Rockefeller Strategic Currency Briefing©

Friday, January 7, 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	83.52	SHORT USD	WEAK	12/23/10	82.98	-0.65%
GBP/USD	1.5445	SHORT GDP	WEAK	12/21/10	1.5497	0.34%
EURO/USD	1.2984	SHORT EUR	STRONG	12/21/10	1.3151	1.27%
EURO/JPY	108.43	SHORT EURO	WEAK	12/23/10	108.76	0.30%
EUR/GBP	***0.8405***	***SHORT EUR***	***NEW*WEAK***	***01/07/11***	***0.8405***	***0.00%***
GBP/JPY	129.00	SHORT GBP	WEAK	11/24/10	131.33	1.77%
USD/CHF	0.9624	SHORT USD	WEAK	12/14/10	0.9624	0.00%
USD/CAD	0.9994	SHORT USD	WEAK	12/13/10	1.0086	0.92%
AUD/USD	***0.9919***	***SHORT AUD***	***NEW*WEAK***	***01/07/11***	***0.9919***	***0.00%***
AUD/JPY	***82.84***	***SHORT AUD***	***NEW*WEAK***	***01/07/11***	***82.84***	***0.00%***
USD/MXN	12.2348	SHORT USD	WEAK	12/23/10	12.2995	0.53%

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 ahead of US payrolls, and on a retreat from risk as European sovereign yields rise and an important agency (Markit) says the ratings agencies are far behind investors in judging European sovereign credit quality.

Payrolls Forecast: The current consensus is 140,000 to 160,000, with a forecast range of 95,000 to 240,000. If the actual number is 150,000, this would be 50% over the pre-ADP forecast and almost 4 times the Nov number (39,000), brining the total of jobs created last year to 1.1 million, according to Bloomberg. Ahead of the release, the yield on the 10-year Treasury note rose to 3.43% from 3.419% at the close yesterday. Stock index futures are down.

One analyst told the WSJ that "Signs the U.S. labor market is showing improvement could spur chatter that the [Federal Reserve] might not need to buy assets...which had been at the heart of [the] dollar's decline." We say this is wildly premature. The Fed's program is scheduled to end in June and even if job growth continues at a high level for all 6 months to June, there is also inflation/deflation to worry about when considering the Fed's perception of the economy. A single number will not justify "chatter" but it might start the idea that QE3 will be off the table.

What's Happening This Morning: The euro fell through the last intermediate low (1.2968 from 11/30) yesterday and even further to 1.2958 at the hand-off from Asia to Europe around 3 am EST today. Yesterday the euro fell in a straight line from 1.3093 at the US open to 1.2966 by the close, almost as though everyone was targeting the last intermediate low and wanted to beat it by 2 points. It's not as stable a move as we would like—try to see the chart on a 4-hour or 6-hour basis—riddled with gaps, and gaps are rare in FX. The downmove has been moderating for a few hours, as usual, and now we expect the usual fresh breakout to the downside, a model of how prices move that is seriously complicated by payrolls this morning. After 7 am, though, the euro hit a new low of 1.2949… it would take a monstrously big pullback on a bad payrolls number to make a dent in this trend.

Note that the CAD is an exception, rising instead of falling against the USD, if by only a little. The RBC FX strategist expresses our view: "When you get the pure U.S. dollar strength, it tends to take Canada with it. It's

a story that I like a lot; if you're bullish on U.S. growth, buy Canada." We get the Canadian version of payrolls today, too, expected to show a continuing rise. The RBC strategist told Bloomberg that the BoC is playing catch-up with the other commodity currencies (presumably AUD). The BoC is on hold (after three hikes starting in June from 0.25% to 1%) but taking no action for the past two meetings. The next BoC policy meeting is Jan 18 and it may come off hold then. Bloomberg notes that "Government bonds rose, with the yield on benchmark 10-year securities falling five basis points, the first drop in three days, to 3.22 percent. The price of the 3.5 percent bond due in June 2020 rose 44 cents to C$102.25."

European Financial Crisis: The debt crisis is heating up ahead of new week's expected issuance. The current expectation is issuance by Spain and Italy next Thursday, Portugal on Wednesday.

Irish 10-year yields jumped 10 bp to 9.29% (a Greek level) with Spanish bond yield spreads over the Bund up 6 bp, despite the China-buying story yesterday. Bloomberg reports that "Belgian government bonds slid, sending the spread over Bunds up 11 bp to 126 bp, the highest since Dec 1. The Markit iTraxx SovX Western Europe Index of swaps on 15 governments rose 1 basis point to a record 214, according to CMA. Swaps on Ireland rose 6 basis points to an all-time high." Note that *The New Yorker* has a story this week on the breakup of Belgium into its two language areas. Yesterday negotiations broke down to bring all 7 political parties into agreement, raising the specter of another election and raising the premium over 105 bp from 80 in June, according to an analyst quoted by Market News. He also notes that there is nothing in the US comparable to a dissolution of a state...

The WSJ says the rise in sovereign debt insurance rose because of the EC study on bank bond haircuts that came out yesterday. "The angst among investors seemed inspired by a European Union proposal that bondholders should share the future cost of bailing out European banks. In the case of a government bailout, the plan said that senior bondholders would suffer losses before a taxpayer-funded bailout. Theoretically, this should be a boon to government bonds, as it would take some of the burden of bailouts away from the government. But investors may have feared that the proposal was a hint that bondholders also might be forced to take haircuts on sovereign debt in the future, as well."

Moreover, "The credit-default-swaps market suggests that Portugal, Ireland, Italy, Greece and Spain still are all rated too highly by the three leading global rating firms, Fitch Ratings, Moody's Investors Service and Standard & Poor's. Italy should be rated BB by this measure, and other countries in financial distress like Portugal, Spain, Greece and Ireland should be rated B, according to an analysis by Markit. All of those implied ratings are in "junk-bond" territory, or below investment grade. Only Greece is rated below investment grade by any major ratings firms. Markit's analysis assigns implied ratings to a country based on how its credit-default-swaps price compares with those of other countries. Belgium has a similar swaps price as Italy and so gets a similar implied credit rating.

