



	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	82.05	SHORT USD	WEAK	12/23/10	82.98	1.13%
GBP/USD	1.5602	SHORT GDP	WEAK	12/21/10	1.5497	-0.68%
EURO/USD	1.3245	SHORT EUR	WEAK	12/21/10	1.3151	-0.71%
EURO/JPY	108.66	SHORT EURO	WEAK	12/23/10	108.76	0.09%
EUR/GBP	0.8487	LONG EURO	STRONG	12/15/10	0.8466	0.25%
GBP/JPY	128.02	SHORT GBP	WEAK	11/24/10	131.33	2.52%
USD/CHF	0.9513	SHORT USD	STRONG	12/14/10	0.9624	1.17%
USD/CAD	0.9995	SHORT USD	WEAK	12/13/10	1.0086	0.91%
AUD/USD	1.0009	LONG AUD	WEAK	12/14/10	0.9993	0.16%
AUD/JPY	82.12	LONG AUD	WEAK	12/09/10	82.55	-0.52%
USD/MXN	12.2495	SHORT USD	WEAK	12/23/10	12.2995	0.41%

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 across the board this morning and the euro is down in all the crosses as an exodus from commodities is spooking equity markets and pushing the dollar index up. Sentiment toward the euro is tending toward the negative, but it's not fully in place yet, with Asian sovereign reported buying euros at intermediate lows and Portuguese 10-year yields steady, even if the 6-month bill auction today was more costly than the last one in Sept.

What's Happening This Morning: The euro fell from the 8 am high yesterday at 1.3434 to 1.3318 at the US close, and thence to a new low at 1.3208 at 6-7 am EST this morning. This looks like a downside channel breakout on the hourly chart, restoring the primary euro downtrend, but the euro is oversold at this level and the newswires report demand from major Asian sovereigns on the dips. In a different perspective, the euro opened in Europe this morning at 1.3268, only a little under the US low at 1.3292. So far today the lowest low is 1.3210 and it looks like the US market will open near there, or 224 points under the open yesterday, more than the usual 120-point range.

Ominous developments in the sovereign debt market—see below—are offset somewhat by a solid gain in the eurozone composite manufacturing and service sector PMI, up to 55.5 from the flash estimate of 55. Also, industrial orders rose 14.8% y/y in Oct (albeit less than 17% forecast in the Reuters survey).

Interpretation of the Fed minutes is mixed. The Fed restated its resolve to maintain low rates via QE, which flies in the face of data showing improving and possibly self-sustaining recovery. The WSJ tries to make hay out of straw with a story about yesterday's eurozone CPI exceeding the ECB target by 0.2%, but admits that Trichet gets applause when he notes that the average CPI over the lifetime of the euro is 1.9%. Any talk of the ECB raising rates to curb inflation is either silly or premature. Still, those forecasting the Fed will raise rates this year (Bloomberg survey forecast is 0.50% by year-end) must be chewing their fingernails.

European Financial Crisis: The crisis is building some steam again ahead of new issuance by Spain next week. First, the Swiss National Bank announced it has stopped accepting Irish government bonds as collateral in money market operations. Second, Portugal sold 6-month bills at an average yield of 3.686% with a heavy 2.6 bid-to-cover but the yield much higher than in Sept (2.045%) and a year ago (0.592%) for the same 6-month tenor. Bloomberg reports that the "yield on the Portuguese 10-year bond was little changed at 6.80



percent, with the two-year note yield falling two basis points to 4.57 percent.” The yield spread with German Bunds is a tad higher today at 376 bp, from 362 bp a week ago, but down from the Nov 11 high at 484 bp. **Third, the Greek yield premium to Bunds widened to a record 974 today.**

Bloomberg also reports that “Austria’s debt agency canceled a scheduled Jan. 11 bond auction, opting instead to sell debt via a syndicate of banks later this month.” Portugal needs to sell a bond in Q1, according to a European manager.

FOMC Minutes: The Fed noted that confidence is higher in the recovery from recent data but “progress toward the Committee's dual objectives of maximum employment and price stability was disappointingly slow” and likely to remain so for some time. Accordingly, QE2 will proceed as planned (about \$600 billion at a rate of \$75 billion per month). The change in the outlook is not sufficient to warrant any adjustments to the asset-purchase program... In other words, the market is ahead of itself. Can we blame the Fed for the commodity crash? Probably not—it was well in process by the time the minutes came out. One economist told Market that 10-year yield lows near 2% (2.04% in Dec '08, and 2.33% in Oct '10) are unlikely to be revisited "but yields above 4% do not look too likely yet, either."

Japanese Yen: Reuters reports that Toyota Pres Toyoda says the dollar/yen has to stay at 90 or above to protect manufacturing and jobs. “(The dollar) has been in the 80s for a very long time, and each company is doing its best to (withstand the pain). But if this keeps up, we (Japan) can't fight to remain a manufacturing base in the world.”

