



| | SPOT | CURRENT POSITION | SIGNAL STRENGTH | OPEN DATE | OPEN RATE | POSITION GAIN/LOSS |
|----------------|---------------|------------------|-----------------|-----------------|---------------|--------------------|
| USD/JPY | 80.97 | LONG USD | WEAK | 05/23/11 | 81.57 | -0.74% |
| GBP/USD | 1.6428 | LONG GBP | NEW*WEAK | 05/27/11 | 1.6428 | 0.00% |
| EURO/USD | 1.4203 | SHORT EURO | WEAK | 05/09/11 | 1.4396 | 1.34% |
| EURO/JPY | 115.06 | SHORT EUR | WEAK | 05/06/11 | 116.70 | 1.41% |
| EUR/GBP | 0.8644 | SHORT EURO | WEAK | 05/09/11 | 0.8802 | 1.80% |
| GBP/JPY | 133.07 | LONG GBP | NEW*WEAK | 05/27/11 | 133.07 | 0.00% |
| USD/CHF | 0.8575 | SHORT USD | NEW*WEAK | 05/27/11 | 0.8575 | 0.00% |
| USD/CAD | 0.9777 | LONG USD | WEAK | 05/16/11 | 0.9744 | 0.34% |
| AUD/USD | 1.0661 | SHORT AUD | WEAK | 05/06/11 | 1.0676 | 0.14% |
| AUD/JPY | 83.37 | SHORT AUD | WEAK | 05/05/11 | 85.76 | 2.79% |
| USD/MXN | 11.6809 | LONG USD | WEAK | 05/16/11 | 11.7688 | -0.75% |

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. Trade recommendations are delivered ONLY in the afternoon report.**

Summary: The dollar fell yesterday and is continuing soft this morning ahead of the US open on a strange combination of factors and with a serious case of the jitters as traders adjust positions according to incoming news and shifting perceptions. Reuters says dollar selling by hedge funds overnight led the way, along with stop-loss short euro covering, in a battle between which currency faces the worse conditions, the dollar or the euro. Yesterday Eurogroup chief Juncker warned that Greece may not qualify for the next tranche of IMF aid, which was euro-negative, but then bad US data pushed the 10-year yield to a 6-month low under the 200-day moving average and everyone forgot Juncker for the moment. Overnight, rating agency Fitch joined S&P in downgrading the outlook for Japan to negative because of the vast debt that will be added to an already high tab from the March earthquake/tsunami/nuclear plant accident.

What's Happening This Morning: The euro jack-knifed yesterday, falling the in morning from 1.4180 at the open to 1.4065 by noon on the Juncker news, but turning around to close at 1.4131 on bad US news. The duel between negative euro sentiment and short euro positions was resolved in the euro's favor after traders recognized that nothing big is going to happen in the Greek situation until after the June IMF report, according to Market News.

Overnight, the euro proceeded to a high of 1.4278, surpassing yesterday's high, over the 68% retracement of the last week's move down, and probably targeting last Friday's high at 1.4354. On the bigger daily timeframe, traders are eyeing the 38% Fib retracement level of the May decline from 1.4940 to 1.3893 at about 1.4350. Some analysts note that the 55-day moving lies at about 1.4330 (and is converging to the 20-day).

Bad US data was the trigger for a turnaround in the dollar upmove that was already running out of steam (especially evident in USD/CHF, for example), meaning traders who were already unwilling to venture into new dollar highs were anxious to pare positions and set off a stop-loss sell-off. This is a good example of a case where data that may not normally move the market was a convenient excuse for re-positioning, and note that the news came out at 8:30 am but we got the currency effect several hours later, boosted along by the European debt developments (see below).



It would have taken ultra-good data to outweigh the emerging technical bias. As it happened, the data was bad. GDP for Q1 failed to be revised upward and was kept at the same preliminary reading of 1.8%, and the cause was a downward revision to consumption (in turn caused by higher energy prices). Weekly jobless claims, which carries far more weight than it should, rose by 10,000 to 424,000 in the May 21 week (and the week before was revised up), when the market was expecting 405,000. Continuing claims fell 46,000 to 3,690 million persons but, as Market News notes, this is higher than the equivalent April week (3,659). And, as we all know, the true number is much higher, probably double. (Some cranks say triple.)

Japan: The USD/JPY was already falling from 81.85 at the NY open yesterday to 81.18 at the close (and 56 of the total 67 points in the single hour 8-9 am). The trigger seems to have been unhappy US economic data (GDP, jobless claims) that inspired a general dollar sell-off, aided by the observation that the dollar was already struggling to hang on to gains (if you can't buy it, sell it). Market News reminds us that the yen and Swiss franc always find favor on "safe-haven considerations." In the case of the Swiss franc, it gained against the dollar but more against the euro. EUR/CHF fell to yet another record low of 1.2160 yesterday and is clinging to the lows today.

Today the dollar/yen went to 80.80 despite the news that Fitch cut its outlook for Japan from stable to negative (after S&P did the same thing in April) on rising indebtedness from the triple disaster in March. Fitch also said "A stronger fiscal consolidation strategy is necessary to buffer the sustainability of the public finances against the adverse structural trend of population ageing." Reuters reports Japan's public debt is already two times GDP of about \$10 trillion, and "rising sharply, at a pace trailing only Ireland and Iceland, both of which have experienced systemic banking crises."

Why does this refreshed fear about Japanese finances not harm the yen? Again, dueling worries. The drop in US 10-year yields yesterday to 3.06% caused more concern in Asia than elsewhere that the US recovery is faltering and may lead to QE3. One analyst told Market News Asia that if June 3 payrolls are weak and talk starts up of QE3, the dollar will fall at an accelerated pace.

Eurozone Crisis: Developments in the Eurozone debt saga had to be followed hour-by-hour to see the effect on the euro/dollar, and even then it's hard to untangle. Remember that yesterday EFSF chief Regling announced China would be a buyer of EFSF paper, rated triple-A despite its intended use for bailing out members whose own paper is junk or near-junk. Market News reports that later in the morning yesterday, another EFSF official "confirmed that China took part in the January auction, which raised money for Ireland's bailout."

