



	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	82.19	SHORT USD	WEAK	12/23/10	82.98	0.96 %
GBP/USD	1.5636	SHORT GDP	WEAK	12/21/10	1.5497	-0.90 %
EURO/USD	1.3400	SHORT EUR	WEAK	12/21/10	1.3151	-1.89 %
EURO/JPY	110.14	SHORT EURO	WEAK	12/23/10	108.76	-1.27 %
EUR/GBP	0.8569	LONG EURO	STRONG	12/15/10	0.8466	1.22 %
GBP/JPY	125.81	SHORT GBP	WEAK	11/24/10	131.33	4.20 %
USD/CHF	0.9428	SHORT USD	STRONG	12/14/10	0.9624	2.08 %
USD/CAD	0.9947	SHORT USD	WEAK	12/13/10	1.0086	1.40 %
AUD/USD	1.0940	LONG AUD	WEAK	12/14/10	0.9993	9.48 %
AUD/JPY	82.94	LONG AUD	WEAK	12/09/10	82.55	0.47 %
USD/MXN	12.2244	SHORT USD	WEAK	12/23/10	12.2995	0.61 %

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 down across the board this morning as risk appetite takes off. Equities and commodities are higher. The Australian dollar is a special case (see below). The euro may be making a run at an upside breakout.

What's Happening This Morning: The euro is trading over 1.3400 at 7:30 am EST, creeping up on the last intermediate high at 1.3423 from 12/31/10. Since that was the last trading day of the year, we perhaps can dismiss it as an exceptional high, and look further back to the high before that, which is 1.3497 from Dec 14. If you can see a chart in 6-hour bars, you will see the euro/dollar is actually trading sideways since the lowest low under 1.30 on Nov 30 (1.2966), even if the range is pretty wide. In short, we are not buying into a euro trend reversal—not with new peripheral bond issuance starting next week—until we are forced. Unfortunately, it looks like force is in the air.

Market News notes that the euro is getting support from Asian sovereigns and spiked over 1.3400 on the flash eurozone CPI, a new 26-month high of 2.2% y/y in Dec. The market had a high number penciled in already (2.1%) so exceeding the forecast seemingly got an outsized outcome. Markets are supposed to be back at full force today in Europe but a jump on such a small data point looks more like holiday-thin trading to our eyes.

Sterling surprised to the upside, putting on almost 200 points from Friday, on a combination of factors. Market News reports they include a clearing bank quarterly dividend requirement, a rumor of Royal Dutch Shell looking to acquire BP, and “yield differentials favouring sterling over the dollar and euro... with Asian sovereign names among the noted buyers.”

Australia is a special case these days, with the AUD failing to get the benefit of the renewed risk appetite on worries about the weather. The state experiencing catastrophic floods is Queensland, which produces and exports both wheat and coal. The FT finds analysts who worry that the next rate hike, expected at the Feb 1 RBA policy meeting, might be postponed because of the floods. Market News doesn't mention floods, exports or the RBA and calls it plain old profit-taking after a big run up.



CFTC Commitments of Traders Report: Market News reports that speculative accounts added to the net euro short position as of Dec 28 to 26,479 contracts from 14,093 contracts the week before. This is a smallish number in comparison to the record net euro long of 119,538 in on May 15, 2007 and the record net euro short of 113,890 contracts on May 11, 2010. Evidently May is a big month for euros.

“In the yen, as per December 28 speculative accounts had a net long position of +29,641 contracts. This compared to the net yen long of +12,529 contracts seen last week and the yen long of +52,478 contracts, seen August 10, which was the largest net yen long seen since Dec. 1, 2009 (+56,907 contracts). The yen position, as per Tuesday, was in contrast to the record net long yen position of +65,920 contracts seen March 25, 2008 and the record net yen short of -188,077 contracts seen June 26, 2007.”

European Financial Crisis: The FT reports that China promised yesterday to buy Spanish bonds (ahead of a top-level meeting with government officials and the king today). The speaker is none other than “Li Keqiang, who is expected to become China’s next premier when the leadership changes in two years. [He] has committed China to buying more Spanish government bonds, in spite of the eurozone’s unresolved sovereign debt crisis. Mr Li’s promise, made shortly before a visit to Spain, Britain and Germany, is the latest example of Chinese diplomatic overtures to the financially fragile nations of the eurozone periphery.”

Mr. Li offered a full-page opinion piece in a leading Madrid newspaper (El Pais), from which we deduce this was no off-the-cuff, deniable story but a policy decision at a high level involving many people, including the editorial writer. Li wrote: “China is a responsible, long-term investor in the European and particularly Spanish financial markets, and we have confidence in Spain’s financial market. That has translated into the purchase of Spanish public debt, a course we will continue to pursue in the future.” The FT notes that we have no information on how much or when China will take this action. We note that we have no information on the quid-pro-quo that Spain must offer to get the money, either.

The FT wrote last week that the week of Jan 10 is when peripheral debt might become the hot issue again. “Banks forecast that eurozone nations could attempt to borrow up to €80bn in January. The European Union and the European financial stability facility, the eurozone’s bail-out fund, are likely to be in the market for up to €13bn to go towards the Irish bail-out. This is at least double the amount of the pre-financial crisis era, when debt loads were much lower. RBS forecasts gross debt issuance in bonds of €814bn in 2011, with up to 10 per cent of this likely to be raised in January.” Redemptions are €555 billion and coupon interest is €189 billion.