Separately, the Nikkei newswire reports that corporate bankruptcies attributed to the too-high yen totaled 56 cases in 2010, up from 35 in 2009. The Nikkei also reports that trading in the AUD/JPY crossrate in margin accounts nearly doubled in 2010, beating the size of transactions in dollar-yen. See the AUD/JPY chart.

The JiJi newswire reports PM Kan will re-shuffle the cabinet after the party meeting next week, and economic data continues to show a struggling economy—Dec new vehicle sales fell 28.3% y/y for the 4th drop and after -30.7% in Nov when the government ended a low-emission subsidy.

Equity Markets: The Dow rose 0.18% and the S&P fell 0.13%. In Asia, the Nikkei followed Wall Street down by 0.17% and the two Chinese indices went both ways—Hang Seng up 0.38% and Shanghai down 0.49%.

Other Markets: Oil closed wildly lower at \$89.38 from \$91.55 the day before. The Reuters data feed shows only the close (presumably because the bid for the high is at odds with the offer for the low). The Reuters newswire reports oil at \$88.66 at about 5 am EST and oil-price.net has \$88.32 at 7 am EST. The WSJ says “February crude oil swung to a two-week low from a 27-month high in falling \$2.17, or 2.4%, to \$89.38 a barrel. Oil is up 9.3% from a year ago.” Bloomberg says oil futures fell as the dollar index “advanced to a one-week high, damping the investment appeal of commodities. Oil traded at \$92.58 a barrel on Jan. 3, the highest since October 2008, and has settled above \$91 in six of the last eight days.

Further, Bloomberg says it’s the biggest drop in 7 weeks and caused by evidence that snowstorms cut gasoline consumption--the Mastercard report says demand for gasoline fell 13% to a 5-year low last week, with the API inventory report on gas saying stockpiles rose by 5.6 million barrels, the most in a year.

Other commodities also fell—the CRB index, copper, wheat, gold, silver, coffee, corn, coal. The WSJ says the gold price drop is the worst in 6 months, the biggest single-day percentage decline since February 2010. Monday was a record high close at \$1422.90 and prices had risen 2.7% in the two weeks before, but yesterday the Feb contract fell \$44.10 or 3.1% to \$1378.50—wiping out all of Dec’s gains (although still up 23% y/y). We agree with commentators that this giant move is profit-taking after a big run-up and yet another reason not to trade around year-end.

The Main Event: The yield on the 10-year T-note rose to 3.342% but see the chart—we added the MACD to see a bigger-picture trend and it is pointing downward.

China Tidbit: Ahead of Hu’s state visit on Jan 19, high level officials are preparing the way. Reuters reports that meetings so far include one between US National Security Advisor Donilon and Chinese



Foreign Minister Yang Jiechi (and Obama stuck his head in the door to be polite). Two topics dominated—the yuan and what to do about North Korea. Funny, the national security advisor talking about trade imbalances. “U.S. complaints that China keeps its yuan currency too cheap, giving it an unfair trade advantage, are likely to feature in the meeting between Obama and Hu. The U.S. trade deficit with China rose 20 percent in the first 10 months of 2010 and could top \$270 billion for the year.” On North Korea, China has so far resisted pressure from the US efforts to take action and wants multi-party talks, instead.

China continues to play the diversification game. Market News reports today that a retired member of the Chinese Academy of Social Sciences and member of the policy committee at the PBOC, Yu Yongding, published an opinion piece in a magazine saying China should cut its holdings of US Treasuries to minimize losses on its foreign exchange reserves and let the yuan move more freely. This seems to be more about liberating China than attacking the US or the dollar. He said, according to Market News, “Moving towards a more market-driven exchange rate would mean reduced intervention in the foreign currency markets, giving China the option of winding down its holdings of U.S. debt.” Yu wants to curtail the growth of FX reverses in general.

“[Yu] has become well known for airing views that are out of step with official government thinking, including advocating a more aggressive exchange rate reform policy and, as recently as last July, calling for Beijing to sell down its holdings of U.S. Treasuries. Yu reiterated that the latest round of U.S. government stimulus could lead to a weaker dollar which would, in turn, erode the value of China's dollar-denominated holdings. These are estimated to total about 70% of its \$2.65 trillion in foreign exchange reserves.

“But he argued the Chinese government must strike a balance between yuan appreciation and maintaining employment in the export sector, adding that it should work towards convincing the public they would benefit from a stronger yuan, and that any move in this direction would not simply be a consequence of U.S. pressure.”

Outlook: Today is a big news day. We get the Energy Dept report on oil and gas inventories, the ADP forecast for private sector payrolls (expected at 100,000, the most since Nov 2007), and the ISM service sector index, probably a rise to 55.7 from 55 in Nov.

The dollar seems to be rising alongside risk aversion, or rather on a drop in risk appetite that is seeing a flight from the euro. Since sovereigns are still buying the euro on dips, this is not a full-bore exodus from the euro and sentiment is not fully negative toward the euro—not when good economic data halts the decline, however temporarily. The Market News London report at 6:20 am EST reflects the situation with great delicacy: “The euro traded with an underlying heavy tone through European morning trade Wednesday, with mainly Asian sovereign demand providing some buoyancy. The release of weak services PMI data in Spain and Italy provided negative weight, but this was countered by core eurozone PMI data coming in stronger than expected. Despite the decent buying interest the rate has been able to counter this and keep the downside pressure on ahead of the New York open, with the rate extending lows in recent trade to \$1.3230.”

