to nail down the technical details; it's enough that you understand the bigger picture. It involves the so-called Eurodollar. Eurodollars are dollar-denominated deposits held at foreign offices of major banks, and therefore fall outside the jurisdiction of the Fed and U.S. banking regulations.

The Fed actually has very little influence over the global dollar market and the exchange value of the dollar. The old currency metrics of balance of trade and moves in capital accounts are leftovers from the world of fixed exchange rates, which have been gone for decades.

What drives the dollar is the Eurodollar market, as conducted by the world's largest banks in London, New York and Tokyo. It's here where global liquidity and interest rates are actually determined.
The Eurodollar market needs a constant supply of depositors parking their money in offshore offices of major banks. Right now, this market is in contraction. Derivatives are being unwound, balance sheets are being trimmed and interbank overnight lending is being financed with collateral. And these banks are demanding the best collateral. They won't accept corporate debt, mortgages or even intermediate-term U.S. Treasuries. The only acceptable collateral consists of short-term U.S. Treasury bills, the shorter the better. This means 1-month, 3-month and 6-month bills. Those are denominated in dollars, of course. In order to get the bills to post as collateral, banks have to buy dollars to buy the bills. This has created enormous demand for dollars. And that partly accounts for the strength of the dollar.

Again, it's not important that you understand the intricacies of the eurodollar system, just that high dollar demand in the Eurodollar market is contributing to dollar strength. The fundamental dollar shortage problem is not going away soon and will continue to support the dollar.

What about the prospect of a BRICS currency union and the move toward a new currency? This new currency would be gold-linked and would displace the dollar in time as a major player in world trade. Shouldn't that be weakening the dollar? After all, the prospect of a BRICS currency should pose a severe threat to the petrodollar, which is a pillar of dollar strength. But this movement is still in its infancy and, unsurprisingly, is experiencing growing pains. It's not yet as unified as it needs to be if it's going to seriously threaten the dollar. And one of those BRICS nations, India, seems to be playing both sides.

It was recently reported that India's government is expected to reject demands from Russian oil companies to pay for Russia's crude oil imports in Chinese yuan. Russia currently has a surplus of rupees and is having trouble spending them. At the same time, demand for yuan has grown as Russia trades more with China.

Meanwhile, India mostly uses the dirham and U.S. dollar to pay for Russian oil imports. Basically, India is currently in a balancing act. They consider Russia an important economic ally while they consider China a geopolitical rival. India fears popularizing the yuan will hurt its own efforts to internationalize the rupee. In fact, India was the only BRICS nation to oppose the introduction of a common currency, fearing it would benefit the yuan. India's refusal to give in to Russia's demands leaves a significant role for the dollar, which is another reason to believe the dollar will retain its strength for the foreseeable future.[4]

Footnotes and Sources

1. The Wall Street Journal, November 24, 2023.
2. The Wall Street Journal, November 24, 2023.
3. The Wall Street Journal, November 24, 2023.
4. zerohedge.com/markets/rickards-whys-dollar-so-darn-strong

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