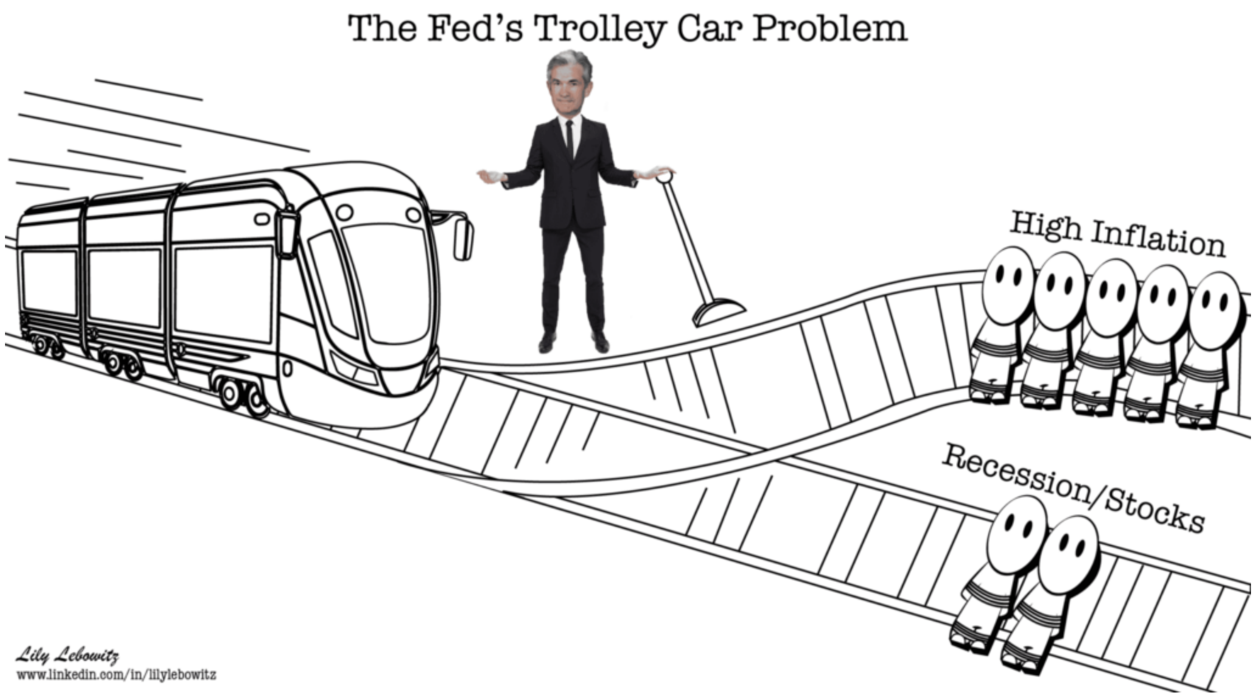
US Dollar Soars, Further Stifling Economic Growth

On Wednesday morning, the US Dollar hit a 20-year high. A strong dollar makes [The Fed's Trolley Car Problem] of tackling inflation without causing a recession even more difficult. While a stronger Dollar reduces the price of imports, it makes exports more expensive. In aggregate, that will slow inflation, but it accelerates our record trade deficit. More importantly, it makes all US Dollar-denominated debt borrowed by foreign entities more expensive. Interest and principal on foreign debt must be paid back in more expensive currency. Below, we provide a hypothetical example to help understand the problem better. Given that many foreign countries, companies, and investors borrow in US Dollars, the stronger Dollar effectively tightens monetary policy for the world. The global nature of the economy and the role of the soaring Dollar will further impede economic growth, thus increasing the odds of a recession.



