

IN MY 33 years of trading, I've never seen such carnage around the US dollar. The downturn that saw the collapse and near-collapse of some of the world's largest financial institutions, changed the game for all of us.

But just months later, the US Treasury's £430bn bail-out is being repaid and those same institutions are reporting massive profits and paying out bumper bonuses. That said, foreclosures on homes, the core of the US economy, have reached two million since 2006, and unemployment is at ten per cent.

In the face of this apparently contradictory information, it's worth reminding ourselves that, despite the bashing it still gets on the markets, it's never a good idea to kick the dollar when it's down. Here's why...

The turbulence has hit exchange rates for the dollar hard, with bigger than normal movements on the back of every significant report that comes out; the value of the dollar has been beaten down because of the slumping economy and a zero interest rate policy by the Fed.

But top analysts are suggesting that 2010 should be a good year for the dollar as it looks to reverse direction against many of its major competitors. Exchange rate charts are already showing a change in trend towards a stronger dollar in the medium- and long-term.

The dollar had, up until the end of 2009, been on a downward trend against its major rivals for weeks, fuelled by negative sentiment towards the US economy and the looming shadow of a much larger deficit to fund the health care bill, with no apparent bottom to the housing crisis.

The view that the economy is improving and that the US government will raise interest rates and begin removing the monetary stimulus seems to me to be quite premature.

While the economy may have levelled off, we are far from reaching the bottom, in my view. In order to have a sustained recovery and growth, we first must know that we have a solid foundation to build that recovery on and see all the economic indicators such as housing and unemployment level off and start to show continued and real improvement.

Cents and Sensibility

MIKE BAGHDADY on why investors would do well to hold off on sterling for the time being and look instead to the mighty greenback – down but not out, it's hit the floor and now, as Yazoo put it, the only way is up

You can't hurry love – or economic recovery. Trends take time to change and much effort to turn, and while the process has begun, it is far from complete.

My view may seem bearish, but the good news is the bottoming process and the recovery have begun in earnest. From a technical perspective, we now need to see a large basing pattern in order to spark a new and strong bull market.

Negative sentiment pushed the dollar towards its lowest historical levels, but in Q4 2009, the dollar began to form a bottom and technically broke its downtrend, beginning the first leg to an upside, so the dollar's near-term losses could be limited.

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Meanwhile, the dollar's two biggest rivals face their own obstacles. The yen is contending with a new finance minister seemingly intent on a more activist stance on the currency as well as a weak fundamental outlook in Japan. And the euro is still overshadowed by credit concerns swirling around Greece and other fiscally troubled countries in the euro zone.

For the medium-term, then, dollar weaknesses are a buying opportunity, and should be taken advantage of. Those who took on currency risk last year were rewarded: foreign currencies rallied along with their underlying equity markets.

And this dollar rally looks different from the last run-up, which began in the summer of 2008 when investors rushed into US dollars in a panic.

While currencies of emerging markets are expected to hold their own or even appreciate against the dollar, emerging-markets' holdings could be especially vulnerable to a decline, after having surged last year, little helped by new banking regulations being introduced by China that would lead to the liquidation of large commodity positions and the accumulation of dollar-based assets and treasuries. In short, you're better off lightening up on your dollar shorts and beginning to add new longs.

Some wealth-management advisers said in January they expect the pound to rebound once the UK election is out of the way and the new government has clarified its plans, but until then advised clients with heavy sterling exposure to diversify into stronger currencies, like the USD.

The UK could well lose its triple-A status unless current deficit-reduction plans change. On top of that, investors are raising serious concerns over the outlook for the UK government bond market.

So there's more reason to avoid buying the pound long-term than the dollar. The pound is top-heavy and technically very weak and until we see evidence on the charts of a technical rebound, it should get weaker still. The mighty dollar is not to be written off anytime soon. ■

MIKE BAGHDADY won 2009's live trading comp at Frankfurt's World of Trading expo, beating the biggest traders in the business.