LOMBARD ODIER
LOMBARD ODIER DARIER HENTSCH

Investment Strategy Bulletin

Persistent dollar strength over? Updating our currency views

Investment Solutions

20 January 2023

Key takeaways

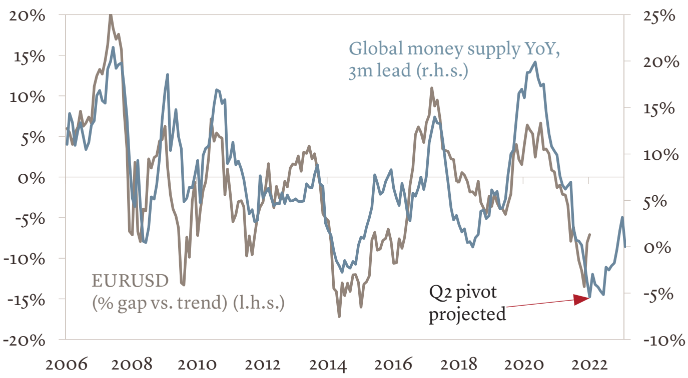
- There are signs that the persistent dollar strength of 2022 may be over.
- We turn underweight on the US dollar (USD), overweight on the Japanese yen (JPY) and have shifted to a neutral positioning on both the euro (EUR) and Swiss franc (CHF).
- In emerging markets, we retain a Brazilian real (BRL) overweight and Chinese yuan (CNY) underweight.

Forecast update

- We raise our assumptions for EURUSD for to 1.12 (1.08 prior), with a likely risk for the move to be frontloaded over the first half of this year
- We lower our USDJPY assumption to 120 (128 prior), with risks skewed to the downside
- We retain a bearish EURCHF assumption of 0.97 for the end of 2023 (0.95 prior), but we believe the pair could first rise towards 1.02 over the first half
- Other forecast revisions will be published in our January FX Monthly

In early December, we altered our EURUSD view, pencilling in a rise to 1.08 (12-month view) but firstly a correction towards 1.02 (three-month view). The reason for assuming that it would still take time for EURUSD to bottom was linked to global liquidity conditions (see chart 1). The global liquidity framework, which served us well over 2022, suggested that the dollar cycle was more likely to peak closer to Q2. At the same time, while a number of forces were suggesting a potential for change (sharp fall in natural gas prices, China reopening, Fed policy), there was no definitive shift. In the past few weeks, this has changed.

1. EURUSD cycle versus global liquidity cycle



* left hand scale, ** right hand scale
Sources: Bloomberg, Lombard Odier

Why is US dollar strength losing steam?

Firstly, global growth expectations for 2023 have improved. The pace of China's reopening has been swift, with restrictions withdrawn in a matter of weeks, rather than months, as was expected. Market participants have thus begun to raise their Chinese growth forecasts (we now forecast Chinese growth of 5% for 2023, up from our prior assumption of 4%), and hence risks to existing global growth forecasts are skewed somewhat higher. This is a reversal from 2022, when weak global growth expectations were supporting the dollar.

Secondly, trends in energy prices are improving the outlook for major economies, especially those heavily reliant on imported energy, notably Europe and Japan. There is a stronger chance now that re-stocking Europe's gas supplies for winter 2023 (beginning Q3 onwards) could be less problematic than the market had expected even a few weeks ago. At the time of writing, January 2023 is shaping up to be the warmest January since 1950, while energy consumption has been much more efficient. Indeed, certain countries have been able to raise their stockpiles in January, when they would usually be falling. This suggests that continued relief on energy prices could be supportive for both the euro and yen, both of which suffered over 2022 from negative terms of trade shocks. The flipside of this is reduced support for the US dollar.

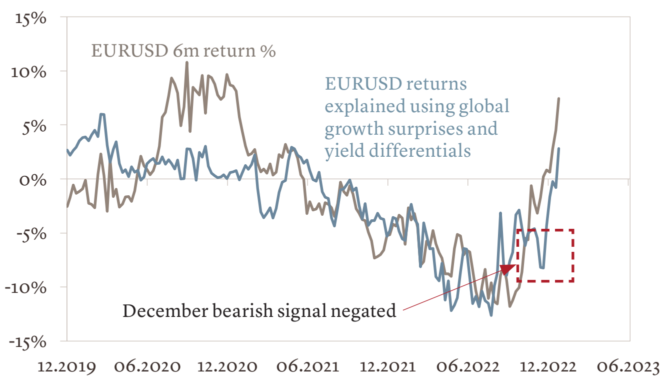
Thirdly, the pace of US rate hikes is slowing. We have now had two negative surprises on US inflation, as well as signs that the pace of gains in core services inflation is easing, and wage growth – although still high – is moderating on some measures (like average hourly earnings). This should allow the Federal Reserve (Fed) to shift down another gear in its rate hiking pace. In parallel, both the European Central Bank (ECB) and Bank of Japan (BoJ) turned somewhat more hawkish in December meetings. These changes have had significant implications for our higher-frequency models for the US dollar (see chart 2) which we must take into account. This is the first time the indicator signals a bullish EURUSD bias (or bearish dollar stance) since mid-2021.

