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JIM RICKARDS'
STRATEGIC INTELLIGENCE

The BRICS Are Ready To Shock The International Monetary System

INSIDE THIS ISSUE

On August 22, 2023, the most significant development in international finance since 1971 will be unveiled. It has the potential to displace the U.S. dollar as the leading payment currency and reserve currency from a standing start in just a few years. The process by which this will happen is unprecedented although it bears some resemblance to the elevation of the dollar under Bretton Woods (1944), and the creation of Special Drawing Rights, SDRs (1969).

This monetary shock will be delivered by a group called the BRICS. What Bretton Woods, SDRs, and the BRICS gambit have in common is gold. The world is unprepared for this geopolitical shockwave. This article explores the unfolding process in depth.

The Birth of BRICS

The rise of the BRICS is one of the most interesting and important geopolitical developments of the twenty-first century for many reasons, not least of which is that it began as a marketing slogan.

In 2001, Goldman Sachs Asset Management published a report titled Building Better Global Economic BRICs by the asset management Chairman Jim O'Neill. The acronym BRIC was created by a Goldman research assistant named Roopa Purushothaman. It stood for Brazil, Russia, India, and China.

The concept was simple. After the fall of the Berlin Wall in 1989 and the collapse of the Soviet Union in 1991, the world entered a new Post-Cold War era characterized by the United States as a global hegemon, and what was called the Washington Consensus. This was the beginning of a new age of globalization.

The tenets of the Washington Consensus as presented by economist John Williamson in 1989 were:

1. Fiscal policy discipline.
2. Moving public spending toward education, health care, and infrastructure.
3. Tax reform by broadening the tax base and lowering rates.
4. Market-determined interest rates moderately positive in real terms.

5. Market-determined exchange rates.
6. Trade liberalization.
7. Liberalization in inbound direct foreign investment.
8. Privatization of state enterprises.
9. Deregulation.
10. Legal security for property rights.

Karl Marx wrote the Communist Manifesto, and John Williamson wrote a kind of Capitalist Manifesto. The Washington Consensus was a playbook for the continuation of the Bretton Woods institutions without the limitations of a gold standard.

In a nutshell, it called for open capital accounts, free trade, and the triumph of private investment over state capital. Investors would seek the highest return (or lowest costs) anywhere in the world with as few impediments as possible. **It was the economic blueprint for globalization.**

Once this blueprint was set, it raised the obvious question of where institutions should invest to optimize performance. The G7 countries (U.S., Canada, UK, France, Italy, Germany, Japan) along with developed economy partners such as Australia and Switzerland already subscribed to most of the principles of the Washington Consensus.

The greatest profit opportunities would therefore exist in the developing economies also called emerging markets, or EMs. Any EMs who moved in the direction of the Washington Consensus were attractive targets for direct foreign investment from the G7 and other developed economies.

China was widely regarded as having the greatest growth potential of any EM as a result of Deng Xiaoping's abandonment of the policies of Mao Zedong in 1979. Mao died in 1975, but the period 1975-1979 was one of political chaos until the arrest and trial of the notorious Gang of Four. Deng led China toward an opening to the West and the adoption of a hybrid economy of capitalist-style markets under Communist Party control.

This effort was set back by the Tiananmen Square massacre in 1989 but regained traction by 1994. It was then that globalization came to China with massive foreign investment and spectacular growth for the next twenty-five years.

China did not come close to meeting the tenets of the Washington Consensus. But Western policymakers formed the belief that if China's growth produced enough prosperity (and profits for the West), eventually China would become "just like us."

In effect, China got a free pass on ideas such as open capital accounts and private property in exchange for massive profits for Western investors and wishful thinking about a future China that would more closely resemble the West.

The case for investing in China was straightforward because of its size and profit potential. Human rights took a back seat. What about the rest?

The EMs were a diverse group of about 100 countries (excluding extremely poor nations like Haiti and closed dictatorships such as North Korea). They ranged from extremely low per capita GDP countries (Liberia, Chad, and Congo, etc.) to relatively high per capita GDP countries that were close to developed economy levels (Malaysia, Chile, and Poland, etc.). Which countries made the shortlist that offered the highest growth potential with some adherence to the Washington Consensus?

Answering that question was the origin of the BRICs report by Goldman Sachs. Goldman simply picked the four largest economies in the world (measured by purchasing power parity) excluding the G7. They happened to be China, India, Brazil and Russia in that order. The initials were scrambled to make a memorable acronym, and so the BRICs were born.

From Marketing Gimmick to Geopolitical Reality

From 2001 to 2006, the term BRICs remained a marketing ploy by Goldman but the idea of BRICs as a powerful block of developing economies was gaining popularity and was routinely used as a kind of shorthand for the nations included in the name.

Then in 2006, the marketing gimmick became a geopolitical reality. At the meeting of the UN General Assembly

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in New York in September 2006, the foreign ministers of Brazil, Russia, India, and China met in a private discussion. Such multilateral groupings in sideline sessions of larger conferences are not unusual. This one was historic and soon morphed into a more substantial platform.

A formal summit of BRIC diplomats was held in Yekaterinburg, Russia on June 16, 2009. The attendees were all national leaders — Lula da Silva from Brazil, Dmitry Medvedev of Russia, Manmohan Singh of India, and Hu Jintao of China.

There was immediate agreement that the BRIC nations should continue the dialogue and work together on critical issues including financial reform and the role of international currencies. South Africa officially joined the group on December 24, 2010, and it was renamed BRICS with the "S" for South Africa. The entire group and other invited nations have been meeting regularly ever since.

In this edition of *Strategic Intelligence*, we will examine the activities of the BRICS since their expansion in 2010 with special attention to their current initiatives in the areas of global reserve currencies and new global payments systems. These initiatives have moved well beyond the talking stage. **We are now getting close to the roll-out of a major new currency that could weaken the role of the dollar in global payments and ultimately displace the dollar in part as a global reserve currency.**

This play for global reserve currency status by the BRICS will affect world trade, direct foreign investment, and investor portfolios in dramatic and unforeseen ways. We will lay out the potential paths with a specific recommendation for readers to both preserve wealth and profit from these historic changes.

The Building of A BRICS Financial Infrastructure

A great deal of attention has been paid to the BRICS initiatives regarding de-dollarization and the launch of a new currency. We cover those topics in detail below. But foreign exchange and currency matters are a small part of the overall BRICS efforts.

The annual BRICS Leaders' Summit conferences make headlines, but that is only one of about 160 BRICS meetings held every year. The BRICS has separate working groups on finance, defense, sports, women's rights, agriculture, natural resources, infrastructure, and numerous other important policy areas. These groups have their own agendas, secretariats, and relevant experts.

This multi-faceted policy nexus strengthens ties among BRICS members and increases their leverage on the global stage. All of these efforts are coordinated at the BRICS Tower, a new skyscraper in Shanghai that serves as the global BRICS headquarters.

Following is a roster of the current BRICS leadership:

Luiz Inácio Lula da Silva
President of Brazil

Xi Jinping
President of China

Narendra Modi
Prime Minister of India

Vladimir Putin
President of Russia

Cyril Ramaphosa
President of South Aftrica

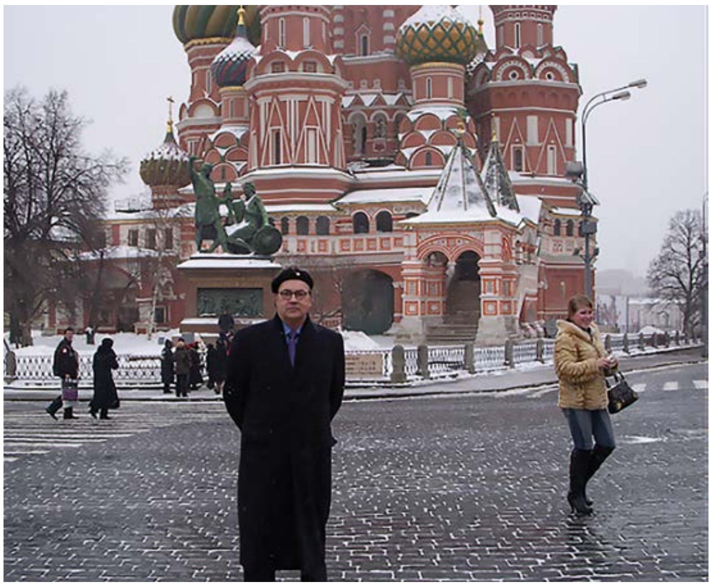
At the BRICS summit conference in Fortaleza, Brazil on July 13-15, 2014, the BRICS agreed to create a New Development Bank (NDB) with $100 billion at its disposal. These funds consisted of $50 billion in initial capital ($10 billion each from the five BRICS) and $50 billion of callable share capital.

The NDB can also access additional funds through NDB bond issues. Several EM countries also own small shareholdings in NDB including Bangladesh, Egypt, the UAE, and Uruguay. NDB funds will be used to support infrastructure, urban development, and agricultural efforts in the member countries and other EMs. The NDB has cooperative agreements with other important multilateral development banks including the World Bank, the Asian Infrastructure Investment Bank, the Asian Development Bank, and the European Investment Bank.

The other institutional advance made by the BRICS was the Contingent Reserve Arrangement (CRA). The CRA is a swing lender designed to help members who are experiencing capital outflows or currency attacks from markets. It was founded in 2015 with $100 billion in capital subscribed by Brazil ($18 billion), China ($41 billion), India ($18 billion), Russia ($18 billion), and South Africa ($5 billion). It functions somewhat like the IMF by providing liquidity to members to give them time to make policy corrections to resolve capital outflows.

