

Bond Models & FX Indicators

This week, we are publishing a complete review of our fixed income and currency indicators, along with an update from our Global Bond Allocation Model.

As a reminder, our bond models are summarized by a Risk Indicator. This consists of three subcomponents: cycle, value, and momentum. A high risk reading is bearish for bonds, and vice versa. The models are an important input to our call on duration and global fixed income country allocations ([Chart 1](#)).

For FX, we focus on technical indicators as currencies are prone to momentum trading. Our intermediate-term oscillator helps to gauge how nascent or advanced a trend may be ([Chart 2](#)). We also provide measures on speculative positioning and sentiment, which can be useful contrarian indicators.

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Chart 1 The Risk Profile Of U.S. Treasuries Is Neutral

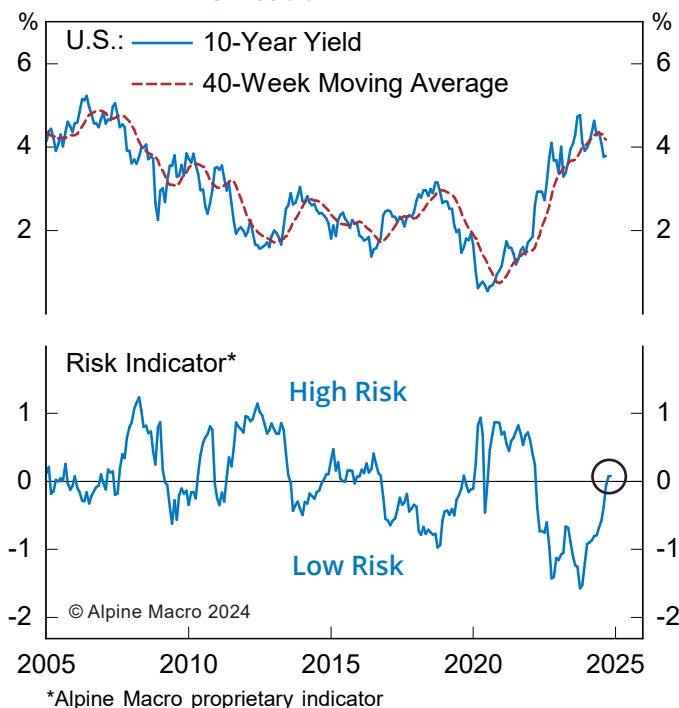


Chart 2 The U.S. Dollar Is Oversold Agreed

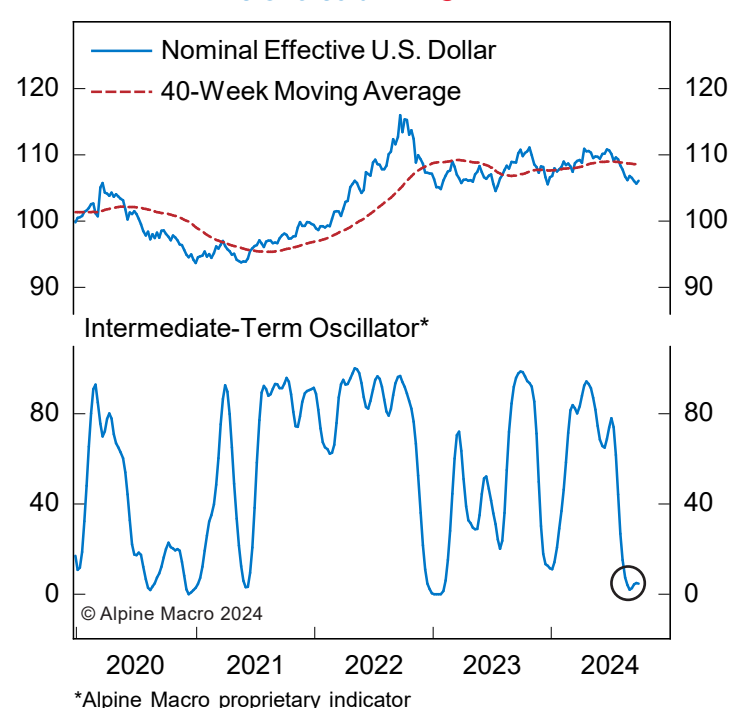
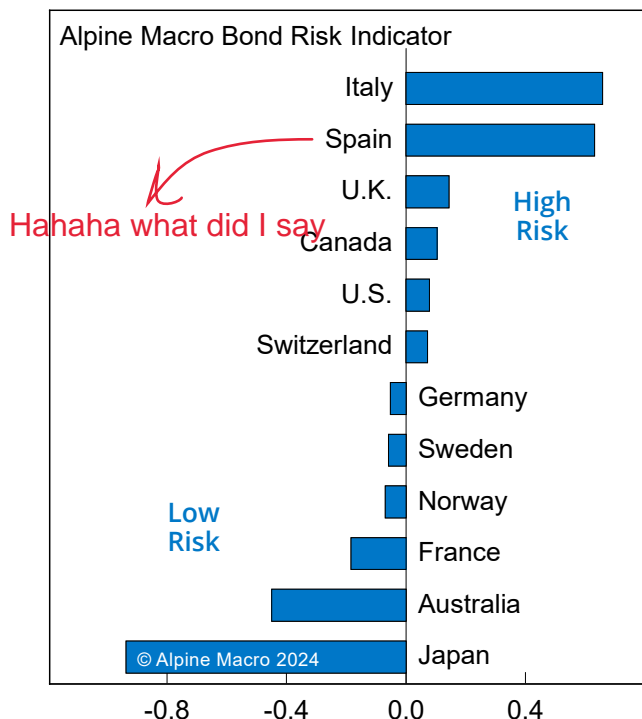


Chart 3 Most Bond Risk Indicators Are Near Neutral



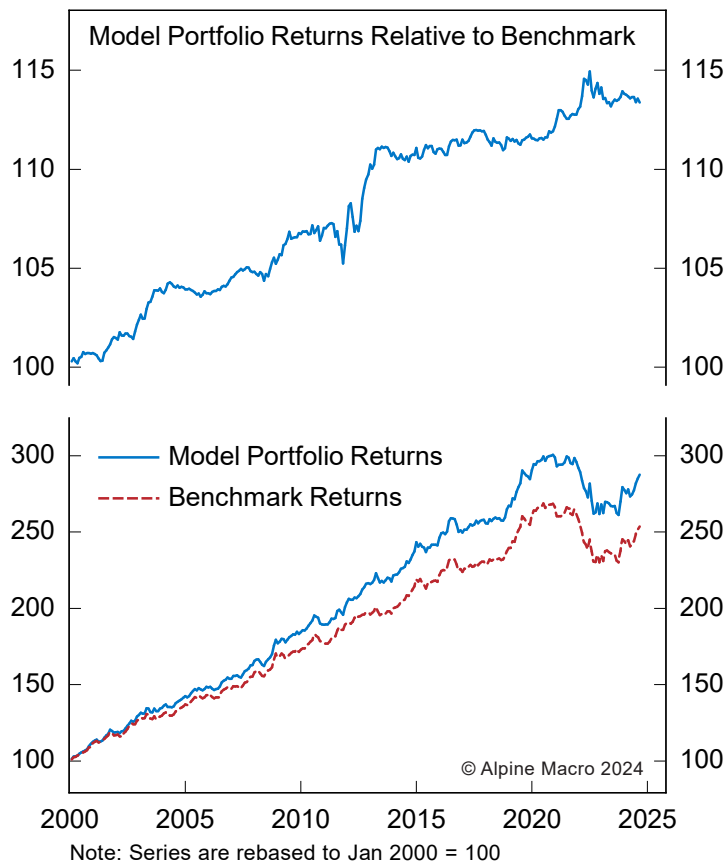
Risk Indicators Return To Neutral

Most of the Risk Indicators for the markets that we track are back to near neutral levels ([Chart 3](#)). With a few exceptions, most bond markets are close to fair value and no longer oversold. Economic cycles are generally weak, but some markets are showing signs of an improvement. This supports our recommendation to be at benchmark on duration.

Our Global Bond Allocation Model (GBAM) utilizes our sovereign Risk Indicators to derive the country allocations.¹ The objective of the GBAM is to outperform a custom benchmark of global sovereign bonds by strategically overweighting and underweighting different countries ([Chart 4](#)).

¹ Alpine Macro *Global Fixed Income & FX Strategy* "Introducing Our Global Bond Asset Allocation Model" (July 7, 2023).

Chart 4 Global Bond Allocation Model's Performance



We do not follow the allocation model blindly as a “black box”, but we use it as an input to our investment process and as a cross-check to our fundamental analysis. [Table 1](#) presents the GBAM’s latest country allocations compared to our custom benchmark.

Since we last ran the model in July, the most significant change has been a sharp downgrade to U.S. Treasuries. From a modest overweight, the model has cut U.S. bonds to the second largest underweight.

From a fundamental perspective, we have been overweight Treasuries due to our outlook for U.S.



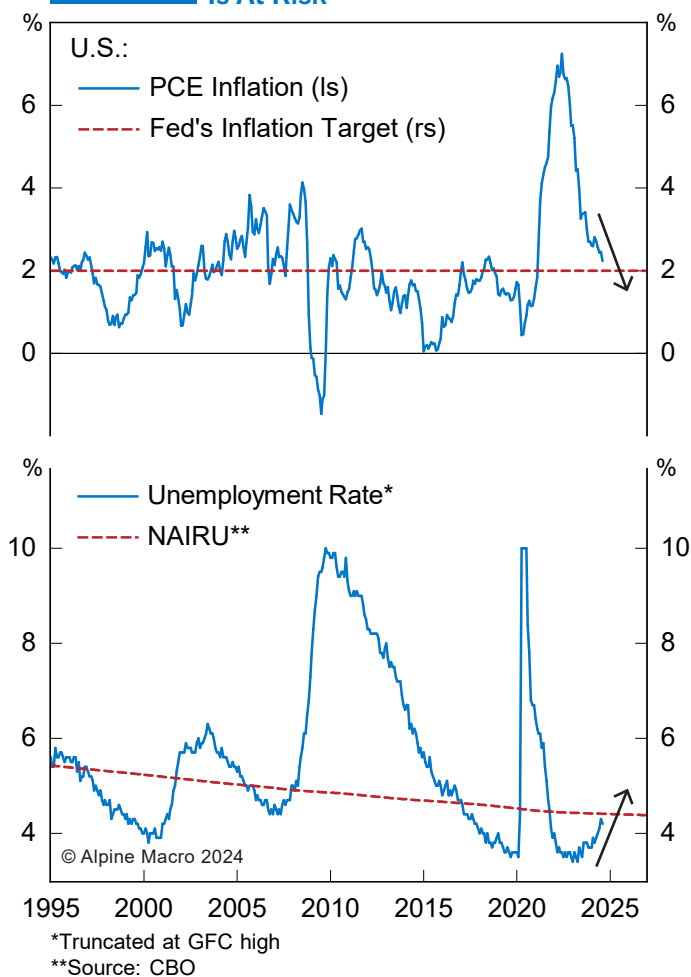
Table 1 Global Bond Model's
Country Allocations

	Portfolio (%)	Benchmark (%)	Deviation (%)
Japan	24.9	14.4	10.6
France	11.8	7.4	4.5
Germany	9.9	6.7	3.2
Australia	7.8	4.9	2.8
Sweden	5.8	4.2	1.6
U.K.	6.9	7.3	-0.5
Switzerland	3.3	4.3	-1.0
Canada	4.0	5.1	-1.1
Norway	1.4	4.2	-2.8
Spain	0.9	6.1	-5.2
U.S.	22.8	28.3	-5.5
Italy	0.5	7.0	-6.5

inflation and the labor market. We believe that the risks to the Fed's dual mandate are skewed to the downside. That is, inflation could fall below the 2% target, while the labor market falls short of maximum employment (**Chart 5**).

Our views on the U.S. economy have not changed, but given the very strong signal from the model, we feel it is prudent to move Treasuries to a neutral weighting. As an offset, we are increasing exposure to core eurozone bonds, which are favored by our allocation model. Falling inflation and sluggish growth will keep the ECB on an easing path, which should take European bond yields lower.

Japan is the major bond market where we are overriding our country allocation model. In sharp contrast to the model that has JGBs as its most favored bond market, we recommend maintaining an underweight position in Japanese bonds.

