



Thesis: USD will rise vs. EUR and global currencies

Last Update: December 4, 2018

Short term: ↑	High confidence in U.S. economy, rising rates, lackluster Eurozone economic growth and rising Italian credit spreads, potential crises in EMK.
Long term ↓	Growing current and budget deficits, normalization of rates and economic growth in the Eurozone and EMK

June'18: USD will rise short-term due to tighter monetary policy and stronger U.S. economic growth. Longer term factors, however, favor a weaker US currency.

Sept'18: The spreading EMK crises (from Turkey to Argentina, then to Brazil and Indonesia and South Africa) increases our conviction of a strong USD.

Nov'18: Conviction of a rising USD is stronger, based on a weakening Eurozone. Draghi's (ECB) may decide to postpone announced monetary tightening given slowing Italy and German (a victim of the trade war) economic growth.

U.S. Dollar Rises (short-term):	U.S. Dollar Declines (short-term)
<ul style="list-style-type: none"> Fed said there will be 3 rate hikes (28% probability) in 2018 (though FOMC comments were more dovish in 11/18) 	<ul style="list-style-type: none"> USD overvalued according to Purchasing Power Parity
<ul style="list-style-type: none"> Eurozone Economic surprises are weakening relative to the U.S. 	<ul style="list-style-type: none"> Large Current Account (i.e, Trade) and Budget Deficits
<ul style="list-style-type: none"> ECB wants to tighten monetary policy but is "trapped" by Italy's politics/budget. Moody's lowers rating to Baa2 (10/18). 	<ul style="list-style-type: none"> Trade war may affect currency. Trump may call for a weaker dollar.
<ul style="list-style-type: none"> Currency Crises in Turkey as of 2018. Strong USD causing EMK weakness, which has knockoff effects 	<ul style="list-style-type: none"> The long USD trade is somewhat crowded amongst speculators (may have peaked in 8/18).
<ul style="list-style-type: none"> 8/18, 9/18: EMK crises spreads to SA, Argentina, Brazil, Indonesia? Arg raises rates to 60% (world high). 	<ul style="list-style-type: none"> The effects of the corporate tax cuts will ebb by 2020. US Yield Curve may turn negative reflecting slowing growth.
<ul style="list-style-type: none"> The US equity and corporate bond markets have had strong returns since'09. 	<ul style="list-style-type: none"> ECB has said it wants to reduce its central bank holdings.