With the NDB functioning like the World Bank, and the CRA functioning like the IMF, the BRICS have replicated the Bretton Woods institutions without participation by the G7 or other major developed economies. This is not a financial sideshow. This institutional architecture will reveal its importance as the BRICS unveil their new world currency patterned on the IMF's special drawing rights (SDRs) in August. **Western elites appear to have been asleep at the switch for the past nine years as the BRICS prepare to do without them.**

The BRICS are also developing an optical fiber submarine telecommunications system that would connect its members. It is being developed under the name BRICS Cable. Part of the motivation for BRICS Cable is to foil spying by the U.S. National Security Agency on message traffic carried through existing cable networks.



Your editor in front of St. Basil's Cathedral in Red Square in Moscow. Russia is one of the original BRICS and has the largest gold hoard of any BRICS member. The new BRICS currency to be announced in August is likely to be gold-linked. This will position Russia to be one of the leading backers of the new currency and the de facto BRICS banker to the world.

A Powerful Alternative to Western Hegemony

The most important development in the BRICS system apart from the currency activities discussed below concerns the expansion of BRICS membership. This has led to the informal adoption of the name BRICS+ for the expanded organization.

There are currently eight nations that have formally applied for membership and seventeen others that have expressed interest in joining.

The eight formal applicants are: Algeria, Argentina, Bahrain, Egypt, Indonesia, Iran, Saudi Arabia and the United Arab Emirates.

The seventeen countries that have expressed interest are: Afghanistan, Bangladesh, Belarus, Kazakhstan, Mexico, Nicaragua, Nigeria, Pakistan, Senegal, Sudan, Syria, Thailand, Tunisia, Turkey, Uruguay, Venezuela and Zimbabwe.

There's more to this list than just increasing the headcount at future BRICS meetings. If Saudi Arabia and Russia are both members, you have two of the three largest energy producers in the world under one tent (the U.S. is the other member of the energy Big Three).

If Russia, China, Brazil, and India are all members, you have four of the seven largest countries in the world measured by landmass possessing 30% of the earth's dry surface, and related natural resources. Almost 50% of the world's wheat and rice production, as well as 15% of the world's gold reserves are in the BRICS.

China, India, Brazil and Russia are four of the nine highest population countries on the planet with a combined population of 3.2 billion people or 40% of the earth's population. China, India, Brazil, Russia, and Saudi Arabia have a combined GDP of $29 trillion or 28% of nominal global GDP. If one uses purchasing power parity to measure GDP, then the BRICS share is over 54%. Russia and China have two of the three largest nuclear arsenals in the world (the other leader is the United States).

By every measure — population, landmass, energy output, GDP, food output, and nuclear weapons — BRICS is not just another multilateral debating society. They are a substantial and credible alternative to Western hegemony. BRICS acting together is one pole of a new multi-polar or even bi-polar world.

The BRICS will be acting on these new membership applications and expressions of interest at their foreign minister's summit in Cape Town, South Africa over the course of June 2-3, 2023. Russia is on record supporting the applications of Algeria and Saudi Arabia to join. China is on record supporting the application of Argentina and also supports Saudi Arabia.

The foreign ministers are likely to approve applications from Algeria, Saudi Arabia, Argentina, UAE, Bahrain and Egypt. Other applicants will remain on the waiting list while the longer list of interested parties will in some cases move to formal applicants. Further action on new members can be expected at the BRICS Leaders' Summit in Durban, South Africa from August 22-24, 2023. The expansion into BRICS+ is well underway.

While global attention has been focused on the BRICS intentions with regard to a new commodity-backed currency to rival the dollar, it's important to bear in mind the BRICS initiatives described above. The BRICS have not been standing still since their formation in 2006. They

BEST OF FIVE LINKS

The Banking Crisis Is Not Over. In Fact, It's Just Getting Started.

It's a mistake to believe that the banking crisis that began on March 10, 2023, with the collapse of Silicon Valley Bank is over. In response to a cascade of bank failures from March to May, regulators took extraordinary and unprecedented actions. The Federal Reserve opened a facility that makes loans against U.S. Treasury securities delivered by member banks as collateral. What's unusual is that the loans are equal to 100% of the par value of the securities, even if the market value is only 80% of the par value. The Fed is lending more than the securities are worth. This facility could result in a trillion dollars or more of newly printed money to make the loans. This money printing spree comes at a time when the Fed claims to be reducing the money supply as part of its inflation-fighting. So, the Fed is tightening and easing at the same time. That's the kind of public policy incoherence that results from free-form intervention in the markets. The FDIC is offering potentially to guarantee every deposit in the banking system without regard to the statutory limit of $250,000 per deposit. They justify this using a "systemic risk" exception to the insurance limit. But systemic risk is undefined and every bank in the system poses potential systemic risk if a run on the bank creates panic leading to contagion and runs on other banks. The FDIC insurance fund is also running low because of the $40 billion or more of claims paid out due to the failures to date. Treasury Secretary Janet Yellen has destroyed confidence in the FDIC system by blurring the limits on insurance offered and depleting the insurance fund. Again, heavy-handed intervention has its costs in terms of uncertainty and lost confidence. It's also critical for everyday Americans to realize that there are long lags between the time a crisis actually begins and the time it reaches an acute stage that comes to everyone's attention. For example, the 2008 global financial crisis hit an acute stage on September 15, 2008, when Lehman Brothers filed for bankruptcy. But it began 18 months earlier in the spring of 2007 when HSBC warned about losses on subprime mortgages. The Russia-LTCM crisis reached an acute stage in September 1998, but it began 15 months earlier in June 1997 when Thailand devalued its currency against the dollar. In six major financial crises between 1974 and 2010, the average time between the origin of the crisis and the acute stage was 13.5 months, and the shortest time was 6 months. If we use those benchmarks and date the crisis from March 2023, it could become acute by this September. If we use the 13.5-month average and date the crisis from November 2021 (Bitcoin crash), then we're already past due. Under any historic method, a major crisis is imminent. As described in **this article**, the watchlist of banks waiting to fail includes PacWest, Western Alliance, First Horizon, Comerica, and KeyCorp. In short, the system is blinking red. The bottom line is that we are facing a severe recession, a financial crisis worse than 2008, de-dollarization, lost confidence in the Fed and the U.S. dollar, political repression through the rise of central bank digital currencies (CBDCs), and extreme social unrest. The winners in this scenario are gold, silver, land, energy, agriculture, and U.S. Treasury notes. The losers are stocks, corporate bonds, and commercial real estate. You should position your asset allocations accordingly to survive the storm. Don't wait until it's too late.

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have erected a headquarters, formed a secretariat, created hundreds of working groups in various subject areas, built secure telecommunications infrastructure and payment channels, and created two durable and well-capitalized multi-lateral financial institutions to rival the World Bank and IMF.

When the new currency launch is announced in August, the currency will not fall on an empty field. It will fall into a sophisticated network of capital and communications. This network will greatly enhance its chances of success.

Before turning to the new currency, we'll look briefly at the policy blunders that created an opening for a new currency. These blunders can all be traced to complacency by U.S. officials about the dollar's status, and U.S. arrogance about the use of the dollar as a financial weapon.

My Warnings of Dollar Sanctions Abuse Were Ignored

There is little doubt about the effectiveness of U.S. dollar-based financial and economic sanctions in pursuit of U.S. policy goals. Financial sanctions on Iran including prohibitions of oil exports and exclusion from global payments systems in 2011 and 2012 were instrumental in bringing Iran to the bargaining table for the P5+1 talks in 2013 that led to the Joint Comprehensive Plan of Action (JCPOA) in 2015. The JCPOA purportedly placed limits on Iran's uranium enrichment programs intended to develop nuclear weapons to destroy Israel.

Still, there are practical and political limitations on the effectiveness of financial sanctions. Unless certain conditions are met, the sanctions will not only fail but they will have unintended consequences that may cause more economic damage to the United States than to the sanctions target.

These conditions are:

1. The target country must have a small- or medium-sized economy with little robustness or resiliency to sanctions.
2. The target country must have limited access to alternative payment channels and few allies in any effort to obtain hard currency.
3. The target country must have limited hard currency reserves or gold with which to evade or wait out sanctions.

Iran satisfied all three of these conditions. The success of Iranian sanctions in 2011-2012 and similar (if limited) success in isolated cases such as North Korea, Syria and Venezuela misled U.S. policymakers into the false belief that sanctions could modify behavior or cause economic collapse (or both) in situations that did not meet the criteria.

On numerous occasions from 2007 to 2014, I warned U.S. officials from the Treasury, Pentagon, and the intelligence community that overuse or abuse of dollar sanctions would lead adversaries to abandon the dollar to avoid the impact of sanctions. Such abandonment would lead to the diluted potency of sanctions, unforeseen costs imposed on the U.S., and eventually to the collapse of confidence in the dollar itself. These warnings were mostly ignored. **We have now reached the first and second stages of this forecast and are dangerously close to the third.**

After the Russian special military operation in response to Ukrainian and U.S. provocations began in February 2022, the U.S. imposed financial and economic sanctions on Russia that were unprecedented in scope and depth.

The U.S. froze assets of the Central Bank of Russia in its control including approximately $150 billion of U.S. Treasury and agency securities. The U.S. banned Russian participation in the SWIFT global financial message traffic system.

