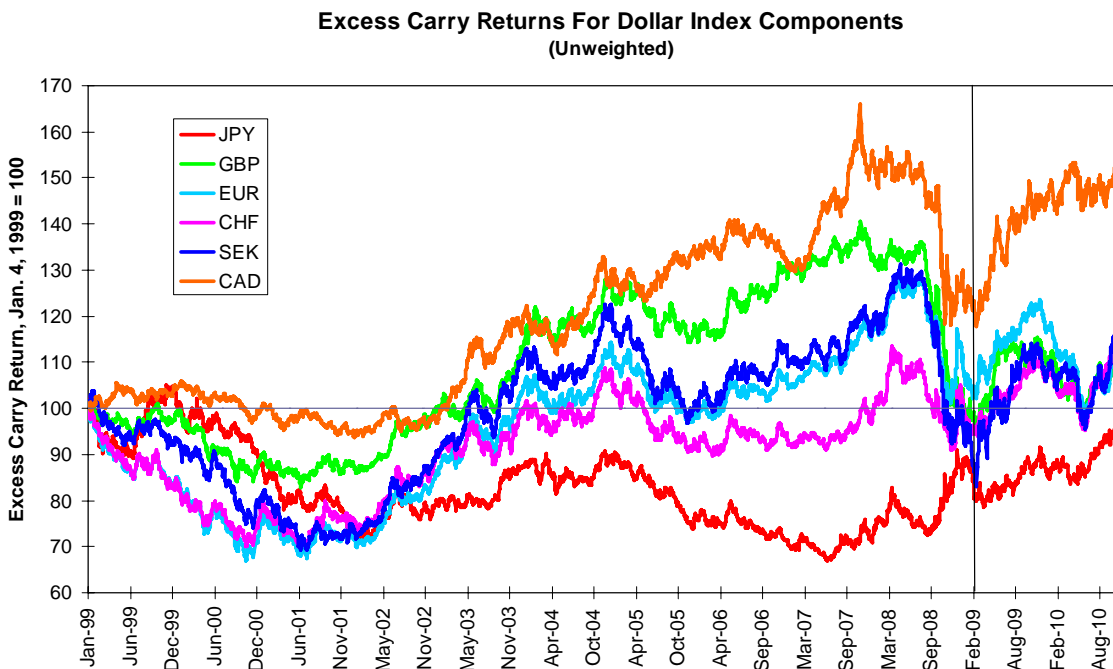


Hard To Hate The Dollar

When I say it is hard to hate the dollar, I mean it is hard to express your loathing of a currency undergoing legalized counterfeiting by going long the dollar index (DXY) or any ETF product based thereon. That includes leveraged ETFs or going short inverse ETFs or inverse leveraged ETFs. Is this a great country, or what: We cannot maintain the purchasing power of a green piece of paper to save our collective lives, but we can dream up all sorts of trading instruments while the Chinese are, oh I don't know, making things to sell us to get more money to buy more Treasury bonds at ever-lower yields to finance our ability to buy more of their stuff and to make the world safe for financial writers who know how to create really long run-on sentences such as the 96-word beauty you just finished reading.

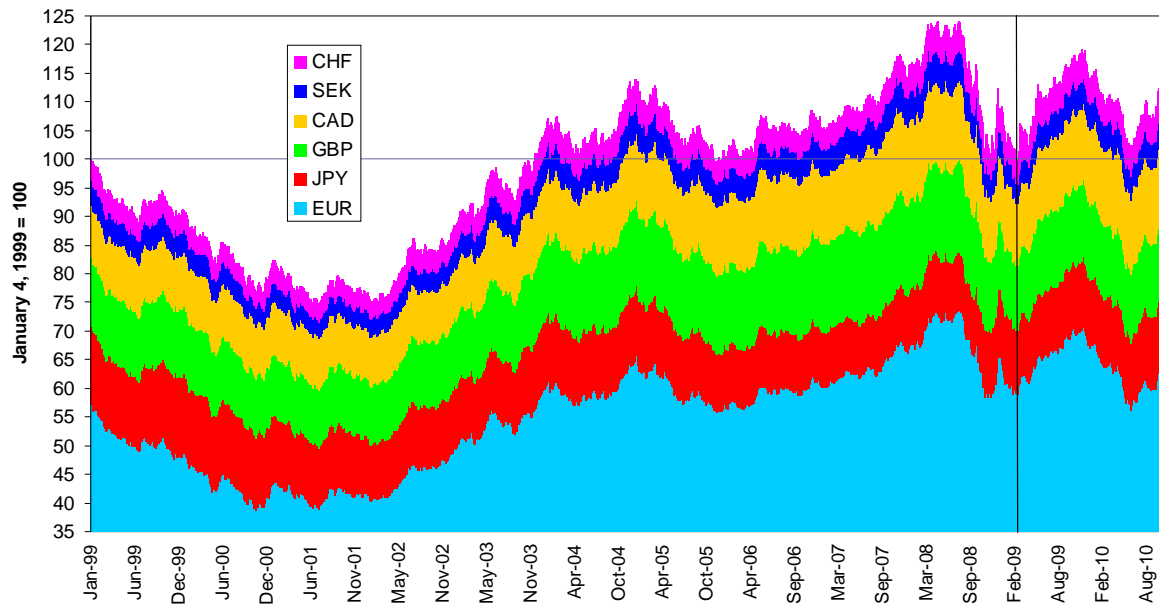
Whenever you go long the DXY in any form you are borrowing the dollar and lending into the basket of six currencies that comprises the index. The importance of this net lending portion of the trade is massive over time and can outweigh spot currency rate changes. Let's take a look at the excess carry return, a measure of net interest rate spread plus spot rate change less the Treasury bill rate for each of the six currencies since the January 1999 inception of the euro. The March 2009 date when the U.S. went to quantitative easing is marked with a vertical line.



Please note how the Canadian dollar and Japanese yen have gained the most since that date. As Japanese interest rates are as low as or lower than ours and as Japan has been printing yen just as we have been printing dollars, we can attribute this gain to spot rate changes. The Canadian dollar's gains are attributable to Canada's higher interest rates.

Now let's weight these excess carry returns by their weight in the dollar index. Incredibly, the net excess carry return for going long the dollar index peaked in mid-2008 and has yet to recover that high despite our best efforts at driving the dollar somewhere into the earth's mantle and quite possibly that molten iron-nickel core we have read about but no one has ever seen.

Excess Carry Return For Dollar Index Components (Index-Weighted)



If our good friends at the European Central Bank, an organization I am sure holds its meetings in a round room so everyone can keep their back to the wall, find a way to join the money-printing party, all bets are off. The gains on the DXY will stall as everyone will win some sort of prize – I suggest Lady Gaga’s unrefrigerated meat dress – for weakening their currency. Explain that idiot-fest to the proverbial Man from Mars.

So while you are embarrassed about the dollar, remember stupidity does not stop at the water’s edge; other central banks are cranking up the printing presses, too. This is why hating the dollar is so hard: You have to love something else made from paper unless you truly believe more than six billion people are going to start lugging around sacks of gold coins.