Chart 5 The Fed's Dual Mandate
Is At Risk


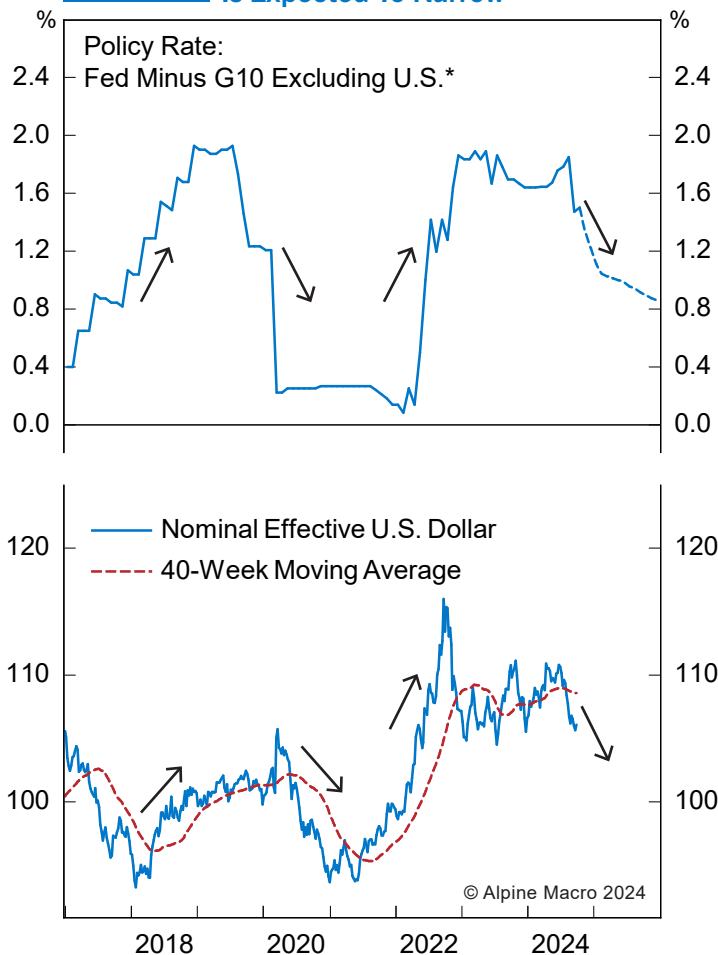
The BoJ will not follow the other G10 central banks in easing policy. And if the Japanese yen comes under pressure again, the BoJ could be compelled to hike rates faster than what is discounted by the market. JGBs offer low yields and have limited scope for capital appreciation.

The Dollar Is Oversold

Our indicators warn that the U.S. dollar is ripe for a bounce. The greenback weakened throughout the summer months. This has pushed our intermediate-term oscillator to oversold levels (**Chart 2**).



Chart 6 The Dollar's Yield Advantage Is Expected To Narrow



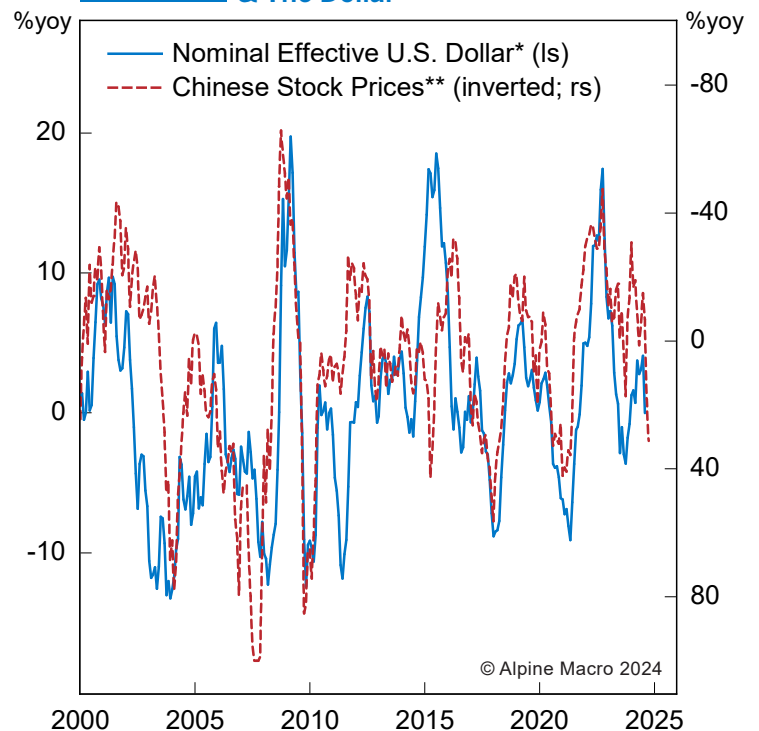
*Equally-weighted average of G10 excluding U.S.; dotted line denotes market expectations from OIS curves

Additionally, sentiment has turned uniformly negative towards the dollar. These are bullish developments from a contrarian perspective.

The bigger issue is whether a recovery in the dollar will be a temporary retracement or the start of a more sustainable uptrend. To make this assessment, investors need to keep a close eye on fundamentals and technicals.

The two most important fundamental drivers of the dollar are interest rate differentials and Chinese growth. A narrowing in the dollar's yield advantage

Chart 7 Chinese Stocks & The Dollar



*Source: BIS

**Truncated at 100 %y/y; source: MSCI

and a stronger Chinese economy would reduce the attractiveness of the greenback.

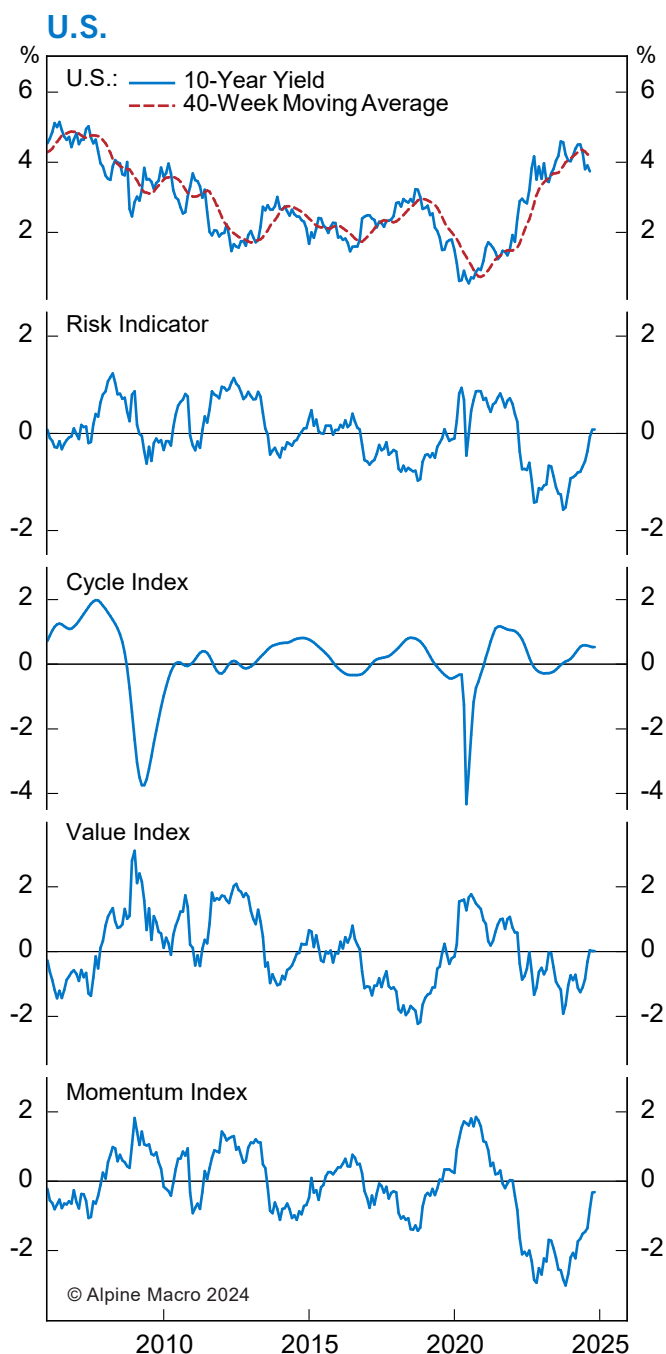
For now, OIS curves expect yield differentials between the U.S. and the rest of the G10 to shrink and the sharp rebound in Chinese stocks points to an improving economic outlook (Charts 6 & 7). A reversal in these trends would signal a more sustainable recovery in the dollar.

From a technical perspective, the dollar broke below the important 40-week moving average. If the dollar fails to move back above this long-term moving average, it will confirm that a cyclical bear market is getting underway.

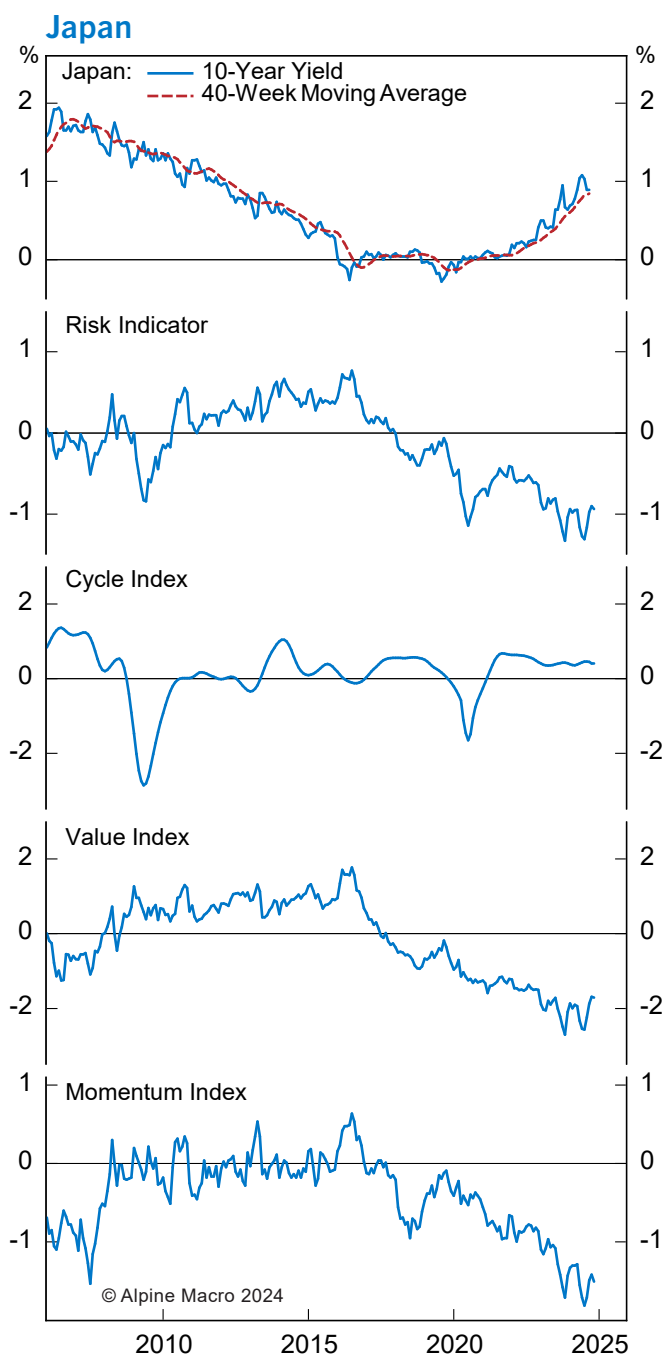
They use technicals too

Harvinder Kalirai

Chief Fixed Income & FX Strategist



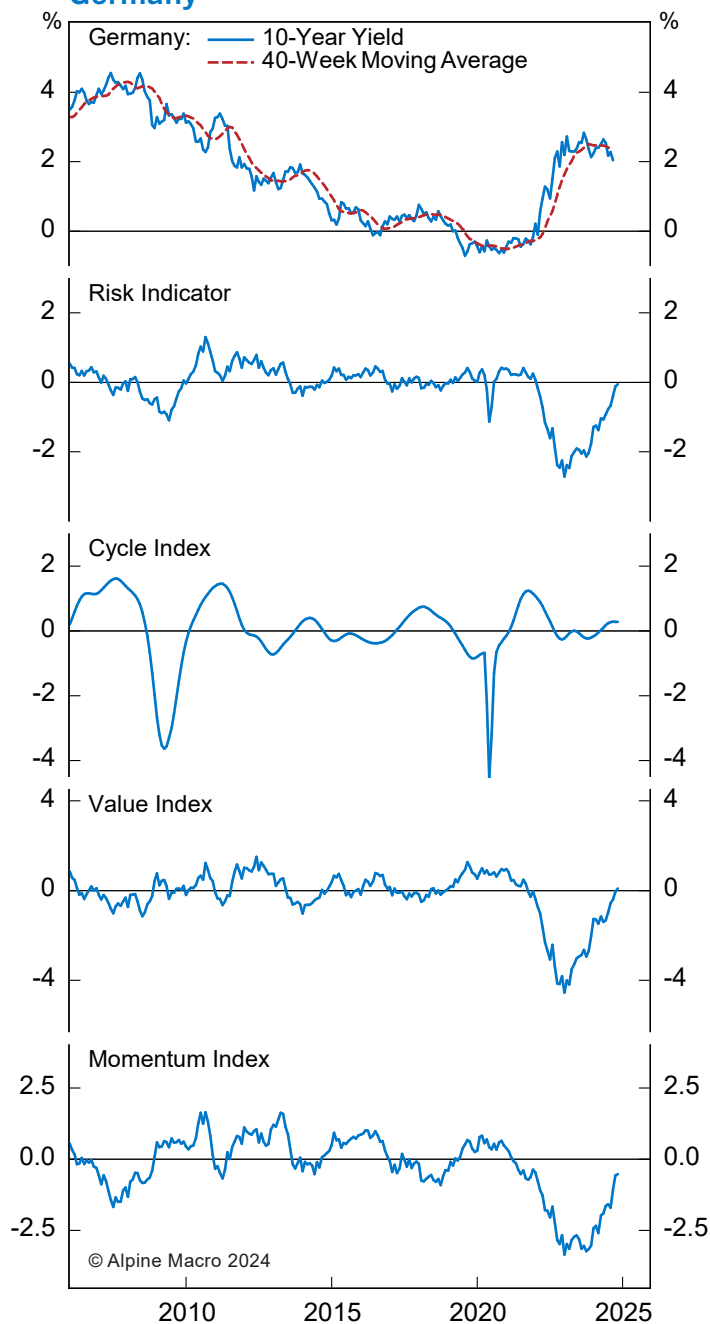
The Risk Indicator for Treasuries is near neutral. U.S. bonds are fairly valued and oversold momentum has been worked off. The cycle index is pointing to modest economic growth.



