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# 2020

HOW MUCH  
TIME DO YOU  
HAVE FOR...

THE U.S. DOLLAR?

Two  
SECONDS



Today we tackle the most important  
question in finance right now...

Has the mighty U.S. dollar reentered  
a bull market?

# ONE MINUTE

Since early September, the U.S. dollar has surged against virtually every other major currency.

This is a big deal.

The dollar isn't just the most important currency in the world. It's the most important asset, period. As the world's reserve currency, movements in the dollar affect everything from Chinese stocks to the price of gold to emerging market bonds.

That's why Real Vision co-founder Raoul Pal calls the dollar the "the daddy of all macro variables."

The U.S. dollar spends most of its time in slow decline. We've all seen the statistic that its lost 97% of its purchasing power in the last 100 years.

This is by design; the global economy functions best when dollars are cheap and plentiful. The U.S. government happily supplies dollars to the world by spending more than it takes in and borrowing the difference. The resulting abundance of dollars greases the wheels of the global economy and helps keep markets calm.

That's the world we've been living in so far in 2017. The dollar has slid approximately 12% this year, helping push equity markets around the world higher. The U.S. and German Dax, for example, continue to put in all-time highs. Meanwhile Japan's Nikkei 225 is making 25 year highs.

Just as important, markets have been unusually tranquil. As we've covered in previous issues, stock market volatility has collapsed to all-time lows.

A stronger dollar would change all of this.

Historically, big surges in the dollar always cause a spike in volatility. And it looks like we're on the cusp of a major dollar rally today.

Pull up a chart of the dollar index and you'll see the telltale bullish signs. After declining for all of 2017, it bottomed in mid-September and is on the verge of completing an "inverse head and shoulders." This reliable chart pattern often precedes a trend reversal.

And it's not just the dollar index that appears to be bottoming. The dollar has achieved a broad-based rally, which adds to its validity.

Look at the dollar vs. the euro...the Canadian dollar... the Chinese Renminbi... the New Zealand dollar... the Swiss Franc... the South African Rand...

It's the same story all around. The dollar has either broken out or looks to be nearing a breakout vs. all these currencies.

In other words, there's a strong likelihood that we're in the early stages of a major dollar rally.

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Assuming we are headed into a period of dollar strength, how should we position our investments?

Over the last 40 years, the dollar has seen three significant bull markets. All of them caused severe financial stress around the world.

The largest dollar bull market ever occurred in the 1980s. The dollar index ripped from around 80 to over 160, sending shockwaves across global markets. The dollar's rally sparked the Latin American debt crisis, and crushed emerging market equities to the tune of 37% in less than 2 years.

Another dollar bull market occurred in the late 1990s. It was smaller, but equally disruptive. The dollar index surged from 80 to 120, initiating the Asia Crisis in 1997 and the collapse of hedge fund LTCM in 1998.



And we all remember the 3rd and most recent dollar bull market. In early 2015, the dollar began to rip higher. By mid-2016 it had surged 25%, causing all sorts of problems.

The price of oil famously plunged over 70%, bankrupting large swaths of the burgeoning “shale” oil industry. Emerging market equities tanked 35%. And while it’s easy to forget now, even U.S. markets were hit hard by the 2015 dollar rally. From early 2015 to early 2016, the S&P 500 lost about 10%. Overall, the S&P 500 went practically nowhere for two full years, and didn’t resume its uptrend until the dollar peaked in early 2017.

The dollar’s recent price action has ignited big debate. Did the dollar bull market that began in 2015 really end in early 2017? Or has it merely been paused for the last 9 months, and is just now beginning its next leg higher?

It’s worth noting that both the early 80s and late 90’s dollar bull markets lasted 6-7 years. And that the smaller of the two saw the dollar index surge 50%.

In comparison, the current dollar bull market isn’t quite 3 years old, and has only gained about 25%. So, it doesn’t come close to matching the length or size of the prior two. Which suggests we’re possibly only about halfway through the dollar bull market that began in 2015.

Commodities would likely be a big loser under a strong dollar. Worldwide, most commodities are bought and sold in dollars. So, a stronger dollar directly causes deflation in commodity prices. Expect oil, gold, silver, natural gas, copper, and agricultural commodities to come under pressure.

The same goes for companies that produce commodities. The SPDR Metals and Mining ETF (XME), for example, has had a great run recently, having gained 150% since its bottom in 2016. A dollar rally would likely bring this to an abrupt end.

