**FACING A WALL: EMERGING US DOLLAR WEAKNESS**
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## CONCLUSION AND OVERVIEW

The broad real trade-weighted United States dollar probably peaked at 103.2 in December 2018 ("TWD"; Federal Reserve Board, H.10; monthly average, March 1973=100). Significantly, that elevation links with the critical TWD pinnacle of December 2016 at 103.4/January 2017 at 103.3, thereby building a formidable double top barrier. This double top ends the glorious long-running major bull move which commenced in July 2011 at 80.5.

Unlike the broad real trade-weighted dollar, the broad nominal trade-weighted dollar has daily data. The broad nominal US dollar probably also formed twin peaks. It achieved an initial summit on 12/28/16 (at 128.9) and 1/3/17 (at 128.8). The nominal TWD's recent high, 12/14/18 at 129.1, edged less than one percent beyond the 2016/17 summit.

The decline in the broad real trade-weighted dollar from its 103.2/103.4 summit probably will be fairly close to and quite possibly more than ten percent. This retreat likely will last at least for several months. The broad TWD's wall of resistance at 103.2/103.4 probably will not be broken anytime soon. If it is, the breach likely will not be substantial; dollar depreciation will resume.

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What interrelated phenomena currently are sparking, or will tend to encourage, near term and long run US dollar weakness?

Growing faith that America's Federal Reserve Board will slow down (at least for a while) its current program of raising the Federal Funds rate represents a key factor in the establishment of December 2018's TWD ceiling. Both the Fed Chairman and other US central bank guardians recently spoke of the need for "patience" on the rate increase front. For example, note Chairman Powell's remarks before the Economic Club of Washington, DC (see the NYTimes, 1/11/19, pB3). Read the transcript of his 1/4/19 comments in an Atlanta, GA conference with other past Fed Chairs.

By reducing the likelihood of (at least) near term boosts in the Federal Funds rate, and thereby cutting the probability of notable yield increases for US government debt securities, the Fed makes the US dollar less appealing (less likely to appreciate further) in the perspective of many marketplace players. The Fed's less aggressive rate-raising scheme (at minimum, a pause in that "normalization" process) mitigates enthusiasm for the US dollar from those aiming to take advantage of interest rate yield differentials (as well as those hoping for appreciation in the value of other dollar-denominated assets such as American stocks or real estate relative to the foreign exchange value of the given home currency). Capital flows into the dollar may slow, or even reverse to some extent.

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Another consideration constructing a noteworthy broad real TWD top is emerging optimism that tariff battles and other aspects of trade wars between America and many of its key trading partners (especially China) will become less fierce. Both the US and China increasingly are nervous regardless the ability of their nations to maintain adequate real GDP increases.

The current United States China 90 day negotiation deadline is 3/1/19. The NYTimes reported signs of Chinese concessions (1/9/18, ppA1, 8). US trade deals with China and other noteworthy nations reduce the incentive for those countries to depreciate their currency relative to the dollar in order to maintain market share for their goods and services within America. Such deals with China may well be vague or not amount to much in actual practice, but even cosmetic progress on the trade war battlefields will tend to weaken the dollar.

Signs of an armistice with China would bolster confidence that US trade feuds with Europe (particularly Germany) will subside. For the near term, the late 2018 deal between the US Administration with Canada and Mexico changing NAFTA treaty arrangements has lessened marketplace agitation regarding trade conflicts in that arena. Whether Congress eventually will enact this deal or a version close to it remains uncertain.

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The current US Administration may seek a weaker US dollar relative to current heights in order to stimulate the economy as election season 2020 approaches.

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The substantial and worsening United States debt situation, particularly in the federal sector as a result of the end-December 2017 tax "reform" legislation, nowadays encourages and increasingly will assist long run dollar depreciation. In its bearish implications for the broad real TWD, this ominous US debt variable at present is somewhat independent of near term Federal Reserve Board and other key central bank policy action and rhetoric as well as the outcome of trade negotiations. However, it nevertheless entangles with these phenomena.