In light of the above, we abandon our prior three-month call for EURUSD (1.02) and now expect EURUSD to remain biased higher, with a year-end target of 1.12 (1.08 previously). Many of the factors cited above could have their greatest impact in the months ahead (against investors' relatively elevated long USD positioning), so the move could well be front-loaded.

The yen – an attractive new haven alternative?

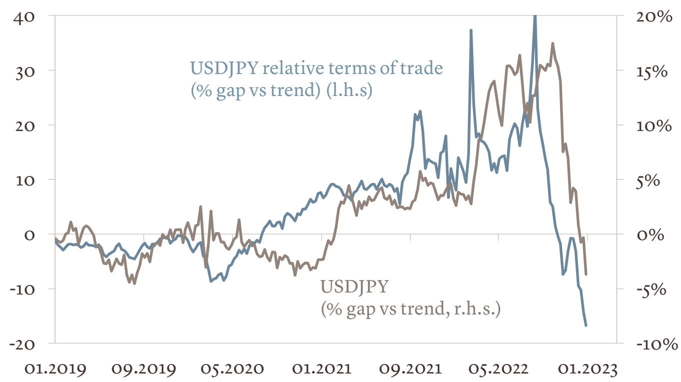
Meanwhile, the Japanese yen is becoming an attractive safe haven alternative to the dollar. We have lowered our year-end USDJPY assumption to 120 (from 128 previously), with risks skewed to the downside. Beyond the recent stabilisation in US yields, the yen is also benefitting substantially from Japan's improving terms of trade (chart 3) and increased expectations for the Bank of Japan to move away from extraordinary monetary stimulus measures (like yield curve control). Investor positioning is still underweight JPY while the scope for further asset repatriation flows by Japanese investors (or even an increase in FX hedge ratios) remains. All these factors indicate that the momentum towards a lower USDJPY could remain strong in the months ahead.

2. EURUSD bias turned higher given upward global growth revisions and moves in yields



Sources: Bloomberg, Lombard Odier

3. USDJPY versus higher-frequency relative terms of trade



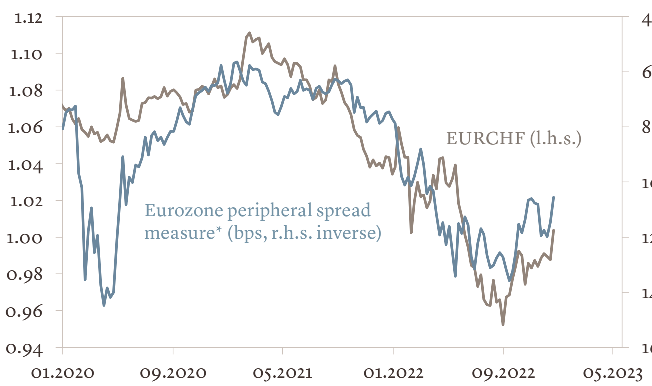
Sources: Bloomberg, Lombard Odier

Long-term Swiss franc strength, shorter term weakness?

As for EURCHF, **our longer-term thesis remains intact**. We believe Switzerland's strong external balances and intervention by the Swiss National Bank – both to temper inflation but also to reduce the size of its large balance sheet over time – will see EURCHF decline on a 12-month time frame.

That said, the next move on EURCHF is likely to be higher, towards 1.02 over the first half. This reflects the more positive turn in EUR sentiment, and a more hawkish ECB. Both have mattered for EURCHF over tactical investment time horizons. Over 2022, despite market-implied real yields in the eurozone moving higher, EURCHF moved lower. This was because weak eurozone growth sentiment kept peripheral spreads widening. EURCHF has been correlated to peripheral spreads from time to time (see chart 4). Given more positive news on both the energy and China fronts, we now have a combination of the ECB further dialling up its hawkish signalling while peripheral spreads are tightening, another positive signal for EURCHF. Furthermore, while the Swiss National Bank showed a strong preference for ensuring EURCHF did not deviate higher over 2022, its tolerance could be somewhat higher now. For one, imported inflation could move lower given the sharp decline in natural gas prices (although these are still at elevated levels). Additionally, the US dollar-Swiss franc exchange rate (USDCHF), also of key importance to imported inflation, is now at the bottom of a 0.90 – 1.00 range (last year it neared the top of the range), so recent USD weakness has helped at the margin.

