

Market Forces Markets

A US dollar slipping below the surface

Mike Mackenzie's daily analysis of what's moving global markets



Michael Mackenzie YESTERDAY

A fresh [diplomatic spat](#) between the US and China has weighed on global equity sentiment, but less so across the currency market and for Wall Street.

The euro remains in breakout mode, with the single currency at one point popping above \$1.16, and up from a low of \$1.1403 on Monday, no less. A proxy of China and global sentiment, the Australian dollar versus the Japanese yen, signals all is well with this currency pair, testing May 2019 levels.

Notably, the US dollar is struggling to derive much of its usual “risk-off” support beyond a weaker renminbi and selective emerging market currencies. The dollar index is flirting with its March close of 94.895, and beyond that level, the benchmark returns to levels seen in September of 2018.

Sapping the dollar tone, the rising pace of Covid-19 cases in the US, which entails an economy facing strengthening headwinds, while other regions such as Europe and China are on an upward reopening trajectory.

That only heightens the importance for US market sentiment of Washington not just cutting another round of stimulus before the month ends, but one that can help offset the hit from renewed lockdowns across much of the country at the moment. At this juncture, the negotiations in Congress and with the White House are not looking promising. True, a last-minute deal is usually the end result, but in this instance a \$1tn package after the \$3tn Cares Act may do little to shift the needle for market sentiment.

Ian Lyngen at BMO Capital Markets cautions “the scope and magnitude of the second round of stimulus appears poised to disappoint”.

Over in the Treasury market, a 10-year yield below 0.6 per cent leaves the benchmark near its March closing low of 0.54 per cent. Not good news for the dollar, let alone expectations of a convincing US economic rebound.

10yr yield testing bottom of the recent range

Yield on 10-year US Treasury (%)



Source: Refinitiv
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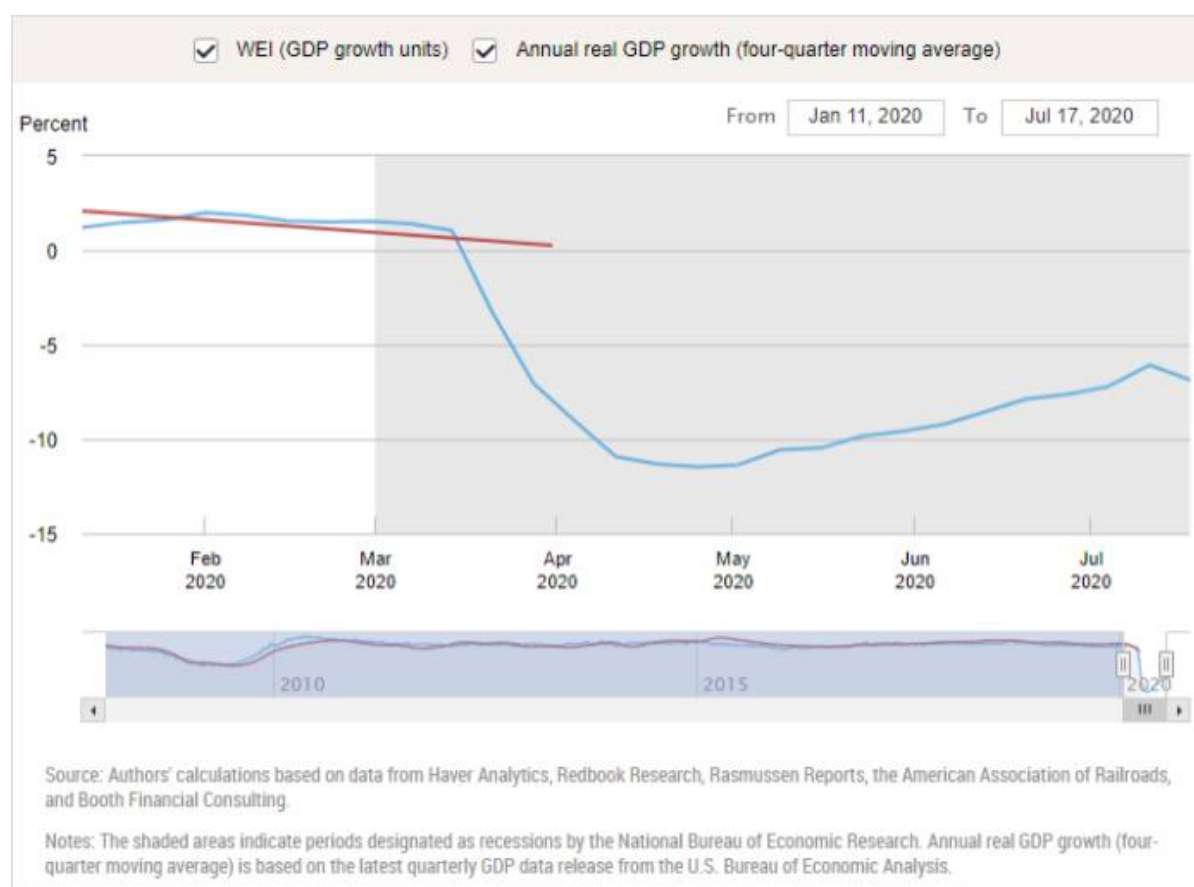
True, the massive thumb of the Fed on the Treasury market scale clouds the yield message to a degree, while bond traders are pricing in a disappointing fiscal response from Washington.

