MACRO TIDES

Macro Factors and their impact on Monetary Policy, the Economy, and Financial Markets

Dollar and Euro

A longer term chart of the Dollar and Euro have been provided so you can reference them as you read my analysis of the Dollar and Euro from 2014. Since the Euro is 57.6% of the Dollar Index, analysis of the Dollar is highly dependent on the outlook for the Euro. The combination of fundamentals, technical analysis, sentiment, positioning in the currency futures markets, and contrary opinion have proven helpful in discerning the intermediate trends in the Dollar and Euro.

Macro Strategy Review
April 2014
<u>Dollar / Euro</u>

At the ECB's monthly news conference on March 6, Mario Draghi said that the strength in the Euro since July 2012 had shaved .4% off annual inflation. "*The strengthening of the Euro exchange rate over the past one-and-a-half years has certainly had a significant impact on our low rate of inflation and, given current levels of inflation, is therefore becoming increasingly relevant in our assessment of price stability*." My expectation that the ECB would take steps to lower the Euro in 2014 appears on track and seems increasingly likely. I have no idea what actions the ECB might take to reverse the Euro's uptrend or when, but the ECB's success in bringing sovereign yields in 2012 may provide a clue. In conjunction with Draghi's "*Whatever it takes*" statement in July 2012, the ECB announced plans for its Outright Monetary Transactions program. Within six months, bond yields had come down dramatically, and the ECB didn't have to spend a dime in achieving their goal. Given this prior success, all the ECB may need is for Draghi to state the desire for a lower Euro and willingness of the ECB to sell Euros if necessary. Currency traders would be happy to accommodate the ECB's wishes, since they could sell the Euro short knowing they were doing so with the blessing of the ECB, and with almost zero chance the ECB would intervene. The ECB wouldn't have to sell a single Euro to achieve their goal.

The Euro represents 57.6% of the Dollar index, so a decline of 7.5% to 9.2% in the Euro versus the Dollar would add 4.3% to 5.3% to the Dollar index. With the Dollar index trading near 80.00, the decline in the Euro would add 3.4 points to 4.2 points to the Dollar index, and easily enable the Dollar to trade above near-term resistance at 81.31. Once above 81.30, the next level of resistance is 84.3 to 84.5, the highs in May and July last year.

Macro Strategy Review
June 2014
<u>Dollar / Euro</u>

After the ECB's meeting on May 8, Mario Draghi said, "*The ECB's governing council is comfortable to easing policy at their meeting in early June*." He also reiterated the connection between the Euro and the low rate of inflation. "*The strengthening of the exchange rate in the context of low inflation is a cause for serious concern*."

It appears currency traders have gotten the message, since the Euro peaked on May 8 at 139.93. As I discussed in April, the 50% retracement of the decline from the July 2008 high of 160.38 to the low in June 2010 at 118.77 was 139.57. The May 8 peak was just .46 from a perfect 50% retracement, which technically is significant. During the week of May 9, the Euro posted a weekly key reversal when it made a higher high, lower low than the previous week, and closed lower. In fact, the May 9 weekly reversal encompassed the three prior weeks, which adds to its importance. This is another technical indication that the trend in the Euro versus the Dollar has turned down. This is one of those times when the fundamentals and the technicals are aligned, which should increase the probabilities that my forecast of a decline in the Euro is on target. As I wrote in the May MSR, "*Shorting the Euro has the potential to result in a profitable trade over the next year*." From a risk management point of view, a stop on a short trade should be either just above the May 8 high or pennies below it.

