Dearest Dollar-Wither and Hence-First published in Forex Journal-January 2010

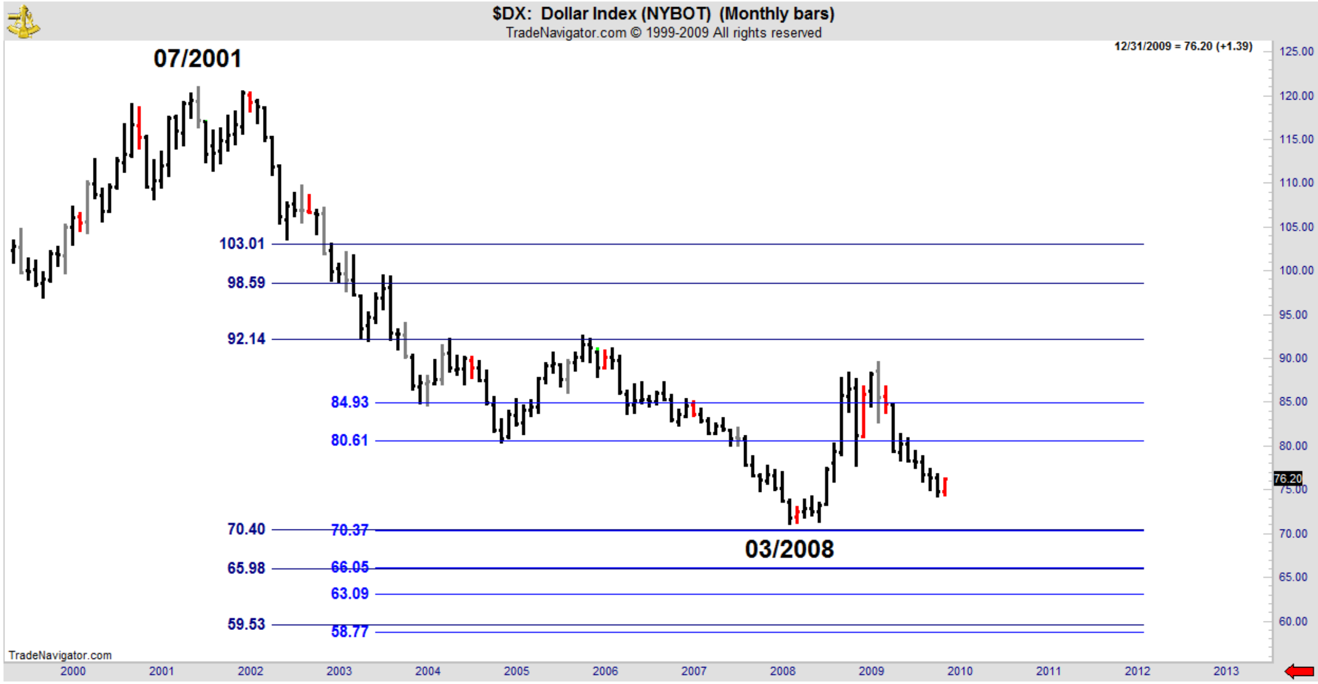
Today we look at the US Dollar Index (DX), its travails and triumphs over the past 18 months and its likely path for 2010 and beyond. I will show you what a valuable and underrated tool this market is for traders and investors alike, and the building blocks that you should consider in assessing what the future holds. Some of these considerations are of a fundamental nature, those prized by economists and talking heads. Whatever their absolute truth, market “fundamentals” are the most useless of all trading tools as they inevitably fail to account for “Time”. Many scoff at the notion that timing is necessary let alone possible, but as you will see, “Time” to traders is almost important as “Price”, both major weapons in the traders’ armament.

Price-The 1st Degree of Trading

Nothing is more important than Price, the 1st degree of trading. Whatever assumptions or insights we may get from our other trading weapons, price is always paramount. Price is what pays. You can’t go to your wife or girlfriend and say “I made 62 days of trading time today, and here’s a nice diamond bracelet!” Only price action is rewarded in trading and investing, although knowledge of time and angles can finesse our entries.

The Danielcode is primarily about Price. The unique mathematical matrix that is the Danielcode creates secret price levels that markets know and recognize but that others do not see. That’s our edge.

