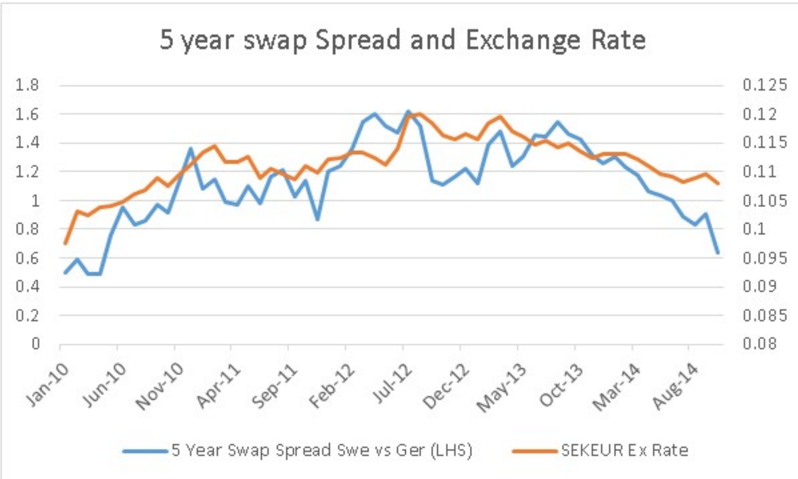
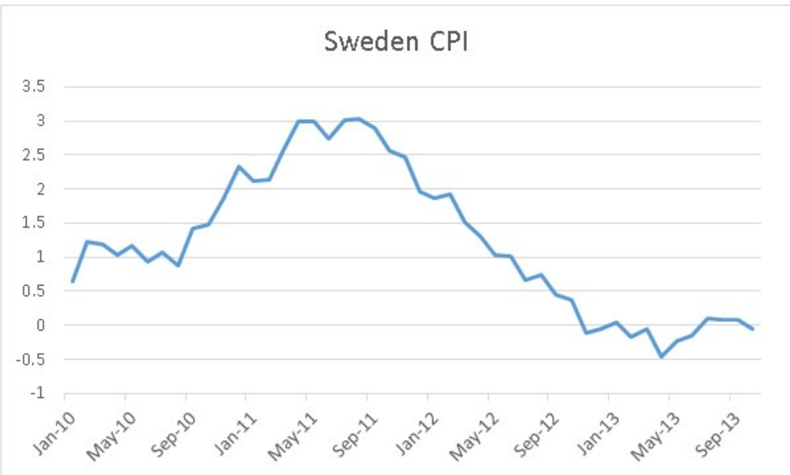
HORSEMAN CAPITAL MANAGEMENT

THE CASE FOR SHORTING THE US DOLLAR

Since the financial crisis we have had two western nations threaten or actually exit zero interest rate policy (ZIRP). The first was Sweden. Sweden started raising rates in 2010 as inflation increased and worries about increasing household debt caused the Central Bank to raise rates.

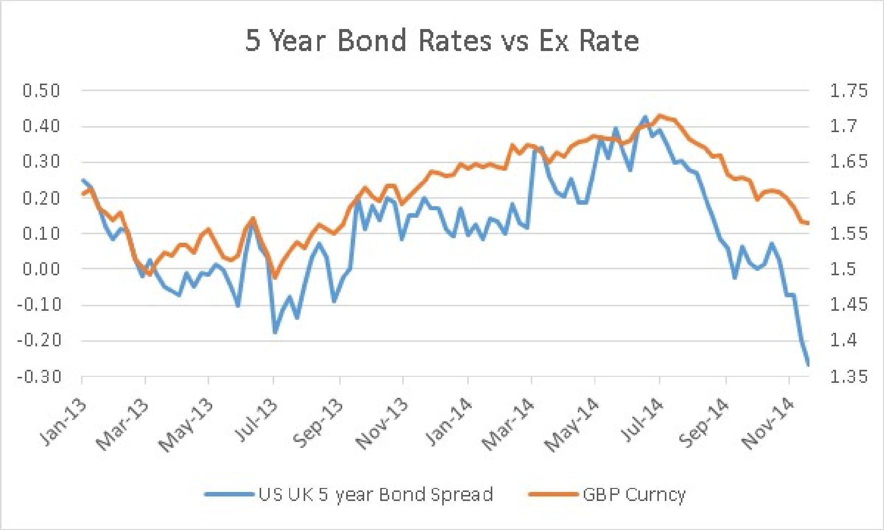


The rise in interest rates made the Swedish Kroner appreciate, so much so that inflation collapsed and the Swedish Central Bank reversed policy and now has negative interest rates to depreciate the Kroner.

