Rockefeller Strategic Currency Briefing©

Monday, January 3, 2011
Price Quotes as of 5:00-6:00 am EST
www.rts-forex.com

	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	81.38	SHORT USD	WEAK	12/23/10	82.98	1.97%
GBP/USD	1.5479	SHORT GDP	WEAK	12/21/10	1.5497	0.12%
EURO/USD	1.3321	SHORT EUR	WEAK	12/21/10	1.3151	-1.29%
EURO/JPY	108.42	SHORT EURO	WEAK	12/23/10	108.76	0.31%
EUR/GBP	0.8604	LONG EURO	STRONG	12/15/10	0.8466	1.63%
GBP/JPY	125.94	SHORT GBP	WEAK	11/24/10	131.33	4.10%
USD/CHF	0.9354	SHORT USD	STRONG	12/14/10	0.9624	2.89%
USD/CAD	0.9933	SHORT USD	WEAK	12/13/10	1.0086	1.54%
AUD/USD	1.0211	LONG AUD	WEAK	12/14/10	0.9993	2.18%
AUD/JPY	83.08	LONG AUD	WEAK	12/09/10	82.55	0.64%
USD/MXN	12.3597	SHORT USD	WEAK	12/23/10	12.2995	-0.49%

Position Gain/Loss (%) is calculated on the difference between Open Rate and Spot. The Gain/Loss is hypothetical—we do not claim to execute trades at these levels. Note that Gain/Loss does not account for the cost/earning of carrying a position, which can be substantial. It is therefore unrealistic and not comparable to a true Gain/Loss accounting of real-world trades done at the same levels. The purpose of the Gain/Loss entry is to show roughly whether the current forecast is right. **This morning FX briefing is an information service, not a trading system. All trade recommendations are included in the afternoon report.**

Executive Summary: The dollar is up against the euro, pound and yen but down against the Swiss franc and Other Dollars. Many non-US markets are closed today, including Tokyo and London, but in equities, it looks like the year is starting with a bang—the Milan index rose almost 4% on good manufacturing data and the S. Korean Kospi hit an all-time high. We get the US version of the manufacturing PMI this morning at 10 am and if it meets expectations (57 from 56.6 in Nov for the fastest growth in 7 months), US equities should do the same thing—rally like crazy.

The euro is especially problematic, having ended the 2010 year down 6.5% y/y but making a surprisingly strong effort to rally in the last few days. Those who traded from Wednesday to Sunday night had the opportunity to make outsized gains as the euro rose and fell by hundreds of points--both ways. The market has yet to return to the theme of EMU sovereign risk contagion.

What's Happening This Morning: The euro went on quite a roller-coaster ride in the last days of 2010, from a low at 1.3050 on 12/23 and a lesser low of 1.3080 on 12/28 to a high of 1.3423 on Friday. A lesser low is a bullish sign but by the time the last day of the year ended, the euro had failed to match the Dec 14 high at 1.3497, although it had surpassed the 62% Fib retracement level of the downmove. Previous intermediate highs and lows, which we call "historic" levels, are really important, but so are absolute numbers of points, and a 343-point gain in three days is a big deal. Then, from the open Sunday night at 1.3368, the euro fell hard to 1.3247 late in the Asian session, and has bounced up to 1.3354 by 7 am EST today.

We often get a new year surprise but this is a doozy of a volatile move, especially since so many markets are still closed, and we confess to having little insight on what happens next. On some measures, the euro is overbought and since it failed to match and surpass the previous intermediate high, we should expect the downtrend to resume—but we will not feel confident about this forecast until the euro reaches 1.3200 or so, the midpoint of the upside breakout last Tuesday. There's something about Tuesdays that inspires big moves…

Today the "reason" for the euro's bounce is a good EMU manufacturing PMI, previously reported in the flash estimate at 56.8 from 55.3 and today revised to 57.1, meaning activity was even better than initially seen.

Moreover, Spain and Ireland seem to be starting to catch up with Germany and France, with Ireland's PMI up for the third month to 52.2 from 51.2 in Nov and Spain's PMI to 51.5 from 50. Greece continued to dip to 43.1 from 43.9 in Nov. Germany, of course, is humming along at 60.7 from 58.1 in Nov and France had a small drop to 57.2 from 57.9 but Nov was, after all, a 10-year high. Italy had a PMI gain to 54.7 from 52.9. Oh, dear—do we have to start following each member as in the old (pre-EMU) days?

The WSJ reports "The expansion in the euro zone's manufacturing activity appears set to continue, with new orders growing at the fastest rate since April, led by Germany, the Netherlands, Austria and France. Export orders increased at the fastest pace for seven months, with the expansion particularly rapid in Germany and France…. Manufacturing firms are responding [to higher orders] by hiring workers, with jobs growth at its highest since October 2000, although job losses continued in Spain and Greece."

The FT headlines that the good PMI in Italy set off a round of exuberance—the Milan FTSE MIB index climbed 3.8% by mid-session.

European Financial Crisis: As we all get ready to face the next chapter in the EMU debt crisis, Estonia joined the EMU on schedule on Jan 1 as the 17th member. We have little fresh news on the crisis. The FT reports that the sovereign debt crisis is starting to affect corporate borrowing capability. "European companies on December 21 paid an average premium of 1.89 percentage points over benchmark government rates, compared with 1.69 percentage points for US groups. That 0.20 percentage points differential was the largest on record. European groups have historically paid lower premiums because of differences in their debt structure.

"The differences are even more pronounced in credit default swaps, used by investors to protect themselves against the risk of bankruptcy at a company. US and European CDS indices were roughly the same at the start of September but have diverged wildly since then. The US investment-grade five-year CDS index has fallen from about 105 to 85 during the period, while the iTraxx Europe five-year index has stayed flat at 105." Some companies are feeling contagion: "The situation is even worse at companies and banks located in peripheral eurozone countries, many of which have, in effect, been shut out of the market. One of the worst performers in recent weeks has been Enel, the Italian utility that has a large debt burden following the purchase three years ago of Endesa, the Spanish electricity group. Spain's soaring financing costs have caused it to postpone plans to repay utilities billions of euros it owes them, sparking Moody's, the rating agency, to place Enel on review for a possible downgrade."

Compare this situation with the US corporate landscape, where companies are sitting on about $2 billion in cash (but states and cities are stiffing their suppliers).

<u>Dollar/Yen Intervention Saga</u>: The dollar/yen made a double top at 84.39 on 12/1 and 84.51 on 12/15 and then proceeded to drop to 80.90 on Friday. If you want to understand the phrase "If you can't buy it, sell it," check out the dollar/yen chart. Today the dollar is bouncing upward a bit to 81.46 so far, but having made a 12-day downmove, a corrective bounce is only to be expected. Last week the FT noted that the move was not going unnoticed in Tokyo, where FinMin Noda said (on Thursday) that trading was "one-sided" and "Our stance remains unchanged that we will take decisive steps when rapid moves occur."

The FT says "Japan spent ¥2,125 billion ($24.7bn) intervening to stem the rise in the yen and support its exporters in the month to September 28. The ministry of finance spent Y1,660bn on September 15, the largest day of intervention in its history. The usually tight correlation between a rise in the dollar against the yen and a rise in US government bond yields over their Japanese counterparts had broken down in recent weeks, said Neil Mellor, of Bank of New York Mellon. He said that breakdown could prompt Japan back into the foreign exchange market to suppress the value of the yen.

"Mr Mellor said the new situation reflected concerns over the fiscal situation in the US, with rising US bond yields a reflection of increased concerns over the country's finances rather than confidence in US growth. "All evidence appears to point to the probability that, once the concerns surrounding the eurozone begin to

ease, then the focus for the markets will switch very firmly back to the dollar's very serious shortcomings," he said. "

We take a different view, that G20 or maybe just the US alone disapproved of the Japanese intervention during September and took Japan to the metaphorical woodshed. Remember that the G20 meeting in October was riddled with barely suppressed arguments over "currency wars." Intervention is probably not on the table again so soon.