According to our indicators, the risk profile of JGBs is attractive. Japanese bonds are cheap and oversold. The cycle index is consistent with moderate GDP growth.

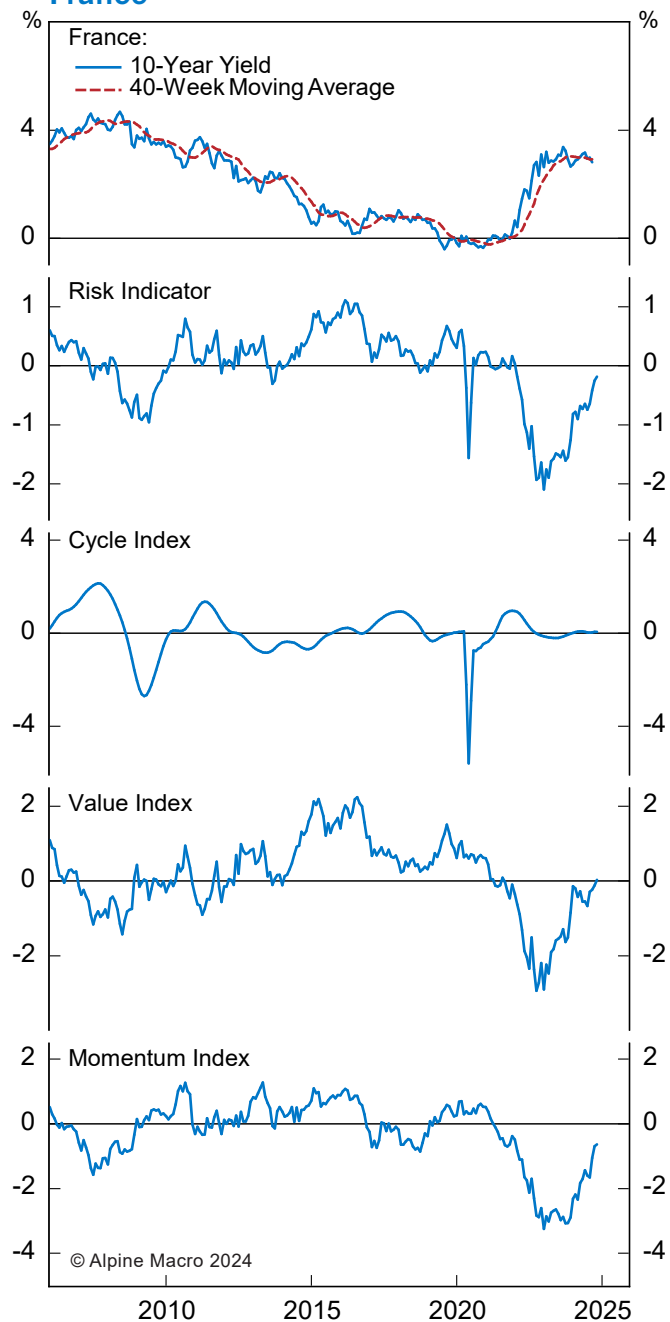


Germany



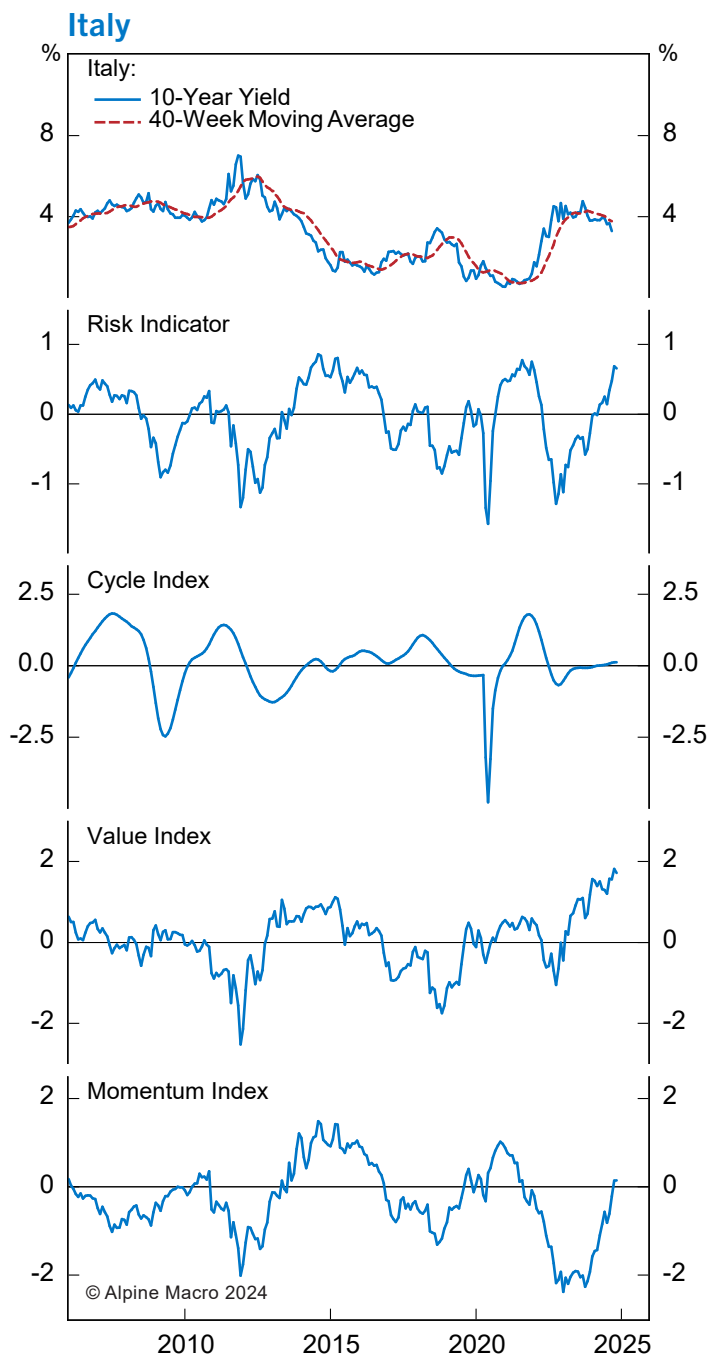
The Risk Indicator has returned to neutral. German Bunds are no longer undervalued or oversold. The cycle index points to sluggish growth.

France

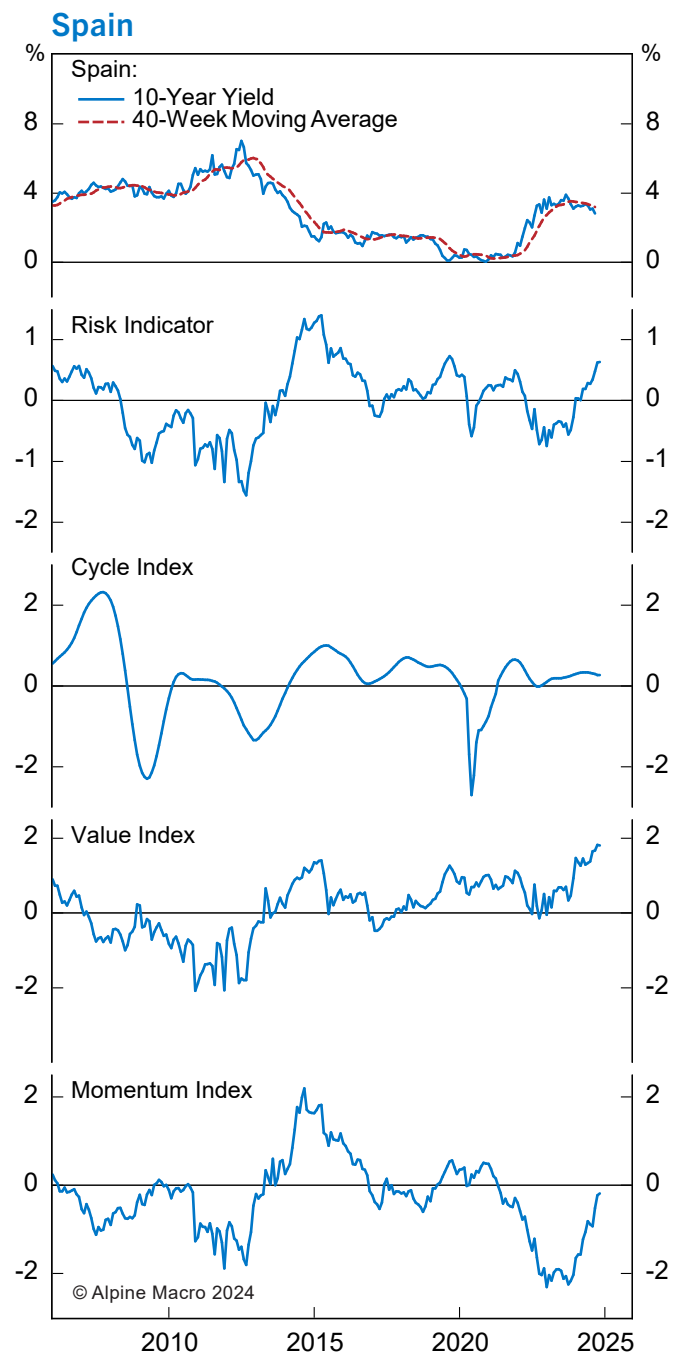


The risk profile of French OATs is similar to German Bunds.



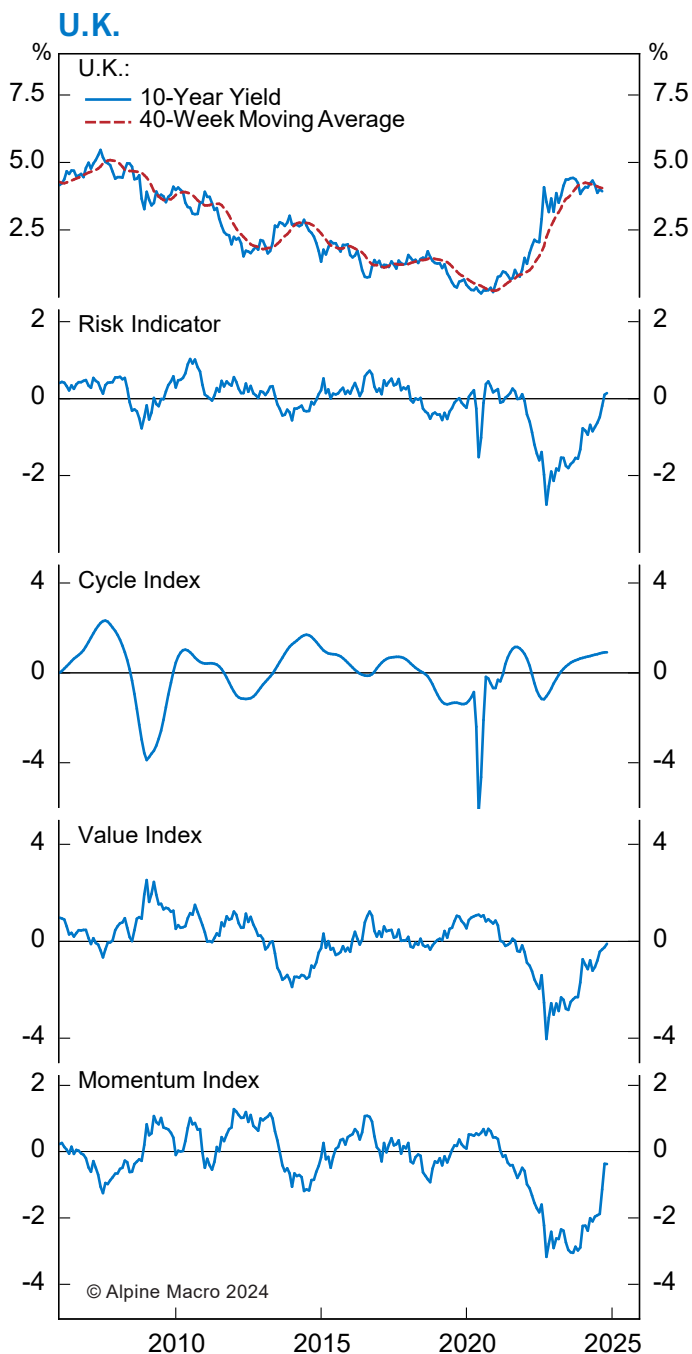


The Risk Indicator for BTPs is the highest of all the bond markets we follow. While the economy is weak, Italian bonds are overvalued and momentum is no longer oversold.

