The US Dollar Is Breaking Out

By JC Parets | August 10, 2018 — 11:58 AM EDT

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I know the U.S. dollar isn't as sexy as Tesla, Inc.'s (TSLA) Elon Musk tweeting market-moving information every few hours or Apple Inc. (AAPL) hitting a trillion-dollar market cap, but I have been waiting all summer for a resolution of this range in the Dollar Index, and it looks like we might be finally getting it. Whether this move is successful and the dollar continues higher, or it's a failed breakout that sends the euro ripping, there will be significant cross-asset implications that are worth thinking about as this move develops.

First, let's start off with a daily chart of the U.S. Dollar Index. In late April, prices broke above the downtrend line from its March 2017 peak and rallied toward its October highs, where prices stalled. For the past two months, prices have consolidated within an ascending triangle of higher lows and many failed attempts to clear the October highs. This gave momentum plenty of time to work off its bearish divergence and for the 200-day moving average to flatten out and begin rising ever so slightly. All of these characteristics are what you'd expect to see during a consolidation period that ultimately resolves higher, but now price is finally confirming it. (For more, see: *The Pros and Cons of a Strong Dollar*.)

From a quantitative sentiment perspective, there's some excess optimism in the options market, but not nearly as much as we saw at the 2014 or 2016 highs, and commercial hedger positioning, while short, is not at an extreme either. From a qualitative perspective, I've not read or spoken to many people with the view that the euro is going higher from current levels, so that's an interesting tidbit.

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Nonetheless, let's look at the Dollar Index's largest component, the euro. Below is a daily chart of EUR/USD that is very much a mirror image of the Dollar Index. Prices broke down from their highs in late April, quickly falling toward former support/resistance, and they have been consolidating in a descending triangleof lower highs and unsuccessful breaks of 1.1540. Momentum remains in a bearish range, and the 200-day moving average has flattened and is beginning to roll over. Now prices are finally confirming what these characteristics were suggesting, a continuation lower, by closing at one-year lows.

From a quantitative sentiment perspective, neither options positioning nor commercial hedger positioning are near extremes, suggesting that there is more room to go to the downside in the euro. (See also: *Forex Currencies: The EUR/USD*.)

Regardless of the outcome, this move is going to have a lot of important implications for commodities(specifically metals), global equity markets (especially those owned through exchange-traded funds with local currency exposure) and other assets around the world.

While sentiment isn't necessarily stretched to extremes in the U.S. dollar and the euro themselves, we are starting to see some multi-year extremes in options and commercial hedger positioning in precious metals. A confirmed failed breakdown and bullish momentum divergence in something like gold or platinum that has been beaten up all year could ignite a counter-trend rally that is exacerbated by the negative sentiment.

I know it's a summer Friday, so I won't make this an extremely long post talking about all the relationships and possible outcomes, but my point is that I'm watching the Dollar Index to see if it can close this week strong and will certainly be thinking about how it's going to affect trends in other markets as I do my homework this weekend. I know many of you will be too.

I'm curious to see what you all are thinking, so let us know by voting in JC's poll on Twitter or dropping us a note using our contact page.

As always, thanks for reading!