Then the EC "offered the breakdown of the largest buyers of Wednesday's E4.75 billion five-year bond auction (EFSM loan for Portugal) on its website, noting investor demand from the UK (17%), Germany/Austria (14%), the Nordics (12%), France (11%), Asia (16%), the Middle East (7%) and the Americas (5%)." The EC confirmed that central banks took 36%, followed by banks (32%).

"The euro rallied sharply as peripheral spreads narrowed, with the pair at one point breaking above \$1.4200, where the rally was capped by Asian sovereign selling. The pair then began to tumble on headlines relating to comments made by Eurogroup president Jean-Claude Juncker, which implied that Greece might not get the next loan tranche from the International Monetary Fund" from a story in the WSJ. Market News notes "If true, this would threaten IMF involvement, as IMF rules dictate that a full one-year plan be in place before a new loan tranche can be released."

Whereupon the euro fell in the wake of the Juncker report. Got that?

Today (and possibly this weekend) we could get more Greek developments. It turns out that a summit rumored yesterday is indeed taking place today among Greek political leaders, starting at 5:30 am in Athens, called by PM Papandreou. The WSJ says that the Greek cabinet already approved €6.4 billion of new austerity measures but by the second week of June, it has to come up with another €2 billion in spending cuts. If it fails to do the deed, it risks not getting the next tranche of the €110 billion bailout, let alone the extra €60 billion it wants in Bailout II. So far opposition political parties are indicating they won't



vote for the next cuts and could force a general election. The WSJ states that the next installment is €12 billion on June 29 and “the government says it has enough cash on hand to continue operating until July 15.” But a decision on non-compliance from the IMF, as Juncker warned, could come sooner.

Equity Markets: The Dow rose 0.07% and the S&P, 0.40%. The Nikkei rose 0.42% despite the ratings agency outlook downgrade. The Hang Seng rose 0.95% and the Shanghai fell 0.97%. The WSJ reports that Chinese stocks have fallen for 7 straight days and 5.2% from May 20. A theme is expected slowing growth and rising inflation, with inflation winning. Also, “investors in China have also been fretting over a potential liquidity squeeze because of the launch of a new board for foreign company listings in the future.”

The Main Event: The 10-year note yield index closed at 3.061% from 3.129% and under the 200-day moving average. Remember, this is a Reuters index, not the true yield, but it’s close enough. The number 3.6% is being quoted everywhere. Market News reports that the key level had been 3.08% and breaching that led to a low at 3.059%--from the high the day before at 3.16%. Bad US data gets the blame, comforting bulls and scaring the pants off the shorts.

And “The Treasury market notched its third good auction in a row this week, something of a rarity. The \$29 billion 7-year note was awarded at 2.429% vs. its on screen bid level of 2.436% at deadline. The bid/cover was good at 3.24%. Indirects took 47.7% and direct took 13%.”

Other Markets: Crude oil closed lower at \$100.23 from \$101.32 and is only marginally higher this morning at 5:45 am at \$100.64.

The FT has a splendid piece on mass confusion in many markets... “The silver market was back to its old tricks on Thursday, when it sought to prove the maxim that bullion tends to take the escalator up but the elevator down. After creeping to within 20 cents of \$39 an ounce as continental Europe was having its croissants, the grey metal was brushing \$36 a few hours later – at one point dropping 4 per cent in a 15-minute slump. On Friday it is trading at \$37.75. Traders have every right to be a tad confused. Further intrigue has been added to silver’s maverick credentials by some seemingly contradictory data. Whereas the gold price has continued to track trends in exchange traded fund holdings, the silver price and ETF holdings have diverged sharply since silver hit its recent low, just south of \$33.

“ETFs were more likely to have been the vehicles that retail investors chose to punt on silver, so this may point to those players continuing to move out of the market, having been burnt when it crashed from near \$50 at the start of May. Net long positions among deeper-pocketed speculators playing the futures contract dropped to a two-year low last week. But judging from recent price action this has been partly reversed.”

G8 Summit: G8 has decided to support the “Arab spring” with a commitment of \$20 billion from multilateral development banks. Other topics will get reported later. We note that in the photos from the leaders walking along in Deauville, Sarkozy is browner than Obama.

Outlook: It can be very hard sometimes to figure out what is driving sentiment when facts and accepted assumptions are in conflict. You do not hear much talk of QE3 in the US or Europe, and yet Market News tells us that overnight, it was the dollar that fell on the idea of QE3 and not the yen, despite Japan being the one to get a second ratings agency outlook downgrade. The reporter writes that at the same time, “the euro turned firmer on short-covering despite lingering anxiety about the debt situation in Greece. Luxembourg’s Jean-Claude Juncker, who leads a group of euro-area finance ministers, said the IMF may not release its portion of aid for Greece next month, spurring concerns that Greece may not be able to get much-needed financial aid. [A Japanese brokerage analyst said] ‘It seems that after having witnessed relatively firm support on the downside despite the plethora of negative news, investors are getting bored with selling the euro. As the euro is also stably moving within the daily Ichimoku cloud, there seems to be a chance for the single currency to test the top of the cloud at around \$1.4350.’”



This is a good example of sentiment and technicals driving interpretation of news. Yes, it's very strange.

The FT identifies the odd combination of factors as “a switch in the way the dollar reacts to disappointing US economic data.” This time it is “providing support to stocks and commodities, as traders find the gospel of the buck's inverse correlation to risk assets difficult to denounce.... Such a bullish tone would normally be met with noteworthy softness in the prices of core bonds, nudging yields higher as investors shifted funds to racier plays. But benchmark US Treasury 10-year yields are little changed near 6-month lows of 3.07 per cent, reflecting continued evidence that economic activity in the US is stuttering. In the recent past, such weak data would give the dollar a somewhat perverse boost as investors bet on funds flowing into perceived haven currencies as risk appetite waned. This is not the case on Friday – as investors are faced with the conundrum of risk assets and core sovereigns both displaying strength in recent sessions.”

