RIA Advice

After a brief post-Presidential election surge in 2016, the U.S. dollar has been in a steady downtrend since•early-2017. The dollar's grind lower has helped to boost non-U.S. currencies as well as commodities prices, which trade inversely with the dollar. Now that the "short-dollar, long everything else" trade has been going on for so long, it has become extremely crowded: the consensus view is that this trade will continue for much longer and even accelerate. On the other hand, the "smart money" are *betting heavily on a reversal* of this trade, as I will show in this piece. For the past several months, the U.S. Dollar Index formed a triangle consolidation pattern as it digested the financial market volatility. The index broke out of this triangle pattern today, which is a bullish sign as long as the breakout remains intact (ie., the index remains above the top of the triangle pattern).

The longer-term chart shows how the "smart money" or commercial hedgers (see the green line under chart) have built up a bullish position in the•U.S. Dollar Index futures. The last several times the hedgers built similar positions, the Dollar Index has rallied. The dollar's downtrend since early-2017 has occurred within a channel pattern, and the triangle pattern discussed in the prior chart can be seen within this channel. The Dollar Index needs to break out of both the triangle pattern and the channel pattern in a convincing manner in order to signal the end of the downtrend.

The euro, which trades inversely with the U.S. dollar, formed a similar triangle pattern over the past several months and has broken down from this pattern today. This breakdown is a bearish sign for the euro and a bullish sign for the dollar as long as the euro's breakdown remains intact (ie., it doesn't reverse and break back into the triangle pattern).

The "smart money" or commercial euro futures hedgers have built their largest bearish position in at least a half-decade, which increases the probability of a bearish-euro/bullish-dollar move in the not-too-distant future. The commercial euro futures hedgers have a short position of nearly 200,000 net futures contracts, which is far larger than their relatively bearish position in 2013 and 2014 before the euro weakened sharply against the dollar.

The "smart money" or commercial futures hedgers are also bearish on the Japanese yen, which would also be bullish for the dollar if they are proven right. The yen experienced bearish moves the last couple times the commercial hedgers positioned similar to how they are positioned now.

The "smart money" are currently bearish on the British pound as well and have a strong track record of positioning bearishly ahead of major pound routs over the past half-decade.

If another wave of dollar strength occurs, it would be very bad news for crude oil and the overall energy sector (crude oil and the dollar trade inversely). The U.S. dollar's surge in 2014 and 2015 was the trigger for the violent crude oil bust. Even more concerning is the fact that the "smart money" are more bearish on crude oil now than they were immediately before the 2014 oil bust, as I discussed in greater detail last week. While oil's short-term trend is still up for now and I believe in respecting the trend, there is a very real risk that another violent liquidation sell-off may occur when the trend changes.

For now, I believe everyone should keep an eye on the U.S. Dollar Index to see if today's triangle breakout has legs and if the index can break out of its longer-term channel pattern. While most market participants currently believe that further bearish dollar/bullish commodities action is practically guaranteed, they need to be aware of the tendency for the market to "tip over when everyone gets to one side of the boat." **Please follow or add me on Twitter, Facebook, and LinkedIn to stay informed about the most important trading and bubble news as well as my related commentary.**