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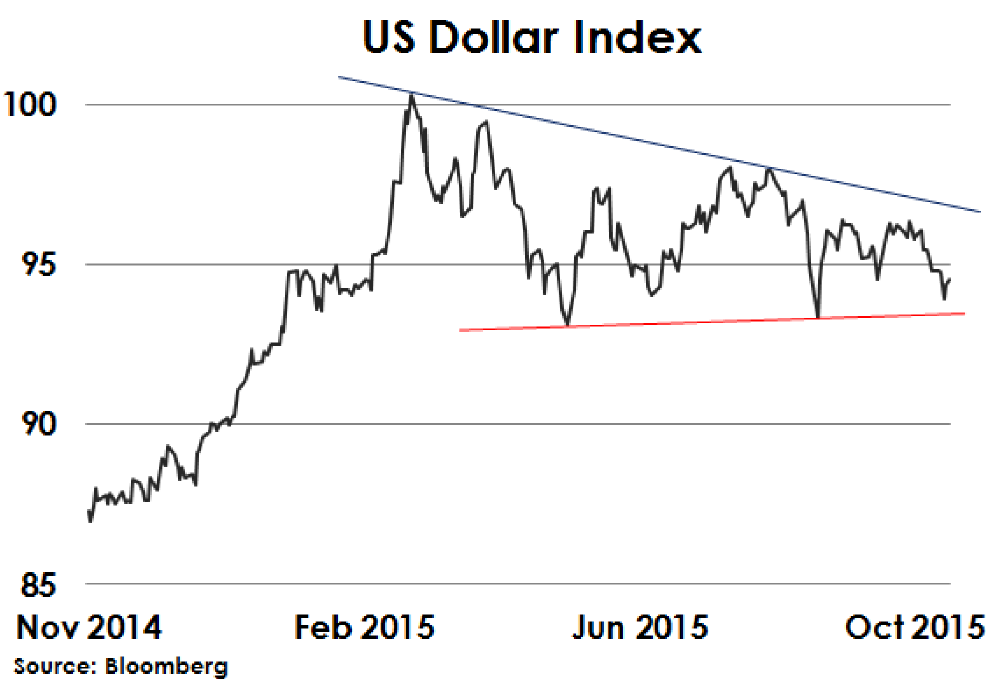
Weekly Market Recap for October 16, 2015

A key development for markets recently has been the weak US dollar. The drop in the USD allowed commodities and emerging markets to rally and it's being called a reversion trade by market pundits (they were down all year and just getting a bounce into year-end). This reversion trade is widely viewed as investors repositioning themselves after the Fed's surprise move to not hike rates. The way I see it is this rally in all things hated (emerging markets, commodities, etc.) is entirely depended on the direction of the US dollar which has failed to make new highs and is now looking vulnerable, see the chart below.



Currently the three most crowded trades are long the US Dollar, short emerging markets and commodities. In reality, these are all the same trade; when the US dollar goes up, commodities and emerging markets go down. The one thing that could go wrong for all these trades and catch a lot of investors offside is the US dollar breaking down further. With investor expectations and positioning in the

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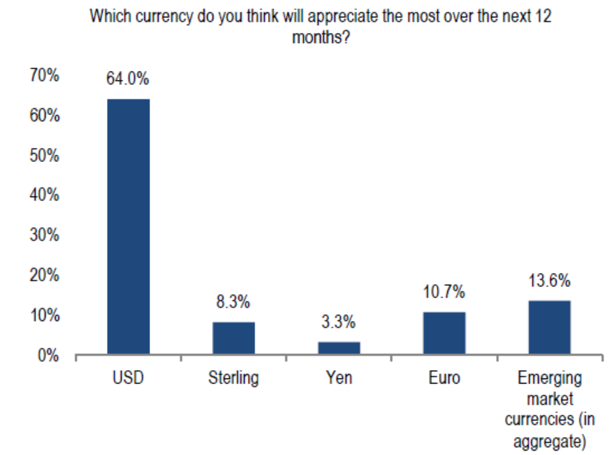
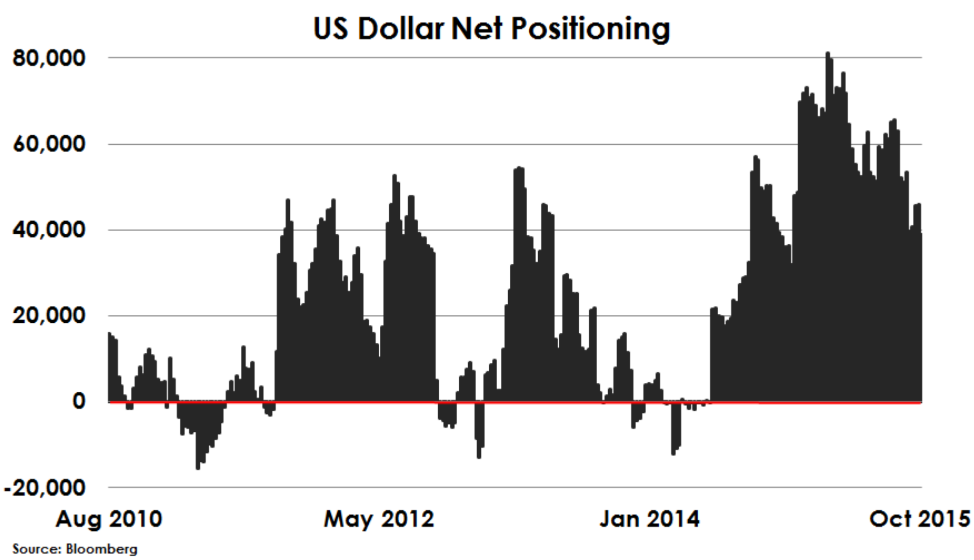
USD at elevated levels (see the charts below), a dollar selloff could be coming soon as the market likes to move against trades that seem like 'slam dunks'.