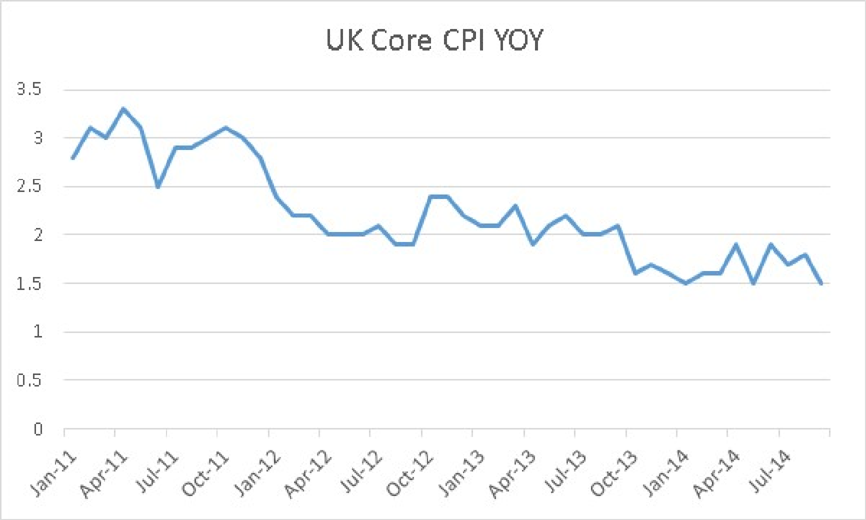


The second western nation that attempted to exit ZIRP is the UK.

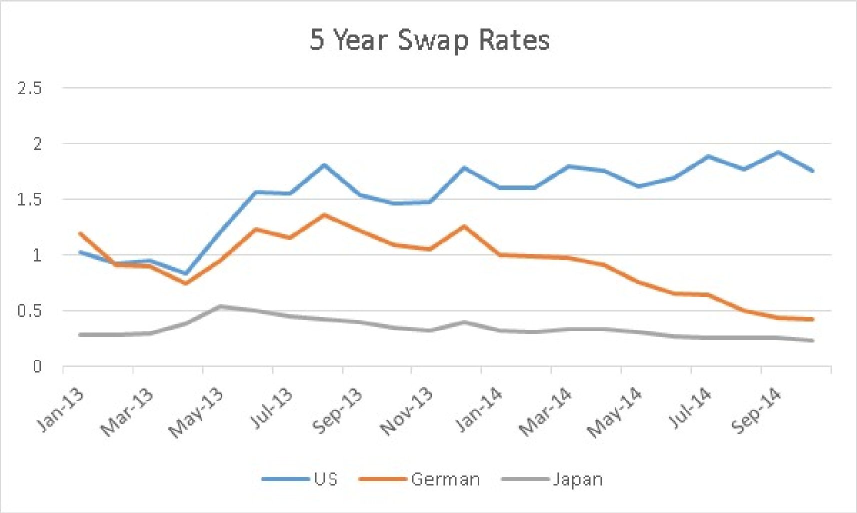
UK inflation has generally been higher, and, driven by London, UK property prices have recovered more than most other developed nations. This led to the Bank of England signalling that interest rates would rise sooner than the market expected. This drove a widening in the 5 year bond rates between the US and UK, and a rally in the Pound.



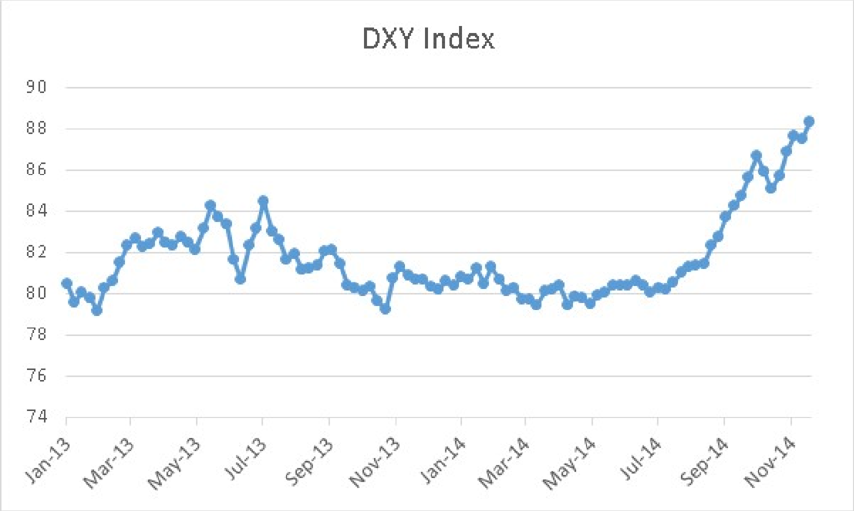
Unfortunately the higher pound led to a collapse in inflation, and lower inflation.