According to the Congressional Budget Office's April 2018 analysis ("The Budget and Economic Outlook: 2018 to 2028"; 4/9/18), US government debt held by the public at end fiscal 2018 would be 78.0 percent of GDP, a substantial increase from the pre-global economic crisis days. Debt held by the public in 2007 was 35.2 percent of GDP (also compare 1993's 47.8pc high). The $804 billion deficit predicted by the CBO for that year equals about 4.2 percent of GDP. The actual deficit for fiscal 2018 reported thereafter by the Trump Administration, $779 billion, stands close to the CBO's April 2018 estimate. In the CBO's forecast for fiscal 2019, the federal deficit exceeds one trillion dollars (4.6pc of GDP). After 2019, yearly shortfalls continue to exceed one trillion dollars, with the 2019-23 deficits averaging a lofty 4.9 percent of GDP.

According to the CBO, the record high for federal debt held by the public as a percentage of GDP was just after World War Two, 1946's 106 percent. The CBO's baseline scenario indicates that percentage will expand to 96 percent by 2028, reach 106 percent in 2034, and balloon to 152 percent by 2048 ("The 2018 Long-Term Budget Outlook"; 6/26/18. See pp7-8 and Figure 3).

Although America is wealthy and prosperous and not a developing/emerging or third-world country, that does not make the US totally immune to the interest rate yield rises (even in an environment of sluggish GDP growth) and currency depreciation sometimes endured by such nations due to their longstanding economic (political) mismanagement.

Dollar depreciation, if substantial, "by itself" may increase the challenge facing America to finance its large national debt needs. So might the process of a notable sustained rise in UST yields, "by itself". If rate increases (especially over the murky long run) apparently beckon, in part due to an awe-inspiring avalanche of US debt securities, why rush to buy debt securities now?

Over the long run, resumed rising US government yields may intertwine with dollar depreciation. Foreigners currently are substantial holders of US Treasury debt. Intertwined rising rates and a feebler dollar likely would motivate many overseas holders of US government debt securities to be smaller net buyers of UST, or even to become net sellers of UST. This in turn probably would accelerate both yield climbs and dollar slumps.

Over the past year, major foreign holders of US Treasury securities have not added to their inventory (US Treasury International Capital/TIC report; 12/17/18). Those holdings were about $6.2 trillion in October 2018 (the latest data point), $6.3tr in August 2018, and $6.3tr in October 2017.

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US household debt has swollen in the past few years. According to the New York Federal Reserve Bank (November 2018), aggregate US household debt at the end of 3Q18 hovered at about $13.5 trillion dollars, soaring above the previous peak achieved during the global economic crisis (3Q08) by about $837 billion. The household debt total may be less burdensome than during the global crisis and its immediate aftermath (given overall boosts to consumer net worth since 2008-09). Yet the substantial arithmetic amount warns of potential pressure on the consumer front, particularly if the economy weakens and stock and home prices decline significantly.

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Looking forward, US corporate quarterly earnings likely will fail to achieve the substantial year-on-year gains derived from the blessings of tax reform legislation. That will make US stocks, as well as many related American assets, appear less attractive to overseas "investors". In the current marketplace context, this too probably will help to undermine the broad real TWD and propel it lower.

FactSet predicts 10.6 percent year-on-year earnings growth for 4Q18 for the S+P 500 ("Earnings Insight", 1/11/19). This will be the first time the index has not reported quarterly year-on-year earnings growth since 4Q17, when the US Congress and President enacted the wonderful tax reform legislation. FactSet's survey projects even slower year-on-year growth for 2019's first three quarters. First quarter 2019 earnings inch up merely 1.8 percent year-on-year versus 1Q18; those of 2Q19 creep only 2.9pc higher relative to the prior year period, with 3Q19's expected up 3.6pc. Though 4Q19's forecast advance is 11.8pc, predicted full year 2019 earnings growth is only 6.9 percent, well beneath calendar year 2018's impressive 20.1pc expansion rate.