"Credit-default-swaps prices also suggest European nations such as Belgium, France and the U.K. also might be at risk of a ratings downgrade of at least one notch. The latter two nations have AAA ratings by all three ratings companies. Downgrades could raise government borrowing costs and add to market anxiety. A downgrade to junk status would force some investors to sell out because they can hold debt rated only as investment grade. 'Markets see the agencies are behind the curve,' said Win Thin, a currency strategist at Brown Brothers Harriman."

The FT reports that a new rumor from the Lisbon press has it that the Swiss National Bank was refusing to accept Portuguese government bonds as collateral for repo transactions—depsite a top Portuguese official saying late yesterday he guarantees Portugal will achieve the 2010 deficit target of 7.3% of GDP from 9.3% in 2009. Also, ECB chief Trichet, speaking in Germany, praised the originator of the stability pact ideas (Theo Waigel, remember him?) and said "In 2011, we must strengthen our efforts even more. We need to see further significant progress on the reduction of excessive fiscal deficits." Both Germany and the ECB think stability pact amendment proposals are too timid.

The new bank bond proposals would prevent what happened to Ireland happening elsewhere. The internal market commissioner, Barnier, would "make bondholders act as a last line of defence, writing down the value of their investments to 'bail in' a bank before taxpayers had to fund a bail-out. The proposals also call

for banks to draw up living wills', making it easier to wind them down in the event of failure. They would also give authorities greater power to intervene earlier in troubled banks, even allowing them to replace management. 'We must put in place a system that is well prepared to deal with bank failures in an orderly manner – without taxpayers being called on again to pay the costs,' Mr Barnier said," according to the FT.

European Economic News: Eurozone GDP for Q3 was revised down to 0.3% from 0.4% previously published, but with the y/y the same at 1.9%. Remember forecasters are seeing as much as 3.5% for the US this year. EMU unemployment in Nov was the same 10.1% as in Oct. In Germany, Nov industrial output fell 0.7% m/m, under forecast, while retail sales unexpectedly fell 2.4% in Nov, too. Market News further reports the ECRI future inflation gauge hit a 25-month high of 98.8 in November, which we think means inflation expectations are strong. We saw something similar in the UK.

Equity Markets: The Dow slipped 0.22% and the S&P fell 0.21%. The Nikkei rose 0.11%, not following the US market mostly because the yen is still softening. The Hang Seng fell 0.42% and the Shanghai rose 0.52%. European bourses are all down this morning and so are US equity index futures. Evidently equity market participants are buying into the idea that rising payrolls will prod the Fed into rate hikes—and it's way too soon to see it that way.

Other Markets: Oil closed down at $88.38 but is a little higher at $89.00 at 6:30 am EST today. The drop yesterday was a surprise, almost $2.00 to the lowest settlement since Dec 17. Traders expect a good payrolls report to push oil back up over $90.

The Main Event: The yield on the 10-year T-note slipped back to 3.419% from 3.483%. Traders are mulling over all the positive news that points to the ADP forecast as correct, but also all the negative reports indicating it's wrong (including the service sector PMI employment component).

Political Tidbit: We are starting to see actual progress on cutting the US budget, and despite the size of the task, taking the deficit seriously is a big plus for the dollar. The Defense Dept had proposed a $100 billion cut, but the White House wants the Defense Sec to find another $78 billion in cuts. Note this doesn't mean a reduction, just growth at a slower pace. (We wonder why the US still needs to spend $200 billion on a new base in Germany. Let Germany build its own base.) Incoming Speaker Boehner already identified $100 million he can cut in the first month in the House itself.

Outlook: Today we get payrolls and the next three hours, like the last 18, will be dominated by it. We always advise that smaller traders do nothing on this one day of the month—it almost always delivers a surprise and a two-way spike. The market gaps right over your stop and target and you miss them both.

If the payrolls number comes in at the high ADP end, like 300,000, the dollar can rally further before Friday profit-taking sets in. We would like to see the euro close the day under the old low (1.2966) and remain under the 200-day moving average for a third day. If the number is the median expected, 150,000, then the FX market response depends on details like revisions and the breakout between private and public sector, but barring a surprise, 150,000 is built in and the dollar should fall. If the number disappoints on the downside, watch out below. In other words, two of three possible outcomes are dollar-negative.

The European sovereign debt story is the biggest FX story in a while and is dominating market sentiment, as expected, but no everyone buys into the flip side of the coin, and ever-rising dollar. JP MorganChase in London advises that the dollar will fall 12% this year against the euro to 1.49 and 7% against the yen to 78, on the Fed keeping rates on hold all year and the deficit remains at toothache highs even if Congress starts cutting it. According to the Bloomberg story, JPMorgan says "The Canadian dollar may be the best performer among major currencies this year if oil averages above $100 per barrel, the bank predicts. 'U.S. growth alone cannot support the dollar as it's highly unlikely that the Fed will be lifting interest rates in the next 12 months Few people will be buying the dollar as an investment vehicle. Many people will continue to use the dollar as a funding currency." The twin deficits are not going away. The current account deficit will widen to 3.4% of GDP (vs. balance for the eurozone) and the 2011 deficit will reach $1.34 trillion, mostly on the extension of the Bush

tax cuts.

Well, maybe so. The Fed staying on hold all year depends on inflation remaining under the 2% target and precoccupying Mr. Bernanke with worries about deflation. To a certain extent, it depends on a lack of confidence in Congress' resolve to cut the deficit, too. But before these issues get clearer, the euro is clearly in for a big ride down on sovereign debt, which of course exporters won't mind one bit ("Don't throw me in the briar patch," said Bre'er Rabbit.) We almost always find trading on big-picture macro to be a mistake, although a sanity check is always worthwhile, too. As master trader Keynes said, the long run is a series of short runs.

