Hedge Funds, in Shift, See Further Dollar Rally

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By Gertrude Chavez

NEW YORK (Reuters) - Most hedge funds, leery of a New Year dollar rebound that has unexpectedly gained near-term momentum, have shifted their bearish view on the currency, expecting its rally to continue over the next few months.

Rising U.S. interest rates and fairly steady economic growth have combined to brighten the dollar's prospects, analysts say, convincing the normally dollar-bearish funds there's money to be made on the buck.

On Thursday, however, the dollar traded broadly lower on profit-taking following gains in recent sessions.

"Hedge funds are shifting their view and no longer are complacently saying that the twin deficits are sufficient reasons for the dollar to continue weakening," said David Greenwald, a partner at Scalene Capital Management, a hedge fund based in Newport Beach, California. He was referring to the huge U.S. budget and current account deficits which have weighed on the dollar on and off for the last three years.

"Hedge funds are starting to think that (interest rate) yield and U.S. economic growth may be sufficient to attract more than ample capital to fund those deficits and even strengthen the dollar," added Greenwald, whose fund has $100 million in assets under management.

Higher yields tend to increase the attraction of short-dated dollar deposits for foreign investors.

Greenwald's upbeat view is confirmed by the VAN Macro Sentiment Indicators for February, a survey released by the Tennessee-based Van Hedge Fund Advisors International on the outlook of hedge fund managers for various asset classes.

The survey found 48 percent of hedge funds, which generally follow market trends, maintained a bullish outlook on the dollar for February, while only 17 percent were bearish and roughly 35 percent held a neutral stance.

A currency fund manager in New York said most hedge funds vacated short dollar positions when the euro fell below $1.29 last week as the dollar proved resilient in the face of a mildly disappointing U.S. employment report for January.

"The break of $1.29 and $1.28 on Friday and Monday probably saw the last of these guys flushed out. On balance, hedge funds are positioned for a dollar rally, although not aggressively so," said the fund manager.

DOLLAR SEEN STRONG FOR NOW, BUT FOR HOW LONG? **Continued ...**

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Hedge fund managers declined to make a long-term bet on how long the dollar's rally will last but said the currency should remain strong for a few more months.

"Our cyclical signals suggest this dollar rally is going to last near term. But probably in the spring, the dollar could resume its weakness and a fall to $1.23 in euro/dollar could trigger that turnaround," said John Taylor, president of the New York-based hedge fund FX Concepts, with assets under management totaling $11 billion.

Others are more cautious: Axel Merk, president of Merk Investments in Palo Alto, California with assets of $50 million and who relies more on a macroeconomic viewpoint, said the dollar's strength is all froth and not based on substance.

"This is just some relief rally we're seeing. I don't see any structural changes on the current account in the pipeline," said Merk.

For most of last year, hedge funds stayed on the sidelines, frustrated by choppy currency price action. But in November and December, the dollar took a nose-dive after the U.S. presidential elections as traders focused on the economy's difficulty in financing its enormous current account gap.

Analysts say those two months saved the day for trend-hungry hedge funds, which had languished as currencies traded in trendless, narrow ranges.

January, however, proved to be a challenge as most hedge funds got slugged by a robust dollar boosted by the outlook for higher interest rates.

The Van Global Hedge Fund index, a long-running hedge fund performance benchmark, fell 0.2 percent net of fees in January, according to a preliminary report this week.

In the foreign exchange market, some of the biggest hedge fund names posted losses. Florida-based John W. Henry & Company Inc. (JWH), one of the largest managed futures advisors in the world with more than $3 billion in assets under management, posted an estimated loss of 18.73 percent in January for its Dollar Program, according to its Web site.

In November and December, JWH had 38.19 percent and 4.51 percent returns respectively as the fund capitalized on the dollar's broad weakness.

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