Refinitiv foresees a similar pattern of reduced year-on-year earnings growth for 4Q18 and the next several quarters of 2019 ("S&P 500 Earnings Scorecard", 1/14/19). The first three quarters of calendar 2018 collectively averaged year-over-year earnings growth above twenty-five percent. However, Refinitiv believes 4Q18 earnings growth will subside to 14.3pc. It forecasts 1Q19 will increase only 3.4 percent year-on-year, with that of 2Q19 up 5.2pc and 3Q19 4.0pc (4Q19 rises 11.6pc). Estimated earnings growth for full calendar year 2019 of 6.3pc plummets sharply from calendar 2018's majestic 23.4pc year-on-year gain.

Admittedly calendar 2019 shows overall moderate corporate earnings increases year-on-year. Yet earnings gains during the first three quarters are rather mediocre, with a significant rise delayed until fourth quarter.

Moreover, what happens to American (and other) stocks and the US dollar if year-on-year United States corporate earnings growth ever becomes negative? This of course has happened numerous times in past decades.

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In addition to flow levels into the American stock marketplace and US interest rate securities, foreign exchange and other financial marketplace observers should monitor trends of foreign direct investment into America. According to the Bureau of Economic Analysis, foreign direct investment in the US was almost $158 billion in 2009. After staying in a range of about $210bb to $242bb over the 2010-2014 span, FDI exploded to $482 billion in 2015 and $486bb in 2016 (compare the 2000 peak at $320bb and 2008's $318bb mountain). The 2017 total slipped to about $292bb. Based on the first three quarters of 2018, US annualized 2018 FDI fell to about $239bb, still a significant sum.

The erosion of FDI from its 2015/2016 peaks thus far may not be too worrisome to US dollar bulls. However, suppose America appears less desirable as a "good investment opportunity"; then less overseas foreign direct investment money will tend to march into the country. Thus from this standpoint, all else equal, the US dollar will tend to be somewhat less attractive than before.

And foreign direct investment into the US has occasionally has reversed. For example, as recently as 2Q18, it was negative ($826 million divestment); liquidation could become substantial (recall 1Q14's nearly $73bb total). According to Reuters (1/13/19; citing a Baker & McKenzie/Rhodium Group study), Chinese foreign direct investment into the United States fell 83 percent in 2018 (and "After taking divestitures into account, net Chinese FDI flows into the United States actually turned negative.").

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Moreover, America's severe political, economic, and other cultural divisions and conflicts likely will encourage diversification away from the dollar. Neither left nor right wing populism has disappeared, and the initial stages of the 2020 election season already are underway. Not only ongoing fierce wordplay between Democrats and Republicans (with a Democratic House of Representatives alongside the Republican Senate and President), but also erratic and divisive Presidential leadership and decision-making, increasingly will inspire marketplace players to place an increasing share of their money, assets, and deals outside of the dollar domain. The US federal government shutdown (relating to a border wall feud!), even if it is resolved soon, hardly inspires confidence in the quality of American leadership. Also note the wave of resignations (or firings) from the President's Cabinet and elsewhere in the Administration.

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Besides, in a multipolar world with a globalized economy, as the US share of the international economic system gradually diminishes, the dollar arguably need not play as significant role as it has in past decades. This fundamental shift away from dollar usage likely will be slow, but it nevertheless will be important for the long run dollar trend. The ability of the Euro Area to hold together despite populist pressure and economic challenges will represent an important variable.

Dollar usage and strength in part interrelate with America's ability and willingness to provide skillful (and collegial) leadership on the global stage. The significant increase in economic and political quarrels with US allies under Trump's (Make America Great Again/America First) policy regime, and the Administration's related nationalistic resistance to multilateral dialogue and solutions, thus probably have other long run consequences. They will propel efforts by nations to diversify to some extent their political and economic relationships away from (or in

addition to) ones with America (even if slowly given America's substantial role in the global economy and its geopolitical power). This political and economic orientation (diversification; shift) away from America probably will help to weaken the broad real trade-weighted US dollar.