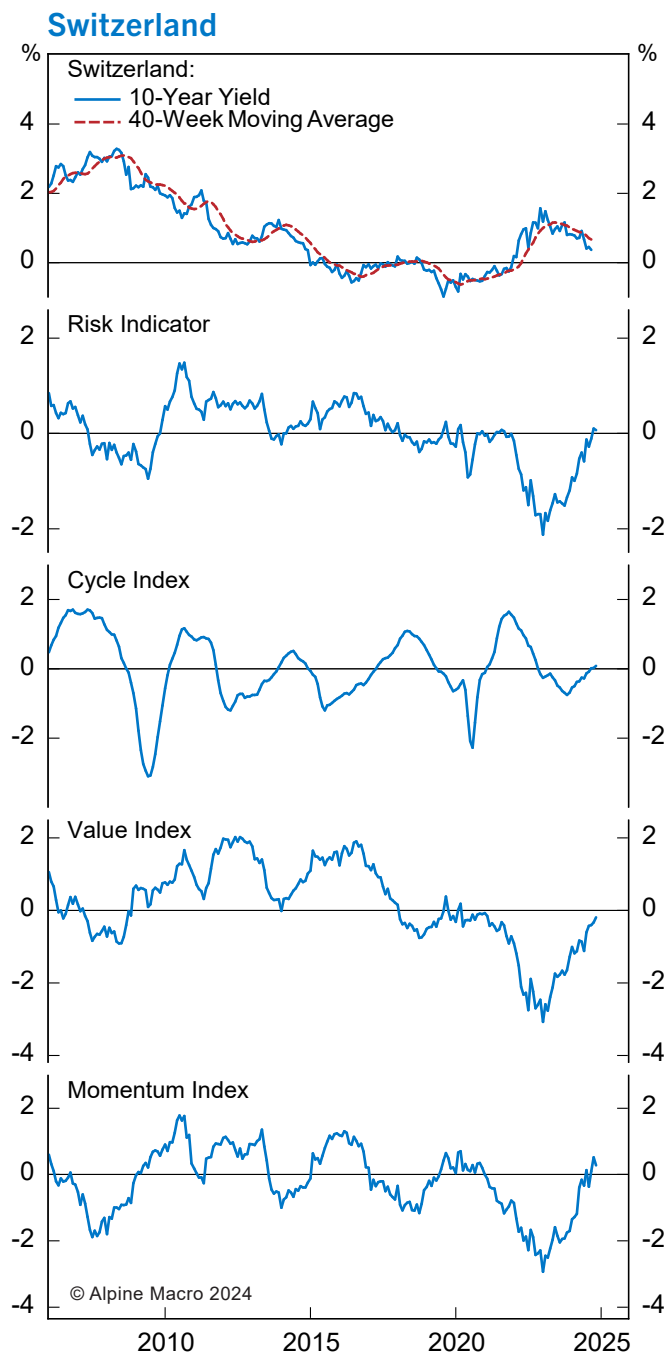


Similar to Italy, the Risk Indicator for Spanish Bonos is elevated. Our models continue to warn that investors should underweight Bonos and BTPs versus core eurozone bonds.



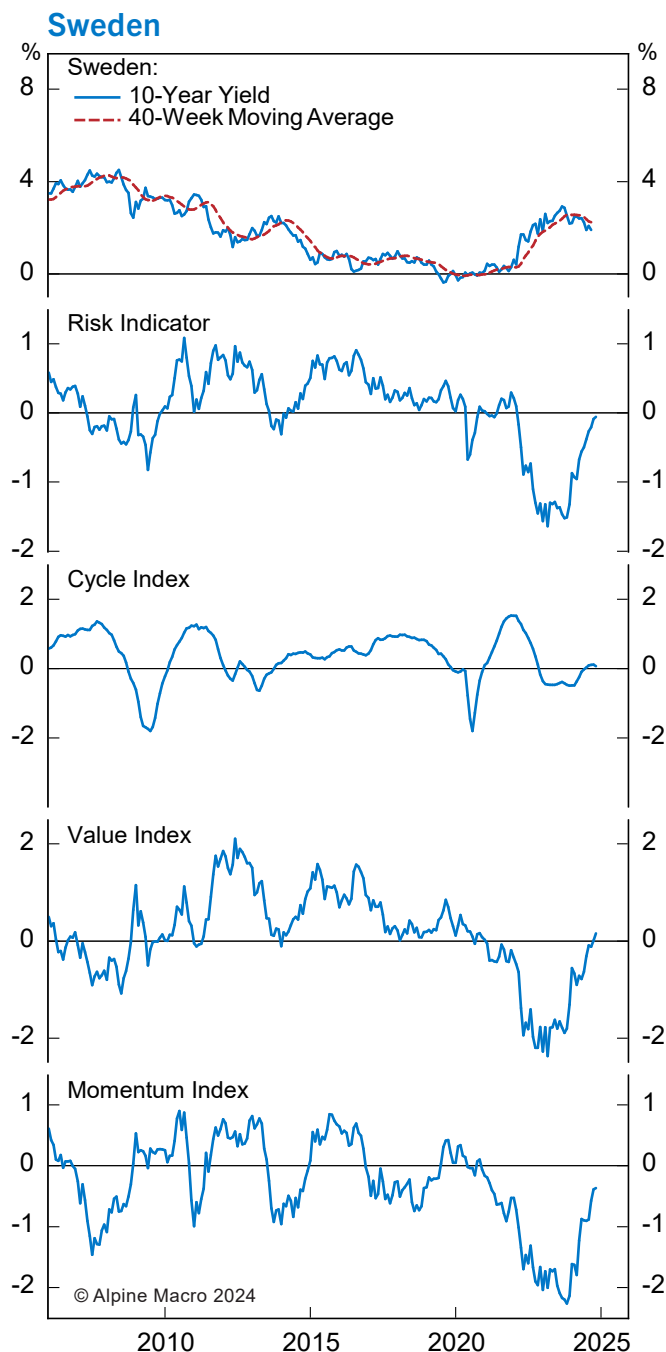


The Risk Indicator has risen sharply to neutral. Gilts are no longer undervalued or oversold, while the cycle index is firming.

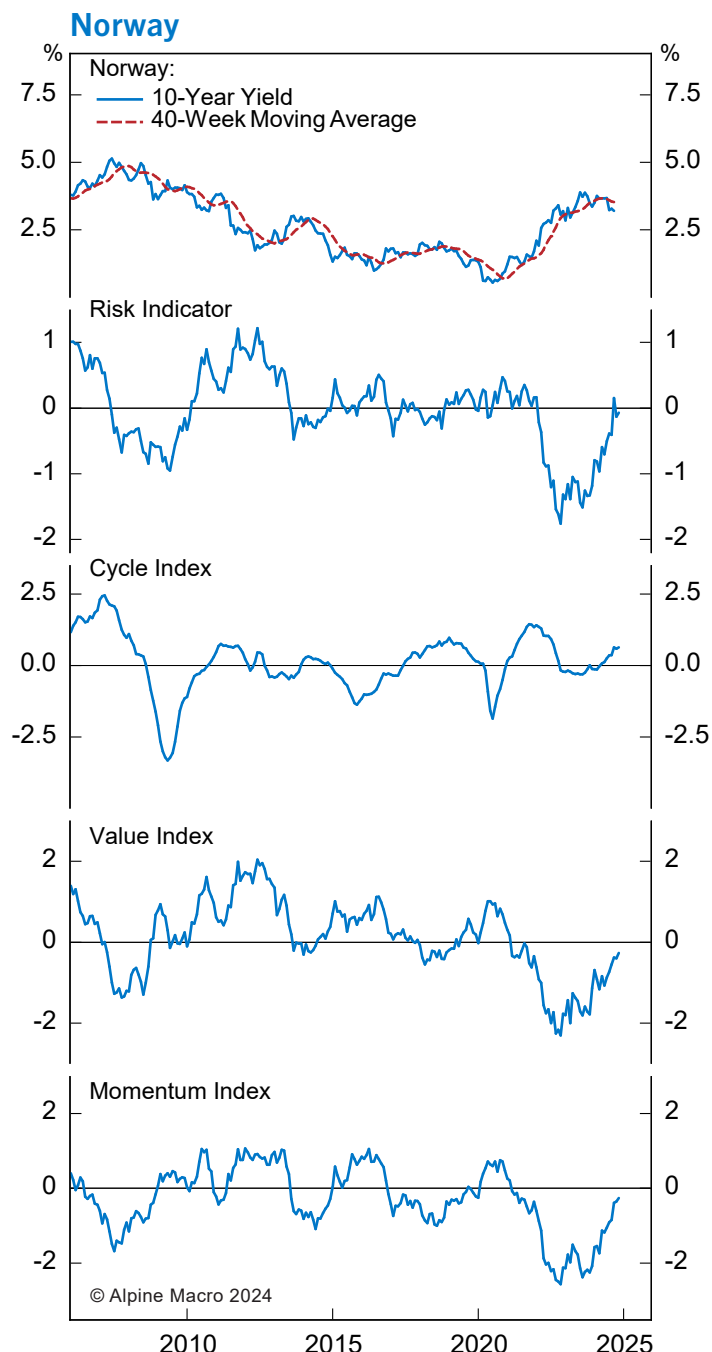


The Risk Indicator is back to neutral. The rally in Swiss bonds has eliminated the undervaluation and the oversold technical conditions. The cycle is weak, but it is on the mend.





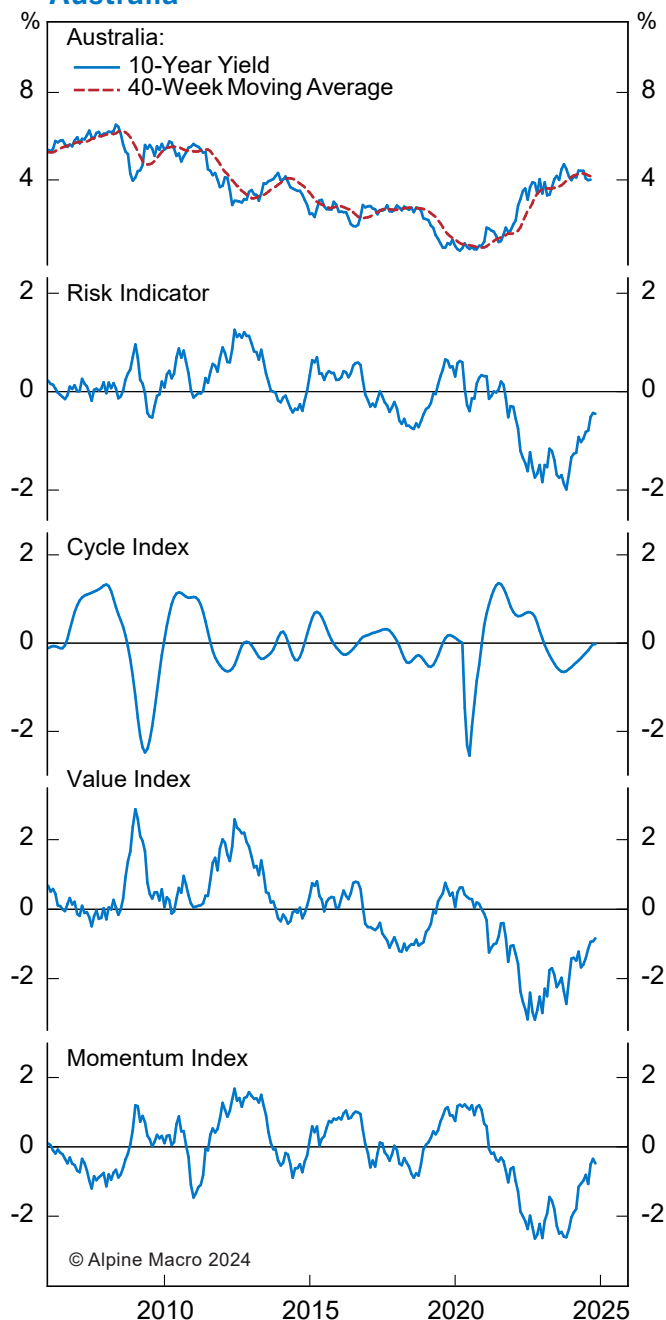
The Risk Indicator is at neutral. Swedish bonds are no longer cheap or oversold. The cycle is soft, but it looks to have bottomed.



