Global macro trader who nailed the 2008 crisis says next 3 months mark 'edge of the cliff' for markets

Financial markets are at a crucial inflection point and Wall Street investors should look no further than the U.S. dollar for the clearest sign of the increasing stress on the system that could ignite a financial crisis a la 2008, says Raoul Pal. The former GLG global macro hedge-fund co-manager, who was among the few investors that predicted and profited amid the 2008-09 mortgage meltdown, told MarketWatch in a Wednesday interview that the current set up has led him to a grim forecast for the economy and markets.

"The conclusion has to be that this is the most fragile point in global financial markets since the eurozone crisis in 2012, and potentially the start of the Great Recession in 2008," he said. Pal says the U.S. dollar's relative strength, measured on a trade-weighted basis, is rippling around the world, particularly as global central banks adopt easy-money policies that appear to be more accommodative than even the U.S. Federal Reserve, driving local currencies lower against the buck.

The dollar is hovering around its highest level since 2002 as of July 31, according to the most recent data from the St. Louis Federal Reserve via Fred on the greenback's trade-weighted strength against other major global currencies (see chart attached). A Wednesday note by currency strategist at Bank of America Merrill Lynch said currencies, or foreign exchange, have become a prominent theme for all assets now. "FX has moved from the sideline to the center stage with escalating trade tension," said BAML analysts including David Woo, Claude Piron and Adarsh Sinha.

On Wednesday, government debt yields plumbed new depths after central banks in Thailand, India and New Zealand cut policy interest rates more than investors expected. Concerns also mounted after Germany reported lower-than-expected industrial production for June, pushing the country's 10-year sovereign debt, known as bunds TMBMKDE-10Y, -9.60%, to record lows at around minus 0.58%. The surprise move by the central banks helped to drive the New Zealand dollar NZDUSD, +0.1551%, known as the kiwi, down 2% against the U.S. currency at its lows, and briefly put the Australian dollar AUDUSD, +0.1923% under severe pressure in early Wednesday action in New York.

Pal, a former Goldman Sachs trader, who also co-founded Real Vision TV, says this backdrop of weakness in global currencies has been a key driver for the downbeat mood in markets. The $5.1 trillion currency market is the biggest of all financial markets and the majority of trade is conducted in bucks, so the "movement of the U.S. dollar is the most important financial input to the global economy," Pal told MarketWatch.

A focus on currencies and its impact on global economies and markets intensified earlier this week after the China's onshore yuan USDCNY, -0.2380% sank to a record low of 7.1 per dollar, breaching a so-called line in the sand for the monetary unit of the world's second-largest economy and indicating that Beijing may be prepared to unleash a variety of tactics to combat the U.S. in a yearlong tariff dispute. Pal said that currency action has helped to set the stage for markets that are trading on tenterhooks.

"The next three months is potentially the edge of the cliff for financial markets and I think we are there today, right now," he said. The trader pointed to crude-oil prices CLU19, +2.96% sinking more than 4%, pushing the commodity into bear-market territory, usually defined as a drop of at least 20% from a recent peak.

Pal said assets like gold GCZ19, -0.55% and oil are both responding to signs of global economic weakness. Bullish bets on the yellow metal are accelerating amid increasing expectations that the Fed will continue to cut rates, an upbeat environment for bullion, even if the dollar continues to firm against its rivals. Meanwhile, investors in oil are wrestling with the prospect that a global slump will harm demand for crude.

The former trader said the moves in markets, with a number of other assets breaching long-term trend lines, has been stunning. "We are seeing an extraordinary turn of events. This is not just short-term market stuff, these are really big levels, so big that I can't quite get my head around what the market pricing actions are suggesting," Pal

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