In other words, professional reporters are not seeing the euro's drop yesterday and overnight as a tipping point. This is cold-eyed realism. Widening the scope, the recent high is 1.3434 from 12/31 and the recent low is 1.3050 from 12/23, so levels around 1.3200 are about in the middle.

Market News points out that yesterday was only the second trading day of the year and the commodity disruption clouds the currency picture. We are not the only technical analyst seeing multiple possible outcomes. Barclays' Capital sees a flag that points to a move under 1.3000 this quarter. The upside is limited and they advise selling on rallies toward 1.3400. In contract, CitiFX sees the weekly close over the 55-day as bullish and persistent efforts to rally up to resistance around 1.3450-1.3500 (and further out, 1.3786 and 1.4283), with a long-term target at 1.4700 and possibly 1.5100.

The dollar looks good today but note that commodities remain on a long-term uptrend and the China reserve diversification story is just getting going. We wonder what effect fiscal sanity or its absence will have on the markets. Europeans are positioning themselves as the sane ones, even if the average eurozone level of



indebtedness is more like 85% than 60% (according to The Economist). ECB policy member Mersch has an op-ed piece in the WSJ today saying efforts to cut spending and reduce deficits are ad hoc and timid so far. At some point, Europe has to return to a stability path, and that means honoring the 60% commitment. It's interesting in its own right that this article appears in the WSJ instead of the usual venue, the FT. As Congress returns to work and all the chatter is about raising the debt ceiling AND cutting US spending (as a quid pro quo), everyone is in doubt about the US stance. Will the US get religion? We guess that if the US fails to pass meaningful cuts and to project the image of fiscal responsibility, it's a big fat dollar negative. The question is whether it's bigger than sovereign default/restructuring in Europe, presumably Greece coming first (assuming Portugal and Spain squeak by). Greek 10-year spreads almost 1000 points over German Bunds is a screaming warning, isn't it?

Still, the charts matter. We need to see 1.3080 and 1.3050 today to believe the euro will resume the downtrend and the corrective upmove is over. The outcome will be known before the fiscal story gets developed, but since the fiscal sanity story is such a big one, this means there will be volatility ahead.



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) or MACD.

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.

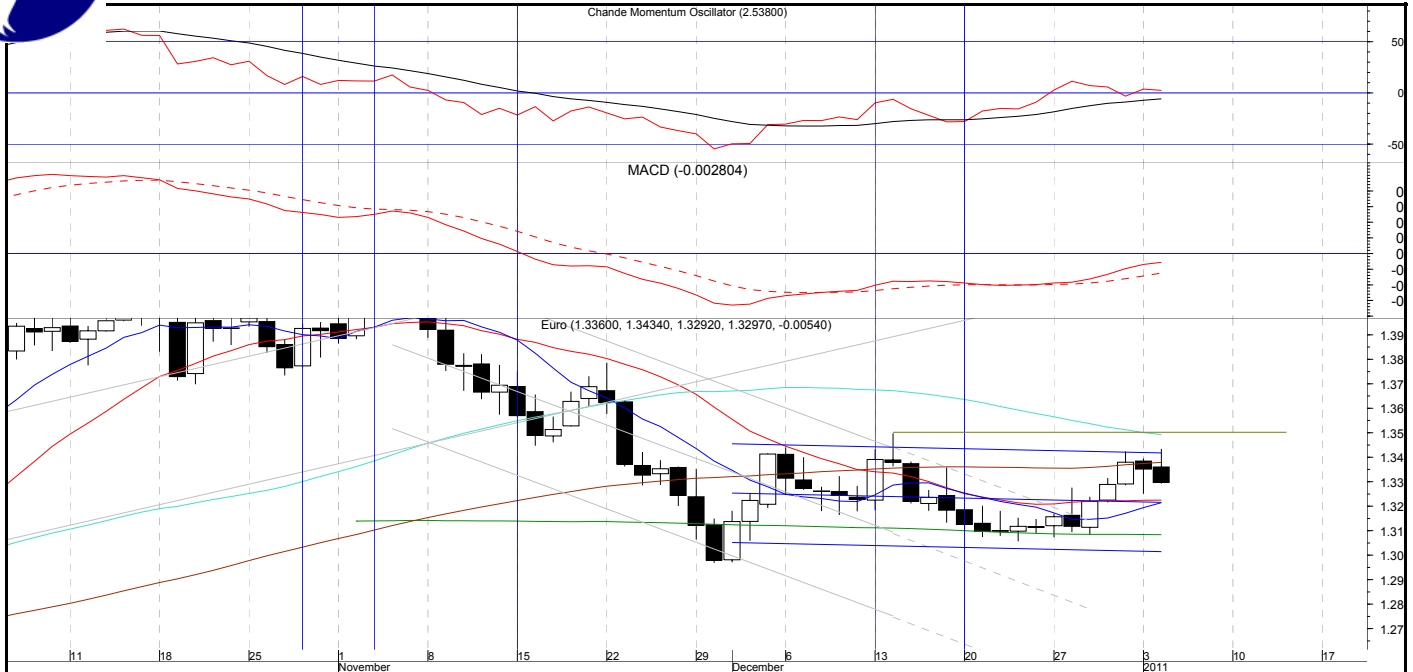
Dollar Index



The dollar index did not make a lower low and did put in an engulfing bull candlestick. A small double bottom is not out of the question.



