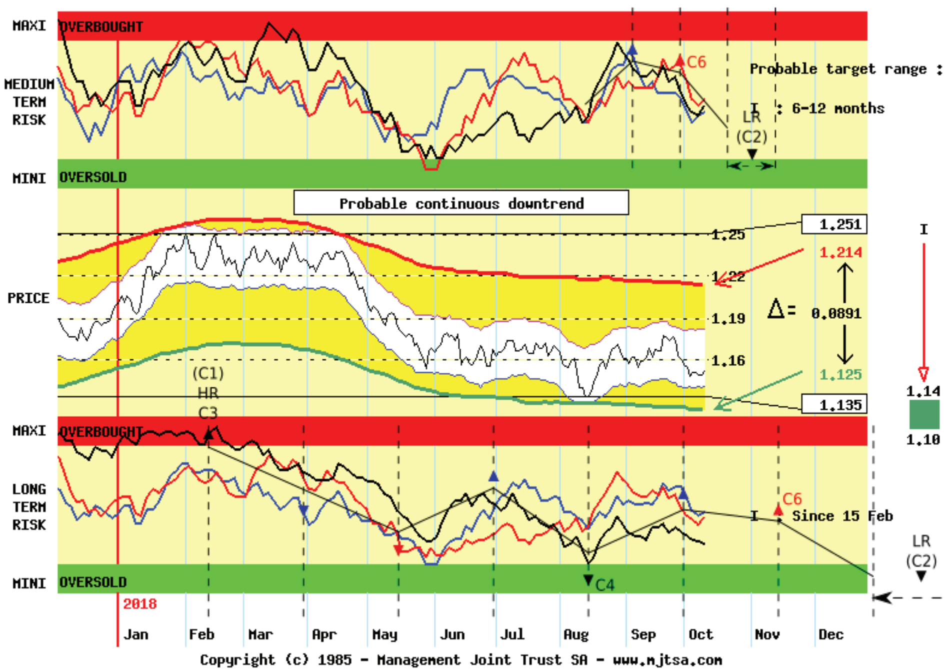
# 50 / MJT - TIMING AND TACTICAL INSIGHT

## Strong Dollar dynamics and related trades

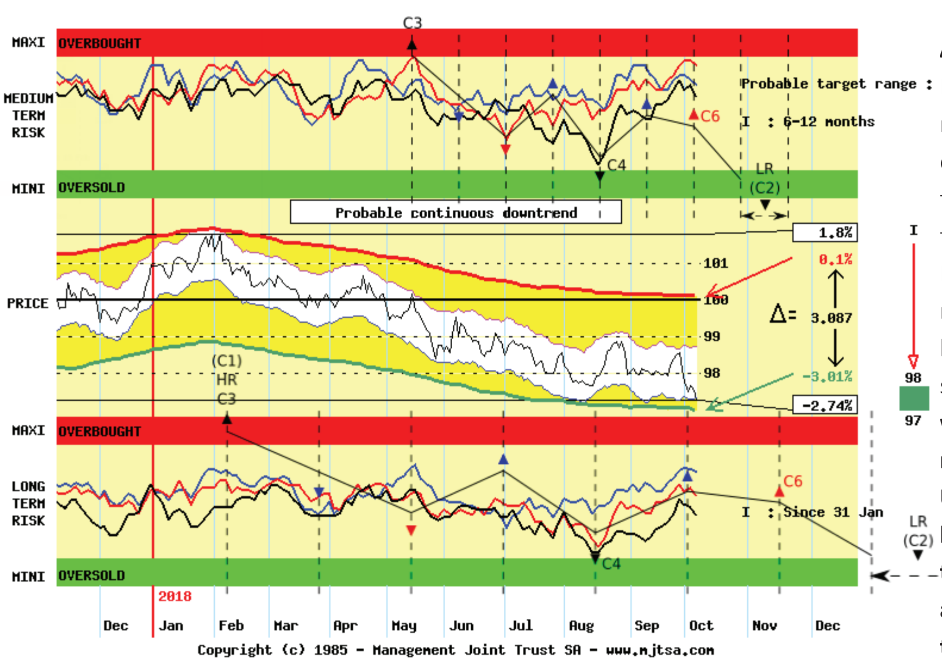
**Strong Growth momentum and rising interest rates are fuelling a constant flow of funds to the US. In this late cycle environment, the USD is indeed the last remaining Growth trade, but it can also turn quite defensive in times of turnmoil abroad as it also benefits from Flight to Safety and repatriation flows. We are still very constructive over the medium to long term prospects for the US Dollar, probably into next Spring, and potentially even towards end 2019. In this article we review, the different USD pairs on a shorter term basis (over the next 2 to 3 months). In an attempt to understand their dynamics, we highlight interesting related trades for each one of them.**