What To Watch Today

Economic Calendar

- 7:30 a.m. ET: **Challenger Job Cuts**, year-over-year, June (-15.8% prior)
- 8:30 a.m. ET: **Trade Balance**, May (-$84.7 billion expected, -$87.1 billion prior)
- 8:30 a.m. ET: **Initial Jobless Claims**, week ended July 2 (230,000 expected, 231,000 prior)

- 8:30 a.m. ET: **Continuing Claims**, week ended June 25 (1.330 million expected, 1.328 million prior)

?**Earnings**

Pre-market

- **Helen of Troy** (HELE) to report adjusted earnings of $2.00 on revenue of $475.25 million&#2013266080;

Post-market

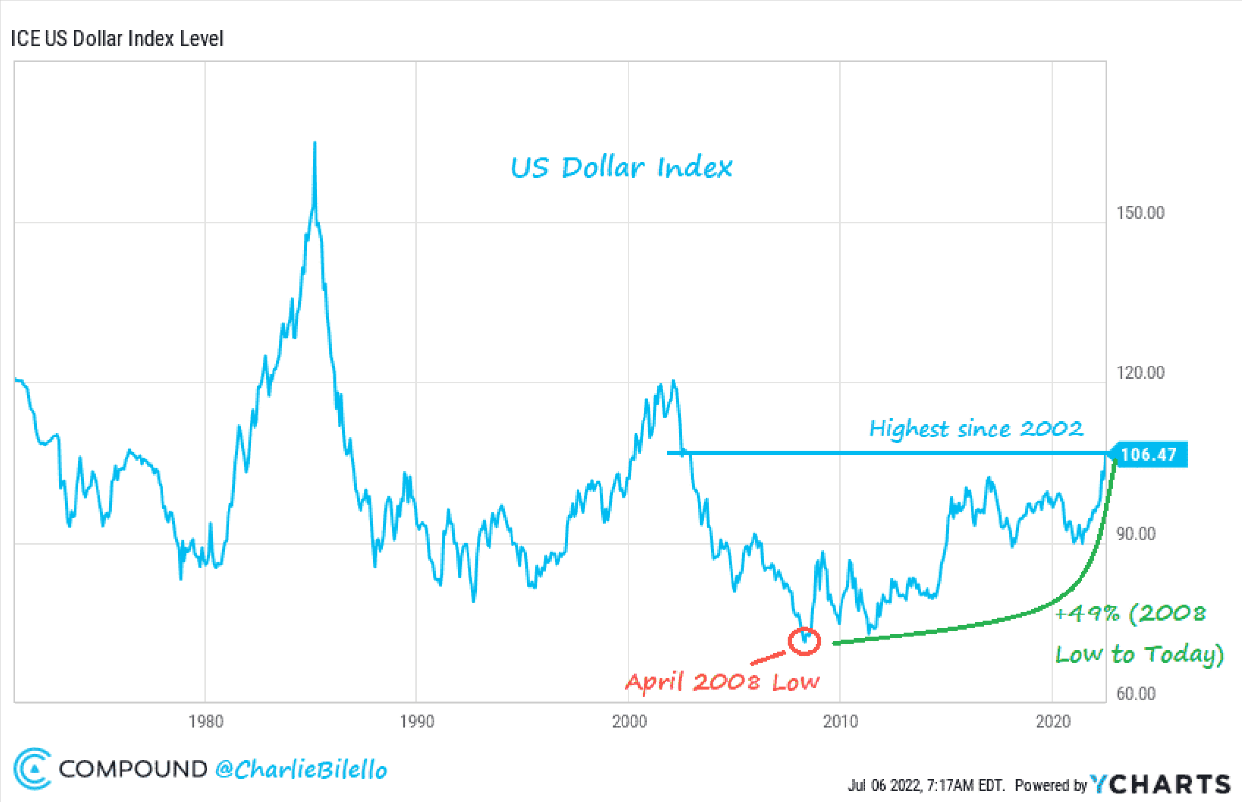
- **Levi Strauss** (LEVI) to report adjusted earnings of $0.23 on revenue of $1.43 billion
- **WD-40** (WDFC) to report adjusted earnings of $1.28 on revenue of $143 million

Market Trading Update - Rally Continues

The July rally continued yesterday, as "buy" indicators continue to support the current advance. The problem is the advance has been weak, volume is declining, and indicators are rapidly approaching overbought. It is likely there is not a lot of upside left to the rally currently, so we will likely be removing trading positions soon. Our concern is that as we enter earnings season, more warnings are likely coming which could pressure stocks lower. We remain cautious for now.

Dollar's Rise Hurts Foreign Borrowers- Example

Before sharing the example, we present the US dollar index graph.