We can offer one tidbit about equity traders feeling frisky on bad US data—they think it pushes off the day of reckoning when the Fed starts nudging rates higher. Commodity guys get to keep cheap margin rates a little longer too—but then why is oil not higher?

As we have been judging all along, the Greek default drama really can't be glossed over all that much longer. It has to come to a head at some point, and if the process is not well-managed, the euro “should” suffer, even if after it's all over, the euro should get a nice relief rally. But talk of a Lehman-scope crisis should not be brushed off. Today the former Bundesbank chief economist Issing appears in the FT to say that Greece is not only illiquid, it's insolvent. It's one thing for Soros or Roubini to say it, but when it's Issing, everyone should sit up and take notice. Nobody has more credibility. The FT says Issing was “the intellectual heart of the ECB from its creation in 1998 until he stepped down in 2006. His comments will fuel financial market speculation that a Greek debt scheduling is inevitable, whatever the ECB says.”

In the US today, it will be a short day ahead of the holiday. We get personal income and spending today, with income forecast up to 2.2% from 1.8% (Reuters). Chances are that the FX market will not get an improved sense of what's what. As one analyst told the WSJ, “We'll probably stagnate at these levels with a small bias toward risk reduction. We're in an environment where conviction is low and volatility is high. Now is not the best opportunity to return to risk.” Golly, doesn't that mean the dollar should stabilize? We guess the euro will fail to match-and-surpass the hurdle at about 1.4350, a number arrived at by multiple routes named above, but that doesn't necessarily mean a resumption of the euro's decline, even if it should. We advise everyone to get square and stay that way until Tuesday.

Note to Readers: Today will be a short day in the US markets because the following Monday is a national holiday (Memorial Day, for the soldiers lost at war). We take it pretty seriously. We will not publish any reports on Monday, 05/30/11.





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.

New Zealand Dollar



The NZD closed much higher on a big bar, surpassing the previous intermediate high and probably breaking the downmove.

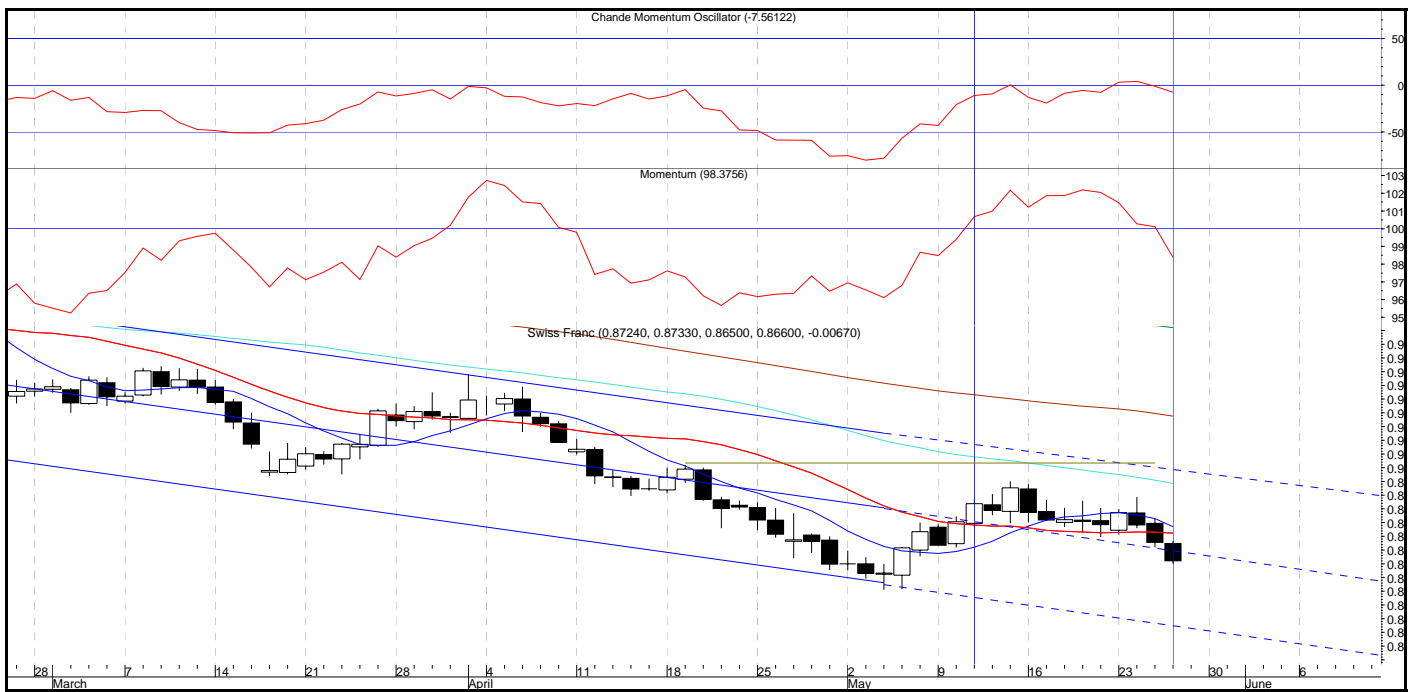


EURO/USD



The euro closed higher, although not at the high of the day. More important is the series of three higher lows—bears are losing. We do not have a breakout (like the NZD) but it's not not to suspect a channel break, even if it doesn't last.

USD/SWISS FRANC



The USD closed lower for the third day (“three black candles”) and well under the 20-day. The downtrend seems to be resuming. See momentum crashing.



UK POUND



The pound closed higher for a third day (three white candles) and over the 20-day. MACD is at the crossover point. We may get position paring and some wobbling after such a big move but are changing the signal to buy.

