Rohr Report

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Key Views

- **So, it's all about the FOMC now? Possibly not so much. In fact, it is likely to be much more about the additional data we shall see, and ensuing market activity. As we discussed in last week's *Capital Markets Observer* III-39, it is very much more likely that the FOMC will only provide 25 basis points of easing today. That is substantially due to be more incremental approach that Mr. Bernanke laid out in his *Monetary Policy under Uncertainty* speech on October 19th; yet that only begins the current tale.**

- **While there are quite a few reports this week, it seems the talking heads are finally toning it down into the holidays. As such, we suspect that the key events after the FOMC decision and statement today will be Friday's US CPI (NOV), and the success or failure of the Bush-Paulson adjustable rate borrower rescue plan. Moreso than any other factor, that will likely determine the fate of the equities, and by extension be a major influence on the other financial markets, and even foreign exchange.**

- **As we suspected, the DJIA holding 13,250 fomented an extension of the rally to a new high above 13,500-50 for a retest of the 13,750-800 area. And as Mark Twain noted many years ago, "History doesn't repeat itself, but it rhymes." In that regard, we further suspected that the equity market strength would bring pressure back on to the fixed income market, as it did in the run up to the October 31st FOMC meeting.**

- **The difference this time is that the fixed income market began breaking well ahead of time, and has sold off more aggressively than the minor hiccup experienced into the previous meeting. While upside leader December T-note stalled into the 114-26 Tolerance of low-to-mid 114-00 resistance, the March contract is below 112-24/-20, with lower support in two 111-24/-16. Yet, that has left the weaker sisters in Europe in quite a bit of duress, as the failure of the March Bund from the 115.50 area as it became lead contract last Thursday created a full two-point drop. Similarly, the Gilt failed badly from its test of the top of its 110.50-.84 resistance, as it took no encouragement from the Bank of England 25 basis point easing last Thursday; in fact, just the opposite.**

- **All of which gets back to the renewed importance of inflation indications as we head toward Friday's US CPI, where the headline number is expected to exceed 4.0 percent. While the ECB is still regarded as the most hawkish of central banks, a more extensive inflation influence may limit the upside for the long ends, even if the equity markets break heavily in the wake of a 25 basis point FOMC easing followed by problems for the subprime borrower rescue plan. The dilemma is the 'silver lining' being a further inter-meeting easing into next week, with negative implications for fixed income.**

Overview

That's right, another easing within a week and a half of today's likely 25 basis point rate reduction by the FOMC. While that would also have implications for the foreign exchange, the fact now is that last week's reversion to weaker economic data in Japan leaves it firmly reestablished as the weakest of the weak sisters, and that means it will continue to play the game of weak sister musical chairs with the US dollar and British pound (and continue to confound the carry trade 'crisis' Cassandra's.) As such, we will leave the discussion of foreign exchange to the Markets Summary section. The same is the case for an energy market which continued to see Crude Oil weaken below support in the 89.00 area, yet in such an orderly fashion as to leave a resurgence possible at any time.

Therefore, the big decisions will be in the relationship between the equity markets and the fixed income, as has been the case for some time. However, the difference now is going to be the degree to which the previous strength in the long dated fixed income markets was at least in part predicated on the degree to which central banks are behind the curve in easing to prevent the worst aspects of the credit crunch and subprime mortgage dilemmas from affecting the broader economies, especially in the US.

That explains quite a bit about each previous sharp selloff in the equity markets fomenting such a strong positive response in the long dated fixed income, significantly with a country bias toward the US and much less strength in Europe. As the US remains the epicenter of Hybrid Adjustable Rate Mortgage (HARM) and subprime debt securitization dilemmas, it is only fitting it is still the firmest fixed income market compared to UK and Europe. Yet it seems that even here the degree to which the Fed may need to begin easing more aggressively if the Bush-Paulson plan develops problems in implementation may spell the end of the dislocation between short-term yields remaining too high to offset the coming weakness, and may even raise some inflation fears.

While there are quite a few reasons, both political and legal, the subprime borrower rescue plan may get into trouble, some of the most daunting aspects are purely practical. Such as how such a diffuse and diverse set of lenders can even be brought together in order to review whether the loans can indeed allow for a suspension of interest rate resets over the next 1-2 years that will last for every bit of five years. Legal challenges notwithstanding, there is also a very daunting political hurdle in benefiting such a limited subset of the besieged borrowers. There has been so much said about that of late, we choose to demure, and merely pass along analysis of one of the key aspects, which we were not sure anybody else had noted.