The following hypothetical example from Dollar Appreciation Threatens the Global Economy, shows how a stronger US Dollar results in higher interest and principal repayment costs for dollar-denominated foreign borrowers.

Let?s consider Loonie Tires, a hypothetical Canadian tire company, and the currency risk they take when borrowing in dollars. This analysis helps understand why the value of the dollar is such an important determinant of borrowing costs and, therefore a global economic lynchpin.

On *June 1, 2021, the Loonie Tire Company borrows $10 million U.S. dollars for one year to purchase rubber. They hope to sell the tires in Canada for the equivalent of USD 12 million. The interest on the debt is USD 500,000, assuming a 5% interest rate. The transaction should result in a USD 1.5 million or 15% profit assuming no other expenses.*

The tire company is borrowing in U.S. dollars, but the sale of tires is in Canadian dollars.

On June 1, 2020, one Canadian dollar bought .83 U.S. dollars. Since then, dollar appreciation versus the Canadian dollar is resulting in an exchange rate of .78 U.S. dollars per Canadian dollar.

The table below compares the transaction?s P&L using the initial exchange rate and the current exchange rate.

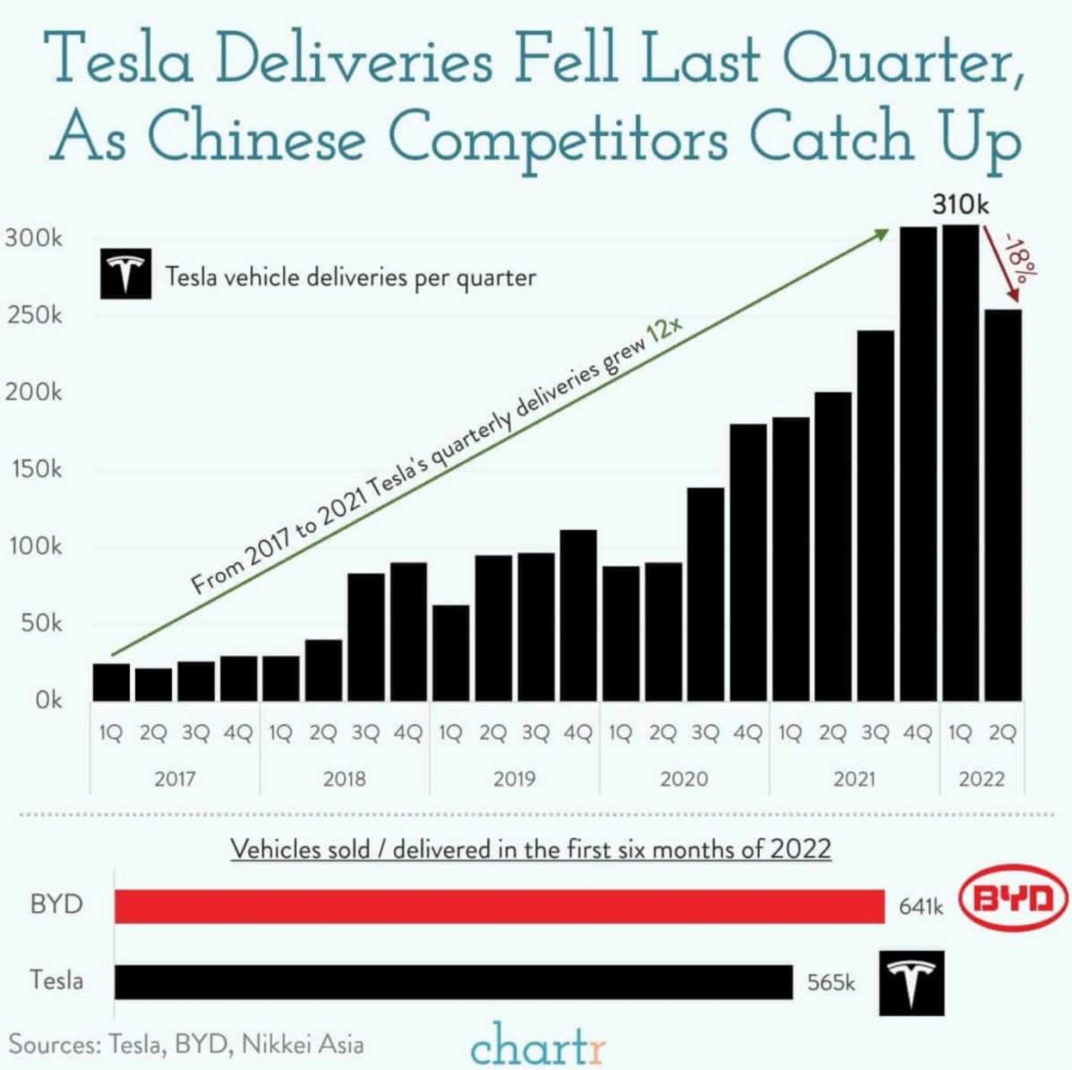
Canadian Tire Company Transaction		
	6/1/2021	Current
Exchange Rate (USD per CAD)	0.83	0.78
Loan Amount (CAD)	12,048,192.77	12,820,512.82
Interest Expense (CAD)	602,409.64	641,025.64
Revenue (CAD)**	14,457,831.33	14,457,831.33
Expected CAD Profit	1,807,228.92	996,292.86
Percentage Profit	15.00%	7.77%
Revenue is equivalent to $12mm USD		