Heat Map legend



5 Year History



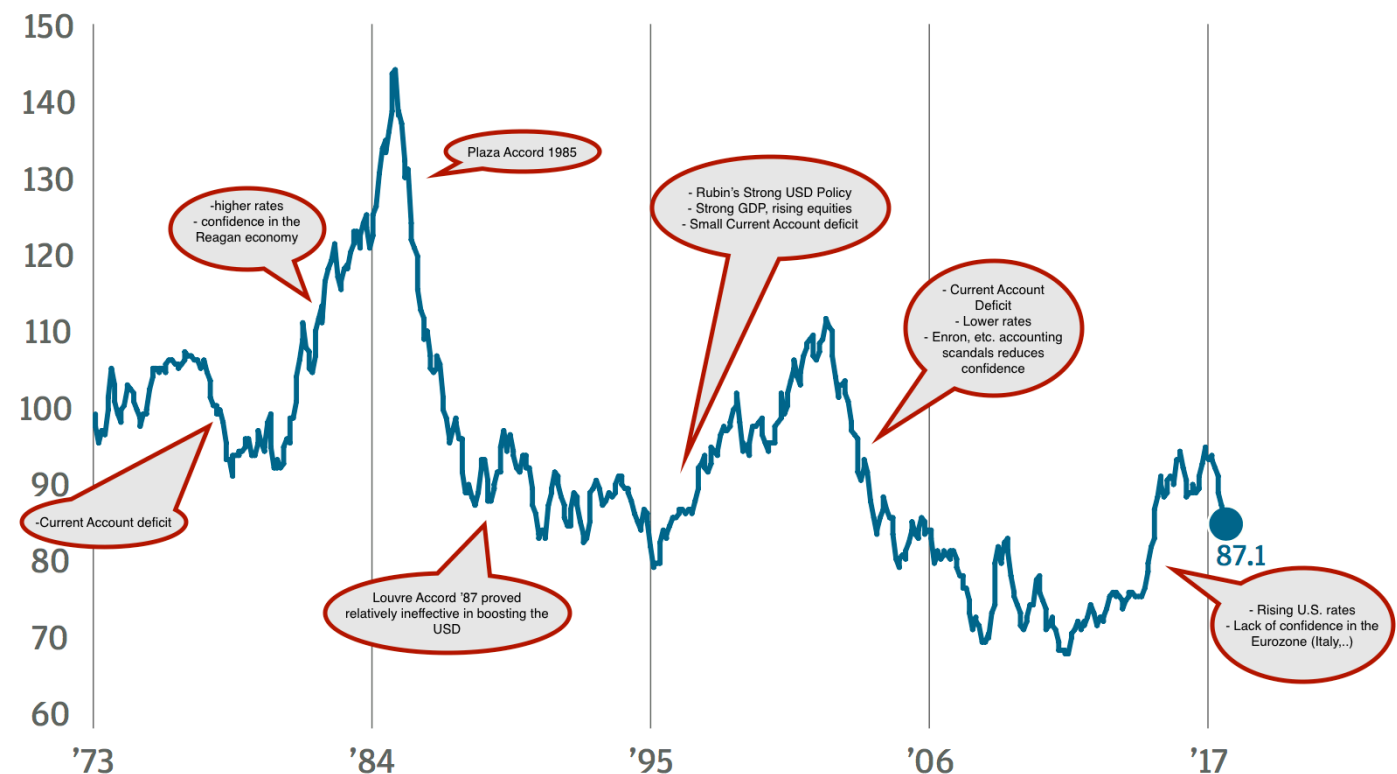
Long-term History



Source: Tradingview

A visual history of the modern U.S. dollar

EXHIBIT 1: NOMINAL MAJOR CURRENCY TRADE-WEIGHTED EXCHANGE RATE, U.S. DOLLAR, MONTHLY, INDEXED



Source: Federal Reserve, FactSet, J.P. Morgan Asset Management; data as of September 30, 2017.

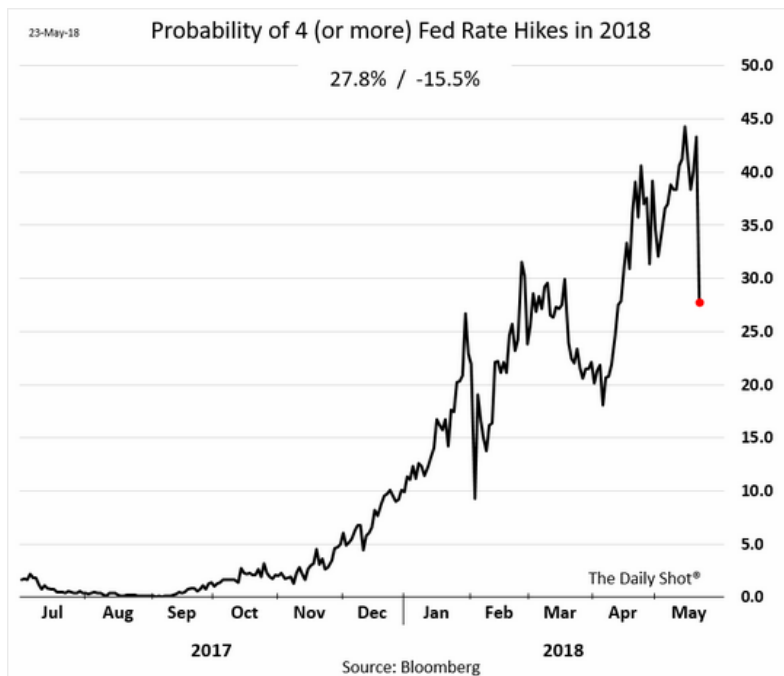
Notes:

- Thesis considers all viewpoints including Classical and Monetary Theories.
- Classical Theory says the economy is “self regulating” and thus it is a “hands-off” approach. In currency markets, the theory expects currencies to be affected by Purchasing Power Parity and Trade Balances (i.e., the current account).
- Monetary Theories are more “hands-on”, meaning it is expected the central bank intervenes by changing money supply and interest rates. More recently, the U.S. and European central banks have purchased fixed income assets.
- Self Feedback loops can and do occur in Fx markets. Participants’ (i.e, investors) views are affected by past changes in currencies or investments designated in those currencies. A rising currency may prompt speculative and non-speculative investment flows into a particular currency/asset depending on historical returns. Hence, serial correlation may be observed in currency markets.
- PPP: Purchasing Power Parity determines a currency level by comparing a basket of goods amongst different countries. It is commonly called the Big Mac Index and reported by The Economist magazine.

