

Strategies, analysis, and news for FX traders

# **CURRENCY TRADER**

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# Greece holding the Euro in the balance

Greece's exit from the Eurozone might be a positive in the long run, but in the short term, it's nothing but trouble for the embattled Euro.

BY CURRENCY TRADER STAFF

More than two years into the European sovereign-debt crisis, the European monetary union remains at risk. The inconclusive results of the May 6 Greek elections have sparked a fresh wave of speculation that Greece could exit the Eurozone as early as this summer. The Euro/dollar pair took it on the chin in the following weeks, sliding more than 6 percent between May 1 and May 30.

The Eurozone is facing political, economic, monetary, and fiscal challenges of such magnitude that some market watchers are warning of the potential for another 2008-like global financial crisis. There are paths out of the current dilemma, but at this point — ahead of the June 17 follow-up Greek elections — there are many more questions than

answers.

"Since the elections earlier this month, everyone around the world recognizes a non-trivial risk that Greece will leave the Euro," says David Resler, chief economic advisor at Nomura Securities. "The markets seem to believe a Greek exit is imminent — at least that seems to be the way it's trading."

Greece might be small, but the implications of its exit from the Eurozone couldn't be more significant.

"It's possible that a small country with less than 1 percent of global GDP could take down the global financial system because of contagion," says Dr. Cary Leahey, global economist at Decision Economics, and previous chief financial market economist at Lehman Brothers. "We could have a 'Lehman moment.'"

Even banks that are in good shape might not lend to others because of fears a counterparty might be exposed to Greek debt, he adds, triggering a domino effect throughout the financial system.

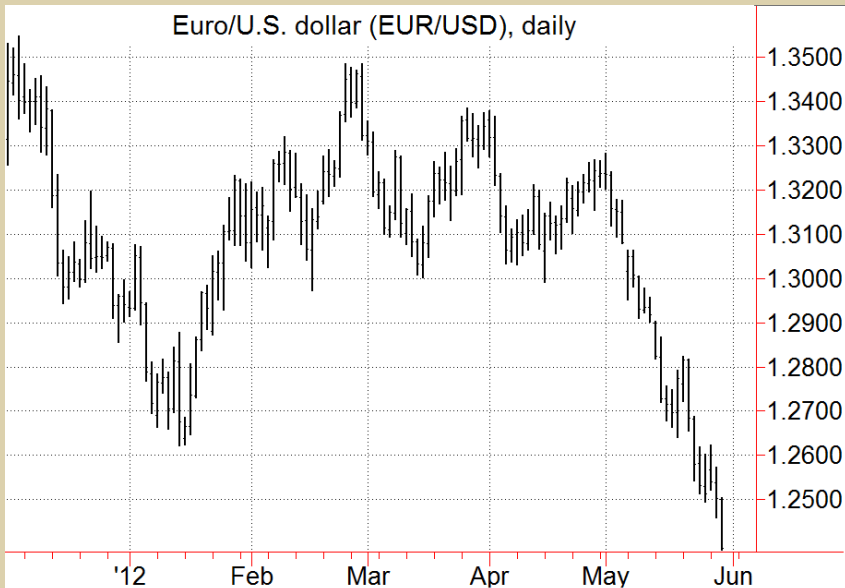
"You could see a situation where banks won't lend, interest rates soar, consumer and business confidence collapse, and no one trusts anything from Spain, Portugal, Iceland, and Italy," Leahey says. "You could have a real problem on your hands, not unlike 2008." Although he thinks the Eurozone and markets overall will "muddle through" the current scenario, numerous risks are still on the horizon.

## Laying odds

Market watchers and forecasters have begun gauging the probability of a Greek exit.

"We believe the odds are close to even that Greece will leave the Eurozone,"

**FIGURE 1: THE LATEST SWOON**



*Greece's inability to form a government and the expectations the June 17 elections will usher in an anti-austerity coalition sent the Euro into another slide in May.*

says Enam Ahmed, senior European economist at Moody's Analytics.

Ahmed adds that if the exit occurs, there's a 75-percent chance it will be disorderly and will trigger a more severe European recession. "The impact on other Euro-area countries will be strongly negative," he says. "Spanish and Portuguese banks are fragile, and a disaster in Greece could infect European financial markets. Rising risk aversion would drive up bond yields, and shaky banks could fail. Spain will most likely need official aid to cope and others may follow. This will also send shockwaves around the world and again we expect a strong negative impact on the global economy."

Nomura analysts conducted an informal poll at the EuroMoney FX Conference in early May, and approximately 70 percent expected Greece to leave the Eurozone in the next 12 months. Others predict similar odds.

"Our economists are saying over the next 18 months there is a 50-75 percent probability that Greece will exit," says Greg Anderson, North American head of FX strategy at Citigroup. However, Wells Fargo analysts are less pessimistic, pegging the odds of a Greek exit at 25 to 30 percent.

## The issues

Many analysts argue the current situation is the inevitable result of the European Monetary Union's inherent limitations. "The big issue is, the Eurozone as we know it doesn't work," notes Conference Board economist Ken Goldstein.

Leahey agrees. "The Euro was created with a monetary union and one central bank, but not fiscal union," he says. "There was a one-size-fits-all monetary policy. The difficulty with that is, depending on how the different economies are doing, some [countries] need higher interest rates while others need lower interest rates. There's no tie-in between shared responsibilities, and no relationship between government borrowing and central banks."

The friction between Germany, which advocates belt-tightening as a way out of the current predicament, and other Eurozone members who want to ramp up public spending, is only growing.

"The average German thinks he's already put up enough money for Greece, and he doesn't want to put up any more," Leahey says. "The headlines show the Germans are not willing to take a shared financial responsibility for the Eurozone as a whole."

Goldstein notes, however, there's an opportunity to use the current crisis to create positive change.

"Use this as a lever to move the Eurozone closer to monetary and fiscal union," he says. "The fundamental reform has to be either shrink the Euro and let Greece go — and maybe Portugal and Spain too — or tighten the union, make it a fiscal union, and develop a Euro-bond market."

However, there are many obstacles in the path to any such developments in the weeks and months ahead.

"There is very little public appetite for Euro bonds," Goldstein says. "The Germans hate the idea of bailing out

the Greeks. And the second problem is that out of the 17 countries using the Euro, you don't need eight or nine votes, you need 17 votes to float a Euro-bond issue."

## The Greek card

Right now the Greek electorate appears to be holding the most significant cards in the deck.

"The next few weeks will be critical, with the Greek election on June 17," says Mary Nicola, FX strategist at BNP Paribas. "It will be important to watch who forms a coalition." In the meantime, she adds, many of the Eurozone stresses will persist and the markets will be driven by headlines.

"Greece is between a rock and a hard place," Goldstein says. "The Greek people are making a statement that they can't live with this. They hate the austerity and they don't see how it will lead to growth in the next five to 10 years, and I agree with them."

A so-called "bank jog" has been occurring in the lead-up to the elections, with depositors pulling assets out of Greek banks. "There's a risk of a deposit run," Leahey says. "If you are in Greece and have 10,000 in Euros at a Greek bank, there is a risk the value of your currency will plummet. You can pull your money out and put it under your mattress, or send it to Germany. There are deposit outflows leaving Greece and to a smaller extent Portugal."

Polls show Greece's left-wing Syriza party is in a position to form a coalition government after the June 17 elections. If they take power, most observers expect they would reject the Greek bailout terms and put their membership in the Eurozone at risk.

While the June 17 elections are a critical event, according to Resler, markets might not give the Greeks and the rest of Europe the luxury of waiting that long. "The risk is that things become unstable before then," he says.

## To leave or not to leave?

There is some debate in the economic community whether Greece would be better off in the long run if it did drop out of the Eurozone. There would be economic contraction and hardship in the short run, but a return to, and massive devaluation of, its previous currency, the drachma, could help the Greek economy right its course.

However, others warn it may not be that easy. "There will be austerity if they stay in the union, but even more if they drop out," Leahey says. "At least they will have funding help from the ECB if they stay. It would be wise for them to stay in the Eurozone."

If Greece does exit, the Greek economy will shrink by another third, Leahey estimates. Goldstein thinks Greek GDP would be cut in half.

According to Leahey, Greece would shift to a barter economy for three to four months while it creates a new currency. "No foreign exporter would dare send anything to Greece because they don't know what they would be paid in," he says. "For three to six months it would be complete and utter chaos."





Given the economic disparities between Greece and other Eurozone countries, Leahey adds, "The dumbest thing was to allow Greece into the Eurozone in the first place."

If the Greek elections result in a coalition at odds with the current Eurozone debt repayment plans, which ultimately results in either Greece choosing to leave or getting kicked out of the Eurozone, contagion is the biggest concern to the global economy and financial markets. "The risk is Europe will see a severe downturn, and it could cut direct trade to the U.S.," Leahey says. "We could have another U.S. economic downturn."

"It's possible we see something that makes the 2008 crisis look like a walk in the park," Resler says.

Given the number of factors, including the Greek elections and Germany's willingness to shoulder a greater financial responsibility, outlining all the possible scenarios is difficult, though. "We're in uncharted territory, trying to hack our way through the bushes to find out what is on the other side," he says.

### Euro action

Not surprisingly, in the near term most analysts advise playing the Euro from the short side, even though it has already sold off considerably and was trading at a nearly two-year low in late May (Figure 2). "We are short AUD, NZD, and EUR, long USD. This is not the time for com-

plicated strategies," wrote Société Générale analysts in the May 17 "Forex Weekly" research note.

"We are likely to grind lower in the Euro," Anderson says. "We have a target at 1.23, but I acknowledge we could go substantially lower if Greece were to exit. On any initial news of a Greek exit, 'the knee-jerk [market reaction] would be negative for the Euro.'"

However, he concedes an exit "doesn't have to mean the end of the Euro, or a complete collapse of the Euro/dollar, particularly if it was well-coordinated and announced over a weekend, and if Europe announced a credible ring fence strategy for the peripheral countries."

Overall, Anderson says a short Euro position vs. the dollar is the best choice, but it makes sense to diversify a bit. He points out that in the sell-off over the weeks ending May 25, the Aussie dollar and Swedish krona fared worse than the Euro, which he attributes to traders taking off risk. He recommends short Euro vs. "high-beta currencies" such as the Aussie dollar, krona, and New Zealand dollar. "In a Greek departure, they will outperform," he notes.

Goldstein warns of the potential for a vast and swift downside move in the Euro/dollar.

"It's possible to see \$1.10 or even parity between the Euro and the dollar, depending on how intense the crisis becomes," he says. "The question is, do we stay there or see a snapback? The answer depends on whether there is any resolution."

**FIGURE 2: APPROACHING LOWS**

Euro/U.S. dollar (EUR/USD), monthly



*The Euro is approaching 1.20, and some analysts see the potential for a move to 1.10 or lower — levels the currency hasn't seen in nearly a decade.*

### The waiting game

For now, there remain more questions than answers. "Some might argue the Euro would be stronger without Greece pulling it down," Resler says. "Or, the Euro could become more fragile [after a Greek exit] and in danger of disappearing as other countries consider defaulting on debt and leaving the Euro."

Leahey highlights a potentially optimistic longer-term scenario. "If Greece leaves the Eurozone and it leads to stronger ties between nations, and three years from now we have tighter fiscal and banking ties and Germany is even more committed, it would be Euro positive."

After the Greek electorate, the Germans could be the ones holding the most important cards. "If Germans continue to resist a Euro bond, it will be a big problem and the end of the Euro as we know it," Leahey says. ☒

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# The Grexit and the Euro

Even if Greece's exit from the Eurozone is inevitable, when and how it occurs will keep the market guessing.

BY BARBARA ROCKEFELLER

The idea of a "Grexit" or "Greek exit" became all the rage in April and May. By the end of May it was clear Greece's membership in the European Monetary Union (EMU) was not viable and an entirely new status would have to be designed. Greece's exit from the Eurozone will be more complicated than a resignation or a dismissal; some links will remain, most likely including free trade and free borders.

For FX market participants, the important questions are: Will the exit be a push or a pull, and when will it occur?

Where will the Euro trade as the Grexit develops? Will Greece keep the Euro or reissue the drachma? What will be the effect of the Grexit on institutional change in the Eurozone?

## Push or pull?

Many think-tankers and academicians, including economic rock stars like Kenneth Rogoff and Simon Johnson, have long argued that Greece must exit the Eurozone and abandon the Euro in favor of a restored and devalued drachma:

Because fiscal union remains a far-off wish, the only economically reasonable solution for Greece's immediate problems is currency devaluation. However, the European Central Bank (ECB) is unwilling to accommodate because rate cuts designed to push down the Euro would violate its treasured key mandate to manage price stability. And even a rate cut to Japanese/U.S. levels wouldn't help the Greek fiscal position, anyway. Therefore, Greece must devalue itself, and the only way to do that is to issue its own currency.

Greek voters and politicians, and indeed just about everyone, says Greece should stay in the Eurozone and keep using the Euro. The European Commission, the Eurogroup, the G8, the OECD, the IMF, and numerous European leaders, including German Chancellor Angela Merkel and German Finance Minister Wolfgang Schaeuble, all say it is to the benefit of everyone if Greece stays in the Eurozone.