EURO/USD



The euro made a higher high but closed lower. The new channel remains flat. We can make the case for rise or fall, with RSI and MACD on the side of more rises.

USD/SWISS FRANC



The USD closed higher on a very big bar in a corrective move, hardly the “minor” pullback we expected.



UK POUND



The pound made a higher high and closed higher, and also closed over the 20-day. The pound is getting support.

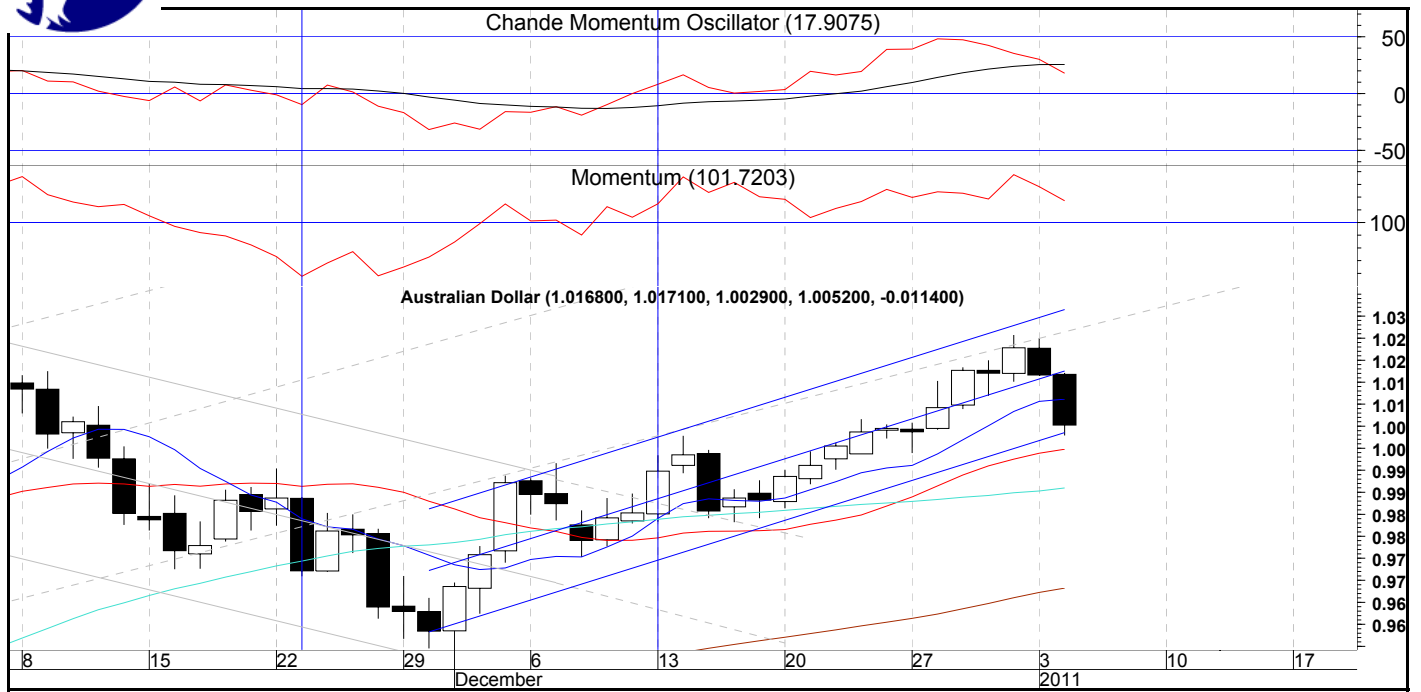
USD/JAPANESE YEN



The USD/JPY closed higher for a second day of the corrective pullback.