## EUR/USD
## Daily graph or the perspective over the next 2 to 3 months



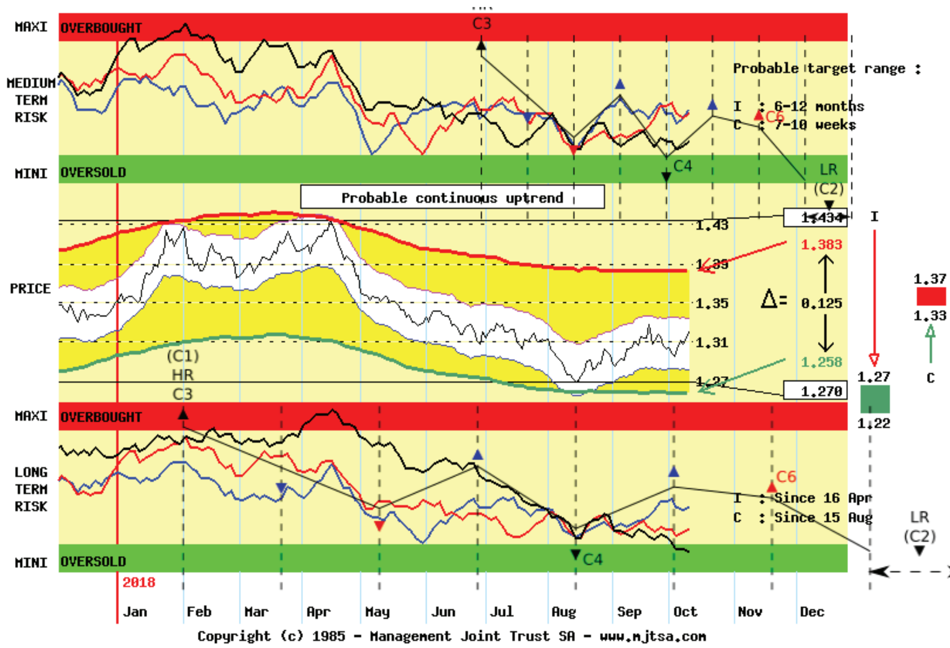

On both oscillator series (lower and upper rectangles), and following its August and September bounce, EUR/USD started to resume lower a few weeks ago as expected. **The sequences we show are still negative, and while a short bounce may materialize towards late October, early November, our long term sequence then continues lower into year-end at least.** Our I Impulsive targets to the downside are suggesting **that EUR/USD could reach back down into the 1.14 – 1.10 range by then.**

## TIP - iShares TIPS Bond ETF vs iShares Rexx® Government Germany 5.5-10.5yr ETF (currency hedged ratio)
## Daily graph or the perspective over the next 2 to 3 months