**FIGURE 1: ATHENS (BLUE) AND MADRID STOCK INDICES, WEEKLY**



*The sovereign-debt crisis has been blamed for quashing equity markets. The Athens and Madrid stock indices are at multi-year lows.*

Source: Chart — Metastock; data — Reuters and eSignal



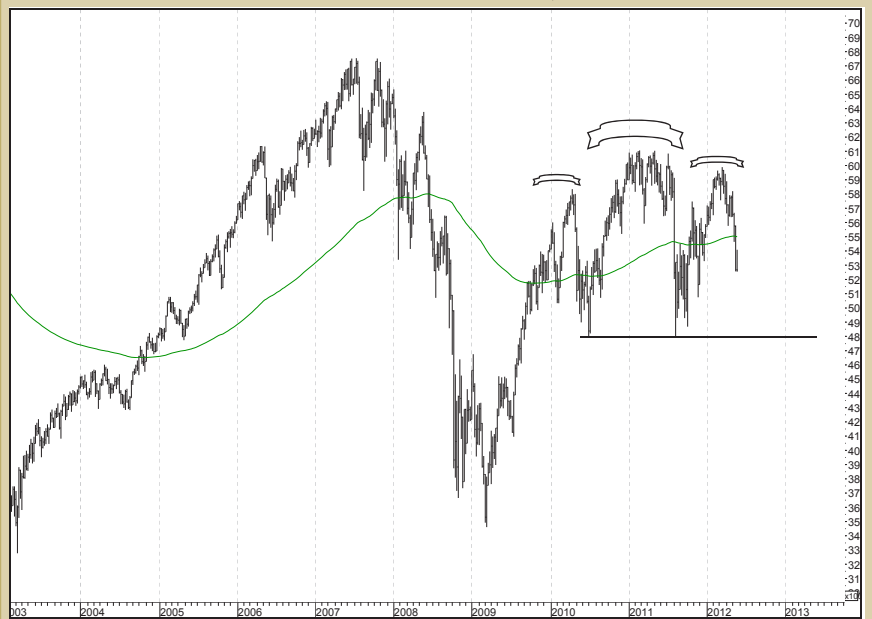
But these assertions are starting to sound empty. The Greeks claim they want to stay but refuse to pay the price of the austerity that comes with it — a classic case of wanting your cake and eating it, too. It seems clear Greek politicians and voters will not be the ones initiating the Grexit.

The Eurogroup has strong incentives to take the lead. For starters, the European sovereign-debt crisis is being blamed for declines in the Euro, global equities, and commodities. It makes a big difference to the FX and other markets whether Greece is rudely ejected or chooses to retire gracefully. An orderly exit that is announced by the Eurogroup would go a long way toward calming markets that have gotten themselves into a tizzy.

The Athens and Madrid stock indices are at multi-year lows (Figure 1). According to Bloomberg, the European crisis has wiped out around \$4 trillion from equity markets — see the FTSE All-World index in Figure 2, which may be forming a head-and-shoulders pattern. (Note that when the Greek debt crisis began in October-December 2009, the FTSE All-World barely budged.) And crude oil has dropped more than 10 percent since the March 2012 (Figure 3). The CRB index has fallen almost 100 points from its high in April 2011. While it is true other factors (such as a possible hard landing in China) should shoulder some of the blame for these moves, the prospect of disorder and a worsening recession in Europe is a root cause.

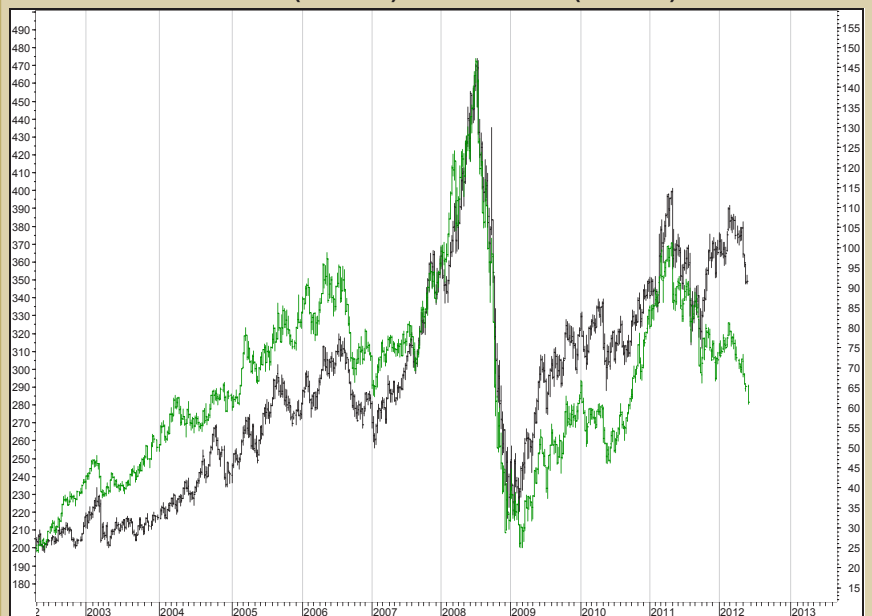
Reputation risk from the Greek crisis is high in another arena, too. As the PIIGS' (Portugal, Italy, Ireland, Greece, Spain) sovereign-debt problems emerged, European leaders wooed China into keeping the Euro as a rising propor-

**FIGURE 2: FTSE ALL-WORLD STOCK INDEX, WEEKLY**



*The FTSE All-World index may be forming a head-and-shoulders pattern.*

**FIGURE 3: CRB INDEX (GREEN) AND WTI OIL (BLACK)**



*As of late May, crude oil had fallen more than 10 percent in less than 12 weeks.*

tion of official reserves, as well as holding on to European investments, including those in sovereign debt, in its sovereign wealth fund, the China Investment Corporation (CIC). But in May the CIC announced it was not buying any more European sovereign bonds and, late in the month, CIC chief Jin Liqun launched a scathing attack on Eurozone leadership, saying the management of the crisis was worse than the crisis itself: "Too much time has been wasted on endless bargaining on terms and conditions for piecemeal bailouts... Since the debt crisis broke out, there has never been a master plan for a resolution. There was only Plan A, never a Plan B." Asia was able to implement austerity policies after its 1997-98 crisis without entertaining "illusions of massive relief funds from outside the region" or believing in "the magic of street demonstrations." In a nutshell, Europe needs to pull up its socks.

The most important reason for the Eurogroup to take the lead in booting out Greece is that the country has behaved in an unacceptable way, and its behavior contaminates the other members. Not to put too fine a point on it, but Greece has engaged in financial fraud. Greece "qualified" when it joined the Eurozone, two years after the Euro's launch, only by fraudulent reporting. The country continued to fail to qualify based on any honest measure since then. Two sets of bailout commitments to the troika (EC, ECB and IMF) were never realistic. In other words, Greece signed contracts over a decade, including the original Maastricht Treaty and the Stability Pact (as well as the bailout contracts) knowing it would not honor them.

When other parties to the treaties and bailout contracts knowingly accept false data and false promises, they become parties to the fraud. Their own citizens then have a case for voting them out of office. All politicians lie, but there must be a limit to the level of falsehood — perhaps the point where lying leads to massively higher taxes and social unrest.

The cost-benefit ratio of continuing to accept Greek fraud is tipping in favor of cost. The May Bundesbank monthly report says the Grexit would be "challenging but manageable." By declining to implement reform that was the specific condition of aid, "it is jeopardizing the continuation of aid payments. Greece will have to bear the consequences of this." Renegotiating the terms of the bailout would end up costing the Eurozone more in the long run, the Bundesbank argues: "A significant softening of agreements... would damage trust in the agreements and treaty of the European Monetary Union and significantly weaken incentives for responsible reform and consolidation measures," the report states. In other words, contagion. The

Eurosystem has already taken significant risks by extending, on trust, its liquidity program to Greece: "In the face of the current situation, it should not significantly broaden those risks. Instead, parliaments and governments of member states should decide about the modality of possible continued support and associated risks," the report says.

Consider that word "modality." It opens the door to a non-membership relationship between the Eurozone and Greece.

Greece is not going to exit voluntarily. The problem, of course, is the May 6 elections that toppled the Greek government resulted in the anti-bailout Syriza party holding the balance of power in the June 17 election. Syriza chief Alexis Tsipras refuses to retreat from a repudiation of the bailout terms, even though a majority of Greeks prefer to stay in the Eurozone.

Tsipras happily admits he wants two conflicting goals, and that he is playing chicken with the Eurogroup. He believes he has the upper hand. He promises to ditch the bailout terms but at the same time actively seeks to retain the Euro, saying a Greek exit will destroy the Eurozone. Tsipras thinks Greece staying in the Eurozone is the only thing that will "save the Euro." Tsipras' point is, if the Greek patient cannot be treated, the crisis will spread to all of Europe.

Because the Eurogroup does indeed fear contagion to Spain and Italy, Tsipras accordingly has a strong hand. But if a sufficiently robust firewall can be constructed to repel any assault on Spain and Italy, the Eurogroup would be free to expel Greece. The German Ministry of Finance and the EC already have special task forces on the Grexit, and even former Greek prime minister Lucas Papademos admitted preparations were being made for a Greek exit. In addition to turning over the Greek problem to the IMF while letting Greece keep some kind of "Friend of the EMU" status, these efforts must be focused on saving Spain and Italy. The evolving Grexit plan probably has more to do with Spain than with Greece itself.

The €750 billion currently available in the combined European Financial Stability Facility (EFSF)/European Stability Mechanism (ESM) almost certainly falls far short of an adequate firewall against a run on the banks and a simultaneous run on the bonds of Spain and Italy. The backstops and firewalls need to be beefed up. It's not clear how this can be accomplished, but to be fair, improved protection was always going to be necessary for Spain, with or without Greece, because of the banking crisis coming along at the same time as the fiscal crisis. Urgency arises to quickly boot out Greece, because failing to do so can

worsen the impending Spanish asset meltdown. Expelling Greece buys time for Spain, and buying time is the one thing European leaders understand.

European leaders have taken a lot of heat over the past few years for indecisiveness and ad hoc fixes. In addition to Greece, governments have fallen in Ireland, Italy, Spain, Portugal, the Netherlands, and France — six of 17 members. Given past experience, we can't count on the lackadaisical European leadership becoming sufficiently emboldened to create an exit plan and present it to Greece as a fait accompli rather than a take-it-or-leave-it option, which has failed. And yet this course of action is exactly what we expect, as uncharacteristic as it would be.

If this scenario plays out, the timing is no longer dependent on the June 17 Greek election. The anti-austerity Syriza party under Tsipras' leadership will likely win enough votes (perhaps 30 percent from about 17 percent in the May election) to prevent a coalition government that would honor the terms of the treaties and bailouts. It will be a stalemate, again. The Eurogroup might as well act preemptively to prevent the crisis getting worse before June 17.

There are several factors that must line up for a Eurogroup-initiated Grexit:

1. The firewall for Spain and Italy must be deemed sufficient;
2. The various task forces must agree on a final Eurogroup plan;
3. The provisional Greek caretaker government must decline to agree to anything;
4. Tsipras must be taken to the woodshed and told if he persists in inconsistent demands, Greece will be expelled — in the next few hours. This would be hardball. Based on past performance, it's not clear the Eurogroup has the courage to act so audaciously, but it has never before been backed against the wall quite so hard.

As for the timing, these shocking events are always scheduled for a weekend, preferably a holiday weekend when at least one market is closed. Memorial Day weekend (May 25-28) had been mentioned but came and went with no announcements. In the usual way of mat-

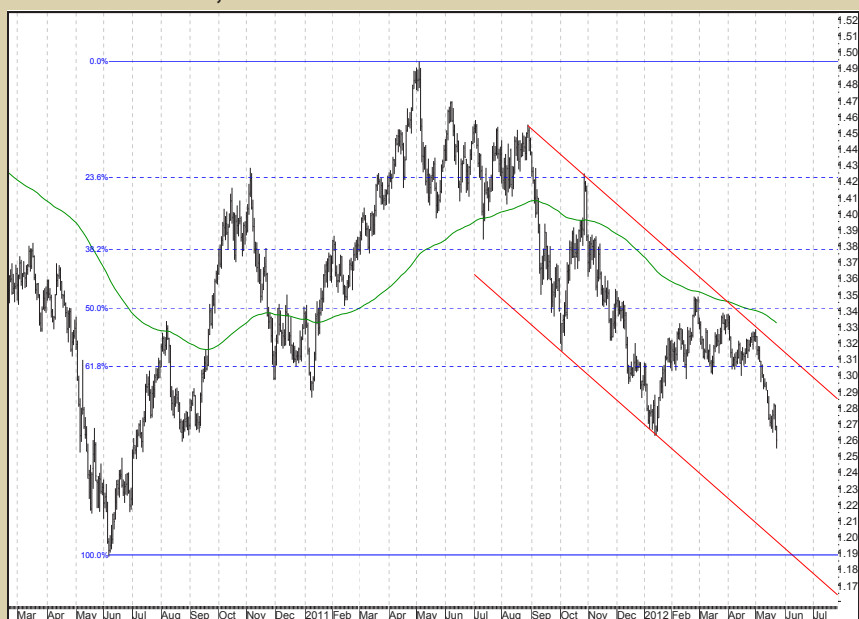
ters of state, it's unlikely the Eurogroup is going to spring a forced Greek exit on the world with no notice at all. Governments go out of their way to avoid being accused of surprising markets. But at the same time, the Eurogroup can't signal a Grexit initiative too boldly, either. The format will be carefully worded leaks, like the reference to "modality" in the Bundesbank report. So the answer to "when" is "any minute."

### Wither the Euro?

Uncertainty and outright fear of disorder are the enemy of market prices. Investors would rather retreat to safe havens than risk catastrophic price moves against their positions. Thus, on the same day in late May, Germany was able to issue a zero-coupon two-year German note in late May and the U.S. Treasury issued a new two-year note at 0.30 percent. In a world starving for yield, it's a sign of the uncertain times that both issues were well-subscribed.

The Euro has already fallen from its May 2011 high of 1.4891 to a low of 1.2513 as of May 24 this year — a 16-percent decline. Figure 4 shows the downturn accelerating. If the classic support and resistance lines are effective, the Euro could make a 100-percent retracement of its most

**FIGURE 4: EURO, DAILY**



*The Euro fell 16 percent from its May 2011 high of 1.4891 to its May 24, 2012 low of 1.2513. A 100-percent retracement of its most recent up move would drop the Euro to around 1.1877.*





recent up move by the first week of June. That would return the Euro to about 1.1877, the level on June 7, 2010. At a guess, Eurozone leaders, while celebrating the export ramifications of a lower Euro, would not be amused by the Euro falling to another Greece-inspired trough — especially a lower low. This is an important motivator, although probably not for intervention beyond the occasional foray into slowing the pace (as rumored in May, with the Bank for International Settlements fronting for the Eurogroup/ECB).