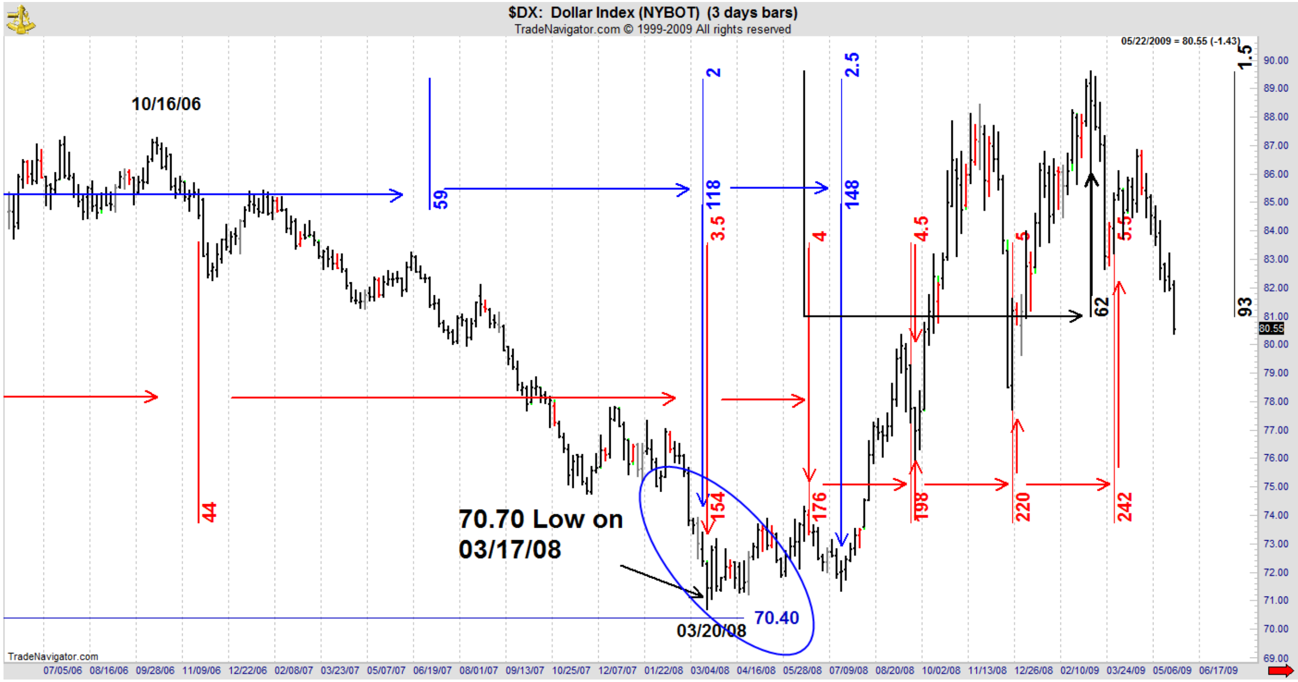
DC price numbers control all markets in all time frames, so let’s see the possibilities for DX as we wander down the lane of insights. This is the monthly chart for DX that has been controlling the major price swings since July 2001. I first published this chart in February 2008 with the expectation that 70.40 would be an important low. And so it has been, as traders both in this market and in Gold know only too well. Just 2 major DC price sequences have controlled this market for the past 8 years. And they will likely continue to control its destiny. The darker blue lines have been and continue to be the dominant price cycles with the lighter blue lines providing inflection points.