SWIFT is best understood as the central nervous system of the global banking payments network. The U.S. and allies seized assets of Russian oligarchs, banned exports of semiconductors and other high-tech equipment to Russia, and banned Russian exports of oil, natural gas, strategic metals, and other key commodities with some exceptions for energy exports that adhered to price caps.

These sanctions have been an across-the-board failure. The Russian economy has barely been impacted and is expected to outperform the U.S. in terms of GDP growth in 2023. The Russian ruble is slightly stronger against the U.S. dollar than before the War in Ukraine began. Russian dollar revenues from energy sales to China and India have more than made up for lost sales to the EU. Russian behavior has not changed at all as evidenced by the recent Russian liberation of Artyomovsk (formerly Bakhmut).

At the same time, the U.S. has experienced persistently high inflation due largely to higher food and energy prices along with experiencing the early stages of a banking crisis with the recent successive failures of Silvergate Bank, Silicon Valley Bank, Signature Bank, First Republic Bank, and the shotgun wedding of the failing Credit Suisse to UBS.

Signs of a severe economic contraction possibly joined with a global financial crisis are abundant including inverted yield curves, negative swap spreads, competitive yields on Treasury bills below the Federal Reserve's overnight reverse repurchase agreement rate, and increasing use of the Fed's Bank Term Funding Program.

This experience — failure of the sanctions to achieve intended goals, and blowback in the form of materially worse U.S. economic performance — were easily predictable based on the failed pre-conditions of successful sanctions programs.

Russia is a large economy with substantial resilience. The country has a huge network of allies with alternative payment channels and hard currency reserves beginning with the BRICS and including other neutral parties from Malaysia to Chile. And Russia has substantial hard currency reserves including 3,000 metric tonnes of gold worth about $150 billion at current market prices. Russia is not a suitable target for financial sanctions. U.S. policymakers failed to realize this through a combination of ignorance and arrogance.

Ironically, the greatest threat to the dollar comes not from abroad but from the U.S. Treasury. Specifically, by seizing the assets of the Central Bank of Russia, the U.S. has weaponized the dollar in a way that undermines the rule of law in the United States and causes other countries to seek alternatives.

This failed weaponization of the dollar led quickly to a desire to avoid ongoing and future dollar-based sanctions by opting out of the dollar system entirely. This desire is not limited to current targets such as Russia but is shared by potential targets including China, Iran, Turkey, Saudi Arabia, Argentina, and many other nations. The BRICS+ and their institutional network present the best platform for a successful effort to de-dollarize global payments and eventually global reserves. We turn now to the status of these de-dollarization efforts.

Ditching The Dollar

The global desire to move away from the dollar as a medium of exchange for international trade in goods and services has gone from a discussion point to a novelty to a looming reality in a remarkably short period of time. It's impossible to check headlines without seeing a new story about major trading partners planning to substitute their local currencies (or in some cases a newly formed currency) for the U.S. dollar in payment channels supporting world trade.

In recent meetings between Malaysian Prime Minister Anwar Ibrahim and President Xi Jinping in China, Malaysia proposed the formation of a multilateral Asian Monetary Fund that would hold non-dollar assets and be prepared to act as a swing lender to member nations running trade deficits. This institution would be an alternative to the International Monetary Fund and would distinguish itself by lending in yuan and other regional currencies rather than dollars or SDRs. The Asian currency loans would be used to pay for imports including oil.

Dubai and China have recently concluded an arrangement whereby Dubai will accept Chinese yuan in payment for oil exports from Dubai. In turn, Dubai can use the yuan to buy semiconductors or manufactured goods from China or can simply sell them to bank dealers for euros or other currencies.

Saudi Arabia and China have been discussing similar oil-for-yuan arrangements but nothing definitive has yet been put in place. These discussions are made complicated by Saudi Arabia's longstanding petrodollar deal with the U.S., and the emerging rapprochement between Saudi Arabia and Iran, another key trading partner of China. Still, some progress along these lines is widely expected.

China and Brazil have recently reached a broad-based bilateral currency deal where each country accepts the currency of the other in trade. China can buy Brazilian soybeans, sugar, oil, aircraft, and other goods for yuan. Brazil can buy semiconductors, solar panels, and other Chinese manufactured goods for reais. Both sides have extensive tourism and other services to offer the other. China is Brazil's largest trading partner having recently displaced the United States in that role.

There is a growing strategic relationship between China and Russia as the two superpowers jointly confront the United States. In the trading relationship between the two nations, Russia can pay in rubles for Chinese manufactured goods and other exports while China pays in yuan for Russian energy, strategic metals, and weapons systems.

Yet, all these arrangements may soon be superseded by a new BRICS+ currency, which will be announced in Durban, South Africa at the annual BRICS Leaders' Summit Conference on August 22-24, 2023. This August meeting is by far the most important BRICS meeting since the founding of the organization in 2006.

A Leaders' Summit means President Xi, President Putin, President Lula, Prime Minister Modi, and President Ramaphosa will all attend in person. This invitee list poses challenges because an arrest warrant has been issued for President Putin by the International Criminal Court in The Hague. South Africa will have to ensure that no attempt will be made to arrest Putin in South Africa. Still, some disruption or efforts by third parties or NGOs to execute the warrant cannot be ruled out.

The BRICS Leadership: (L to R) President Lula of Brazil, Prime Minister Modi of India, President Xi of China, President Putin of Russia, and President Ramaphosa of South Africa. This group will attend a Leaders' Summit in South Africa on August 22-24, 2023.

The BRICS+ (Brazil, Russia, India, China, South Africa, and other countries invited to join the BRICS summits) have been working to create a multilateral trade currency pegged to a basket of commodities for use in trade among members.

Initially, the BRICS+ commodity basket would include oil, wheat, copper, and other essential goods traded globally in specified quantities. The commodities in the basket would be converted into SDRs using existing market prices (usually given in dollars) and converting those dollar prices to SDRs at market rates determined daily by the IMF. The final step would be to specify an exchange rate between SDRs and the BRICS+ currency. Based on that conversion, the value of a single unit of the BRICS+ currency could be determined for purposes of trade in all goods and services.

In all likelihood, the new BRICS+ currency would not be available in the form of paper notes for use in everyday transactions. It would be a digital currency on a permissioned ledger maintained by a new BRICS+ financial institution with encrypted message traffic to record payments due or owing by participating parties. (This is not a cryptocurrency because it is not decentralized, not maintained on a blockchain, and not open to all parties without approval).

The latest information from the BRICS working groups is that this basket valuation methodology is encountering the same problems that John Maynard Keynes encountered at the Bretton Woods meetings in 1944. Keynes initially suggested a basket of commodities approach for a world currency he called the bancor.

The difficulty is that global commodities included in any basket are not entirely fungible (there are over 70 grades of crude oil distinguished by viscosity and sulfur content among other attributes). In the end, Keynes saw that a basket of commodities is not necessary and that a single commodity — gold — would better serve the purpose of anchoring a currency for reasons of convenience and uniformity.

The U.S. Treasury representative at Bretton Woods, Harry Dexter White (a covert Stalinist agent) agreed that gold would be the international currency anchor but trumped Keynes by insisting that the dollar be the dominant currency linked to gold, not the bancor. Twenty-five years later, the IMF finally created a world currency, the special drawing right (SDR) anchored to gold. However, the gold anchor was abandoned in 1974, and the SDR has been tied to a basket of reserve currencies ever since.

Based on this history and the impracticality of commodity baskets as uniform stores of value, it appears likely that the new BRICS+ currency will be linked to a weight of gold. **This plays to the strengths of BRICS member Russia and China, who are the two largest gold producers in the world and are ranked sixth and seventh respectively among the 100 nations with gold reserves.**

The End of Reserve Status For The Dollar? Not So Fast

These and related developments are frequently touted as the "end of the dollar as a reserve currency." Such comments reveal a lack of understanding as to how the international monetary and currency systems actually work. The key mistake in almost all such analyses is a failure to distinguish between the respective roles of a *payment* currency and a *reserve* currency.

Payment currencies are used in trade for goods and services and remittances of dividends, interest, royalties, and other flows from direct foreign investment. The examples cited above are all efforts to substitute local currencies (or new multilateral currencies) for the dollar as a means of payment in trade relations and remittances.

Reserve currencies (so-called) are, in effect, the savings accounts of sovereign nations that have earned them through trade surpluses. These balances are not held in currency form but in the form of securities. When analysts say the dollar is the leading reserve currency, what they actually mean is that countries hold their reserves in securities denominated in a specific currency. For 60% of global reserves, those holdings are U.S. Treasury securities denominated in dollars. The reserves are not actually in dollars; they're in securities.

As a result, you cannot be a reserve currency without a large well-developed sovereign bond market. No country in the world comes close to the U.S. Treasury market in terms of size, variety of maturities, liquidity, settlement, derivatives, and other necessary features.

Such a large liquid securities market requires the participation of underwriters (called "primary dealers" in the U.S.), clearing banks, reliable and fast payment channels such as Fedwire and the Depository Trust & Clearing Corporation (DTCC) based in New York. The U.S. has had 230 years since Alexander Hamilton created the U.S. Treasury market to perfect these institutions. No other country comes close.

Above all, investors require that the issuer of the securities have a good rule of law. Neither China nor Russia nor the other countries noted has adequate rule of law. Germany, Italy and Japan do but those bond markets are not big enough to absorb global savings. The U.S. Treasury market (and therefore the dollar) win the reserve role by default.