The FT displays a table of issuers showing the €814 billion by name, with Germany, France and Italy accounting for €594 billion of it, or about 70%. Italy, with €215 coming up (the biggest amount), is less of a worry because it has a huge domestic market for government debt (like Japan). The FT goes on to say Portugal has to refinance €20 billion by mid-year, while Spain is the bigger problem with €80 billion needed, more than currently available under EFSF. The RBS economist states the obvious--“Nothing can be ruled out in the eurozone. It will only take a few auctions to go poorly and that could hit sentiment and see a snowball effect.”

Equity Markets: The Dow closed up 0.81% and the S&P, 1.13%. See the chart. Tokyo followed along on economic optimism, up 1.65% to the highest level since May. The Hang Seng rose 0.99% and the Shanghai, 1.59%.

Other Markets: Oil closed higher at \$91.55 from \$91.38—not much—and remains at the same \$91.55 at 6 am today. Yesterday oil managed a high of the day at \$92.58, the highest since Oct. 7, 2008, but we say failure to hold the high is meaningful.

Bloomberg reports that the Energy Dept report tomorrow will probably shows crude inventories probably fell last week in their longest decline since 2009. The survey comes up with a forecast of a drop in crude supplies by 1.75 million barrels from 339.4 million in the week ended Dec. 31, with gasoline stockpiles



higher by 50,000 barrels from 214.9 million and distillates higher by 625,000 barrels from 161 million.

Bloomberg also says “Hedge funds raised bullish bets on crude in the week ended Dec. 28 to the highest level in more than four years, on speculation that futures will continue to climb as the U.S. economy recovers. Oil rallied 15 percent last year, adding to a 78 percent surge in 2009. The funds and other large speculators increased net-long positions, or wagers on rising prices, by 4.6 percent in the seven days ended Dec. 28, according to the Commodity Futures Trading Commission’s weekly Commitments of Traders report. It was the biggest total in records going back to June 2006.”

The Main Event: The yield on the 10-year T-note rose to 3.342% from 3.305% as the manufacturing PMI encouraged optimism about recovery and equities rallied. In addition, the Treasury bought \$7.79 billion (and will buy something every day this week). The WSJ says corporates will be competing with Treasuries, with high issuance expected. Yesterday Berkshire Hathaway Finance was the “first investment-grade corporate issuer out of the gate in 2011, selling \$1.5 billion of senior unsecured notes.”

Market News notes that on Thursday, the Treasury will announce the size of next week’s issuance, probably in 3-year (\$32 billion), 10-year (\$21 billion) and 30-year (\$13 billion). Tomorrow Congress returns and will start debate on fiscal prudence, with Bernanke speaking to the Budget Committee on Friday (after payrolls). One analyst says the anti-Fed rhetoric will start right back up again, including questions about how inflationary QE2 will be. In a vague way, attacks on the Fed and its independence are anti-dollar, since so many members of Congress seem to be such idiots.

US Economy: The ISM manufacturing index rose to 57.0 from 56.6 in Nov, about as expected. The employment component fell (to 55.7 from 57.5) but new orders rose to 60.9 from 56.6.

The Friday payrolls report is, as always, the big one. Dow Jones has a forecast of 140,000 in Dec, of which nearly all (138,000) will be private-sector. Nov had 50,000 private sector jobs, so this is a lot—but the Dec data is contaminated by holiday hiring, even though the statisticians try to keep straight temp vs. permanent and full-time vs. part-time.

UK Economy: The manufacturing sector PMI hit a 16-year high in Dec at 58.3 from 57.5 in Nov after a slowdown over the summer, the highest since Sept 1994. Jobs and exports are rising and the only black spot is prices, with input prices at the highest since the series began in 1992. Separately, the housing market did do a double dip and mortgage approvals reported by the BoE “remained depressed at just over 48,000, close to their average in the past six months and less than half the number of mortgages agreed on average every month in the decade before the financial crisis,” according to the FT.

“Net lending to companies continued to fall and lending to households grew at a weaker pace. Both businesses and households are pushing money into reducing debt, but the damaged banking sector is both less willing and less able to lend. M4 money – which includes notes and coins in circulation, deposits and shorter-term bonds – excluding financial sector distortions rose at a 3.5 per cent annualised rate in the three months to November. That is more than earlier in the year, but still well below the 6-9 per cent pace that the Bank hoped it could achieve through its £200bn of cash injections into the economy through quantitative easing.”

The FT also reports a survey of 78 economists who mostly think the country will be able to complete the deficit-reduction program without triggering a double-dip recession, although inflation remains a problem and they worry about the eurozone’s debt issues.

Separately, Market News reports that the YouGov/Citi survey of UK inflation expectations among the general public shows a big increase, with the one-year median expectation at 3.5% (from 3.3% expected in the Nov survey). This is the highest since Sept 2008. For the next 5-10 years, the public sees 3.8% for inflation, from 3.5% in Nov and the highest since May 2008. This has to worry policy-makers. Market News also reports a piece from The Telegraph newspaper citing calculations from the accounting firm Deloitte that “the cost of many goods and services will rise by between 5% and 8% as businesses use [Monday’s] increase in Value Added Tax from 17.5% to 20% to mask a more dramatic price review. The comments focus on expected price rises by many gyms, mobile phone companies, restaurants and shops in order to recoup the escalating cost of petrol, energy,



cotton and other key commodities.”

