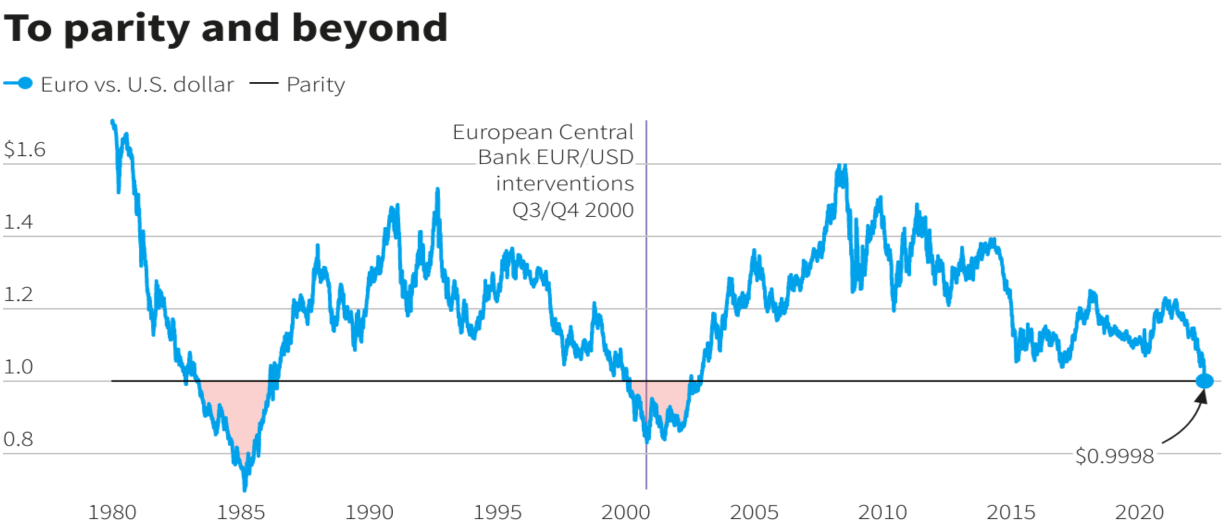
PORTFOLIO MONTHLY REPORT – June/July 2022

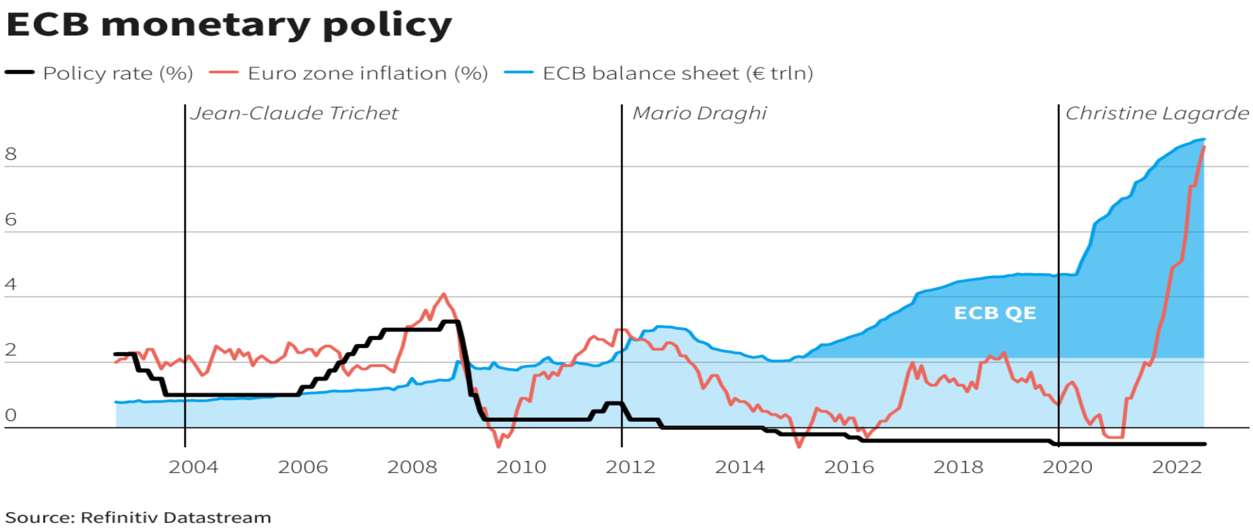
Situation

Hail the mighty dollar. This is a chart of the dollar index, a measure of the currency against a basket of other currencies and you can clearly see the dollar has become a lot stronger in the last two years. That is an increase from 90 to 108 or +20%. Dominating the index is the rate against the Euro and the chart below shows that relationship over a longer period. Recently the two currencies have reached parity ie. one dollar is now worth the same as one Euro. This last happened 20 years ago !



Note: July 13, 2022 data as at 12:45 GMT
Source: Refinitiv Datastream, ECB

The main reason this has happened is the difference in interest rates and expectations for future interest rates. At the moment in Euroland rates are zero and even ten year German bonds for example only offer 1% while the US ten year bond offers nearly 3%. The expectation is that rates in the US will continue higher, even after a 0.75% rise in July to 2.5% while the ECB only increased rates by 0.5% to 0% (yes, zero from negative) and is are unlikely to raise rates again any time soon.



This has implications for the global investment world. Commodities for example are priced in dollars and therefore for countries other than the USA commodities have got a lot more expensive in local currency terms. This has been one cause of higher inflation over the last year.

There is a view that by the end of this year the US central bank will stop raising rates. This is the so called „Powell Pivot“ named after the chairman of the Federal Reserve in the USA whereby he will pivot away from rising rates and start cutting them. With inflation rising in the USA, a change of direction to cutting rates would be a major change of policy and inpact the investment world.

I see little chance of the ECB raises rates this year to combat inflation. In the UK rates are at 1.25%. There is a Bank of England meeting on 4 August so a modest rise is likely but still well below the rate of inflation.

In the past inflation has only been contained when short term rates are higher than inflation. That is highly unlikely given the current inflation rate of 9% in the US and Europe. In the USA they might continue to rise to say 3.5 % and perhaps inflation comes down close to that amount to close the gap but at the moment that view looks highly optimistic. Even if that did happen it would take a full year to allow the base effects from today, to drop out of the calculation.

So it looks like a strong dollar is here to stay for a while and also persistent inflation.

Best wishes

Tim

2 August 2022