Equity Markets: The Dow closed up on the last trading day by 0.07% and the S&P down by 0.02%. Many markets remain closed today (London, Japan, China, Australia) but European bourses rose strongly this morning, with the German DAX up 1.5% and the Paris CAC up a whopping 2.2% at mid-morning. Earlier, the South Korean Kospi rose 0.9% to hit an all-time high and the Hang Seng rose 1.7%.

Other Markets: Oil closed higher at $91.38 from $89.84 amid talk of $100 being easily within reach. At 8:17 am EST today, oil is up to $92.81, a 27-month high on what Bloomberg says is "speculation the U.S. will sustain an economic recovery into this year, bolstering consumption in the world's largest crude user." Last week the Energy Dept reported fuel demand at the highest since May 2008, one of the key factors in forecasts for the good PMI this morning.

"Oil advanced 15 percent last year, building on a 78 percent rally in 2009, as signs the global economic recovery is gaining momentum stoked demand for raw materials. Commodities beat increases in equities, bonds and the dollar as China led a recovery from the deepest recession since World War II. Crude may fall this week, a Bloomberg News survey showed. Eighteen of 31 analysts and traders, or 58 percent, forecast prices will decline through Jan. 7. Ten respondents, or 32 percent, predicted futures will rise and three estimated there will be little change." December had the biggest and longest drop in inventories in a year, 7.2% under the 5-year average.

The Main Event: The yield on the 10-year T-note dipped to 3.305% on the last trading day of the year, from 3.369%. Market News notes that the range last year was high of 3.99% (April 5, 2010) and a low of 2.387 (October 7, 2010). The Bloomberg survey sees an average of 3.53% for this year.

US Economy: US data has been a bit better of late, raising the prospect of too-soon celebration. NYT op-ed writer Krugman, who is annoying but must be read, says we are at risk of failing to notice that even if growth were at 4% over the next few years, employment is very, VERY slow to respond. He is still pushing for stimulus spending like the Depression-era WPA, despite the new mood in Washington fully against any such thing on deficit grounds. When we hit the debt ceiling on March 15 or so, Krugman says, the Republicans "will try to force President Obama into economically harmful spending cuts." We wonder if instead, evidence of reining in big government might inspire banks and corporates, together sitting on some $3 trillion in cash, to start lending and spending (and hiring).

Krugman also worries about the Fed ending QE2 and not getting to QE3 and more, "partly because Republicans are trying to bully the Fed into pulling back, but also because a run of slightly better economic news provides an excuse to do nothing. There's even a significant chance that the Fed will raise interest rates later this year — or at least that's what the futures market seems to think. Doing so in the face of high unemployment and minimal inflation would be crazy, but that doesn't mean it won't happen."

Oh, please. First, the Fed is independent and while it has to be sensitive to the mood of Congress, we have no evidence Bernanke can be bullied. Second, perception of rising rates are a signal to banks and businesses that they had better get up off their duffs and start making plans to take advantage of the biggest giveaway in history—zero rates. Krugman is pushing the conventional wisdom but we say sometimes unconventional wisdom works, too. In the Reagan era, mere talk of cutting government and setting business free from government interference was sufficient to goose the economy. It was all talk without much real action, and it was dreadful and dumb "supply side economics" to boot, but to a certain extent, it worked. Behavioral economics is still fooling around with experiments on individuals' perception of risk and value, but we wonder if it's not time for behavioralists to move into the macro sphere. The problem, of course, is that the US economy and markets

are not a laboratory and experimentation is wildly dangerous, but it looks like we have no choice.

The WSJ points out that capital spending is likely to be robust now that tax deductibility will be 100% this year. "Investment by U.S. companies in equipment and software in the third quarter was up 15% from a year earlier to $1.08 trillion, nearly matching prerecession levels, government data show." If companies don't expand investment, they may pump money into dividends—a S&P analyst says more than half of the companies whose stocks are included in the S&P 500 index will raise their dividends. Another option is overseas expansion, alas. But the sums are huge, dwarfing government stimulus. The WSJ never names an amount for the hoard of corporate cash, but says "At the end of the third quarter, cash held by 419 nonfinancial companies in the Standard & Poor's 500 list was up 49% from three years ago—before the start of the recession—while total debt was up a more modest 14%, according to an analysis by The Wall Street Journal. The improvement in just the past year was even more pronounced: cash was up 10.6% from the 2009 level, while debt grew 2%.

"Profits are higher, too, after companies slashed their work forces and closed less-efficient operations. Total U.S. corporate profits in 2010's third quarter rose 26% from a year earlier to $1.64 trillion, the highest in four years, according to government data. With this stronger foundation, coupled with new confidence about the global economy, corporations are looking to expand."

Canada: As of Jan 1, the corporate income tax rate was reduced to 16.5% from 18% last year and 19.5% when the graduated cuts were begun. On Jan 1, 2012, the rate will drop to 15%. Canada now has the lowest tax rate on new business investment in G7 and by next year will have the lowest statutory tax rate in G7. If the EMU considers Ireland's 16% corporate tax rate "predatory," why would the US not think the same thing of Canada? Such a low corporate tax rate is a huge competitive advantage.

China: Market News says that as of the last trading day of the year on Friday, the net gain in 2010 in the dollar/yuan was a measly 3.12%. The Friday central parity was 6.6227 and the close was 6.5897 (vs. 6.8270 at end-2009), the highest since reforms began in July 2005. The yuan is up 24.96% from the July 2005 revaluation including that day's 2.05% reval.

On Friday China announced that exporters can keep a bigger portion of earnings overseas instead of being forced to convert into yuan. This raises the interesting question of how Chinese businessmen view currency vs. country risk. The yuan is still rising, so taking money home is rational, but the regime is authoritarian and expropriation not a remote possibility. Just a few years ago, China would have been worried about capital flight….

In other news, over the weekend China reported a drop in momentum, with the purchasing managers index down to 53.9 in December from 55.2 in November, although the index has stayed above the 50 break-even mark for 22 straight months, according to Market News. "The overall new orders index fell sharply to 55.4 in December from 58.3 in November. Metal products, beverage and transportation equipment industries still booked a reading of over 60. But chemical products, oil refining and other industries saw a reading of under 50. Along with falling new orders, the production index also fell to 57.5 in December from 58.5 in November, indicating slower but still strong output growth.

"While overall new orders fell, export orders growth accelerated, suggesting slower domestic demand growth for Chinese products. The index measuring new export orders inched up to 53.5 in December from 53.2 in November…. Cost pressures also moderated for Chinese manufactures in December. The index measuring input prices fell sharply to 66.7 in December from 73.6 in November. Of the 20 industries surveyed, six of them saw readings of over 70 in December, compared with 15 in November.

"The overall business conditions index inched down for a third straight month to 62.08 in December from November's 64.14 and 65.03 in October. In similar fashion to the CFLP, the HSBC China manufacturing Purchasing Managers' Index fell to 54.4 in December from 55.3 in November, with output and new business rising at the slowest pace in three months. Domestic demand underpinned the growth in December, with export business growing at a much slower rate, HSBC said."

Outlook: This is a big week for data. Monday we get the ISM manufacturing index and Nov construction index and tomorrow it's auto sales, factory orders and the minutes of the Dec 15 FOMC. Note that tomorrow the UK gets a jump in VAT from 17.5% to 20%--eeek. On Wednesday, dissenter Fed Pres Hoenig makes a speech, and the data includes the service sector ISM and the usual ADP private jobs report. Thursday the ECB meets, and Friday has a ton of news-driven potential—not only jobless claims but Nov consumer credit and speeches by both Yellen and Bernanke, who addresses the Senate Budget Committee. The Fed next holds a policy meeting on Jan 25-26. And ahead of Chinese Pres Hu's visit to the US on Jan 18-19, we will get plenty of rhetoric on non-level playing fields and unfair exchange rates.