Japan: Prime Minister Kan announced an initiative to get tax reform by June, including agreement on raising the consumption tax (from 5%) to fund the deficit, expected to rise to 200% of GDP this year.

FX Industry Note: Bloomberg writes that unwound losing carry trades “are losing more money than at any time in at least a decade. The strategy lost 2.5 percent in 2010 as the dollar -- a favorite for financing the trades because of record low U.S. rates -- appreciated, according to an index compiled by UBS AG, the world’s second-largest foreign-exchange trader. That’s more than the 0.98 percent drop in 2008 when the collapse of Lehman Brothers Holdings Inc. caused credit markets to freeze and the worst performance for so-called carry trades since at least 1999 when UBS began releasing yearly figures.”

Exits from failed carry trades may help the dollar recover further than the 4.5% rally since the 12-month dollar index low on Nov 4. “Gains in manufacturing and retail sales are leading investors to buy the dollar, rather than sell it to fund other investments.”

The best carry trade last year was USD into AUD, returning 19.1%, with the S. African rand next (18.7%) and then the yen (14.5%). But “Last year, investors who had borrowed dollars to buy the Danish krone and the euro lost 6.4 percent and 6.2 percent respectively, according to data compiled by Bloomberg. Inflation-adjusted yields on benchmark 10-year Treasuries are 2.20 percent, near the most in a year, which may help the U.S. lure investors. The figure is higher than 1.26 percent for Germany, 1.03 percent in Japan and 0.10 percent in the U.K.” A Japanese bank analyst says “There used to be consensus that the dollar will weaken. But now maybe there isn’t. The dollar-carry trade faces the risk of unwinding.”

We say the analyst is not paying attention to the Fed, which wants to keep yields down to boost the economy and at least not worsen the mortgage market. Also, the bias against the dollar is much bigger deal than mere yield comparisons.

Outlook: Market News notes that strengthening risk appetite yesterday led to perception that oil and gold will soon re-test “the psychological \$100 level in oil and the life-time high of \$1430.95 in gold in coming sessions.” Assuming the same inverse correlation that the market believes in, this is bad news for the dollar. The perversity is quite annoying—risk appetite goes up on good US data but the dollar falls on commodity price rises based on that very same growth.

Later today we get the FOMC minutes from the last policy meeting (Dec 14), with no real surprises expected, and probably more talk of Friday’s payrolls, including forecasts of ADP’s forecast. More important by far is untangling the European debt issuance situation. Germany confirmed today that tomorrow it will be re-opening the 10-year benchmark 2.5% issue (€5 billion). France is also in the schedule. Market News notes that new supply is countered by sizeable reinvestment flows, with redemption payments due from Germany (€23.25 billion) and also Austria (€22.65 billion), with coupon payments due from Italy (€410 million), Austria (€510 million) and Germany (€13.21 billion). This turns “net cash flows positive to the tune of €46.8 billion.” If we understand this correctly, redemptions of maturing issues that is bigger than new issuance pushes more euros into the hands of investors. Why would we not think that a higher supply of euro cash should cause the euro to fall?

While the FT says issuance will begin next week, Market News notes that the WSJ reported over the weekend that Portugal is expected to hit the debt markets this week with a €500 million 6-month T-bill auction. At the last such auction in Dec, “Portugal paid 3.403% for 3-month money and 5.281% for 12-month money.”

We have quite a muddle of factors today. It looks like the euro is going to test the old high at 1.3497 just ahead of potential crisis-triggering events (sovereign debt issuance). What are these traders thinking? We are not getting comments from high officials saying the debt issuance is going to go okay and so far the Chinese promises are noteworthy but still just words, not actions. If it’s animal spirits, the euro’s rise is very risky indeed. We still have a weak sell signal from yesterday’s close on the big-picture models but a buy signal on the faster-moving traders’ models. This kind of divergence is common between the two timeframes but this time it’s really uncomfortable. If and when euro shorts start covering like crazy, the euro could burst upward a lot farther



than we imagine right now, like 1.3776, the 62% retracement of the downmove from the Nov high. We find this really, really scary.



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 third day. The low surpasses the previous low (but the close does not). We hesitate to name it a trend reversal because it's the first trading day of the year and changes may be rapid now.



EURO/USD



The euro closed a little lower but with a long lower shadow that indicates bears lost on the day. Notice that the linreg channel drawn off the recent low is dead flat. The two moving averages are inching toward an upside crossover.

USD/SWISS FRANC



The USD closed higher on an inside day, but by only 2 points. A minor pullback is only to be expected.



UK POUND



The pound closed lower and under the 20-day, and has stayed inside the channel with only one close over the 20-day. It's a big bar and we think that has weight this time.