We think the anti-euro mood is strong and on real, factual underpinnings. The move has been so big that it's hard to imagine what would derail it now. One interesting question is whether sterling is trading on its own merits or as the anti-euro. We say watch the pound and watch oil.

Rockefeller
Strategic Forex Briefing©

Chart Prices as of the NY close on
Thursday, January 6, 2011

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.

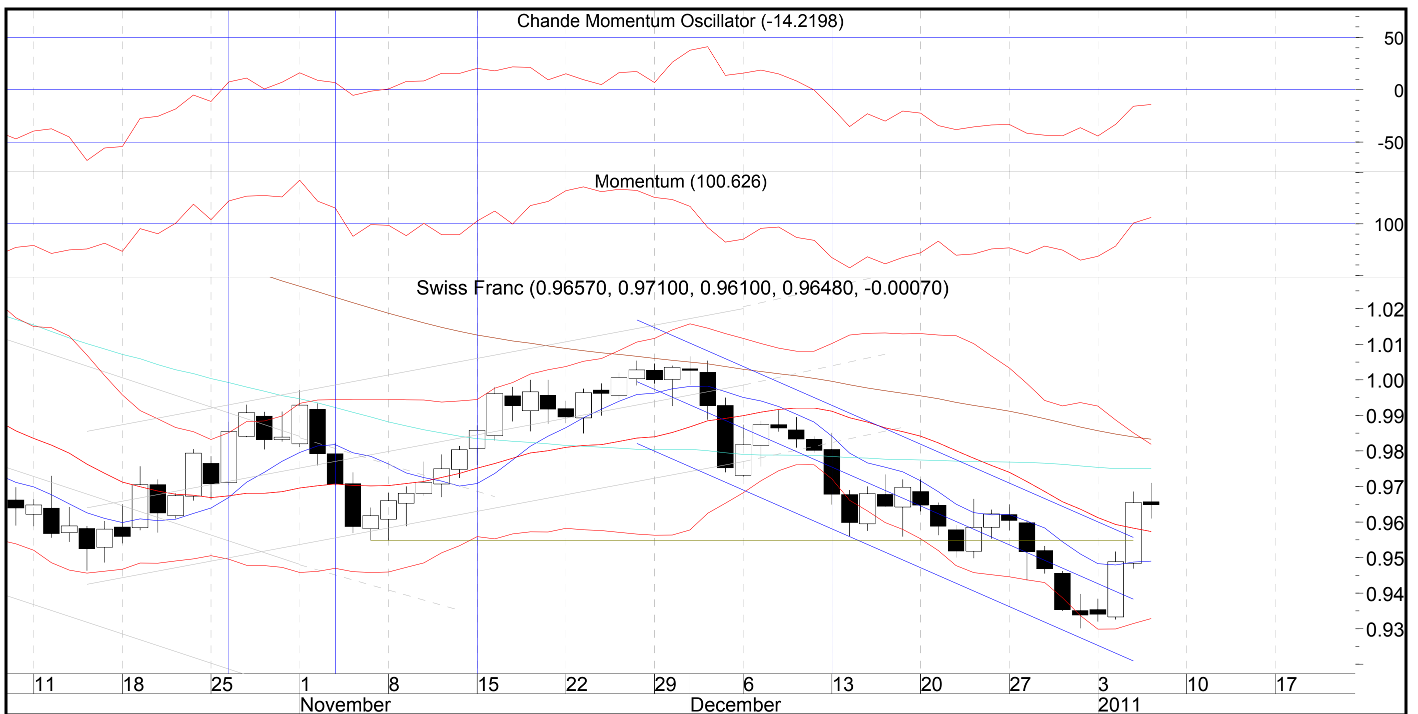
Dollar Index

The dollar index put in a third white candle and MACD is holding over the zero line. We re-drew the channel to include the second bottom and now it's possible to see an uptrend returning. The green 200-day lies at 87.711.

EURO/USD

The euro closed lower and under the 200-day moving average with MACD about to cross to the downside. The last low is 1.2969 from 11/30.

USD/SWISS FRANC



The USD made a higher high but not a higher close and on a doji bar, so we will wait one more day to switch the signal.

