



FEDERAL RESERVE

INVESTMENT INSIGHTS

Is Fed Policy Appropriate?

**U.S. DOLLAR FALLS AND GOLD SURGES
AMIDST EASY MONETARY POLICY**

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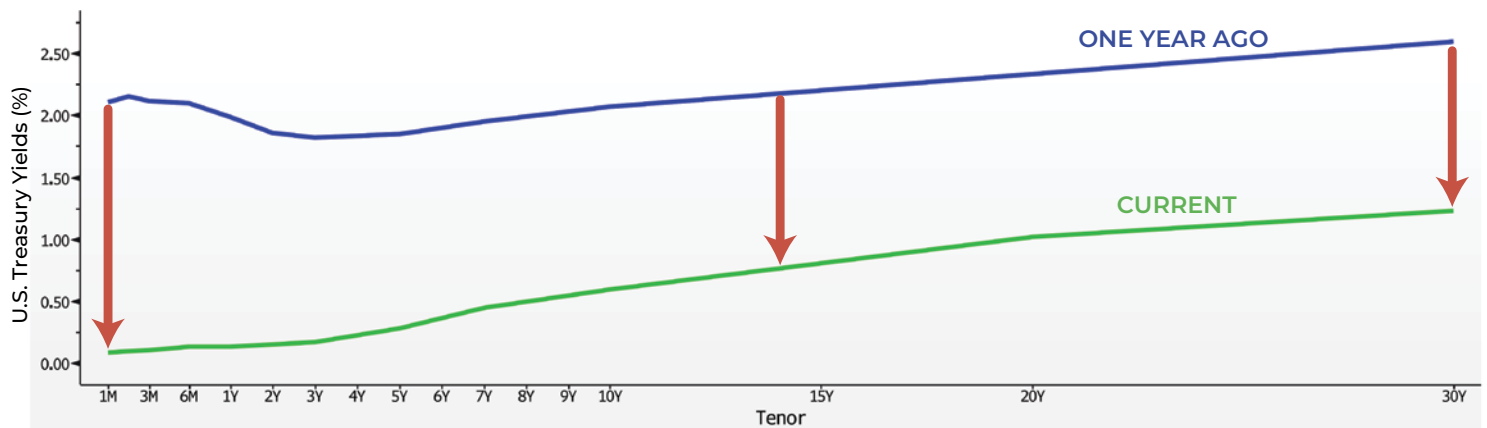
KEY TAKEAWAYS:

- » Federal Reserve’s aggressive policy actions have pushed U.S. interest rates to historic lows. The Congressional Budget Office and Fed Fund futures point to interest rates remaining low well into the next decade.
- » The U.S. dollar has fallen, and gold prices have surged in response to Fed policy. We expect these moves to continue over the short term, as a reflection of likely slower U.S. economic growth vs. rest of the world and a lack of safe-haven alternatives to Treasuries.
- » A decline in the U.S. dollar is a significant tailwind to international stocks and bonds. International stocks have lagged their U.S. counterparts for more than a decade and we may be at the beginning stages of a reversal in performance if U.S. dollar weakness persists.

1. FED POLICY ACTIONS HAVE PUSHED INTEREST RATES DOWN

As Exhibit 1 shows, the Federal Reserve’s aggressive monetary policy response to the COVID-19 global pandemic has pushed U.S. interest rates across all maturities down significantly, compared to a year ago. The Fed Funds rate has been slashed to zero to reduce borrowing costs for consumers and businesses. Simultaneously, the Fed has embarked on large scale asset purchases and unique direct lending programs to businesses to ensure proper functioning of credit markets. The Federal Reserve’s Open Market Committee—responsible for setting interest rates—has committed to maintaining an accommodative monetary policy well into the future, and Fed Fund futures confirm this “lower for longer” view. The Congressional Budget Office is also projecting very low interest rates well into 2025.

EXHIBIT 1: FED’S AGGRESSIVE POLICY ACTIONS HAVE PUSHED INTEREST RATES ACROSS MATURITIES LOWER



Source: Bloomberg. Current as of July 27, 2020.