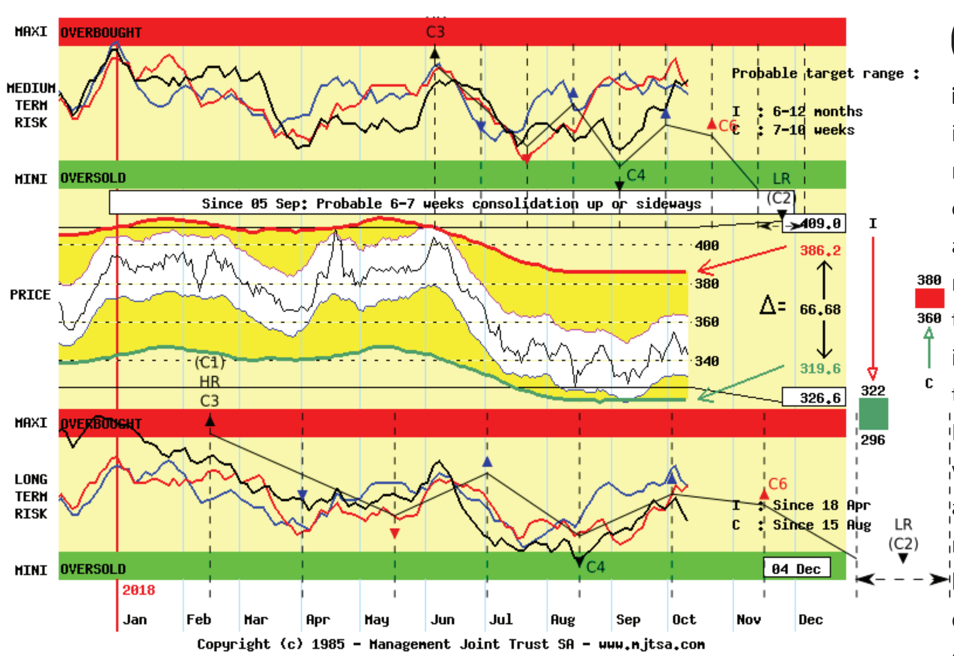

As shown in previous issues of The Capital Observer, we believe that EUR/USD is currently influenced by 2 main factors. On the positive side, our denominator (TIP), rising inflation expectations in the US, which usually weigh on the US Dollar and positively influence the EUR/USD pair. On the negative side, our numerator (REX German Government bond Index), which rises as risk-off positioning increases in the EuroZone. **In a way, we are comparing nominal Bund rates in the EuroZone vs real rates on US Treasuries. Recently, what the ratio has been telling us, is that the rising interest rates differential between the US and Europe has been much greater that the increase in US inflation perspectives. Hence, US Tips are declining much quicker than Bund yields and the ratio is resuming lower. As with EUR/USD, we expect the ratio to continue its decline towards year-end at least, although a slight bounce may also be expected here towards late October / early November.**

## GBP/USD
## Daily graph or the perspective over the next 2 to 3 months



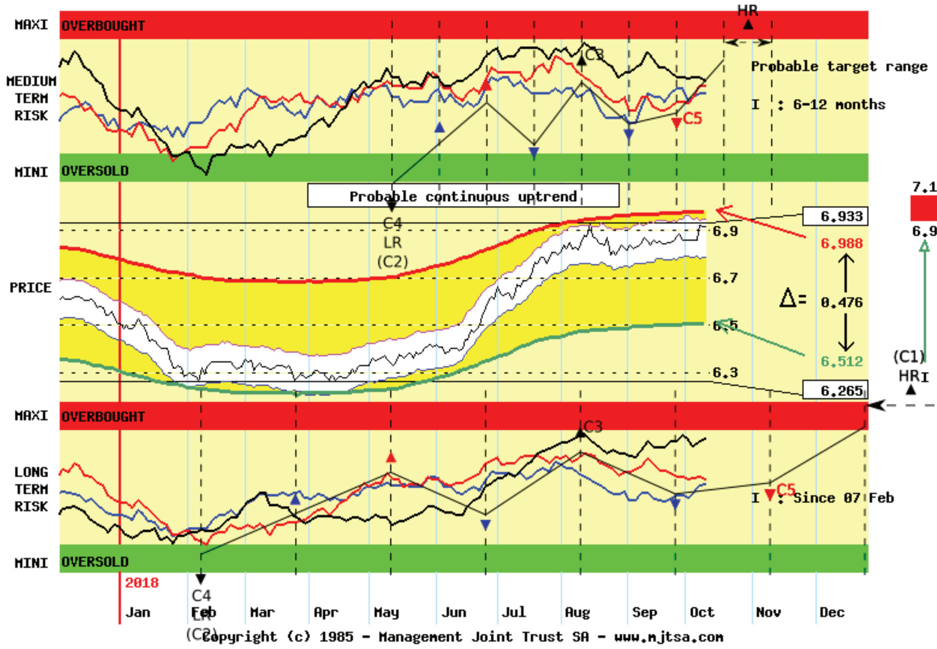

The British Pound is currently hanging through the last innings of the Brexit negotiations. Yet, whatever, their outcome, its downtrend vs the US Dollar for now is still in place (similarly to EUR/USD). Both our oscillator series (lower and upper rectangles) are suggesting that GBP/USD could indeed continue lower towards year-end. **As with other pairs vs the US Dollar, a slight bounce may materialize towards late October, early November, yet the downtrend then resumes lower again from mid November. Our I Impulsive target to the downside (right-hand scale) are suggesting that it could reach back into the 1.27 – 1.22 range over the next few months**. Given uncertainties around the current Brexit negotiations, we cannot exclude a positive surprise if the two parties finally come to an agreement. Perhaps, this could be concomitant with the bounce we expect towards end October. However, for now, the trend on Cable is still heading lower, and it would need to move above our C Corrective targets to the upside (above 1.37; right-hand scale) to theoretically reverse. We are still some ways away.