A Grexit announcement would be wildly Euro-favorable, at least initially. The FX market would keep a gimlet eye on Spanish benchmark bond yields, bank recapitalization, and other contagion matters; worsening contagion could strike a blow to the Euro. But on the whole, restoring the Eurozone's integrity would be seen as a good thing and could trigger a massive upside correction. Some analysts say that when the announcement does come, it will come very fast and we will not be fully prepared. That sounds like a fair assessment, but let's not forget that buying time is what the Eurogroup does best. We may think a Grexit is imminent (and it should be to minimize contagion to Spain and Italy), but denial and delay are standard operating procedure. Some experts think a Grexit won't come until year-end or January 2013. It's possible we will all be so jaded about this subject by then that the real Grexit will, indeed, be a surprise.

### The drachma

Critics say Greece can't manage its way out of a paper bag, so how can it manage a return to the drachma? But in practice, it's not that complicated. Greece already has its own printing press that produces Euros. It can mothball the Euro plates and bring the drachma plates out of storage. The banks will do the heavy lifting in terms of changing the bookkeeping, refilling the ATM's, and so on. At the least, the changeover would provide employment to hordes of computer-savvy youngsters with an inkling

of accounting. This may sound flippant, but consider that Europeans have been switching currencies and denominations for more than a hundred years. A change in money is something to which people adapt almost instantly. As for the value of the drachma to the Euro, experts assume the first issuance will be at par and floating, with a very rapid drachma devaluation (probably at least 30 percent) immediately afterwards.

Capital controls would probably accompany the reintroduction of the drachma to prevent massive outflows; there's nothing to "manage" if outflows are not permitted.

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**It's probably not going too far to say that Greece leaving the Eurozone, voluntarily or not, is the best of all possible outcomes for the viability of the Eurozone.**

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Of more import is the presumed default on the existing Euro-denominated debt, some of it held by European banks and a portion held by the ECB itself. Any bank, including the ECB, that has not prepared for Greek default has been asleep at the switch for three years. Having a crisis-management plan in the event of default is a core business practice for a bank. As usual, creditor committees will be formed and negotiations will drag on for years. It would be surprising for any bank outside Greece actually to fail because of Greek default — and if they do, national governments will

step in. Banking authorities in each country have no doubt already made plans along these lines. Talk of a shock that will bring down the European financial sector is, therefore, wildly overdone. Sovereigns have been defaulting for centuries. Banks have failed or nearly failed because of sovereign default for centuries. We have mechanisms and procedures in place.

A Grexit may be the impetus for one major institutional change in the Eurozone: bigger and better consolidated bank oversight and regulation. The final step in a logical chain of events could be changing the charter of the ECB to allow it to be the lender of last resort to commercial banks in the Eurozone.

### Institutional ramifications

The bigger institutional issue is fiscal union, which is the only real alternative to a Grexit. Economic historian Niall

Ferguson, among others, opines that Germany gets so much economic benefit from the Eurozone that it cannot afford to let it fall apart. Therefore it must give in to Greek brinkmanship and to fiscal union, which are joined at the hip. (It strains credulity how one member leaving the Eurozone constitutes “falling apart” when the remaining members will have asserted their integrity and commitment to Eurozone principles.)

It’s critical to note the EMU already has a significant amount of fiscal union and is acquiring more with every passing year. What fiscal union does exist has been creeping in mostly through the back door and mostly so quietly that voters are not really aware of it. The capital behind the ECB, the European Investment Bank, and other entities constitutes a form of fiscal union. When the ECB’s capital was increased last year, the money came from the taxpayers in each country. The European Financial Stability Facility and its replacement, the European Stability Mechanism, are funded by the taxpayers of each country, too. The European Investment Bank, which will probably be used to boost growth, is based on fiscal union — i.e., each member chipping in with national taxpayer money. It’s fiscal union by stealth, which is the only way it can be achieved without disrupting the appearance of democracy in each country.

The Germans may not be quite as patient as the Japanese, who see nothing odd in looking out 50 or 100 years, but they are certainly more patient than the Greeks or the French. The reason the EMU could achieve monetary but not fiscal union in the first place was the richer countries knew their voters would not approve. This was explicit from the beginning and is explicit today. If a referendum on fiscal union were held in Germany, the voters would reject it. And that’s what wrong with raucous demands for Germany to open its purse and let the Greeks feast on it. The German voters won’t stand for it and are guaranteed by the Maastricht Treaty that they don’t have to. Chancellor Merkel has a legal, social, economic, financial, and moral obligation to the voters who elected her.

The mandate from the Maastricht Treaty says: “RESOLVED to continue the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as closely as possible to the citizen in accordance with the principle of subsidiarity.”

“Subsidiarity” means a central authority should have a

secondary function, performing only those tasks the smallest authority cannot, with all other matters delegated to the smallest authority. In the U.S., its parallel is the constitutional principle that the federal government gets to do only those things the states cannot so, like foreign affairs and national defense. In other words, central EMU institutions like the ECB and ESM are allowed to take central control only when the member states are up a tree and can’t manage a situation. Like the U.S. Constitution, one of the desirable features of the Maastricht Treaty is that it allows for change, making it a “living” document.

So, while Germany opposes a policy change that would allow the ECB to become a lender of last resort, for example, the legal framework of the EMU allows it. Another area of potential reform is writing down the circumstances, terms, and conditions of a member’s exit, something the original Maastricht Treaty deliberately omitted. Well, now an exit provision is needed. There is no reason for a change in the Treaty to takes months and months of wrangling (although that is probably what we should expect). The preferred course of action would be for a Grexit now and a treaty amendment later, but let’s hope it doesn’t come to that.

Greece leaving the Eurozone is very Euro-favorable. It means the triumph of contract law over political blackmail. It vindicates the basis of the EMU — treaties that embody public management promises. Forcing Greece to exit the Eurozone might even be construed as a legal obligation of the Treaty signatories. In fact, it’s probably not going too far to say that Greece leaving the Eurozone, voluntarily or not, is the best of all possible outcomes for the viability of the Eurozone. We may still see capital outflows from Spain and Italy or a run on the banks, but the probability of those events decreases once Greece is no longer a preoccupation. Greece cannot be saved. Spain can be.

Unfortunately, the probability of an imminent Grexit is not very high. We may have to suffer though the Greek election in June and a summer of discontent that includes talks regarding a treaty amendment allowing the ejection of Greece. The process seems too slow when what we need is bold, courageous action — now, in the next few days and weeks. But a Grexit is inevitable and whenever it comes, be ready for a Euro rally. ☒

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*For information on the author, see p. 4.*



# Singing the praises of the Singapore dollar's future

Singapore's currency is well-positioned to benefit in the emerging era of Asian economic dominance.

BY PETER PHAM

Watching the twists and turns of the financial saga unfolding in New York and Europe suggests many traders and professional money managers have Stockholm syndrome when it comes to Wall Street and the Federal Reserve. However, if they took the time to stop and look around they would see capital is fleeing the West for the East.

According to *The Financial Times'* fDi Intelligence, Singapore not only receives more foreign direct investment than any other major financial center in the world, it receives more than New York, London, Frankfurt, and Switzerland combined. Southeast Asia, especially China, will be the engine of economic growth in the 21st century because of one simple idea: Capital flows to where it is treated best.

## The courtship of COMEX capital

While the Fed is busy manipulating the yield curve with Operation Twist and protecting huge U.S. banks at the expense of savers, the Monetary Authority of Singapore (MAS) is putting together rules for trading OTC derivatives to make them more transparent.

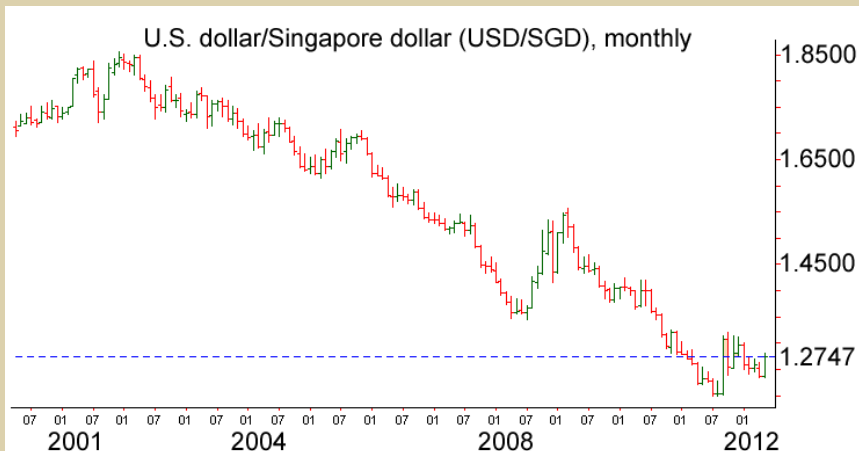
They are also moving to take advantage of the massive flows of gold and silver, treating them as currencies rather than commodities by removing the 7-percent goods and services tax on all precious metals transactions. This will reduce the arbitrage between the physical market and the futures market by reducing rehypothecation. Singapore is courting precious metals refiners to provide liquidity and establish a fixed price that is more useful for Southeast Asia.

It's no secret volume in precious metals futures have fallen dramatically since gold peaked in September at \$1,926 per ounce, and discontent is palpable among traders, a growing number of whom feel the market is not trading openly. The implosion of MF Global and the breakdown in the clearinghouse mechanism has also removed liquidity. Many farmers and hedge funds no longer leave cash in their accounts overnight, distrusting overnight action. A primary function of commodities futures markets has been destroyed in the past year.

## The European ultimatum

The Singapore dollar (SGD) has been in a bull market relative to the U.S.

FIGURE 1: U.S. DOLLAR/SINGAPORE DOLLAR



Since the 2002 peak in the USD/SGD rate, the SGD has appreciated 31.4 percent vs. the dollar.



dollar since the USD/SGD exchange rate peaked at 1.85 in 2002 (Figure 1). Since then the SGD has appreciated 31.4 percent.

The SGD's relationship with the Euro is more complicated, with the EUR/SGD trading opposite to the USD/SGD from the end of the Asian Crisis in 1999 to the Lehman collapse in 2008 (Figure 2). Since then the SGD has appreciated vs. both currencies, although the EUR/SGD pair has been much more volatile.

The situation in the Eurozone is reaching a crisis point, and a number of recent reports have Singapore's banks facing the same abyss. Moody's reported Singapore's banks are exposed to European debt to the tune of 39 percent of GDP; other sources quote a figure as high as 60 percent.

There are a number of scenarios that might play out given these circumstances. The first one is easy to understand. If the situation in Europe is truly not fixable, it will be very bearish for Singapore's banks and the SGD will be under tremendous pressure relative to currencies that don't have a great deal of European exposure. European bank failures will crater the economy of Singapore, as well as that of Hong Kong, which has a comparable level of exposure to Europe, according to Moody's. Shorting the SGD vs. the Japanese yen, for example, would make sense given Japan's low exposure to Europe.

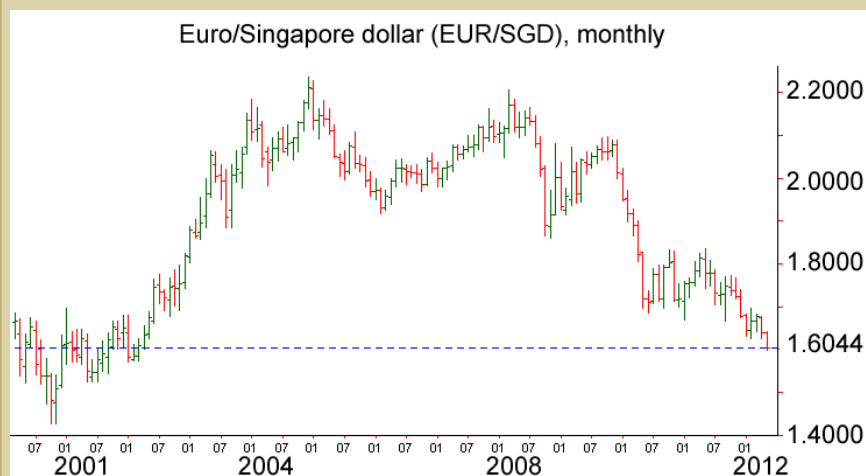
The next two possible outcomes are more complex. A dominant theme of economist Jim Rickards' analysis is that the European Union (EU) has always been the means by which Germany would ultimately conquer Europe — foregoing military conquest in favor of financial conquest. If that's the case, the Southern European countries (Greece, Spain, Italy) will not be allowed to leave the Euro, and Germany will bail them out using a mixture of austerity and direct capital infusions. These countries will accept higher levels of inflation than they want to, while putting the apparatus in place to fulfill Mr. Rickards' hypothesis.

In this case Singapore's banks will get a de facto bailout; the Euro will muddle through and strengthen vs. the U.S. dollar, which will then have to face its own fiscal and monetary crisis. And the EUR/SGD rate should continue on

its present course (SGD positive).