Norway's risk profile is similar to Sweden's. The cycle is slightly stronger, but Norwegian bonds offer slightly better value.

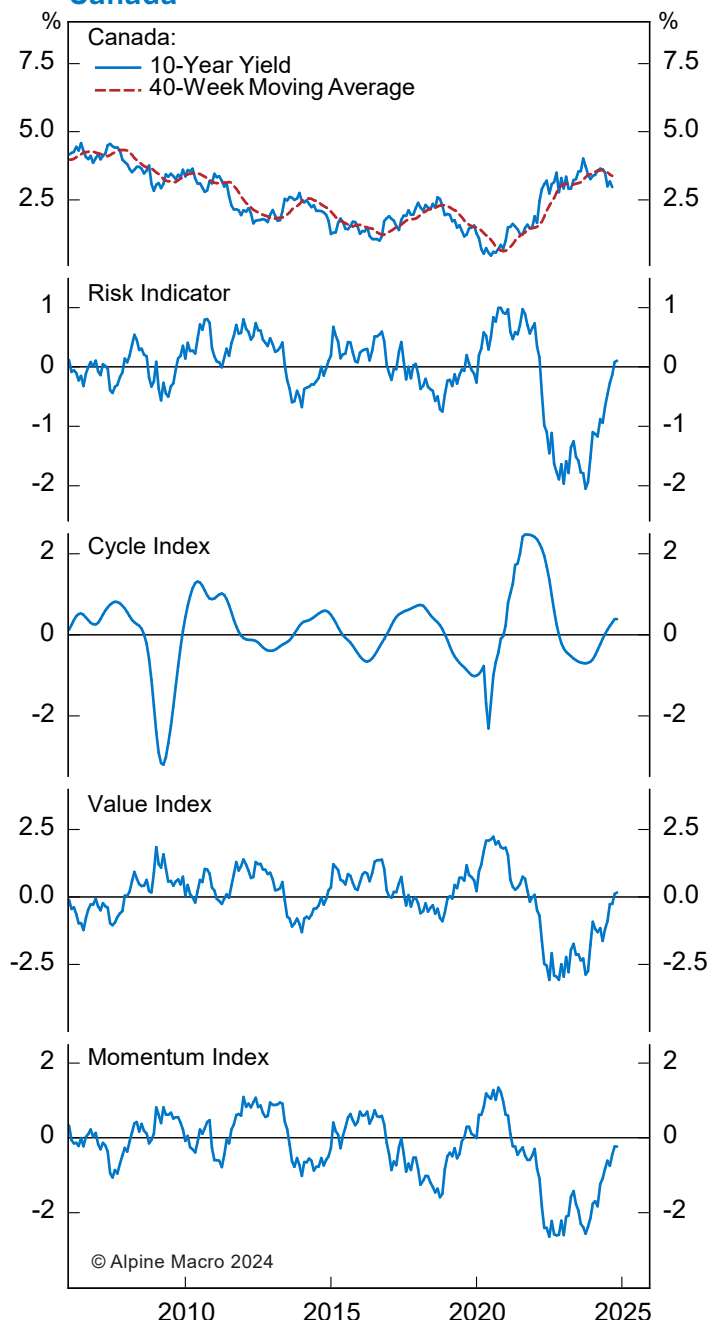


Australia



The Risk Indicator has recovered from record low levels, but it remains below neutral. Australian bonds are modestly cheap. The cycle index is inflecting higher, but it is still weak.

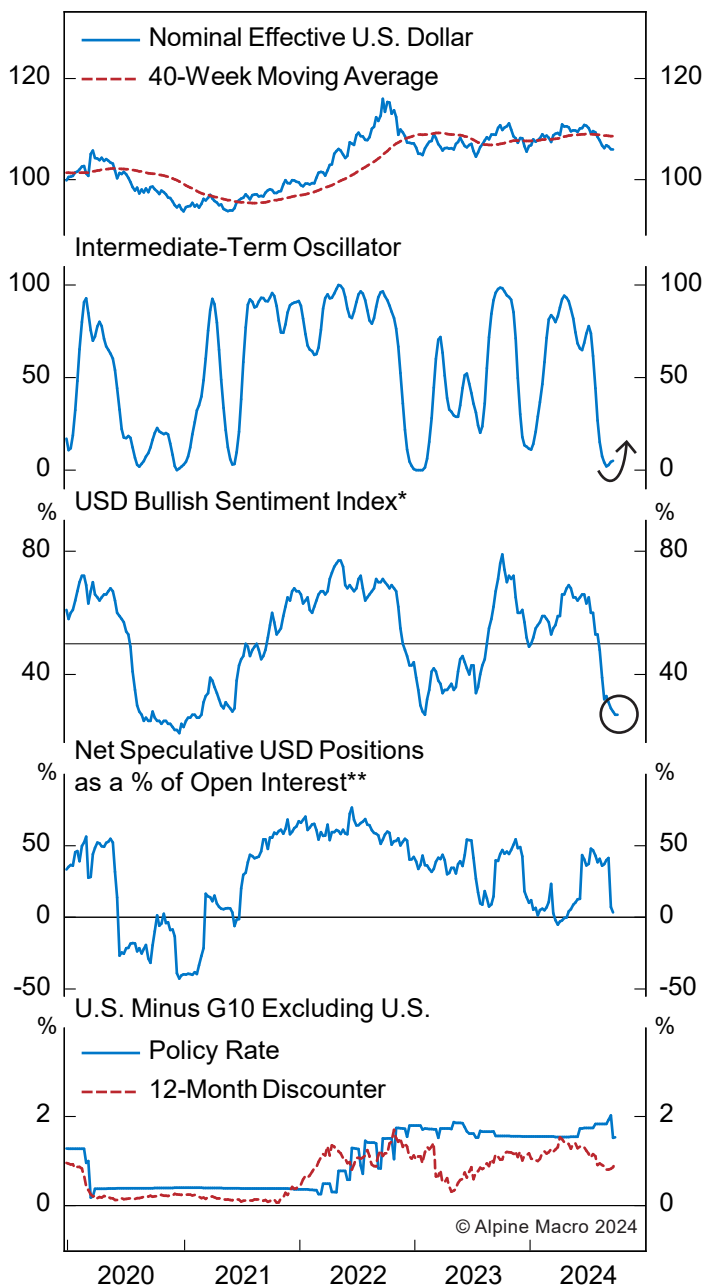
Canada



The Risk Indicator has risen to neutral. Canadian bonds are fairly valued and no longer oversold. Although the cycle index has bottomed, it signals sluggish growth.



U.S. Dollar

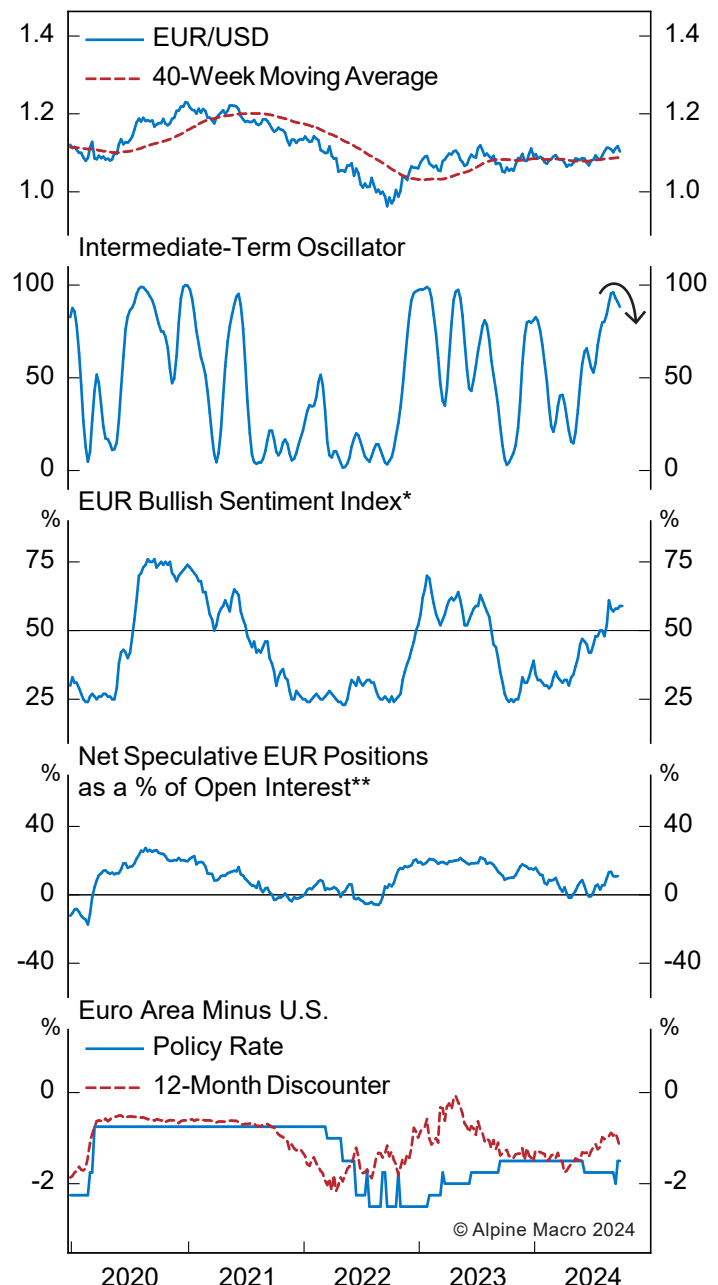


*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

Our indicators point to a technical bounce in the dollar. The intermediate-term oscillator is oversold and sentiment is at depressed levels. These are bullish signs from a contrarian perspective. Should the dollar fail to break back above the 40-week moving average, it will confirm that a cyclical bear market is getting underway.

EUR/USD



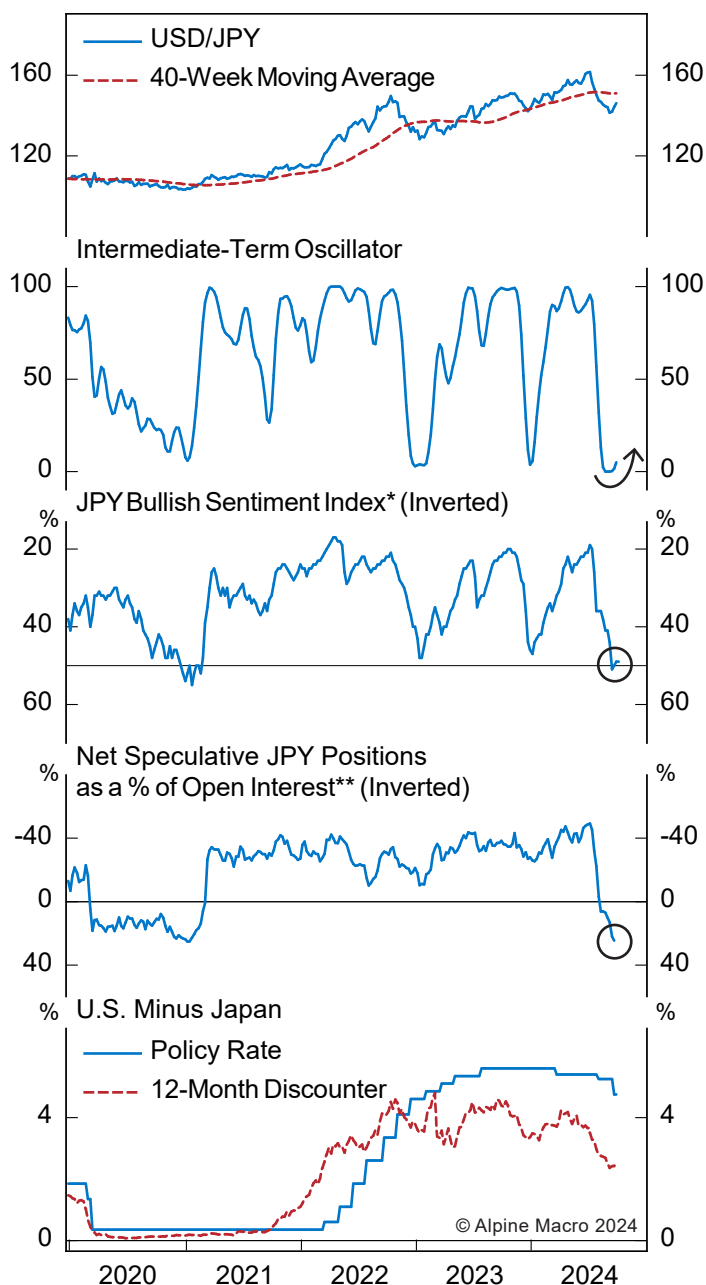
*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

The euro looks poised for a pullback. Our intermediate-term indicator is peaking at overbought levels. Any retracement needs to hold at the 40-week moving average for the euro to maintain a cyclical uptrend.



