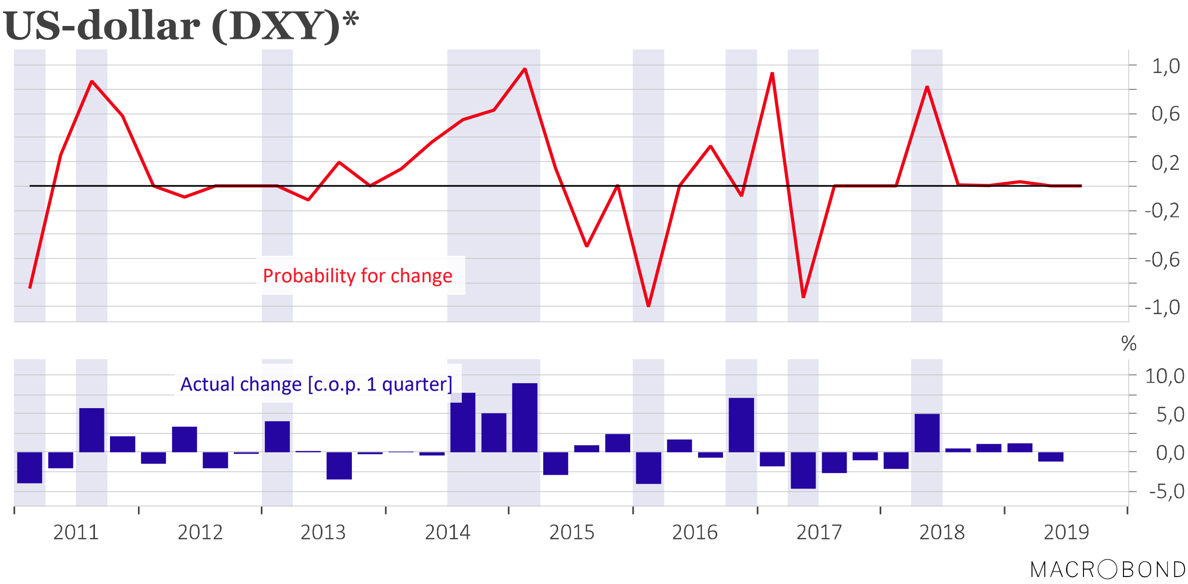
Our models signal a low probability for a significant change of the US-dollar in general terms during the third quarter, in either direction. However, against the Swedish krona there is a significant probability for a stronger dollar, specifically because of the krona's sensibility to lower Swedish bond yields and rising risk aversion. The results may seem strange given the extreme focus on US monetary policy during 2019. But the fact of the matter is that neither these probability models nor other research of ours, have found any statistically significant relationship between Fed's policy rate and the US-dollar.

Stable US-dollar in the third quarter

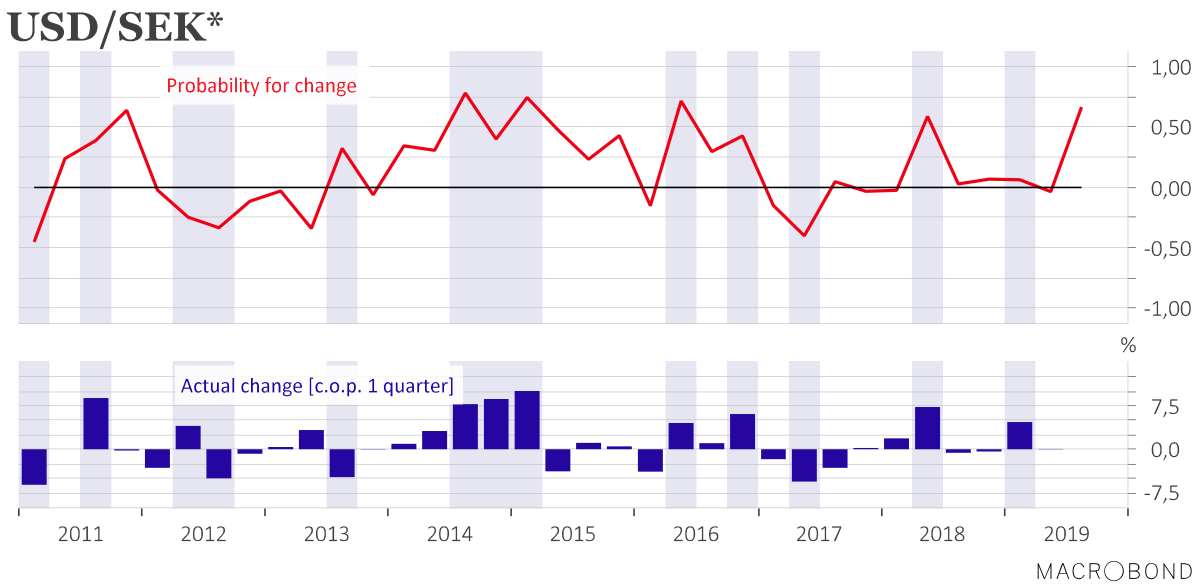
Our models give no signals of a significantly stronger or a weaker US-dollar in the third quarter. This is highlighted in the chart below, where the red line shows the probability of a significant change in the US-dollar, in terms of the DXY-index. This gauge has been neutral for the last five quarters. The blue bars show the actual quarterly change of the DXY during the corresponding quarters. Historically the signals have had a reasonably good hit-ratio for major dollar movements (which are the shadowed areas in the chart). A noticeable exception is the market euphoria around the presidential election in the end of 2016/beginning of 2017, where the timing of the models was dubious. (A description of the models is presented in the box below.)