Bullishness on the dollar was a strong consensus view among those surveyed



Source: Credit Suisse Global Equity Strategy Investor Survey (September)



The fundamental event which could initiate a dollar selloff would be an announcement from the International Monetary Fund to include the Chinese Yuan in the SDR basket (see my post [here](#) for more details). The last decision was made on November 15th, 2010 so we should expect similar timing for this year's decision. If included, roughly $1 trillion of global reserves will move into

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Yuan, largely out of US dollars. The decision would be positive for Chinese risk assets and by default, negative for the US dollar.

The US dollar is at a crossroads and the ongoing consolidation is running out of time. One way or another it will break out of the range and an unanticipated US dollar selloff would lead to significant repositioning and volatility.

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Weekly Market RunDown

Stocks	Price (today's close)	Weekly % chg	YTD %chg
S&P/TSX	13838.10	-1.01%	-5.43%
S&P500	2033.11	0.90%	-1.25%
Nikkei	18291.80	0.83%	4.82%
FTSE100	6378.04	-0.59%	-2.86%
Euro Stoxx50	3264.93	0.45%	3.77%
Shanghai Composite Index	3391.35	6.45%	4.84%
Emerging markets ETF	36.25	0.86%	-7.74%
Nasdaq	4886.69	1.16%	3.18%

Bonds	Yield	Weekly Net chg	YTD Net chg
Canada 10 year bond	1.46%	-0.06%	-0.33%
US 10 year bond	2.03%	-0.06%	-0.14%
Avg. cdn 5 yr mortgage rate	4.64%		-0.15%
US 30 year mortgage rate	3.80%	-0.09%	-0.19%

Commodities & FX	Price (today's close)	Weekly % chg	YTD %chg
Gold	1176.100	1.75%	-0.93%
Silver	16.020	1.28%	1.82%
Oil	47.160	-4.98%	-19.78%
USD/CAD	1.291	-0.26%	11.10%
EUR/CAD	1.466	-0.33%	4.23%
USD/YEN	119.480	-0.66%	-0.25%
EUR/USD	1.135	-0.07%	-6.18%

Gas	Price	Yest. Avg	Year ago avg.
US gas price at pump	2.28	2.29	3.16
Canada gas price at pump	1.15		1.31

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Reads of the Week

China's middle class overtakes US as largest in the world

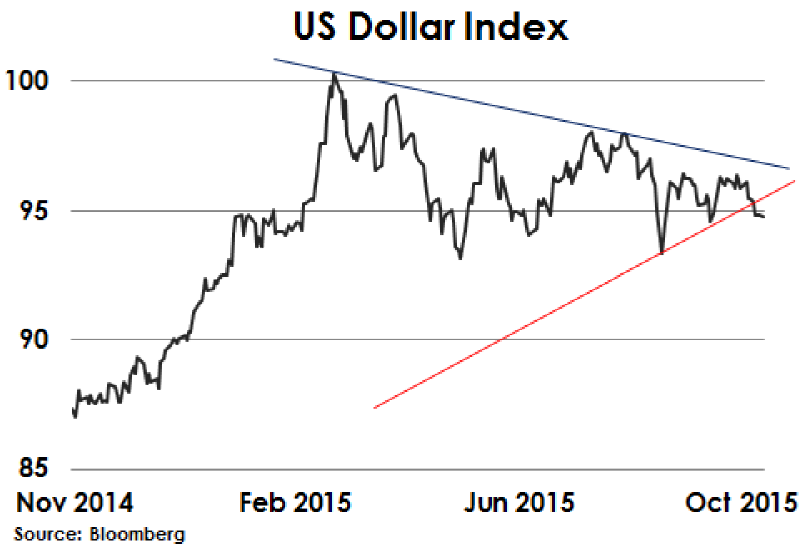
No one knows what the Fed is doing

World's biggest leveraged ETF halts orders on liquidity concern

This Week's Macro Thoughts

US Dollar at a crossroads

As I've stated many times this year, the direction of the US dollar is key to investing in the current environment and right now it's sitting at a crossroads. The chart below shows how the US dollar index (known as the DXY and shown with support lines drawn in) is down slightly since March and looks rather vulnerable here. What the US dollar does is key to any enduring strength in the recent emerging markets and commodities rally.



