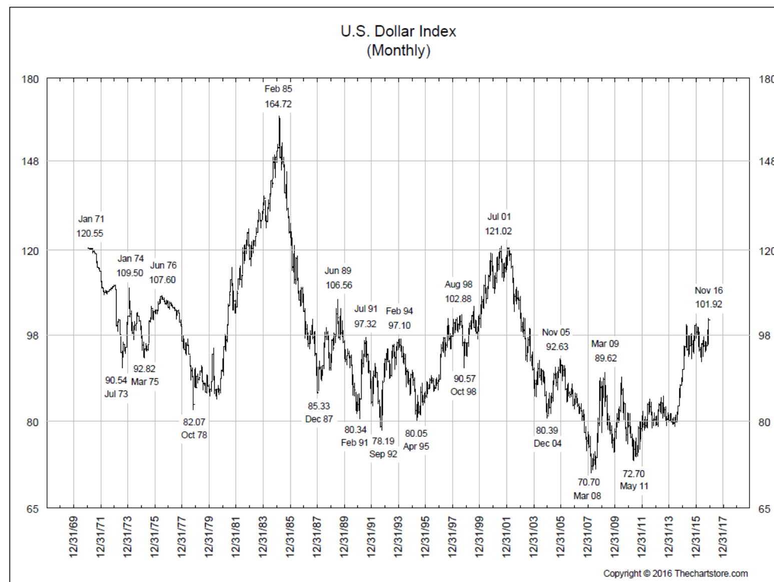
On1Page: U.S. Dollar Strength?

12/20/16

Much is being made about the recent strength in the U.S. Dollar (USD) and how its continued rise is "inevitable" given the recent rise in interest rates. Many of these comments are not communicated in proper context nor historical perspective. The USD did exhibit significant strength in 2014 as the Fed's "Quantitative Easing" program came to an end, but once that ascent was completed in early 2015, the U.S. Dollar remained in a relatively tight trading range and the recent "strength" was largely a rebound from earlier "weakness". The USD did just reach a "13-year high", but that high was only about 3-4% above the peak levels in 2015 and early 2016.

History of the U.S. Dollar Index Since 1970



<u>"Understanding the USD & Interest Rates – It Isn't Difficult, It's Just Not That Simple"</u>

Currencies respond less to "nominal" interest rates, than they do "real" interest rates (nominal rates adjusted for prevailing or anticipated inflation). Countries with high interest rates, but even higher rates of inflation, will generally see their currency depreciate.

Inflation in the U.S. is close to 2%, but the Fed Funds rate is still less than 1%, resulting in a negative real rate of interest. If the inflation rate rises faster than the Federal Reserve raises interest rates (a very possible outcome with sub-5% unemployment), the real rate can become even more negative even though the stated rate is rising.

As you can see in the above chart, the USD is typically rising or falling very sharply, only to reverse in a dramatic fashion. If President-Elect Trump's economic policies had been implemented earlier in the economic recovery when many deflationary forces were in place, they would have likely resulted in a stronger USD. Now they are just as likely to result in a weaker USD due to the inflationary pressures they might create. Also, the movement of funds into a currency due to higher available interest assumes that the funds are not already there. That is not the case with the US economy because there have been historic inflows of foreign capital into both US equities and U.S. Treasuries, but that may be reversing. China's holdings of US Treasuries are down about $14 billion in the past year putting their holdings to the lowest level since 2010 as they attempt to support the yuan (i.e. depreciate the USD relative to the yuan; USA Today 12/16/16). *While the USD can certainly rise from current levels in the short-term, the prior six years of USD strength can just as easily give way to a six or so year period of decline given historical patterns since the periods of strength and weakness tend to be symmetrical.*

Disclaimer: This commentary is provided to you for informational purposes only. Any specific firm or security presented should not be construed as an endorsement or recommendation by Juncture Wealth Strategies, LLC. No advice may be rendered by Juncture Wealth Strategies, LLC unless a client service agreement is in place. Please consult with your financial advisor before making any investment.