The Golden Alternative To The Dollar

So, what we see in the headlines is an attack on the dollar in terms of its payment currency status. But there is currently no alternative to the dollar in terms of its reserve currency status because of the absence of a sovereign bond market of sufficient size and operational capacity. That role will be very difficult to dislodge, perhaps taking ten to twenty years to establish the necessary infrastructure and gain the trust of market participants.

Your editor in Batman Alley, a popular artist's community and graffiti art section of São Paulo, Brazil. Brazil is the third largest BRICS economy after China and India, and is the tenth largest economy in the world. Brazil also has the seventh largest population in the world at 216 million people after China, India, the U.S., Indonesia, Pakistan and Nigeria. Brazil has the fifth largest land mass in the world after Russia, Canada, China and the U.S. By every measure — output, land and population — Brazil is a powerhouse nation and will be a critical bridge between developed and developing economies in the new multi-polar world.

If no other currency can easily replace the reserve currency role of the dollar, is there any alternative at all? Yes, gold is ready and waiting in the wings. That's the real danger to the U.S. Treasury market — that sovereign nations turn to gold to escape the dollar. That trend began over ten years ago. Yet, it cannot go much further without exponential increases in the dollar price of gold. Such gains should not be thought of as gold "going up." They are best understood as the dollar going down. The implications of that are highly inflationary as the world saw in the late 1970s.

Talking about the dollar being stronger or weaker makes little sense unless one has an objective metric. When one describes the dollar as weak or strong it begs the question: Compared to what? Most traders and investors use an index like DXY or Bloomberg. These are heavily weighted to EUR. As a practical matter, the EUR/USD cross-rate is the simplest comparison.

The difficulty is that all dollar indices compare currency to currency. That's meaningless when you're discussing a crash. If the dollar is crashing based on a loss of confidence, the euro and yen will suffer the same fate. If one major currency goes down, they will all go down. They're all in the same lifeboat and they all sink or survive together.

The only objective metric for dollar strength is the dollar price of gold by weight since gold is not a central bank currency. This resolves the valuation conundrum as follows:

1. Dollar strength can only properly be measured in gold.
2. Gold is money but it is also a commodity.
3. EMs are dollar poor but commodity rich.
4. The new BRICS+ currency will be linked to gold.

So, the collapse of the dollar really means higher inflation and a much higher dollar price for gold. That means other commodity prices will rise in lockstep. A commodity boom favors BRICS and EMs generally (as it did in the late 1970s and early 1980s).

When gold goes from $2,000 to $10,000 that is better understood as an 80% devaluation of the dollar: from 0.0005 ounces per dollar to 0.0001 ounces per dollar. That's a collapse of confidence, but you'll miss it if you're looking at euros or yen. Those currencies will be collapsing at the same time. You have to look at gold.

This dynamic could lead the BRICS+ currency to displace the dollar as a dominant payment currency more quickly than most expect because of the link to gold. Also, a BRICS+ currency could gain acceptance far faster than the local currency of any member country because the market for goods and services is so much larger.

Today, if Russia accepts yuan in exchange for oil it is practically limited to China as a place to spend or invest the yuan. If Russia accepted the BRICS+ currency instead, it could spend or invest the same currency in India, Brazil, Turkey, Mexico or any other member country. The common currency moves the non-dollar scheme from something close to barter to a true currency union.

A BRICS+ Bond Market

In the foregoing analysis, I made the distinction between a payment currency and a reserve currency and wrote that the former can be done fairly easily, but the latter cannot be done practically except by using gold. The impediment to another currency as a reserve currency is the absence of a bond market where reserves are actually invested. With gold, there's no need for a bond market to absorb reserves because you have the physical gold as the resulting asset. A gold-back currency balance could perform similarly.

We noted above that no sovereign bond market comes close to the U.S. Treasury market in terms of volume, diverse maturities, infrastructure, and rule of law, and that's why it's so difficult to displace Treasuries as reserve assets even if you wanted. Notwithstanding that condition, the BRICS+ currency offers the opportunity to leapfrog the Treasury market and create a deep, liquid bond market that could challenge Treasuries on the world stage almost from thin air.

The key is to create a BRICS+ currency bond market in twenty or more countries at once, relying on retail investors in each country to buy the bonds.

The BRICS+ bonds would be offered through banks and postal offices and other retail outlets. They would be denominated in BRICS+ currency but investors could purchase them in local currency at market-based exchange rates. Since the currency is gold-backed it would offer an attractive store of value compared to inflation- or default-prone local instruments in countries like Brazil or Argentina. The Chinese in particular would find such investments attractive since they are largely banned from foreign markets and are over-invested in real estate and domestic stocks.

It will take time for such a market to appeal to institutional investors, but the sheer volume of retail investing in BRICS+ denominated instruments in India, China, Brazil and Russia and other countries at the same time could absorb surpluses generated through world trade in the BRICS+ currency.

Of course, the BRICS+ members themselves could purchase the bonds in place of U.S. Treasuries. Central banks could serve as market-makers. Interest rates would be low because the gold-backing is countercyclical to inflation. Redemption facilities could be offered through the same local outlets that sold the bonds.

In short, the way to create an instant reserve currency is to create an instant bond market using your own citizens as willing buyers.

The U.S. did something similar in 1917. From 1790 to 1917, the U.S. bond market was for professionals only. There was no retail market. The First and Second Banks of the United States bought government bonds to redeem the Revolutionary War debt and to finance the War of 1812. The Civil War was financed by a Philadelphia banker named Jay Cooke who made a market in government bonds. The Treasury bond market existed throughout the nineteenth century, but there was no material retail involvement.

That changed during World War I when Woodrow Wilson authorized Liberty Bonds to help finance the war. There were bond rallies and Liberty Bond parades in every major city. It became a patriotic duty to buy Liberty Bonds. The effort worked, and it also transformed finance. It was the beginning of a world where everyday Americans began to buy stocks, bonds and securities as retail investors.

A Liberty Bond poster from World War I imploring American citizens to purchase these new U.S. Treasury securities to help finance the war. The patriotic campaign was wildly successful and opened the door to large-scale retail investment in government bonds for the first time.

For many Americans, a Liberty Bond was their first investment outside of land, silver, and bank deposits. Many of the famous "wire houses" such as E. F. Hutton (1904), Merrill Lynch (1914), and Dean Witter (1924) date from around this period.

If the BRICS+ use a kind of Liberty Bond patriotic model, they may well be able to create international reserve assets denominated in the BRICS+ currency even in the absence of developed market support.

This entire turn of events — introduction of a new gold-backed currency, rapid adoption as a payment currency, and gradual use as a reserve asset currency — will begin on August 22, 2023, after years of development. Except for direct participants, the world has mostly ignored this prospect. The result will be an upheaval of the international monetary system coming in a matter of weeks.

How To Take Advantage of the Coming BRICS Shock

The BRICS+ gold-backed currency has moved from a discussion point to a near reality faster than all but a few realize. The BRICS (2006) had to develop the financial infrastructure first with the NDB (2014), and the CRA (2015) before turning to the currency. The process was accelerated by the U.S. weaponization of the dollar at the start of the War in Ukraine (2022). Payments systems, telecommunications systems and high-grade encryption were also required. Since 2006, BRICS members China and Russia have each more than tripled their physical gold reserves.

All of the pieces are now in place. The new currency arrives on August 22. Since the BRICS+ currency will be gold-backed, and since participants in the scheme will continue to buy gold in order to maintain the needed backing support for the new currency, the price of gold will remain strong and steadily grow. A gold investor can effectively hitch a ride on the BRICS+ currency train and be part of the future of international finance.

Investors can anticipate the monetary earthquake by buying gold today.

All the best,

Jim Rickards
Editor, *Strategic Intelligence*

Driving Season Puts The Spotlight On Our Favorite Refiner

By Dan Amoss, CFA

This month we recommend a second trade in an oil refining specialist with roots stretching back to the days of famous industrialist John. D. Rockefeller.

Our first trade, from October 2022 to February 2023, netted us a quick 12% return. Since then, this stock has corrected back to our original entry price even though it's cheaper, with fewer shares outstanding.

Founded in 1887 as Ohio Oil Company, what later became known as Marathon Oil was acquired by Rockefeller's Standard Oil two years later. The company became independent again in 1911 after the Supreme Court ripped apart Standard Oil.

Through the mid-20th Century, Marathon Oil made nice progress as an integrated oil company. It fended off a hostile takeover from Mobil in the early 1980s and spent most of the next 20 years owned by U.S. Steel.

In 2011, Marathon Oil spun off its refining and pipeline assets into **Marathon Petroleum (NYSE: MPC)**.

MPC's assets are what we're interested in today. We see another 50% upside in MPC shares over the next year as investors recognize the durable profit potential of its assets.

But first, let's cover some background on the refined product market. And we'll discuss why U.S. refiners, including MPC, are in a new golden age.

Last October, you may recall hearing news stories about tight diesel supplies across many areas of the U.S.

The Biden administration constantly promises action to "fight" high prices for gasoline and diesel. However, this administration has only made politically expedient, short-term-oriented moves like draining the Strategic Petroleum Reserve.

The cold, hard reality that green energy advocates need to accept is that **the billion-plus fleet of internal combustion engines around the world will need diesel and gasoline for decades into the future.** Pandering to a political base of radical environmentalists will only result in the loss of political power, whether it's in the U.S. or Europe.