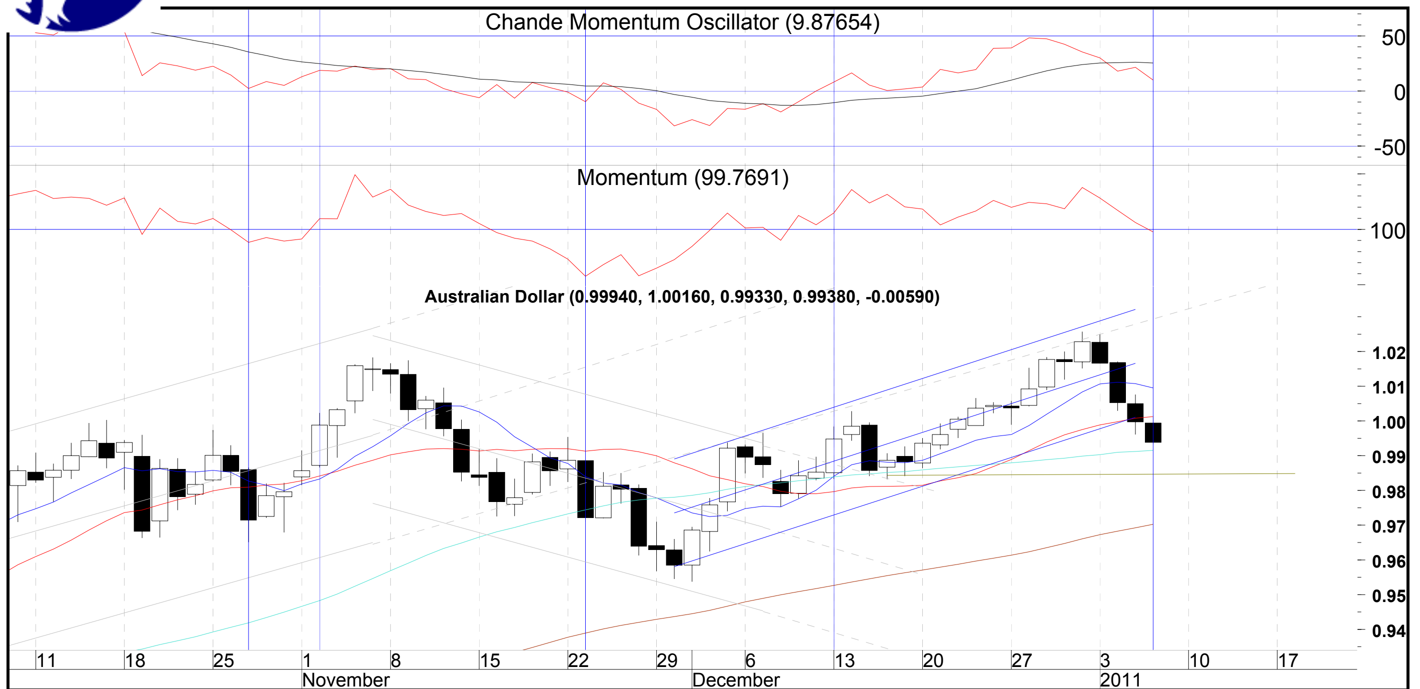
UK POUND

The pound made a lower low and closed red support. The green 200-day lies at 15411. MACD is still rising, however.

USD/JAPANESE YEN

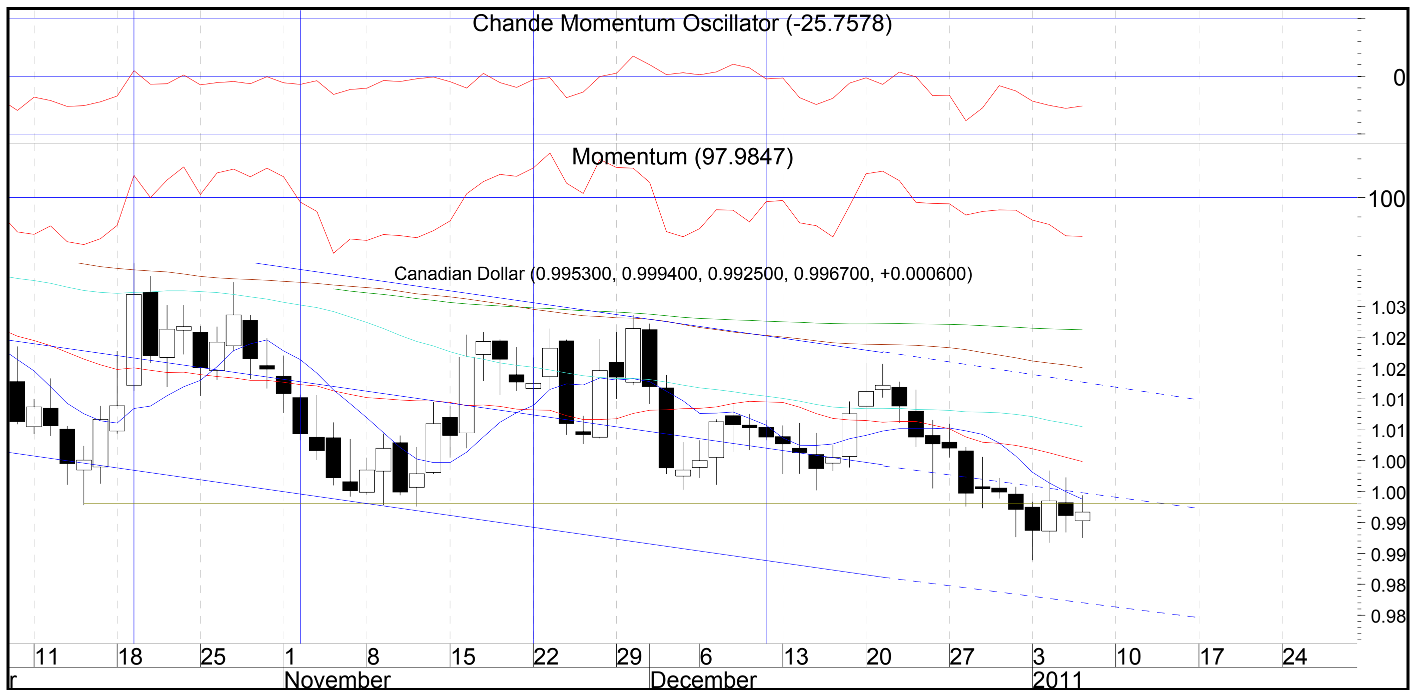
The USD/JPY closed higher for a 4th day and is now pressing against the channel top. Even if we get a full breakout, we expect some wobbling and probably a pullback here—deeply complicated by US payrolls today.

AUSTRALIAN DOLLAR/USD



The AUD closed lower for the 4th day and broke the channel. The last low is 9832 (gold line).

