DXY – Sustained Profit Taking in a Seasonally Negative Environment?

28 November 2024

Forecast (Nov 2024)	Spot	0-3m	6 – 12m	LT
DXY	106.50	102.88	103.21	95.93

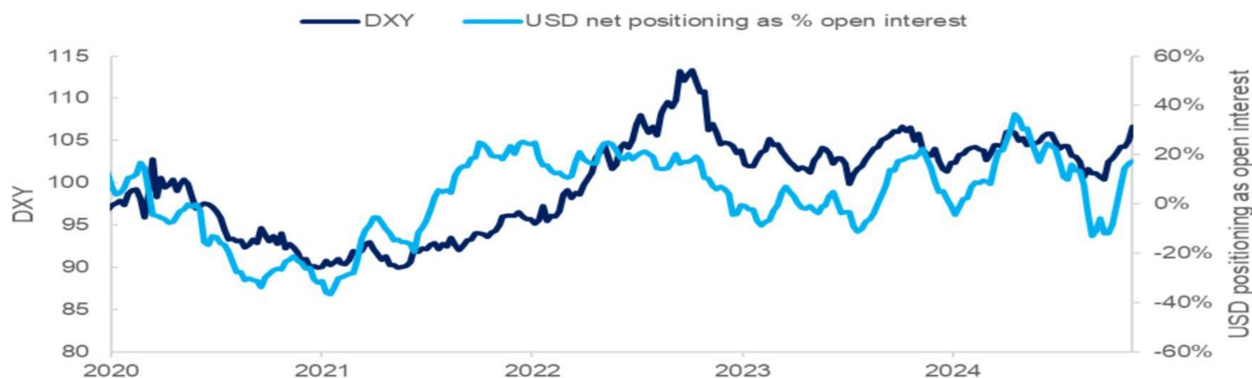
- The broad-based USD Index's (DXY) initial 1.5% spike to 105.25 in the immediate aftermath of Trump's election win was followed by a dip 24 hours later as investors sought to take profits on the Trump trade. But the decline stalled once DXY dropped by around 100 pips to ~104.25 some 2 days later as buyers sprung back into action on firming expectations about a possible Republican Red Sweep. Investors view such an outcome would likely make it easier for Trump to push through his aggressive policy agenda through Congress. The result was another leg higher in DXY over the next 6 days, taking the index to slightly above 107.00, ~175 pips higher than the peak seen in the 24 hours after the result of the presidential election. It was only once a Red Sweep was confirmed that the DXY rally lost steam as profit-taking ensued, leaving the index to settle into a 106 – 107 range.

- Investors view a Republican Red sweep of White House and Congress will likely be a green light for Trump to extend his tariffs, re-onshore manufacturing into the US, add substantial additional (supply-side) fiscal stimulus and aggressively enforce immigration law. The combination of domestic demand stimulus through net tax cuts and restrictions on foreign supply would likely fuel growth accompanied by higher inflation which in turn could potentially change the Fed's reaction function to a significantly less dovish stance translating into higher US rates versus the rest of the world and encouraging strong capital inflows to boost the dollar.

- But the big question though still remains on how much of Trump's stated agenda will be implemented even with a Republican Red Sweep. Furthermore, among his policy pledges, Trump has also campaigned on a promise to lower inflation and is an advocate of a weaker dollar especially versus Asian FX (CNY, JPY). How he squares this with his stated policy agenda is yet to be seen.

- And then there is market positioning too – since the end of September when markets started to price the Trump trade, US short rates have already pared back ~100bp of Fed easing discounted for 2025 and the DXY Index has strengthened 6.8%, twice the gains seen in the same time period following the November 2016 elections when Republicans also won with a Red Sweep. The Commodity Futures Trading Commission report on FX positioning by non-commercial participants (hedge funds) shows FX futures traders are already holding sizeable long US dollar positions approaching multi-year highs. Such a skewed positioning in the past has often led to a more sustained profit-taking environment subsequently, reversing the earlier gains in the DXY Index. The catalyst for such a move may well come as soon as December as it is a month that has been seasonally negative for the US dollar since 2017. A subsequently more balanced positioning amidst a lower dollar would likely make investors better able to digest Trump's actual policy agenda with less market disruptions.

FX markets are already positioned net long USD well before the election result



Source: Bloomberg, November 21, 2024

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Bond credit quality ratings		**Rating agencies**	
Credit risk	**Moody's[1]**	**Standard and Poor's[2]**	**Fitch Ratings[2]**
Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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- lack of liquidity in that there may be no secondary market for the fund and none is expected to develop;
- volatility of returns;
- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- manager risk.

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