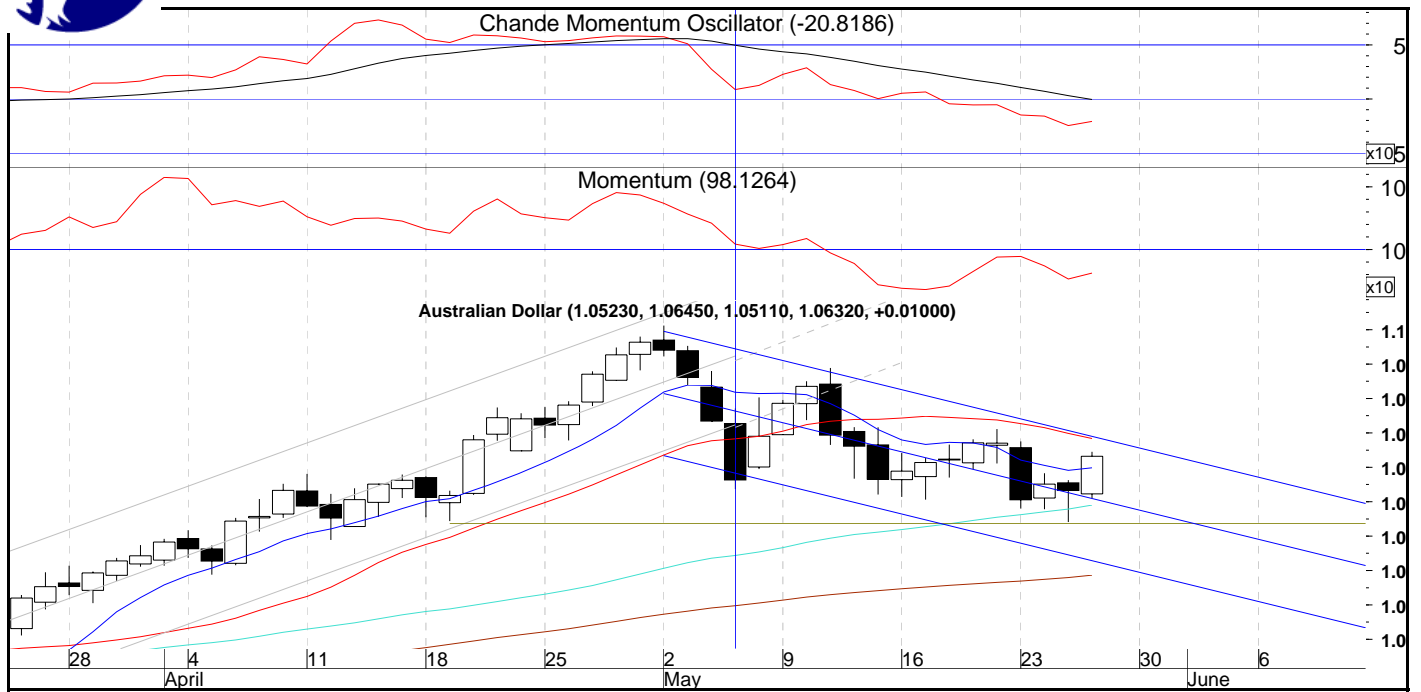
USD/JAPANESE YEN



The USD/JPY closed down and just under the 20-day on a big bar. We restored the primary-move down-trend channel and expect a signal change in the next day or two.

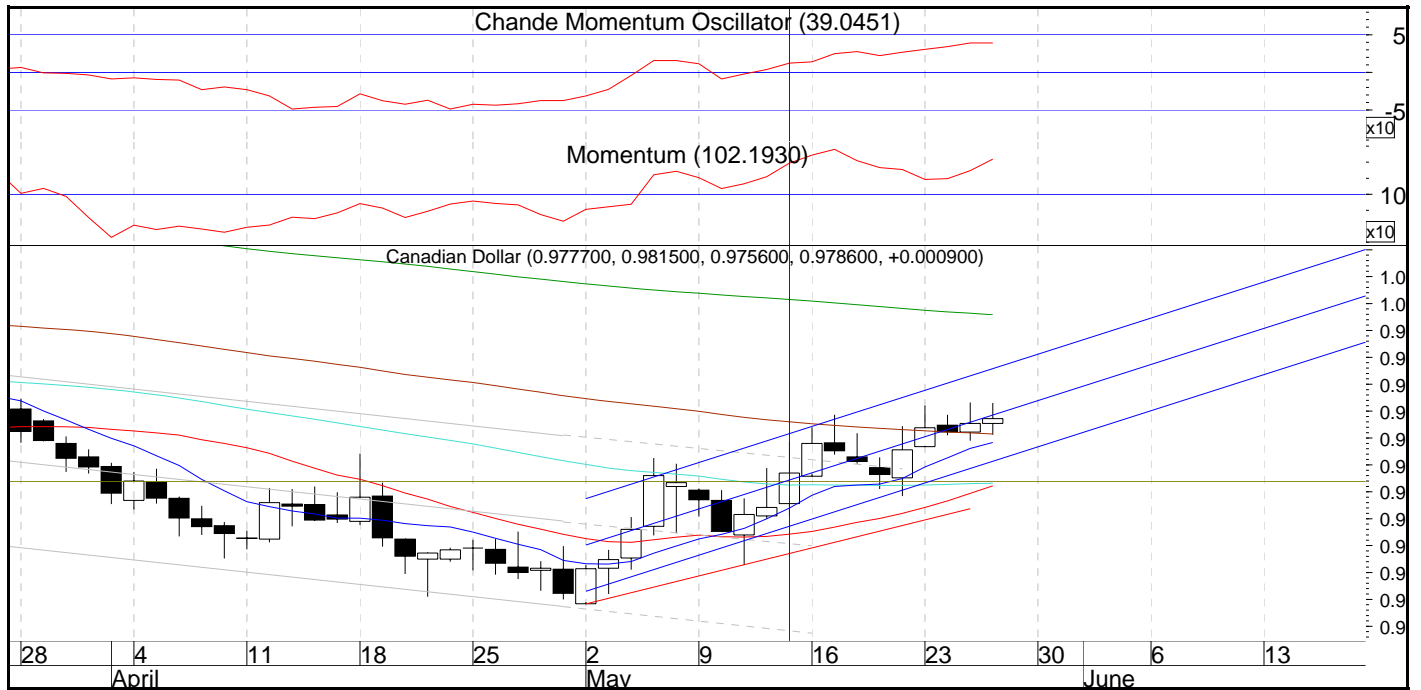


AUSTRALIAN DOLLAR/USD



The AUD closed higher on a fairly big bar (if not to NZD standards) and closed over the 10-day. The 20-day lies at the channel top and should be easy to break unless risk aversion comes back.