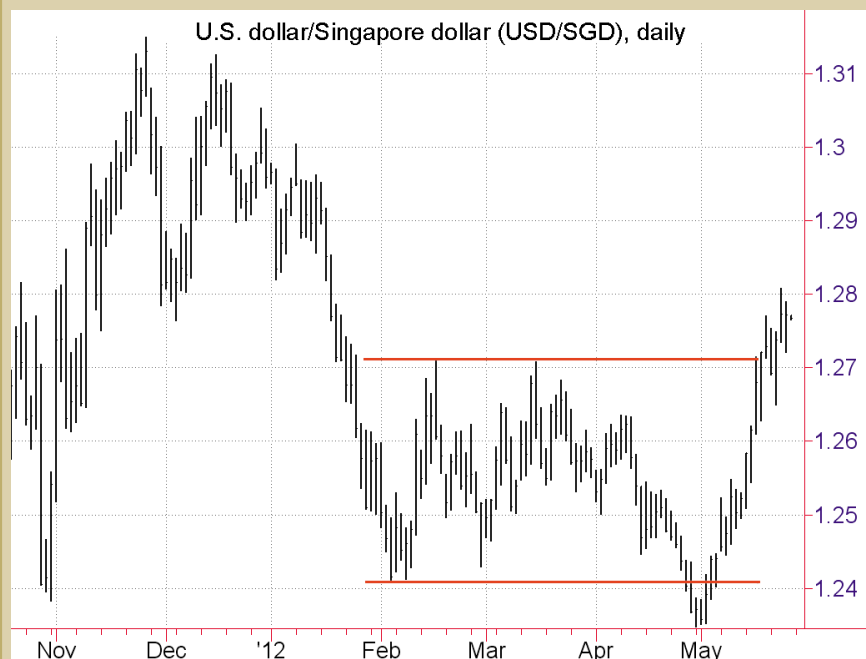
The final scenario combines two outcomes, depending on what sovereign debt Singapore's banks are holding. If Greece and the rest of the PIIGS (Portugal, Italy, Ireland, and Spain) leave the EU (either with the EU's consent or more messily), it could be either very bullish or very bearish for the SGD. If the banks are exposed to the PIIGS, the EUR/SGD spread will widen significantly as the Euro strengthens on removal of the anchors that have been weighing it down. If the banks are holding primar-

**FIGURE 2: EURO/SINGAPORE DOLLAR**

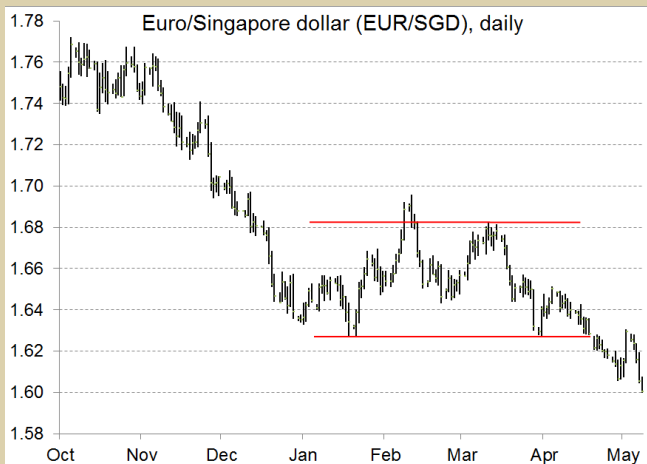


*The EUR/SGD rate's longer-term performance has been more volatile than the USD/SGD's.*

**FIGURE 3: UPSIDE MOVE**



*After falling below 1.24 in late April, the USD/SGD pair broke out of the upside of its multi-month consolidation.*

**FIGURE 4: DOWNSIDE BREAKOUT**

*The EUR/SGD recently broke out of the downside of its early 2012 trading range.*

ily German bunds, the SGD should continue to trade at a premium to the Euro because they'll be better situated to weather the EMU break up from half a world away than, say, Deutsche Bank and UBS. The EU would then become a Northern European currency bloc, Southern Europe would be left to its own devices and the world will continue on its path to a multi-polar currency regime.

Looking more closely at recent history shows an upside breakout in the USD/SGD at 1.27 that tracks the tremendous flows into U.S. Treasuries since the beginning of May. This came after a four-month consolidation between roughly 1.2350 and 1.27 (Figure 3). The yield on the 30-year T-bond is below 3 percent and the 10-year T-note closed the week below 1.7 percent. These are indicators of extreme stress; large amounts of capital are flooding into the relative safety of U.S. sovereign debt simply because it is the only market large enough to truly absorb it without severe dislocation.

The opposite is occurring in the EUR/SGD, suggesting that after averting a global meltdown stemming from a Greek-debt default, the Euro was given a reprieve and a solid bid existed at EUR/SGD 1.63 (Figure 4). That level failed on May 4 and the market hasn't come close to it since. It's reasonable to assume the majority of European debt held by Singaporean banks is of the distressed variety, otherwise there would have been a stronger up move. In the weeks since the Greek elections on May 6, the EUR/SGD sold off to its lowest point near 1.60. The spread between the USD/SGD and EUR/SGD is now at an all-time low.

In the short term the SGD looks bearish vs. the U.S. dol-

lar and bullish vs. the Euro. In the past year the European Central Bank (ECB) has had to bear the brunt of monetary easing, in the wake of the Federal Reserve's TARP, QE1, and QE2 programs. This time it was the Europeans turn to monetize some of this debt. The ECB and the Swiss National Bank both accommodated. It will be the Fed's turn next.

### The golden parachute

Since May 1, 2011 the Singapore dollar has outperformed the two major currencies in terms of gold. Over roughly the following year the EUR/SGD rate declined 11.2 percent in that time, while the USD/SGD pair rallied 4.1 percent. Looking at the pairs in terms of gold, however, tells a different story.

The Singapore dollar strengthened 1 percent vs. gold in that time while the Euro fell 20 percent vs. the metal, and the U.S. dollar declined 3 percent. This time period is significant because the Fed was winding down its QE2 program and embarking on Operation Twist, while the ECB was busy stamping out the fires in Greece with its own alphabet soup of policies (the EFSF, LTRO) that resulted in unprecedented balance sheet expansion.

When the Fed engages in another round of QE (to protect U.S. banks with heavy exposure to PIIGS' debt) it will light a fire under the price of gold in dollar terms. This will be bearish for the USD/SGD because Singapore's banks win no matter who bails them out.

There is little worry Italy will be allowed to leave the EU, however. Their nearly 2,500 tons of gold ensure the ECB has the backing to keep the Euro afloat. Greece and Spain together account for less than 400 tons, and by the time the dust clears they likely won't have that because the ECB will have taken it in exchange for bailouts.

With the changes to the Singapore gold market in October, there is the possibility of their attempting to fill the reserve currency void left by the dollar and challenge the Chinese yuan as the Association of Southeast Asian Nations (ASEAN+3) reserve currency. China has been buying gold in record amounts — 76 tons in March alone. But as of early June Singapore has not made an official gold buy in years.

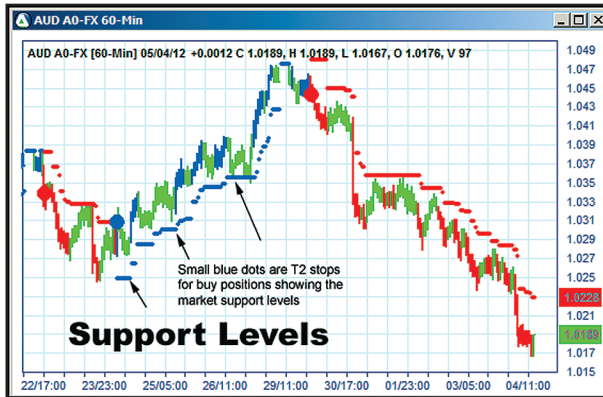
However, their capital markets are far deeper than China's and the government is taking a leadership role in facilitating the Asian Economic Community's move toward banking integration across the region. This positions Singapore to benefit from the turmoil in the U.S. and Europe, albeit not without shocks. ☒

*For information on the author, see p. 4.*

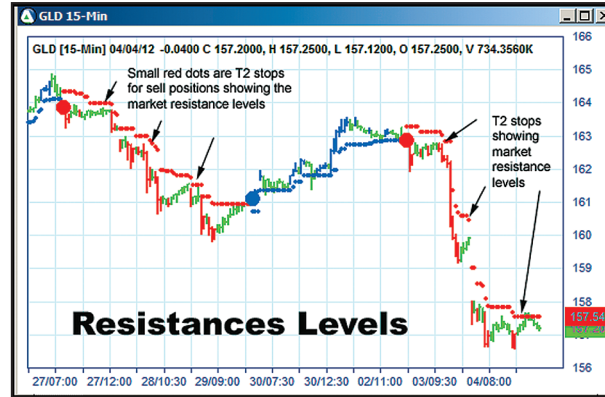
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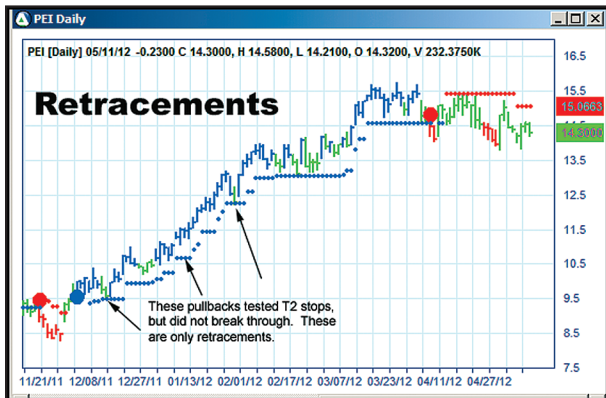
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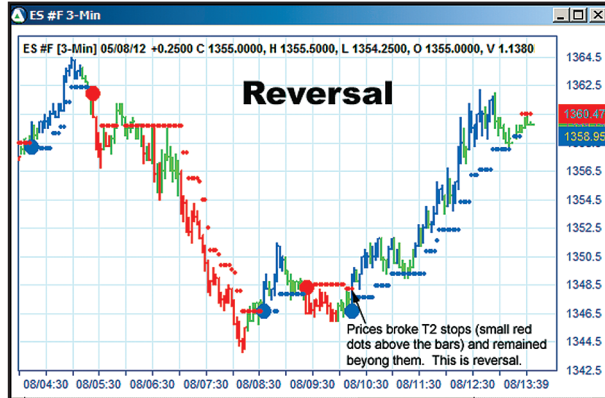
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# Outside days: Looking past the clichés

Outside days are usually ascribed neat and tidy price implications, but analysis in the Aussie dollar shows they don't necessarily follow the script.

BY CURRENCY TRADER STAFF

Folk wisdom and mysticism can be comforting (or amusing), but they can lead the unwary down fruitless and sometimes even dangerous paths — think divining rods at the benign end of the spectrum and submerging “witches” in water at the less-forgiving end. Nowhere is that more true than in the markets. Consider the interminably repeated properties attributed to outside bars (those with higher highs and lower lows than the bar immediately preceding them). Having tested or penetrated both extremes of the previous bar, the price action of an outside bar is usually described as a sign of “uncertainty” — a market not sure of where it's going, so it goes both ways. However, the direction of the close — for example, whether the outside day closes above or below the previous day's close or

above or below the opening price — is assumed to be a sign of how the market has resolved itself, and a harbinger of future momentum in that direction.

Figure 1 shows a roughly two-month stretch in the Australian dollar/U.S. dollar pair (AUD/USD) from 2010. The bars with blue dots are outside days that closed higher than the opening price and above the previous day's close. In all cases but one (after the July 13 outside day), the pair moved higher immediately and continued to rally for several days. So, outside day plus bullish close equals upside follow-through, correct?

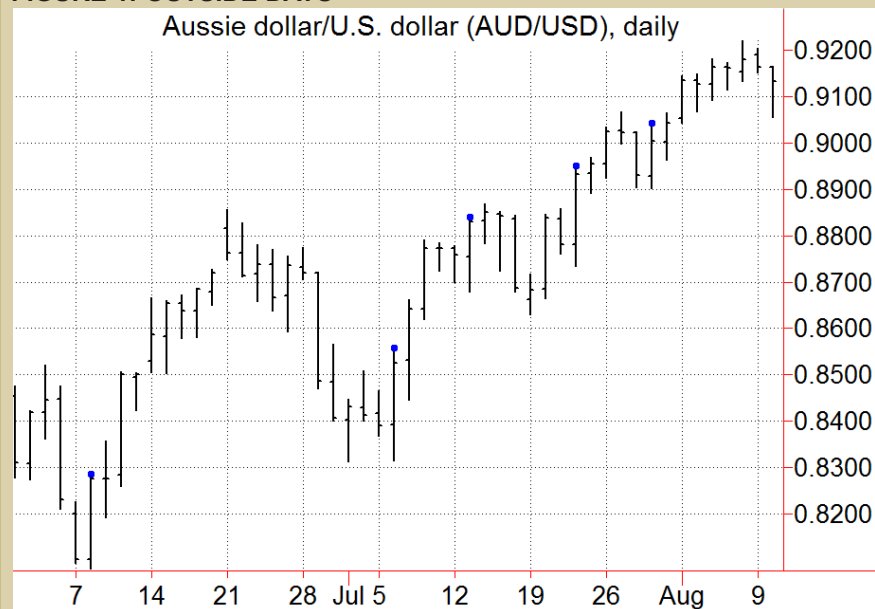
Well, since the Aussie/U.S. dollar pair rallied more than 13 percent low to high in the period captured in Figure 1, it could be argued that you could have thrown darts to pick buy points and enjoyed admirable results. In fact, the pair closed higher on a daily basis 58 percent of the time, and holding the pair from close to close over any five-day period would have generated a profit 70 percent of the time; hold 10 days and the winning percentage increased to 80 percent.

Analyzing a longer time period — May 20, 2002 through May 22, 2012 — reveals the price behavior after outside days in the Aussie dollar is much more complex than that implied by market folk wisdom.

## A mixed bag

Figure 2 shows the entire analysis window in weekly bars. Despite the cataclysmic downturn during the 2008-2009 financial crisis, the AUD/USD's trajectory was clearly upward during this 10-year period — the pair gained more than 110 percent from its 2002 low to its 2011 high.

**FIGURE 1: OUTSIDE DAYS**



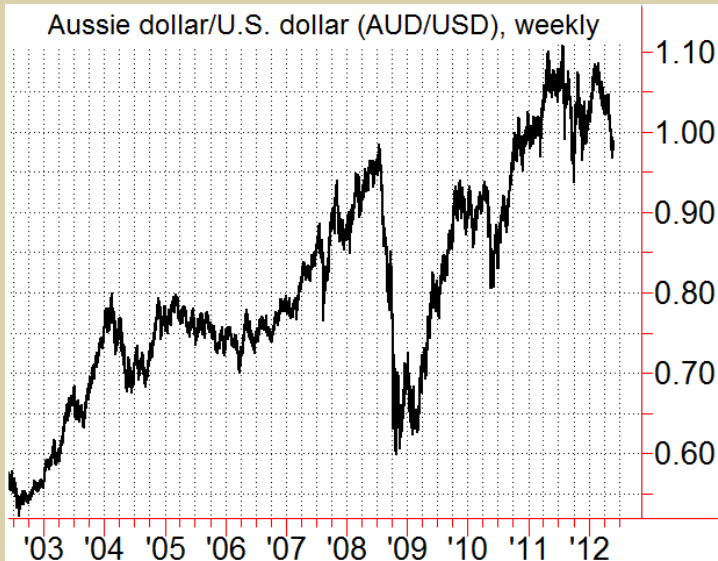
*Most of these up-closing outside days were followed by up moves.*

That upside bias is evident in Figure 3, which shows the AUD/USD pair's average and median close-to-close moves in the first 10 days, as well as 15 and 20 days after the 245 outside days that occurred in the analysis window. The pair's benchmark performance (the average and median moves for all 1-10, 15-, and 20-day periods in the analysis period) is included for comparison. In this and all subsequent charts, the average and median benchmark moves are represented by the black and gray lines, respectively, while the average and median moves after outside days are represented by the blue and red lines, respectively.