## THE BROAD REAL TRADE-WEIGHTED DOLLAR: HISTORY AND TRENDS

In the currency universe, most financial, political, and media storytellers focus on cross rates between two nations, such as the US dollar versus the Chinese renminbi. However, analysis of the broad real trade-weighted effective exchange rates for a given country offers better insight into the overall situation for that nation's currency.

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The broad real trade-weighted dollar's major bull move to its December 2016/January 2017 and December 2018 pinnacle probably has been sufficiently extensive in price movement (distance) and time duration terms to indicate that a move to a bearish trend is probable. The bull climb from July 2011's record low floor at 80.5 to the December 103.4/January 2017 103.3 pinnacle was 28.4 percent and extended five and one-half years. Extending the "strong TWD" period to December 2018's high near 103.2 makes the rally six and one-half years.

Examine two previous major bull advances in the broad real TWD. The TWD appreciation from October 1978's 84.1 major bottom to March 1985's 128.4 pinnacle was 52.7 percent. That enormous leap admittedly was greater than the voyage commencing in July 2011. Yet a 28.4pc move still is substantial. And the duration dimension is very important for assessing the probability of marketplace trend changes. October 1978/March 1985's TWD skyrocketing lasted about six and a half years, roughly the same as the July 2011/December 2018 one. The towering rally from July 1995's 84.0 to February 2002's 112.8 ascended 34.3 percent and ran about six and two-thirds years. The July 2011/December 2018 TWD appreciation's 28.4pc jump is not substantially smaller than July 1995/February 2002's. The longevity of the July 1995/February 2002 and July 2011/December 2018 rallies is about the same (and they also commenced in the same calendar month).

The highly significant TWD bull move during the murderous 2007-09 global economic disaster was much shorter in distance and considerably briefer in time than the 1978/1985 and 1995/2002 rallies. The 15.1 percent advance from April 2008's 84.1 to March 2009's 96.8 lasted one year. The bull move from July 2011's record depth substantially surpassed the April 2008/March 2009 one in both the price (distance traveled) and time parameters. The average percentage move of the 1978/1985, 1995/2002, and 2008/2009 TWD climbs is about 34.0 percent, fairly close to the appreciation that began in July 2011.

In financial marketplaces, the existence of a notable year-long interim price trend within, and in the same direction of, the longer-running major trend can portend a substantial change in that major trend. The interim rally from January 2018's 94.8 low to December 2018's 103.2 level stretched 8.9 percent and lasted about a year.

The broad nominal TWD was 127.3 as of 1/4/19 (most recent available data point), a 1.4 percent drop from its December 2018 high.

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A key barricade for the bull move which started in July 2011 appeared during a winter calendar period with December 2016/January 2017's 103.4/103.3 pinnacle. In addition, note the calendar

timing of the significant interim high prior to the achievement of the December 2016/January 2017 summit, January 2016's 101.3. These calendar time considerations (parallels) increase the probability that December 2018's 103.2 elevation was a final peak (created a double top for the TWD major bull climb that began in July 2011). Not only did December 2018's TWD high occur at about the same calendar time as these notable two prior highs; December 2018's level almost duplicated the height attained in December 2016/January 2017.

Marketplace history of course is not marketplace destiny. History need not repeat itself, either entirely or even partly.

Yet an overall historical summary of the calendar month timing variable since 1973 in relation to major or important interim price turns in the broad real TWD further supports the view that a major high in the TWD probably is in place (or will be very soon). Numerous prior major and interim broad real TWD highs and lows have occurred in the calendar December through March period. This calendar timing pattern arguably indicates the probability that the December 2016/January 2017 and December 2018 levels "together" represent a major high.

**Major highs: January 1973 at 107.6; March 1985 at 128.4; February 2002 at 112.8; March 2009 at 96.8.
**Interim tops: January 1994 at 91.4; January 2016 at 101.3
**Major lows: None
**Interim lows: January 1983 at 106.3; December 1988 at 89.8; December 1998 at 98.7; January 2018 at 94.8

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Currency wars, competitive depreciation, and trade conflicts will not disappear forever. However, the resistance barrier for the broad real trade-weighted dollar at 103.2/103.4 probably will not be broken by much, if at all, over the next several months (and perhaps for much longer). What are some crucial resistance and support levels for the TWD?