Market News compares year-end 2010 with year-end 2007, before the mud hit the fan, noting that Fed funds still at zero is far off the level in Dec 2007 at 4.25%. "The U.S. unemployment rate, at 9.8% in November, is a tad better than the 10% rate seen in December 2009, but remains nearly double the 5.0% unemployment rate seen in December 2007." Of all the comparisons, an interesting one is personal net worth: "In an October update, the Investment Company Institute estimated that U.S. retirement assets totalled $15.7 trillion as of June 30, 2010. While this is down from the $17.9 trillion in total assets held at the end of 2007, it is better than the $13.9 trillion seen at the end of 2008. The $15.7 trillion represents 36% of total U.S. household financial assets, the ICI said. Forty-five percent of this total is invested in mutual funds, 11% in bank and thrift deposits, 8% in life insurance companies and 36% held in brokerage account securities.

"Given that U.S. Treasury yields have fallen markedly since June 30 (from about 3.92% to current levels around 3.32%) and the S&P 500 is up over 22% from June 30 closing levels at 1030.71 to current levels around 1259, it is likely that U.S. retirement assets at the end of 2010 will be getting closer to 2007 levels. Whether "paper wealth" translates into stepped-up consumer spending is uncertain, but these gains inspire confidence…."

The year-end prognostications from everybody and his Uncle Jack are disappointing. The Bloomberg surveys, for example, predict oil at $87 on average this year. We'd rather see the range… Gold will average $1400, and we say that's probably low unless the 10-year yield fails to do better than 3.53% forecast and Fed funds at 0.50%. Most questionable of all is the euro forecast at 1.30. This kind of forecasts arises (at a guess) from the practice of removing the high and low forecasts and averaging the rest, and it's worth absolutely nothing. Also not worth much are the equity market forecasts—straight up everywhere, with the slope of Chinese equities steeper than Europe and the US.

As we start the new year, we feel more optimistic than many about the US economy, although growth tends to be a weak predictor of currency strength and the dollar has a lot of bias against it. We imagine the sovereign debt issue in Europe will keep getting kicked down the road and it remains to be seen whether outside parties, especially China, really do step in to rescue falling names like Portugal, as seemingly promised. Reserve diversification remains very much the elephant in the living room. In other words, only nasty shocks will support the dollar as a safe-haven—until yield kicks in later in the year.

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Chart Prices as of the NY close on
Friday, December 31, 2010

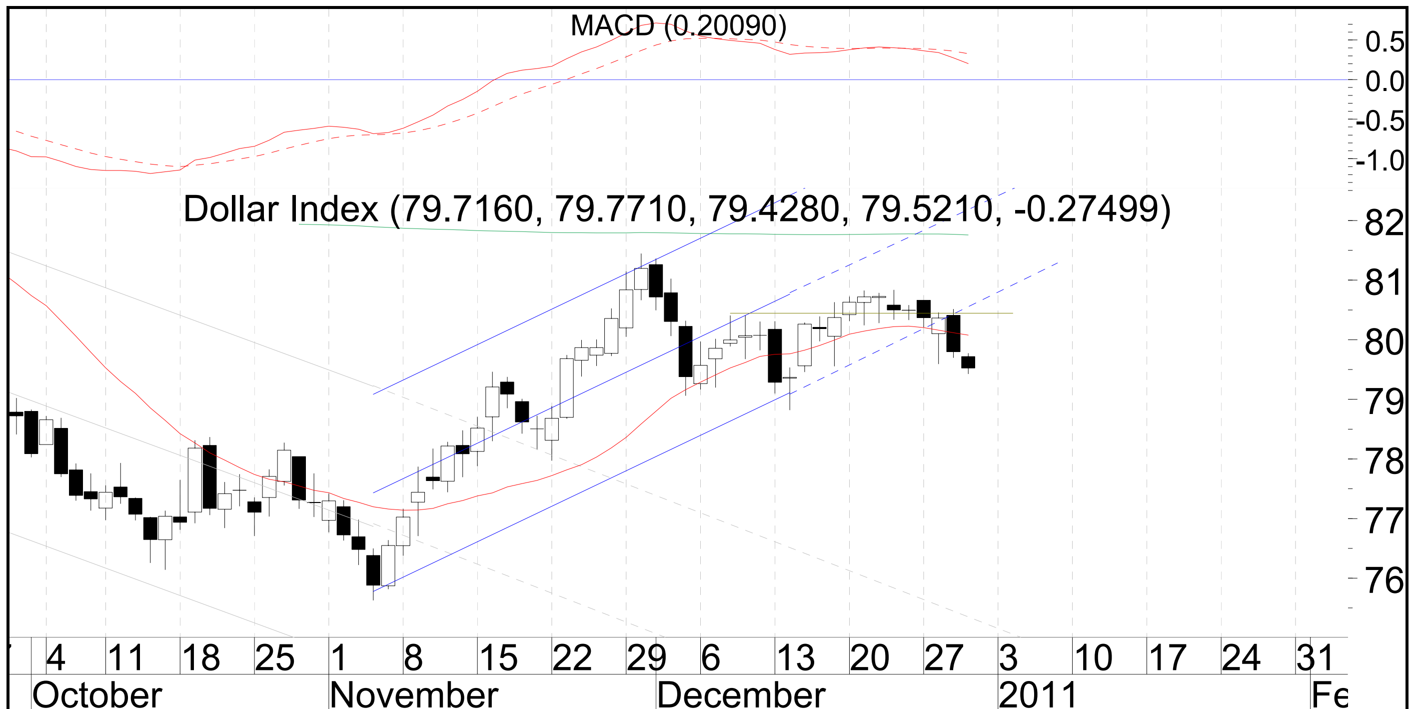
Daily Morning Chart Package

Chart Legend

Top Box: Chande momentum oscillator (relative strength index).
Center Box: Momentum (today's close divided by the close x days ago).
Bottom Box: Previous Trading Day Open-High-Low-Close.
9-day or 10-day moving average in Dark Blue.
20-day moving average in Red
55-day moving average in Turquoise.
100-day moving average in Dark Red
200-day moving average in Green.
Active linear regression channel in Blue. Previous linear regression channel in Gray. Competing linear regression channel in Red. Linear regression forecast in dotted blue. Linear regression alone in double black (occasionally). Key previous high or low horizontal line in Dark Yellow (occasionally). Hand-drawn support or resistance in red (occasionally). Vertical Blue lines mark dates of signal change from buy to sell or sell to buy.

Spot data from eSignal at 6 pm close, except EUR, GBP, JPY, CHF, CAD and AUD, whose prices are from 4 pm. Futures data courtesy of Reuters. Charts prepared in Metastock.

Dollar Index



The dollar index closed under the red 20-day for the second day and broke the channel bottom, too. It has to surpass the previous low 78.819 from 12/14 to confirm the uptrend has ended.

