BNY

iFlow

MACRO MORNING BRIEFING

December 6, 2024

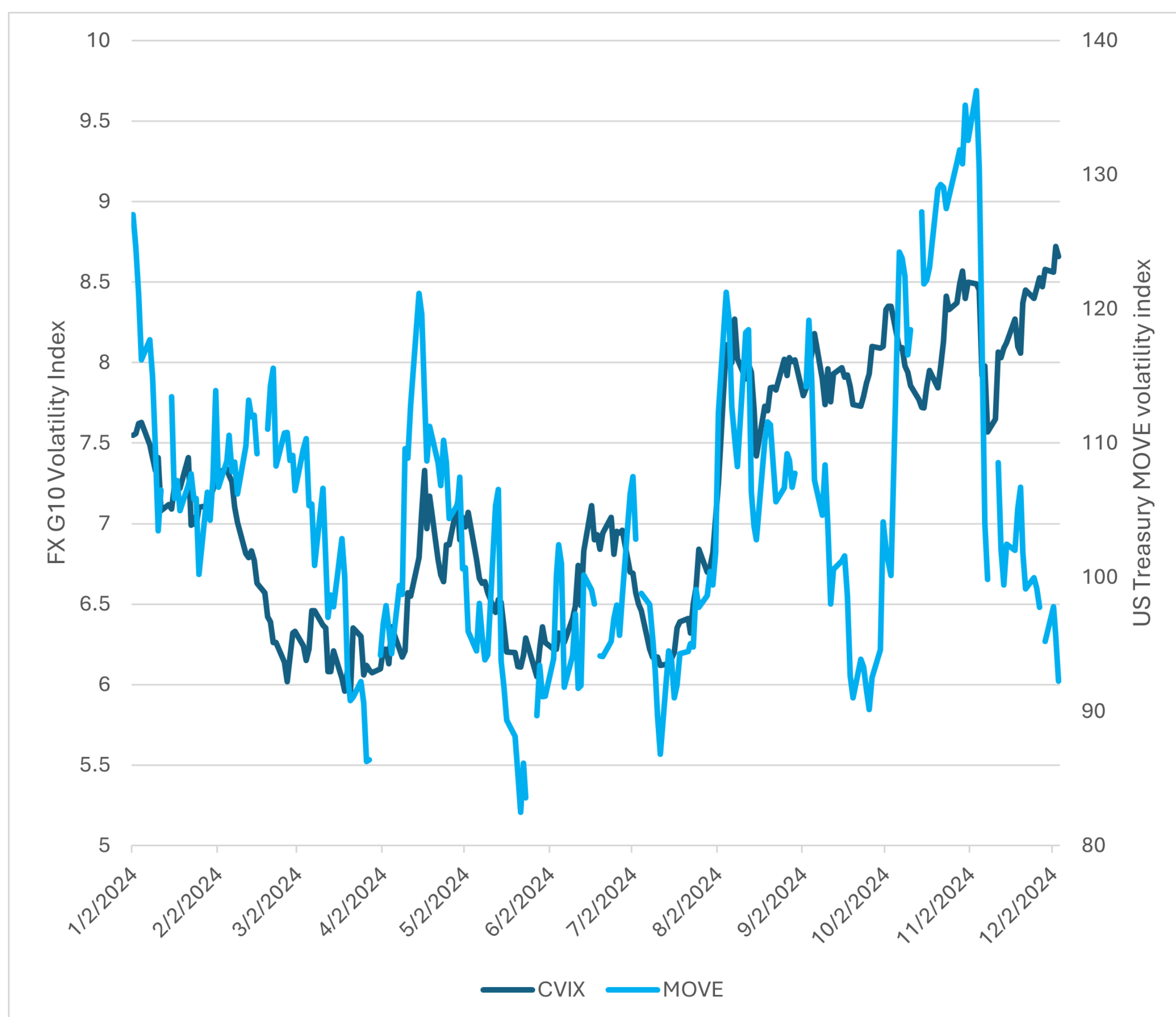
USD and Uncertainty

- The deviation of G10 FX volatility vs. Equity VIX and Fixed Income MOVE indices stands out as we end the first week of the last month of 2024. FX volatility is at a high for the year, while equities are near their July lows and the MOVE index is back to its September lows when the FOMC started easing.
- The correlation of USD to Global Equity flows from our data reveals abnormally negative correlation – the 26th percentile over the 20-year history. The negative relationship between USD gains and equity market pain globally matters for 2025.
- The move back up to neutral in carry and in trend factors for FX suggests the drivers for the USD are not about rates or momentum but something else – while our equity Mood index has moved even lower to 4th percentile lows.