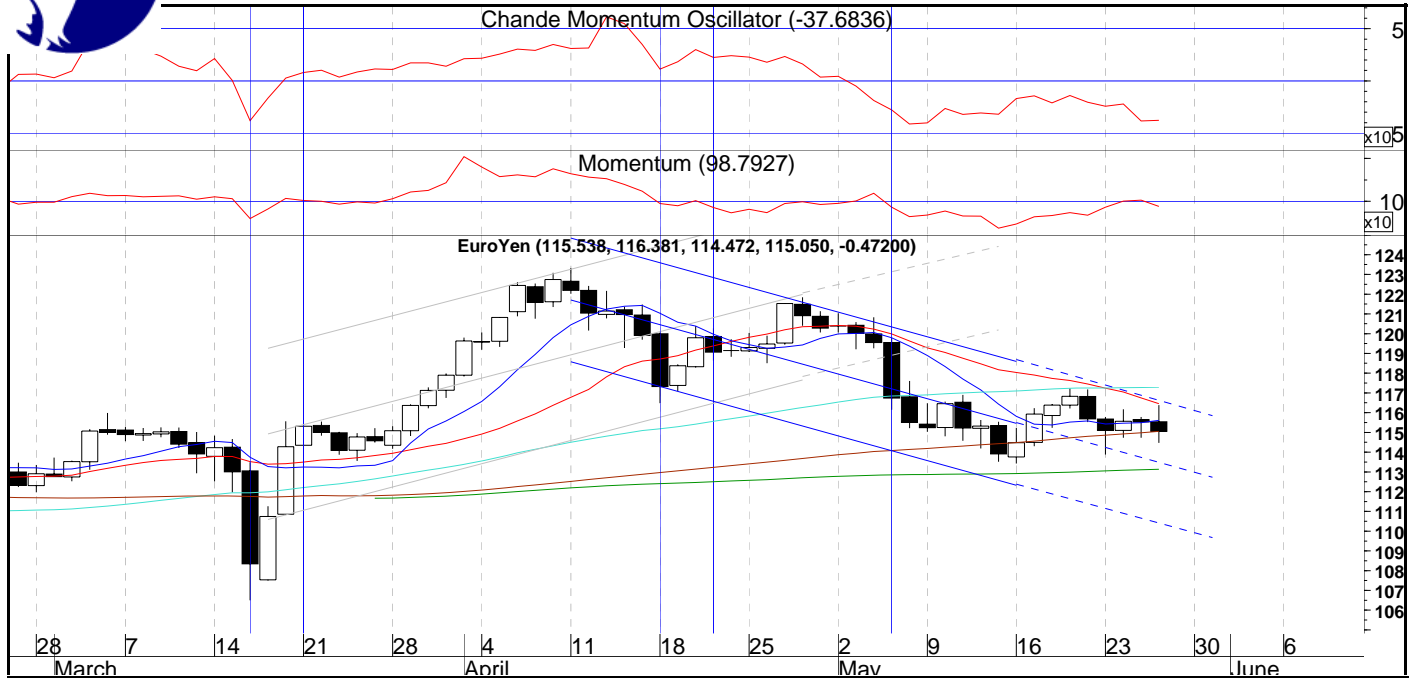
USD/CANADIAN DOLLAR



The USD/CAD made a higher close on an inside day. We find this fishy—everything else is higher against the dollar—what's happening to the CAD?



EURO/YEN



The euro/yen closed lower and nearly at the dark red 100-day.