The chart, which shows the performance after all outside days regardless of whether they close higher or lower, tells us a few important things about the AUD/USD's typical price movement during the analysis period, as well as its tendency after outside bars. First, notice the relationship between the black benchmark average line and the gray benchmark median line. They are fairly close together, and for the most part the average line is above the median line. The median line is more representative of the pair's typical performance, but the higher average line suggests outlier moves tend to be to the upside — that is, a small number of large up moves skew the average returns higher.

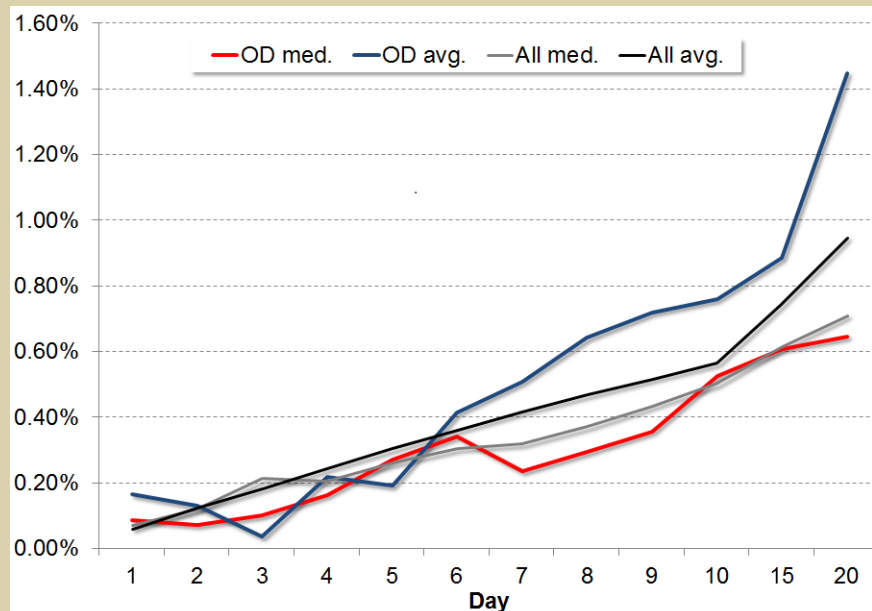
Now look at the performance after outside days. The blue (average) and red (median) lines aren't distinguished much from the benchmark performance through day 5 — if anything, both slightly underperform. From day 6 forward, the average gains after outside days pull away from the benchmarks as well as the median post-outside day line, which more or less tracks the benchmark median performance line. Overall, the tendency after outside days is similar to the market's benchmark bias: Price tends to go up after outside days, with a minority of big gains skewing average performance higher (at least after day 6). But

**FIGURE 2: ANALYSIS WINDOW**



*The May 2002-May 2012 analysis period was biased to the upside, despite the 2008 sell-off.*

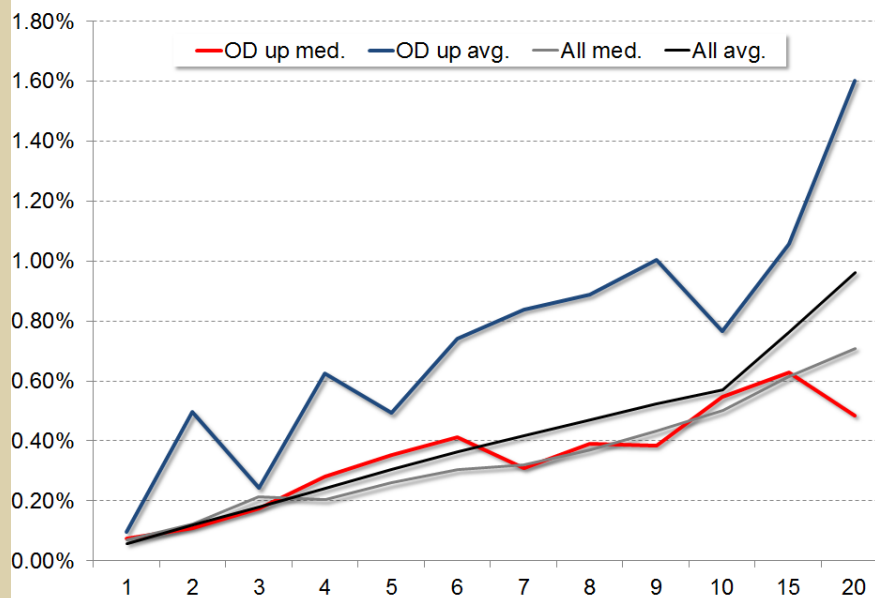
**FIGURE 3: AFTER ALL OUTSIDE DAYS**



*The average returns after outside days were (after day 6) larger than the AUD/USD pair's benchmark gains, but the median returns were much smaller.*



**FIGURE 4: AFTER UP-CLOSING OUTSIDE DAYS**



The blue average line suggests some of the moves after up-closing outside days were larger than normal, but the red median line implies the typical result was not nearly as bullish.

if we take the median performance as more representative of the typical result, we shouldn't expect anything out of the ordinary after most outside days in the AUD/USD pair.

But since Figure 3 shows the results after all outside days, let's analyze the performance of different subsets of these days to see if we can isolate any reliable outperformance — or under-performance.

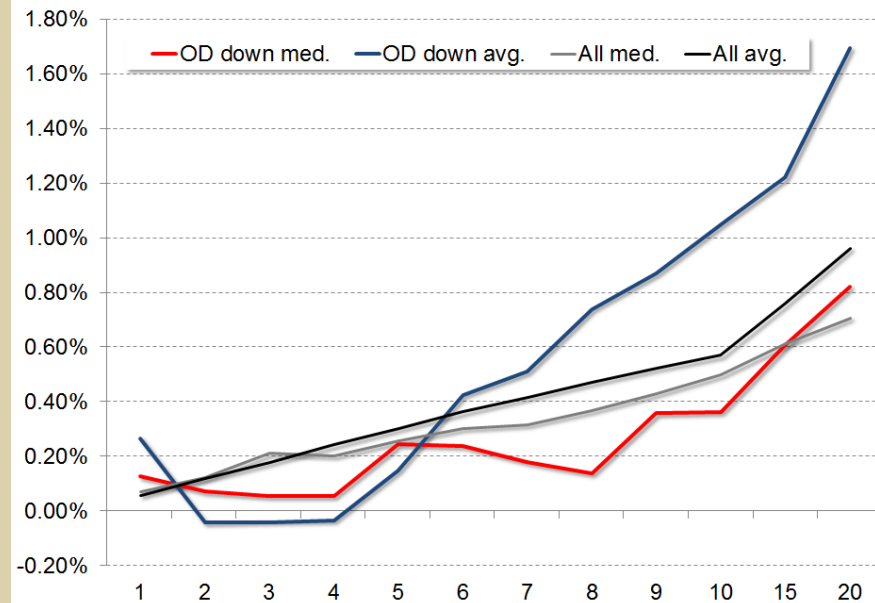
## **“Bullish” and “bearish” closes**

Figure 4 shows the performance after the 132 outside days that closed above the open and above the previous day's close. The average gains after these bullish outside days were larger than the pair's benchmark gains (and the post-outside day gain at day 9, for example, was approximately 33 percent higher than the average after all outside days), but the median returns were not significantly different. Again, a minority of larger gains skews the average higher, while the typical result is much more modest.

Figure 5 shows the results after the 109 examples of “bearish” outside days — those that close below their opens and below the previous day's close. Aside from some initial weakness through day 4, the average return line actually ascends at a much more rapid pace than its counterpart in Figure 4. (Although it's a bit of a stretch to attribute too much of an impact to a single day, the average returns from day 10 forward are actually larger than those for the bullish outside days.) However, the median returns are (again) much smaller — mostly below the benchmark returns but, importantly, still positive. Those looking for reliable short-trade opportunities after down-closing outside days in the Aussie dollar during this period would likely have been disappointed.

Given the results in Figures 4 and 5,

**FIGURE 5: AFTER DOWN-CLOSING OUTSIDE DAYS**



Aside from initial weakness through day 4, the average return line rises more rapidly than its counterpart in Figure 4. The median returns, while mostly below the benchmarks, are still positive.

it would be reasonable to assume the AUD/USD pair's upside bias during the analysis period is the determining factor here, and that up-closing or down-closing outside bars have minimal impact on the Aussie dollar's price action. Let's take a look at how the results stack up when they're segregated with a basic trend filter.

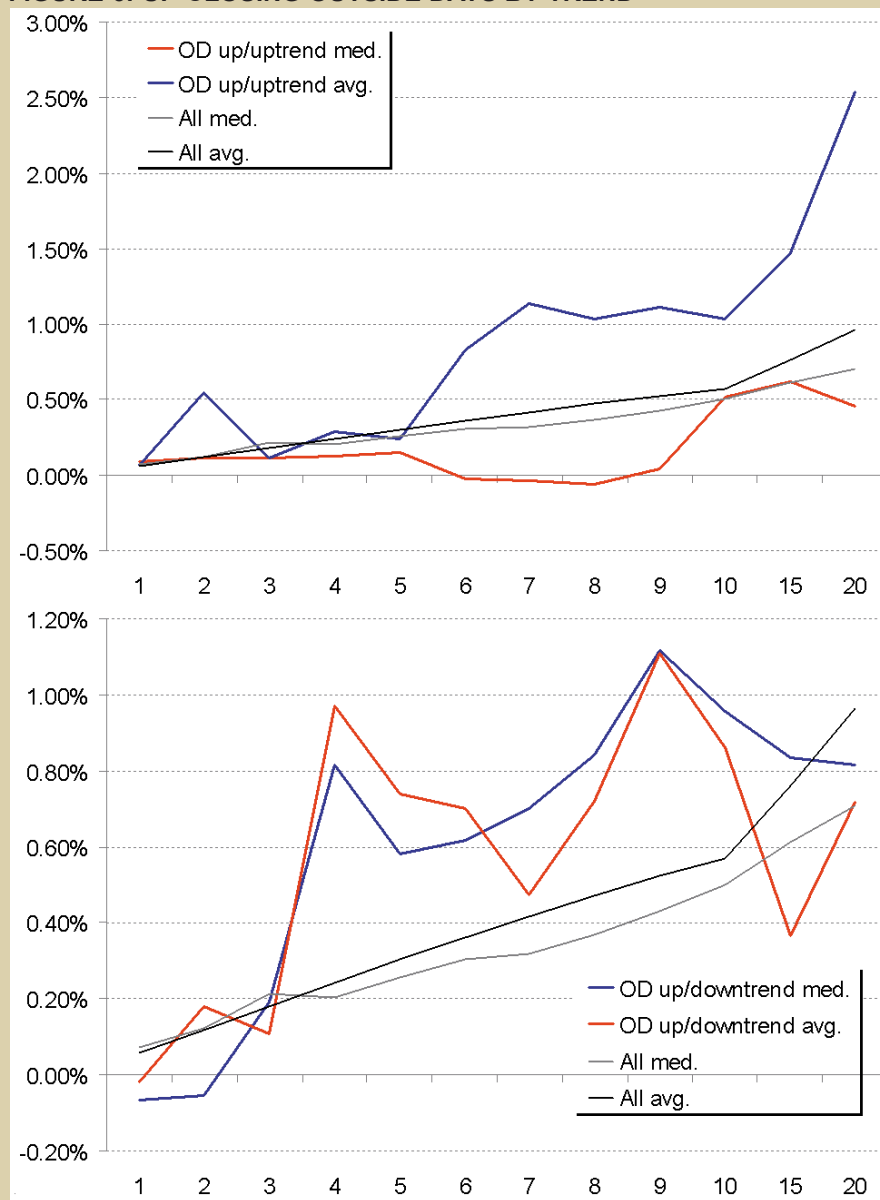
### Outside days within trends

Figure 6 compares up-closing outside days that closed either above the close 21 days earlier (top) or below the close 21 days earlier (bottom) — a simple way to gauge whether the market has short-term positive (“uptrend”) or negative (“downtrend”) momentum. This measure, including the number of days used in it, is arbitrary — other metrics and look-back periods could be used — but the differences it reveals are noteworthy.

The results after the 89 up-closing outside days that occurred in defined up moves exaggerate the pattern evident in the previous examples: The average returns skew to the upside (especially from day 10 onward) while the median returns underperform more than usual. This performance flies in the face of expectations for upside momentum to provide an extra kick to an up-closing outside bar.