USD/CANADIAN DOLLAR

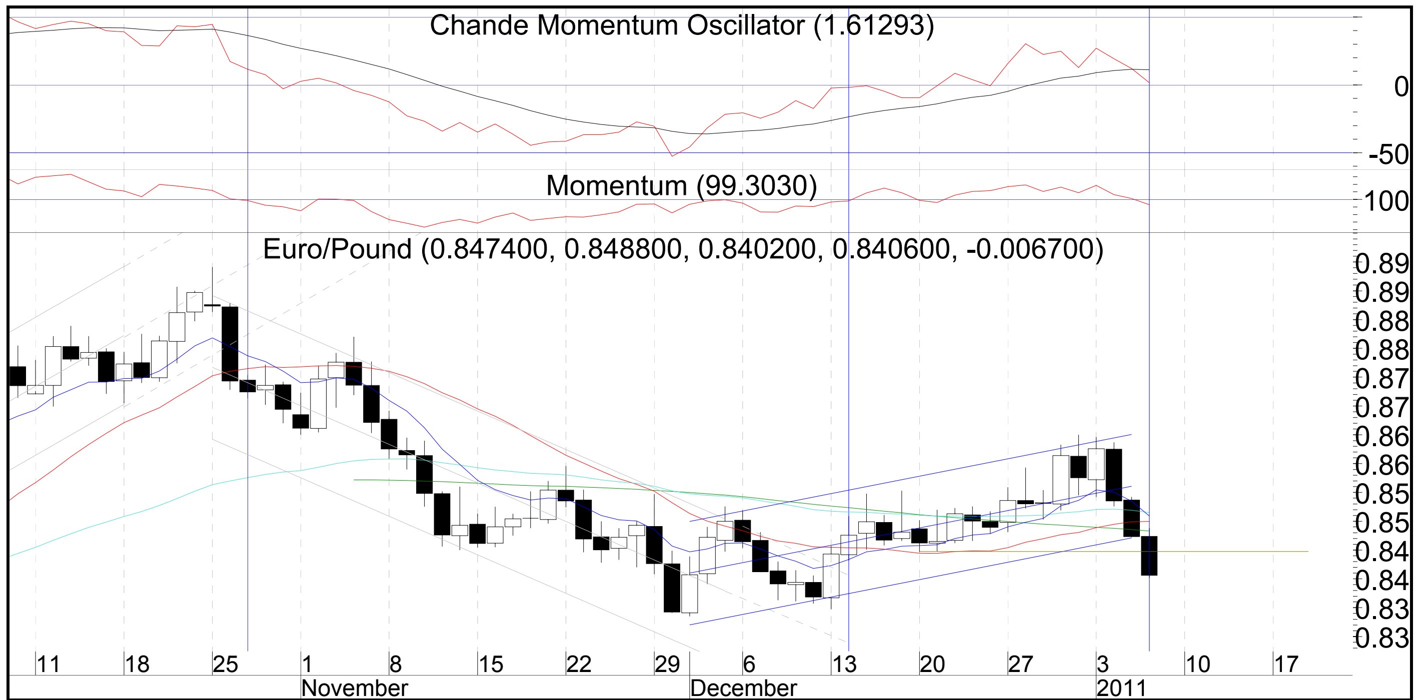


The USD made a lower low but closed higher. RSI is flat and momentum continues to fall. That old low gold region is hard to get past.

EURO/YEN

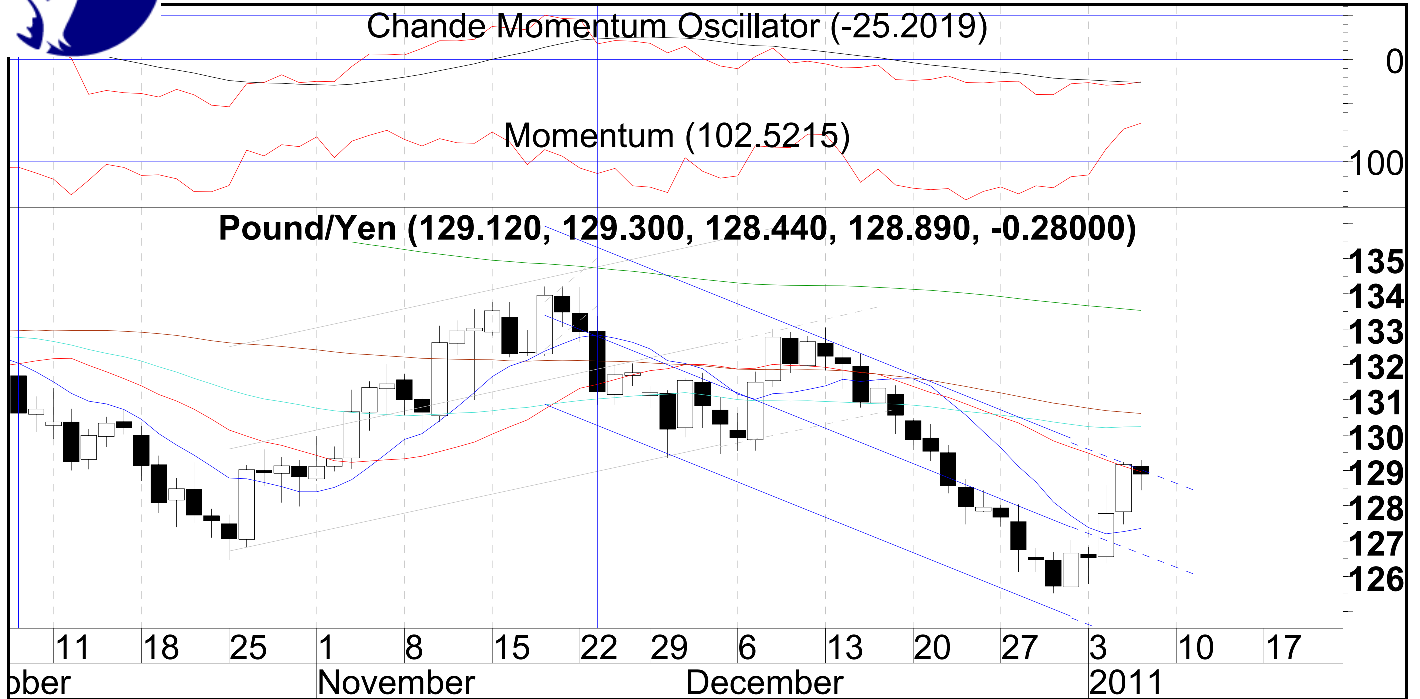
The euro/yen closed down and under the 10-day. Momentum retreated from the crossover point.