Macro Strategy Review
October 2014
<u>Dollar</u>
The Return of the Almighty Dollar and Deflation
Between July 2001 and March 2008, the Dollar index fell from 121.29 to 70.69, or 50.6 points. A .382% retracement (a common Fibonacci rebound from a large decline) of the 50.6 point decline would be 19.33 points and targeted a rally to 90.01. This target is just above the highs of 89.25 in November 2008, 89.71 in March 2009 and 88.80 in June 2010. The price range of 88.80 to 90.00 is likely to attract the Dollar index like a magnet in coming months. Should the Dollar index reach this range, as we expect it will the odds of it breaking out above the range are good. The Dollar has already tested this zone three times, so a breakout after a fourth attempt should be a near certainty. The 50% retracement of the Dollar's 50.6 point plunge from 2002 to 2008 would target 95.99, and a 61.8% rebound (another common Fibonacci rebound from a large decline) would suggest a possible high of 101.97. I like the higher target for two reasons. After breaking through serious resistance at 89.00-90.00, a rally to just 95.99 seems too small, whereas a pop to 100-101.97 is a more appropriate follow through. Finally, if I am correct about the Euro Zone's extended economic malaise, the Euro will need to decline significantly from current levels.

Macro Strategy Review
January 2015
<u>Dollar / Euro</u>
The Euro is coming down to an area of chart support near 120.00 that would normally invite the covering of short positions. I believe that the long term and larger problems facing the Eurozone economy are structural and beyond the reach of monetary policy. However, the ECB has no other option than to further devalue the Euro to boost inflation and hopefully lift growth through more exports. As I wrote in the May MSR when the Euro was 138.00, "*Shorting the Euro has the potential of being a profitable trade over the next year*." It has and will likely continue to be in 2015, since I think the Euro could fall to 100.00 over the next twelve to fifteen months.

Macro Strategy Review
May 2015
Dollar / Euro
When the Euro was trading above 138.00, I suggested shorting the Euro in the May 2014 MSR. In last month's MSR I said that from a money management perspective, it seemed reasonable to cover a portion of the short position if the Euro dropped under 1.0650. On April 13 and 14, the Euro did trade under 106.50.

The Dollar peaked on March 13 at 100.38 just shy of my long term target of 101.00-10200. Last month I thought the Dollar had entered a consolidation / corrective period that could last two to four months and include a great deal of choppy trading. After a fair amount of choppiness, the Dollar traded as high as 100.27 on April 13, which coincided with the Euro falling under 106.50. As this is being written on April 24, the Dollar is trading at 97.18. I still think a decline to 92.60 to 94.77 is likely, before another Dollar rally takes hold. (The Dollar fell to 92.52 in August 2015)

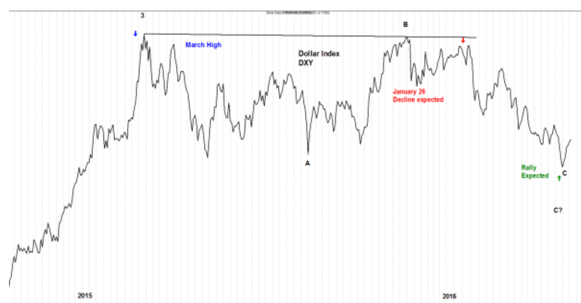
Macro Strategy Review
October 2015
Dollar / Euro
In the April MSR I thought the Dollar index had entered a consolidation / corrective period that would include a fair amount of choppy trading. I thought the Dollar index would decline to 92.60 – 94.77 from the mid-March high of 100.38, before another rally took hold. In the July MSR I revised my downside range to 90.20 – 93.30, and thought a decline into this range would complete the correction that commenced after the mid-March high. The Dollar reached a low of 92.52 on August 24, before reversing higher. As noted previously, I expected the Dollar to rally above 100.38 in coming months. My guess is that the Dollar index can reach 103.00 to 106.00 in coming months.

In the May 2014 MSR I suggested shorting the Euro when it was trading above 138.000. In the April 2015 MSR I suggested covering a portion of the short position when the Euro traded under 106.500, which it did in mid-April. In the July 2015 MSR, I thought the Euro would exceed the 1.1472 high it recorded on May 15, and rally to 1.170-1.185. I thought a rally to 1.170-1.185 would complete the countertrend rally from the mid-March low. I suggested using a portion of the short trade that was covered below 1.0650, to re-short the Euro above 1.170. On August 24, the Euro traded above 1.170, before reversing lower. I would use 1.1575 as a stop on that portion of the short trade. I think the Euro will at least fall below its March 2015 low, before a significant rally is likely. (The Euro fell to 1.0352 in December 2016)