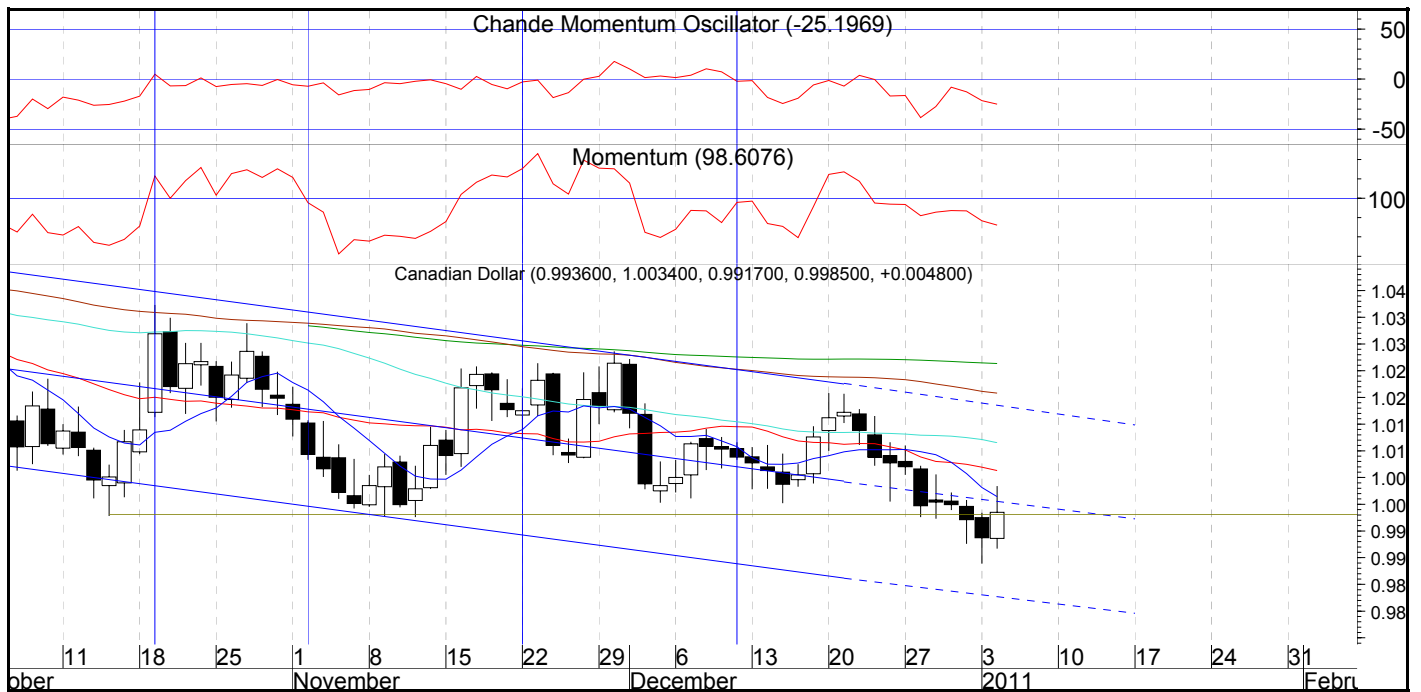


AUSTRALIAN DOLLAR/USD



The AUD closed lower on big bar and is nearing the channel bottom and red 20-day. RSI crossed its moving average as confirmation.

USD/CANADIAN DOLLAR



The USD closed higher but without an impressive close and momentum continues to fall.