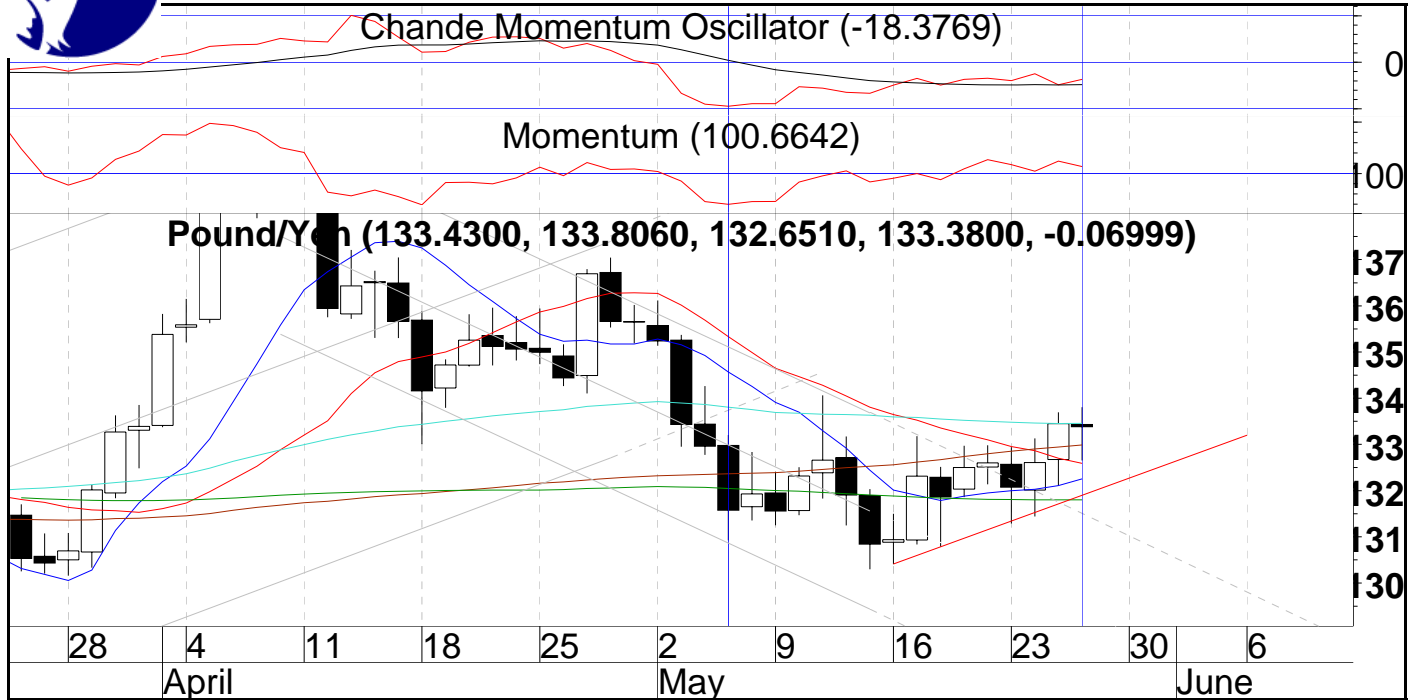
EURO/POUND



The euro/pound closed lower and is nearing the green 200-day at 8582.



GBP/JPY



The pound/yen closed higher and at the 55-day for the second day.

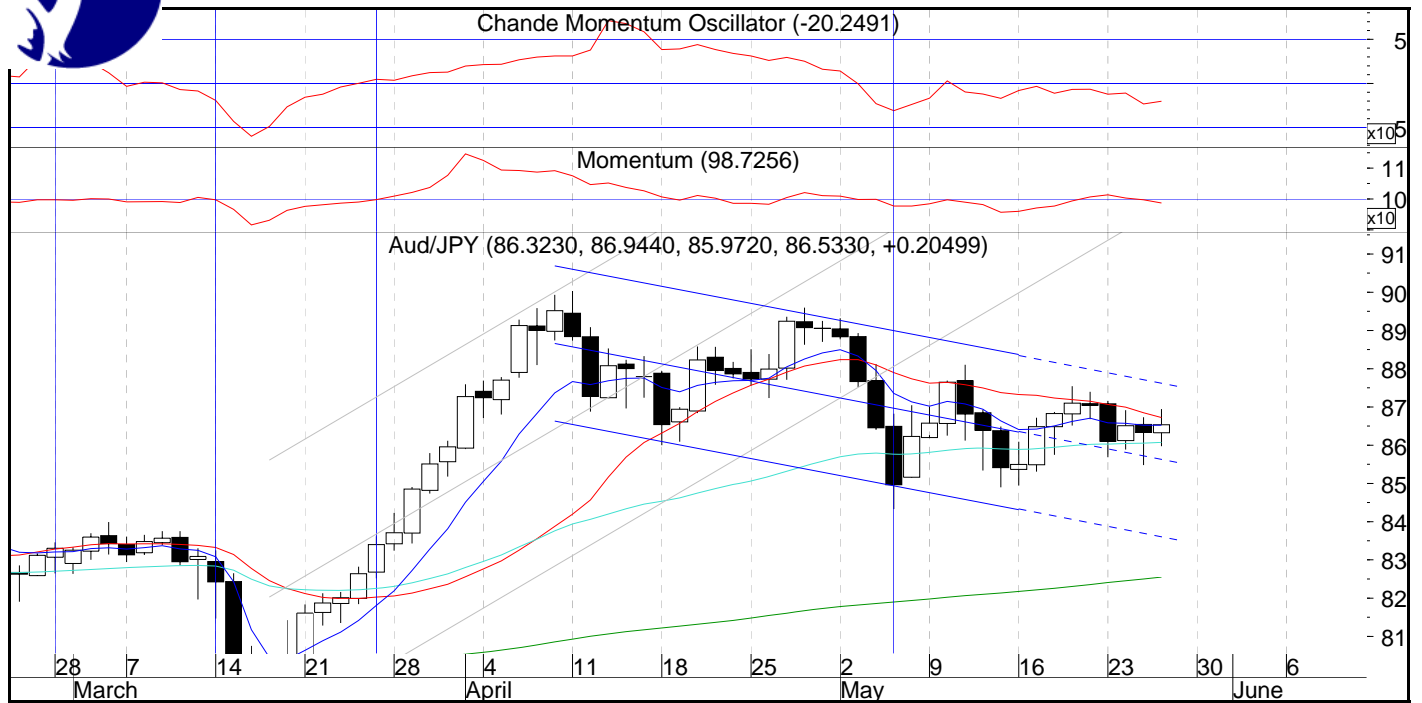
MEXICAN PESO



The dollar closed lower on a doji bar, with the low touching the 20-day. We fear this upmove will be ending soon.