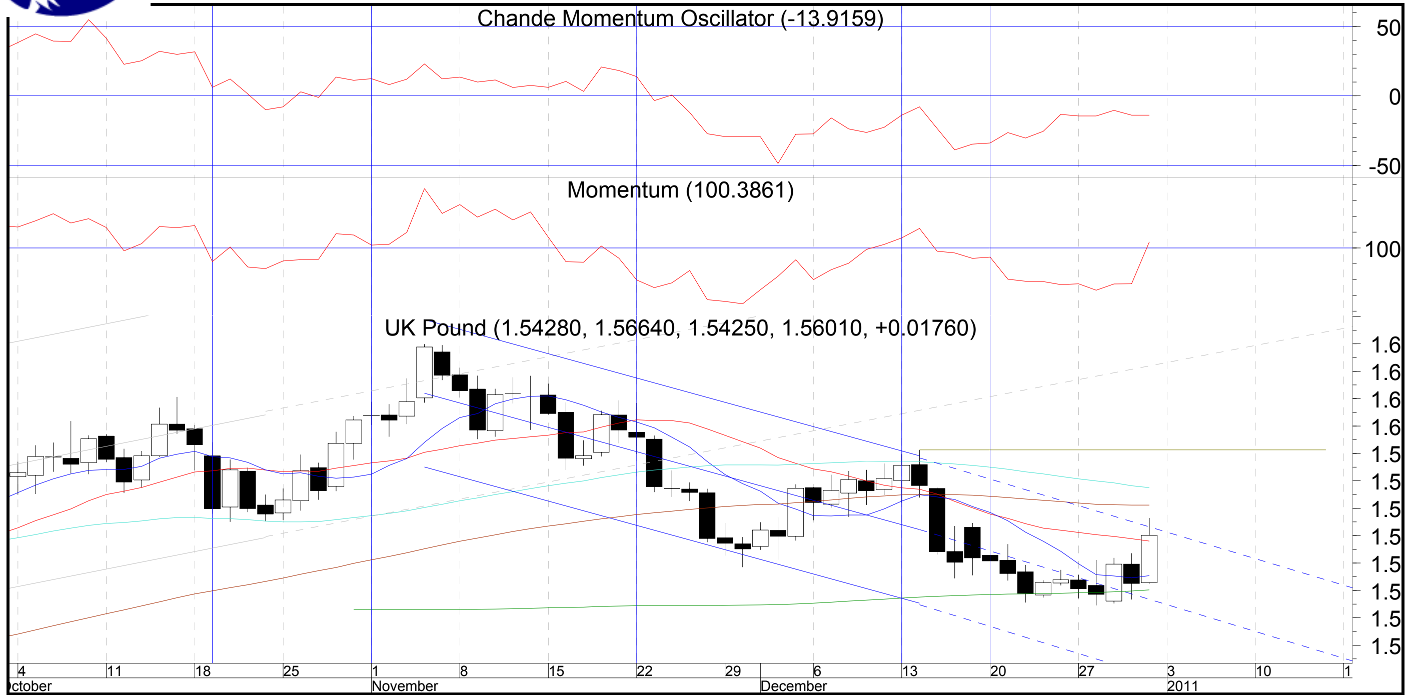
EURO/USD

The euro closed over the red 20-day for the second day and over the linreg channel for the third day, with momentum over the decision line. Normally these indications might trigger a signal change but we want to see the previous intermediate high get surpassed to be convinced (1.3498 from 12/14).

USD/SWISS FRANC

The USD fell further and closed the year at the bottom of the B band, which sometimes suggests a bounce upward.

UK POUND

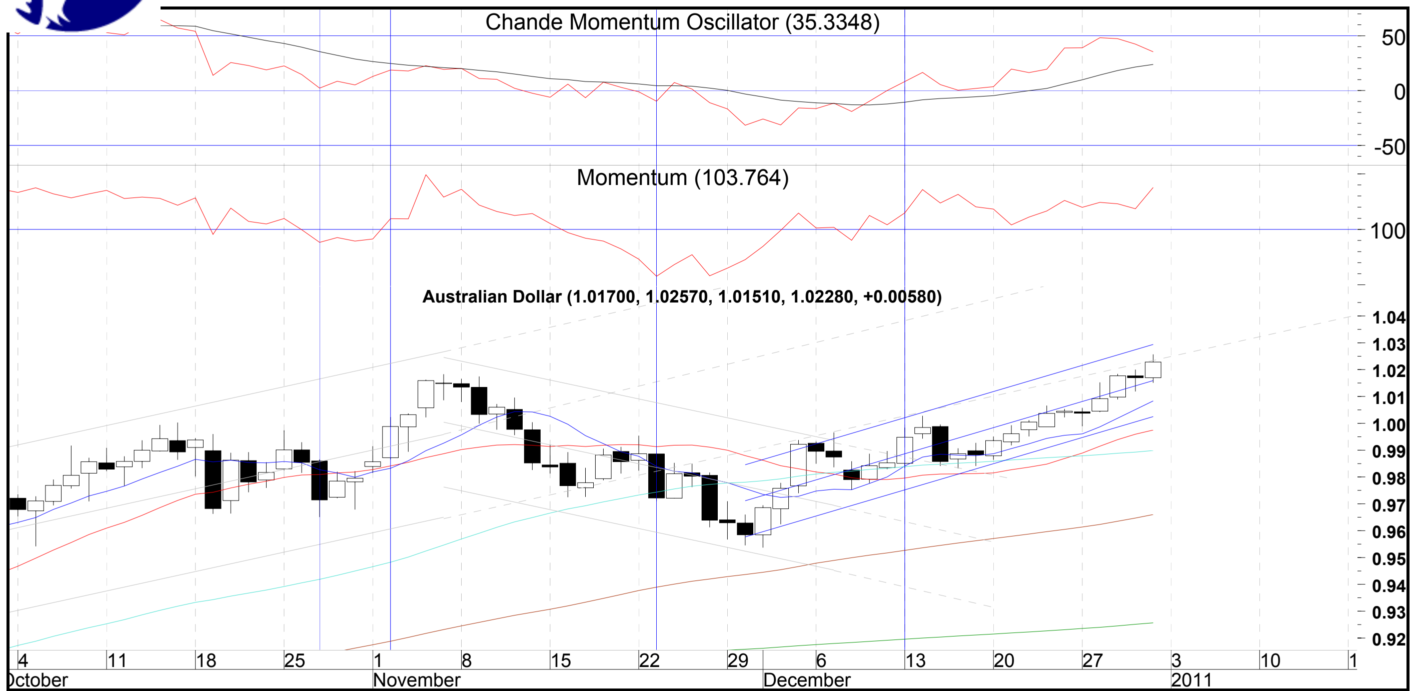


The pound closed over the red 20-day on the last trading day of the year, with momentum going positive. Again we want to see the past intermediate high at 1.5912 from 12/14 be surpassed to be convinced a trend reversal is occurring.

USD/JAPANESE YEN

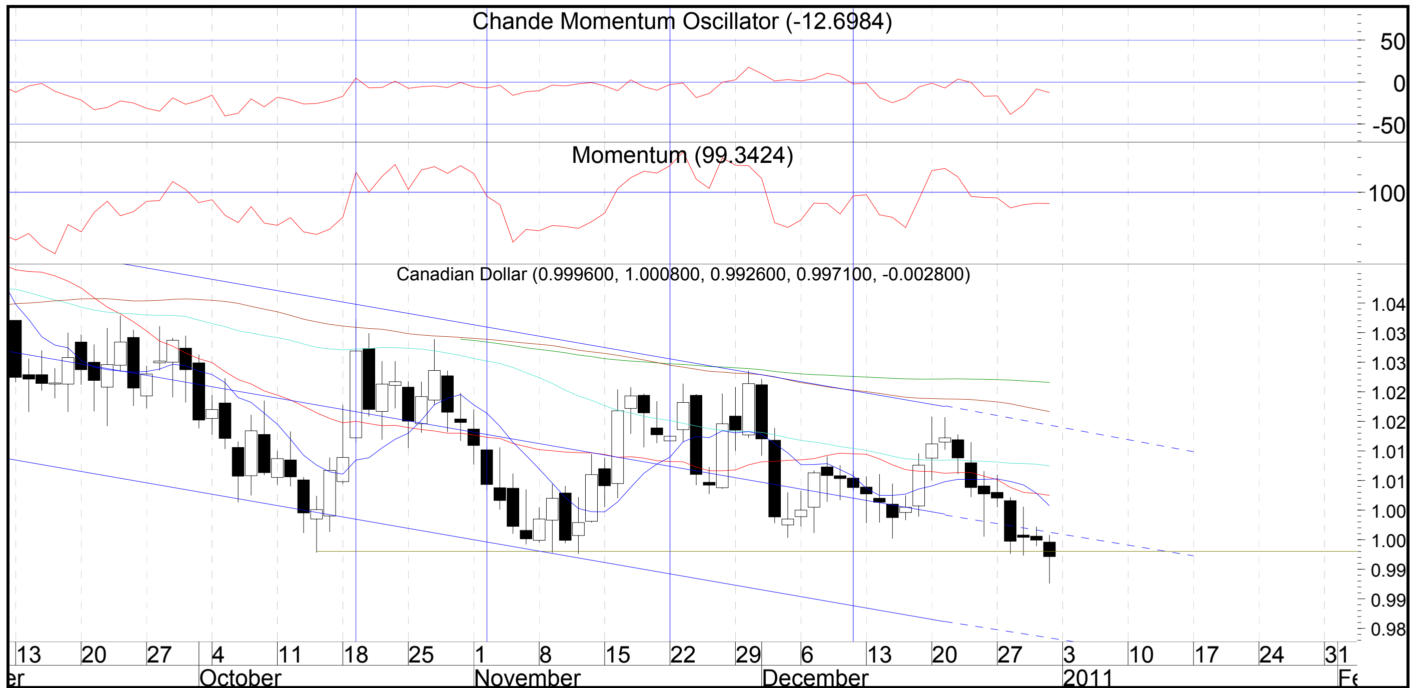
The USD/JPY closed lower for the 12th day in a row—wow. RSI indicates it may be getting oversold. The last low was 80.23 from Nov 1.

