

Dominating Dollar

The resounding story for the markets these last few weeks has been the unequivocal strength of the US dollar. The dollar closed higher Friday for the ninth straight week as it continues on its best run in 17 years. This has been the move in the dollar that many investment professionals were looking for as they anticipated the US Fed to end their Quantitative Easing program and begin to raise the Federal Funds rate, but the move in the dollar really did not come to fruition until the latter half of this year. That, however, is not the only story that has been supporting the strong dollar trade as a number of both domestic and international factors are weighing in on the foreign exchange markets.

The international story is based on the action of western central banks. As the US has passed their inflection point from making policy more to less accommodative, the question through the end of the summer has been what future measures will be taken by the European Central Bank and Bank of Japan? And unfortunately for the Bank of England, despite efforts by Governor Mark Carney to talk up the pound, a referendum on Scottish Independence on the 18th of this month has substantially weakened the pound translating to a stronger greenback.

On the domestic side it's perhaps investor's lax expectations that shifted this market. The San Francisco Fed put out a paper this week looking at how investors and futures markets were anticipating when

the Fed might begin to tighten policy and at what pace versus what members of the Federal Open Market Committee (FOMC) were actually saying in their most recent June meeting. What the San Francisco Fed found was that the market and investors are behind the curve in anticipating when the Fed will begin to raise rates. This is inherent in an expectation that the accommodative policy will be around longer than the Fed currently plans on delivering.

This all leads into what will be a very important week for the markets. The FOMC meets Tuesday and Wednesday, and following that on Thursday Scotland votes. No question, volatility which has been vacant from currency markets for so long is finding its way back. Accommodative policy from the world's most influential central bank had dampened volatility from the FX markets. As we've learnt, this had an effect of suppressing and stabilizing interest rates at record low levels. But as the Fed shifts back to a less discernible role in the markets, volatility in currencies will begin to rise.

The unknown going forward is what it means for the US dollar, and commodity prices, along with equities and the outlook for earnings of US companies, with a foreign income stream. The same questions holds true for most other financial markets. A stronger dollar provides headwinds and at this stage the dollar looks like it will continue to dominate.

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