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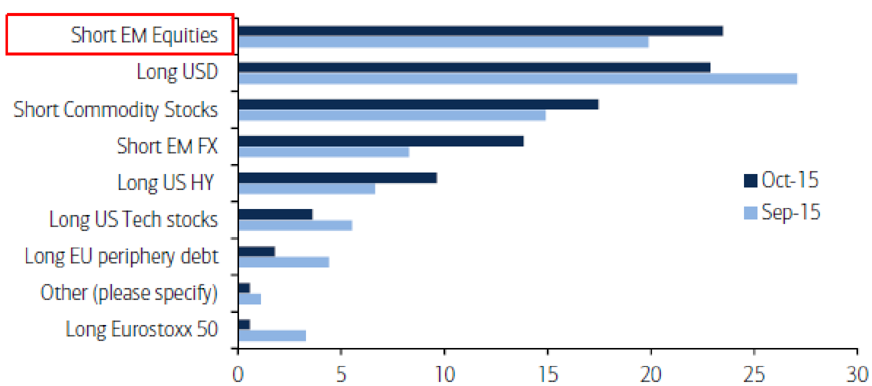
The current consensus view on the rally in emerging markets and commodities is that it is simply a reversion trade with investors repositioning themselves after the Fed's surprise move to not hike rates. Almost all market pundits believe this is a short-term rally that will end quickly. To me, it entirely depends on the direction of the US dollar.

A strong US dollar is very much the consensus opinion if you see the chart below. The top three trades are really all the same trade. US dollar goes up, commodities, emerging markets and emerging market currencies all go down. It is complete consensus and as we've seen over and over again, the market likes to move against trades that seem like 'slam dunks'.

What do you think is currently the most crowded trade?



Source: BofA Merrill Lynch Global Fund Manager Survey

The ongoing consolidation in the US dollar is running out of time and one way or another; it will break out of the range. How could the US dollar break lower and turn all of the above consensus trades flat-footed? I believe the International Monetary Fund's decision to include the Chinese Yuan in the SDR basket is one event that could break the strong dollar. See tomorrow's post about the SDR decision.

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China SDR decision coming soon

As I've covered on this blog before, see here, the decision to include the Chinese Yuan in the Special Drawing Rights basket is a significant development which will add volatility to markets. The source of the volatility will stem from the conversion of roughly $1 trillion is global reserves into Yuan, a large percentage of which would be US dollars sold to purchase Yuan.

Special Drawing Rights (SDR) is a basket of international currencies defined and maintained by the International Monetary Fund which acts as a reserve asset and internal accounting unit between the IMF and its members. The currencies which make up the basket are reviewed every five years.

Currently there is no set date for the upcoming SDR decision but it could be happening very soon; for reference the 2010 decision was made on November 15th. Once the Yuan is accepted into the SDR basket the decision would not be effective until September 2016, however markets will not wait until the effective date.

There is still the issue of whether the Yuan will actually be accepted into the SDR basket since the International Monetary Fund has to determine if the Yuan fulfills the criteria of "freely usable" (meaning is the Yuan widely traded and widely used in international transactions). However the International Monetary Fund has already extended the effective date until September 2016 to minimize market disruption if the Yuan is included, so it would be odd if they went through all this just to leave the current basket unchanged.

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China's providing a global boost

In response to weak Chinese economic data the yield on their 10 year sovereign bond broke through key support levels to 2010 lows. The Chinese bond market is signaling things aren't great as investors bought bonds seeking safety from the stock market crash.

China's policy makers have been trying to support economic growth and approved a spending package to drive infrastructure investment. These actions should provide a much needed boost to commodity prices.

CHINA YIELDS AT MULTI-YEAR LOWS

Source: Strategas Research Partners

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Wal-Mart crushed over outlook

On Wednesday Wal-Mart's stock price fell over 10% suffering its largest one day drop in 27 years. Wal-Mart surprised analysts by lowering profit guidance mainly due to investments in labour and in e-commerce. The company plans to spend $2 billion on e-commerce over the next two years as Wal-Mart tries to improve its position against Amazon in the online retail space.

There's a perception Wal-Mart is playing catch up with Amazon which has already passed Wal-Mart in terms of market cap in the S&P 500. The online retail space is growing and taking sales away from brick and mortar stores which is why Wal-Mart is trying to develop a presence. By the latest measures, online sales accounted for $78.8 billion of total retail sales, or roughly 6.6%. There is plenty of room for growth in online sales and Wal-Mart doesn't want to miss out.