AUSTRALIAN DOLLAR/USD



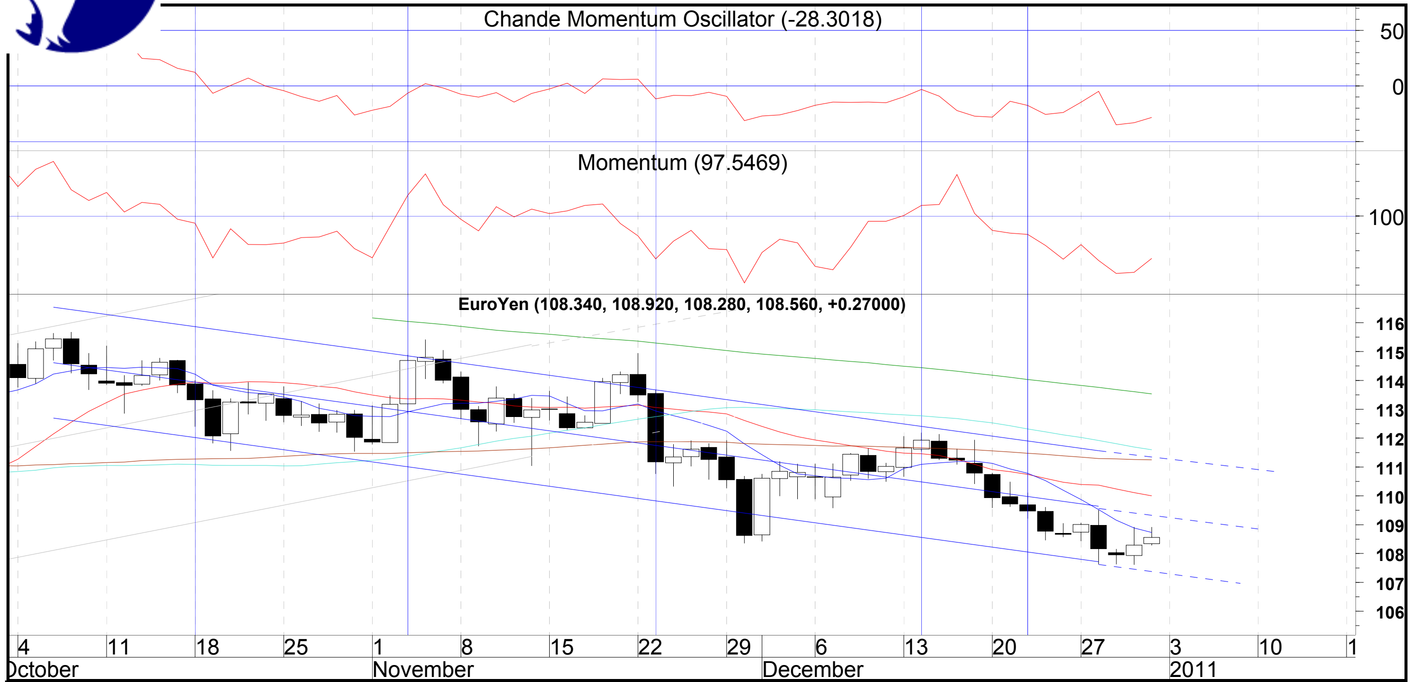
The AUD made a higher high and close, finally beating the old high from November, but such a long sequence of gains without a profit-taking pullback is rare. See RSI drooping.

USD/CANADIAN DOLLAR



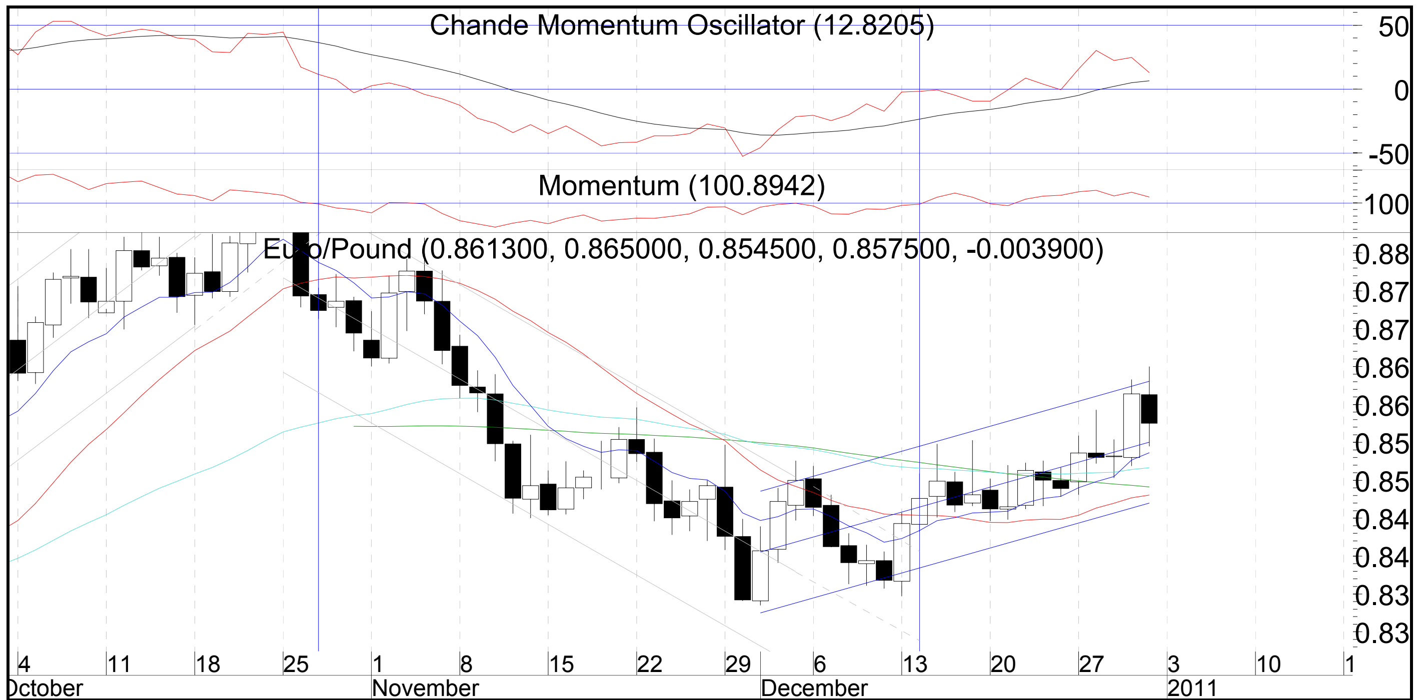
The USD finally closed under the lowest low from October but note that momentum is flat.