> **…the billion-plus fleet of internal combustion engines around the world will need diesel and gasoline for decades into the future.**

Until we see more political support to maintain U.S. oil, gas, and refining production capacity — *and years* of catch-up investments are made — we will keep bumping up against constraints.

Demand for refined products remains strong despite high prices. Gasoline and diesel prices might seem high, but that's only because it's natural to make a mental anchor to super-low prices in 2020 and early 2021. Gasoline and diesel are not very high *relative to the value they create for all sectors of the economy*.

Why U.S. Refineries Are In A New Golden Age

Hydrogen is a crucial ingredient in the oil refining process. It dilutes the carbon in the end product, which allows for increased production of high-quality fuels. Where do refineries get hydrogen? They get it from natural gas. **Access to lower-cost natural gas is why U.S. refineries will enjoy a huge competitive advantage versus competing refineries in Europe and Asia.**

Natural gas prices in Europe have cooled off over the winter as demand has slowed. Europe luckily enjoyed the warmest winter in memory. But it won't always be unseasonably warm. Another surge in gas prices will remind investors that it will be difficult to *profitably* refine crude in Europe.

The continent may see more refinery shutdowns in the years ahead. If so, it will rely more on imported products from geographies that have been investing in refineries, including the Middle East. Mothballed European refineries act to tighten refined product supply, which boosts profits at U.S. refiners.

Sanctions on Russian refined products have worsened refined product supplies — especially distillates (heating oil and diesel). Of course, Russia gets around sanctions by exporting to third parties. But the net effect is an increase in miles traveled for the global refined product tanker fleet. That means there will be more refined products on the water and fewer products sitting in onshore tanks. Tighter onshore supplies keep prices high.

As I've often repeated in *Strategic Intelligence*, underinvestment in the oil patch is a big deal. It doesn't get enough attention in the financial media, but it will eventually get addressed. Voters will demand it. **Without enough reliable energy supply, all other links in the economic value chain will malfunction.** All other sectors of the economy are contingent on the smooth functioning of the energy system.

Without enough reliable energy supply, all other links in the economic value chain will malfunction.

Underinvested also describes the state of the refinery industry. According to the U.S. Energy Information Administration, U.S. refining capacity fell for the second straight year in 2021. It started 2022 at 17.9 million barrels per day, down from 19 million barrels pre-Covid. So even if demand for gasoline and diesel demand falls in a recession, tighter refining *capacity* will cushion the downside risk in refining *margins*.

Data collected by the International Energy Agency (IEA) on global refining capacity paints a similar picture. In its flagship oil market report, the IEA reduced its worldwide refinery production estimate for 2023 by 720,000 barrels per day. Demand reduction, OPEC+ production cuts, and lower contributions from sanctioned Russian refineries are all factors pushing refinery runs lower.

In *Strategic Intelligence*, we like to recommend cyclical stocks when their sectors have been underinvesting. **Refining has been underinvesting for several years, so it's a good time to own refiners.** The mid-2000s was a golden age for U.S. refiners. Profits were high and consistent, and refining stocks left the S&P 500 in the dust.

In a March 2022 report, BofA Securities analyst Doug Leggate made a solid case that the U.S. refining industry is in a *new* golden age.

"We believe the U.S. refining industry is on the cusp of a new 'Golden Age,'" writes Leggate, "characterized by a reset in sustainable mid-cycle refining margins. [They are] disproportionately advantaged vs international peers on multiple levels. Specifically, we see U.S. refiners overlooked as net beneficiaries of structurally higher natural gas costs ex-U.S. — a critical input to the margin necessary to clear higher international operating costs. On what we believe is a conservative outlook for a sustained natural gas differential based on the long-dated forward strip prices and greater go-forward dependence from Europe on LNG to meet incremental demand. We suggest the relative advantage for all U.S. refiners can have greater duration than the original 'Golden Age' in the mid-2000s."

Europe is structurally short of diesel. Also, the global economy demands refined products that can only be produced by highly complex refineries. Evidence confirms that Leggate's golden age refinery thesis is intact. This is as much a *supply shortage* story as it is a demand story.

In a May 11, 2023 report, Leggate noted that **gasoline inventories are the tightest they have ever been for this time of year** — ahead of driving season.

"Ahead of summer, gasoline has once again taken the lead from distillate as the key driver of refining earnings. This week, product supplied which measures the amount of gasoline delivered out of the primary supply chain (i.e., wholesale to retail channels), fully reversed last week's drop, indicating that consumers demanded 9.3 million b/d of gasoline last week, exceeding last year's figures on a seasonal basis. Note that given that the Weekly DOEs have consistently understated demand by 150,000 b/d since last May compared to the DOE's more accurate monthly report, it is possible that demand could be higher — which would align with commentary from the refining industry this past earnings cycle and reviewed in last week's OIM. After another sizeable drop of 3.2 million [barrels], US gasoline inventories have declined 10 of the last 12 weeks, leaving stockpiles at the tightest ever level for this time of the year, setting up a constructive outlook ahead of peak summer demand."

In short: Due to limited capacity and strong global demand, earnings at refiners have been phenomenal. Even if earnings fall in 2023, they will remain above the late-2010s average for years…

U.S. Refineries Are Much More Profitable Post-COVID

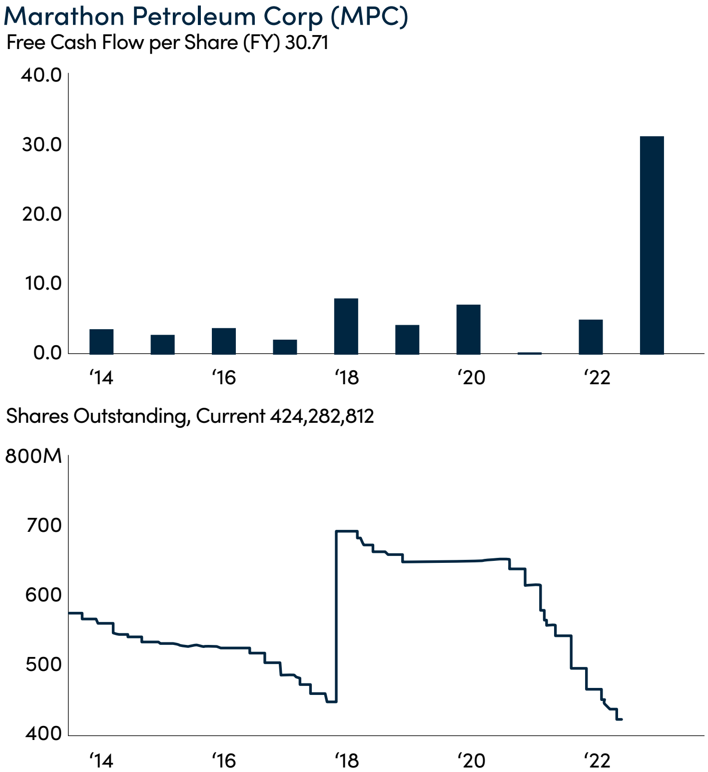
Headquartered in Findlay, Ohio, **Marathon Petroleum (NYSE: MPC)** is a leading downstream energy company. It owns the nation's largest refining system and Marathon brand gas stations.

MPC also has a big ownership stake in a valuable pipeline network. It holds a majority interest in MPLX LP, a publicly traded midstream pipeline company. MPLX pays reliable dividends to its owners. MPC shareholders benefit from these dividends because they can fund the company's hefty stock buyback program.

Since MPC was spun out of Marathon Oil in 2011, it's done a nice job of creating value for shareholders. It created MPLX as a separate public entity, which attracted an income-oriented shareholder base. It acquired Andeavor (formerly known as Tesoro Corp.) in 2018 for a fair price.

And in 2021 and 2022 it earned huge profits. Marathon Petroleum sold off its Speedway retail operation and used the proceeds to buy back MPC shares. The number of shares outstanding has fallen by an incredible 35% over the past two years. That gives each remaining MPC share a much larger claim on the company's future profits.

Here is a chart of Marathon's free cash flow (FCF) per share in blue and its shares outstanding in black. FCF per share surged to $30.71 in 2022. Even if this number settles into the range of $15 to $25 over the years ahead, that still makes MPX stock trading near $110 very cheap.



The black line in the chart shows MPC's shares outstanding. Notice that starting in 2013, the share count fell steadily due to stock buybacks. Then, it spike higher in 2018 to fund the brilliantly timed acquisition of Andeavor. The deal substantially boosted MPC's revenue and cash flow production. Then, once the Covid panic subsided, buybacks resumed at a remarkably fast pace.

On May 2, management announced that the company bought back $4.4 billion in stock in the first four months of 2023. This pace can continue.

Wall Street expectations for MPC's earnings look too low. The Street expects earnings per share to fall from $18.46 in 2023 to $12.93 in 2024 and $10.92 in 2025. In other words, few analysts expect a *new golden age for refiners*.

In contrast to Wall Street, we think earnings at MPC will stay high for years to come. And the longer that earnings remain in a high range, the higher the price investors will pay for the stock.

In the mid-2010s, when refining margins were not nearly as high, MPC often traded at 15 times earnings. With sustainable earnings potential above $11 per share, the stock could trade up to $180 a year from now, for a 65% upside. In the meantime, tight diesel, heating oil, and gasoline supplies could spark another nice rally from now through late 2023.