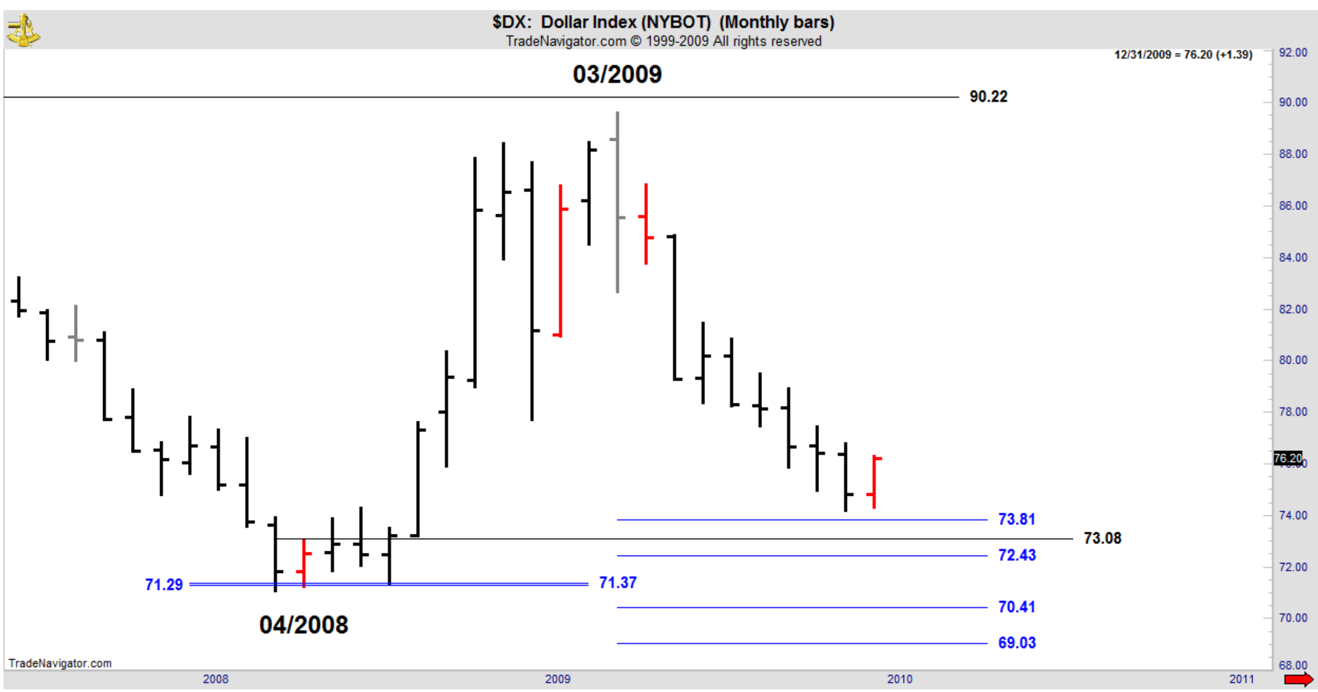
Timing the Dollar-The 2nd Degree of markets

In previous articles (see the "Articles" tab at the Danielcode website, www.thedanielcode.com) I have shown you how we called the low in the Dollar Index for March 2008 and how that assisted us in calling for a top in gold and silver simultaneously. The relationship between the dollar and gold is one that is important for gold traders and investors and some months ago I wrote an article setting out that the usual inverse correlation between these markets had ended, and that they were trending in unison. That article showed that historically, when the DX and gold trend together, that pattern never exceeds three months and always ends with a substantial move in one or the other. "Never" and "Always" are strong words, particularly for inter market correlations, so it pays to know about these occasional anomalies. In this case the dollar took a hit as the linear correlation dissolved and we reverted to the more customary inverse correlation.

The chart below will refresh your memory of the Danielcode time Cycles that led us to the call for the dollar to make a low at $70.40 in March 2008, which we published in the public domain some weeks prior.