USD/JPY

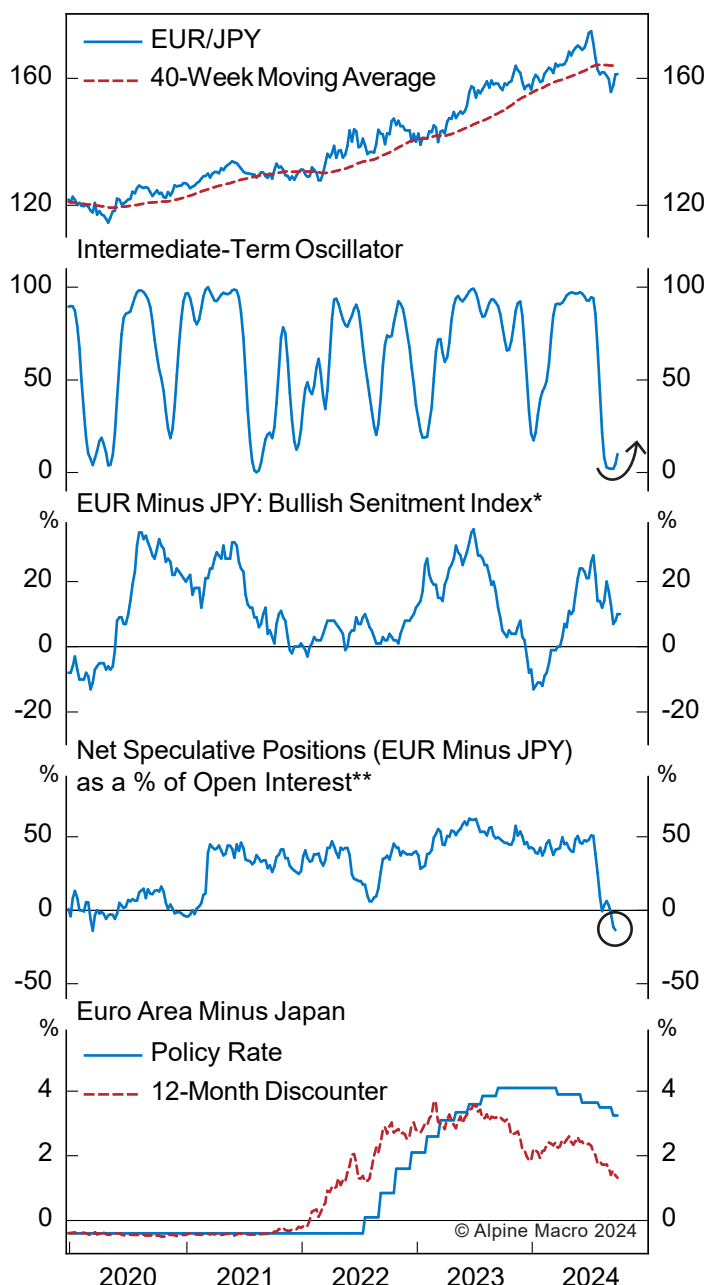


*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

Our indicators warn of an upside correction. Momentum is oversold, while sentiment and positioning have flipped sharply in favor of the yen. Beyond a technical correction, USD/JPY needs to hold below the 40-week moving average to signal that the primary trend has turned down.

EUR/JPY



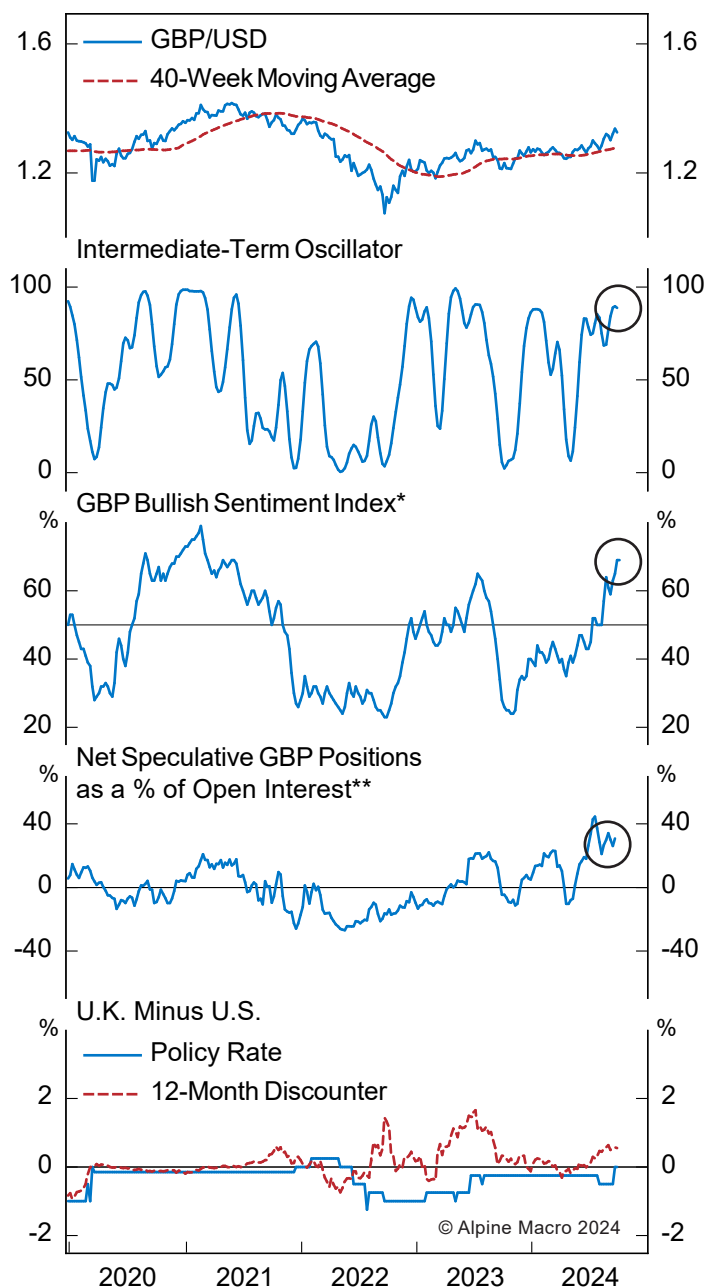
*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

The intermediate-term oscillator for EUR/JPY is oversold, while relative positioning has swung sharply towards the yen. Although a bounce looks likely, the primary trend will remain down as long as EUR/JPY can hold below the 40-week moving average.



GBP/USD

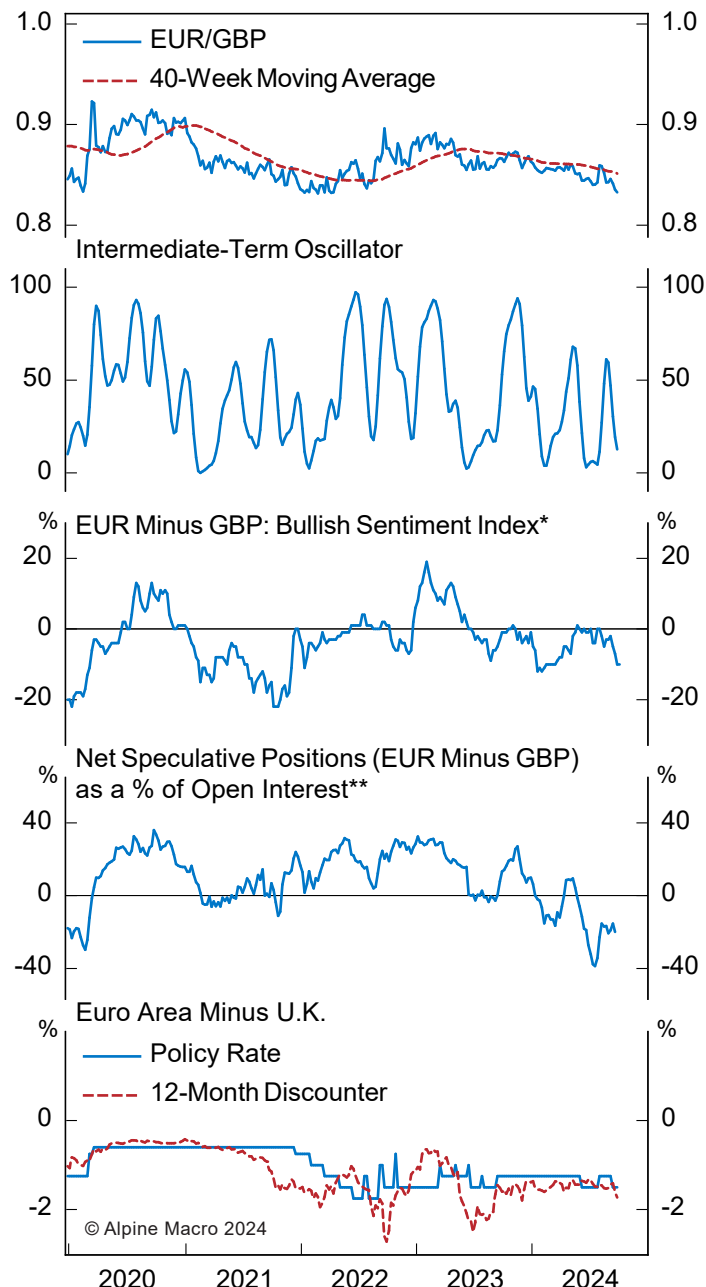


*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

Cable is ripe for a pullback. Our intermediate-term oscillator is overbought, sentiment is bullish, and specs are loaded up with long sterling positions. However, the primary uptrend will stay intact until GBP/USD can break below the 40-week moving average.

EUR/GBP



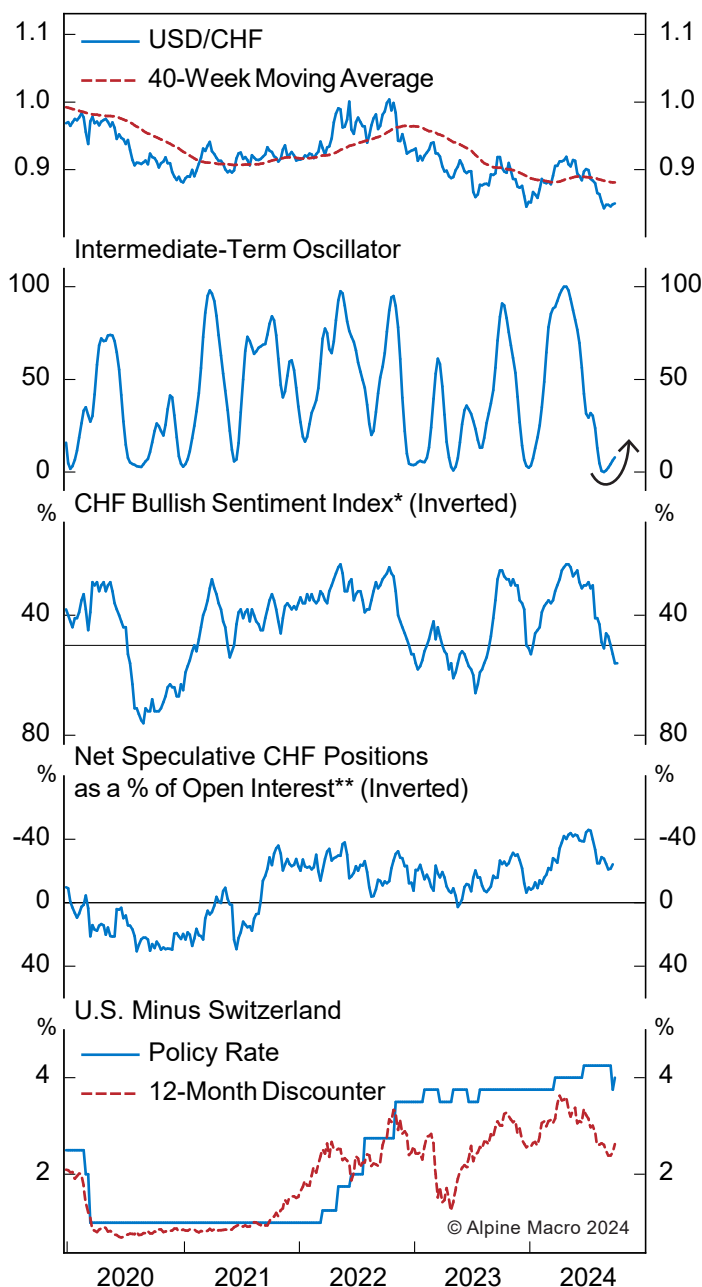
*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

The primary bear market remains in place with EUR/GBP holding below the falling 40-week moving average. But some type of consolidation or retracement should be expected with our intermediate-term oscillator becoming oversold.