The surprise events of December revolve around global political turmoil as the French government fell on a vote of no confidence, leaving Macron once again looking for a safe leader to form a new coalition. The declaration of martial law by South Korean President Yoon proved to be short-lived and leaves the leader facing impeachment risks. Both events highlight the difficulties around budgets and the divisions in local politics as well as the pressures globally on servicing debt and supporting financial stability. EUR weakness has been matched by our own iFlow outflows with the selling pressures the worst in a decade. KRW volatility has also been significant with the Bank of Korea offering unlimited liquidity and supporting the currency after the 1-month NDF started trading at over 1,444.

Beyond politics abroad, there is also the US exceptionalism at home driving the USD. US Q4 growth expectations, the shift in FOMC rate cut outlooks into 2025 and the growing consensus in markets that Trump policy will support USD gains like 2016 drive. But there are some headwinds as well as investors worry about valuation for 2025, fear that global weakness will hurt the profitability of some US global companies and expect rotation trades to start 2025 where underperformers beat winners in stocks and bonds. The link of USD uncertainty to Fed policy uncertainty worked well in explaining currency movements and risks until the US election. The breakdown of the correlation highlights how something is different as we head into 2025.

Exhibit #1: FX and Fixed Income Volatility

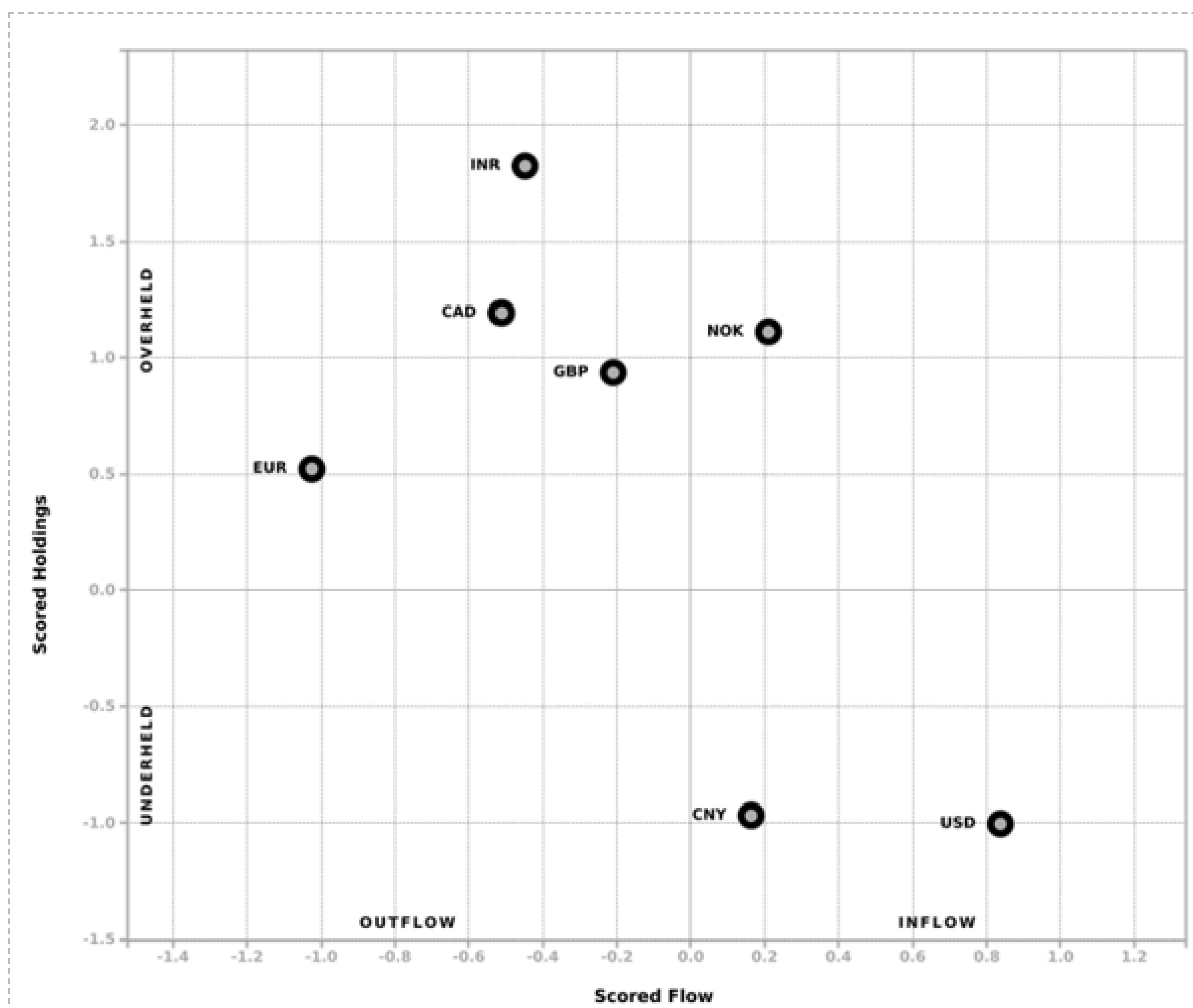


Source: Bloomberg, BNY

USD positioning is notable in that we have the smallest USD short since April 2023 when the Silicon Valley Bank led to a significant washout of US bonds and stocks

and USD short hedges. The rally up in the current dollar index and the unwinding of the short USD position match in iFlow as the last three months have been flat for US shares but that understates the turmoil across various currency pairs. The holdings in CAD remain long as do GBP and NOK. What happened in November is in EUR and INR. The way to show the moves in FX from November to now most clearly is in the shift of holdings in these pairs in iFlow. There is only one currency other than the USD now in a short-covering vector – CNY. This stands out as a significant warning shot for a market being one-way in USD views.