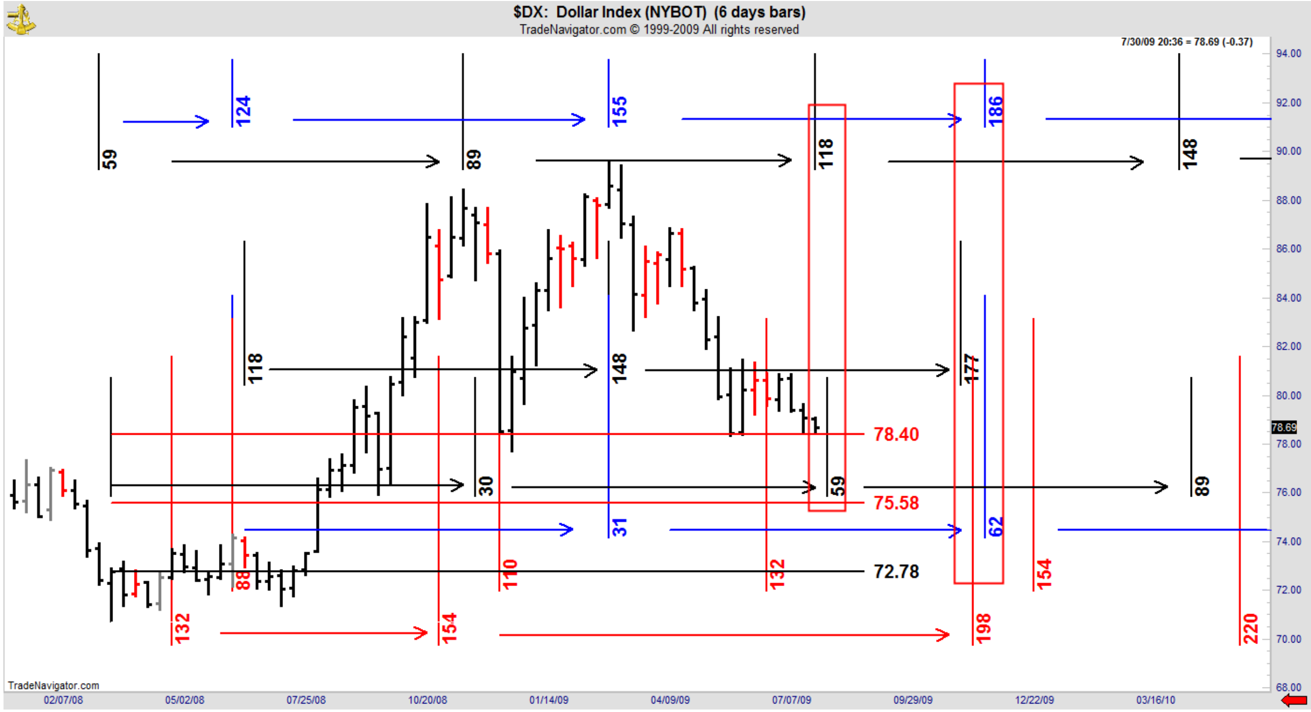


The next work that we did on the dollar indicated that we had a target of 90.20 as a high for the rally and the chart below illuminates that call. That was fairly simple. We see the Danielcode black line, the last level of support and resistance for the appropriate swing, appearing in many charts in multiple time frames. This is the DC price level that called the major lows in the Australian SPI 200 Index and the Shanghai Composite Index in March 2009 and November 2008 respectively.



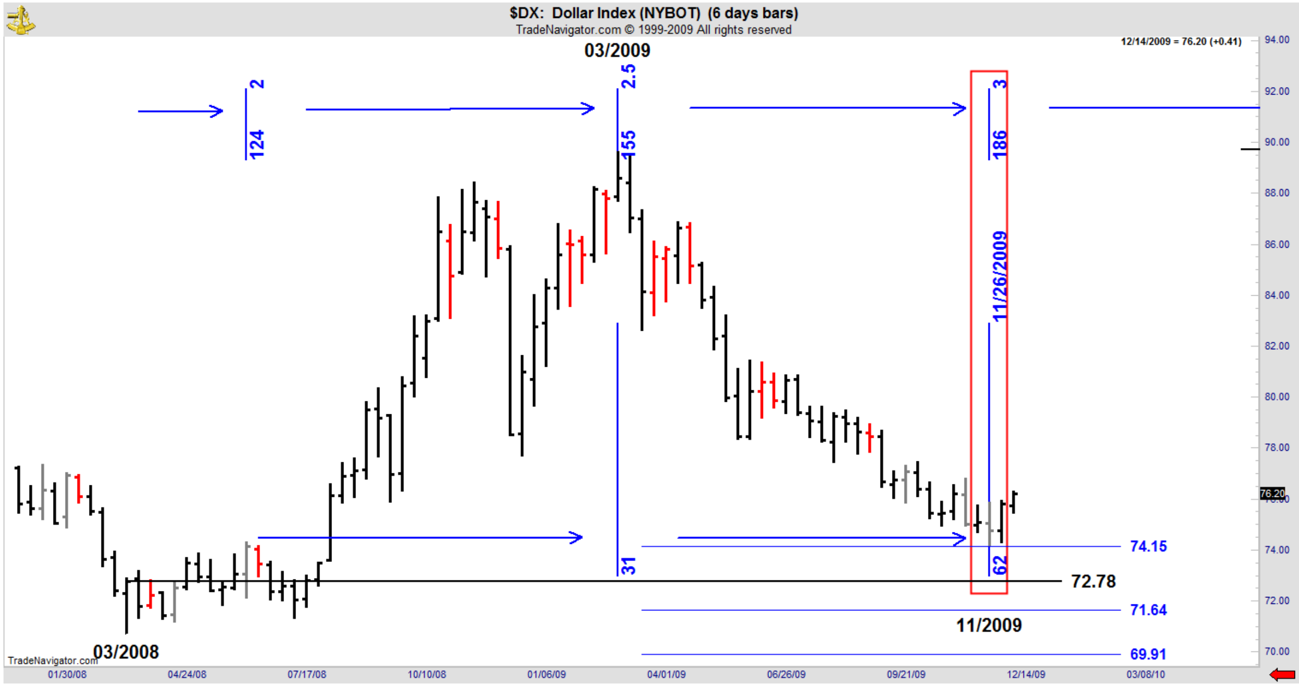
So far we have managed to be fairly prescient on the dollars ups and downs and it seems that we are now at another watershed moment for the dollar.