USD/CHF

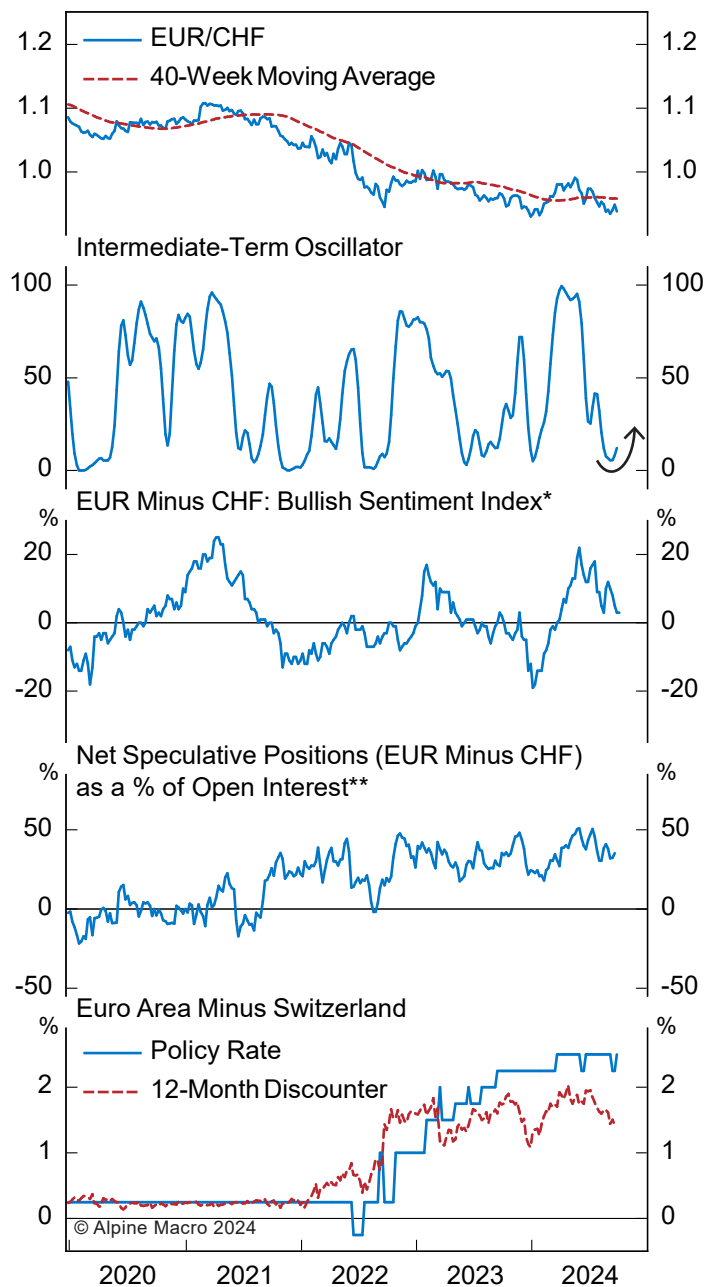


*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

USD/CHF is due for a bounce with our intermediate-term oscillator hooking up from oversold levels. Nevertheless, the primary trend is down with USD/CHF comfortably below the 40-week moving average.

EUR/CHF



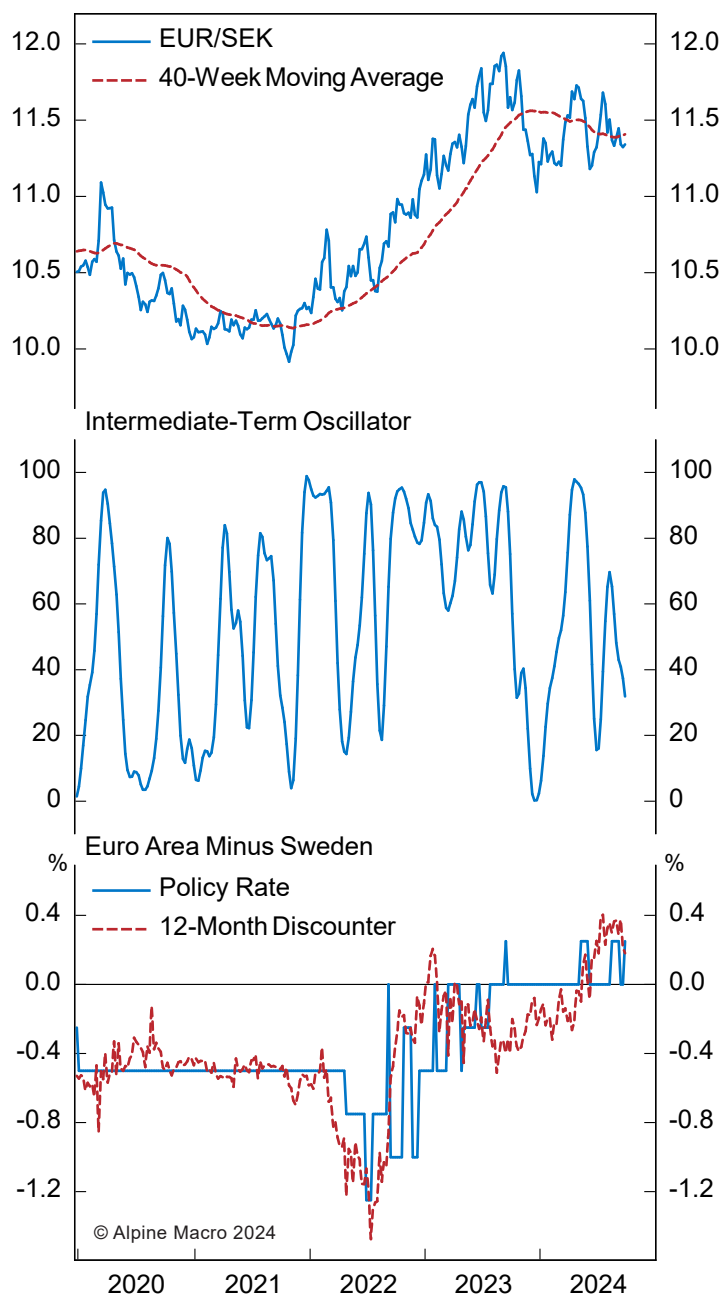
*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

The picture for EUR/CHF is similar to USD/CHF. Oversold momentum warns that some type of recovery is likely. However, with the cross below the 40-week moving average, the primary trend is downward.

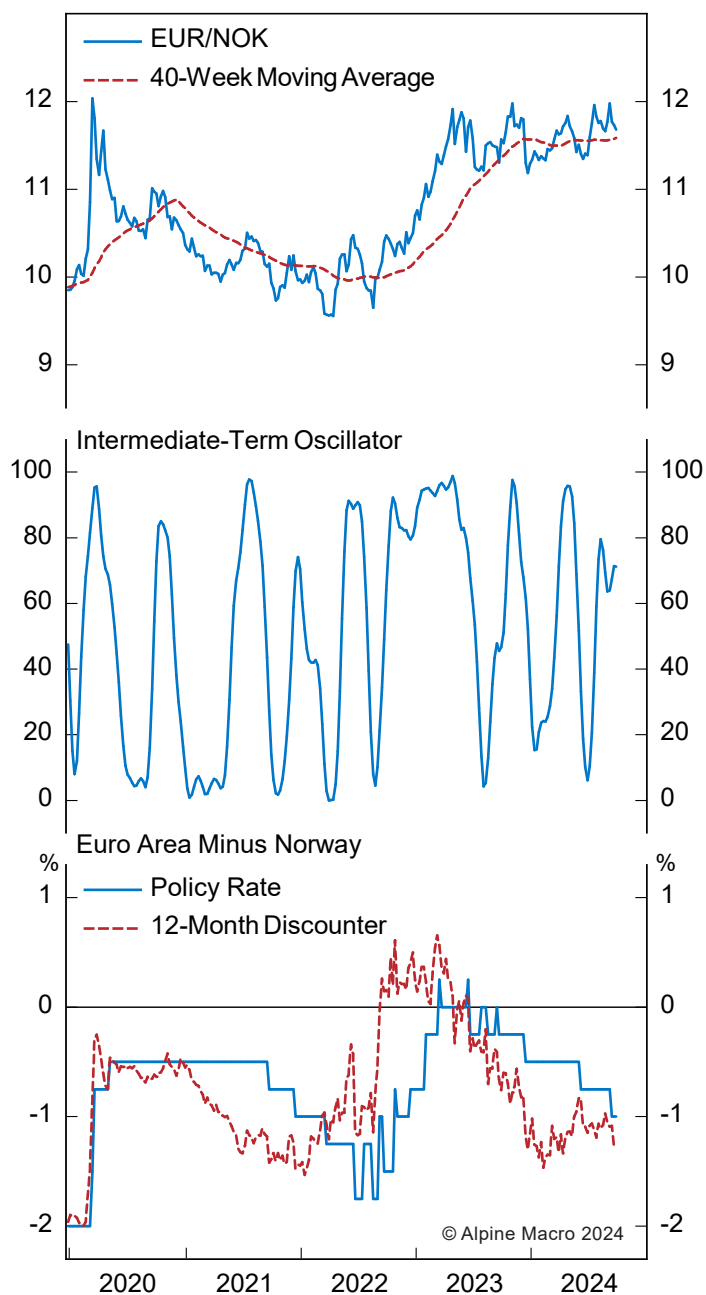


EUR/SEK



EUR/SEK is flirting with the falling 40-week moving average and our intermediate-term oscillator has more downside potential before becoming oversold.

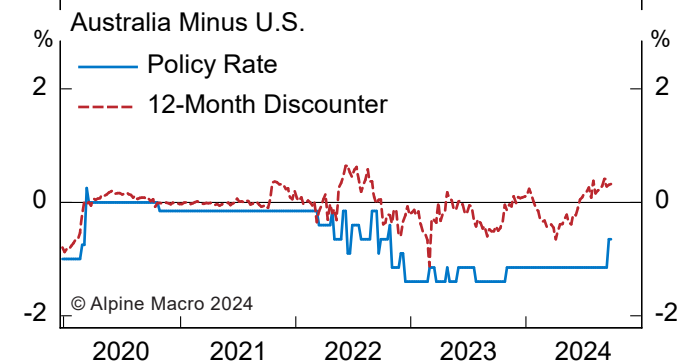
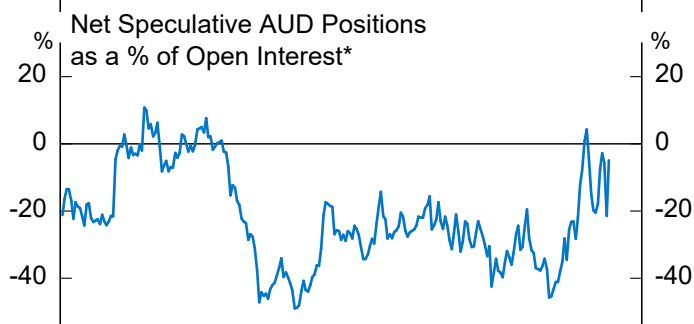
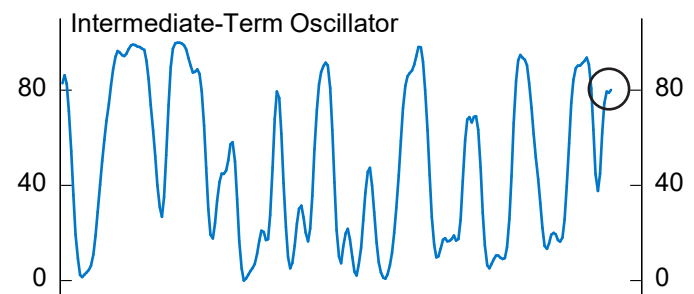
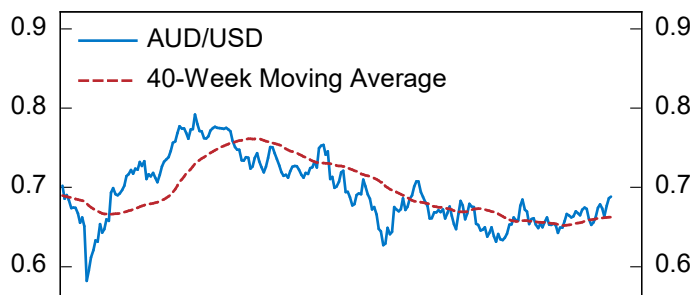
EUR/NOK



EUR/NOK has been gyrating around its flat 40-week moving average for the past year, signaling no strong trend.