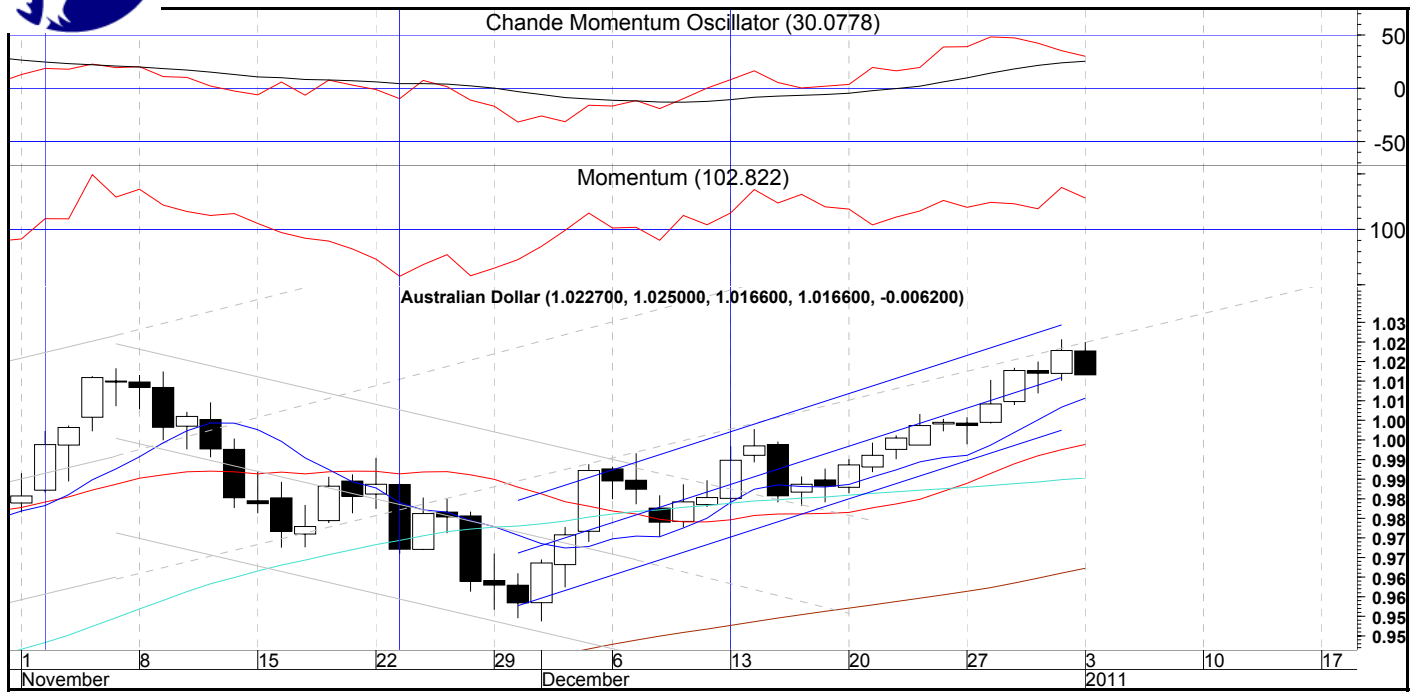
USD/JAPANESE YEN



The USD/JPY closed higher after 12 straight lower closes. A little pullback is certainly called for. The bar is an engulfing bull candlestick and so we should probably expect a continuation.

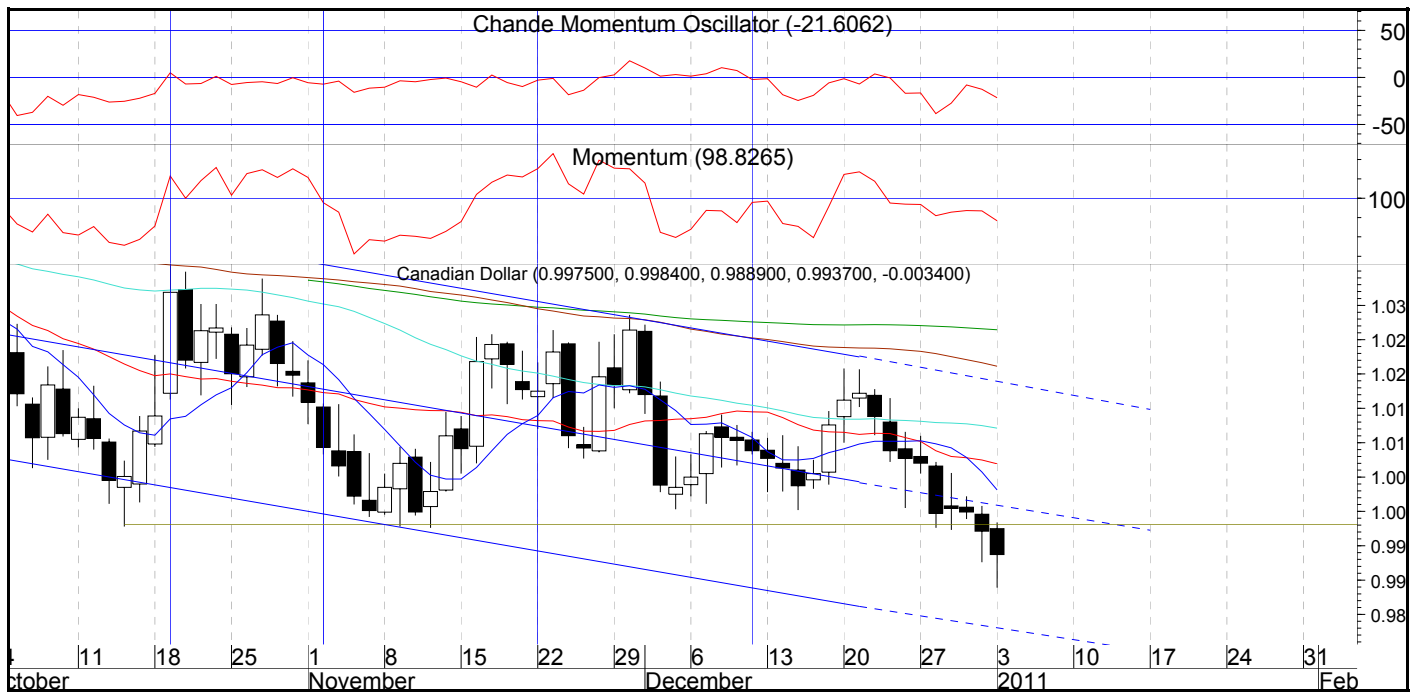


AUSTRALIAN DOLLAR/USD



The AUD closed lower on a bar that is almost identical to the Friday bar except for the direction on the day. A minor pullback would not be a surprise.