Beneath the 103.2/103.4 summit, remember January 2016's very important interim top at 101.3.

A five percent drop from the broad real TWD's 103.4 top equals 98.2. At present, a critical pillar supporting the broad real TWD is the global economic crisis era's March 2009 high at 96.8. Also, a twenty percent rally from 80.5 (July 2011) gives 96.6. April 2016's 96.5 was an important interim valley within the major bull trend on the way up to the December 2016/January 2017 pinnacle (see also the interim high in June 1989 at 96.2).

A ten percent correction from 103.4 gives 93.1, a fifteen percent tumble 87.9. A twenty percent collapse equals a feeble 82.7.

## **RECENT CROSS RATE HISTORY AGAINST THE DOLLAR**

Currency cross rates of course do not all necessarily move in the same fashion (whether in direction, distance, or timing) against the US dollar. Nations often have diverse economic and political strengths, weaknesses, stakes, and agendas, including in the realms of currency and trade wars. Within the foreign exchange theater in today's intertwined global economy, although competitive depreciation can appear desirable to numerous nations (or regions), the entire world cannot depreciate "all at the same time".

The following table includes the present-day percentage weights within the broad real TWD for several of America's leading trading partners (Federal Reserve, H.10).In this table covering key US partners, note the roughly similar timing of their recent cross rate lows against the dollar. Note how various countries and the Euro Area made an important cross rate low against the US dollar between mid-December 2018 (early December, for the Mexican peso)/early January 2019 alongside the broad nominal TWD's high on 12/14/18 at 129.1. The assorted cross rate troughs underline the likelihood that December 2018's 103.2 broad real trade-weighted dollar level was a major high.

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| Currency | Percent of Broad Real TWD | Recent Cross Rate Lows Against the US Dollar (Date) |
|---|---|---|
| **China** | 21.6 | Key low 12/11/18 at 6.918 followed those at 6.980 (10/31/18) and 6.961 (11/30/18) |

[These 2018 renminbi cross rate troughs against the dollar formed a double bottom with 12/16/16's 6.965 (near the important support level of 7.000). Note the roughly similar calendar timing (12/11/18 and 12/16/16) as well.

China's 1/14/14 cross rate peak against the dollar at 6.039 occurred about four years before the 4Q18 bottoms, as well as at about the same calendar time.

In regard to current trends, keep in mind that the renminbi's important high 3/27/18 high at 6.243 against the dollar was fairly close in time to the Euro FX's 2/16/18 top at 1.256 versus the dollar.]

| Currency | Percent of Broad Real TWD | Recent Cross Rate Lows Against the US Dollar (Date) |
|---|---|---|
| **Euro Area** | 17.2 | 1.122 (11/12/18); 1.127 (12/14/18); 1.131 (1/3/19) |
| **Mexico** | 12.8 | 20.66 (12/6/18); level near 20.96 bottom 6/15/18 |
| **Canada** | 11.9 | 1.367 (12/31/18) |
| **Japan** | 6.5 | Important rally from 113.7 (12/13/18) preceded by 10/4/18's 114.6 low |
| **United Kingdom** | 3.6 | 1.244 (1/3/19) |

[Will Brexit troubles cause British Pound cross trends against the US dollar to diverge from the patterns of other nations relative to the dollar?]

These six trading areas add up to about 73.6 percent of the TWD. Several of these currencies probably are long run alternatives to the US Dollar for international transactions and government reserve holdings.

Gold recent rally from 11/13/18's 1197 (prior lows 8/6/18 at 1161, 9/28/18 at 1180) perhaps intertwines to some extent with these cross rate lows against the US dollar (and the highs in the broad real and nominal TWD).

## OTHER FINANCIAL MARKETPLACES

The broad real trade-weighted dollar's level and patterns are relevant for and interrelate with those in key stock, interest rate, commodity, and real estate marketplaces. The extent to which and reasons why foreign exchange levels and trends (whether for the US dollar or any other currency) converge and diverge from (lead/lag) those in stock, interest rate, commodity, and other marketplaces is a matter of subjective perspective. Opinions differ.

