



Rockefeller Strategic Currency Briefing[©]

Friday, December 24, 2010
Price Quotes as of 5:00-6:00 am EST
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	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	82.91	SHORT USD	WEAK	12/23/10	82.98	0.08 %
GBP/USD	1.5445	SHORT GDP	WEAK	12/21/10	1.5497	0.34 %
EURO/USD	1.3116	SHORT EUR	WEAK	12/21/10	1.3151	0.27 %
EURO/JPY	108.77	SHORT EURO	WEAK	12/23/10	108.76	-0.01 %
EUR/GBP	0.8488	LONG EURO	WEAK	12/15/10	0.8466	0.26 %
GBP/JPY	128.09	SHORT GBP	WEAK	11/24/10	131.33	2.47 %
USD/CHF	0.9627	SHORT USD	STRONG	12/14/10	0.9624	-0.03 %
USD/CAD	1.0060	SHORT USD	WEAK	12/13/10	1.0086	0.26 %
AUD/USD	1.0430	LONG AUD	WEAK	12/14/10	0.9993	4.37 %
AUD/JPY	83.25	LONG AUD	STRONG	12/09/10	82.55	0.85 %
USD/MXN	12.3515	SHORT USD	WEAK	12/23/10	12.2995	-0.42 %

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.**

Note to Readers: We will not publish the morning briefing next week, Dec 27-31. We will publish the two afternoon traders' advisory reports.

Executive Summary: The dollar slipped back a little as risk appetite continues to seduce traders into stocks and commodities. The MSCI world equity index is holding at just under yesterday's close, which was the highest since Aug 2008 (pre-Lehman) and up about 10% this year. Good US economic data gets the credit for pushing the rally along. The CRB index is at a new high and oil is trading over \$91. Today will be very light, with equities closed in the US and all markets closed in most of Continental Europe. The FX market in the US will close early today (although our traders' advisory reports will be published at the usual time).

What's Happening This Morning: The euro spiked up about 50 points early yesterday in New York, from 1.3090 at the 8 am open to 1.3142 by 11 am, and traded sideways to close at 1.3131. Asia took it only a bit higher to 1.3148 and it's back down to a low of 1.3107 at 5 am EST. If this is the correction after a rout, it doesn't amount to much. Far more impressive was the USD/CHF, which spiked to 9665 alongside the euro at mid-morning yesterday, from 9494 the night before, although it has not bested the level since.

We have no real "reason" for the euro and dollar/Swiss franc spike except short-covering in a very thin market as a few stops got hit. Market News reports that the move was seen as "order-driven and therefore may not reflect larger global investor sentiment." With interesting timing, right after the euro hit the hit, Fitch announced its downgrade of Portugal, and that put an end to any corrective rally.

As for dollar/yen, after making a downside breakout late Wednesday, it has made very little progress since then but seems to be holding under 83.00.

European Financial Crisis: In mid-morning yesterday, Fitch announced it was lowering Portugal's "Long-term foreign and local currency Issuer Default Ratings (IDR) to 'A+' from 'AA-' and the Short-term foreign currency rating to 'F1' from 'F1+'. At the same time, it affirmed Portugal's Euro Area Country Ceiling at 'AAA,'" according to Market News.



The ratings agencies are still out of sync. Fitch is now on the same page as Moody's (A1) but S&P seems to be lagging with Portugal at A-minus. Obviously we have to expect dueling downgrades in the first quarter unless the EMU takes some initiative not yet on the table to put a halt to it.

Equity Markets: The Dow rose 0.12% but the S&P gave back 0.16%. Asian markets were all a bit lower and this morning the Eurofirst 300 index is down a little on yesterday's Fitch downgrade of Portugal.

Other Markets: Oil closed higher at \$91.51 from \$90.48 and is holding firm at \$91.41 at 6 am EST today.

The Main Event: The yield on the 10-year T-note steadied at 3.393% from 3.346% the day before.

US Economy: US data continued to come in pretty good, even minor things like weekly jobless claims (down 3000 to 420,000 and the 4-week moving average up a mere 2500 to 426,000 and continuing claims down 103,000 to 4.064 million).

The final University of Michigan consumer sentiment index rose a bit, as forecast, to 74.5 from 71.6 in Nov and 74.2 in the preliminary. Bond vigilantes, take note—1-year inflation expectations are 3% and 5-year inflation expectations *lower* at 2.8%.