4. EURCHF versus peripheral spread measure*



Sources: Bloomberg, Lombard Odier

*Simple average of 10Y sovereign bond yields for France, Italy, Spain and Portugal as a spread to German bund yields

Conclusion – portfolio positioning changes

Given the recent rapid shifts in currency markets, in January we made several changes to our currency allocation in client portfolios. Firstly, after having taken steps to reduce our USD overweight exposures in both November and December, we have now shifted to an approximately 3% USD underweight across portfolio profiles. Secondly, we have moved to a neutral EUR stance in USD and GBP client-based profiles (having already made this move in EUR and CHF client-based profiles). Thirdly, we have neutralised our CHF overweight across profiles given the tactical setback we expect for the Swiss franc in coming months. Fourthly, we have moved from neutral to overweight on the Japanese yen across profiles. Finally, we retain our overweight in the Brazilian real and our underweight in the Chinese yuan.

Kiran Kowshik, FX Strategist

Important information

This is a marketing communication issued by Bank Lombard Odier & Co Ltd (hereinafter "Lombard Odier").
It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a marketing communication. This marketing communication is provided for information purposes only. The contents of this marketing communication have not been reviewed by any regulatory authority in any jurisdiction. It does not constitute an offer or a recommendation to subscribe, purchase, sell or hold any security or financial instrument. It contains the opinions of Lombard Odier, as at the date of issue. **These opinions and the information contained herein do not take into account an individual's specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes personalised investment advice to any investor.** Tax treatment depends on the individual circumstances of each person and may be subject to change in the future. Lombard Odier does not provide tax advice. Therefore, you must verify the above and all other information provided in the marketing communication or otherwise review it with your external tax advisors. Some investment products and services, including custody, may be subject to legal restrictions or may not be available worldwide on an unrestricted basis. The information and analysis contained herein are based on sources considered reliable. Lombard Odier uses its best effort to ensure the timeliness, accuracy, and comprehensiveness of the information contained in this marketing communication. Nevertheless, all information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice. **Investments are subject to a variety of risks**. Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. **Past performance is no guarantee of current or future returns, and the investor may receive back less than he/she invested**. The value of any investment in a currency other than the base currency of a portfolio is subject to foreign exchange rate risk. Exchange rates may fluctuate and adversely affect the value of the investment when it is realised and converted back into the investor's base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset.
European Union Members: This marketing communication has been approved for use by Lombard Odier (Europe) S.A. in Luxembourg and by each of its branches operating in the following territories: **Belgium**: Lombard Odier (Europe) S.A. Luxembourg • Belgium branch; **France**: Lombard Odier (Europe) S.A. • Succursale en France; **Italy**: Lombard Odier (Europe) S.A. • Italian branch; **Spain**: Lombard Odier (Europe) S.A. • Sucursal en España Lombard Odier (Europe) S.A. is a credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
In addition, this marketing communication has also been approved for use by the following entity domiciled within the European Union: **Spain**: Lombard Odier Gestión (España) S.G.I.I.C., S.A.U., an investment management company authorised and regulated by the Comisión Nacional del Mercado de Valores (CNMV), Spain.
Hong Kong: This marketing communication is distributed in Hong Kong by Lombard Odier (Hong Kong) Limited, a licensed corporation registered by the Securities and Futures Commission of Hong Kong ("SFC") to carry on Type 1, Type 4 and Type 9 regulated activities under the Securities and Futures Ordinance ("SFO") in Hong Kong.
Singapore: This marketing communication is distributed in Singapore by Lombard Odier (Singapore) Ltd for the general information of accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the Securities and Futures Act (Chapter 289). Recipients in Singapore should contact Lombard Odier (Singapore) Ltd, an exempt financial adviser under the Financial Advisers Act (Chapter 110) and a merchant bank regulated and supervised by the Monetary Authority of Singapore, in respect of any matters arising from, or in connection with this marketing communication. The recipients of this marketing communication represent and warrant that they are accredited investors and other persons as defined in the Securities and Futures Act (Chapter 289). **This advertisement has not been reviewed by the Monetary Authority of Singapore**.
Panama: This marketing communication has been approved for use in Panama by Lombard Odier (Panama) Inc., an entity authorised and regulated by the Superintendencia del Mercado de Valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.
Israel: This marketing communication has been approved for use in Israel by the Israel Representative Office of Bank Lombard Odier & Co Ltd, an entity not supervised by the Bank of Israel, but by the Swiss Financial Market Supervisory Authority, which supervises the activities of Bank Lombard Odier & Co Ltd.
South Africa: This marketing communication has been approved for use in South Africa by the South Africa Representative Office of Bank Lombard Odier & Co Ltd, an authorised financial services provider. Registration number 48505.
Switzerland: This marketing communication has been approved for use in Switzerland by Bank Lombard Odier & Co Ltd, a bank and securities firm authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).
United Kingdom: This marketing communication has been approved for use in the United Kingdom by Lombard Odier (Europe) S.A. – UK Branch, a bank authorised and regulated by the Commission de Surveillance du Secteur Financier ('CSSF') in Luxembourg and authorised in the UK by the Prudential Regulation Authority ('PRA'). Subject to regulation by the Financial Conduct Authority ('FCA') and limited regulation by the Prudential Regulation Authority. Financial Services Firm Reference Number 597896. **Details about the extent of our authorisation and regulation by the Prudential Regulation Authority and regulation by the Financial Conduct Authority are available from us on request.**