The results after the 42 up-closing outside days that occurred in defined down moves are even more surprising. After random-to-weak returns in the first three days, both the average and median post-outside day returns spike higher. Although both lines are volatile, they also both are above the

**FIGURE 6: UP-CLOSING OUTSIDE DAYS BY TREND**

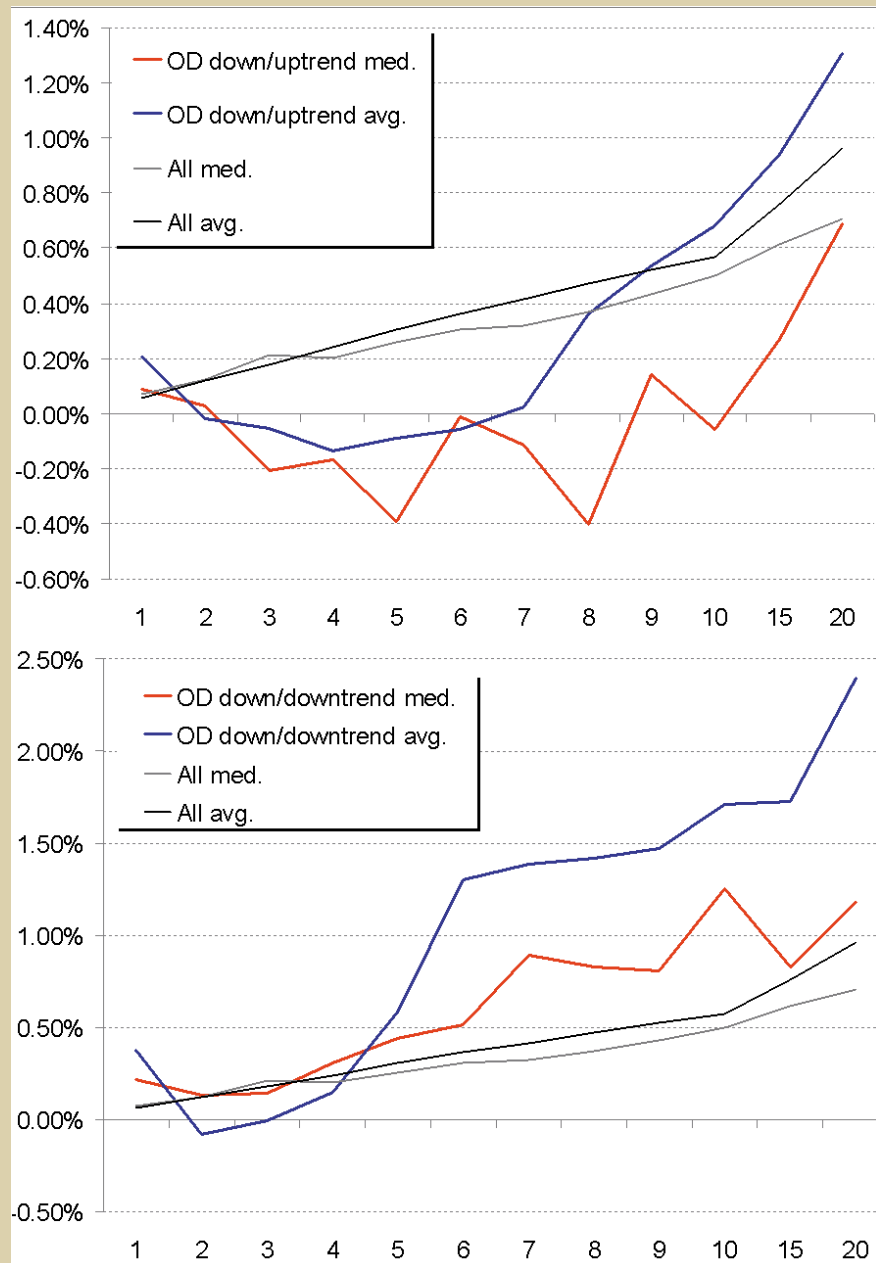


*Upside momentum failed to provide an extra kick to the results for up-closing outside bars (top), while up-closing outside days that occurred in defined down moves were followed by much more positive returns (bottom).*





**FIGURE 7: DOWN-CLOSING OUTSIDE DAYS BY TREND**



The AUD/USD pair posted some of its most negative returns in the first eight days after down-closing outside days within up moves (top), while down-closing outside days within down moves were followed by some of the biggest gains (bottom).

benchmark returns through day 10.

The last eye-openers are in Figure 7, which compares down-closing outside days that closed above or below the close 21 days earlier. After the 60 down-closing outside days within up moves (top), the Aussie dollar posted some of its most negative returns in days 1-8, when the AUD/USD pair either underperformed its benchmarks or declined outright.

Finally, after the 50 down-closing outside days within down moves (bottom), the pair posted some of the biggest gains of the study, with both the average and median lines positive and above their benchmarks after day 4; both returns were above 1 percent at day 10. Traders shorting down-closing outside days when the pair was lower than it was 21 days earlier were likely surprised at how wrong they were.

### Inverting common wisdom

Two aspects of this study bear special emphasis. First, it shows how analysis can topple widely held beliefs about price patterns. Second, it is important to treat markets individually. Universality, in anything less than the broadest terms, is more difficult to achieve in trading than most people think. Yes, markets can either go up, down, or sideways, and Market A won't necessarily go about that the same way as Market B.

To underscore this final point, next month's issue will include the results of the same outside-bar analysis for the Euro/U.S. dollar pair (EUR/USD) and the Euro/Japanese yen pair (EUR/JPY). ☐



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# Currency harvest, asset returns

Stock and higher-risk bond performance can be directly linked to the relationship between the forward curves of high- and low-yielding currencies.

BY HOWARD L. SIMONS

One of the more tried-and-true currency trading strategies is the [carry trade](#) of borrowing a low-yielding currency to lend in a high-yielding currency. Indeed, aside from the occasional blow-up when a high-yielding currency is broken by action such as George Soros' famous bet against the British pound in 1992, carry trading has been the most profitable strategy employed over time by currency-

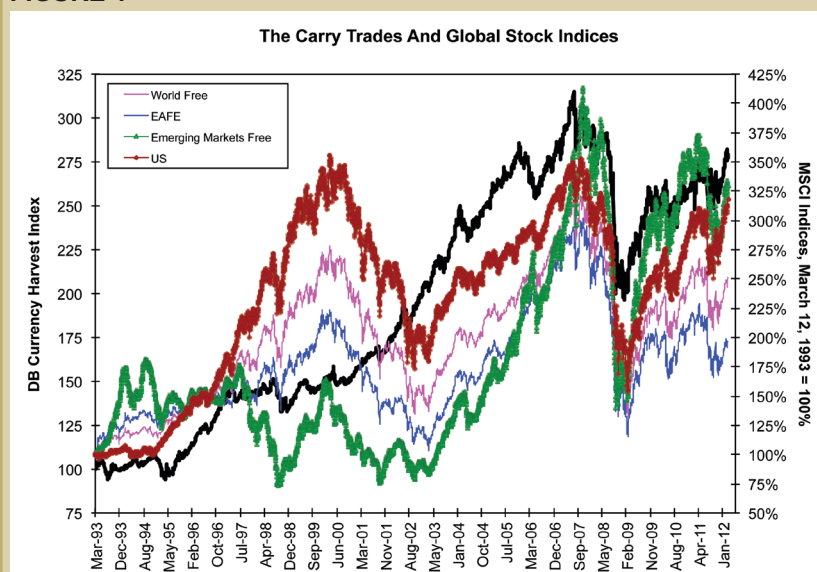
oriented CTAs (see "Currency traders should be humbler," *Currency Trader*, May 2007).

The financial services industry, like Hollywood, always takes a good idea and either beats it to death or seeks out greater and more innovative uses for it, depending on your point of view. One example of such product expansion is the Deutsche Bank G-10 Currency Harvest index, which

represents an easy-to-understand strategy of going long a basket of five high-yielding currency futures and short a basket of five low-yielding currency futures; the composition of the two baskets can change over time.

Let's analyze this index against a set of global equity market and higher-risk bond indices to see whether this particular twist on the currency carry trade is linked to returns on assets. The prior supposition is it should be given the role monetary stimulus has played in each global financial bull market since the mid-1990s. The equity indices involved are the MSCI total return indices for the U.S., for the Emerging Markets Free, for the EAFE (Europe, Australasia, Far East), and for the World Free markets. The higher-risk bond indices involved are the Merrill Lynch total return measures for U.S.

FIGURE 1



Prior to May 2003, the DB Currency Harvest index (black line) scarcely had a relationship with any of the equity indices. By the financial crisis and its aftermath, though, the relationship was striking.

high-yield, for European high-yield, and for emerging markets. All indices involved are measured in U.S. dollars.

### The equity index picture

If we map the equity indices re-indexed to the March 12, 1993 start-date for the data against the DB Currency Harvest index, we see a rather striking evolution (Figure 1). Prior to the Federal Reserve's first declaration of war on deflation in May 2003, this measure of currency carry scarcely had a relationship with any of the equity indices. That started to change going into the global equity peak of October 2007; by the financial crisis and its aftermath, the relationship was quite striking.

If we convert the index data to a set of rolling 90-day correlations of returns of the four stock indices against the DB index, a second relationship emerges (Figure 2). The large jump in correlation of returns in late 2007 broke only during the very depths of the financial crisis and then stayed at near-record levels during the liquidity-fueled global equity rallies post-March 2009. There were two exceptions: the first in May-June 2010, a period following the "flash crash" and the Greek sovereign-debt crisis; and the second during the August 2011 revival of that very same sovereign-debt crisis. Overall, the correlation of returns has been a global barometer of risk.

### The higher-risk bond picture

Now let's look at the fixed-income indices. We should expect the DB Currency

FIGURE 2

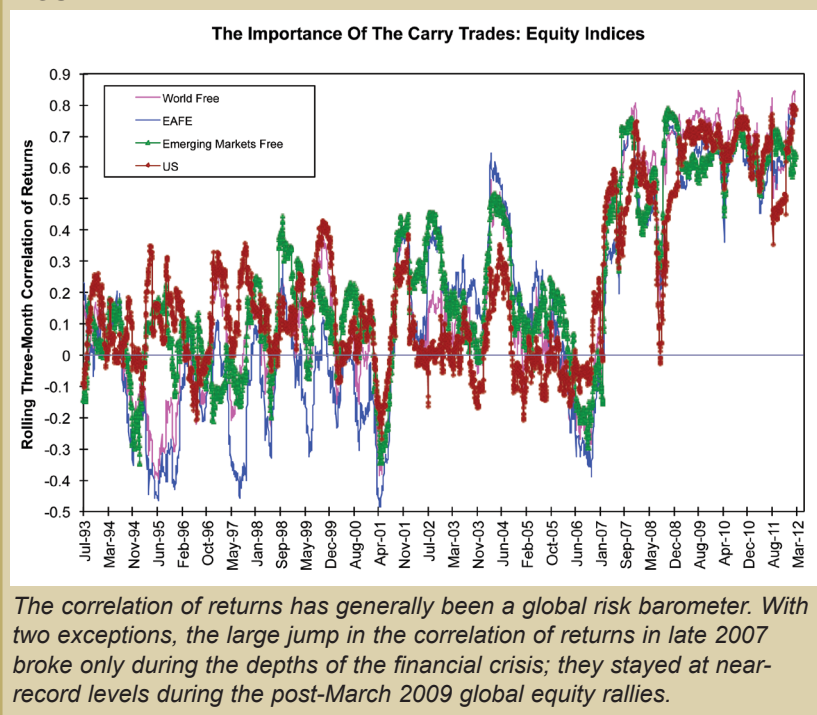


FIGURE 3

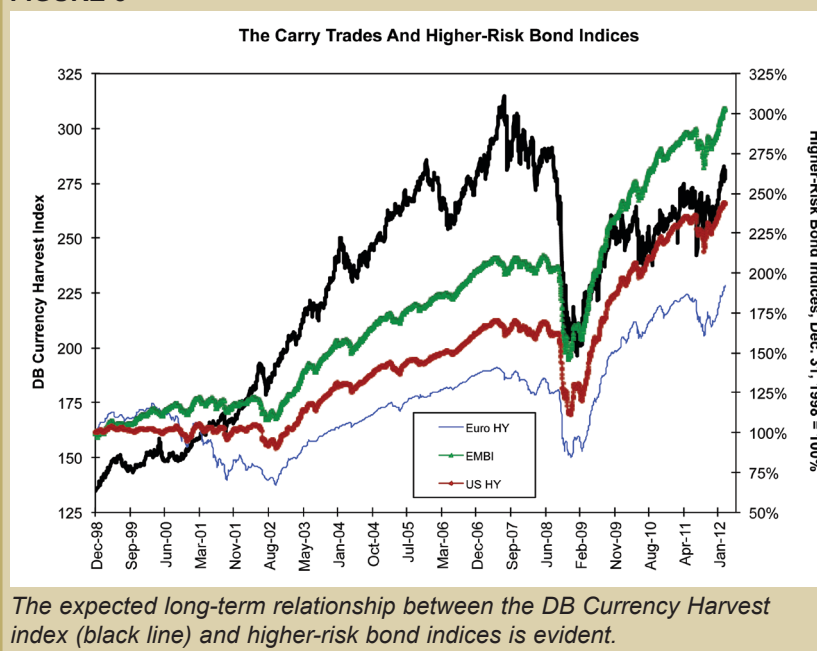
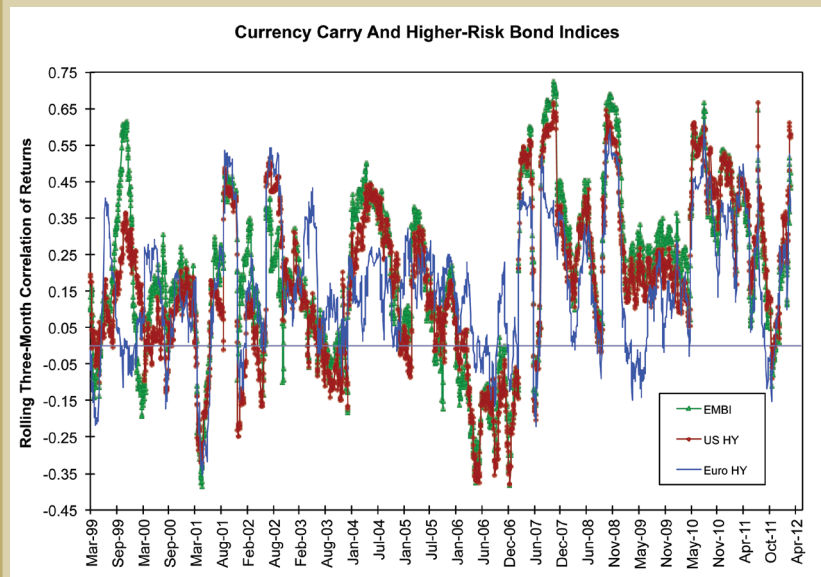




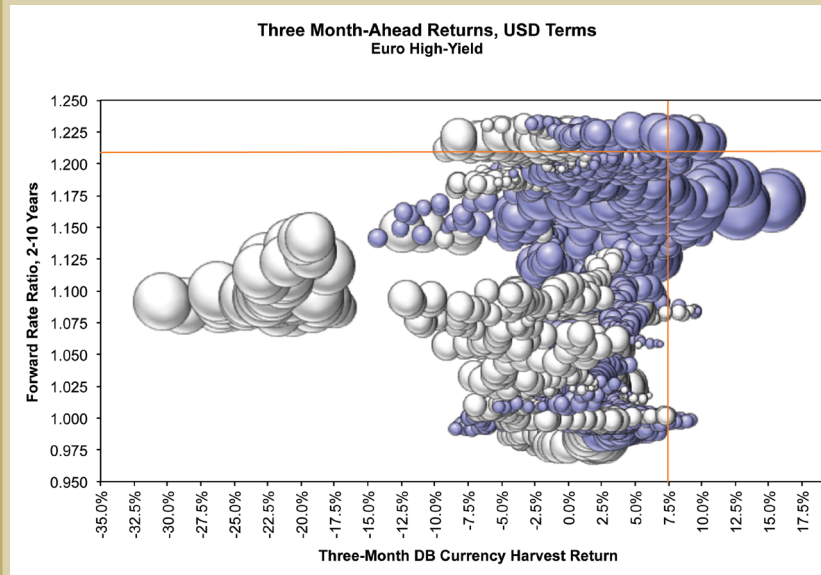


FIGURE 4



Rearranging Figure 3's data to show the rolling three-month correlation of returns reveals an absence of consistently high correlations of returns (in excess of 0.70).