ACTION TO TAKE:

Buy Marathon Petroleum (NYSE: MPC) up to $120 per share.

Best regards,

Dan Amoss

Dan Amoss, CFA
Senior Analyst, *Strategic Intelligence*

Jim's insights into global issues and how they will affect investors are always very interesting and thought-provoking. I enjoy every issue and thank Jim for his work! -Dan M

Tap Into This Well-Managed 10% Yield Play

By Zach Scheidt, Contributing Editor

When I find a stock that pays a 10% dividend yield, my inner skeptic comes out.

After all, high dividends tend to attract buyers, driving share prices higher. And the higher the share price, the lower the yield. That's just how markets tend to reach equilibrium over time.

But every once in a while, investors pass over a great deal like the one I'm about to show you.

Maybe because it's politically incorrect, maybe because investors misunderstand the business, or maybe because investors are too enamored with mega-cap tech stocks to be bothered with more traditional dividend stocks.

Today, I want to introduce you to a high-yield income play that's absolutely perfect for today's challenging market.

My guess is the stock won't stay this cheap for long. Which means you've got a limited amount of time to lock in this income stream before the price moves higher.

A Temporary Pullback for Oil & Gas

Today's income play is **Devon Energy (DVN)**, one of the largest independent exploration and production companies in North America.

Devon operates onshore wells across the continent with exposure to the Delaware, STACK, Eagle Ford, Powder River Basin, and Bakken resources. At the end of last year, the company had reserves of 1.8 billion barrels of oil equivalent, and DVN pumped out roughly 611,000 barrels per day.

The company is incredibly well-managed and very profitable. (We'll get into Devon's details in a moment).

But in today's market, investors aren't giving the company enough credit for its profits. That's because oil prices have pulled back, raising concern for traditional energy stocks like DVN.

The chart below shows the spot price for North American WTI crude oil. And as you can see, crude oil peaked above $120 per barrel before pulling all the way back to its current price of just above $70.

North American WTI

Natural gas prices have followed a similar — but more pronounced — pattern. Thanks to ample supplies and limited exporting capacity, U.S. natural gas prices have also pulled back substantially this year.

U.S. Natural Gas Prices

Naturally, energy producers like DVN make more profits when oil and gas prices are high. And they realize smaller profits (or losses) when prices pull back. So, it makes sense that stocks like DVN have been under pressure for the last few quarters.

But if you look at the macro picture for both oil and natural gas, there are plenty of reasons to be optimistic. And as investors, we know our best profits will be made when we buy low ahead of a rebound — especially for stocks that pay reliable dividends!

Oil prices have pulled back for several reasons including recession fears, distributions from the Strategic Petroleum Reserve (SPR), and exports from Russia that still find their way into the global oil supply.

But later this year, the U.S. is likely to start *refilling* the SPR (driving more demand for crude oil). OPEC+ is likely to *cut production* (reducing global supply)… And the global economy has been surprisingly resilient helping to drive organic demand for energy of all kinds.

Meanwhile, new natural gas export facilities are set to come online over the next few months. And growing demand for electricity is driving demand for clean-burning natural gas — one of the few environmentally friendly ways to generate *reliable* power.

Bottom line, despite the current pullback for oil and natural gas prices, the future looks *bright* for Devon Energy. **This means now is a good time to invest before the stock starts surging higher.**

Business Management at Its Best

There are a number of great energy stocks for investors to choose from - all of which will benefit from higher oil prices.

But DVN stands head and shoulders above most other oil and gas producers. Especially for investors who place a high priority on collecting income from their positions.

For starters, DVN is a low-cost producer. In the first quarter of this year, DVN posted production costs of just $12.02 per barrel. Of course, there are other costs that have already been paid such as land acquisition costs, permitting fees and other ancillary expenses.

But at the heart of its business, DVN is able to tap into its wide base of energy resources without spending much for each additional barrel of oil produced. And this helps the company generate plenty of additional cash — even when oil prices pull back!

Secondly, DVN's management team is very frugal and proactive with how it spends the company's cash. The company has a history of acquiring resources from other companies at attractive prices. And Devon also places a high priority on *returning cash* to shareholders.

This is done in the form of share buybacks and a very unique dividend policy.

Energy companies like DVN have drawn ire from the Biden Administration for share buybacks. When a company uses cash to buy back shares, it reduces the number of shares outstanding. And that means every million dollars of profit is now divided between *fewer shares* — making each share that investors still own more valuable.

Devon has earmarked $3 billion of the company's cash for share buybacks. And since DVN's stock price has pulled back in recent months (thanks to lower oil prices), the cash can be used to buy back *more shares* — creating even more long-term value for investors.

In the first quarter of this year, DVN spent $692 million of its buyback cash — getting a great deal for the shares it repurchased.

Devon also has a unique "fixed + variable" dividend policy. Under this program, DVN pays a fixed quarterly dividend of $0.20 per share. It then uses up to 50% of the company's free cash flow to pay out the "variable" portion of its dividend.

Over the past year, investors received quarterly payments of $1.27, $1.55, $1.35 and $0.89 per share. All four payments add up to $5.06 per share. And when you compare that to DVN's current share price near $48, you get a dividend yield north of 10%!

Of course, the "fixed + variable" approach means that sometimes investors will receive smaller dividends. For instance, the company's next dividend payment will "only" be $0.72 per share.

But as oil prices stabilize and DVN's cash flow increases, I expect the variable portion of DVN's dividend to be much higher later in the year.

A Perfect Play for Capital Growth AND Lucrative Income

Now is the perfect time to tap into this cash-rich energy play. A temporary pullback in oil prices has left DVN out of favor with Wall Street. But the company continues to generate plenty of cash even with lower oil prices.

Oil and natural gas prices will likely trade higher later this year. At the very least, we will see some stabilization, helping to drive more investor interest into the oil and gas sector.

Once energy markets stabilize, DVN will likely rebound sharply. If this stock only makes it halfway back to its October highs, you'll still receive more than a 30% capital gain on your investment.

And that gain is *on top* of the oversized income payments you'll collect each quarter from DVN's fixed + variable dividend policy.

In short, this is the perfect time to invest in DVN.

I recommend buying up to $55 per share and holding for at least a year. That way, you can collect plenty of income. And if you hold your position for more than 12 months, you should pay a lower tax rate on your capital gains.

Remember — a solid source of income can sometimes be determined by good timing. Take advantage of the temporary pullback in oil prices now by investing at a favorable entry point with DVN.

Here's to growing and protecting your wealth,

Zach Scheidt
Contributing Editor, *Rickards' Strategic Intelligence*

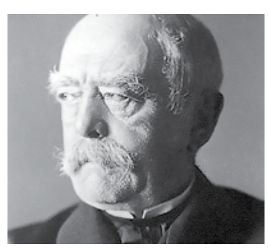
I appreciate Jim combining the market and the issues that impact it. Knowledge is power and actions get reactions, and he puts them together. **– Joel S**

"Russians Always Come For Their Money" — How To Prepare For The BRICS Sticker Shock

By Byron W. King, Senior Geologist

"Do not expect that once taking advantage of Russia's weakness," said Otto von Bismarck, "you will receive dividends forever." No, continued Germany's Iron Chancellor, "Russians always come for their money."

I thought of Bismarck's quip as I read the pre-publication draft of Jim Rickards's top-line article in this month's issue of Strategic Intelligence, regarding BRICS+ and where the global monetary system is headed.



Germany's Iron Chancellor, Otto von Bismarck, 1815–1898.

Jim details how American policy blunders created an opening for a new global currency, an alternative to the dollar that will be a gut-punch to the U.S. economy. Details are yet to be defined with this next-generation medium of both exchange and preserving wealth; but likely we'll soon see some sort of BRICS-backed monetary unit, perhaps by August when the world's new moneymakers meet in Shanghai.

In his article, Jim writes, "These (policy) blunders can all be traced to complacency by U.S. officials about the dollar's status, and U.S. arrogance about the use of the dollar as a financial weapon."

Bam! Nailed it! That's a bombshell insight, dropped right down the smokestack of American cultural, political, and monetary hubris.

Let's discuss Jim's point a bit more and amplify some key elements. Then, further along, I'll offer specific advice on how to prepare for the BRICS+ "sticker shock" that's about to hit the world and wash ashore in the U.S. like a monetary tsunami.

The Dollar: America's Cultural Keystone

First, the basics. No doubt, you've heard over many years that the dollar is the world's reserve currency. Also, you likely know (and Jim discusses this in his article) that this reserve currency status has been the case since the formation of the petrodollar in 1974, and before that tracing back to Bretton Woods in 1944 with a gold-backed dollar.

Indeed, it's not hard to argue that the dollar has been globally dominant for over five generations, well over a century. The dollar transformed into the world's principal trade currency as early as 1914, during World War I when both Britain and France went broke after just four months of waging war with Germany. From the end of 1914 to November 1918, what kept "The Great War" running was a large measure of U.S. credit, backed by a good-as-gold U.S. dollar.

Jim refers to this wartime dollar power in his article, namely how the U.S. government raised funds by issuing Liberty Bonds. And even before the U.S. entered the war in April 1917, Federal Reserve-backed U.S. bank credit funded massive exports of food, munitions, and much else from America to Britain and France.

Without all that U.S. credit, and absent the massive volumes of goods and munitions it paid for, it's likely that the European belligerents would have economically exhausted themselves. The war would have wound down and world history would be quite different from what we have today.