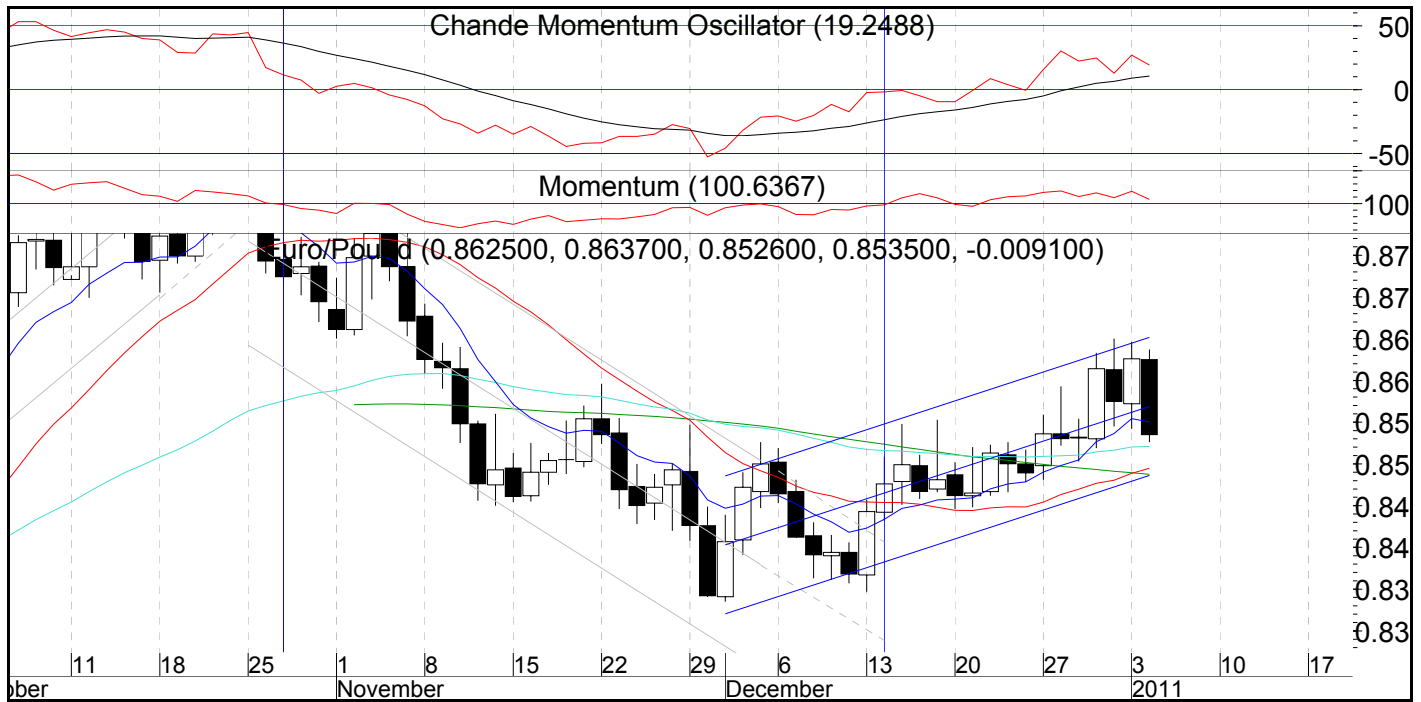


EURO/YEN



The euro/yen closed lower by 4 points after failing to hold a higher high over the red 20-day. Momentum looks good, though. .

EURO/POUND



The euro/pound closed lower on a big downbar.



GBP/JPY



The pound/yen closed higher on a big bar, albeit not near the high. See momentum.

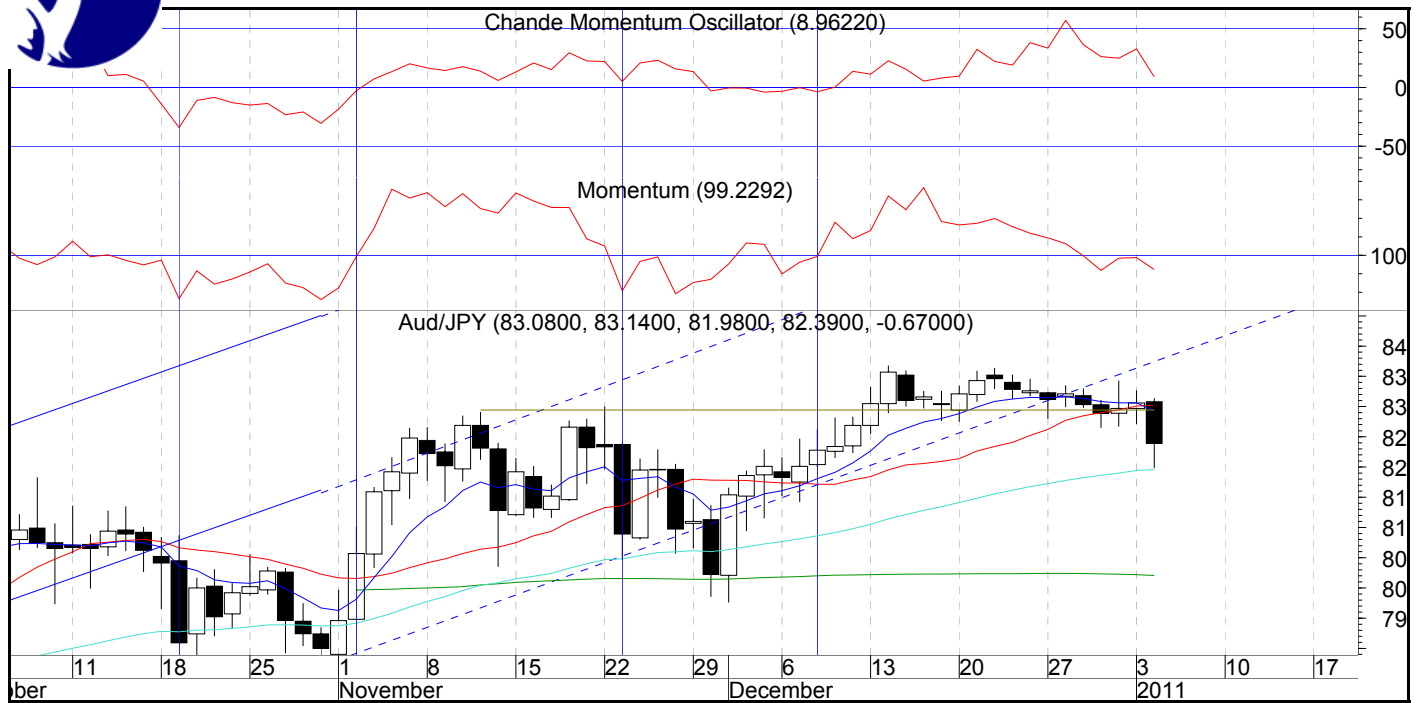
MEXICAN PESO



The dollar made a lower low and closed right on the range line.



AUD/JPY



The AUD/JPY closed down hard on a big bar, although the close is off the low. This will be a sell signal tomorrow.