Tesla Deliveries Fall

*"The electric vehicle maker reported that it had delivered just over **250,000** cars globally, an **18%** drop on the effort from Q1 when the company had shipped more than **310,000**.*

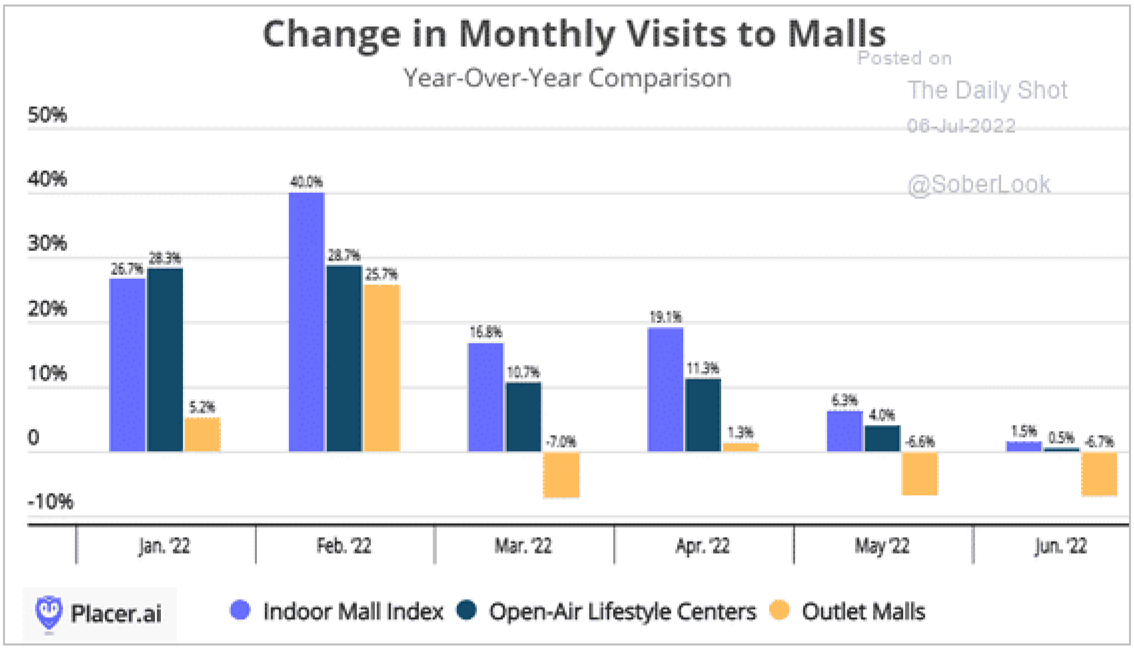
*Like Nike, Tesla has been struggling with COVID restrictions at its factories. Tesla's Shanghai factory ? known as the Giga Shanghai ? had to close multiple times in the first quarter, and broader supply chain constraints like the computer **chip shortage** haven't helped either.*