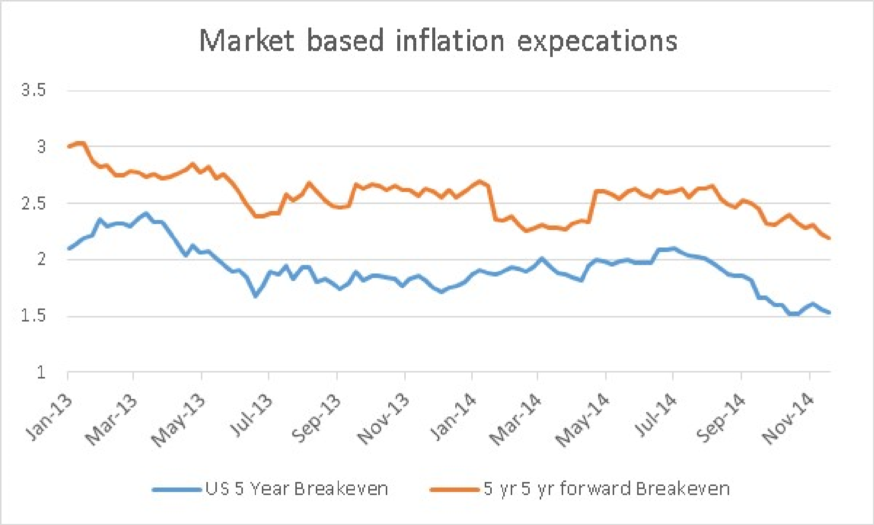
The market has noticed that both the Bank of Japan and the ECB are signalling further easing, while the US has exited QE and is thinking about raising rates in either 2015 or 2016. This can be seen in the respective 5 year swap rates.



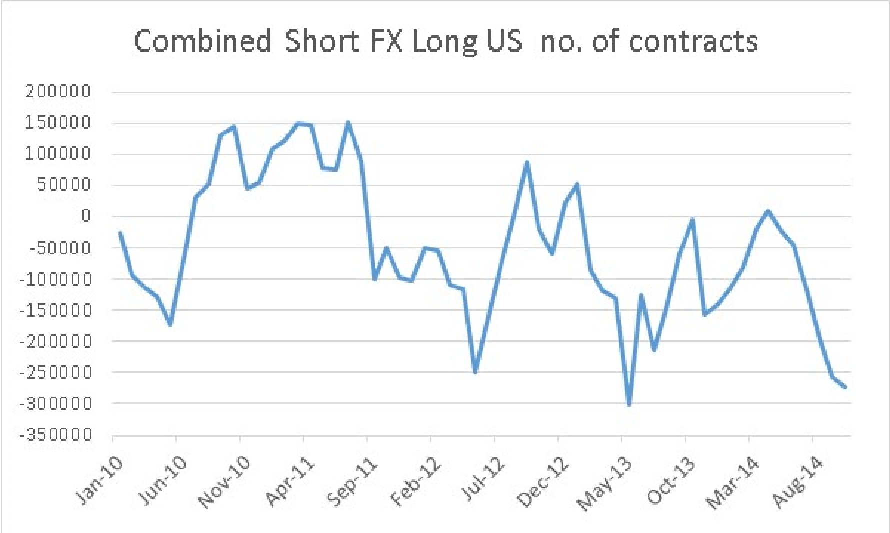
This had the effect of causing a sustained rally in the US dollar. Below is the DXY Index which is US Dollar Index based on USD exchange rate against major world currencies.



Market based measure of inflation is moving lower in the US.



To get an idea of total USD position I combine Euro, Yen, Sterling and Aussie net shorts together. As can be seen below, the market has rarely been more long the USD.



The big risk for the market going into 2015 is that US inflation data weakens substantially, leading the market to expect smaller interest rates increases in the US and causing the US dollar to fall. In the UK and Sweden, inflation slowed about a year after we began to see spreads widen. If that holds for the US, then we should see inflation fall in the US about now.

INFORMATION

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