

Dollar Another Leg Down?

Date: 2021-04-23

Upcoming Economic Events (Singapore Local Time)

- 2021-04-27 11:00 BoJ Monetary Policy Statement & Interest Rate Decision
- 2021-04-29 02:00 Fed Monetary Policy Statement & Interest Rate Decision
- 2021-05-04 12:30 RBA Rate Statement & Interest Rate Decision
- 2021-05-06 19:00 BoE Monetary Policy Summary & Interest Rate Decision

The focus of the coming weeks is on central bank meetings. We expect most central banks to keep the accommodative monetary policies unchanged.

Markets in Focus

Figure 1 US Trade Weighted Nominal Broad Dollar Index



After a quarter of consolidation and what seems to be a counter-trend rally since the beginning of 2021, the Dollar has started to weaken again, and we believe that the downtrend will resume from here.

We use the US Trade Weighted Nominal Broad Dollar Index published by the Fed as a better representative of the US Dollar strength against a basket of other major currencies, instead of the more conventional Dollar Index (DXY) which carries too much weightage (57%) in the Euro currency.

Figure 2 Generic 1st GBPUSD Future



GBP/USD's uptrend since last April is still intact, and price bounced off right at the trend support a few days ago. The price action confirmed a breakout of the 1.5-month bull flag and a continuation rally is likely to follow.

Figure 3 Generic 1st Gold Future



After its 62% rally from the 2019 low, Gold's performance has been disappointing since. In early March Gold has retraced exactly 50% of this entire rally and subsequently established a double bottom at that level (1674). With 38.2% level (1765) decidedly penetrated, price action starts to look constructive and attractive again.

Figure 4 Gold vs US 10Y Real Yield (inverted)



Gold price has historically been tightly correlated with real yields. Falling real yields (nominal yields not being able to keep up with the rising inflation) and a weaker Dollar are both tailwinds to Gold price.

Market Views

In the current macro environment, the US Dollar is undoubtedly one of the most important things investors need to pay attention to, because once we get the direction of the Dollar right, the rest will fall into places naturally.

As shown in Figure 1, the Q1 consolidation was healthy and necessary for the longer-term downtrend of the US Dollar from a technical perspective. It cleared some of the extreme short Dollar positioning accumulated since the mid of 2020; it also reset the Relative Strength Index (RSI) from Oversold back to normal level.

The reasons for a substantially lower US Dollar are mainly the combination of accommodative monetary and fiscal policies of the US. The Fed's balance sheet has increased from USD 4.1 trillion to USD 7.7 trillion in the short span of one year, outpacing all other major central banks. The implication for a weaker US Dollar is that assets like Emerging Market equities and commodities will continue to be supported.

How to play the theme out

A hypothetical investor who is looking to express the weaker Dollar view can consider the following 2 trades¹:

Case Study 1: Long GBP/USD

If the investor were to buy the GBPUSD Future (6BM1) at around 1.395 and set the stop below the recent low of 1.365, his maximum loss per contract for the trade would be $(1.395 - 1.365) \times 62500 = 1875$ USD. A measured target for the bull flag breakout would point to 1.45, giving the investor $(1.45 - 1.395) \times 62500 = 3437.5$ USD.

Case Study 2: Long Gold

If the investor were to buy Gold Future (GCM1) at around 1790 and set the stop below the 50% retracement level of 1670, his maximum loss per contract for this trade would be $(1790 - 1670) \times 100 = 12000$ USD. A potential first price target would be around 1882 and subsequently 2070, resulting in $(1882 - 1790) \times 100 = 9200$ USD and $(2070 - 1790) \times 100 = 28000$ USD, respectively.

¹ Examples cited above are for illustration only and shall not be construed as investment recommendations or advice. They serve as an integral part of a case study to demonstrate fundamental concepts in risk management under given market scenarios.

Background

Inspirante Trading Solutions Pte Ltd (“ITS”) was incorporated in Singapore in July 2020. Founded by the partners of Synergy Link Capital Pte Ltd (“SLC”) to consolidate their initiatives in FinTech solutions, research, and training programs for different market participants, while SLC continues its focus in proprietary trading. ITS focuses on providing clients bespoke trading solutions such as algo trading systems, risk management systems, research reports, education and training courses. With a strong technical background, unparalleled understanding and insights from the actual market practitioners, ITS managed to obtain FinTech certification recognized by the Monetary Authority of Singapore within two months of incorporation. ITS is now actively collaborating with various trading groups, exchanges and brokers in multiple countries.

The trainers and researchers in ITS have been regularly speaking on various exchange/broker hosted trading seminars and writing for various research publications over the years. Catering to both aspiring and experienced traders, we want to help in bridging the void between the theoretical and practical aspects of derivative trading, with guidance from our team of seasoned and active traders.

Disclaimer and Warning

No reproduction, transmission or distribution permitted without consent of **Inspirante Trading Solutions Pte Ltd** (“ITS”). Unauthorized review, dissemination, distribution or copying of this message is strictly prohibited and could subject you and your firm to liability and substantial fines and penalties. If you would like clarification, please email contact@inspirantets.com. The material contained herein is the sole opinion of ITS. This research has been prepared by ITS using information sources believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. It is intended for the sole use by the recipient to whom it has been made available by ITS. The delivery of this report to any person shall not be deemed a recommendation by ITS to effect any transaction in any securities discussed herein. No content provided by ITS, whether contained in this report, the website or otherwise, is providing investment, tax or legal advice, including but not limited to any advice which is listed as a regulated activity by the Monetary Authority of Singapore. No content should be used or regarded as an offer or solicitation of an offer from ITS to buy or sell securities.

The opinions and statements contained in the commentary on this page do not constitute an offer or a solicitation, or a recommendation to implement or liquidate an investment or to carry out any other transaction. It should not be used as a basis for any investment decision or other decision. Any investment decision should be based on appropriate professional advice specific to your needs. This content has been produced by Inspirante Trading Solutions Pte Ltd. CME Group has not had any input into the content and neither CME Group nor its affiliates shall be responsible or liable for the same.

CME GROUP DOES NOT REPRESENT THAT ANY MATERIAL OR INFORMATION CONTAINED HEREIN IS APPROPRIATE FOR USE OR PERMITTED IN ANY JURISDICTION OR COUNTRY WHERE SUCH USE OR DISTRIBUTION WOULD BE CONTRARY TO ANY APPLICABLE LAW OR REGULATION.