Exhibit #2: FX Scored Flows and Holdings

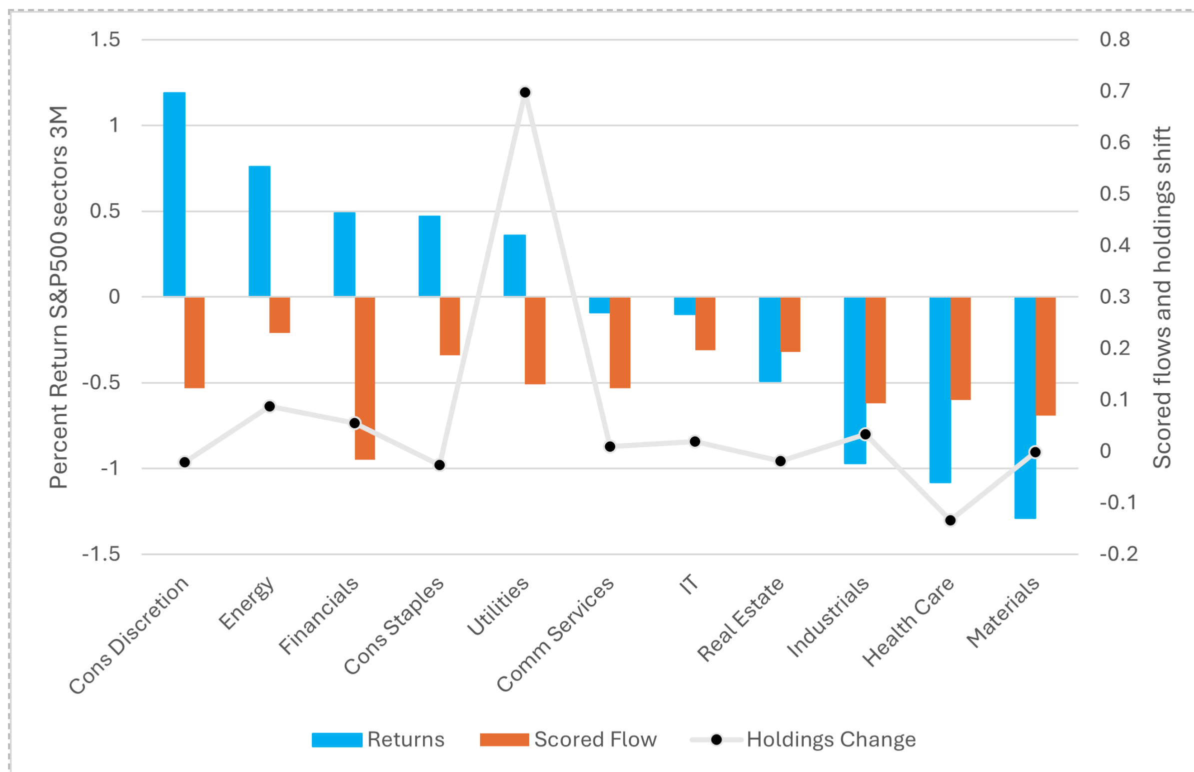


Source: iFlow, BNY

How the markets think about the uncertainty of 2025 starts with how they are positioned for it. This is where the iFlow database is a significant help for those looking around the corner for risks ahead. The valuation worries expressed by equity analysts for 2025 start with the US economic growth – as it accounts for 27% of the world's $88trn – but has 70% of the capital market in equities. Some of this can be explained by the global reach of US big tech companies. The sector earns almost 60% of its revenues outside the US and that looks important to risk ahead. One fear

is how President Trump's tariff plans play out into the year ahead and whether other nations react with similar actions potentially hurting corporate global revenue streams. We can see that the current equity holdings by US sector continue to highlight the role of technology. As we have discussed in previous briefs, the risks and rewards to a new administration are in how the cross-section of foreign revenues and current positioning and performance lead to a potential 2025 rotation trade for investors.