** The probability signal is related to the quarter indicated in the chart, with information from the preceding quarters.*

It may seem strange that the models are signalling a low probability for a significant change in the US-dollar, given the current focus on US monetary policy and the strong moves in other financial assets during the last 12 months. However, several important factors affecting the US-dollar in our models work in opposite directions. For example, lower and more expensive non-US bond yields, together with rising global risk aversion and rising volatility in credit markets, are signals for a stronger dollar going forward. On the other hand, lower US bond yields and lower volatility in EM equities works in favour of investment outflows from the US and thereby a weaker dollar. Consequently, the net effect is that the signals of the models are neither for a significant rise nor a significant fall in the DXY-index in the third quarter of 2019.

For investors with an interest in the USD/SEK-cross, we have estimated probability models with a similar approach. However, these models point to a 66% probability of a significant rise of the US-dollar against the Swedish krona in Q3. See the chart below. Lower, and consequently more expensive, Swedish bond yields together with rising global risk aversion has a more significant impact on the probability for a rise USD/SEK than on a stronger dollar in general terms (DXY). The fact that US bond yields also have fallen has a smaller effect on USD/SEK.



** The probability signal is related to the quarter indicated in the chart, with information from the preceding quarters.*

Taken together our models signals a low probability for a significant change of the US-dollar in general terms during the third quarter, in either direction. However, against the Swedish krona there is a significant probability for a stronger dollar, specifically because of the krona's sensibility to lower Swedish bond yields and rising risk aversion globally. The results may seem strange given the extreme focus on US monetary policy during 2019. But the fact of the matter is that neither these probability models nor other research of ours, have found any statistically significant relationship between Fed's policy rate and the US-dollar. (See also https://www.reconpatrol.com/wp-content/uploads/2019/06/Fed-and-the-dollar.pdf.)

This is how we did it

With the use of statistical modelling we have processed more than 40 different variables for signals of future movements of the US-dollar. We found around ten variables which historically have had a reasonable explanatory power. They are of different kinds, such as measures of market volatility and risk aversion, price data from fixed income and credit markets, and finally in-house valuation models for different financial markets.

Both for the DXY and the USD/SEK we made two (probit) models each, one looks for signals for a significant rise of the DXY index or USD/SEK in the next quarter, while the other looks for signals for a significant decline. Significant here is defined as a quarterly move either up or down of 4%, which is around 1 standard deviation. The models don't include the same variables, but different combinations of the variables described above. The net probabilities of the two models are shown as the red line in the charts above.

The models can have problems catching and digesting short-term or sudden signals inside a quarter. In worst case these signals can affect probabilities in subsequent quarters even if they have subsided. There could of course be factors that affect the US-dollar that the models have missed entirely. The results that we present here should therefore be interpreted as a barometer of when a range of indicators reach levels or change in a way that historically has increased the probability of a significant movement in the US-dollar. We hope this will help investors to take positions in currency markets and make judgements on currency hedging.

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