Yesterday's Financial Times included a Comment column from regular contributing analyst Clive Crook entitled “The trouble with the Paulson plan." While Mr. Crook does a fine job of demolishing the notion that the US mortgage market is significantly a private enterprise affair in the first place, he also includes the telling remarks from the Democratic chairman of the House financial services committee, Representative Barney Frank. We must admit that we were not fans of Mr. Frank in his previous purely populist *modus operandi*. Yet he has evolved markedly in his understanding of the financial markets and their nexus with the political sphere. As such, his observation on the key weakness of the Paulson plan cast doubt on whether it can indeed ever come to fruition, at least insofar as that requires some sort of legislation, which will rest with the House of Representatives.

Mr. Crook noted that the response from the chairman of the financial services committee was that, (paraphrasing) “the plan bizarrely confines its promised assistance to borrowers with poor credit histories. More than a third of mortgages currently in foreclosure were granted to prime borrowers; and, of those, more than half were adjustable-rate loans. Under the Paulson scheme, prime borrowers who get into trouble when their teaser rates reset will have to refinance, if they can; otherwise, they are on their own. Borrowers who struggled to improve their credit scores before taking out their mortgages are going to feel aggrieved. In many cases, the reward for those efforts will be eviction.”

As we were not sure anybody else had noted the good chairman's skepticism regarding the political viability of the plan, we were very happy to see Mr. Crook focus on that most telling of remarks from such a prominent force in the US Congress. Even if such a political solution were possible, all of this would still only apply to a very limited subset of troubled borrowers. Yet, in the event it seems that the best Mr. Bush and Mr. Paulson will be able to do is put into effect the original, fully market-based approach of bringing lenders and borrowers together. That also only applies to a very limited subset of the troubled borrowers on the 1.3 million adjustable-rate mortgages which are due to see interest rates reset in 2008, with another 1-2 million following that.

All of which means the credit crisis is hardly over based on what the central banks have done so far, and in fact it is just getting warmed up. And that is why it will take much more central bank easing and overall liquidity infusions than anything experienced to date to significantly offset the drag on the developed economies from the evolving restrictive credit environment. Ironically, strong economic data is preventing them from providing the more aggressive anticipatory accommodation that is likely necessary to actually address the problems.

Yet, as discussed previous, Mr. Bernanke has now committed to a much more incremental approach in line with the ‘Brainardian’ ethic of not overreacting to current (and especially projected) financial crises. As such, his credibility might be significantly diminished if he were to provide a full 50 basis point easing in the face of the recent strong economic news and elevated levels of equity markets. For a full discussion of his seeming penitence for having rewarded those who had made bad bets when the Fed eased by 50 basis points back on September 18th, please see our extended review of Mr. Bernanke's *Monetary Policy under Uncertainty* speech from back on October 19th. That was where he prominently alluded to Bill Brainard’s idea that central banks should not ‘overreact’ to any near term shocks (***CMO*** III-35, [**Ready for Prime (Mover) Time?**, Tuesday, October 23, 2007.]

However, in that same speech, Mr. Bernanke also reviewed many other theories of effective central bank management of the economy and the markets. Quite a few of those focused upon advantage, indeed the need at times, in central banks acting in a way which surprises the markets. That leaves the door open to additional Federal Reserve activity if necessary into the pre-holiday period next week. As Mr. Bernanke and other prominent members of the system have made clear, they will do "what is necessary" to prevent disorderly financial markets from impacting the general economy. And therein may lie the 'silver lining' of further Fed easing next week if equities respond poorly to a nominal easing today. The pressures on the Fed brought about by any equity market failure into the very disjointed holiday calendar were extensively reviewed in last week’s ***CMO*** III-39.

Markets Summary

EQUITIES (with trend influence and central bank prerogative background)

That the **DJIA** remains the prime mover for the trend decisions elsewhere is still apparent at present in its ability to lead the recovery from the spillover from extreme emotional weakness into the 12,800 (with a tolerance to 12,750) two weeks ago. That it also held and extended the rally after the anticipated weakness of US Existing Home Sales figures and Beige Book reinforced the sense that a 'bad news is good news' mentality was coming into effect early on prior to today's FOMC meeting, along with what was some better than expected economic data as well.