2. U.S. DOLLAR IS FALLING, AND GOLD IS SURGING IN RESPONSE TO FED POLICY

The U.S. dollar and gold have experienced sharp moves this year, due primarily—in our view—to monetary policy expectations. However, there may also be other factors at play. The drop in the U.S. dollar may be reflecting the market's expectations of slower U.S. economic growth vs. the rest of the world over the next few years. One driver of this might be the widespread impact of COVID-19 on the U.S. economy. Similarly, in addition to monetary policy, surging gold prices may also be reflecting a lack of attractive safe-haven assets—with Treasury yields at record lows.

EXHIBIT 2: U.S. DOLLAR AND GOLD PRICES ARE MOVING SHARPLY IN RESPONSE TO FED POLICY

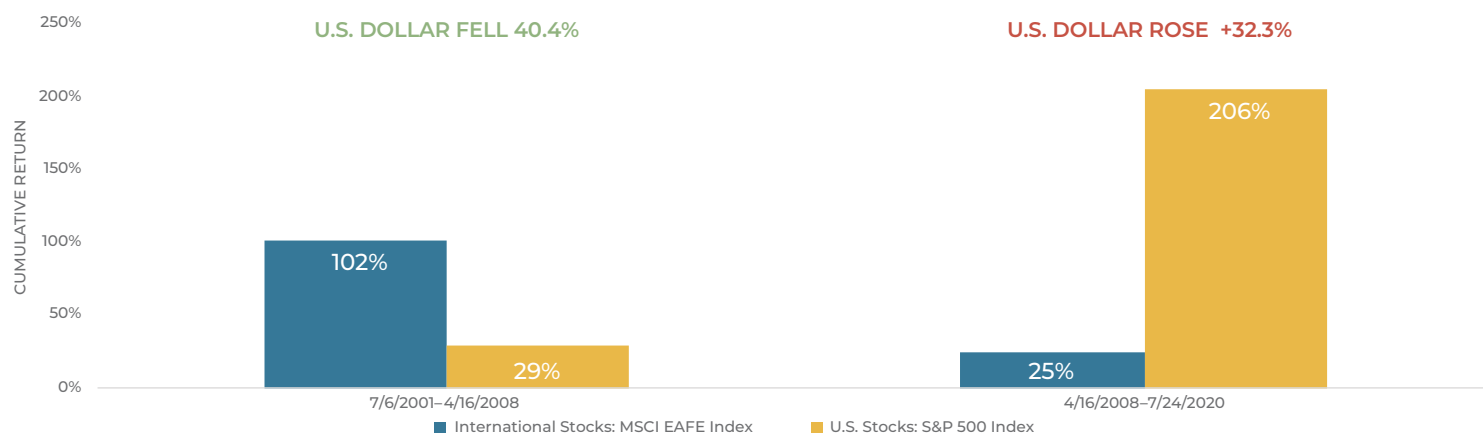


Source: Bloomberg.

3. DECLINE IN U.S. DOLLAR HAS HISTORICALLY BEEN A TAILWIND FOR INTERNATIONAL ASSETS

According to the U.S. Currency Education Program, as much as half of the total dollars in existence are estimated to be in circulation outside of the U.S. In addition to being used as hard currency in day-to-day transactions, debt issued by some foreign corporations and governments, especially in the emerging markets, are priced in U.S. dollars. A decline in the U.S. dollar provides certain benefits for international investments. When the U.S. dollar declines in value, dollar-denominated debts for foreign governments and corporations become cheaper to pay back. This may reduce default risk and improve earnings for these companies.

EXHIBIT 3: WEAKER U.S. DOLLAR HAS HISTORICALLY BEEN A TAILWIND FOR INTERNATIONAL STOCKS



Source: Bloomberg.

Secondly, for investors using U.S. dollars, international funds and equities get a boost to performance from the currency exchange rate. Just looking at the past few decades, we can see the decline in the U.S. dollar created a tailwind for international equities from 2001 to 2008 and the U.S. dollar rise created a headwind from 2008 until now. A continuation of this downtrend would be one ingredient for better performance from international equities and fixed income.



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