Nov new home sales actually rose, up 5.5% to a rate of 290,000, less than expected but the supply overhang reduced by 2% to 197,000, the lowest since March 1968. The median sales price rose 8% to \$213,000 in November, down only 2.7% y/y.

The number everyone was watching was Nov durable goods orders, down 1.3% for the second month of decline but led by weakness in aircraft (-53.1%) and autos (-2.9%). Ex-transport, orders rose 2.4%. The key number, nondefense capital goods ex-aircraft, rose 2.6%. Today the WSJ follows up with a story that companies are ramping up hiring plans, confirming a better mood.

And finally, Nov personal income rose 0.3% and personal consumption expenditures rose 0.4%, the old pattern of spending more than is earned. Q4 is shaping up to be pretty good for consumption, which of course makes exporters happy. PCE core inflation was a rise of only 0.1% m/m and 0.8% y/y, the lowest since 1960.

China: Market News reports that ahead of the US-China summit, the yuan is moving up a little, as usual. China generally gives the US some of what it wants, a rising yuan, around these events. Evidently it's a form of courtesy. The Market News report says "Prices of non-deliverable forward contracts for trading the Chinese yuan against the U.S. dollar extended gains on Friday, supported by the spot yuan exchange rate. One-year yuan contracts were up more than 100 pips to 6.4890/940 in mid-afternoon, indicating expectations of a 2.2% appreciation of the Chinese yuan against the U.S. dollar in one year's time. The Chinese central bank raised yuan central parity against the US dollar to a one-and-a-half-month high at 6.6371 this morning, up for the fourth session in a row. Market players expect more yuan appreciation in the next three weeks ahead of the Chinese President Hu Jintao's state visit with U.S. President Barack Obama in Washington on Jan. 19."

The WSJ opines that the summit of Presidents Hu and Obama (named as Jan 18, not Jan 19) will yield almost nothing on the currency front. As an olive branch, China could offer some creep in the exchange rate from the range since mid-Nov at 6.62 and 6.67, but "... in the near term, Chinese leaders won't want to see exports, a key component of both growth and employment in China, flag too much. So they will want to keep the currency cheap. Another reason: Beijing fears a sharp rise in the currency will lure in a destabilizing surge of 'hot money'." We should expect only "yuan gradualism in 2011." Forecasts like this bring out the gypsy in us. We just wrote this week that whether China supports the euro as a major policy move toward reserve currency status will be the potential top driver next year... but the WSJ finds the



subject unworthy of any mention.

Outlook: Today is going to be a dud for traders, with practically no markets open, and next Monday will probably be the same (London and some other markets closed). But the last week of the year sometimes sees bigger moves as traders and investors do some last-minute position-adjusting and maybe some setting-up exercises for the upcoming year.

Everyone remembers 2005, when the euro crashed in January from the 2004 year-end close at 1.3553 to 1.3030 by end-Jan. The move started the very first day of the year and at the time, we noted that a report by one of the big houses (we seem to recall it was Goldman) was the trigger event. Before that, of course, was the launch of the euro in Jan 1999, when the 1998 year-end closing of the hypothetical euro had been 1.1719 but Jan 1999 saw it fall to 1.1367. In short, January can be a bad month for the euro and we certainly have cause to imagine it happening again.

Since we all expect dueling downgrades and rising yield spreads, why would investors not be planning a general exodus from the euro this time, too? And while, we're at the judgment game, the outlook is uncertain about the UK economy (will austerity strangle growth?) and even more uncertain about the US (will Washington get serious about reining in deficits?). If we don't like the UK, US or Europe, that pretty much leaves Canada, Australia/New Zealand, and emerging market currencies. How to speculate in these? The yen carry trade. We therefore expect a replay of the yen rise to intervention-talk levels near 80. That's probably not going to happen in a single week next week, but strategists must be getting ready for it, including those who reside in government offices in Tokyo.

The usual caveats apply—that nothing big and awful comes along to upset the apply cart. Next week would be a good time for terrorists to pull a stunt. There is always the possibility of a natural catastrophe. But as Market News puts it, players are biased to sell euros on rallies. We see the highest high the euro can reach next week as 1.3498 (intermediate high from 12/14). On the downside, watch 1.2965, the lowest low from Nov 30. That low will get broken if traders do some pre-2011 positioning.

Happy holiday to all!

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