EURO/POUND



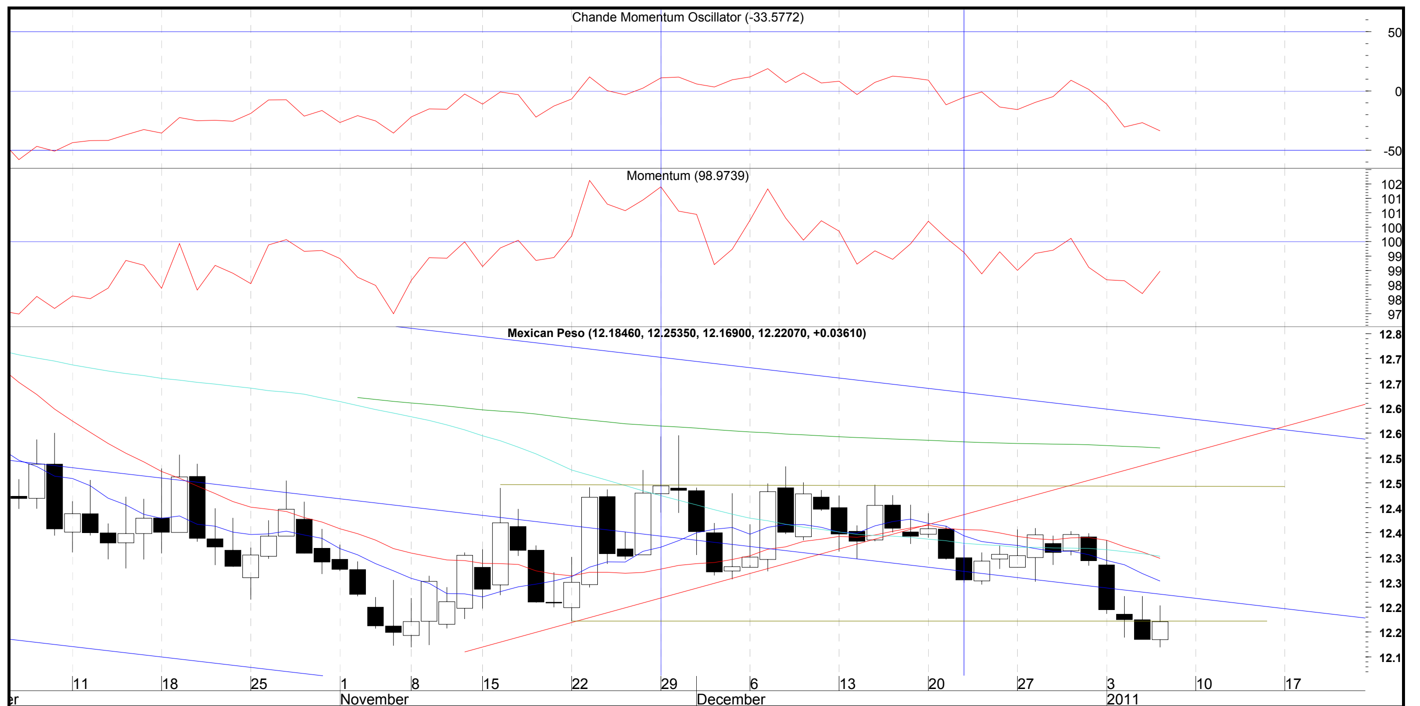
The euro/pound closed lower for a third day and fully under the channel. The old low is 8446 from 12/20.

GBP/JPY



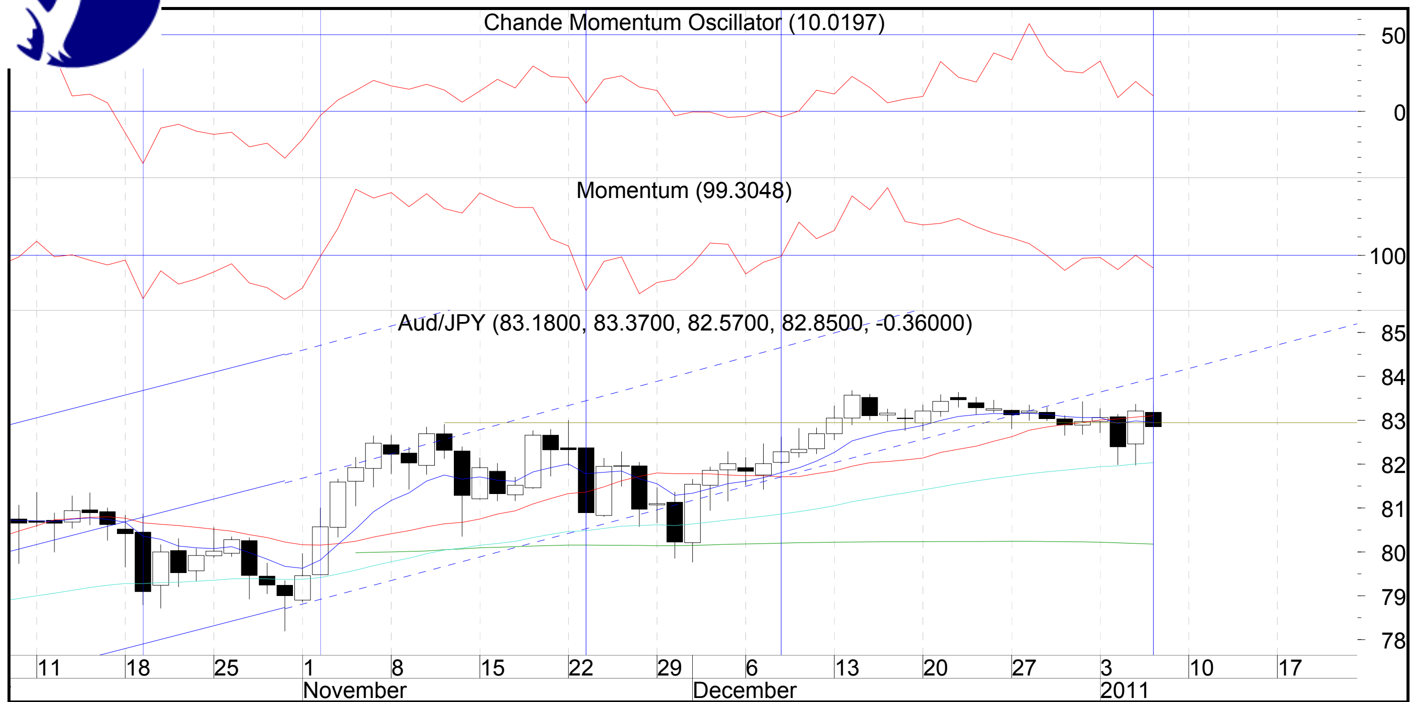
The pound/yen made a higher high but closed lower and at the channel top and 20-day. The move is too fast for the moving averages to keep up.