A test of 1 per cent for this important Treasury benchmark looks far away at this juncture and Greg Faranello at AmeriVet Securities says:

“With growing virus cases, parts of the economy shutting back down and questions around the employment picture, a break through the lower end of the range on the US long-end should not be ruled out.”

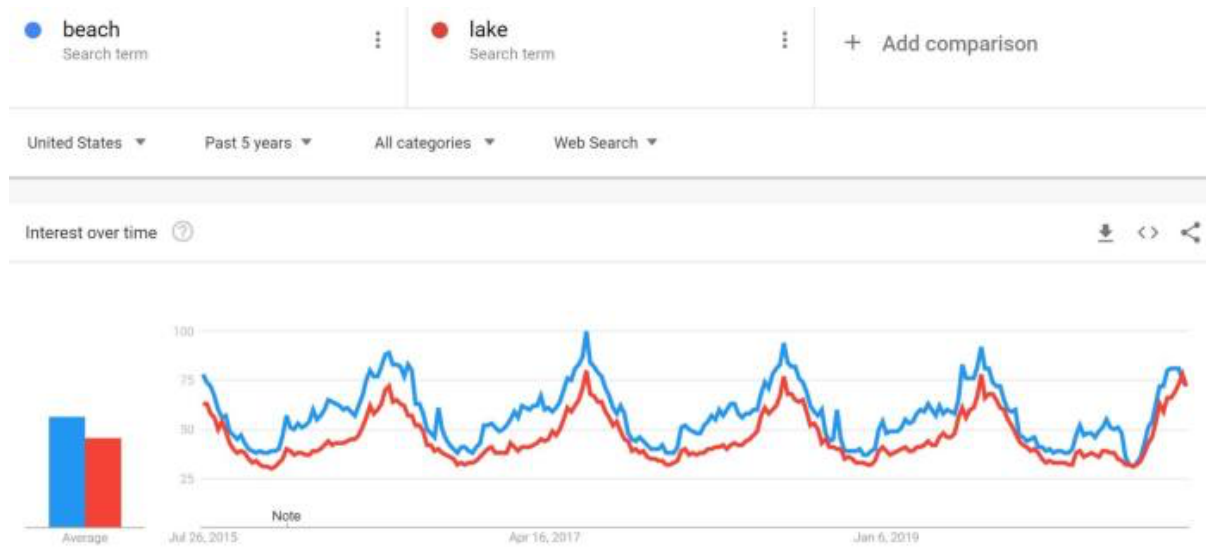
S&P Global Economics says the expected “bounce back in third-quarter real GDP growth — of 22.2 per cent (annualised) — in our June forecast is now at risk of weakening”. The catalyst for a downgrade rests on the scale of closures before Covid-19 is contained.

The latest Weekly Economic Index of real-time activity from the New York Federal Reserve is also not an encouraging development.



Usually high summer is distinguished by a booming service sector with people on holidays from work and school. Worryingly for hopes of a third-quarter bounce, real-time metrics of foot traffic in restaurants, regional hotels, cinemas and other barometers of the service sector are languishing.

Even searches on Google for “beach” and “lake” have failed to register their usual early July peak as shown below and courtesy of DataTrek.



Now the combination of fiscal and monetary support has certainly helped propel equities and credit well beyond their lows seen in March. Indeed, the yield on higher-rated US investment-grade credit is below 2 per cent for the first time.

Longer-term, the jury remains out on whether fiscal support truly amounts to stimulus, or merely helps cushion the blow from elevated levels of unemployment and a rising tide of small business failures.

Stephen Dover at Franklin Templeton believes equity sentiment may well face a test and that “stock market and economic fundamentals will not remain disconnected forever”, and he adds:

“This time around, the negative catalyst could be economic disappointments relative to expectations for a sharp, ‘V-shaped’ recovery.”

Finally, the trend of a weaker dollar and doubts over the US recovery plays well for proponents of European equities versus the S&P 500 that are dubbed “value” companies. Vincent Deluard at StoneX argues:

“European value stocks, whose valuations are generally lower and whose earnings are already starting to rebound, are a much better bet than US value stocks, which face the additional risk of a new wave of economic lockdowns in the fall.”

Vincent illustrates here that “bouts of outperformance of European value stocks have tended to overlap with periods of dollar weakness”.



Quick Hits — What’s on the markets radar?

Gauging further upside for the euro is very much a story at the moment and Mark McCormick at TD Securities believes there is “plenty of euro runway in the quarters ahead” — less so immediately — and he cautions:

“The test of \$1.20 may happen sooner, but we stress that lots of good news has been priced and we still prefer to buy on dips than chase things.”

Gold has also extended its recent gains, topping \$1,870 an ounce for the first time since September 2011 and nearing its record of \$1,920. Beyond a weaker US dollar for precious metals is a 10-year Treasury real yield — adjusted for inflation — back at the record low seen in 2012, around minus 0.9 per cent. Earlier this year, the benchmark was above zero. Fed policy has certainly crushed this market and in turn spurred quite a bid for gold. A gain of 27 per cent since March 19, and up 31 per cent over 12 months, is some performance.

As for real yields, TD Securities thinks the Fed will soon expand its Treasury debt purchases in order to prevent long-dated nominal yields rising. Under that approach, TD believe there is scope for 10-year real rates declining towards minus 1.5 per cent.

Your feedback

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