

Dollar Another Leg Down?

Date: 2021-04-23

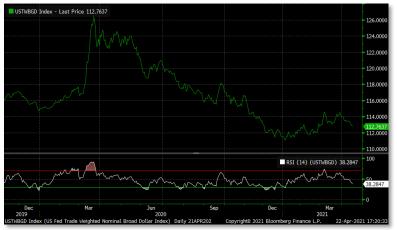
Upcoming Economic Events (Singapore Local Time)

- 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.

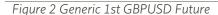
Markets in Focus

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.

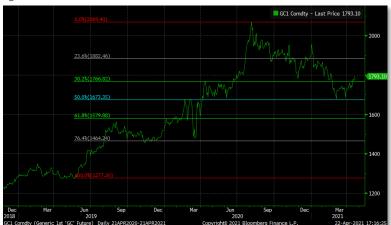
We use the US Trade Weighted Nominal Broad Dollar Index published by the Fed as a better representative of the US Dollar strength against a basket of other major currencies, instead of the more conventional Dollar Index (DXY) which carries too much weightage (57%) in the Euro currency.





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 trades 1:

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.

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