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The Aerial View

Morning Briefing

A Rare Event

- **USD is showing notable correlations to a number of key instruments**
- **It is rare for these to emerge at same time**
- **They have been associated in past with run up to/aftermath of market turbulence**

One thing that is certain is that the USD is currently tracking remarkably closely to a range of key US instruments.

At present the 200-day rolling correlation for the NASDAQ Composite against the USD Index stands at -74.8% (i.e. the USD tends to be weakening as the equity index strengthens and vice versa). This is closely followed by a -74% correlation against the Dow Jones Industrial Average, -73.9% against the S&P 500 and -65.6% against the Dow Jones Transportation Index.

Correlations against key gaps along the yield curve stand not that far behind these. The rolling correlation between the USD Index and the US government 2-year/30-year yield gap stands at 68.8%, for the 5-year/30-year gap at 66.3% and 65.7% for the 2-year/10-year spread.

The correlations between the USD Index and outright treasury yields are catching up rapidly with both groups with the number against the 2-year at -65.6% (i.e. the USD tends to weaken as yields head higher), against the 5-year at -55.8% and against the 10-year at -44.8%.

Simon Derrick
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Email >

Newswatch

1.

Kuroda assures that 'powerful monetary easing' still required >

2.

UK Government rules out customs union with EU post-Brexit - BBC >

3.

Services activity ticks

It is rare for correlations of this strength to appear collectively for any length of time for the USD Index against this particular set of instruments. Indeed, this appears to have happened just three times over the past 40 years.

> ***It is rare for correlations of this strength to appear collectively for any length of time***

The first time came in late 1978. It emerged in the latter stages of a two-year old USD downtrend fueled by lax US monetary policy (the gap between headline inflation and the Fed Funds rate stood at not dissimilar levels to those seen over the past few years).

This move, in turn had helped the S&P 500 to sustain its post-1974 rally. However, the Fed was tightening policy as it fought to bring inflation back under control. The three-month period that the correlations reached the extremes currently registered coincided with the USD finding a base as the Fed continued to tighten and culminated in a 15% slide in the S&P 500.

The second time came in the summer of 1987 and coincided with the latter stages of the post-Plaza Accord USD downtrend (in fact the yield curve correlations did not quite reach the current extremes).

The Fed was tightening policy in order to stabilize the USD and a sudden rise in inflationary pressures, while the S&P 500 continued to rally aggressively. The correlations abruptly fell apart in October 1987 following Black Monday (a 20% decline in one day).

> ***However, the Fed was tightening policy as it fought to bring inflation back under control***

The third period came between December 2008 and May 2009. This differs from the previous two episodes in that it came after (rather than before) a major stock market slide.

up in Japan >

4.

China's Caixin PMI hits near five year high >

5.

Australia's services activity strengthens in January >

On the Radar

February 5, 2018

• EZ Jan composite final PMI (0900 GMT): Reuters consensus forecast 58.6; previous 58.6

• EZ Dec retail sales (1000 GMT): Reuters consensus forecast 1.8% y/y; previous 2.8% y/y

• US Jan ISM non-mfg PMI (1500 GMT): Reuters consensus forecast 56.3; previous 55.9)

Featured Article

However, it remains interesting that it was again connected with a period of extreme market turbulence.

While it doesn’t follow that events will play out in the way they did in the past, it still seems worth highlighting that the levels of correlation currently being seen between the USD Index and key US asset markets have previously been associated with either the run up to or the aftermath of major market events.

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