USD/CANADIAN DOLLAR



The USD closed lower but the long lower shadow indicates sellers didn't have it all their way.

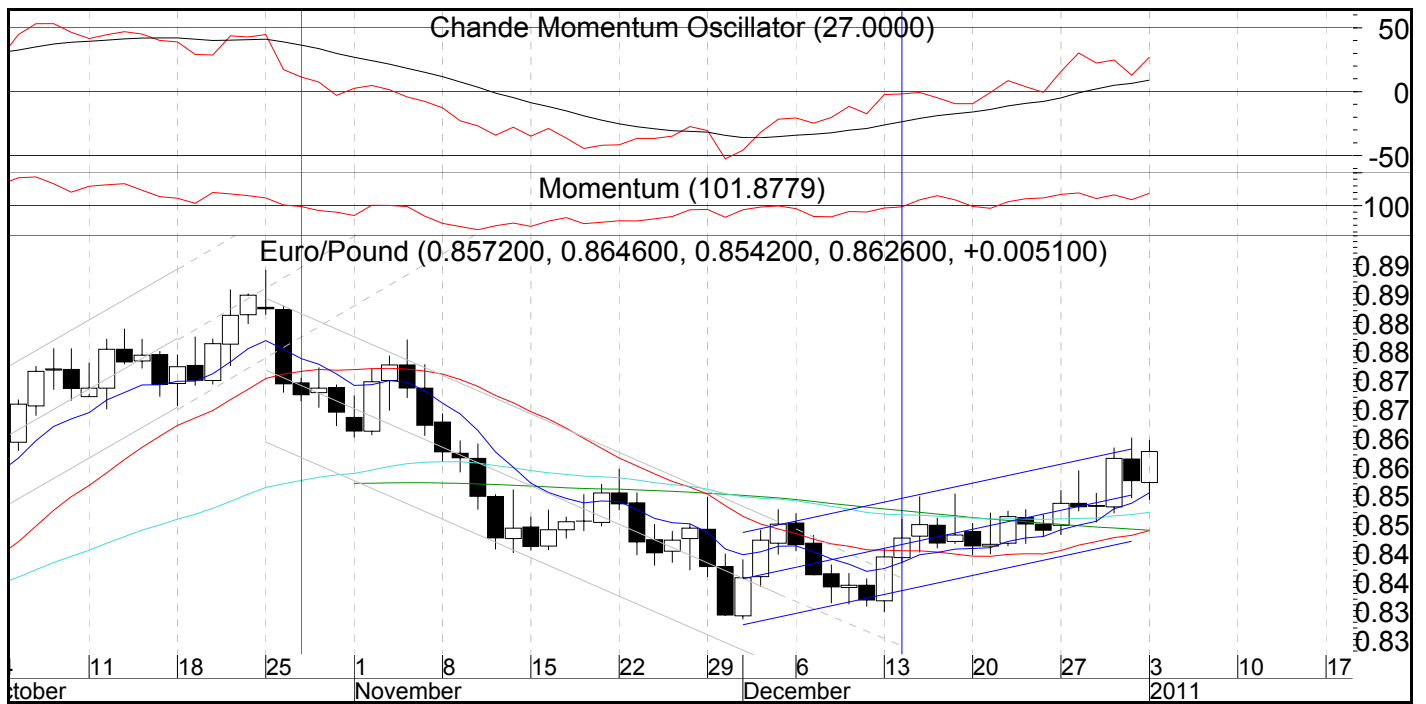


EURO/YEN



The euro/yen closed higher for a third day with RSI and momentum rising. We expect any upside correction not to exceed the red 20-day around 109.93.

EURO/POUND



The euro/pound failed to make a higher high but closed higher and on an engulfing bull candlestick.



GBP/JPY



The pound/yen closed a little lower but on a doji bar with a long lower shadow, raising expectations of a bit of bump up the next day.