## Goldman Sachs Industrial Metals Index
## Daily graph or the perspective over the next 2 to 3 months



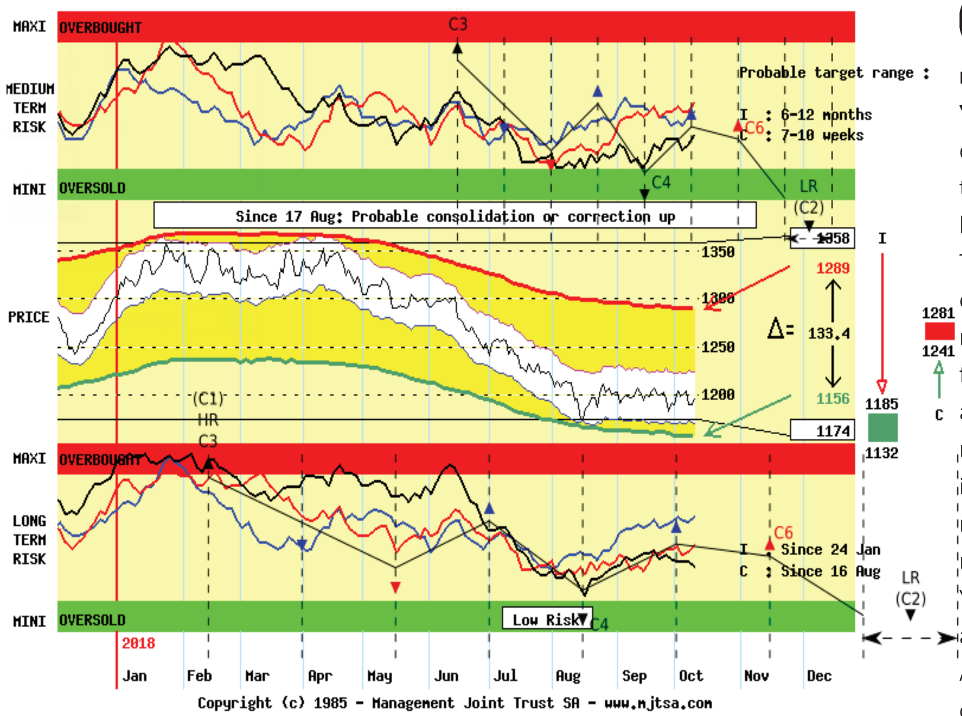

**Cable is often associated with the Metals & Mining industry**. Indeed, the FTSE 100 includes most of the biggest miners in the World. On the other hand, Industrial Metals are often associated with China, yet over the last few quarters, the parallel with Cable is also quite compelling. Both topped out in April, although Industrial metals did resist a while longer into June. Both also made an important intermediate low mid August and have since been rebounding quite vigorously. On both oscillator series (lower and upper rectangles), **as with Cable, we now expect Industrial Metals to resume lower towards year-end**. A bounce may materialize towards late October, early November on our long term term oscillators (lower rectangle), but by mid November, the trend resumes lower again. Our I Impulsive targets to the downside (right-hand scale) suggest that **Industrial metals could continue some 5 to 13% lower over the next few months.**