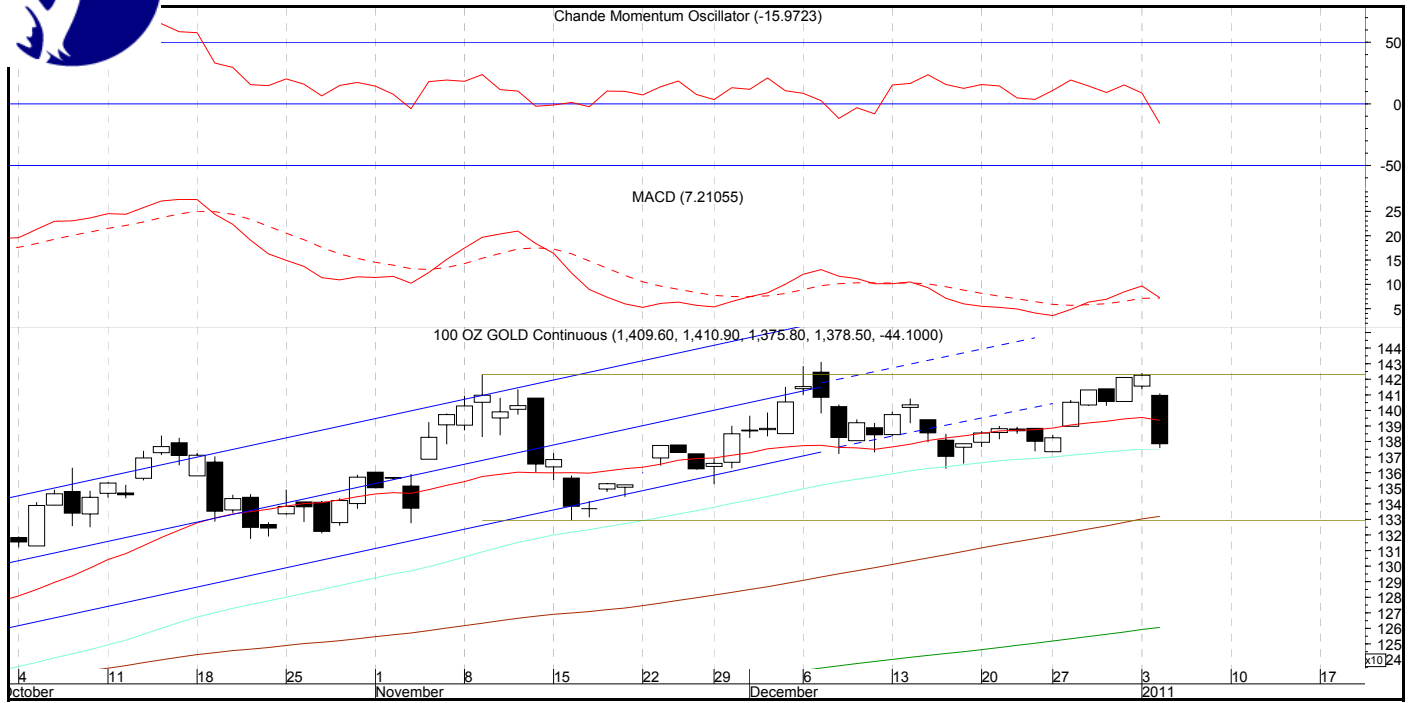
10-Year Note Index



The index closed higher at 3.346% from 3.342% and right at the red 20-day, but faces upside resistance.