Exhibit #3: US Sector Returns and Holdings and Flows



Source: iFlow, Bloomberg, BNY

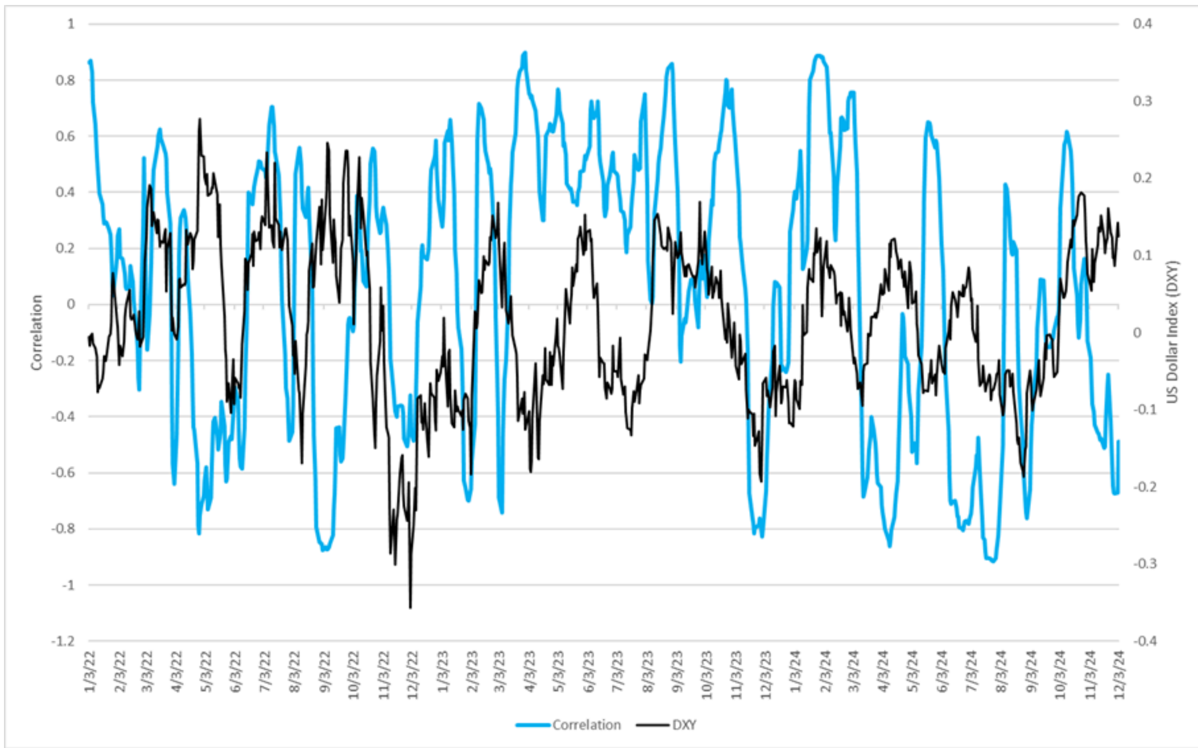
Outside the US, the asset allocation points to holding more growth stocks and fewer bonds. In addition, there is a correlation relationship between FX and global equities that drives how 2025 rotation risks work. The only FX market other than the USD seeing short covering is CNY. The difference between US and China views on equities is substantial. Growth outlooks for the US in 2025 have a consensus of 2.5% GDP and 2.5% CPI – 5% nominal, while in China the consensus forecast is 4% GDP and 1% CPI – also 5% nominal but that is below the 10-year average. Over the past 10 years, China has averaged a CPI of 1.8% and a GDP of 5.8% for a nominal of 7.6%, while the US over the past decade has had an average CPI of 2.8% and GDP of 2.4%, a nominal of 5.2%. But for the past four years, the US has had a