## Chinese Yuan per USD
## Daily graph or the perspective over the next 2 to 3 months



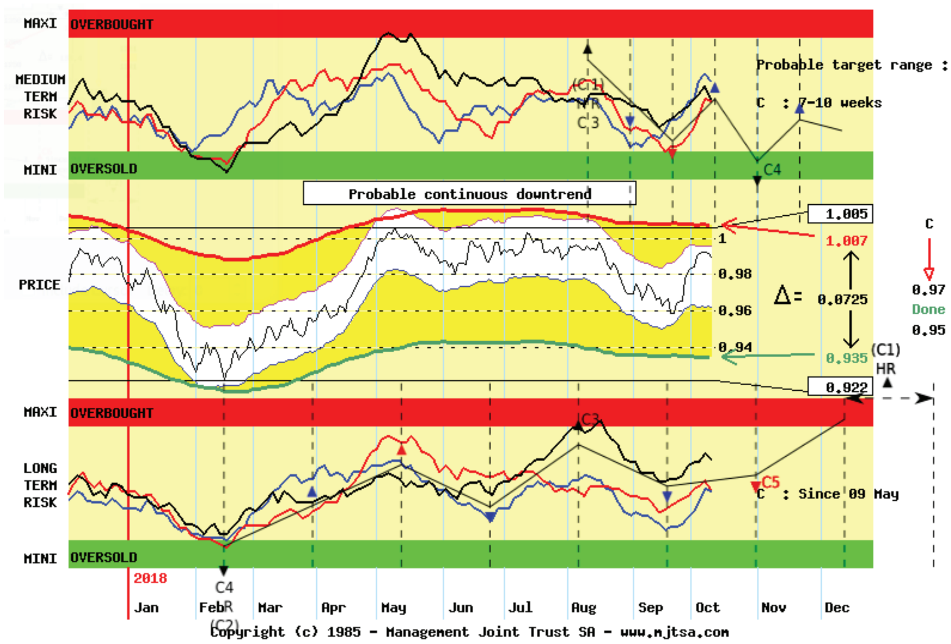

This week the POBC announced a further 1% cut in its RRR rate. The RRR rate is the reserve requirement ratio that China's banks need to hold. Reducing it, unleashes fresh capital into the Chinese domestic economy to the likes of 1.2 Trillion Yuan or 175 billion US Dollars per 1%. This is the third cut this year following a 1% cut in April and a 0.5% cut in July. As a consequence of this quasi monetary easing, the Yuan has been declining (rising USD/CNY). Going forward, both our oscillator series (lower and upper rectangles) are pointing to **further US Dollar strength vs the Yuan over the next few months. It could extend into year-end at least, and USD/CNY could rise beyond the 7 mark into the low 7 teens**. As with EUR/USD, a slight counter-trend move may materialize towards late October, early November, yet the trend then resumes higher again from mid November.

## Gold spot (USD/oz)
## Daily graph or the perspective over the next 2 to 3 months



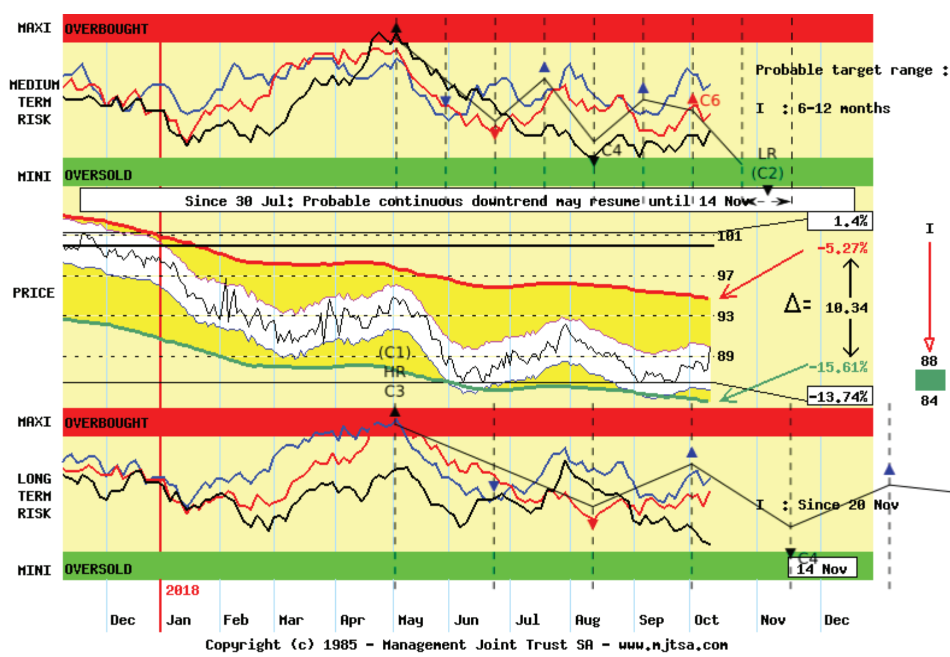

**Over the last couple of quarters, Gold has been remarkably correlated to the Yuan.** Gold usually suffers in a deleveraging spree as it is often used as collateral and gets liquidated during margin calls. The recent sell-off in Chinese equities, along with the Yuan, may provide some explanation for their co-movement. Gold also suffers from rising interest rates, and especially rising real interest rates. These are currently straining global financial markets, and China and the Yuan especially, which provides another interesting parallel. Also bear in mind that China owns USD 1.5 trillion in US treasury, if they did start to sell some of them, US interests would undoubtly ratchet up once more, and the Yuan and Gold would then continue to suffer. Hence, as with USD/CNY in reverse, on both oscillator series (lower and upper rectangles), **Gold should continue its downward path until year-end at least.** As with EUR/USD and the Yuan, a slight bounce may materialise towards late October, early November. Yet, from mid November, it starts to resume lower again. **Our I Impulsive targets to the downside are suggesting that it could make new lows by then, towards the 1'185 -1'132 range.**