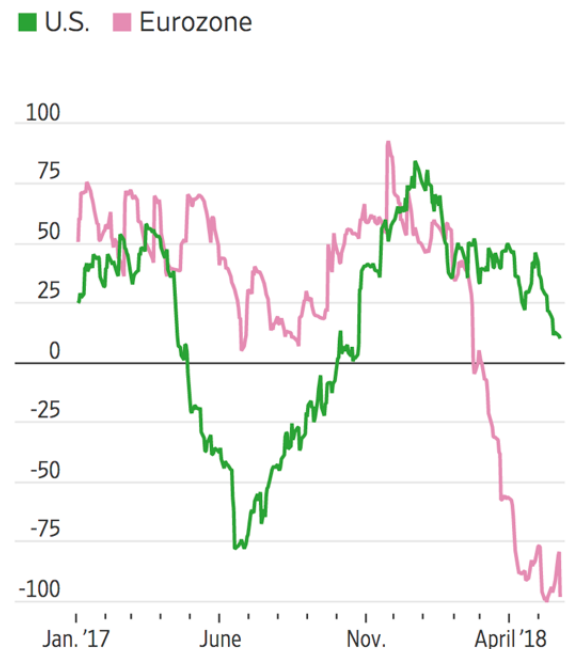
ETFs:

Ticker	Name	Comments
EUO	Proshares	Inverse, 2x leveraged, same expense ratio, <1%, as EUFX, have K-1
EURX	Proshares	Inverse, not leveraged, have K-1
FXE, ULE	Invesco / Proshares	Long EURO, not leveraged, have K-1 forms

Charts supporting or contradicting the above thesis (charts are retained given the evolution of the data over time)



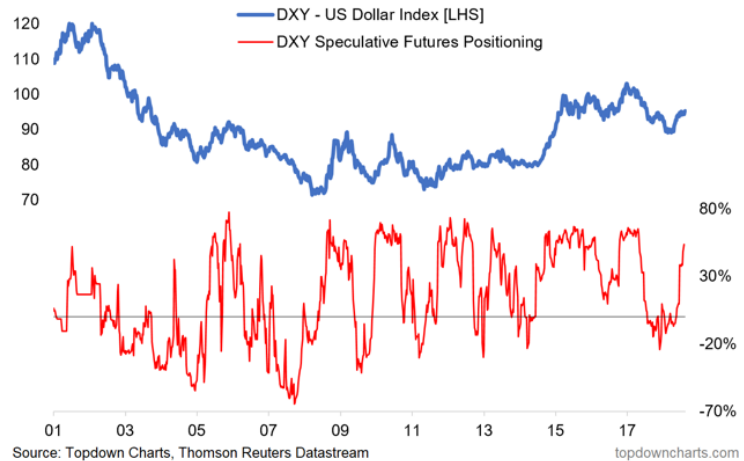
Citigroup Economic Surprise Index



4. The euro has been tracking the German 10yr bond yield adjusted for inflation expectations.



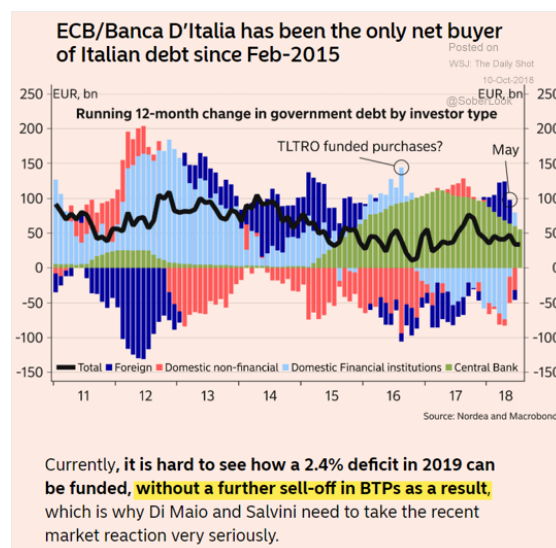
Long US Dollar becoming a crowded trade



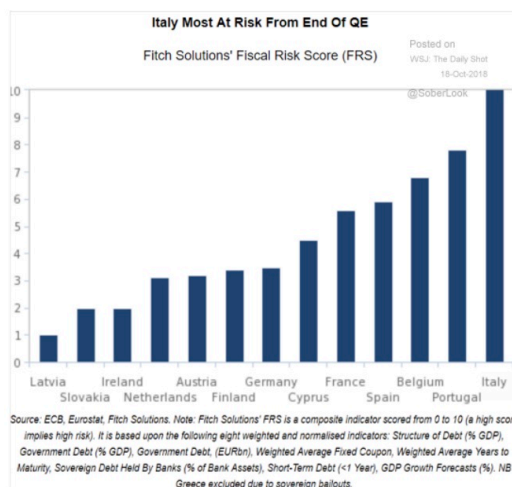
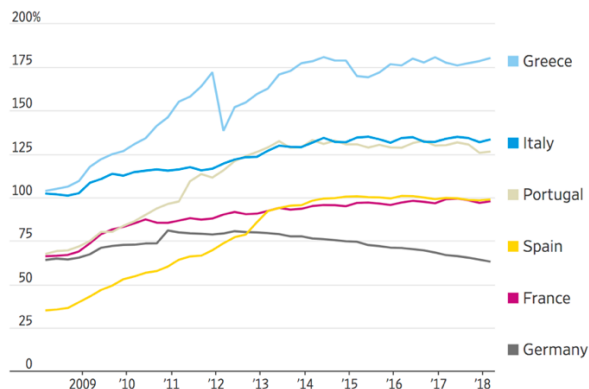
4. Which currencies are overvalued/undervalued? This table compares the various fair-value models.