MEXICAN PESO



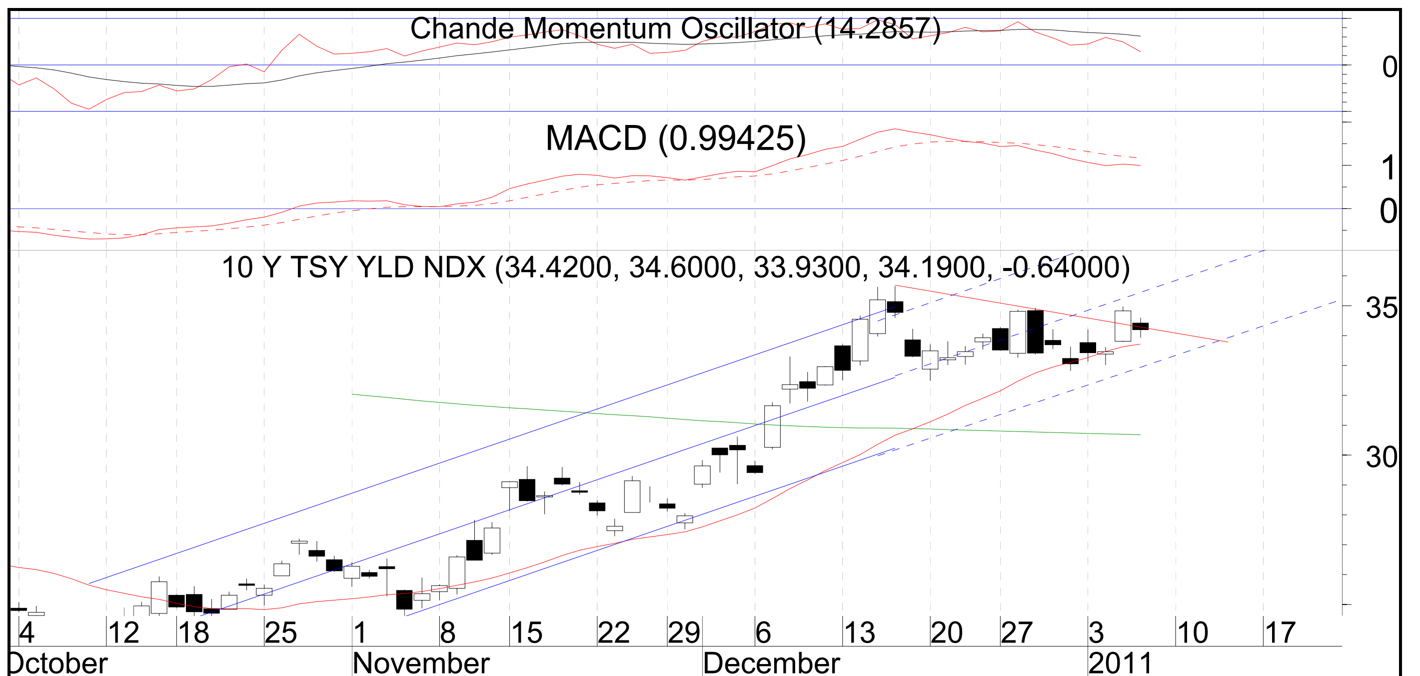
The dollar made a lower low but closed higher, if still under the gold old-low range line.

