Philequity Corner (June 8, 2020) By Wilson Sy

The end of the strong US dollar?

After many years of uninterrupted strength, the strong US dollar may finally be over. The dollar index (DXY) is down 5.8%. More importantly, almost all currencies have rallied sharply against the US dollar.

Among developed currencies, the Norwegian Krone strengthened the most since hitting bottom in March (+20.4%), followed by the Australian dollar (+17.6%), the British pound (+9.3%), and the euro (5.4%). Among EM currencies, the Indonesian rupiah (+16.3%) rebounded the most after reaching its lows. This is followed by the Brazilian real (+15.7%).

Reasons for the dollar weakness

1. **The dollar carry-trade is over.** In the past, the dollar-euro "carry" used to be around 3% a year. But with US interest rates near zero, there is no carry trade and shorting the euro to buy US dollars is no longer attractive,
2. **Fed measures weighing on the dollar.** The unprecedented Fed stimulus, which led to almost doubling its balance sheet to $7 trillion, is weighing on the dollar. Dubbed as unlimited QE, the Fed spent around $3 trillion in just three months, which is already equivalent to the QE1, QE2, QE3 programs combined.
3. **EU Recovery Fund boosts the euro.** The proposal for a 500-billion-euro European Recovery Fund, which addresses the current pandemic crisis and opens the door for a future fiscal union, is positive for the euro. The recovery fund is a potential game-changer for Europe and may have tilted the demand away from the dollar. The euro is the largest component of the DXY, comprising almost 60%. Its appreciation will play a significant role in the broad dollar weakness over time.
4. **Search for yield.** Investors searching for returns are selling safe-havens like the US dollar, Japanese yen, and Swiss franc, and buying into higher-yielding EM currencies, including the Philippine peso. The Philippine peso closed at 49.80 last week- the first time in 2 ½ years it closed below 50 against the US dollar.
5. **Massive fiscal stimulus brings optimism to the global economy.** Since the pandemic crisis began, governments around the world enacted unprecedented stimulus programs to combat the effects of the pandemic and boost their economies. These measures aim to increased consumer spending and help businesses recover from the fallout of the COVID-19 outbreak.
6. **Risk-on mode.** The re-opening of many economies after a long and painful lockdown and hope for a COVID-19 cure or vaccine caused financial assets worldwide to rally. This also resulted in the hunt for bargains in laggard stock markets and bombed-out sectors like financials, restaurants, casinos, cruise lines, and airline stocks. Commodities and oil also went up, contributing to the strength of EM currencies.
7. **Shortest bear market.** The Nasdaq 100 became the first US index to reclaim its all-time last week. The broader Nasdaq Composite is just 0.25% below its record high, while the S&P 500 and Dow

Jones indexes are 5.9% and 8.3% below their respective all-time highs. The February 19 – March 23 decline in the S&P 500 that lasted for 24 days is now the shortest bear market on record.

8. **Furious rally in global stocks.** While US stocks led the rally, stock markets worldwide are increasingly participating in this rebound as investors look for higher returns. This move has likewise benefitted the PSE index, which has now rebounded 61.4 percent from its March lows. With money flowing not only into the US but to other markets as well, the demand for other currencies has increased.
9. **Mishandling of pandemic response and George Floyd protests.** President Trump's mishandling of the COVID response and the mismanagement of the George Floyd case that resulted in widespread unrest may have caused negative sentiment on the US dollar
10. **China's digital currency threat.** China announced recently announced that it is developing its sovereign digital currency, the so-called Digital Currency Electronic Payment (DCEP). This development may be seen as a threat to the US dollar's role as a reserve currency.

Blow-off top may be the turning point in the dollar

While movements in currencies take time to develop, recent technical actions may indicate that a turning point may be at hand. A double top in DXY has formed, which signals a possible reversal. A break below key support at 94.60 would confirm the change in the dollar's long-term direction.

Legendary hedge fund manager George Soros was famous for saying that "volatility is greatest at turning points." During the five weeks from February 20 to March 27, the US dollar index (DXY) exhibited pronounced volatility as it swung 1,800+ bp when it oscillated from 100 down to 94.6, then back to 102.94, and down again to 98. In prior five-week periods, the DXY ranged less than 300bp. This change of character in DXY may be indicative of a major turning point in the dollar.

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