So far, we’ve discussed many asset classes that would be at risk under stronger dollar: emerging markets, commodities, companies that produce commodities, foreign currencies, and likely U.S. stocks. We’d like to give you some good news too. But in reality, there aren’t many winners under a strong dollar.

U.S. bonds, however, would likely be a bright spot. They tend to rally when the dollar rallies. US bonds have been declining for most of 2017, potentially setting up a nice entry point for traders who believe a stronger dollar has taken hold.

If you’re interested in U.S. bonds as a trading idea, you may want to [check out Real Vision co-founder Raoul Pal’s new presentation on the dollar and bond market](#). Just published last week, it’s already one of our most popular and highly-rated films ever. While we’re of course biased, we believe watching this film is one of the most productive and educational ways to spend 18 minutes of your time.

In it, Raoul connects the dots in a way that few can. He explains why he expects “terrifying strength to come” in the dollar. Ultimately, Raoul expects the dollar index to hit 120 -130, and for U.S. bond yields to sink much lower (bond prices to go much higher).

Whether you’re a dollar bull or bear, the most important thing is to recognize the power of the dollar. It’s truly the straw that stirs the drink of global macro. Getting its direction right will be the single most important decision many investors make as we head into 2018.

As we all know, 2017 has been characterized by a steady, orderly climb in equity markets. If you expect this to continue into 2018, a flat to weaker dollar should be part of your forecast.

On the other hand, a strengthening dollar would bring something altogether different. Markets would likely see renewed volatility, and the easy profits that have come from being long equities would disappear.

Finally, keep one last thing in mind. More so than any other asset class, currencies tend to experience long, strong, self-reinforcing trends. So, if the dollar gathers momentum, it could climb higher than many people expect.

See you next week.





# IF YOU ONLY LOOK AT ONE CHART



Bye-bye breadth.

Since the beginning of the year, the S&P500 (white) has outperformed the S&P500 equally weighted index (green). But both have been blown away by the Dow Jones Industrials index (orange), with its miserly selection of 30 stocks. Leadership is now concentrated in only a handful of names.



SPX Index (S&P 500 Index) SPX vs Dow Daily 30DEC2016-07NOV2017

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# 6 DEGREES OF (CONNECTION)

1

## THE MIGHTY DOLLAR AWAKENS

If a massive shift is taking place in the currency world, there are multiple degrees of connection.

Pull up a chart of the dollar vs. the euro and you'll see it clear as day. The dollar has spent most of 2017 putting in bearish "lower highs and lower lows," vs. the euro. But in the last few weeks, it has formed a vaunted "head and shoulders" reversal pattern. The pattern is well-defined and symmetrical, which increases the odds that this bottoming process is the real deal.

The exchange rate between the dollar and euro is crucial. They are, by far, the two most important and frequently used currencies in the world.

## ROCKET FUEL FOR A DOLLAR RALLY

2

The Federal Reserve appears ready to pour gasoline on the fire of the dollar rally. At its meeting last week, the Fed made clear that it intends to continue raising interest rates in the U.S. The current Fed Funds range is 1% - 1.25%.

Importantly, markets believe what the Fed is saying. The Fed Funds futures market is pricing the odds of a December rate hike at about 90%, and a second-rate hike by June 2018 at 60%. These odds are the result of traders betting on the outcome, and thus tend to be more reliable than, say, a pundit on TV with no skin in the game.

All else equal, higher interest rates and higher yields should attract investment if it goes hand in hand with growth. Therefore, gradual rate hikes by the Fed should push the dollar higher.



**3**

## **BIG TIME GROWTH IN THE U.S.**

The Fed has been excruciatingly slow to raise rates in the aftermath of the 2008 financial crisis. Sluggish economic growth has been a main reason why. The Fed has been cautious not to take any action that might derail the U.S.'s already-weak recovery.

If the most recent GDP numbers are any indication, this concern is fading away. The U.S. posted 3% economic growth in the most recent quarter – significantly better than the 2.5% expected. It has now posted two consecutive quarters of 3.0%+ growth for the first time since 2014.

**4**

## **AT LONG LAST, GROWTH RETURNS TO EUROPE**

It's not just the U.S. that's experiencing strong growth. For the first time in a while, Europe too is enjoying a string of good economic news. GDP growth in the Eurozone recently hit 2.5%, its highest level since 2011. And Eurozone unemployment has fallen to its lowest levels since 2009.