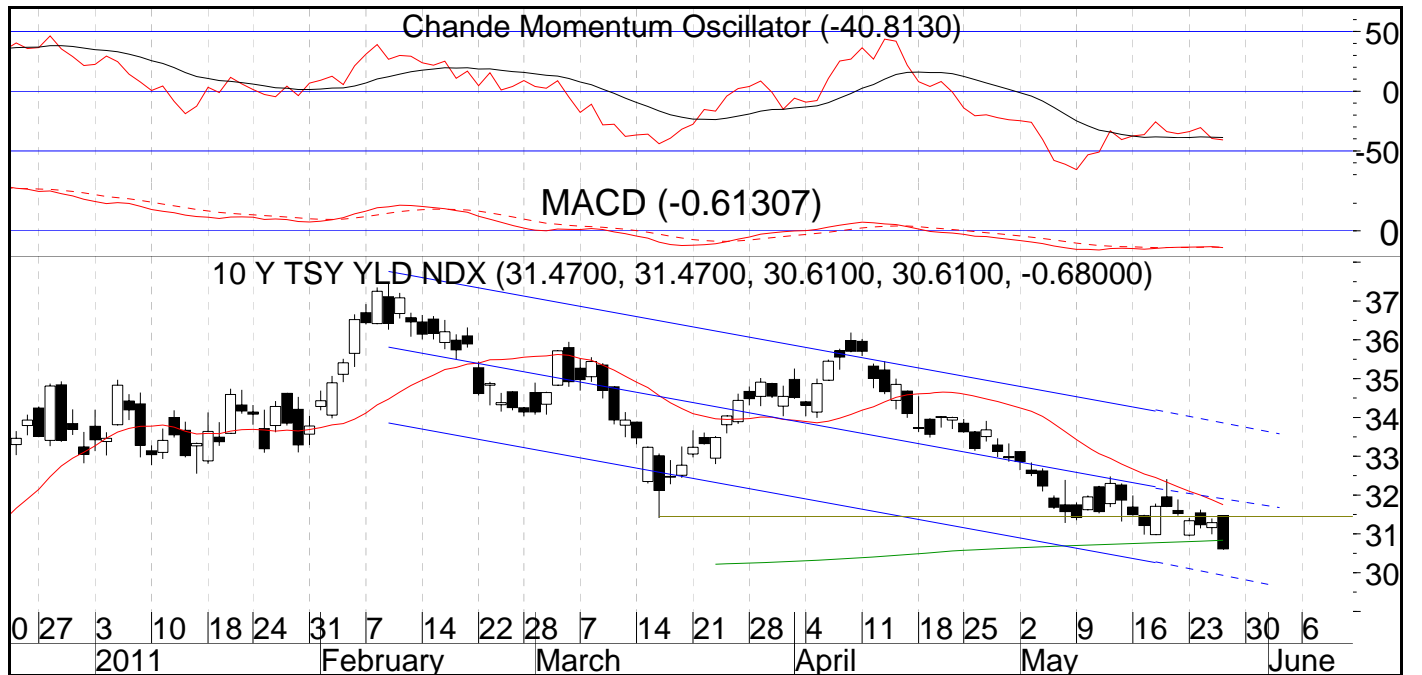


AUD/JPY



The AUD/JPY closed higher but not quite to the 20-day.

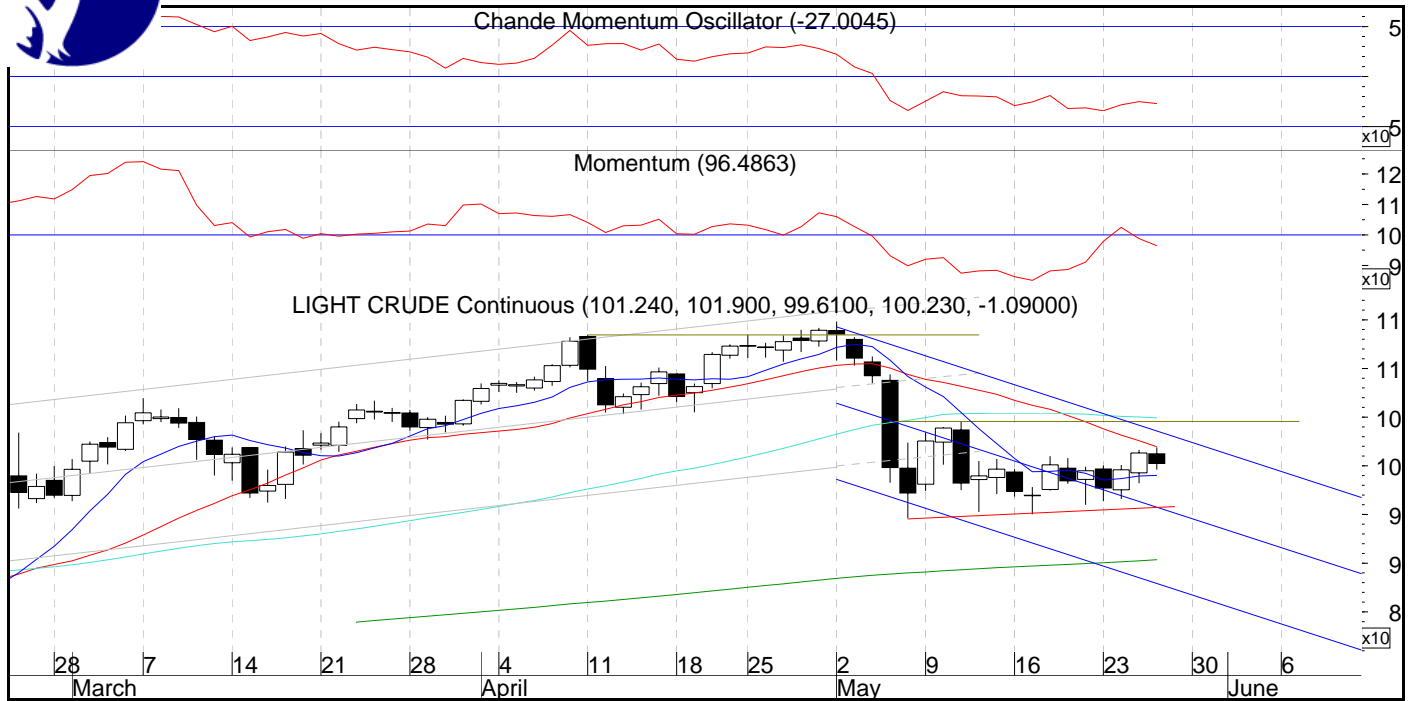
Reuters 10-Year Note Index



The index closed lower on a big bar at 3.061% from 3.129% and *under the green 200-day*.

