

13:32 EST 11/06 TheFXSpot: Upward Dlr Correction Eyed At Some Point, ButWhen?

By Vicki Schmelzer

NEW YORK, Nov. 6 (MNI) - Market players would not be surprised to see the dollar correct sharply higher at some point, given the declines already seen in a relatively short time frame.

However, they are hard pressed to judge when this rally might occur and what the catalyst for such a move might be.

The euro, currently at \$1.4554, posted a new life-time high near \$1.4570 Tuesday, which put the pair up 10.4% at the time, when compared to end of December closing levels near \$1.3200.

This year there has been a marked shift in trading style, with speculative accounts increasingly using cross positions, rather than a dollar long or short against another currency, to express a view.

Rather than speculate in such "vanilla" pairs as euro-dollar, sterling-dollar, and dollar-yen, these accounts have found value and profitability also in cross pairs such as sterling-yen, Swiss-peso and Aussie-Canada.

At times, this cross trading makes it difficult to discern if players are actually selling dollars due to a U.S. specific event or instead are buying other currencies on the crosses due to carry trade positioning.

Whatever the reason, the dollar is down across the board this year and the downtrend shows no sign of abating.

"For the dollar, cyclical and structural (factors) have aligned," said Harvinder Kalirai, vice president and currency manager at CIBC Asset Management.

Dollar negatives, such as the U.S. current account balance and world central bank reserve diversification, are again on the market's radar screen at the same time it is digesting the fallout from the subprime mortgage crisis and ensuing credit crunch, he explained.

In prior bouts of extreme dollar weakness, such as the late 1970s/ early 1980s and again in 1995, the greenback reached a point of being "washed out," with no quick fix to turn things around, Kalirai said.

A specific catalyst, such as rapidly rising U.S. interest rates (1970s/80s) or the balancing of the U.S. fiscal budget (1995), was needed to put the dollar back on track again, he said.

For the greenback to finally bottom out and potentially again rise, the dollar "needs to be washed out and there has to be a change in macro policy," Kalirai said.

Deciding how and when these circumstances might unfold is a formidable task.

"One way is to think in terms of overshooting and undershooting," Kalirai said, and that "the dollar needs to be cheap for a while."

Using a "fair value" level for the euro of \$1.2000, history shows that after its inception in January 1999 the euro "undershot" by quite a bit, by falling to \$0.8225 in October 2000.

If the euro could fall nearly 40 "big figures" at a time where the dollar was rising, then it is logical to assume that the pair could climb 40 "big figures" during a period where the dollar was falling.

"Why can't we overshoot to the upside at \$1.6000?" would be the thinking under this strategy, Kalirai said.

Both U.S. and eurozone corporate strategists have had to field a flurry of questions from clients either looking to hedge their FX exposure for year-end, or to hedge in 2008.

"I can't tell people to sell dollars at this level -- it feels so overextended," said one eurozone strategist.

For those wanting to invest overseas, she recommended keeping back a portion of the monies to be invested.

"Keep a third and wait for a dollar rally," the strategist said.

One U.S. strategist, dealing with trend-following institutional clients, said with the dollar largely rangebound over the summer, firms were looking at other asset classes, never thinking that FX would see the strong trend that it did during the fall.

These accounts jumped on the dollar-sell/buy yen carry bandwagon eventually, but there was always a sense of chasing the move, she said.

"They wish their position was bigger than it was," the strategist said.

Dollar Rates in New York Trade:

	Eur-Dlr	Dlr-Yen	Eur-Yen	Stg-Dlr	Dlr-Swiss
1:22 p.m.	1.4554	114.50	166.64	2.0862	1.1448
11:39 a.m.	1.4558	114.40	166.54	2.0858	1.1452
9:59 a.m.	1.4558	114.55	166.76	2.0882	1.1438
7:34 a.m. Tue	1.4545	114.75	166.90	2.0865	1.1452
4:28 p.m. Mon	1.4465	114.47	165.58	2.0797	1.1539

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