EURO/YEN



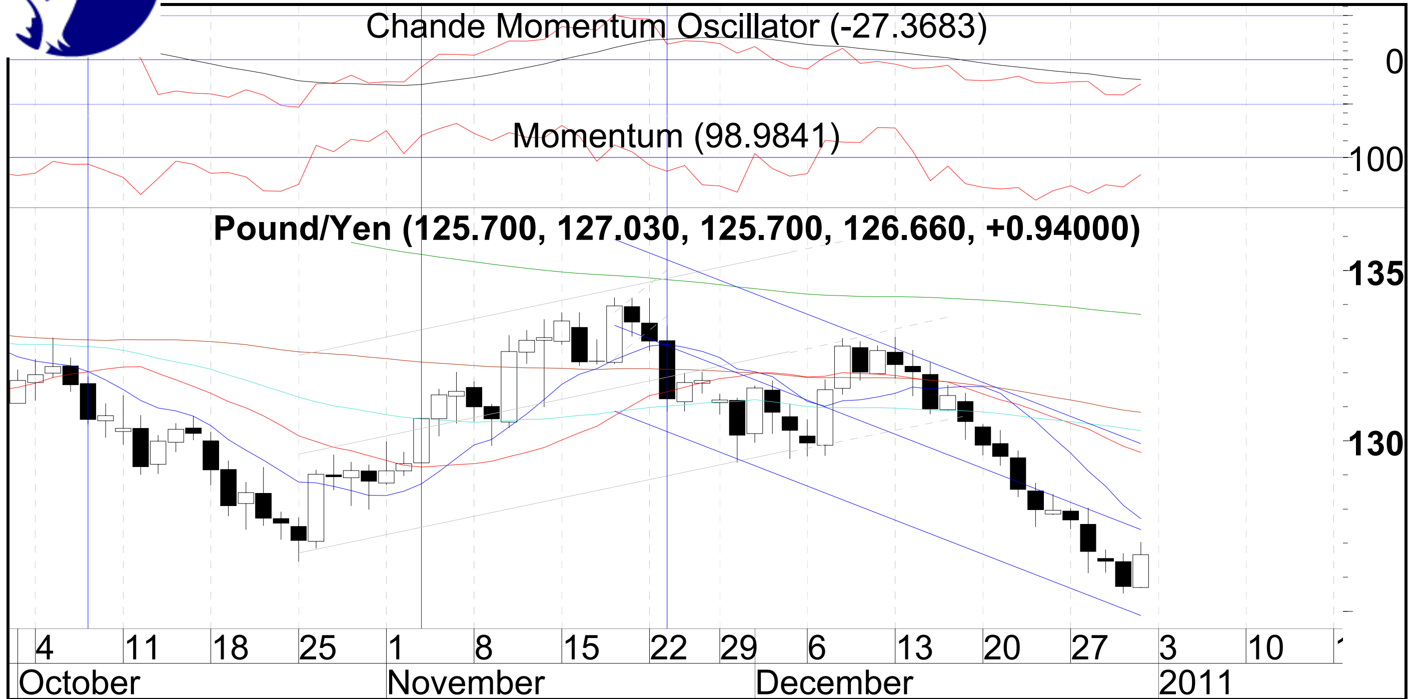
The euro/yen closed higher for a second day with RSI and momentum rising. We expect any upside correction not to exceed the red 20-day or channel top.

EURO/POUND



The euro/pound made a higher high but closed lower to end the year.

GBP/JPY

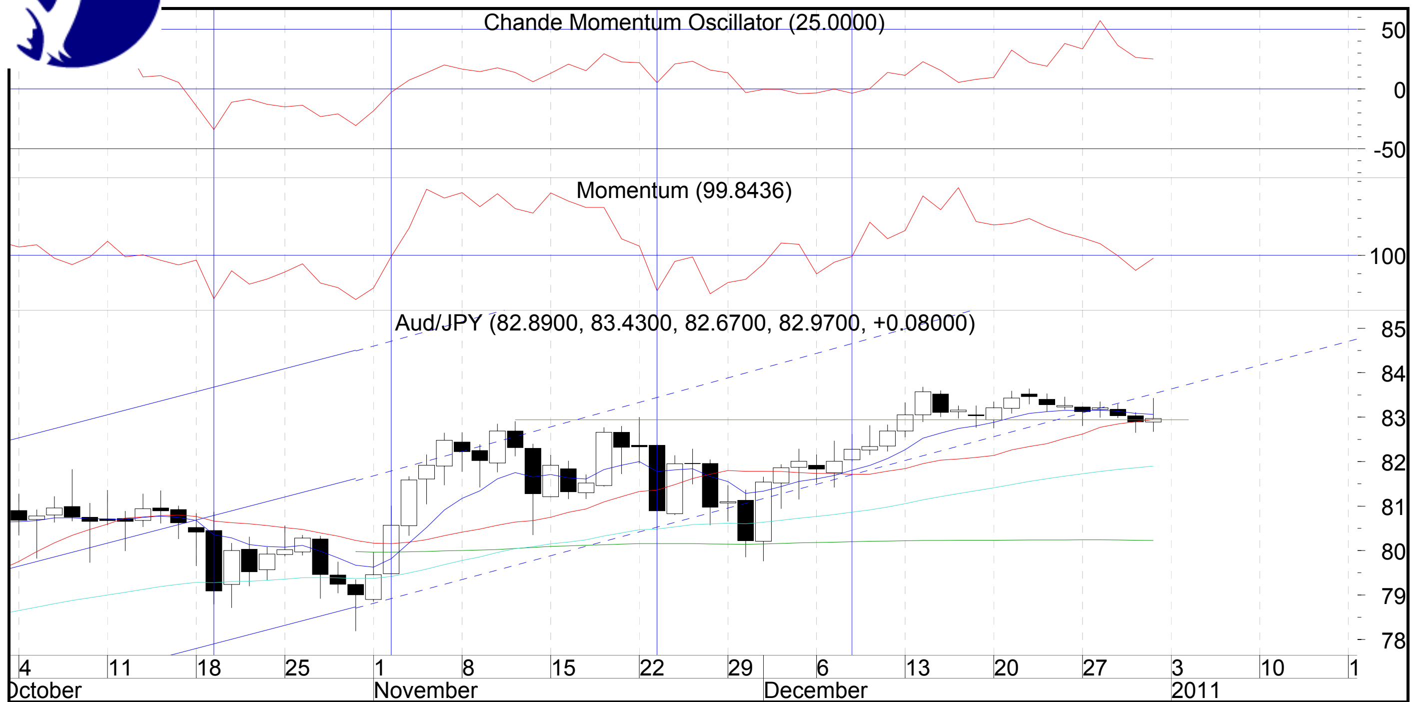


The pound/yen closed up on the last day of the year after an extraordinary run to the downside. It is running out of juice in momentum.