A Range of Low-Frequency Fair Value Models					
	PPP	FEER	BEER	IMF EBA	Average
USD	10%	1%	7%	12%	7%
AUD	-1%	-2%	1%	3%	0%
CHF	8%	-6%	-14%	11%	0%
NZD	-1%	3%	-10%	1%	-2%
EUR	-3%	-3%	-2%	1%	-2%
CAD	-7%	4%	-6%	-8%	-4%
GBP	-4%	0%	-9%	-10%	-6%
SEK	-14%	8%	0%	-26%	-8%
NOK	-1%	-1%	-18%	-12%	-8%
JPY	-18%	-10%	-7%	-17%	-13%

Source: IMF, PIIE, Macrobond, TD Securities

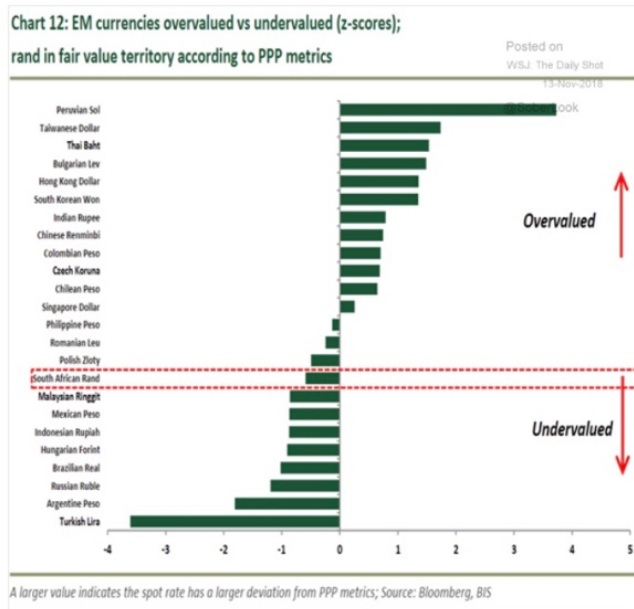
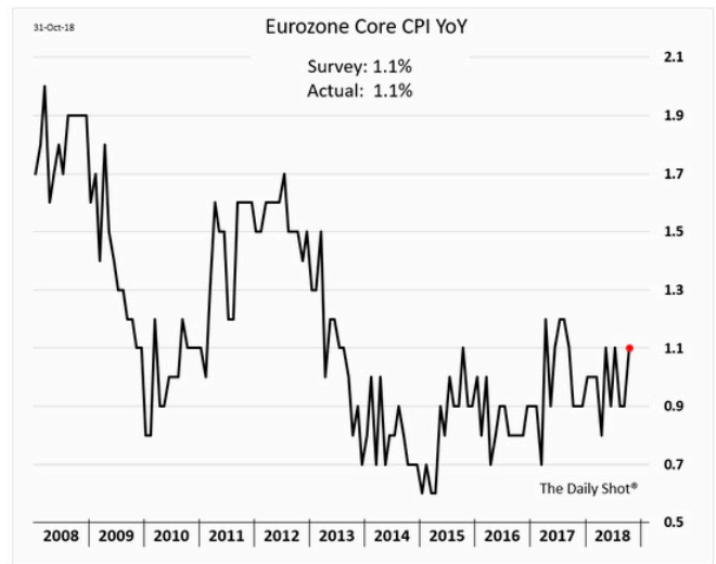


Government debt as a percentage of GDP



Source: [Fitch Solutions](https://www.fitchratings.com/web-content/fitch-solutions/fitch-solutions-fiscal-risk-score-frs)

- The 10yr US-Germany **real** rate differential:



economic surprise indexes

■ U.S. ■ Eurozone ■ Japan



Note: Below zero economic data worse than expected, above zero better than expected.

Source: Refinitiv