*Tesla's minor hiccup follows years of remarkable progress that made it the largest EV manufacturer in the world. But just as it struggles with its operations in China, it's also facing rising competition from within the country. Chinese rival **BYD** reported just this week that it sold **641,000** EVs in the first six months of this year, more than Tesla's **565,000**, leading some to proclaim that **Tesla has officially been dethroned** as the world's largest EV maker." - Chartr*



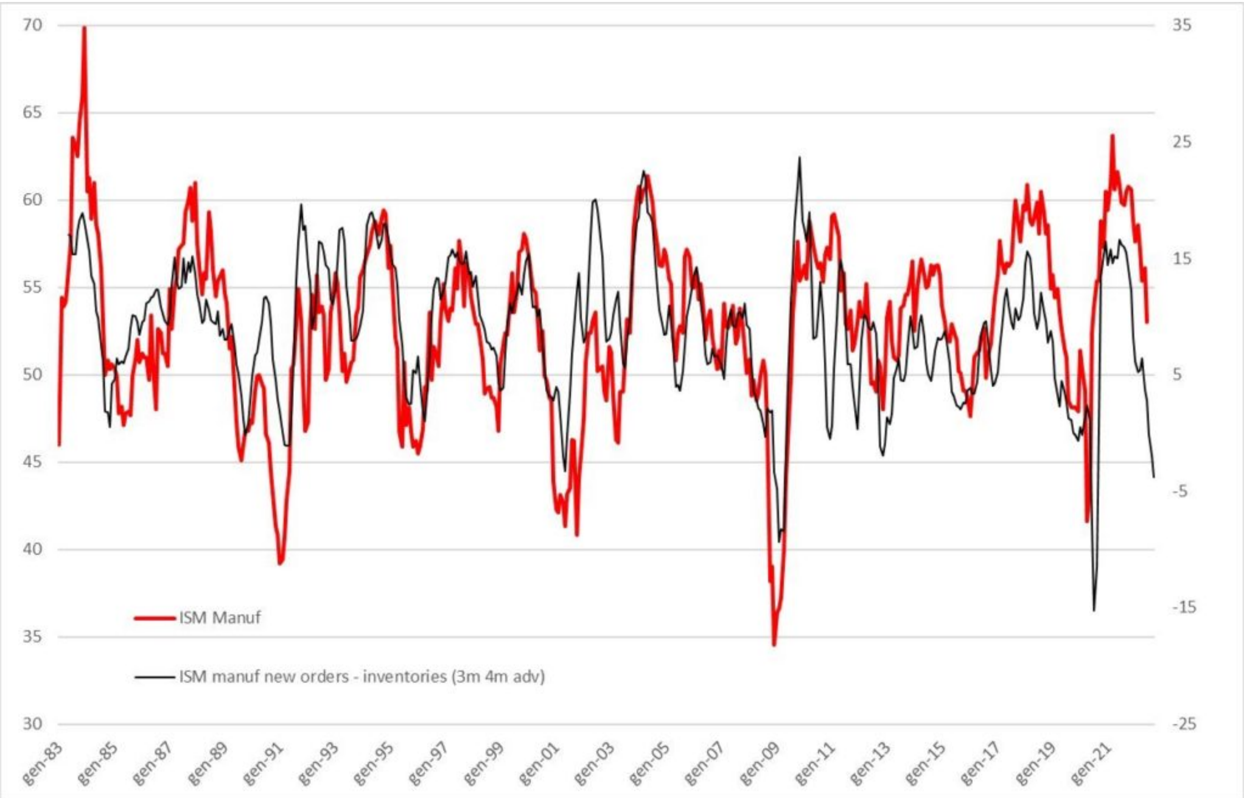
Mall Traffic Economic Indicator

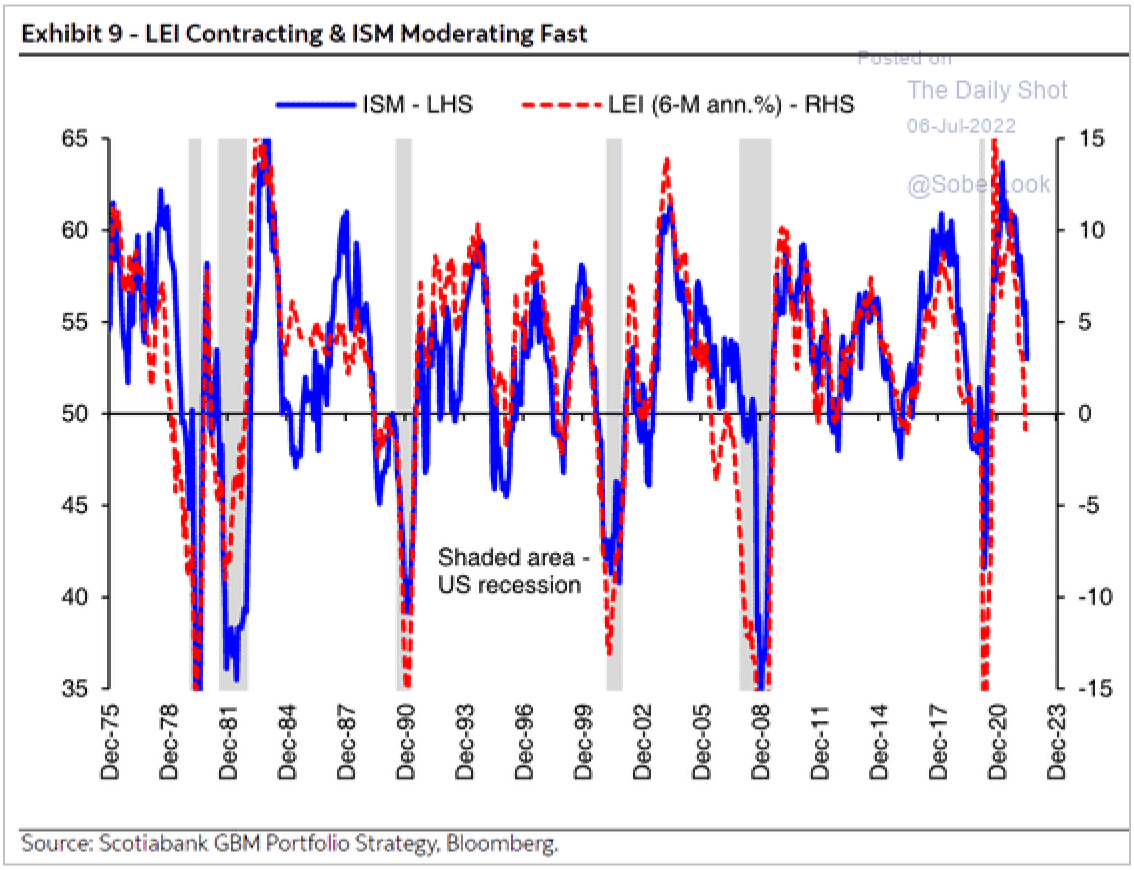
Through the first four months, mall traffic was significantly higher than in the prior year. The pace, however, is slowing rapidly. In fact, visits to outlet malls are now declining. Two factors help explain the weakening mall traffic. First, many customers avoided malls in the first few months of 2021 due to Covid. As such, the year-over-year comparison is making "normal" mall traffic in 2022 appear larger. Second, with a recession looming and high inflation reducing purchasing power, some consumers are taking a step back from shopping. Interestingly, the outlet malls are faring the worst. One would think they would see better traffic as they tend to offer lower-priced goods. While that may be true, many outlet malls tend to be located in further-out suburbs. As such high gas prices may be hindering some consumers from making the trip.



New Orders Matter

A reader asked us why the media focused more on the poor New Orders Index within ISM, rather than the whole ISM Index. The simple answer is that New Orders is one of the sub-indexes that tends to lead the ISM index. As New Orders slow, manufacturers have to slow down production, which weighs heavily on the broader ISM Index. The graph below shows the strong correlation between ISM and New orders. As shown, the three-month average of New Orders tends to lead ISM by four months. If the relationship holds up, we should expect a sub-45 ISM reading. Such would be approaching the levels of the last four recessions. The second graph shows that Leading Economic Indicators (LEI) also strongly correlates with ISM. It also portends a sub-50 ISM (economic contraction) in the coming months.





Please [subscribe to the daily commentary]** **to receive these updates every morning before the opening bell.

If you found this blog useful, please send it to someone else, share it on social media, or contact us to set up a meeting.