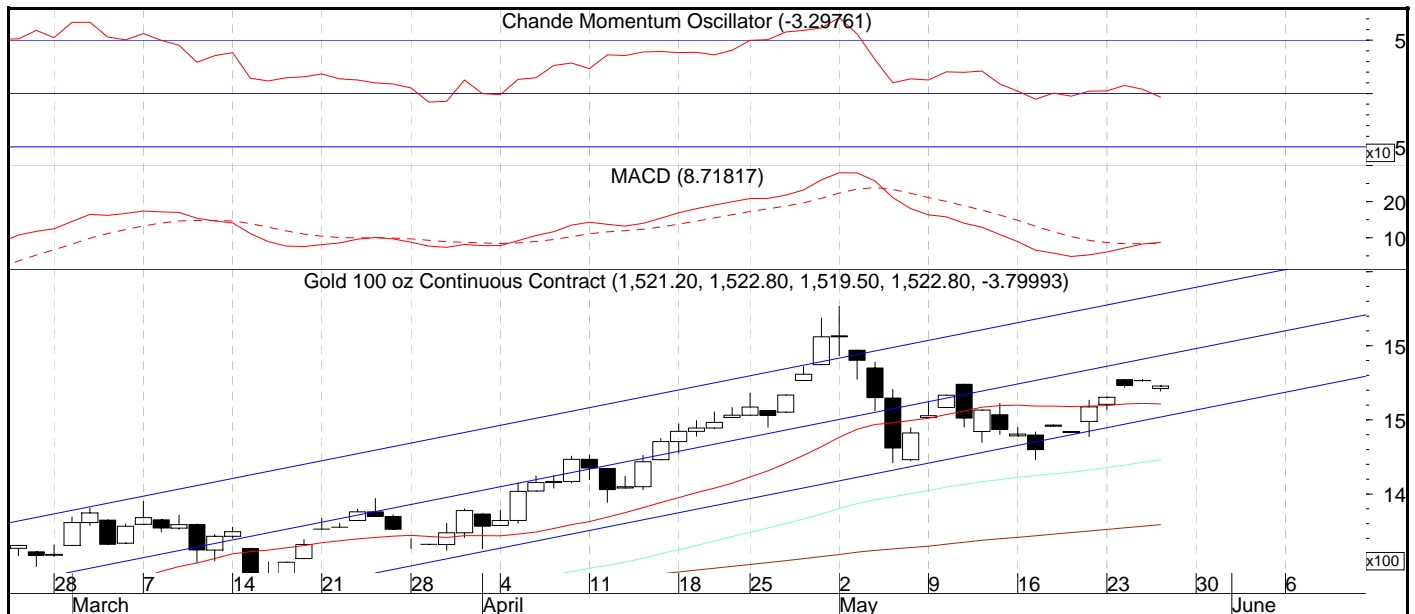


NYMEX Light Crude Oil (Continuous Futures Contract)



Oil closed 9 cents lower at \$100.23 from \$101.32 and failed to match-and-surpass the red 20-day. See momentum going negative again.

Reuters Gold Continuous Futures Contract



Gold closed lower at \$1522.80 from \$1526.60 and on a third bar with hardly any real body.

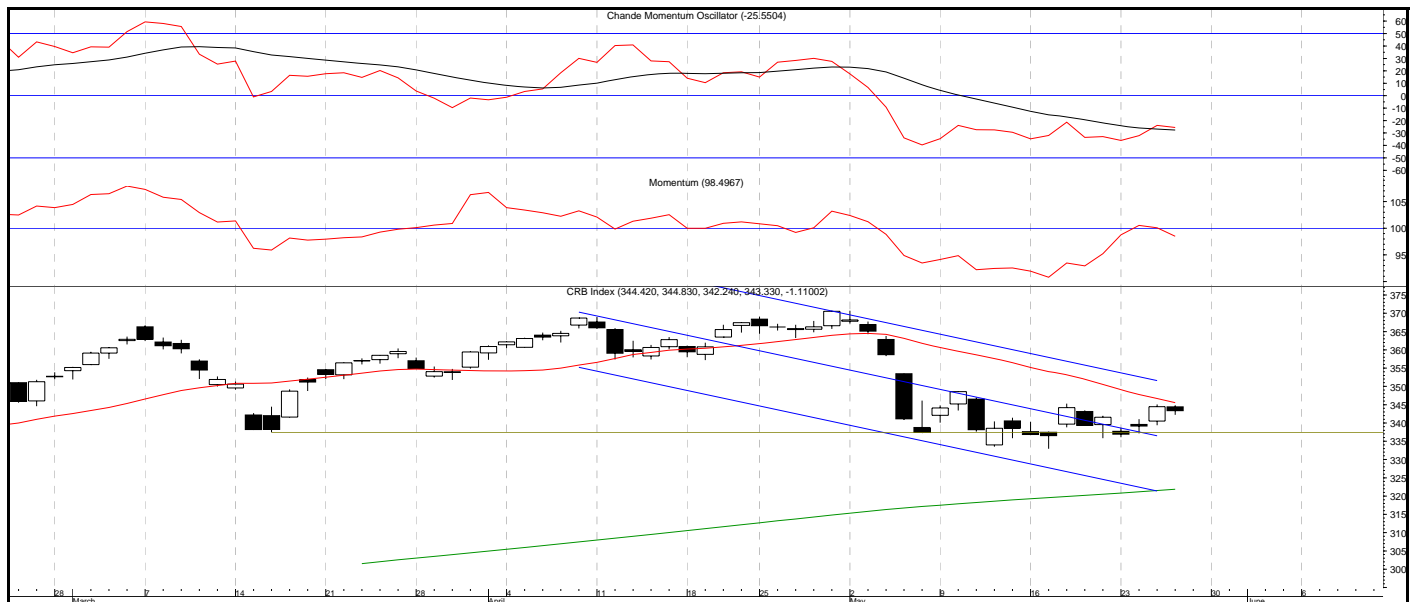


S&P 500



The S&P closed higher at 1325.69 from 1320.47 and is hanging on just over the 100-day, which seems to be serving as support. .

CRB Commodities Index



The index closed lower at 343.33 from 344.44. RSI and momentum are now falling. We mis-wrote yesterday—it's the channel bottom that is meeting the 200-day, not the price. It is curious that the index remains under the 20-day.