## USD/CHF
## Daily graph or the perspective over the next 2 to 3 months



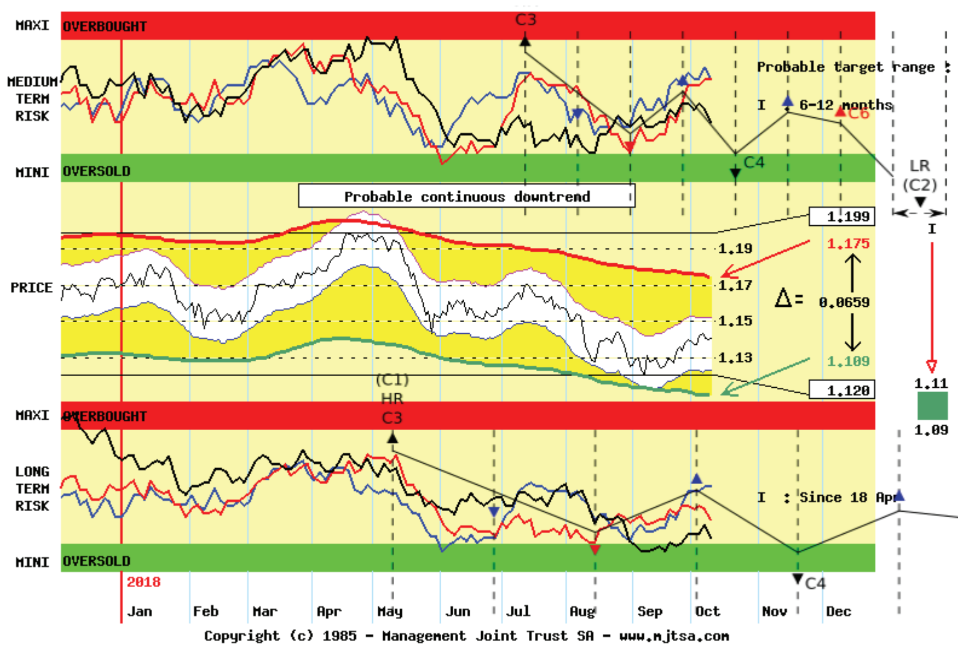

US Dollar / Swiss Franc has been kind of an oddball since the beginning of the year. It is pretty much the only US Dollar pair that did not manage to make new highs during the Summer. This probably reflects the rather defensive bias of the Swiss Franc. Recently, the US Dollar has been rallying again on the back of the rising interest rate differential and tamed inflation expectations in the US (similar to EUR/USD in reverse). Both oscillator series (lower and upper rectangles) now suggest that **USD/CHF could see a slight consolidation to the downside towards late October, early November, but that by mid November, it should then start to resume up quite strongly into year-end. The I Impulsive targets to the upside we can calculate over the next few months are between 1.0150 and 1.0440** (1.3 to 1.7 times our historical volatility measure "Delta" - here at 7.02%; middle rectangle, right-hand side- added to the graph's lows), while our C Corrective targets between 0.97 and 0.95 to the downside should continue to provide support during retracements.