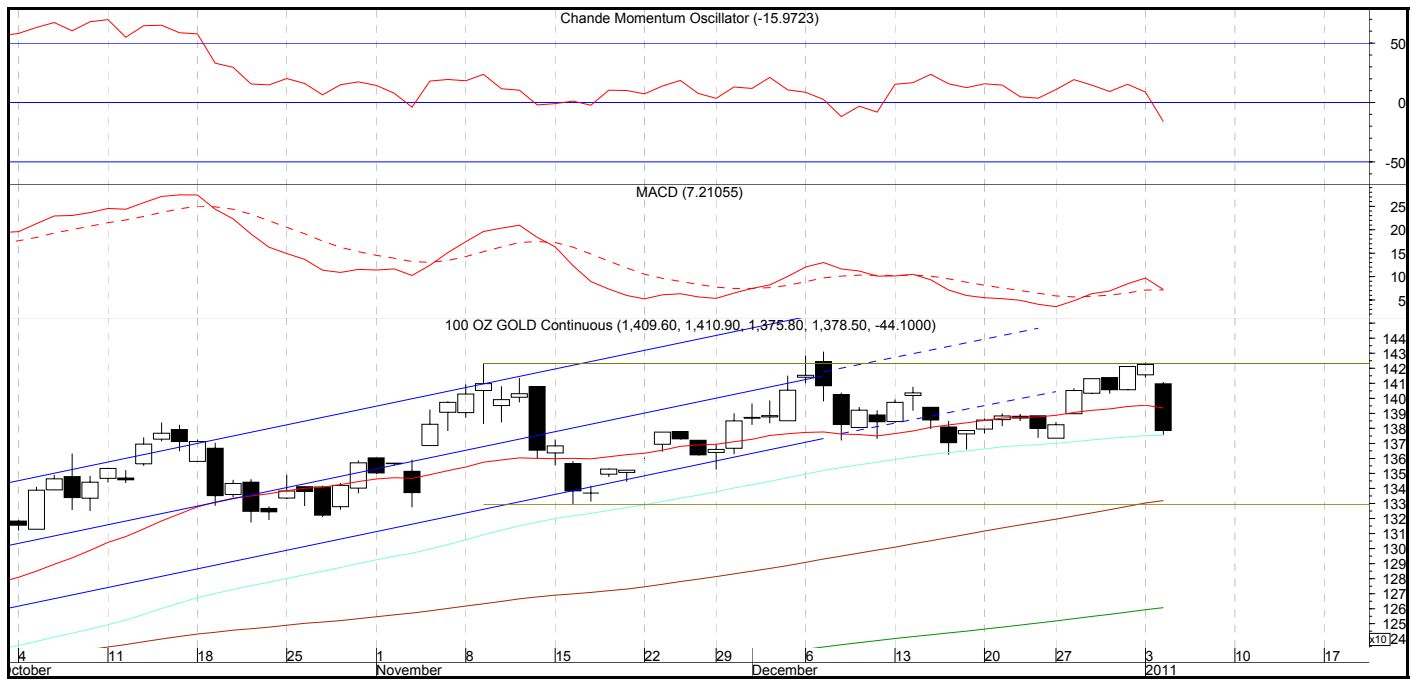


NYMEX Light Crude Oil (Continuous Futures Contract)



Reuters has a data error and is showing oil at a single price yesterday, \$89.38 (dot near the red 20-day).

Gold Continuous Futures Contract



Gold closed lower and under the 20-day on a big bar, with the close at \$1378.50 from \$1422.60.

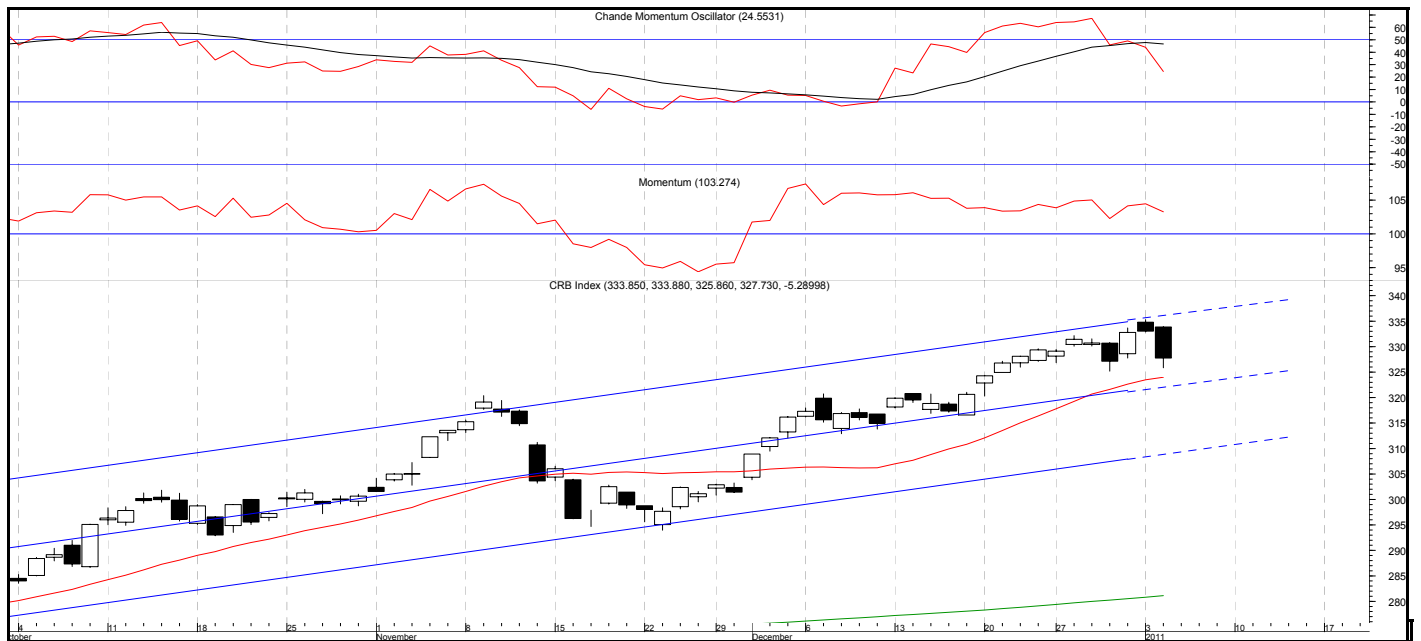


S&P 500



The S&P closed a little lower at 1270.20 from 1271.87 but with a long lower shadow indicating bears lost.

CRB Commodities Index



The index closed down at 327.73 from 333.02 on a big bar.