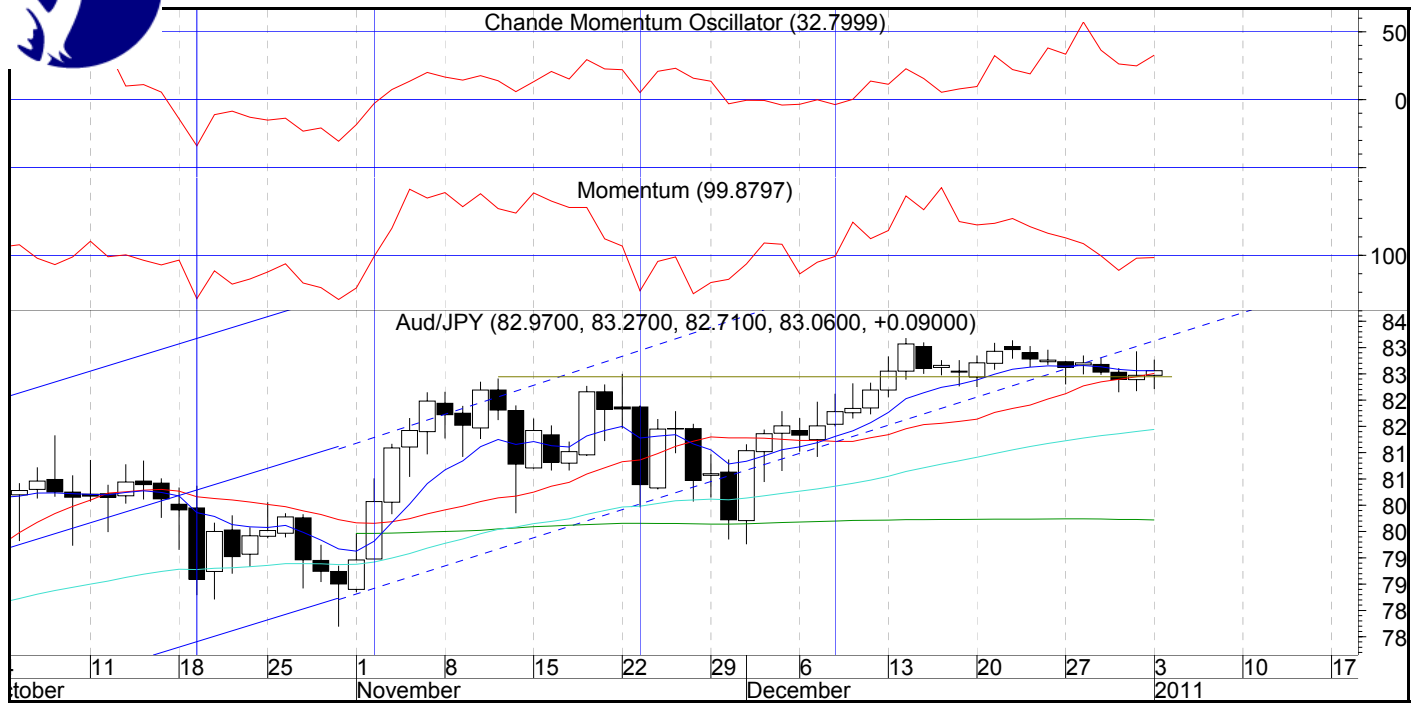
MEXICAN PESO



The dollar closed lower on a big bar and is nearing the gold line marking the last intermediate low.

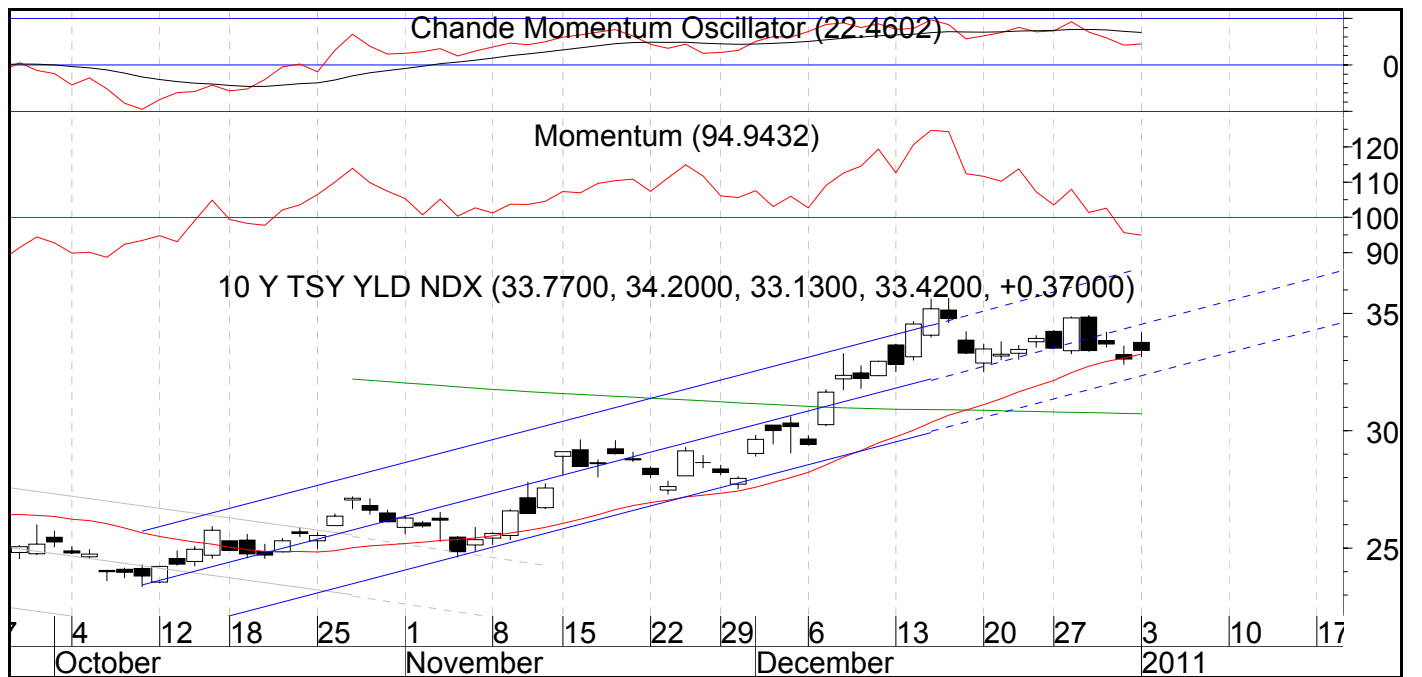


AUD/JPY



The AUD/JPY closed a bit higher and up on the day but basically flat.