SWITZERLAND

GENEVA
Bank Lombard Odier & Co Ltd[1]
Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG
Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE
Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY
Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH
Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS
Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the National Bank of Belgium (NBB) and the Financial Services and Markets Authority (FSMA).

LONDON
Lombard Odier (Europe) S.A.· UK Branch[2]
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom
london@lombardodier.com
The Bank is authorised in the UK by the Prudential Regulation Authority (PRA). Subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the Prudential Regulation Authority. Financial Services Firm Reference Number 597896. Details about the extent of our authorisation and regulation by the Prudential Regulation Authority and regulation by the Financial Conduct Authority are available from us on request.
Lombard Odier Asset Management (Europe) Limited
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom
london@lombardodier.com
Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).

LUXEMBOURG
Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 Luxembourg · Luxembourg
luxembourg@lombardodier.com
Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
Lombard Odier Funds (Europe) S.A.
291, route d'Arlon · 1150 Luxembourg · Luxembourg
luxembourg@lombardodier.com

MADRID
Lombard Odier (Europe) S.A. · Sucursal en España[2]
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).
Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).

MILAN
Lombard Odier (Europe) S.A. · Succursale in Italia[2]
Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com
Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.

PARIS
Lombard Odier (Europe) S.A. · Succursale en France[2]
8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com
Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg · No.B169 907.
Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.

AFRICA | AMERICAS | MIDDLE EAST

ABU-DHABI
Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch
Al Maryah Island · Abu Dhabi Global Market Square · Al Khatem Tower · 8th floor · P.O. Box 764646 · Abu Dhabi · UAE · abudhabi@lombardodier.com
Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.

BERMUDA
Lombard Odier Trust (Bermuda) Limited
3rd Floor, Victoria Place · 31 Victoria Street · Hamilton HM 10 · Bermuda · bermuda@lombardodier.com
Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.

BRASIL
Lombard Odier (Brasil) Consultoria de Valores Mobiliários Ltda.
Avenida 9 de Julho No. 3624, Torre DGN 360, 6° andar · Jardim Paulista · CEP 01406-000 · São Paulo · Brasil
sao.paulo.office@lombardodier.com
Supervised by the Comissão de Valores Mobiliários of Brazil.

DUBAI
Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE
dubai@lombardodier.com
Under the supervisory authority of the Central Bank of the UAE.

ISRAEL
Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
Not supervised by the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.

JOHANNESBURG
South Africa Representative Office · Bank Lombard Odier & Co Ltd
4 Sandown Valley Crescent · Sandton · Johannesburg 2196 · South Africa · johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

NASSAU
Lombard Odier & Cie (Bahamas) Limited
Lyford Cay House · Western Road · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA
Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.
Lombard Odier (Panama) Inc.
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

ASIA - PACIFIC

HONG KONG
Lombard Odier (Hong Kong) Limited
1601 Three Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com
A licensed entity regulated and supervised by the Securities and Futures Commission ("SFC") to carry on Type 1, Type 4 and Type 9 regulated activities under the Securities and Futures Ordinance ("SFO") in Hong Kong.

SINGAPORE
Lombard Odier (Singapore) Ltd.
9 Raffles Place · Republic Plaza #46-02 · Singapore 048619 · singapore@lombardodier.com
An exempt financial adviser under the Financial Advisers Act (Chapter 110) and a merchant bank regulated and supervised by the Monetary Authority of Singapore.

TOKYO
Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).

1 *Private bank and securities firm authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).*

2 *Branch of Lombard Odier (Europe) S.A., a credit institution based in Luxembourg, authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.*