## SMI vs S&P500 Index (currency hedged ratio)
## Daily graph or the perspective over the next 2 to 3 months



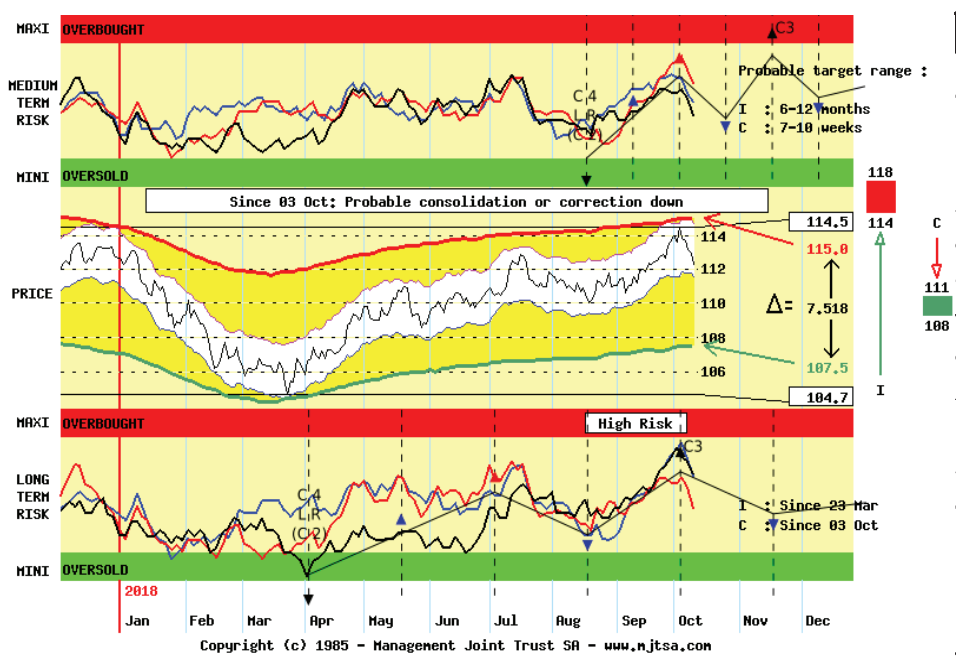

The hedged currency ratio of the SMI vs the S&P500 offers a weaker version of the developments in the USD/CHF pair. Indeed, Switzerland is an export driven economy, and its sector mix is rather defensive. Its stock market should hence profit for both reasons, when the Dollar, which is currently quite defensive, starts to rise. This has been the case during the March to April US Dollar rally, during its Summer plateau, and just recently over the next few weeks. On this relative graph, both our oscillator series (lower and upper rectangle) are suggesting that **the SMI will resume its underperformance vs the S&P500 towards late October / early November before the SMI starts to bounce again vs the S&P500 towards year-end. This may correspond to the US Dollar retracement we expect towards late October, early November, before it accelerates up again towards year-end.**

## EUR/CHF
## Daily graph or the perspective over the next 2 to 3 months



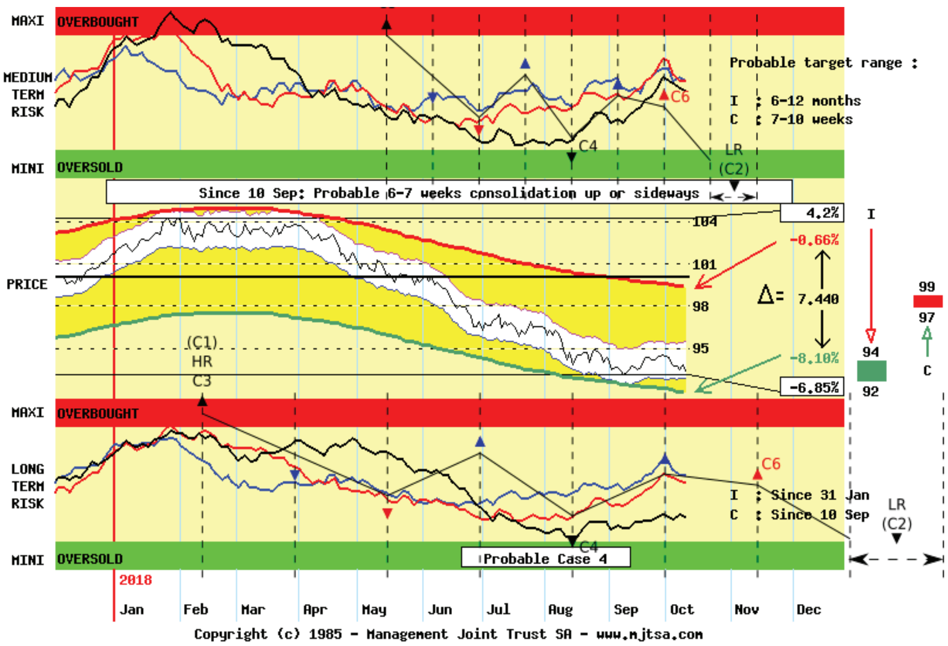

Following its recent bounce, **EUR/CHF could now resume its downtrend** on both oscillator series (lower and upper rectangles), **probably towards late October first and then again towards mid/late November and perhaps even December**. Our I Impulsive targets to the downside (right-hand scale) are suggesting that it **could reach down towards the 1.11 – 1.09 range over the next few months. EUR/CHF shows strong parallels with the EuroStoxx 50 Daily graph shown on page 38 of this issue. This is logical as EUR/CHF is often considered as the Risk-ON / Risk-OFF gauge in Europe, especially between the EuroZone and the rest of developed Europe**. Hence, it shows a similar downside path that the one we are projecting on the EuroStoxx 50 into late November.