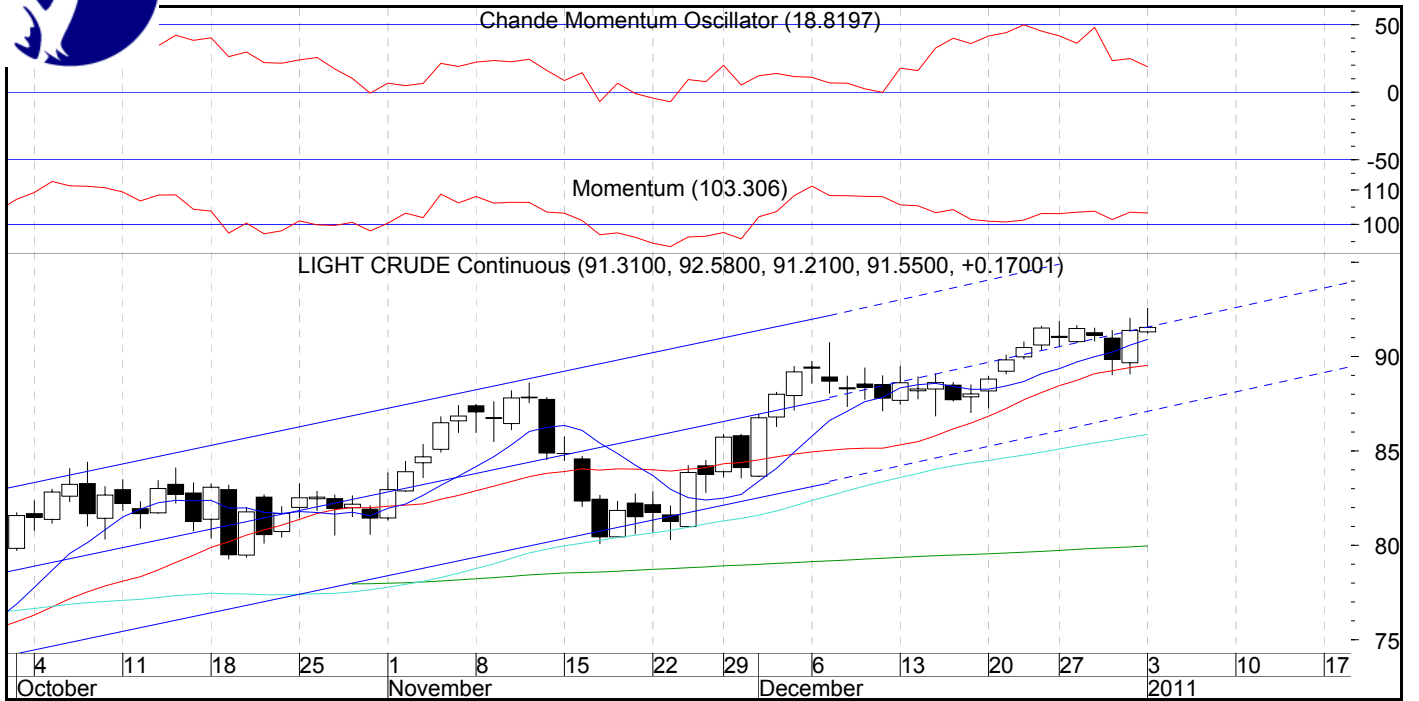
10-Year Note Index



The index closed higher at 3.342% from 3.305% and fully over the red 20-day moving average. Momentum remains negative, though.