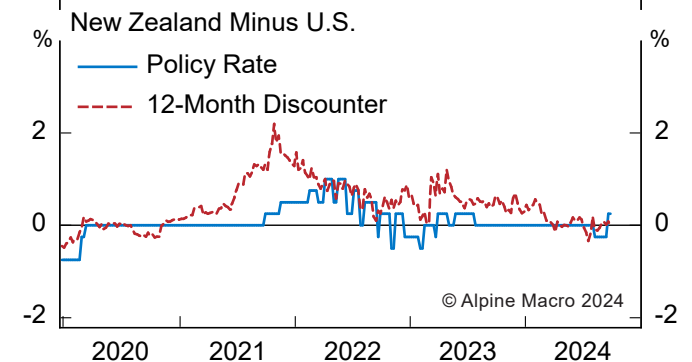
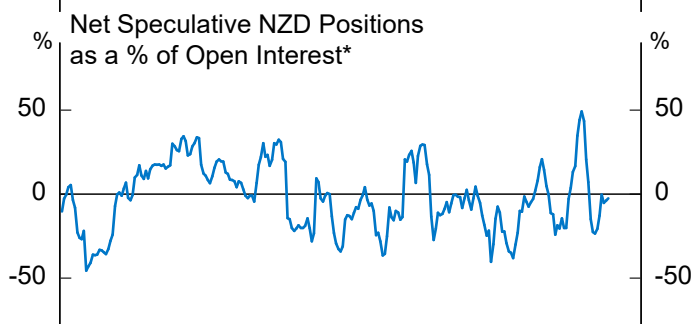
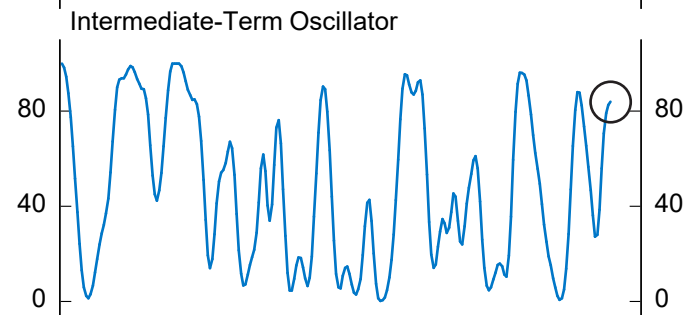
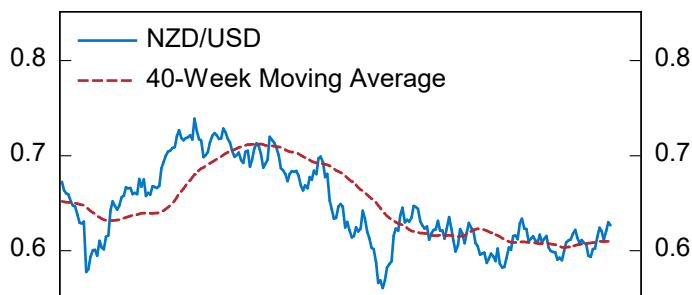


AUD/USD



*Source: Commodity Futures Trading Commission

NZD/USD



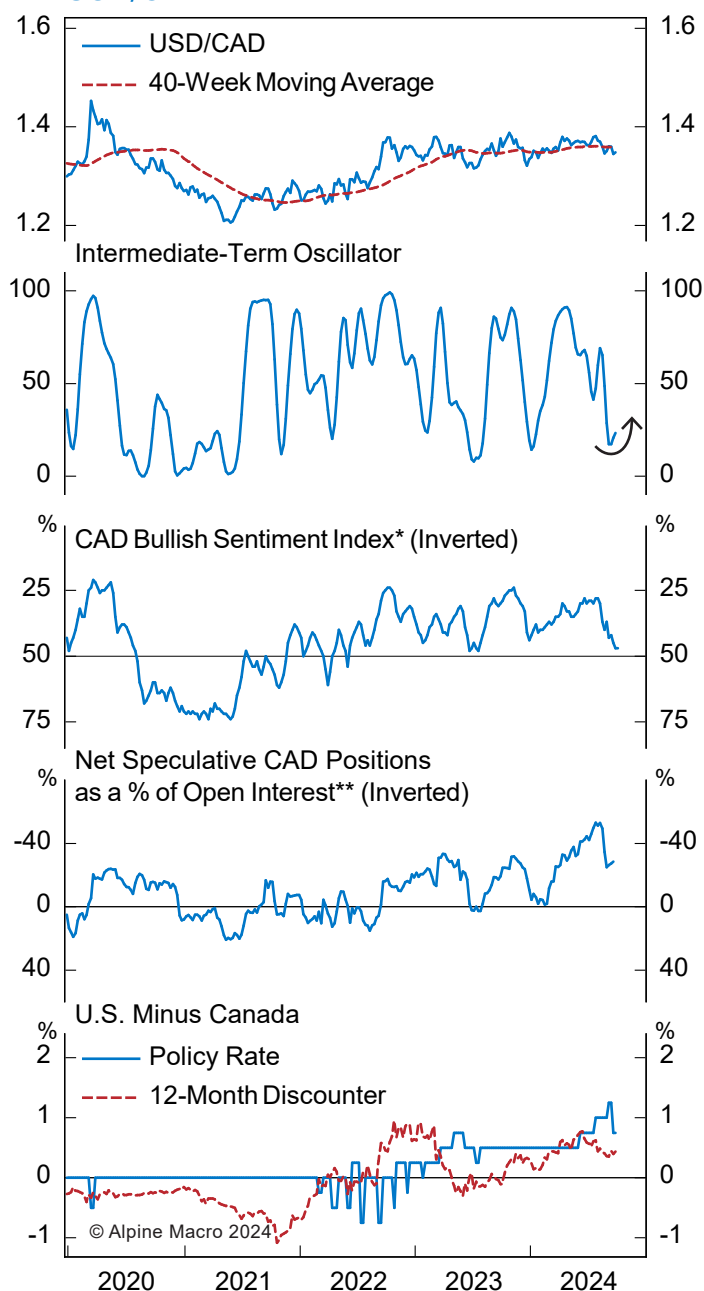
*Source: Commodity Futures Trading Commission

AUD/USD could be due for a consolidation or retracement with our intermediate-term oscillator nearing overbought levels. The Aussie has broken above the 40-week moving average and it needs to hold above this key support level to indicate that the cyclical bear market is over.

Similar to the Aussie, the intermediate-term oscillator is becoming overbought. If the Kiwi can hold above the 40-week moving average, it would signal an end to the bear market.



USD/CAD

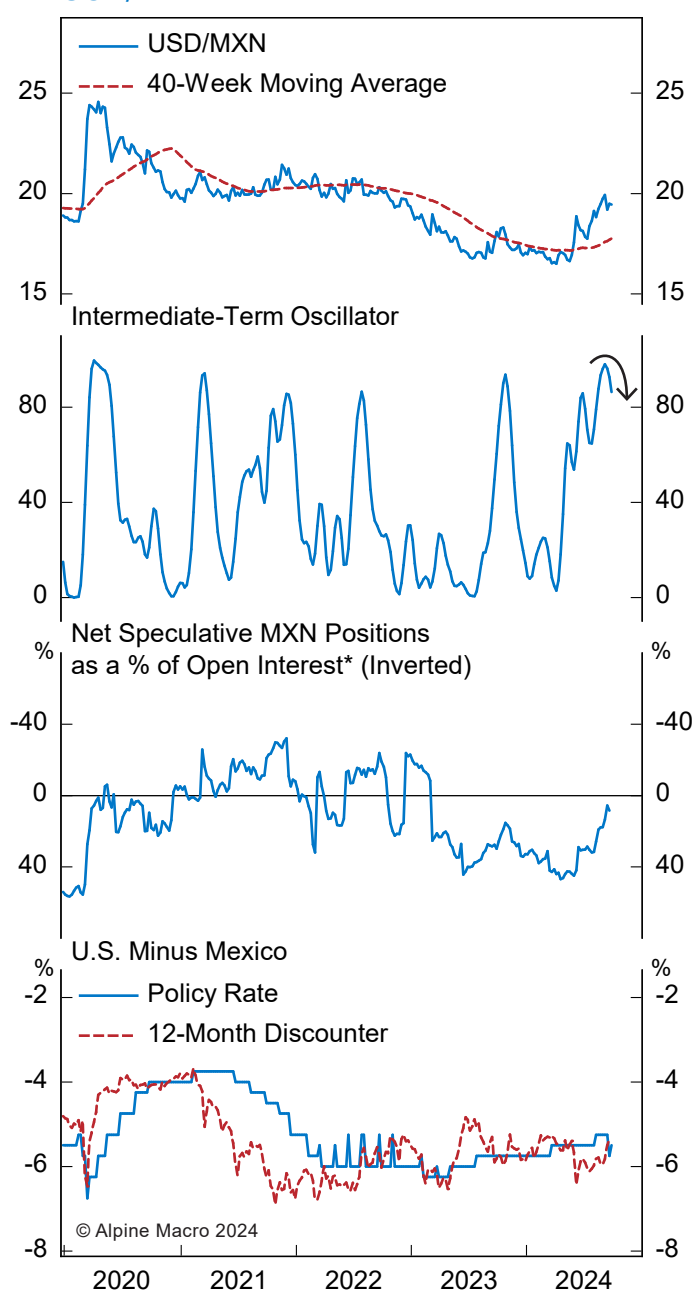


*Source: Consensus-inc.com

**Source: Commodity Futures Trading Commission

The oversold intermediate-term oscillator warns that a bounce could be in store. From a big picture perspective, USD/CAD has been trendless, hovering around the flat 40-week moving average.

USD/MXN



*Source: Commodity Futures Trading Commission

The intermediate-term oscillator is overbought and indicates that USD/MXN's sharp rally is due for a retracement. From a cyclical perspective, the break above the 40-week moving average suggests that the cyclical bear market is over.



Currency Outlook

Vs THE DOLLAR		
	1-3 Months	9-12 Months
EUR	UP	UP
JPY	UP	UP
GBP	UP	UP
CHF	UP	UP
CAD	FLAT	UP
AUD	UP	UP
NZD	UP	UP

Vs THE EURO		
	1-3 Months	9-12 Months
JPY	UP	UP
GBP	UP	UP
CHF	UP	UP
SEK	FLAT	UP
NOK	FLAT	UP

Fixed-Income Outlook

OVERALL PORTFOLIO DURATION	
AT BENCHMARK	
COUNTRY ALLOCATION*	
U.S.	43
Japan	1
Eurozone	34
Core	45
Periphery	2
U.K.	3
Switzerland	2
Norway	2
Sweden	3
Canada	4
Australia	4

* Numbers denote allocation where 1 = maximum underweight and 5 = maximum overweight

Currency Positions							
Recommendations	Open Date	Open Level	Target	Stop	P&L		
					Spot	Carry	Total
Long AUD/NZD	2019-04-29	1.0574	1.2000	-	4.13%	-4.05%	0.08%
Long Gold	2022-03-04	1,928	-	-	37.77%	-	37.77%
Short USD/JPY	2024-08-23	146.23	-	-	-0.29%	-0.58%	-0.87%
Long GBP/USD	2024-08-23	1.3094	-	-	0.24%	-0.03%	0.21%
Long AUD/USD	2024-09-27	0.6896	-	-	-0.71%	-0.01%	-0.72%

Fixed Income Positions						
Recommendations	Open Date	Open Level	Target	Stop	P&L	
Long 2-Year/Short 10-Year U.S. Treasuries	2022-12-02	4.24%/3.51%	-	-	86.87 bps	





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