With this perspective, it's no stretch to say that the dollar is not just a powerful monetary unit; in fact, its history makes it a keystone of modern American culture.

The Top Dog of Global Monetary Instruments

Americans in general, and American politicians in particular, have strong, unquestioned beliefs about their beloved currency. In the minds of many, the so-called "Almighty Dollar" reigns supreme, a Colossus in global affairs.

Indeed, to anyone alive now, the dollar has always been the granite foundation of American power, and again to many, it always will be. To an ironclad mindset like that, use of dollars as the world reserve currency is as natural a state of affairs as breathing air.

Meanwhile, in Washington, D.C. and other power centers, we have a long-embedded, highly politicized collection of "deciders" (to use a term made famous by President George W. Bush).

And to the last person, that national-level governing class has been raised and educated in a certain way, to believe that the dollar is a natural form of inherent wealth, if not an immutable force of nature.

Along these lines, Jim discusses how (at least for now) no other currency has the scope, breadth, or highly evolved framework of bond markets to displace the dollar. Per Jim, it goes back to the 1790s and Alexander Hamilton. And importantly, Jim lays out the critical distinction between a trade currency and a reserve currency.

Sure, countries can decide to trade day-to-day in their own currencies, yuan-for-dinar or rubles-for-rupees. But then comes the issue of proper settlement, of exchange rates, and establishing a correct measure of value-for-value. Otherwise, international trade is just a fancy form of barter.

Then comes the next issue of the longer term. Namely, how can a country ensure that any surplus or reserves of the other party's local currency will retain value over time? Well, for over a century, using the dollar solved much of the problem.

The point is that, for multiple generations, the world has used dollars both for trade and also to save wealth in a way that builds up reserves from past surpluses. Think of how, since the 1970s, OPEC nations took surplus dollars from oil sales and bought U.S. bonds; or how since the 1980s, China and Japan have used dollar surpluses from trade to buy bonds.

Overall, for many decades the dollar has reduced financial risks inherent in trade and offered its holders a legally secure means to store wealth over time, allowing for modest, built-in inflation.

From the perspective of American politicians, policymakers, bankers, and other trade-dependent businesses (think of Boeing or General Electric, etc.; and many others) the dollar made life easy. America's dollar was, is and remains the top dog of global monetary instruments.

And Then Came Sanctions...

Now, we get to sanctions, which Jim discusses in his article.

I'll just add that dollar and trade-based sanctions have been around for a long time.

For example, in the late 1930s and early 40s President Franklin Roosevelt placed escalating levels of sanctions on Japan due to that nation's invasion of China. And per postwar records, it's clear that U.S. sanctions on Japanese oil imports, in the summer of 1941, directly led to the Japanese decision to attack the U.S. later that year on December 7. (See ***Bankrupting the Enemy: the U.S. Financial Siege of Japan Before Pearl Harbor***, Edward S. Miller, U.S. Naval Institute Press, 2007.)

More recently, in the 1980s the U.S. placed economic sanctions on South Africa over that nation's internal policies of apartheid, which arguably had much to do with the downfall of that system. And there are many other examples of U.S. and allied Western economic sanctions, from Iran, continuously since the 1980s, to Serbia in the 1990s, and many more.

Then we come to 2014 when Russia moved into Crimea, an area that has been Russian since 1783 when Katherine the Great gained title under a treaty with Ottoman Turkey. But in the post-Soviet world after 1991, and by accident of Cold War history, Crimea wound up as part of Ukraine.

You probably know the story here. Russia's "polite, little green men" took over Crimea, and the place became a legalistic cause to the West. This led to increasing levels of U.S. sanctions against Russian people and businesses, and even Russian government sub-agencies.

All of which brings us to February 2022, and the Russian special military operation (SMO) in Ukraine which led to massive increases in levels of U.S. sanctions. These sanctions included the U.S. government seizure of over $300 billion of Russian state assets held abroad, either in U.S. accounts or elsewhere subject to U.S. and other international legal attachments.

Plus, add in sanctions and seizures against Russian individuals, businesses, and other state-level properties; seizing the yachts, airplanes, soccer teams and other properties of Russian oligarchs, you may recall.

You can think whatever you want about Russia's SMO in Ukraine, good, bad or indifferent. But the fact is that at the time Russian tanks rolled into Ukraine, the U.S. and Russia were not at war in any proper sense of international law. There was certainly no declaration of war by the U.S. Congress, quaint as that notion may be anymore.

And yet, despite the still-benign, non-belligerent status of affairs in 2022, the U.S. government seized a large whack of Russian money and property: government, business, and personal. Which brings us back to Chancellor Bismarck and what he said about Russians, which I noted at the outset: they "always come for their money."

"Play Fair, or Do Not Play"

Bismarck had more to say along those lines: "And when they come (ie. Russians, coming for their money), do not rely on an agreement signed by you, you are supposed to justify. They are not worth the paper it is written. Therefore, with the Russians, the rule is to play fair, or do not play."

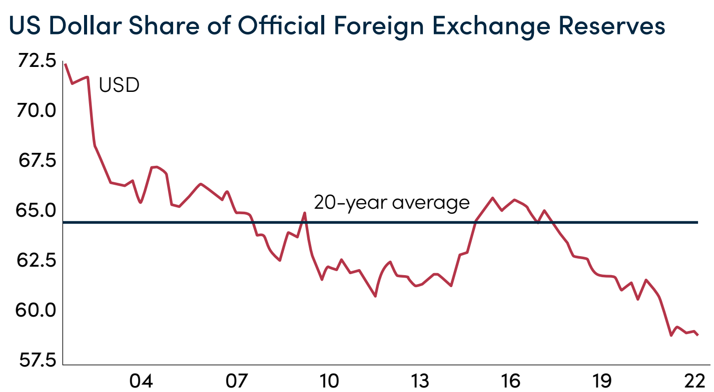
Well, here's the long and short: last year the Russian government, and many Russian people and businesses, held large sums of dollars. And the U.S. government summarily seized the stash.

There was no hearing, no court case, no Fifth Amendment "takings" litigation, no nothing. Just the stroke of a pen at the Treasury Department and a massive sum of Russia's wealth was gone. Poof!

From Russia's perspective, this peremptory seizure of national and private assets was nothing short of banditry and theft. And these U.S. actions annihilated the credibility of the American legal and monetary system.

In the Russian view, U.S. dollars, bonds, and the general U.S. financial system are no longer a means to transact business or store wealth. To Russia, any future monetary relations with the U.S. are just plain finished. It's over.

Beyond the situation with Russia, as things unfolded in 2022-23 this new aversion to holding U.S. dollars and assets became a perspective adopted by many other nations across the globe. In essence, America's draconian use of sanctions burnt down U.S. monetary credibility that otherwise required a century and more to create. It all went up in smoke.



As of the end of 2022, the USD accounted for less than 60% of official foreign exchange reserves. This is one of the lowest shares in the past 20 years.

Russia of course, plus China, and many other nations across the world saw what happened with U.S. sanctions and were shocked. That is, other governments, pretty much everywhere, looked at their dollar holdings and realized (not that they had not long sensed it) that their national wealth was and is subject to the whim and caprice of mercurial U.S. politicians.

Indeed, at this point in history, there's a growing perception across the world that the U.S. is actually a treacherous counterparty. If you know where to look and what to read, more and more you will see the term "non-agreement-capable," as applied to dealing with the U.S. government. That is, the U.S. might sign a deal but will renege at its convenience.

Just the threat of U.S. sanctions has curbed many countries' enthusiasm for holding dollars, in light of the long arm of U.S. jurisdiction whenever they they transact in America's currency. That is, dollars in any transactions are always subject to U.S. jurisdiction and legal process — even if the people using them have "nothing" to do with the U.S. Because if you use U.S. dollars, can hound you.

As an American, you can disagree with what much of the rest of the world is beginning to think. "Hey, no; we're good guys!" is the reply, reflecting the positive self-image of the U.S. But the fact is that many other people — foreign people! — seem to disagree. **And they've turned the old Goldman Sachs marketing ploy of BRIC into a new geopolitical movement.**

Keep this in mind as you watch the near-term evolution of BRICS+ into a growing body of nations across the globe, working to find some other way to transact trade and preserve wealth that cuts the dollar out of the pattern.

In other words, we'll awaken one morning to news from Shanghai, that BRICS+ is setting up an alternative trade and wealth currency, and definitely not using dollars.

Perhaps the new BRICS+ unit will use energy and/or commodities, or maybe just good old gold. But it's a safe bet that exclusion of the dollar, and shutting out U.S. monetary meddling, will underpin this new economic arrangement.

When that happens, we in the U.S. and West will endure a rapid, widespread measure of sticker shock. We'll see immediate and downward moves in the buying power of dollars as BRICS+ plants a new monetary flag high on the hill of world developments.

As it all evolves, the next version of any global security, political and economic system will not be framed by the U.S. alone. Countries everywhere will pursue their own priorities and produce new arrangements, likely overlapping and often competing.

One commentator, Samir Saran of India's Observer Research Foundation, predicts a new age of "limited liability partnerships" in a multipolar world where the U.S. and its dollars no longer dictate outcomes.

How to Protect Yourself

The bottom line is not just that the Russians are coming for their money, to echo the famous words of Bismarck. It's that when BRICS+ comes out with its new monetary unit (probably this summer), the dollar will be in big trouble. First, the rest of the world will need far fewer dollars for trade. So, many of the bucks currently used in international trade will migrate back to *El Norte*, leading to inflation at home.