Macro Tides
February 2016
Dollar
Based on the longer term chart of the Dollar index, I do not think the Dollar has topped. Since the low in March 2008, the pattern in the Dollar suggests that the Dollar has completed wave (1) up in November 2008, a corrective wave (2) in April 2011, and since May 2014, has been moving higher in wave (3). Wave (3) has been subdividing and appears to have completed wave 1 in July 2012, wave 2 at the low in October 2013, with the high in March 2015 representing wave 3 of (3). Since that high, the Dollar has been chopping sideways in wave 4. Once wave 4 is complete, the Dollar index should rally to a higher high above last March, and potentially run to 103.00 to 106.00 in wave 5 of (3).

(Chart February 9, 2007 – February 24, 2016)

Macro Tides
May 2016
<u>Dollar</u>



As discussed in the May 2 *Weekly Technical Review*, I thought the Dollar would bottom between 92.00 and 93.00 in the first half of May. "*The price pattern has, or is close to, completing a big A, B, C correction of the Dollar's 21 point move up from its low of 79.00 in May 2014*." Based on how the Dollar traded on Tuesday May 3, the low may have occurred. From a high of 100.39 in March 2015, the Dollar dropped to 92.62 on August 24 (Wave A), before rebounding to 100.51 on December 2 (Wave B). The Dollar then dropped to 91.88 last Tuesday before reversing and closing at 92.93. This appears to be the end of Wave C.

Macro Tides
January 9, 2017
<u>Dollar</u>
In a May 2016 interview on CNBC, candidate Trump provided his view of the Dollar. "*I love the concept of a strong Dollar, and in many respects obviously I like a strong Dollar. While there are certain benefits, it sounds better to have a strong Dollar than in actuality it is*." This statement provides a valuable insight as to how Trump might respond if the Dollar continues to increase in value in 2017. It suggests that Trump might not hesitate to talk the Dollar down, if he thinks it will help improve U.S. trade competitiveness and bring jobs back to the U.S.

The Dollar has rallied strongly in the wake of the election, the Federal Reserve's decision to increase the Fed funds rate, and the Fed's forecast of an additional three rate increases during 2017. The consensus of strategists is that the Dollar will continue to rally in coming months. Surveys of currency traders have recently indicated that more than 90% of traders are bullish the Dollar, which means they have already bought the Dollar. The last two times bullish sentiment toward the Dollar exceeded 90% was in March

2015 and January 2016. The Dollar subsequently declined by more than 7% in the months following these two periods of ebullience. As I wrote in the November 28, 2016 Weekly Technical Review (WTR), "*Although the Dollar may push modestly higher going into the Fed meeting or year end, the next bigger move is likely to be down."* In the December 19 WTR I noted "*that the Dollar had pushed to a new high after the Fed's forecast of three rate hikes in 2017, but the Dollar's RSI was negatively diverging. This suggests the upward momentum is beginning to wane. With year-end right around the corner, the Dollar may hold up or push slightly higher. But with so many bulls (over 90%) and momentum showing signs of fatigue, a reversal in the Dollar is coming, which is likely to bring the Dollar down to 100.00 at a minimum*." The Dollar pushed to a new intra-day high of 103.82 on January 3 and closed at 101.38 on January 5, a decline of -2.35% in less than 3 days.

Macro Tides
January 9, 2017
<u>Dollar</u>
In the January issue of Macro Tides, I discussed Trump's view of the Dollar and suggested that Trump might not hesitate to talk the Dollar down sometime in 2017. The only surprise is that he didn't even wait until he was in office to do it. In an interview with the Wall Street Journal published on January 17, he described the Dollar as "*too strong*." He also said the U.S. might need to "*get the Dollar down*" if a change in tax policy pushes it up. "*Having a strong Dollar has certain advantages, but it has a lot of disadvantages*."

