Reason #1 For A Stock Market Crash - Dollar vs Foreign Currency

Bear market warning flags are waving rapidly these days. There are numerous bear market signals and today I am going to focus on the dollar vs foreign currencies.

I call this Reason #1 but it does not mean this is the #1 reason why a stock market crash is looming. I see many bear market warning signals and the dollar vs foreign currency is the first one I chose to talk about.

S&P 500 Recent Market Tops

Let's first take a look at the S&P 500 over the last 25 years:

If you look at the 200 week moving average (red line) in 2000 and late 2007, you'll notice the gap between it and the 50 week moving average (blue line). We are seeing a similar picture today.

There are a couple reasons why we've seen the S&P 500 run up to new highs. One reason is interest rates. Not only in the US but around the world, interest rates are at the lowest levels in history. In some countries interest rates are 0% or have negative interest rates.

When interests rates are so low, those who rely on yields from their savings account need a new place to put their money. I saw this first hand when my Capital One 360 Savings (formerly ING) hit a high of 4.50% in 2006. My savings interest rate has been 0.75% for the last few years now.

I experienced a savings yield decline of 83%! For people who were relying on the yields from their savings, it no longer made sense to keep their money in savings. The easiest move savers could make was to invest in dividend stocks which paid 2% or more annually. This transfer of money from savings to the stock market has had an artificial impact on the stock market highs we are seeing today.

US Dollar vs Foreign Currencies

Along with low interest rates around the world we have also seen sluggish foreign currencies. Let's take a look at some major currencies of the world:

We are starting to see the Euro, Canadian dollar and Yen moving higher in 2016. The British Pound was also starting an ascent higher in 2016 but BREXIT put a stop to that. That's a unique situation and I feel the British pound would have continued to rise if BREXIT did not happen.

With interest rates and foreign currencies lower all around the world, the safest place for foreign investors to put their money was in the US stock market. The US dollar was the only currency rising when all others were falling.

US Dollar and Stock Market in Decline

In 2015, the US dollar topped out at the same level twice. In 2016, the US dollar has started its descent. The RSI, MACD and overall value are all declining.

A major reason for the US dollar declining is foreign money exiting the US stock market. Foreign money came to the US because the currencies for foreign investors were going down in value and the US dollar was going up. Foreign investors also invested in the US stock market because their stock markets were under performing and the US stock market was out performing their markets.

Foreign investors have profited in 2 ways by investing in the US Stock market. First, they have profited on converting their declining currency into a rising US currency. Second, the US stock market has been hot and out performing any other market in the world.

Now we are at one of the highest P/E's in the S&P 500 over the history of the market at a 25 trailing P/E. This is considered very expensive. There are more reasonable valuations in the international markets abroad.

From the historical P/E ratio chart of the S&P 500, you can see the P/E ratio rarely rises above 25, and when it does, the market ultimately crashes.

Now that the US market has become quite expensive and foreign currencies are trending higher, it's time for foreign investors to pull their money out of the US.

I believe we are going to see a mass exodus of foreign money out of the US stock market. Just as foreign investors profited twice by coming into the US market, they will lose twice if they don't pull out now.

We see the first wave of foreign money exiting the US markets in 2016 as the US dollar has been floundering and trending lower. The smart money has been exiting the US which includes hedge fund managers and large insurance companies. The next wave of foreign money outflows will be happening soon.

Conclusion: Dollar vs Foreign Currencies

We can always tell when the market is high risk but it's hard to know what will actually pop the bubble. I feel the coming market crash will be a significant decline for three reasons:

1. We have interest rates which have remained at historical lows.
2. Money that would normally be in savings has been thrown into the stock market.
3. Foreign investors bringing their money to the US due to their currency declining.

In the first chart of the S&P 500 over the last 25 years, you can see the two major tops prior to today's market were right around the same level. Today's market has significantly surpassed the prior two tops due to these three factors.

The US dollar vs foreign currencies is one reason why I am not too interested in starting a dividend focused portfolio at this time. My money will do better in ETF's such as FXC and ULE. When the market does start to tumble, I will have made money instead of losing money. Then I can invest in a dividend minded portfolio.

Hi readers! What do you think about the US dollar vs foreign currency markets? Do you think it will be a catalyst for a stock market crash?

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