Second, many nations across the world will realize that their products are not simply raw commodities or goods that they must sell for dollars. No, their products have actual, inherent value in the sense that they can be defined in terms of the new BRICS+ monetary unit.

It means that, yes, countries will still sell things to the U.S., but they'll want something other than those high-risk promissory notes of the U.S. Federal Reserve.

So, what kinds of investments stand to gain soon after the BRICS+ events begin to unfold? Well, think in terms of energy and hard assets.

There's an old Texas expression that I recall from my days at the former Gulf Oil Co., now part of Chevron: "If you don't have an oil well, get one."

You get the point, right? Own real things with real value. And if you can't get your own oil well, then follow the advice of my colleagues Dan Amoss and Zach Scheidt in this issue, to look at Marathon Oil or Devon Energy, both great companies in the oil patch space.

Look at these ideas, and of course, there are many other oil and energy companies that will benefit when their reserves in the ground skyrocket in value as the new BRICS+ monetary regime takes market share from dollars.

In the hard asset space, look at metals and miners, especially companies with pounds in the ground, and a plan to move these ores, minerals and elements to market.

Right now, one beaten-down bargain is **Sibanye Stillwater Ltd. (NYSE: SBSW)**, a $5 billion market cap company focused on platinum-palladium mining in South Africa and Montana. The current share price of about $7.00 is near a three-year low.

The general down-trend is due to issues in South Africa regarding electricity shortages and mine interruptions; plus, rising costs at the company's palladium mining operation in Montana.

Still, Sibanye Stillwater has vast resources in the ground, and up and running operations that produce critical metals in a world where demand is growing, and supplies are running thin. Looking ahead, and as metal prices rise generally — and let alone what will happen when the BRICS+ units come along — this company has solid upside, while the current dividend yield is in the range of 7.5%.

Another long-term play with immense upside is **Seabridge Gold (NYSE: SA)**, a $1.1 billion market cap company with a range of exploration and development plays in the Canadian and U.S. gold and copper space. The current share price is in the range of $13.50, which is slightly up in recent months but down from last year's highs.

Seabridge is not a mineral producer, nor generating revenues. But management has an uncanny ability to raise funds without major shareholder dilution, and the exploration team is outstanding in every way. Indeed, the company has three key projects ongoing this summer in Nevada and Canada, each of which has the potential to move the proverbial needle as drill results come in.

All this, and when the BRICS+ situation breaks open, expect a flood of desperate dollars looking for the best of the best gold plays, of which Seabridge is right in the top echelons.

As always, these ideas are not official recommendations. Watch the charts as you buy in, and never chase momentum. The point is to get positioned in energy and hard assets before the BRICS+ events take on a life of their own, and usher in a major turn of fortune to the U.S. dollar and the political fools who have made a mess of it.

That's all for now… Thank you for subscribing and reading.

Best wishes…

Byron W. King
Senior Geologist, *Rickards' Strategic Intelligence*

JIM ANSWERS

How would an attack by China on Taiwan impact the U.S. economy given its reliance on Taiwanese chip production?

-George B.

There's no doubt that an attack by China on Taiwan would have a profoundly adverse impact on Taiwan itself and the United States because of U.S. reliance on Taiwanese chip production.

However, there are a number of possible mitigating effects, including the timing of such an attack and any preparations that could be made in the meantime. The simplest analysis is the sooner the attack, the greater the adverse impact. If an attack does not come until 2028 or later, it's possible the impact on the U.S. will be slight, if any. Following is an analysis of how a number of factors including timing will affect the outcome.

Taiwan Semiconductor Manufacturing Company (TSMC) based in Hsinchu, Taiwan has been the largest semiconductor fabricator ("fab") in the world since 1987. Not only is it the largest fabricator, but it is also the most sophisticated. The performance of semiconductors in central processing units is measured by the distance between transistors in a chip. The shorter the distance, the faster the chip can process information because electrons have shorter distances to travel. Distance in the fastest chips today is measured in nanometers.

The fastest chip ever made is 2 nanometers; it was manufactured in 2022 by IBM. TSMC manufactures a 3-nanometer chip and is making significant progress with partners at MIT toward production of a 1-nanometer chip. Intel is also close to the 3-nanometer chip and will no doubt make progress to smaller distances in the near future.

By contrast, Chinese chips are no faster than 7 nanometers and are more typically 8 nanometers. Russia is also stuck at the 8-nanometer level. That's fine for applications such as smartphones and some video games, but it's not fast enough for the most advanced weapons systems and other cutting-edge applications.

Therefore, the importance of TSMC lies not only in its size but in the quality and speed of its chips. They are a crucial piece of the U.S. supply chain for weapons, intelligence, satellite telecommunications, and artificial intelligence.

That said, dominance in semiconductors comes not only from tech breakthroughs in size and speed but also from the equipment needed to manufacture super-fast chips. In that category, the U.S. has clear dominance.

Most of the equipment used by TMSC, Samsung, and Toshiba either comes from the United States or is manufactured under licenses from U.S. patent holders. This gives the U.S. good resilience if it had to replace foreign chip manufacturers from Taiwan, South Korea or Japan. China has no such resilience and would have to rely on its own equipment and fabs if facilities in Taiwan were destroyed.

And it is certain that the facilities of TMSC and other Taiwanese semiconductor giants and their suppliers would be destroyed in the event of a Chinese invasion. They would not be destroyed by Chinese invaders who would value them highly. They would be destroyed by the Taiwanese themselves or by the United States at the first sign of an invasion.

This plan of destruction is part of U.S. military doctrine and goes by the name of the "Bird's Nest Strategy." Ironically, that name comes from an old Chinese proverb: "If the nest is broken, how can the eggs survive?" The answer is that the eggs can't survive. If China invades Taiwan, the "eggs" (semiconductor fabrication plants and technology) won't survive. They will be destroyed by the U.S. to keep them from falling into Chinese hands.

The TSMC building in Hsinchu Science Park, Taiwan could be a major target for China if they were to ever invade, and some former U.S. officials have mumbled about the need to prepare for "scorched earth" to deny China the company's assets.

The impact will be enormous at least in the short run. Most Americans realize semiconductors are in smartphones, computers, laptops, televisions and other tech devices. Fewer realize that semiconductors are also embedded in automobiles (about 1,400 chips each), dishwashers, refrigerators, toasters, ovens, toys, and just about everything you use (the Internet of Things, IoT) as well as assembly lines, drilling operations, transportation systems, and much more.

While not all of these chips are the 3-nanometer grade, an invasion of Taiwan would disrupt global supply chains as manufacturers raced to substitute slower chips where possible, which simply shifts the logjam to other parts of the supply chain. U.S. GDP might be expected to decline 10% or more and hold at that new low level indefinitely.

Of course, the Bird's Nest Strategy begs the question of where the U.S. and its allies will get cutting-edge semiconductors once the Taiwan facilities are destroyed.

Some of that capacity could come from Intel, which is U.S. based and is investing over $20 billion in two new fabs in Oregon that should be completed by 2025. However, Intel is already operating near capacity and the additional plants are still a few years away. Even those plants won't provide all the capacity needed.

The more robust solution is that TSMC is also spending over $20 billion to build two new fabs in Arizona with the most advanced technology available. Obviously, TSMC is as familiar with the Bird's Nest Strategy and the threats from China as any U.S. analyst. Their goal is to survive as a company in addition to whatever contribution they might make to the Taiwanese or U.S. side in a war with China.

Fabs are extremely difficult to build. Specifications have to be met exactly. Some environments must be particle free and have precise temperatures and humidity levels. That takes specialized systems that are themselves difficult to install. The new Taiwan fabs may not be ready until 2026.

So, the U.S. is in a window of critical vulnerability. If a Chinese invasion took place in 2023 or 2024 and the Bird's Nest Strategy was implemented, the U.S. (and the world) would face an acute shortage of the highest-performing chips, in addition to massive supply chain disruptions that accompany any war.

If a Chinese invasion can be forestalled until 2025 or 2026, the U.S. should be able to muddle through with the new Intel and later the new TMSC facilities in addition to existing capacity from IBM and other U.S. fabs.

If we know the timeline, you can be certain the Chinese know it too. Their window of opportunity is probably now or never. U.S. dominance in semiconductor technology will grow in the years ahead and likely leave China badly behind by 2026. The window for invasion with maximum economic damage to the U.S. is the next two years. The countdown clock has begun.

Jim Rickards

Jim Rickards is an expert on the global monetary system, helping you understand how policies shape the markets… and impact your wallet.

His work is regularly featured in the *Financial Times, Evening Standard, The New York Times, The Telegraph, The Washington Post, The Wall Street Journal* and he is frequently a guest on the BBC, RTE Irish National Radio, CNN, NPR, CSPAN, CNBC, Bloomberg, and Fox Business.

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His work has also appeared in Seeking Alpha, Motley Fool and *The Wall Street Journal*

Byron King

Byron was a *Strategic Intelligence* contributor from 2016-2019. He is a Harvard-trained geologist, former Navy pilot and retired lawyer who will be our eyes and ears in the mining and defense sectors with perspectives you won't find anywhere else.

His insights have been featured on MSN Money, Marketwatch.com, Fox Business News, CNBC's Squawk Box, Larry Kudlow, Glenn Beck and PBS's NewsHour. He has also been published in the *Financial Times, The Washington Post* and *The Wall Street Journal.*