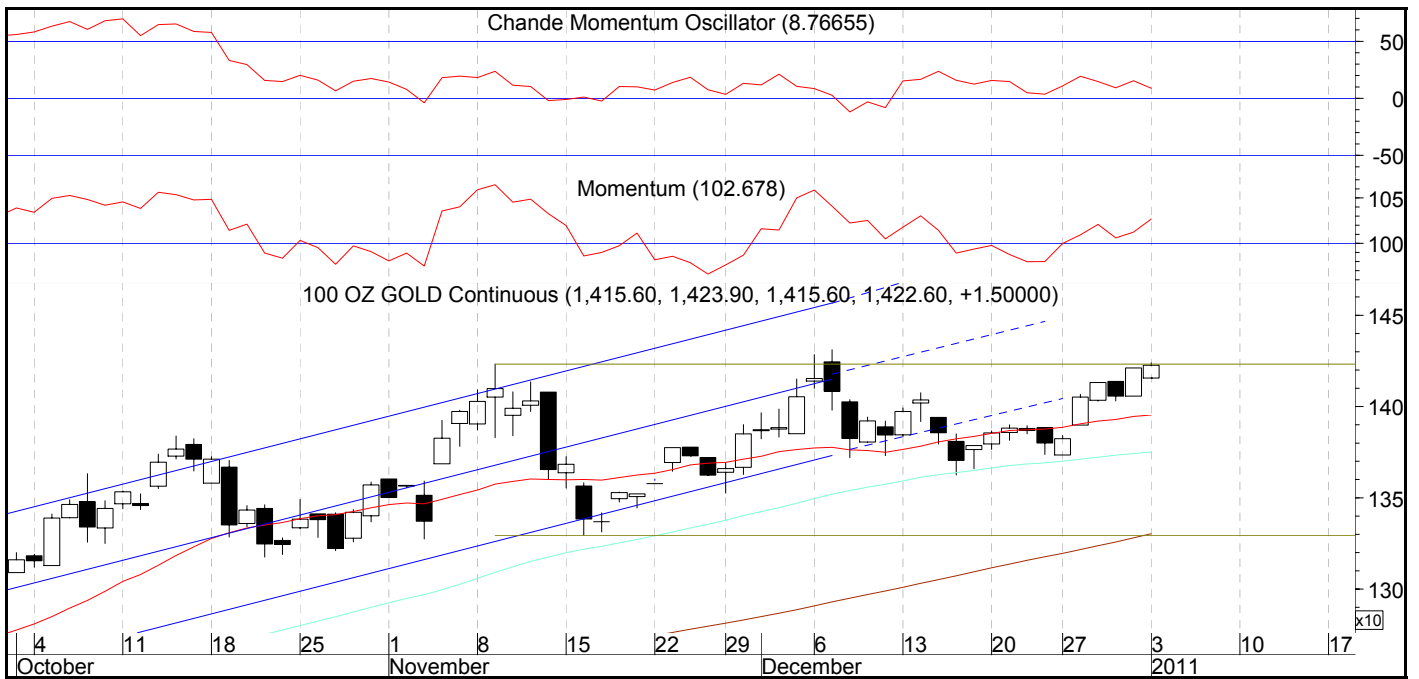


NYMEX Light Crude Oil (Continuous Futures Contract)



Oil closed higher at \$91.55 from \$91.38—not much, and the long upper shadow indicates bulls failed to hold the high into the close.

Gold Continuous Futures Contract



Gold closed higher at \$1422.60 from \$1421.10 and right at the top of the gold trading range band.

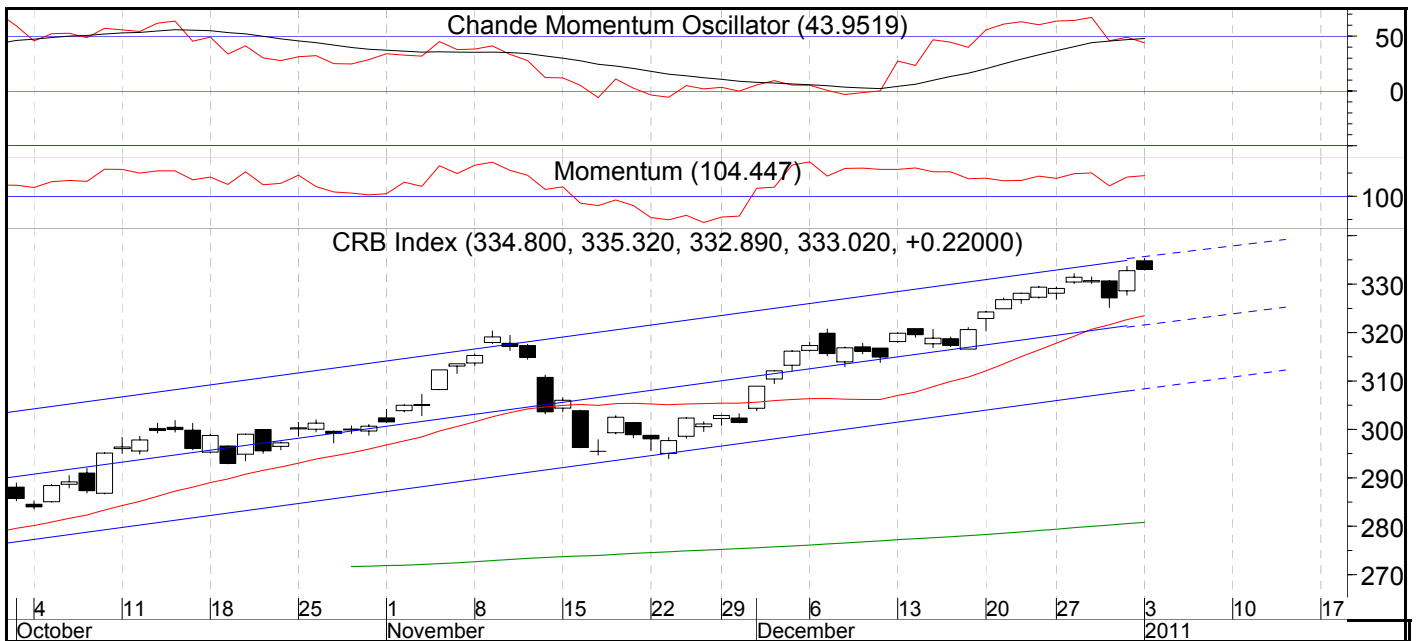


S&P 500



The S&P closed higher at 1271.87 from 1257.64 at year-end and on a big bar.

CRB Commodities Index



The index closed higher at 333.02 from 332.80 but with the close under the open, hmm.