Weekly Technical Review
August 21, 2017
<u>Dollar</u>
Ideally, the Dollar will post a lower low so that a divergence can form in its RSI. This seems increasingly likely given the nature of the Dollar's rebound from the low at 92.548. From a trading perspective, taking a small long position in the Dollar (1/4 or 1/3) if it drops below 92.93 is appropriate. The low in May 2016 was 91.92 so the risk is about 1%. Adding (1/4 or 1/3) on a decline below the 92.54 low makes sense since there should be an RSI divergence. The Dollar has declined by more than 10% since January, so a rally of at least 3% to 4% is coming.

Weekly Technical Review
August 21, 2017
<u>Dollar</u>
Technically, the Dollar has done everything that was expected by falling below 91.88 and posting a new low that was unconfirmed by the Dollar's RSI. Based on the instructions I provided, buying a 1/3 position when the Dollar dropped below 92.93, 1/3 below 92.54, and 1/3 below 91.88, the average cost is 92.44. For now, a stop on a close below 91.50 is recommended.

Macro Tides
September 6, 2017
<u>Dollar</u>
I am a big fan of using contrary opinion in helping identify lows and highs in various markets. The contrary opinion trade for the Dollar is to look for a rally since the short position in Dollar futures is the highest in years, as most traders expect the downtrend in the Dollar to continue.

Weekly Technical Review
November 13, 2017
<u>Dollar</u>
The Dollar index broke out of an inverse head and shoulders pattern on October 26, rallied to 95.15, and then pulled back to test the breakout when it fell to 94.258 on Friday. The breakout generated a measured move to 96.00 and maybe 97.00. Based on instructions, traders are long the Dollar index from 92.44 and should use a close below 93.80 as a stop.

Weekly Technical Review
November 20, 2017
<u>Dollar</u>
As discussed in recent weeks, the Dollar index broke out of an inverse head and shoulders pattern on October 26. The breakout generated a measured move to 96.00 and maybe 97.00. Once a market average like the Dollar or the S&P 500 breaks out of an inverse head and shoulders, the one thing it is not supposed to do is fall below the neckline of the pattern. On November 14, the Euro rallied strongly on good GDP reports from Germany, Italy, and France which caused the Dollar to fall below the neckline at 94.20. Based on the decline below the neckline, I sold my position in the Dollar ETF (UUP) at $24.43 after buying it on August 29 at $23.83. Based on WTR instructions, traders were long the Dollar cash index from 92.44 and told to use a close below 93.80 as a stop, which triggered on Friday when the Dollar cash closed at 93.66.

Macro Tides
February 5, 2018
<u>Dollar</u>
Markets often don't reward logic. Since January 3, 2017 the Dollar Index has declined by 13% even though the Federal Reserve has increased the federal funds rate by 75 basis points and is expected to raise it by another .25% at its March meeting. A big rally in the Dollar could certainly upset the apple cart and lead to an unexpected correction in global equity markets. Sentiment is quite negative the Dollar especially after Mnuchin's comments. Technically, the Dollar still needs more time and will probably make a lower low in coming weeks as the Euro is making its high. Prior to the Dollar's rally in September and October 2017, the Dollar made an initial low in August, bounced, and then recorded a lower low in early September. I expect something similar will unfold in coming weeks which would provide technical evidence that the down trend was nearing an end. As discussed in January, the repatriation of overseas profits could provide the Dollar a lift starting in the second quarter and beyond.

Macro Tides
March 4, 2018
<u>Dollar</u>
If the Euro declines in coming months the Dollar Index will rally since the Euro comprises 57.6% of the Dollar. The recent low was 88.25 (cash) and could be retested amid trade discussions that include retaliatory actions by other countries in response to U.S. steel and aluminum tariffs. Once the top in the Euro is confirmed, the Dollar chart suggests a rally to near 95.00 is possible in coming months. This would represent an increase of almost 8.0% from its low at 88.25. A Dollar rally of this magnitude could prove a headwind for U.S. stocks, some commodities, and Emerging Markets, especially if Treasury rates breakout before Labor Day and are joined by higher rates in Europe.

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