AUD/JPY



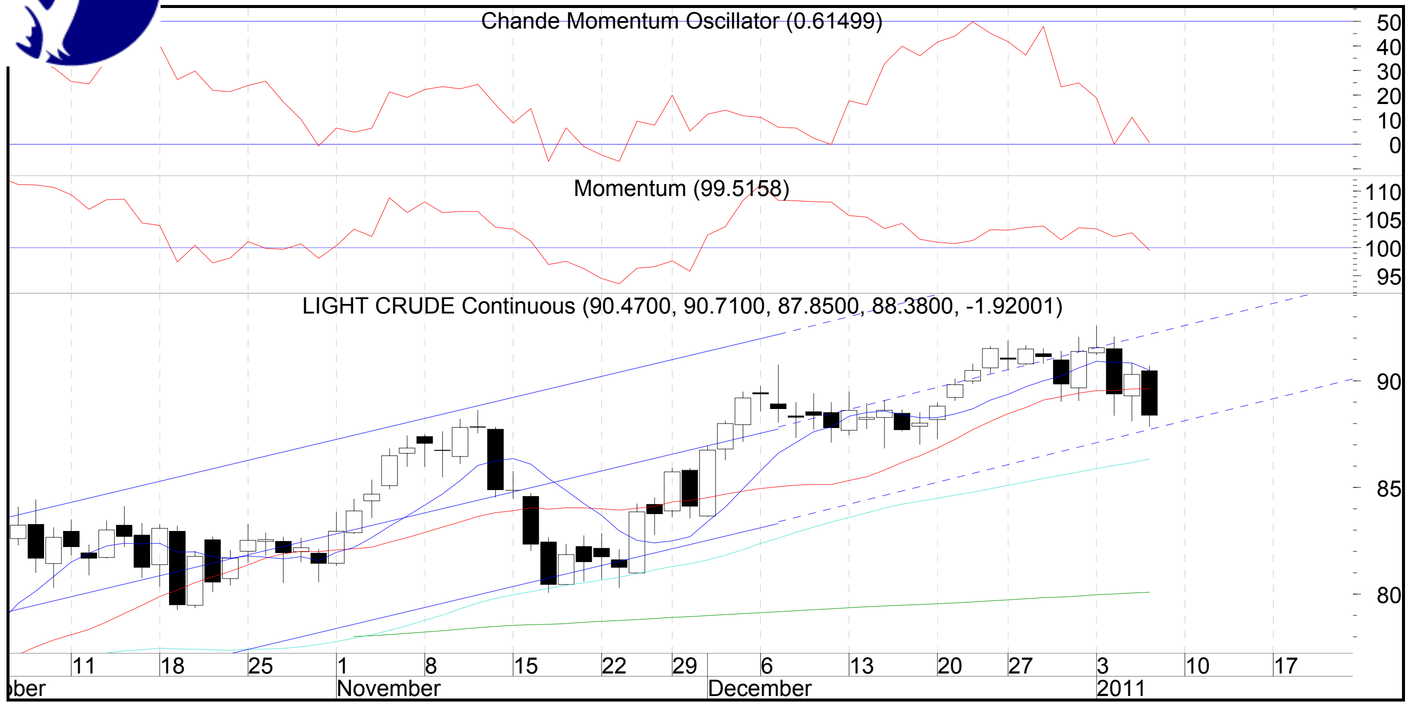
The AUD/JPY closed lower on an inside day. We changed the signal but this one is iffy.

10-Year Note Index



The index closed lower at 3.419% from 3.483% and right on red support.

NYMEX Light Crude Oil (Continuous Futures Contract)



Oil closed lower at $88.38 from $90.30 and under the 20-day.

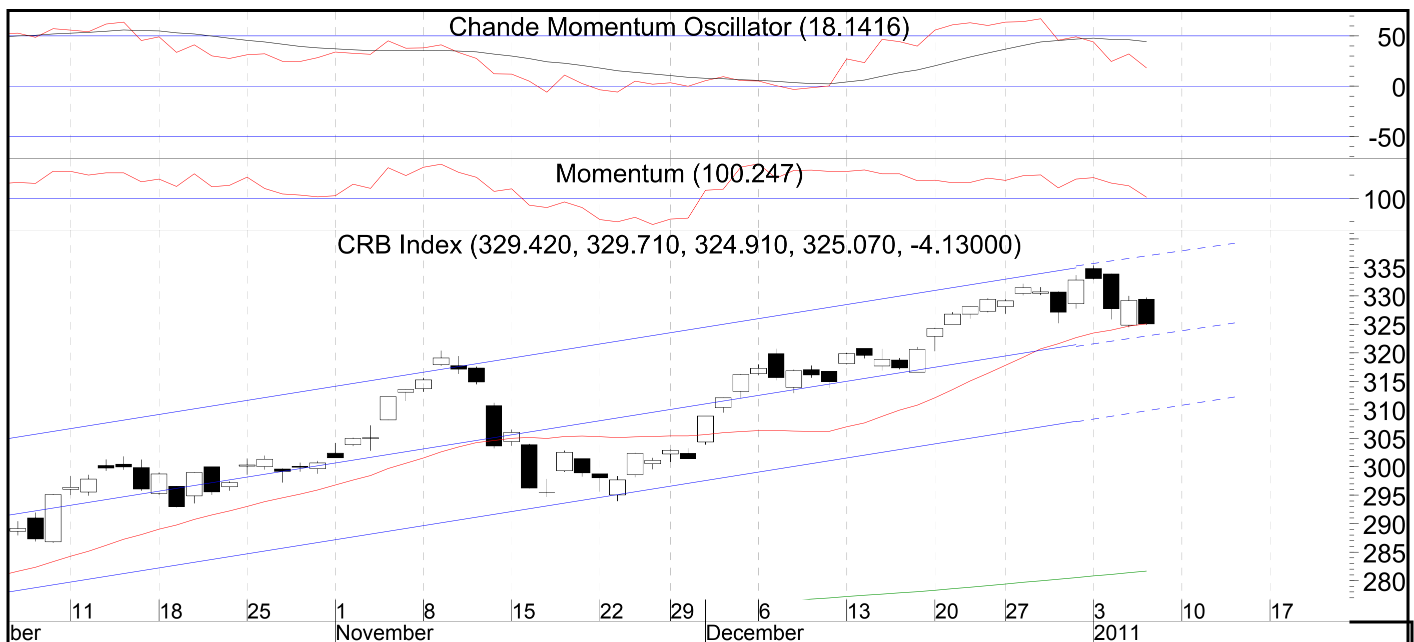
Gold Continuous Futures Contract

Gold closed lower at $1371.40 from $1373.40 and right on the turquoise 55-day.

S&P 500

The S&P made a higher high but closed under the open at 1273.85 from 1276.56 the day before.

CRB Commodities Index



The index closed lower at 325.07 from 329.20 but supported by the 20-day. RSI and momentum are both falling.

www.rts-forex.com

©Copyright by Rockefeller Treasury Services, Inc.

ber@rts-forex.com
Southbury, CT 06488