On 27 July 2009, I published the following Danielcode Time Cycle Chart at the DC website.



The chart is under the “Trading Reports” tab at the web site and has been available free to all who were interested enough to study this amazing timing phenomenon. The chart showed us two primary time targets highlighted by the red rectangles. Remember that we are in the business of trading probabilities, and we always require price action to prove that the turn has been made. So far we have had some price action and it appears that an intermediate low of some importance is near, but price action always is right; theories and forecasts are highly fallible.

Updating that chart to its current status, and simplifying it for clarity, we can see that the second time grouping focused on the 6 day period ending 11/26 as the high probability time target for at least an interim low. At the time of writing, we have at lest a recognizable low precisely on that target date which combined two iterations of the 62 DC “week” cycles being a primary time cycle of 62, one of just 3 time cycles that define all markets, and 2.5 “times” the primary cycle at 155 trading days. Note that the same cycles gave us the 2009 high in this market in the DC week closing 03/06. Not bad for a chart posted for public view over 5 months ago. So we have a tradable low, but that’s just part of the story.



If you are interested in the proper construction of market timing cycles, the correct methodology is laid out for you in some detail in the two "Master Class" articles at the DC website.

Market timing cycles are part of the dark arts of trading, known only to a few, and understood by even fewer. At the March lows in the equities, which the Danielcode forecast to the day and to the a couple of tics, conventional wisdom gave birth to the idea that many had called this low in advance when nothing could be further from the truth. 97% of traders were bearish according to sentiment reports at that low which means that at the most 3% could have been right and the fact that almost all commentators and advisory services now claim that they saw that low in advance is really just a rewriting of history.

So now we have the 1st and 2nd degrees of chart analysis in place. Price is the 1st degree and Time is the 2nd degree. In our timing chart earlier, you may not have seen that the low of the 11/26/09 bar was 74.17, just 2 ticks from the DC blue line target. We have at that time and price, a confluence of axis; what WD Gann referred to as "Time and price being squared". And that's important. A turn at the DC black line of 72.78 which I have long awaited would have been more satisfying, but we have what the market gives us and price and time recognition at least, has occurred. None of this is set in stone. The definitive turn signals have not been confirmed yet. Much is still to unfold. That's always the way in markets.

Angles-The 4th Degree of Markets

Having dealt with Price and Time we can now turn our attention to the 4th degree of markets; angles. This simple device combines elements of the vertical axis of charts, that is price, and the horizontal axis, time.

