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# WHAT ARE TECHNICALS SAYING ABOUT CURRENCY MARKETS?

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09/10/2018

While [factor](#) investing in equities appears to be gaining traction, investors ignoring [momentum](#) in the [foreign exchange \(FX\)](#) market may be exposing themselves to undue risk. Below, we examine the trends in [technical](#)s for the U.S. dollar, euro, Japanese yen and British pound to find clues for where FX markets could head next.

## Methodology

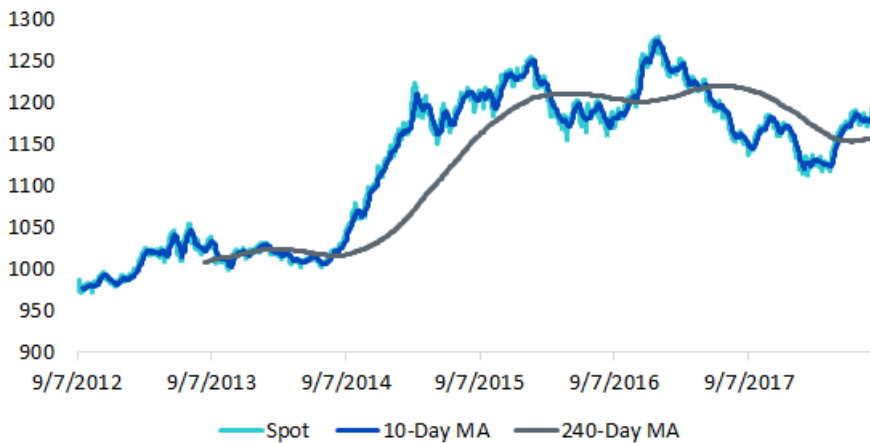
Through our research on currency markets, we identified three distinct factors that help explain movements in FX markets over the short, medium and long term. In the short run, momentum can be a powerful predictor of future FX returns. This idea is based on currencies that recently have appreciated tend to do so until those moves are exhausted. In the medium term, [carry](#) (or [interest rate differentials](#) between countries) can also influence relative exchange rates. The idea that higher interest rates attract foreign capital causing the exchange rate to appreciate is widely cited in academic research. Finally, in the long-run, the concept of [purchasing power parity](#) also helps explain exchange rates. Over time, currencies cycle from being overvalued to fairly valued to undervalued. It stands to reason that currencies that are overvalued should be hedged.

While we have shown that all three factors can be combined to improve [currency hedging](#) decisions, this analysis focuses on the short-term drivers of exchange rates: momentum. In this case, should the 10-day moving average cross above the 240-day moving average, that currency is likely to continue to appreciate. Below, we highlight broad-based positioning in the dollar as well as the euro, the yen and the pound.

## Broad Dollar

After an impressive run from 2011 to mid-2015, the dollar<sup>1</sup> generally has been in a corrective phase. This appears to have changed at the end of 2017. In May 2018, the 10-day moving average crossed the 240-day moving average, signaling a move higher for the dollar. In our view, looking at broad-based measures of the dollar against other major markets and trading partners can help signal broader trends. Interestingly, from 2011 to mid-2015, virtually no foreign currency appreciated against the dollar. With the exception of the Mexican peso, no other foreign currency has appreciated against the U.S. dollar since it broke out on May 10, the day the momentum signal was triggered. In our view, investors should continue to reassess [currency risk](#) in the current strong dollar environment.

## BBDXY Technicals (10- & 240-Day Moving Average)



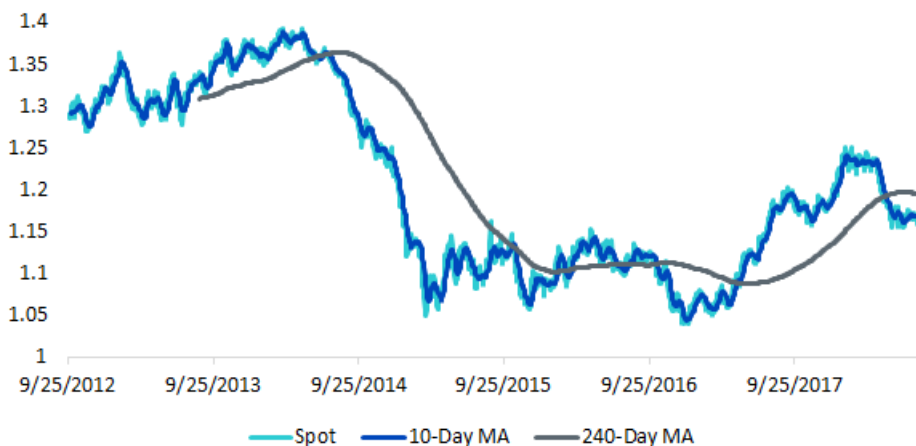
Source: Bloomberg, as of 8/21/18. Past performance is not indicative of future results. You cannot invest directly in an index .

For definitions of terms in the chart, please visit our [glossary](#).

**European Euro (EUR)**

While the euro remains much weaker than it was in 2014, both 2016 and 2017 saw a fairly strong resurgence against the dollar. On May 15, 2018, the euro broke below the 240-day moving average, signaling the potential for further weakness against the dollar in the coming weeks. In our view, as long as the euro continues to trade under 1.1929, any rebounds should be sold tactically.