nominal of 8.4%, while the nominal for China during this period has been 6.3%. From a macro top-down analysis profit margins on top of nominal growth correlate to P/E. In the US, the S&P 500 has a P/E of 25.5 and a forward 12M P/E of 25.1, while in China the CSI 300 P/E is 15.9.

The uncertainty of policy shifts from taxes to tariffs has lifted FX markets into focus as a tool for adjustments beyond monetary or reactive actions to US changes. Many see the risks focused into a handful of currencies, but the correlation of the USD index to global equities stands out as an example of how modest cross-border hedging has been in the last quarter. The shift up in the USD and down in our flow correlations to global equities makes clear that investors are set up for ongoing USD gains. What's also clear is that correlations are not causation – with the relationship of the dollar to equity flows noisy and mean-reverting. The current negative correlation may have further to go but the duration of this is weeks, not months.

Bottom Line: As we peer into 2025 and look for opportunities, the USD and its relationship to other asset classes stands out as a barometer. Current volatility in FX markets is a warning sign for the relative calm in fixed income and equities. Fiat currency is the shock absorber for outside policy shocks. The rally up in risk assets and the hope that US growth continues regardless of new US administration shifts in fiscal and trade ahead seems too sanguine. Investors want clarity and liquidity to invest beyond the USD. There are upside risks to a recovery in China or Europe which could surprise in the year ahead, but they may also be in Japan or Brazil – as US exceptionalism looks expensive to the rest of the world.

Exhibit #4: US Dollar Index Flows and Correlation to Global Equity Flows



Source: iFlow, Bloomberg, BNY

Please direct questions or comments to: iFlow@bny.com

Disclaimer & Disclosures

Bob Savage
HEAD OF MARKETS STRATEGY AND INSIGHTS

CONTACT BOB

Can’t see the email? View online

iFlow
We can gauge how the world’s money moves.
Because a fifth of it moves through us.
Learn More
Contact Us

This email was sent to , and was sent by The Bank of New York Mellon 240 Greenwich Street, New York NY 10286.

We take our data protection and privacy responsibilities seriously and our privacy notice explains how we collect, use, and share personal information in the course of our business activities. It can be accessed here.

Your privacy is important to us. You can opt out from receiving future Newsletters by unsubscribing via this link at any time. You can also select the topics that you want to receive by managing your preferences.

This message was sent from an unmonitored email box. Please do not reply to this message.

Contact Us | iflow@bny.com

© 2024 The Bank of New York Mellon Corporation. All rights reserved.

This message was sent from an unmonitored email box. Please do not reply to this message.