The tool I use for this exercise is a regression channel which is available on most charting packages. Mine comes from Genesis Financial Technologies of Colorado Springs USA. I have used these charts for about 16 years, with great satisfaction. In statistical analysis there is something magical about Standard Deviations. You can read as much or as little as you like at various math websites, but the condition that we are interested in, is that markets find it hard to close above 2 standard deviations from the mean on most time frames. Last Wednesday, 12/02 I published a chart showing Comex Gold closing above 2 standard deviations from the mean on the DC 6 day chart. I advised that the likely outcome of this action was a fast pullback to the mean. This from a published article and members forum at the DC website:

- "Gold-DC 9 day chart
  Prop trend signal is up.
  Regression channel signal is up.
  Current period bar completes 12/02
  Markets find it hard to close above the regression channel. The upper edge of the channel is at 1175. If this market closes on Wednesday above that number, the most likely prospect is a pullback to the centre of the channel, which for the next period will be at 1128."

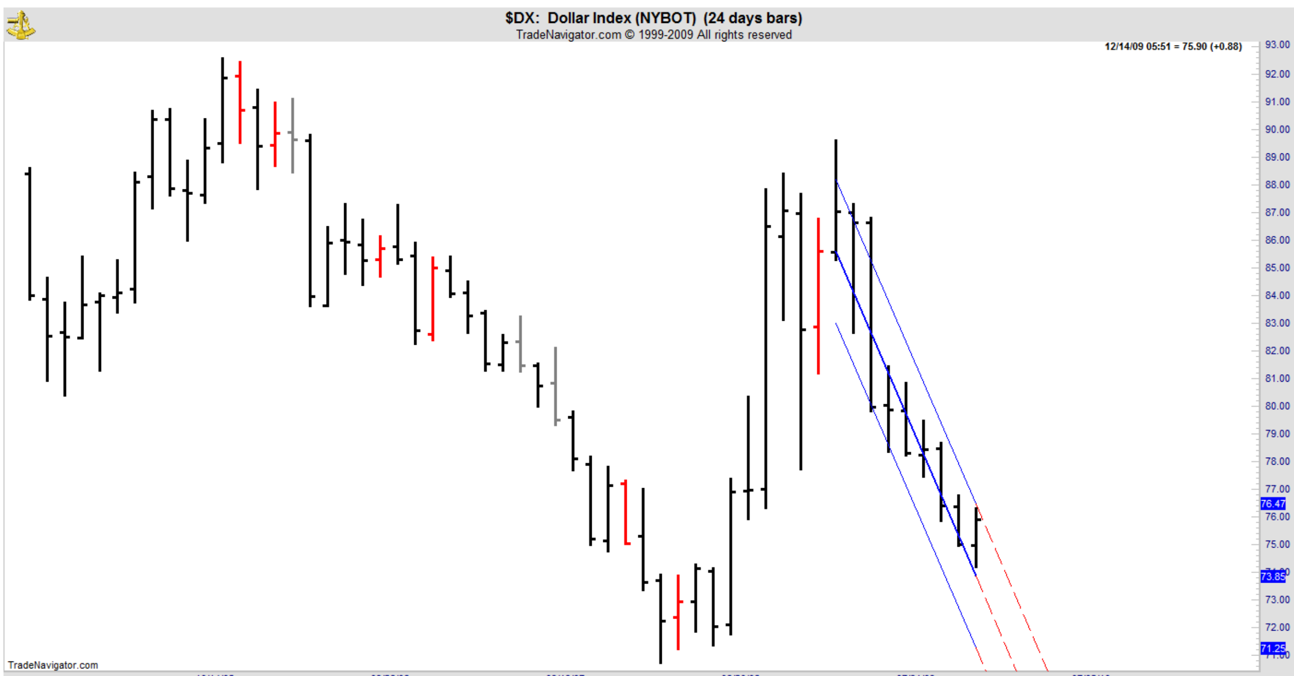
  And you of course had the T.03 signals as well. Some part of $8000 per one contract! And Silver; and more. Well this just finished off a great week."

And it got better; The chart below shows how this simple analysis set up a trade worth some part of over $10,000 per 1 Comex contract. These little gifts make your equity curve and show that analysis pays.

Have we digressed by wandering into Gold? Not really. DX is directly and inversely (usually) correlated to many markets, and I wanted to give you a simple example of the benefits of thinking about the 4th degree.

