

# CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 5, 2020

## On to 2020....Buckle Up

The repercussions that may follow the assassination of General Soleimani are of paramount importance to peace in the Middle East and in the world. The killing had a very sharp impact on many investment assets on Friday and, as the Monday markets in Asia open, one observes a continuation of these. I discuss this below, but first, a review of recent months.

*Although the killing of General Soleimani is at the forefront of everyone's thinking, and although the immediate impact on financial markets is sharp, we take a look first at the ways by which the actions of the Federal Reserve have pushed stocks higher and lowered expectations that a recession is at hand.*

*The repo market is complex, but the salient point is that the Fed, since September, has pumped more than \$300 billion into the financial system. Because the appetite by companies for borrowing is very low, the money appears to have flowed into financial assets.*

**The Fed and the repo market.** As discussed in previous *Core Comments*, the actions of the Federal Reserve Board, both its three cuts in the short-term rates it controls directly and its vast and unexpected buying of short-term Treasuries beginning in the autumn, caused the stock market to rally quite strongly in the last quarter of 2019. As to the unexpected Treasury purchases, malfunction of the so-called repo market, by which banks lend to each other overnight, caused rates for such loans to spike to 10 percent in September. This part of the financial system is opaque but important. Rather than explaining it here, I point to a mid-December article in *The Economist* that addresses the matter. As for the year end, things functioned as they should, so, in the short term, the Fed has been successful in smoothing a suddenly unruly corner of our financial system: <https://www.economist.com/finance-and-economics/2019/12/18/despite-the-feds-efforts-the-repo-market-risks-more-turbulence>

In its rescue of the repo market, the Fed put some \$300 billion of new money into the system. Although the Fed is at pains to say this is not a renewal of Quantitative Easing, market participants recognized this as yet another gigantic infusion of liquidity into a system in which demand for borrowing to fund corporate activity has been weakening. (In the autumn, while the Fed was increasing the money supply at the rate of ten percent annualized, commercial and industrial lending contracted by one percent.) So where does the money go? Into financial assets. Thus the strong stock market in the last three months.

Recession fears, at their peak in August and September, have subsided. This is more a hoped-for event than one likely to be realized. Corporate profits have continued to weaken; manufacturing activity in the US and other developed countries have continued to weaken; job openings have declined for six months. One could go on. There is little evidence that economies are improving. Although the US has appeared to avoid falling into a recession in 2019, the best one can say is that it is flying at stall speed.

**By**

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**2020 begins.** Although the fourth quarter of 2019 was a strong one for stocks, 2020 has not begun well. The assassination of Iranian General Soleimani by the United States on Friday morning New York time caused an immediate sharp sell off in stock markets around the world and sent investors toward safe-

*The sharp increase in 'safe-haven' assets, including gold and long-term Treasuries, has given a significant boost to Core's investments. We have avoided stock investments for more than a year, keeping us out of harm's way in the aftermath of the Soleimani killing.*

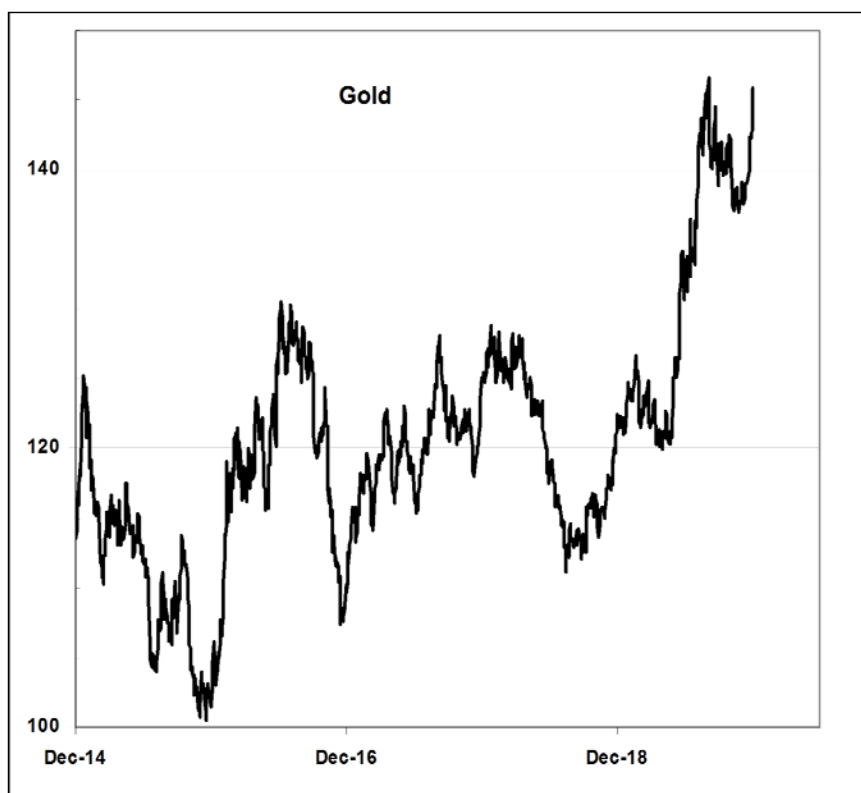
haven assets, notably including gold and long-term US treasuries in both of which Core has substantial investments. Iran promises retaliation and, given that General Soleimani was, by most accounts, the second most important Iranian leader, we can probably take the retaliation threats seriously.

The US stock market rallied more than 25 percent during 2019 while profits of firms in the S&P 500 declined each quarter. This suggests that stocks trade at precariously high levels. The killing heightens already elevated geo-political risk. Let us remember the six-month long riots in Hong Kong, the sharp disagreements between China and America and the nuclear threat from North Korea.

We cannot know how Iran will respond and, unfortunately, we cannot be sure that the next moves by the United States will be calibrated to foster peace. Iran has engaged in provocative actions since Mr. Trump repudiated the nuclear arms treaty negotiated by the Obama administration. Then, in response to the December 27 rocket attack on an Iraqi military base near Kirkut and the raid on the US

embassy in Baghdad, comes the sudden attack on General Soleimani, with the bare explanation that further threats to US personnel were planned.

Unless something dramatically awful unfolds from this killing--and we can certainly hope that the dramatically awful will not come to pass--it is likely that effects on the markets in which we invest will be muted. But, when comes the retaliation and when comes the further slowing of the US economy, stocks will give up their high-wire act. This will provide the opportunity to invest in stocks at lower prices than now prevail. After a year in which Core invested cautiously for you and produced solid investment returns in Treasuries and gold, we anticipate an investment environment that will offer opportunity for further relatively low risk and productive investing.



**A word about gold.** In the last year, Core's second largest investment, after long-term US Treasury Bonds, has been gold. When we made the investment, gold was rousing itself from a significant decline and, with the view that geo-political disturbances were rising, the case for owning gold seemed strong. As the nearby chart shows, gold enjoyed strong gains in 2019. It stuttered a bit in the autumn as recession fears faded and the Fed pumped vast new sums of money into the system. But well before Iran's havoc and Soleimani's assassination, gold resumed its upward march and, as of early Monday trading in Asia, it has exceeded its late summer highs. Another element in gold's rise is the desire of many countries, China, Russia and others, to withdraw support from the US dollar, the world's reserve currency. Gold purchases by major foreign central banks have been remarkably high in the last year. For better or worse, part of gold's strength represents anti-American sentiment. Gold's ascent will not be a smooth path, but the rather fraught geo-political environment reminds us of gold's safe-haven value.

**CORE**Comments



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