In any case, with the probability that the December 2018 broad real TWD level was a major high (part of a double top connected to December 2016/January 2017, let's portray recent highs and lows of key stock and commodity benchmarks and the US Treasury 10 year note.

| | **Recent High (date)** | **Recent Low (date)** |
|---|---|---|
| **S+P 500** | 2941 (9/21/18);<br>2940 (10/3/18) | 2347 (12/26/18) |

[The S+P 500 attained its important interim high on 1/26/18 at 2873 alongside the major highs for advanced nation stocks in general (URTH) as well as for emerging marketplace stocks (MXEF).

Many marketplace strategists define a stock marketplace bear move as a twenty percent or greater decline from a peak. A twenty percent fall from the monumental autumn 2018 peak at 2941 is 2353; compare 12/26/18's low at 2347. Given the timing of the Federal Reserve patience rhetoric, the central bank general probably is fighting bravely to keep the S+P 500 from breaking decisively beneath the critical twenty percent decline level.

For the S+P 500, in regard to the 10/3/18's final high, recall that the 2007 Goldilocks Era zenith occurred during calendar October, on 10/11/07 at 1576.]

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|---|---|---|
| **URTH** (advanced nation stock index) | 94.23 (1/26/18);<br>92.84 (9/26/18) | 74.72 (12/26/18) |

[URTH is an iShares/MSCI ETF. Its 9/26/18 top fits in with the S+P 500's highs around then.]

| | | |
|---|---|---|
| **MXEF** (emerging market stock index) | 1279 (1/29/18) | 930 (10/30/18);<br>945 (12/26/18) |

[The MXEF is the MSCI emerging stock markets index, from Morgan Stanley. The MXEF's collapse from its January 2018 pinnacle was bloody. The MXEF decisively fell greater than ten percent from that peak (underneath about 1151) following 6/7/18. In regard to the late September 2018/early October highs in the S+P 500 and URTH, underline the timing of the MXEF's final (decisive) break beneath the 20 percent decline level of 1023. The MXEF slumped after 10/3/18's 1035 close.]

| | | |
|---|---|---|
| **US Treasury 10 Year Note Yield** | 3.25 percent (10/5/18);<br>3.26pc (10/9/18) | 2.54pc (1/4/19) |

[The US 10 year government note yield closed under 3.00 percent on 11/30/18 at 2.99pc.]

| | | |
|---|---|---|
| **Broad GSCI** | 504 (10/3/18) | 366 (12/26/18) |

[The broad S&P Goldman Sachs Commodity Index cratered about 27.4 percent alongside global equities after early October 2018.]

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|---|---|---|
| **North Sea/Brent Crude Oil** (nearest futures continuation) | 8674 (10/3/18) | 4993 (12/26/18) |

[The OPEC daily basket low was 12/26/18 at 5011. Also, the recent trough for the London Metal Exchange LMEX/base metals index, 1/3/19's 2730, occurred close in time to those in the petroleum complex.]

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Note the close timing link in late September/early October 2018 between stock benchmarks, the UST 10 year note yield, and commodities in the "Recent Highs" column. In the "Recent Lows" category, these marketplaces likewise all reached lows around the same time, late December 2018/early January 2019.

Since the broad real TWD probably made an important high in December 2008 (broad nominal TWD recent high on 12/14/18), perhaps the subsequent (small) decline in the TWD helped stocks and commodities to bounce upward a bit and the UST 10 year yield to ascend modestly following end December 2018/early January 2019.

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For additional marketplace analysis, see "American Housing: a Marketplace Weathervane" (12/4/18); "Twists, Turns, and Turmoil: US and Other Government Note Trends" (11/12/18); "Japan: Financial Archery: Shooting Arrows" (10/5/18), "Stock Marketplace Maneuvers: Convergence and Divergence" (9/4/18), "China at a Crossroads: Economic and Political Danger Signs" (8/5/18), and other essays.

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