## USD/JPY
## Daily graph or the perspective over the next 2 to 3 months



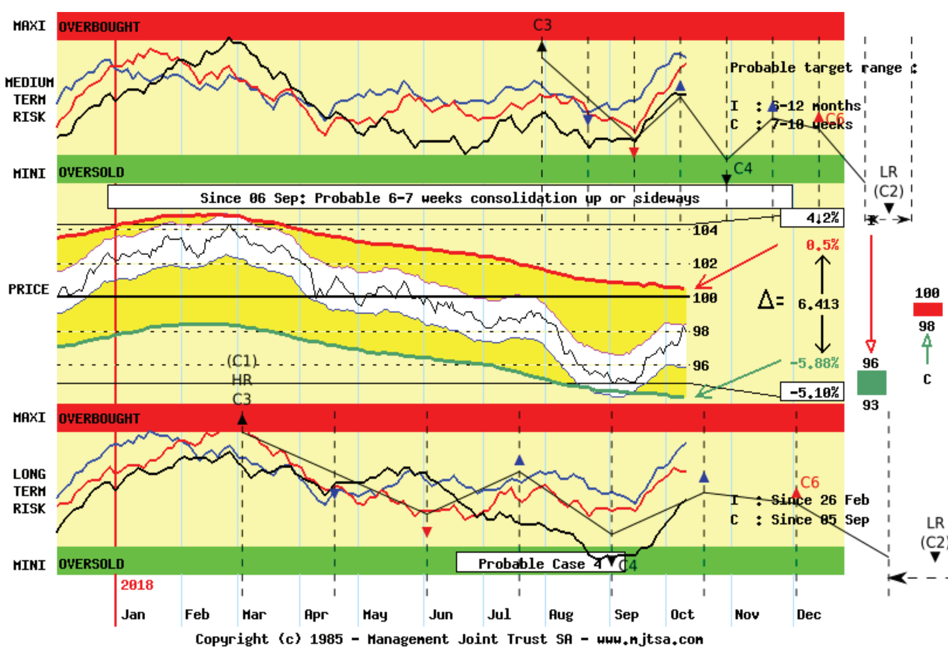

**USD/JPY may have just topped out** on both our oscillator series (lower and upper rectangles). This top may be only intermediate, yet could also mark the end of the upside correction on the pair since Q3 2016. Our Weekly graphs, which are also on a top would confirm the latter. Our I Impulsive targets to the upside (right-hand scale) have been reached, although they could theoretically extend into the high teens (on the next leg up if it materializes). To the downside, **we expect strong "Make or Brake" support in the 111 – 108 zone and towards late October / early November. USD/JPY is obviously very much correlated with the Japanese market**, which has also reached an important top (intermediate or final) as shown on page 44**. Its price action since March also bears resemblance with Brent Oil**, which we show on page 27, and which has now reached a High Risk situation. All three in our view are late cycle out-performers: strong USD/JPY, a persistent risk asset uptrend and strong Commodities. They should all start to reverse down once the risk asset Bull market finally weakens, which may just have happened.

## Emerging Market currencies
## Daily graph or the perspective over the next 2 to 3 months




This study would not be complete if we did not analyse Emerging Markets currencies. The portfolio we show includes the largest 8 emerging market currencies, cap weighted according to their respective countries' weighting in the MSCI Emerging Markets index. On both our oscillator series (lower and upper rectangles), **following their bounce since mid August, we expect these to continue lower probably towards year-end**, although a slight bounce may materialize towards late October, early November (similar to other USD pairs) . **Our I Impulsive targets to the downside (right-hand scale) are suggesting that the move down is pretty much exhausted. Yet, if we scope out to the Weekly graph, the downside potential into next year is still quite compelling, between 5 and 10%, which is quite substantial for currency moves.**

## Emerging Market Currencies comparison – Commodity Producers vs Importers
## Daily graph or the perspective over the next 2 to 3 months




**Within the Emerging Markets currency space, it is interesting to highlight the relative strength between Commodity producing countries and Importers**. We have left out China and the Thai Baht in this equal weighted comparison, and focused on RUB, BRL, ZAR (Commodity producers) vs INR, MXN, KRW (Commodity importers). **The ratio is basically following USD pairs down**, although with a slight lag. On both oscillator series (lower and upper rectangles), **it should now resume lower, probably from mid October into early next year.** According to our I impulsive targets to the downside (right-hand scale), their underperformance could amount to a further 3 to 4%. This analysis is not very encouraging for Commodities and related trades.

**Concluding remarks :**

**The recent rise in US yields is mostly driven by real rates. Indeed, inflation expectations (breakevens) have rebounded a bit since mid August, but nothing like the acceleration we have just seen on Treasury yields. This is highly positive for the US Dollar over the next few months as proxied by the rising US to the rest of the world interest differential, while inflation remains rather tamed. A slight contra-trend may materialize though towards late October, early November. EUR/USD is on the other side of this equation, along with GBP/USD, or the Yuan vs the USD, as well as related trades such as Industrial metals or Gold. EUR/CHF is also quite interesting as a risk-ON / risk-OFF indicator in Europe. It should continue lower over the next few months along with the EuroStoxx 50. On the other hand, USD/JPY (which is usually defensive) has remained strong until just recently, yet may have just topped-out, together with other late cycle plays such as the Nikkei or Oil. Finally, Emerging markets currencies should continue to suffer over the next few months. This is especially true for the currencies of commodity producing countries, and we expect them to underperform their importing peers, probably into early next year.**