PORTFOLIO MONTHLY REPORT – April 2022

Situation

When I see a chart like the one above I try to understand what is going on and if there are any opportunities. It shows the value of the US dollar compared to a basket of other currencies and the higher the number the higher the value of the dollar. So in early 2020 when covid19 arrived in the western countries there was a rush into dollars. This happens in times of global uncertainty but within a few months it had fallen and dropped to a low in mid 2021 since when it has shot up again. It stands today at 103.67 the highest for 20 years. So what is going on?

Currency valuations are influenced by several factors one being the interest rate and another the rate of inflation. In the USA last week they increased rates to 1% but the inflation rate is 8.5% well above the interest rate. But in Euroland it is just as bad where the interest rate is zero and inflation quoted at 7.5%. So there is little difference however the longer term rates favour the USA at 3% over 10 years, while in Germany the yield is just 1%. Interestingly rates in Italy have recently shot up to 3% and given both Germany and Italy use the Euro this will concern the ECB. Given the Euro is the largest component in the dollar currency basket the relative rise in the dollar versus the Euro has caused much of the above chart. But it is also the case for Sterling and the Yen, both weaker against the US dollar.

It is not so much the current numbers but the expectation that drives these movements and the expectation is that US rates will rise considerable this year. I am not so sure, as there is much that might cause a global recession and then rate rises will be unlikely. If that happens it will be true of all major economies and so the marginal difference will be little and the US dollar may stay stong relative to other currencies.

Usually when the US dollar is strong commodity prices are weak and visa versa but this is not the case today. All commodites from oil to gas to metals to food have risen in price over the last year despite a stronger dollar. Other forces are clearly in play such as trade bottlenecks due to the covid19 restrictions.

With inflation now high and rising and the risk of recession real, the fear is that we end up with stagflation ie. no growth but with inflation, as we experienced in the 1970s.

A stronger dollar of course makes countries with high debts denominated in dollars less attractive for investors such as most emerging markets. But debt has also soared in developed markets as a result of years of QE and recent covid19 measures. To fight inflation the text book policy is to raise rates above the inflation rate. That would mean for example the ECB should raise rates to 8% which is what the Bundesbank did in the early 1990s. It will be interesting to see what the central banks do this year as their target inflation of 2% is way back in the rear view mirror!

Best wishes

Tim 10 May 2022