**EUR Technicals (10- & 240-Day Moving Average)**



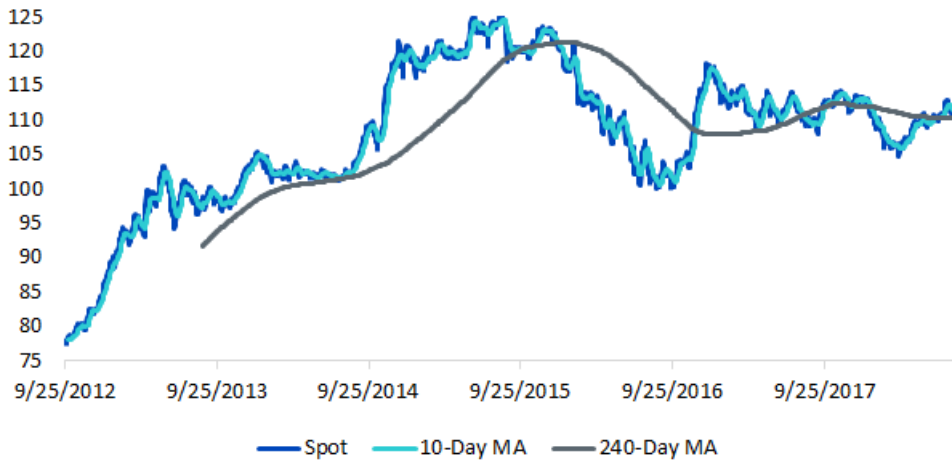
Source: Bloomberg, as of 8/21/18. Past performance is not indicative of future results. EUR spot currency values

**Japanese Yen (JPY)**

With few exceptions, the yen experienced a period of trend depreciation for over three years. Since that time, it has entered a period of consolidation. However, as of June 20, 2018, the technical position shifted to signal a potential period of yen weakness. In our view, as long as the yen remains above 110.4, it appears as though the market is

signaling a strong dollar, weak yen pattern.

**JPY Technicals (10- & 240-Day Moving Average)**

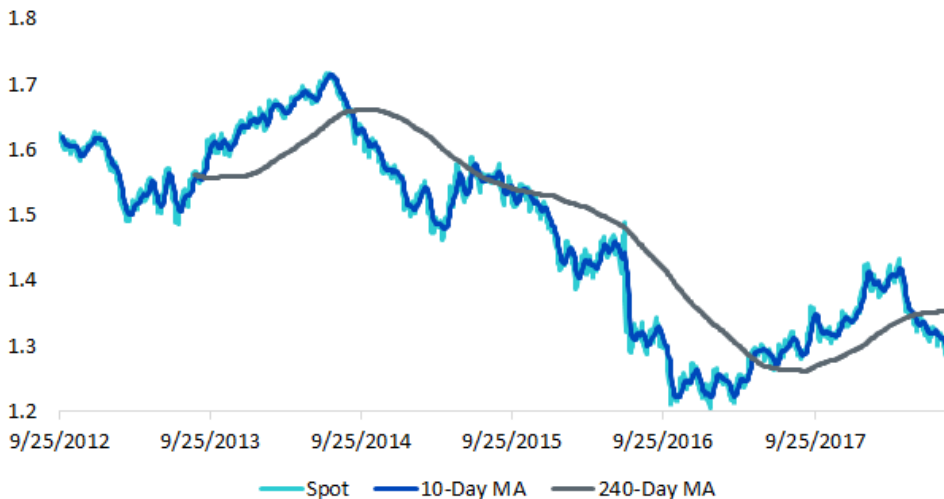


Source: Bloomberg, as of 8/21/18. Past performance is not indicative of future results.

**British Pound (GBP)**

While the pound had been weakening well in advance of Brexit, depreciation accelerated rapidly after the June 23, 2016, referendum. Falling to 1.20 versus the dollar, the pound had also entered a corrective phase. However, on May 24, the technical picture began to improve for dollar strength after breaking through 1.3475. While the British government continues its negotiations with the European Union, it seems that risks for the pound remain skewed to the downside.

**GBP Technicals (10- & 240-Day Moving Average)**



Source: Bloomberg, as of 8/21/18. Past performance is not indicative of future results.

**Summary**

In our view, one of the broadest measures of the dollar appears to be breaking out while some of the most liquidly traded currencies are breaking down. In response, we believe

investors should continue to be vigilant in managing the foreign currency risk of their portfolios. Our list of solutions runs the gamut of fully hedged strategies such as [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#), [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#) and [WisdomTree International Hedged Quality Dividend Growth Fund \(IHDG\)](#) to dynamically hedged strategies that rely on the three-factor methodology above. For the dynamic approaches, [WisdomTree Dynamic Currency Hedged International Equity Fund \(DDWM\)](#) and [WisdomTree Dynamic Currency Hedged International SmallCap Equity Fund \(DDL5\)](#) are currently 75% hedged across the currencies of the [MSCI EAFE Index](#). In our most recently launched strategy, [WisdomTree International Multifactor Fund \(DWMF\)](#) was 84% hedged as of this writing.

<sup>1</sup>As proxied by the Bloomberg Dollar Spot Index (BBDXY).

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## DEFINITIONS

**Factor**: Attributes that based on its fundamentals or share price behavior, are associated with higher return.

**Momentum**: Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**Foreign Exchange (FOREX, FX)**: The exchange of one currency for another, or the conversion of one currency into another currency.

**Technical indicators**: Type of analysis that tries to determine future price patterns using historical price patterns.

**Carry**: The amount of return that accrues from investing in fixed income or currency forward contracts.

**Interest Rate Differentials**: The Difference between the 2 Year interest rate swaps of the United Kingdom vs. the United States.

**Purchasing power parity**: Academic concept stating that exchange rates should adjust so that equivalent goods and services cost the same across countries, after accounting for exchange-rate differences.

**Currency hedging**: Strategies designed to mitigate the impact of currency performance on investment returns.

**Currency risk**: the risk that an investment will decline in value due to a change in foreign exchange rates.

**MSCI EAFE Index**: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.