Regression Channels have a number of purposes, one of which is to define trend. In talking about trend, we must always define the time period that we are interested in. Markets habitually have a number of different trends on differing time cycles happening contemporaneously, so an up trend on one time period may be a down trend on another. And that indeed is the position in DX as it rallies out of its appointed turn on the DC time cycles. The trend on the 6 day chart is verging up. The setup bar for the minor trend change is complete and awaits confirmation, or rejection shortly:

Whilst the trend on the DC "monthly" chart remains firmly down:



You can approximate these regression channels on your own charts, but for a more nuanced understanding of regression channels, you need to know that all markets have a unique vibration that once attained, never changes. For DX it is 62, and strangely for Gold it is 44. This means that the precise range of the regression channels varies for each market, but just to see the effect of this study, use 2 standard deviations as your tool and you will not be far out.

Fundamentals

The US Dollar is the world's reserve currency. It is the life blood of international finance. No other currency is close to challenging for pre-eminence despite some wooly thinking from the fringe dwellers. And it is also a fiat currency. That means that it has no ascertainable value, unlike the ill fated Gold Standard which is much mourned by Gold buffs, but which in truth also had elements of a fiat currency as the US Government varied the “official” price of Gold in 1933-4. The value of the Dollar is just what the market says it is, and the main mover in that ongoing debate is the President of the United States through his servant, the US Treasury. As a fiat currency, money issued by US Treasury is ultimately just a promise to pay, backed by the full faith and credit of the US Government. Notionally, given a static net worth of that “full faith”, every additional Dollar that is issued dilutes the value at the margin of every Dollar already in circulation. And as growth of the economy and population expands, so does the money and “promises” in circulation. Hopefully the full faith and credit expands in concert. And markets also price in risk. What the Dollar is worth in calm times is different to its value in times of financial stress. Safe haven status has a value too.

The two forces of fundamentals driving the Dollar are the amount of promises being made by US in the form of deficit spending, bank bailouts, operating deficits, bad debt and suspect mortgage purchases and the billions or perhaps trillions in guarantees and international understandings which are well hidden from the public’s eyes. These are things of which we can only guess. The second factor is the standard economic response to nation rebuilding. Globalization, which is just a fancy term for labor arbitrage, has seen the US industrial base hollowed out as jobs have been outsourced to those with cheaper operating systems in wages, conditions, compliance and environmental standards. That means the East. The major challenge for a President looking to find work for 9 Million or more unemployed in US is answering the questions “Where and How”.

Realtor’s jobs are not coming back, nor is much of the construction, hospitality and services industries. The much vaunted “green jobs” are not going to create the kinds of numbers required to create near full employment in US, and for our international readers, the decisions on the value of the Dollar are peculiarly for the US alone to make.

Factually, US is going to have to rebuild its factories to create a large enough pool of employment for unskilled and semi skilled labor; just the people hurting most from present unemployment. This is neither glamorous or sexy. It is unlikely to be the thrust of major political speeches, nor will it make the front pages of the major newspapers. At least not in these terms. But realists realize that more output and more jobs from established factories is what it is going to take. And the single greatest help that Government can offer to exporters (remember the US consumer is tapped out, so exports are more important than ever to this economy), is to make their goods more competitive internationally. And that means weakening the exchange rate, as a weaker Dollar makes exports cheaper and imports more expensive. Just what the US needs if it is going to rebuild its industrial backbone.