MEXICAN PESO

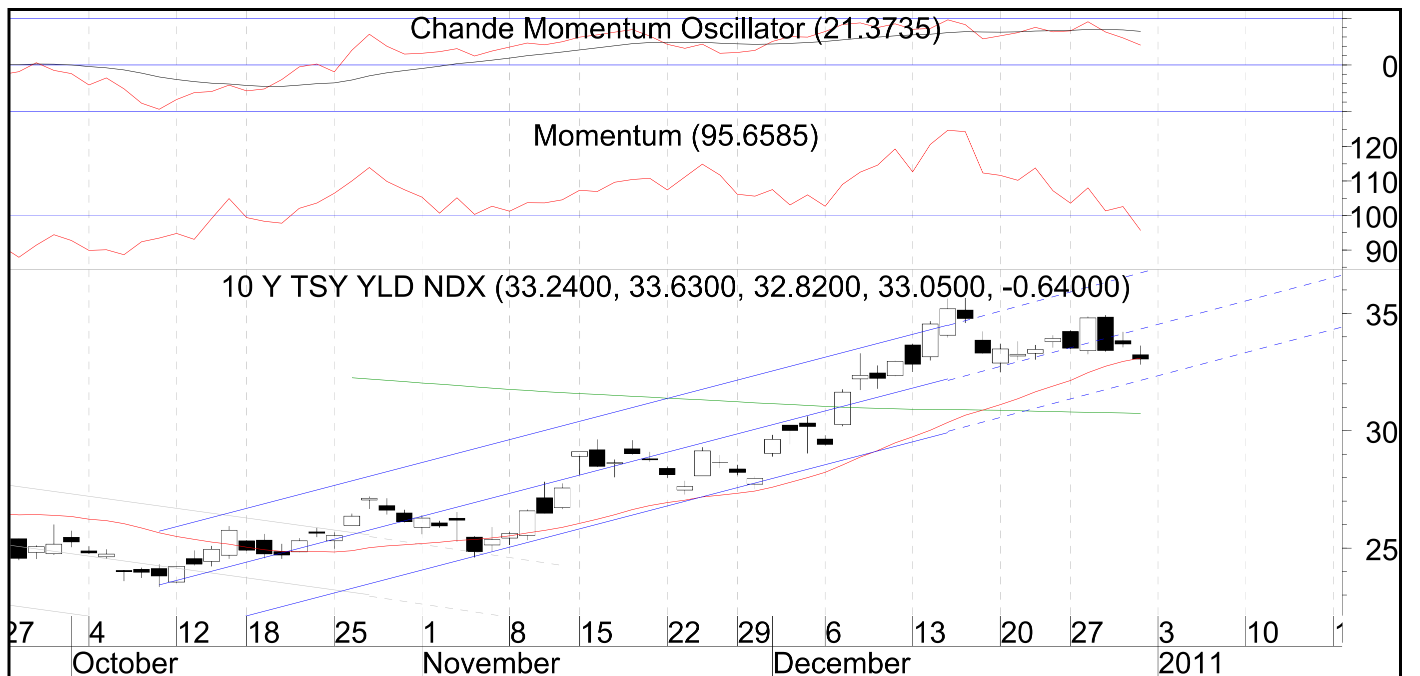
The dollar closed lower and under all the moving averages to end the year, but looks consolidative in a wide range between the two gold lines. Momentum, however, is sharply negative.

AUD/JPY



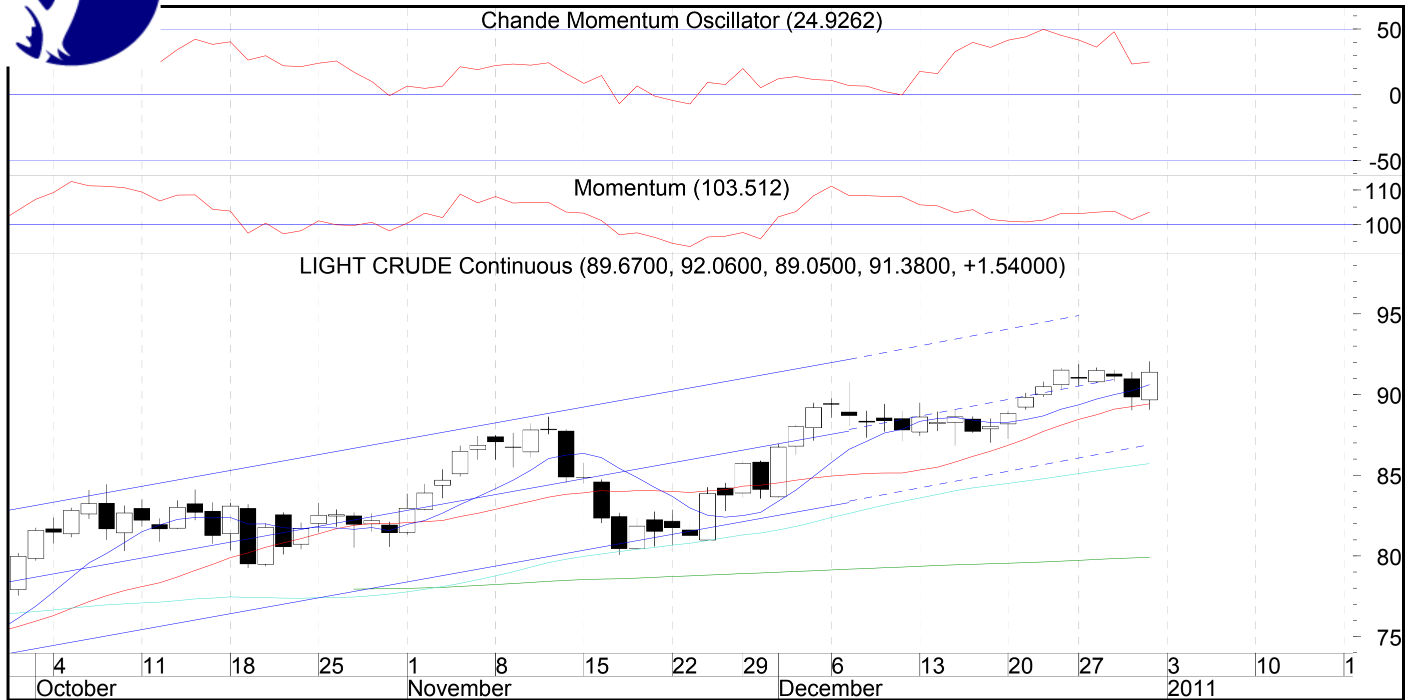
The AUD/JPY closed right at the 20-day moving average but we are nearing a moving average crossover to the downside, illogical as that may seem.

10-Year Note Index



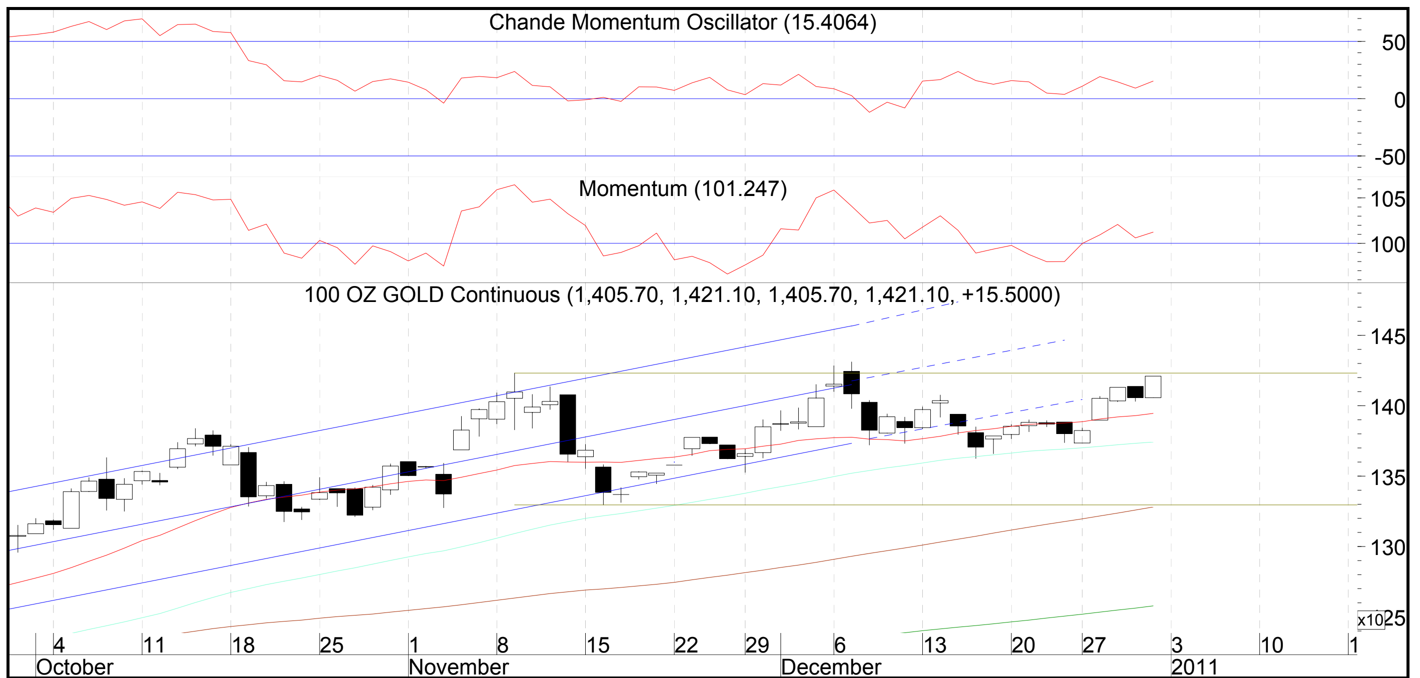
The index closed lower at 3.305% from 3.369% and under the red 20-day moving average. Momentum went negative.

