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## Volatile US equities send confusing dollar signals

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Thu Apr 21, 2005 03:30 PM ET

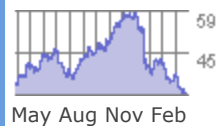
By Gertrude Chavez

NEW YORK, April 21 (Reuters) - Volatility in the U.S. stock market this month has confused currency market traders who usually see higher stock prices as good for the dollar and vice versa.

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#### EBAY.O (eBay Inc)

Last: \$31.25  
 Change: -0.30  
 Up/Down: -0.95%



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A tight correlation between rising U.S. stocks and a stronger dollar was especially evident during the stock market's bull run of the late 1990's, when foreign investors bought dollars to invest huge amounts of capital in the equity market.

The correlation, however, has reversed since 2000, some analysts say, with a bullish U.S. stock market usually a bearish sign for the dollar. But for the past several months, the relationship between the two assets has become much harder to pin down.

Stronger U.S. equities generally suggest a greater appetite for risk. But with U.S. interest rates lower now than in the late 1990's, investors prepared to take more risk are now more likely to buy emerging market currencies to take advantage of higher bond yields and more volatile stocks markets in those countries.

In recent days, however, analysts have once again kept an eye on the sharp selloff in U.S. stocks to 5-1/2 month lows, blaming the decline for the dollar's weakness. A further drop in U.S. equities prices reflected weaker earnings, analysts say, which in turn may be evidence of a slowing economy.

A slower U.S. economy might discourage foreign investment in the United States, analysts say, and make it more difficult to finance the outflow of dollars represented by the huge U.S. trade deficit.

"The pieces don't fit together. In the foreign exchange, you look at data one way, and the next week you look at something else in a different fashion," said Alan Ruskin, director of research at 4Cast Inc in New York.

"What can we draw from all this? Confusion. Right now, the market has lost

its grasp on what exactly is driving what," he added.

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Asian central banks have also become a more important factor in the dollar's direction, as they have intervened heavily against their own currencies and bought dollars instead in the past couple of years. That has blurred the relationship between the dollar and stock market.

#### BLEAK U.S. EQUITY OUTLOOK

On Thursday, the dollar was slightly weaker in very choppy trading after Federal Reserve Chairman Alan Greenspan warned about unsustainable U.S. fiscal deficits.

U.S. stocks, on the other hand, rallied after mobile phone maker Motorola Inc (MOT.N: [Quote](#), [Profile](#), [Research](#)) and online auctioneer eBay Inc (EBAY.O: [Quote](#), [Profile](#), [Research](#)) gave upbeat prospects.

But even though stocks were rising Thursday, the outlook for U.S. equities remained gloomy, analysts say.

"My outlook on U.S. equities remains negative because their profitability outlook does not look great. Companies are being squeezed on both ends -- high raw materials prices on the supply side and, on the other, consumers that are hesitant to spend because they are overly in debt," said Axel Merk, president of Merk Investments, an asset management company based in Palo Alto, California.

Sean Callow, currency strategist at IDEAGlobal in New York, said sluggish U.S. equity markets foreshadow flagging U.S. growth, which is a negative for the dollar. Although the dollar-stocks link can sometimes be nebulous, Callow believes currency markets would do well to keep an eye on the stock market for clues on the U.S. economy and the dollar.

"To the extent that equity weakness reflects declining optimism over global growth prospects, expectations of tighter monetary policy will be marked lower. Given the huge current account deficit and currently still low U.S. short-term rates, the dollar has considerably more to lose than most from the prospect of more moderate tightening," Callow said.

A string of weaker U.S. economic indicators has also pared back expectations of a faster pace of interest rate rises by the Federal Reserve, which had been supporting the U.S. dollar, analysts said.

Growth in U.S. payrolls in March was far from stellar at 110,000, disappointing even the most dollar-bearish analysts.

The U.S. March producer price index, an inflation gauge, showed benign pricing pressure, although the U.S. March consumer price index came in higher than expectations, leaving the direction of U.S. interest rates, stocks and the dollar unclear for now.

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