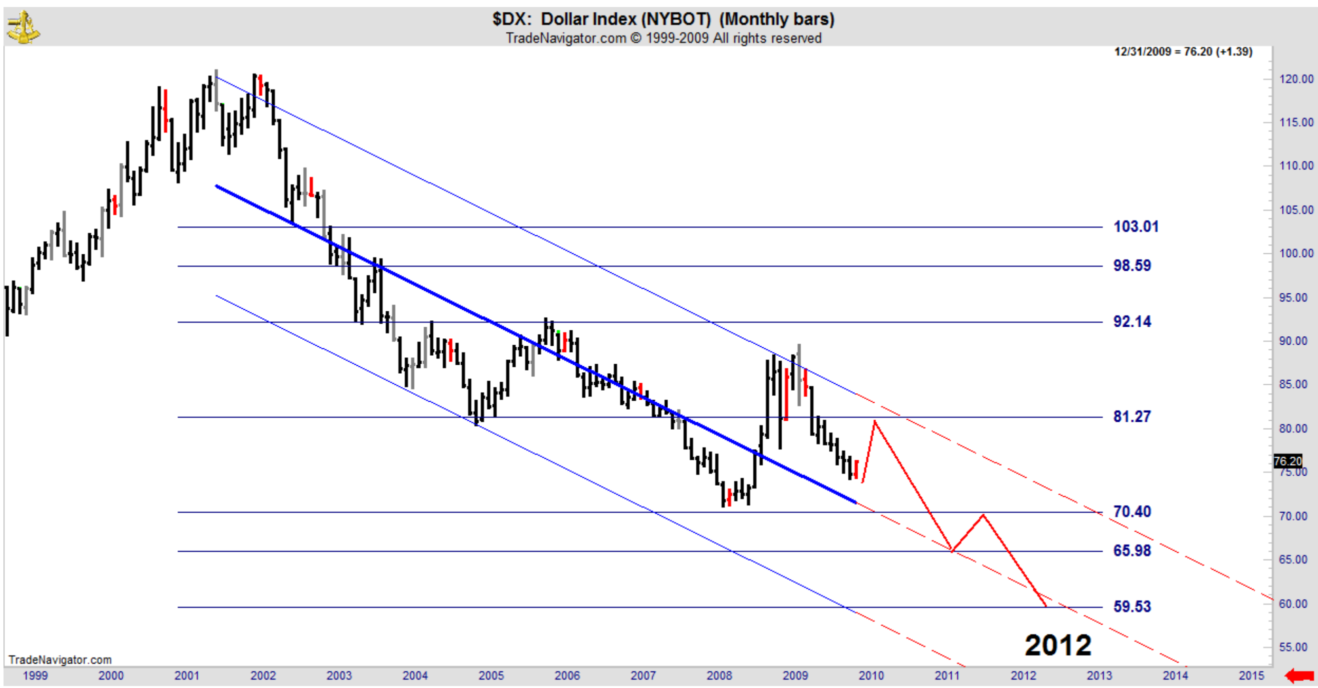
So the two major driving forces of US Dollar value are aligned. And both say down. Add a bit of tinkering at the fringes as Bernanke et al continue with near zero official interest rates to help bankers prize their way back to solvency by cannibalizing access to cheap taxpayers funds, to on lend to the same taxpayers. And not only does nobody seem to mind, but the mindless economists who control the group speak of the US proletariat, actually praise Bernanke and Geithner, the two most responsible for failing to oversee the US banking system, as they now rob Peter to pay Paul.

It’s a strange world indeed when savers are sacrificed to make good the fate of the most intemperate lenders, the banks. One major ramification of US Dollar devaluing that seems to excite no comment, is China’s policy of pegging its currency to the Dollar. Whilst buckets of angst are regularly emitted over the perceived under valuation of the Yuan, not much is said about the fact that as US devalues, so does China. That’s what the peg is for Sport. Bernanke’s recent comment that the decline in USD is “orderly” is code for “we’ll devalue as fast as we can, but not at a rate that draws too much attention”. That indeed is a rational approach in these desperate times on behalf of those looking for work in America.

Now the Hence

My best appreciation of what the charts are saying, combined with a dose of common sense and realism, qualities sadly lacking these days, is to take a step back and again utilize our regression channel, but on a much longer time span. We may be seeing an intermediate low in DX as we have “Time and Price” from our Danielcode charts and as WD Gann said so presciently, “When time and price are squared a change in trend will occur”. But he didn’t tell us what time frame he was referring to, and thus like most of Mr Gann’s pronouncements, a number of alternative interpretations are open to the thinking man. My best guess is that we may see a rally now. With short interest in DX at historic highs, a rally that gets into the stops will grow wings. But that will just be another rally and signpost along a single road.

Here is that road:



I like 59.53 as our foreseeable destination in this market. Breaking 60c will have enough shock value to make this a headline event, and it’s still just on trend.

I hope that the various techniques that I am expounding here will be of interest and assistance to you.

If they pique your interest to think more about markets and to think in different ways, I will be succeeding in my aims. For those that want to learn more about these techniques there is a plethora of information available at the Danielcode website, and I invite you to visit us at any time.

Luke 9:26 For whosoever shall be ashamed of me and of my words, of him shall the Son of man be ashamed, when he shall come in his own glory, and *in his* Father's, and of the holy angels.

10 December 2009