MarketThoughts.com Believes the U.S. Dollar Index is Making a Significant Bottom

MarketThoughts (http://www.marketthoughts.com), a stock market advisory and educational site operated by Henry To, CFA, and Rex Hui, trading systems programmer brings to you an exclusive analysis on why the bear market in the U.S. Dollar Index is coming to an end.

Houston, TX (PRWEB) December 6, 2006 -– The bear market in the U.S. Dollar Index that began in early 2002 is most likely coming to an end. According to Henry To, Editor of MarketThoughts.com: “The year 2002 began with a perfect opportunity to go short the U.S. Dollar Index – given that the Federal Reserve was aggressively cutting short-term rates, a hugely decelerating U.S. economy, an ever-rising budget deficit as a percentage of GDP, and the signing of the Patriot Act in October 2001 – which made many Middle Eastern investors weary of investing in the United States. In retrospect, that was the perfect storm for the U.S. Dollar and the perfect shorting opportunity, a trend further compounded by the beginning of the U.S. Dollar carry trade that occurred later that year.”

However, many of these bearish factors for the U.S. Dollar are now fading or have faded away. We first discussed the possibility of a surprised year-end rally in the U.S. Dollar Index in our November 12, 2006 commentary, with further arguments and backup in our November 23, 2006 and our November 30, 2006 commentaries. In those commentaries, we cited many reasons for the U.S. Dollar Index to bottom out and to mount a surprise year-end rally, with the possibility of a further upside rally in 2007.

Among them are:

- From a high of 90% of their foreign reserves, the People's Bank of China has already decreased their foreign reserves that are held in U.S. government paper to 67%. Given that approximately 70% of China's trade with other countries is quoted in U.S. Dollars, there is no need for the People's Bank of China to further diversify their reserves away from U.S. Dollars. In other words, the People's Bank of China will and should not be selling any more U.S. dollars for Euros or the British Pound going forward, especially at current levels.

- Over the best part of the last 20 years, speculative or investment flows of funds have had more of an impact than trade flows, and given the proliferation of hedge funds that now operate on a global basis (and given that pension funds are now getting into the “currency overlay” game), the overwhelming impact of speculative flows on the currency market vs. the impact of trade flows is getting higher by the day.

- Even if trade flows have a significant impact, there are no longer reliable ways to measure trade surpluses or trade deficits anymore, especially for a knowledge-based economy like the United States. For example, the Chinese measurement of its trade surplus with the United States is actually half the amount of the official trade surplus amount that is published by the United States government. In this day and age, how does one account for the “exporting” of software downloaded through the internet? Or the payment for financial services rendered, such as investment banking or investment management services rendered by Goldman Sachs or by the Renaissance hedge fund?

- Over the last ten years, the change in the rate (second derivative) of the budget deficit has actually had more of an impact on the value of the U.S. Dollar than the trade deficit (which has had no relationship). The state of the budget deficit (as a percentage of GDP) has been steadily improving since 2004. During fiscal 2006, it is projected to hit 2.3% of GDP, which is a substantial improvement from fiscal 2004, when it hit 3.6% of GDP.

- Despite all the hype surrounding the narrowing yield differentials between the Euro and the U.S. Dollar, it should be noted that the U.S. Dollar still holds a 200 basis point advantage over the Euro in the Fed Funds market. Moreover, the six-month rate of change of the OECD leading indicators for the Euro Zone has been weakening, vs. the six-month rate of change for the United States – which has actually been strengthening. Given that Germany will increase its VAT from 16% to 19% effective January 1, 2007, and given rising income taxes (not to mention a serious clampdown on tax evasion) in Italy next year, there is a good chance that the Euro Zone economy will significantly slow down next year.

- Many of the countries in the Euro Zone have been too dependent on export growth in recent years, especially export growth to countries in Central and Eastern Euro pe. It is to be noted that the finances of many of these countries in both Central and Eastern Europe are now very precarious, given that some of these countries are running trade deficits in excess of 10% of GDP. This is not unlike many technology companies in the late 1990s – when much of their revenue and earnings growth came from providing vendor financing to technology or internet start-up companies. If Central or Eastern Europe experiences a sudden economic downturn, this could have a very adverse effect on countries in the Euro Zone who depend on exports for a significant amount of their economic growth.

Going forward, we at MarketThoughts.com believe that the U.S. Dollar will continue to depreciate in value, but not against the Euro, the British Pound, the Yen, or even the Canadian or Australian Dollar. For more details, please visit our website at marketthoughts.com.

The mission of MarketThoughts.com is to provide the highest level of performance, service, integrity and education to our readers. This involves providing insights into the factors that will affect the stock market and individual stocks - helping our readers to maximize returns in favorable investment climates and protecting assets in unfavorable climates. We provide our readers with a twice-a-week commentary designed to educate subscribers about the stock market and the economy beyond the headlines. This commentary usually involves focusing at the fundamentals and technicals of the current stock market, but may also include individual sector and stock analyses - as well as more general investing topics such as the Dow Theory, investing psychology, and financial history.

In January 2000, the cofounder, Henry To, CFA of MarketThoughts.com alerted his friends and associates about the huge risks created by the historic speculative environment in both the domestic and the international stock markets. Through a series of correspondence and e-mails during January to early April 2000, he discussed his reasons and the implications of this historic mania, and suggested that the best solution was to sell all the technology stocks in one's portfolio. He also alerted his friends and associates about the possible ending of the bear market in gold later in 2000, and suggested that it was the best time to accumulate gold mining stocks with both the Philadelphia Gold and Silver Mining Index and the American Exchange Gold Bugs Index at a value of 40 (today, the value of those indices are at approximately 150 and 370, respectively).