FIGURE 5



In this chart and in Figure 6 and 7, the concentration of large colored bubbles in the upper-right section and large white bubbles in the lower-left section indicate higher-risk bonds' prospective total returns are a function of both a steep yield curve and currency carry.

Harvest index to have had a more consistent long-term relationship with higher-risk bond indices, as both are carry trades (see "Currency carry and yield curve trading," *Currency Trader*, January 2010). Figure 3 shows this does, in fact, appear to be the case.

However, if we rearrange this data and display the rolling three-month correlation of returns, we do not see the consistently high correlations of returns in excess of 0.70 (Figure 4). This would seem to suggest global equity trading is fueled more by currency differentials than is global higher-risk bond trading. Restated, global hot money chases stocks, not higher-risk bonds.

### Prospective returns

However, we do know the credit spreads in high-yield bonds globally came in after the peak of the financial crisis; indeed, this may be by definition, as the end of a financial crisis can be defined by the retraction of credit spreads.

Because the end of the crisis was induced in part by the very steep yield curve in the U.S. and the open invitation by the Federal Reserve to buy all manner of risky assets, we should be able to associate prospective returns on higher-risk bonds with a steep yield curve and with the currency carry trade.

We can map the three month-ahead total returns on each of these bond indices as a function of the DB Currency Harvest's return over the past three months and the

U.S. forward rate ratio between two and 10 years ( $FRR_{2,10}$ ). This is the rate at which we can lock in borrowing for eight years starting two years from now, divided by the 10-year rate itself. The more the  $FRR_{2,10}$  exceeds 1.00, the steeper the yield curve is.

In Figures 5-7, positive prospective returns are depicted with colored bubbles, negative returns with white bubbles; the bubbles' diameters correspond to the absolute magnitude of the bond index's total return. The last values on each chart are marked by a crosshair.

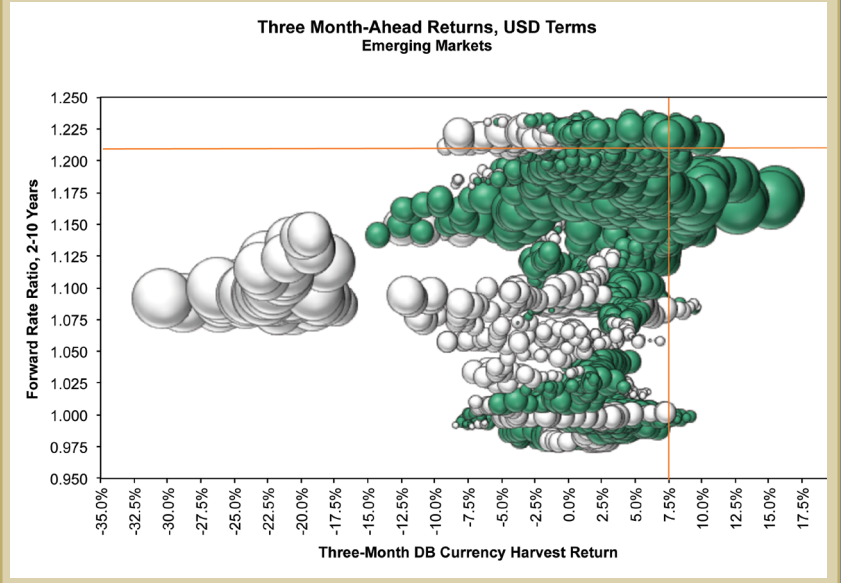
If higher-risk bonds' prospective total returns are, in fact, a function of both a steep yield curve and currency carry, we should see a concentration of large colored bubbles in the upper-right sections of these charts and large white bubbles toward their lower-left sections. This is exactly what we see in all three cases.

The conclusion seems strikingly clear for both global equity indices and for higher-risk bond indices: When the "harvest" or gap between the forward curves of high- and low-yielding currencies opens up, both equities and higher risk bonds will do well, especially if the yield curve in the funding currency, here the U.S. dollar, is steep.

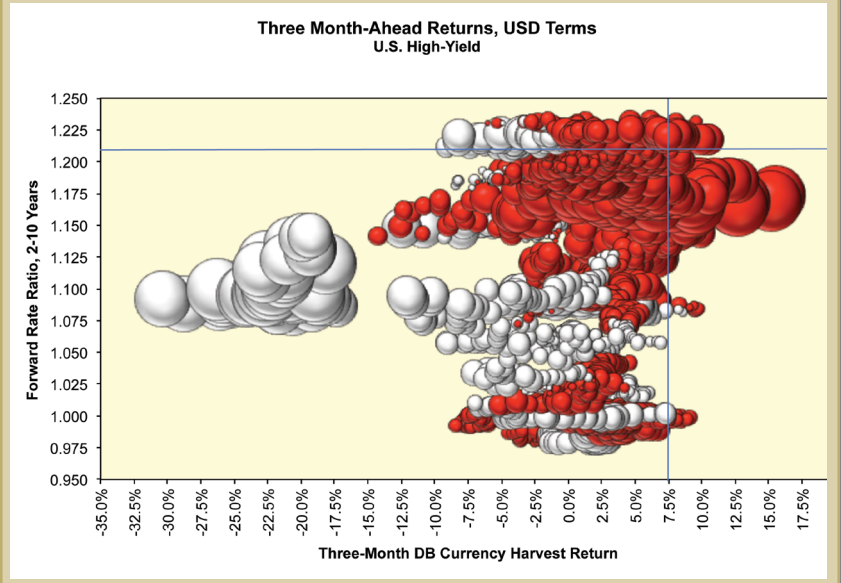
Are successful traders born or made? The answer seems to be, "made," but by central banks on a mission. ☒

*For information on the author, see p. 4.*

**FIGURE 6**



**FIGURE 7**





CPI: Consumer price index

ECB: European Central Bank

FDD (first delivery day): The first day on which delivery of a commodity in fulfillment of a futures contract can take place.

FND (first notice day): Also known as first intent day, this is the first day on which a clearinghouse can give notice to a buyer of a futures contract that it intends to deliver a commodity in fulfillment of a futures contract. The clearinghouse also informs the seller.

FOMC: Federal Open Market Committee

GDP: Gross domestic product

ISM: Institute for supply management

LTD (last trading day): The final day trading can take place in a futures or options contract.

PMI: Purchasing managers index

PPI: Producer price index

Economic release (U.S.)	Release time (ET)
GDP	8:30 a.m.
CPI	8:30 a.m.
ECI	8:30 a.m.
PPI	8:30 a.m.
ISM	10:00 a.m.
Unemployment	8:30 a.m.
Personal income	8:30 a.m.
Durable goods	8:30 a.m.
Retail sales	8:30 a.m.
Trade balance	8:30 a.m.
Leading indicators	10:00 a.m.

The information on this page is subject to change. *Currency Trader* is not responsible for the accuracy of calendar dates beyond press time.

June	
<b>1</b>	<b>U.S.:</b> April personal income and May employment report and ISM manufacturing report <b>Brazil:</b> Q1 GDP <b>Canada:</b> Q1 GDP
<b>2</b>	
<b>3</b>	
<b>4</b>	
<b>5</b>	<b>Canada:</b> Bank of Canada interest-rate announcement
<b>6</b>	<b>U.S.:</b> Fed beige book <b>Australia:</b> Q1 GDP <b>Brazil:</b> May CPI and PPI <b>ECB:</b> Governing council interest-rate announcement
<b>7</b>	<b>Australia:</b> May employment report <b>France:</b> Q1 employment report <b>Mexico:</b> May 31 CPI and May PPI <b>UK:</b> Bank of England interest-rate announcement
<b>8</b>	<b>U.S.:</b> April trade balance <b>Canada:</b> May employment report <b>UK:</b> May PPI <b>LTD:</b> June forex options; June U.S. dollar index options (ICE)
<b>9</b>	
<b>10</b>	
<b>11</b>	
<b>12</b>	<b>Japan:</b> May PPI
<b>13</b>	<b>U.S.:</b> May PPI and retail sales <b>France:</b> May CPI <b>Germany:</b> May CPI
<b>14</b>	<b>U.S.:</b> May CPI <b>Hong Kong:</b> Q1 PPI <b>India:</b> May PPI
<b>15</b>	<b>Japan:</b> Bank of Japan interest-rate announcement
<b>16</b>	
<b>17</b>	
<b>18</b>	<b>Hong Kong:</b> March-May employment report <b>LTD:</b> June forex futures; June U.S. dollar index futures (ICE)
<b>19</b>	<b>U.S.:</b> May housing starts <b>Hong Kong:</b> Q1 GDP <b>UK:</b> May CPI <b>FND:</b> June U.S. dollar index (ICE)

<b>20</b>	<b>U.S.:</b> FOMC interest-rate announcement <b>Germany:</b> May PPI <b>South Africa:</b> May CPI <b>UK:</b> May employment report <b>FDD:</b> June forex futures; June U.S. dollar index futures (ICE)
<b>21</b>	<b>U.S.:</b> May leading indicators <b>Brazil:</b> May employment report <b>Hong Kong:</b> May CPI <b>South Africa:</b> Q1 GDP
<b>22</b>	<b>Canada:</b> May CPI <b>Mexico:</b> May employment report and June 15 CPI
<b>23</b>	
<b>24</b>	
<b>25</b>	
<b>26</b>	
<b>27</b>	<b>U.S.:</b> May durable goods
<b>28</b>	<b>U.S.:</b> Q1 GDP (third) <b>Germany:</b> May employment report <b>South Africa:</b> May PPI <b>UK:</b> Q1 GDP
<b>29</b>	<b>Canada:</b> May PPI <b>France:</b> Q1 GDP and May PPI <b>India:</b> May CPI <b>Japan:</b> May employment report and CPI
<b>30</b>	
<b>31</b>	
July	
<b>1</b>	
<b>2</b>	<b>U.S.:</b> June ISM index
<b>3</b>	
<b>4</b>	
<b>5</b>	<b>Brazil:</b> June PPI <b>UK:</b> Bank of England interest-rate announcement <b>ECB:</b> Governing council interest-rate announcement
<b>6</b>	<b>U.S.:</b> June employment report <b>Brazil:</b> June CPI <b>Canada:</b> June employment report <b>UK:</b> June PPI <b>LTD:</b> July forex options; U.S. dollar index options (ICE)





Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	269.5	324.4	-2.79% / 59%	-6.43% / 100%	-5.53% / 78%	.58 / 85%
AUD/USD	AD	CME	140.1	145.7	-2.20% / 35%	-5.73% / 96%	-7.74% / 86%	.26 / 37%
GBP/USD	BP	CME	112.2	185.6	-3.23% / 100%	-4.51% / 100%	-1.41% / 50%	.54 / 88%
CAD/USD	CD	CME	96.6	133.4	-2.41% / 65%	-4.27% / 93%	-2.66% / 70%	.47 / 77%
JPY/USD	JY	CME	79.6	141.0	1.53% / 81%	1.43% / 32%	2.15% / 65%	.18 / 38%
MXN/USD	MP	CME	48.5	151.7	-2.42% / 31%	-8.61% / 100%	-8.16% / 95%	.27 / 68%
CHF/USD	SF	CME	47.8	52.1	-2.77% / 59%	-6.37% / 100%	-5.19% / 76%	.58 / 92%
U.S. dollar index	DX	ICE	26.2	54.4	1.92% / 39%	4.91% / 100%	4.17% / 78%	.57 / 78%
NZD/USD	NE	CME	14.1	19.5	-2.02% / 20%	-7.38% / 92%	-7.07% / 76%	.25 / 58%
E-Mini EUR/USD	ZE	CME	3.3	8.7	-2.79% / 59%	-6.43% / 100%	-5.53% / 78%	.58 / 85%

Note: Average volume and open interest data includes both pit and side-by-side electronic contracts (where applicable). Price activity is based on pit-traded contracts.

The information does NOT constitute trade signals. It is intended only to provide a brief synopsis of each market's liquidity, direction, and levels of momentum and volatility. See the legend for explanations of the different fields. Note: Average volume and open interest data includes both pit and side-by-side electronic contracts (where applicable).

#### LEGEND:

Volume: 30-day average daily volume, in thousands.

OI: 30-day open interest, in thousands.