NYMEX Light Crude Oil (Continuous Futures Contract)



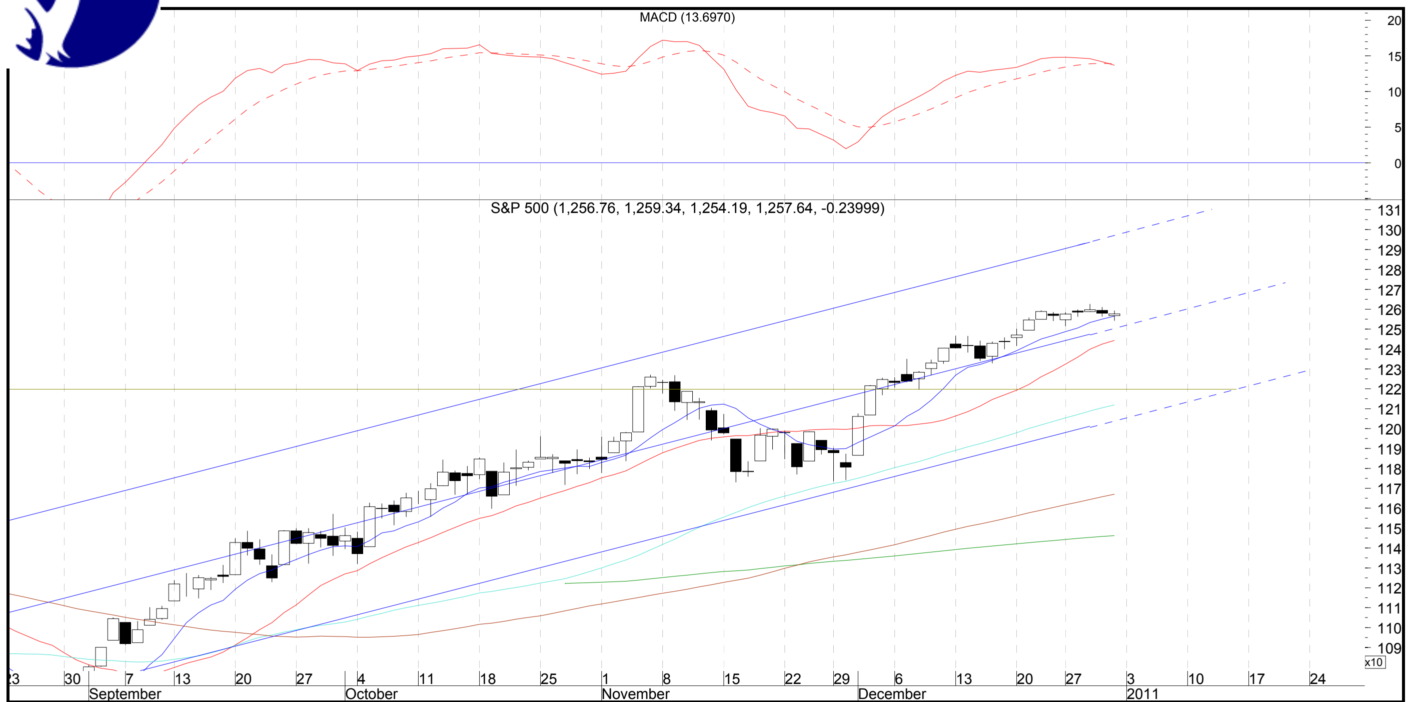
Oil closed higher at $91.38 from $89.84 on an engulfing bull candlestick.

Gold Continuous Futures Contract



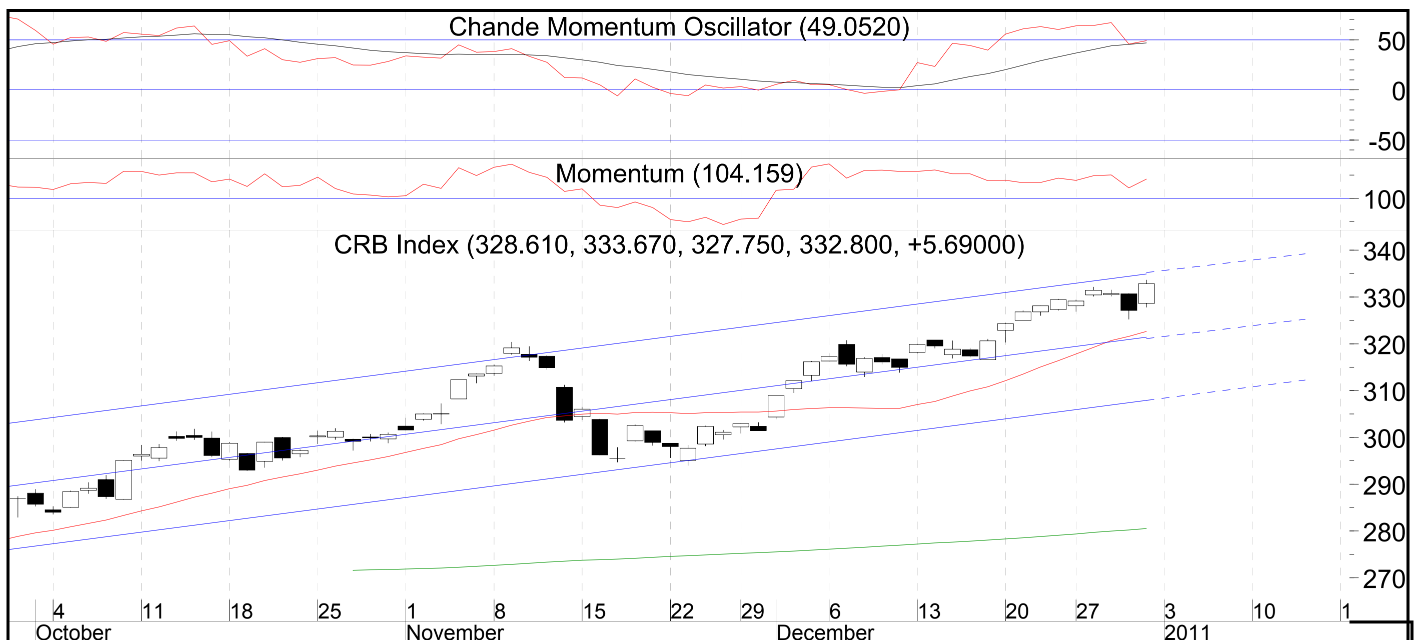
Gold closed the year higher at $1421.10 from $1405.60 and at the top of the gold trading range band.

S&P 500



The S&P closed at 1257.64 at year-end from the highest high of the year on 12/29 at 1262.60. MACD looks a bit iffy.

CRB Commodities Index



The index closed higher at 332.80 from 327.11 and is back to an overbought level in RSI.

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