Importantly, Europe's strong economic performance has been broad based. Countries like France, Spain, and Ireland are all pulling their weight with solid growth. This is an improvement over the past when Germany was almost singlehandedly driving economic growth in Europe.



## WHEN WILL THE ECB TAKE ITS FOOT OFF THE GAS?

5

Despite the recent good economic news, the European Central Bank still has its foot stamped down on the stimulus gas pedal. The base interest rate in Europe remains at a rock-bottom 0.0%, and the ECB is still conducting its massive Quantitative Easing program.

With economic growth improving, the ECB may find it difficult to justify this ultra-loose monetary policy. Especially if inflation picks up or the euro weakens substantially.

We're already seeing early signs of monetary tightening. The ECB recently announced it plans to scale back its QE purchases from 60 billion euros/month to 30 billion. It will begin this taper process in January.

6

## A SHOWDOWN BETWEEN THE FED AND THE ECB

If things keep improving in Europe, expect the ECB to slowly raise interest rates, much like the Fed has done in the U.S. This would likely cause the Euro to strengthen. And due to the nature of the dollar index, it's almost impossible for the euro and the U.S. dollar to rally at the same time...

The dollar index is a composite of the dollar vs. several other currencies. At a 58% weighting, the euro is far and away the largest component. The yen is the next largest at just 14%.

As a result, movements in the dollar / euro exchange rate are the primary driver of the dollar index. Which goes to show just how crucial the euro/dollar exchange rate is.

For now, with the Fed having already begun its rate hike cycle, the mighty dollar appears headed for a rally. But the Eurozone will have to start playing catchup with monetary policy soon. When that time comes, expect a showdown between these two crucial currencies, unless USD strength has already done the tightening for the ECB.





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KILLER CHART PACK BRINGS YOU VISUAL INVESTMENT  
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# THE SNIPPET

AS OF 2017, THERE IS AN ESTIMATED **\$1.12**  
TO **\$1.5 TRILLION USD** OF ACTIVE SHORT  
VOLATILITY EXPOSURE IN DOMESTIC  
EQUITY MARKETS.

ARTEMIS CAPITAL MANAGEMENT  
“VOLATILITY AND THE ALCHEMY OF RISK”,  
OCTOBER 2017



# Ask Milton

question

Milton,

What does Trump's choice of Jerome Powell as the new Fed Chair mean for the market?

answer

Probably nothing. Powell has bundles of real world experience (which is great news) and perhaps his biggest attribute is that he doesn't hold a PhD. But let's be realistic, shall we? The simple truth is that the FOMC has very carefully, very deliberately backed itself into a corner and they are now largely at the mercy of the markets. No matter who is in the Chair, if the markets start to get volatile and, God forbid, go down, all eyes will turn to the Fed for a rescue attempt and I don't think anybody sitting in that chair will be able to do anything but send out the lifeboats.

What Powell's appointment WILL mean is that the market spends a ridiculous amount of time trying to handicap his next move, work out how hawkish or dovish he is and second-guess both his upcoming decisions and those he will have already made. That is a shame but it's perfectly understandable given the level to which the central bank has inserted itself into the process of freely-operating capital markets.

Ultimately, when all is said and done, he will likely continue the policies of the Yellen, Bernanke and Greenspan Feds.

With any luck, I'll be completely wrong... I sure hope so.

Milton





# 6xW + 1H

## What's hot on Real Vision this week...

### WHO

World famous entrepreneur, investor, and shark Mark Cuban

### HOW

In a wide-ranging discussion, Cuban explains his view on central bank actions... why Artificial Intelligence is the best place to invest in the next decade... his thoughts on cryptocurrencies... why Amazon stock is his single largest public holding... and much more. It is truly a "must watch."

### WHAT

In the words of a Real Vision subscriber:  
A "delightfully entertaining" conversation with hedge fund manager Kyle Bass

### WHERE

Filmed in Dallas and available on Real Vision Television globally

### WHEN

Released November 3rd on Real Vision

### WHY

A world-class expert on investing and technology, Cuban shares his unique perspective on how technological advances will transform our world.

### WHAT PEOPLE ARE SAYING

"Another masterpiece from the crew at Real Vision. Extremely bright and switched-on individuals in discussion about various topics. Well worth the subscription." **PRAKASH V**







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