10-day move: The percentage price move from the close 10 days ago to today's close.

20-day move: The percentage price move from the close 20 days ago to today's close.

60-day move: The percentage price move from the close 60 days ago to today's close.

The "% rank" fields for each time window (10-day moves, 20-day moves, etc.) show the percentile rank of the most recent move to a certain number of the previous moves of the same size and in the same direction. For example, the % rank for the 10-day move shows how the most recent 10-day move compares to the past twenty 10-day moves; for the 20-day move, it shows how the most recent 20-day move compares to the past sixty 20-day moves; for the 60-day move, it shows how the most recent 60-day move compares to the past one-hundred-twenty 60-day moves. A reading of 100% means the current reading is larger than all the past readings, while a reading of 0% means the current reading is smaller than the previous readings.

Volatility ratio/% rank: The ratio is the short-term volatility (10-day standard deviation of prices) divided by the long-term volatility (100-day standard deviation of prices). The % rank is the percentile rank of the volatility ratio over the past 60 days.

### BarclayHedge Rankings: Top 10 currency traders managing more than \$10 million (as of April 30 ranked by April 2012 return)

	Trading advisor	April return	2012 YTD return	\$ Under mgmt. (millions)
1.	24FX Management Ltd	5.90%	6.73%	66.1
2.	Harmonic Capital (Gl. Currency)	4.14%	5.57%	916.0
3.	QFS Asset Mgmt (QFS Currency)	4.04%	-3.17%	868.0
4.	Regium Asset Mgmt (Ultra Curr)	3.44%	10.27%	25.1
5.	Metro Forex Inc	2.68%	8.34%	136.0
6.	Ortus Capital Mgmt. (Currency)	2.45%	-3.82%	3311.0
7.	Swing Capital (FX)	1.99%	-0.46%	67.0
8.	Gedamo (FX Alpha)	1.80%	2.43%	18.1
9.	Gables Capital Mgmt (Global FX)	1.60%	0.85%	30.0
10.	CenturionFx Ltd (6X)	1.60%	40.09%	18.5

### Top 10 currency traders managing less than \$10M & more than \$1M

1.	Adantia (FX Aggressive)	10.50%	6.42%	2.9
2.	Iron Fortress FX Mgmt	2.01%	-3.17%	6.7
3.	BBK (RESCO L/S FX)	1.68%	-4.02%	3.5
4.	MFG (Bulpred USD)	1.07%	11.21%	1.2
5.	Valhalla Capital Group (Int'l AB)	0.96%	0.00%	1.5
6.	BEAM (FX Prop)	0.54%	-3.83%	2.0
7.	MatadorFX (MFX1)	0.28%	-0.59%	1.7
8.	Gavan Dunne (FX Momentum-Client)	0.01%	-0.03%	3.5
9.	Trident Asset Mgmt. (Gl. Currency)	0.00%	-0.18%	7.0
10.	Forexmax (Prop)	0.00%	-4.62%	6.1

Based on estimates of the composite of all accounts or the fully funded subset method.

Does not reflect the performance of any single account.

PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE.



## CURRENCIES (vs. U.S. DOLLAR)

Rank	Currency	May 29 price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Japanese yen	0.01259	1.12%	1.29%	-2.10%	0.0132	0.0119	4
2	Hong Kong dollar	0.128825	-0.04%	-0.10%	0.41%	0.129	0.1281	6
3	Chinese yuan	0.15789	-0.40%	-0.53%	0.73%	0.1589	0.1538	7
4	Taiwan dollar	0.033765	-1.36%	-0.13%	2.72%	0.03490	0.032	5
5	Thai baht	0.03167	-2.67%	-3.78%	-0.81%	0.0336	0.031	13
6	Singapore dollar	0.78357	-3.07%	-1.80%	2.05%	0.832	0.7606	2
7	Great Britain pound	1.56918	-3.52%	-0.99%	1.11%	1.6507	1.5308	1
8	Canadian dollar	0.97587	-4.32%	-2.74%	1.23%	1.059	0.9467	3
9	Indian rupee	0.017985	-4.54%	-11.12%	-5.91%	0.0226	0.0177	16
10	Brazilian real	0.50389	-4.93%	-14.09%	-5.47%	0.65	0.4803	17
11	Euro	1.25682	-5.18%	-6.43%	-5.70%	1.4638	1.2514	11
12	Swiss franc	1.04551	-5.24%	-6.19%	-3.34%	1.3779	1.0418	9
13	Australian Dollar	0.984985	-5.94%	-8.49%	-0.32%	1.1028	0.9478	15
14	Swedish krona	0.139925	-6.03%	-8.01%	-2.73%	0.163	0.1391	8
15	South African rand	0.12001	-7.10%	-9.51%	0.89%	0.1498	0.1166	14
16	New Zealand dollar	0.761405	-7.41%	-9.23%	1.09%	0.8797	0.7397	12
17	Russian ruble	0.03124	-8.33%	-9.38%	-1.88%	0.0364	0.0303	10

## GLOBAL STOCK INDICES

	Country	Index	May 29	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	South Africa	FTSE/JSE All Share	33,440.20	-2.79%	-2.50%	5.70%	34,482.43	29,601.61	2
2	Switzerland	Swiss Market	5,914.70	-2.98%	-3.19%	6.93%	6,575.80	4,695.30	8
3	Mexico	IPC	38,126.85	-3.38%	0.82%	6.77%	40,050.20	31,659.30	3
4	France	CAC 40	3,084.70	-3.99%	-10.65%	1.91%	4,023.59	2,693.21	14
5	U.S.	S&P 500	1,332.42	-4.68%	-5.05%	11.48%	1,422.38	1,074.77	7
6	India	BSE 30	16,438.58	-5.08%	-7.40%	2.69%	19,619.70	15,135.90	5
7	Germany	Xetra Dax	6,396.84	-5.39%	-6.70%	10.29%	7,523.53	4,965.80	12
8	Canada	S&P/TSX composite	11,609.30	-5.56%	-8.18%	-1.05%	13,901.60	10,848.20	10
9	Singapore	Straits Times	2,801.85	-5.93%	-6.42%	4.23%	3,227.28	2,521.95	6
10	UK	FTSE 100	5,391.10	-6.04%	-8.18%	1.01%	6,084.10	4,791.00	9
11	Australia	All ordinaries	4,168.20	-6.69%	-5.01%	0.02%	4,804.10	3,829.40	1
12	Japan	Nikkei 225	8,657.08	-7.42%	-10.97%	2.11%	10,255.20	8,135.79	11
13	Hong Kong	Hang Seng	19,055.46	-9.66%	-12.11%	4.38%	23,707.90	16,170.30	4
14	Italy	FTSE MIB	13,107.13	-10.18%	-19.84%	-10.39%	21,188.80	12,781.60	15
15	Brazil	Bovespa	54,633.00	-11.63%	-16.99%	-1.21%	68,970.00	47,793.00	13

## NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	May 29	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Yen / Real	JPY/BRL	0.024975	6.28%	17.89%	3.50%	0.0261	0.0192	1
2	Pound / Aussie \$	GBP/AUD	1.5931	2.57%	8.19%	1.43%	1.626	1.4637	4
3	Pound / Franc	GBP/CHF	1.500875	1.82%	5.54%	4.60%	1.5056	1.1778	6
4	Aussie \$ / New Zeal \$	AUD/NZD	1.293635	1.59%	0.82%	-1.38%	1.3229	1.2354	12
5	Pound / Canada \$	GBP/CAD	1.607975	0.83%	1.79%	-0.12%	1.6354	1.5302	8
6	Euro / Aussie \$	EUR/AUD	1.27598	0.79%	2.25%	-5.40%	1.382	1.2269	7
7	Canada \$ / Real	CAD/BRL	1.93668	0.65%	13.22%	7.09%	2.0301	1.5997	2
8	Euro / Franc	EUR/CHF	1.202105	0.06%	-0.26%	-2.44%	1.2406	1.0376	11
9	Euro / Real	EUR/BRL	2.494235	-0.26%	8.92%	-0.24%	2.6261	2.204	3
10	Aussie \$ / Franc	AUD/CHF	0.94211	-0.73%	-2.45%	3.13%	0.99	0.7477	13
11	Euro / Canada \$	EUR/CAD	1.287895	-0.90%	-3.79%	-6.84%	1.4316	1.2841	16
12	Franc / Canada \$	CHF/CAD	1.07136	-0.97%	-3.55%	-4.51%	1.3569	1.0676	14
13	Aussie \$ / Real	AUD/BRL	1.95476	-1.06%	6.53%	5.45%	2.0268	1.6402	5
14	Aussie \$ / Canada \$	AUD/CAD	1.00934	-1.70%	-5.91%	-1.53%	1.0755	0.9981	20
15	Euro / Pound	EUR/GBP	0.80094	-1.73%	-5.49%	-6.73%	0.9038	0.7976	19
16	Pound / Yen	GBP/JPY	124.675	-4.50%	-2.25%	3.31%	134.07	117.58	9
17	Canada \$ / Yen	CAD/JPY	77.535	-5.32%	-3.98%	3.41%	84.49	72.63	10
18	Euro / Yen	EUR/JPY	99.86	-6.15%	-7.61%	-3.65%	117.44	97.22	17
19	Franc / Yen	CHF/JPY	83.07	-6.20%	-7.38%	-1.23%	105.79	80.46	15
20	Aussie \$ / Yen	AUD/JPY	78.26	-6.88%	-9.65%	1.85%	88.31	72.72	21
21	New Zeal \$ / Yen	NZD/JPY	60.495	-8.38%	-10.39%	3.29%	68.81	57.23	18

## GLOBAL CENTRAL BANK LENDING RATES

Country	Interest rate	Rate	Last change	November 2011	May 2011
United States	Fed funds rate	0-0.25	0.5 (Dec 08)	0-0.25	0-0.25
Japan	Overnight call rate	0-0.1	0-0.1 (Oct 10)	0-0.1	0-0.1
Eurozone	Refi rate	1	0.25 (Dec 11)	1.25	1.25
England	Repo rate	0.5	0.5 (March 09)	0.5	0.5
Canada	Overnight rate	1	0.25 (Sept 10)	1	1
Switzerland	3-month Swiss Libor	0-0.25	0.25 (Aug 11)	0-0.25	0.25
Australia	Cash rate	3.75	0.50 (May 12)	4.5	4.75
New Zealand	Cash rate	2.5	0.5 (March 11)	2.5	2.5
Brazil	Selic rate	9	0.75 (Apr 12)	11	12
Korea	Korea base rate	3.25	0.25 (June 11)	3.25	3
Taiwan	Discount rate	1.875	0.125 (June 11)	1.875	1.75
India	Repo rate	8	0.5 (Apr 11)	8.5	7.25
South Africa	Repurchase rate	5.5	0.5 (Nov 10)	5.5	5.5





GDP		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Q4	3/26	5.0%	15.6%	6/8
	Brazil	Q4	3/6	4.2%	6.5%	6/1
	Canada	Q4	3/2	1.5%	5.4%	6/1
EUROPE	France	Q4	3/28	0.2%	1.7%	6/29
	Germany	Q1	5/15	0.9%	3.0%	8/14
	UK	Q4	3/27	0.6%	2.9%	6/28
AFRICA	S. Africa	Q4	3/29	3.3%	10.3%	6/21
ASIA and S. PACIFIC	Australia	Q4	3/7	0.4%	2.8%	6/6
	Hong Kong	Q1	5/11	-8.0%	3.2%	8/10
	India	Q1	5/31	3.4%	12.0%	8/31
	Japan	Q1	5/17	1.0%	4.1%	8/13
	Singapore	Q1	5/25	0.2%	1.6%	8/24

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q1	5/18	6.7%	-0.5%	-0.6%	8/21
	Brazil	April	5/24	6.0%	-0.2%	-0.4%	6/21
	Canada	April	5/11	7.3%	0.1%	-0.3%	6/8
EUROPE	France	Q4	3/1	9.4%	0.1%	0.1%	6/7
	Germany	April	5/31	5.2%	-0.3%	-0.7%	6/28
	UK	Jan.-March	5/16	8.2%	-0.2%	50.0%	6/20
ASIA and S. PACIFIC	Australia	April	5/16	5.1%	0.0%	0.1%	6/7
	Hong Kong	Feb.-April	5/17	3.3%	-0.1%	-0.3%	6/18
	Japan	April	5/29	4.6%	0.1%	-0.1%	6/29
	Singapore	Q1	4/30	2.1%	0.1%	0.2%	7/31

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	April	5/11	0.9%	9.8%	6/13
	Brazil	April	5/2	0.6%	5.0%	6/6
	Canada	April	5/18	0.4%	2.0%	6/22
EUROPE	France	April	5/15	0.1%	2.1%	6/13
	Germany	April	5/11	0.2%	2.1%	6/13
	UK	April	5/22	0.6%	3.0%	6/19
AFRICA	S. Africa	April	5/23	0.4%	6.1%	6/20
ASIA and S. PACIFIC	Australia	Q1	4/24	0.1%	1.6%	7/25
	Hong Kong	April	5/22	0.5%	4.7%	6/21
	India	April	5/31	2.0%	10.2%	6/29
	Japan	April	5/25	0.1%	0.4%	6/29
	Singapore	April	5/23	0.5%	5.4%	6/25

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	April	5/11	1.2%	12.9%	6/13
	Canada	April	5/30	0.0%	0.4%	6/29
EUROPE	France	April	5/31	0.0%	2.7%	6/29
	Germany	April	5/18	0.2%	2.4%	6/20
	UK	April	5/11	0.7%	3.3%	6/8
AFRICA	S. Africa	April	5/31	0.3%	6.6%	6/28
ASIA and S. PACIFIC	Australia	Q1	4/23	-0.3%	1.4%	7/23
	Hong Kong	Q4	3/13	0.2%	6.5%	6/14
	India	April	5/14	2.1%	7.2%	6/14
	Japan	April	5/25	0.3%	-0.2%	6/12
	Singapore	April	5/29	-1.7%	1.2%	6/29

As of May 31 LEGEND: Change: Change from previous report release. NLT: No later than. Rate: Unemployment rate.