Of course, the current bout of anticipatory exuberance has assisted the DJIA in exceeding the 13,350 area, and extended resistance in the 13,500-50 area that is now near term support. However, it has also stalled at no better than the more critical resistance at 13,750-800, and how it responds after today's likely 25 basis point easing will be very critical for the trend of the markets in to the holidays. Once the FOMC is out of the way, any slippage back below 13,500, and especially below the 13,250 support that was held at the bottom of the selloff last Tuesday could be very troubling for the equity markets. The perverse 'bad news is good news' mentality left any near term selloff of any major extent less than likely prior to the FOMC meeting; in its wake, that will be less so the case.

That is especially so if the FOMC holds to the more incremental view and policy approach adopted after Mr. Bernanke's *Monetary Policy under Uncertainty* speech on October 19th. Note that it was instrumental in fully deflating the DJIA back below the original failure level at 13,700 (even though it rallied above it again into the October 31st FOMC meeting) after the sharp easing in mid-September had encouraged it to rally to a modest new all-time high. Both prior to mid-September and subsequent, the tendency has been for the equity markets to fail shortly after the more accommodative expectations for the FOMC action and statement are not forthcoming.

That has been especially so when some negative credit market news surfaces. Yet in this case, there is the additional 'likely culprit' of any obvious failure of the Bush-Paulson subprime borrower rescue plan to act as a negative which the equity markets may find very troubling. Naturally, any lack of success for that plan will take at least a few days to become apparent. That said, adjournment of Congress for their holiday break next week will provide an obvious horizon into which the plan will either be seeming to gain traction, or possibly end up on the shoals of a stormy Congressional passage.

And that is one of the key influences that may provide the context for a very disturbing equity market failure into next week, which the Fed will not be able to ignore if DJIA (for instance) is melting down below 13,250 and especially the 13,000 area. Any drop below 13,250 will put the DJIA back below key moving averages, Negate a recent UP Break from the down channel from its all-time highs just below 14,200, turn daily MACD DOWN, as well as keep weekly MACD DOWN (as it has only recovered modestly from the late October DOWNturn.)

All of which would leave recent trading lows at 12,724 under threat, which is not something we feel the Fed will take lightly into a disjointed holiday trading schedule. That might also mean the 12,500-300 support around the August trading lows would be jeopardy.

Yet, that type of activity being countered by an inter-meeting Fed easing would indeed be quite a 'silver lining.' It would both demonstrate that the Fed is capable of moving back to a more incremental approach to heading off the worst effects of the fallout from the subprime loan and credit market problems into next year, and demonstrate that they are perfectly willing to "do what is necessary" to prevent the disorderly financial markets from spilling over into a major drag on the general economy. That would finally establish the Bernanke Fed as the sort of credible central bank which will neither over-stimulate the economy to bail out financial bets, nor allow the more disruptive aspects of those bets to overly depress the general economy.

In other words, a return to and reestablishment of much more classic and predictable central bank behavior, even if some complain that they are surprised by the inter-meeting activity. However surprised they may be, Mr. Bernanke's *Monetary Policy under Uncertainty* speech bought him all of the latitude he and his cohorts at the Fed may need in order to do whatever they deem necessary under rapidly evolving circumstances.

While Mr. Bernanke has made quite a show of the drive for greater transparency under his regime, it seems that we are back to the deft touch which Mr. Greenspan often applied to the market, even if the rhetoric might seem a bit more intelligible to most folks. And thankfully so. As we had noted many times previous, the mindless drive for her transparency and data dependency were less than effective, and not really an honest portrayal of how a modern central bank should operate.

The exact same psychology applies to the **December S&P 500**, which reestablished supports in the 1,451-44 and 1,432 areas, with the recent 1,407 trading low the buffer this side of the next extended supports in the 1,375-1,365 area August and March lows (respectively.) All of that will now migrate over to the March contract, which has additional advantage in trading at a ten dollar premium to the December into the contract expiration at the end of next week. That should assist the end also treating recently violated resistance in the 1,485 and 1,495 areas as support, even though it has its own resistance anywhere up to be daily chart gap at 1,535 (league contract equivalent 1,525.)

While we have focused on it previous, it is still very interesting how the various equity market trend indications are evolving. The daily MACD's have indeed turned UP on the recent sustained recovery, yet weekly MACD's remains in negative territory, with even the upside leader European equity markets only having weekly MACD's that are back in balance, and need further improvements in the indices in order to turn UP. That also sets up some real tension into today's FOMC meeting.

For now it is enough to note that next resistances in the DAX are 8,025-40, 8,100 area and the July 8,151 high of the up trend. Lower support remains the recently reinstated 7,750-00 range and in the 7,600 area, with extended support not until the 7,400 area that was neared on the recent selloff. Similarly, recently weaker sister **FTSE** had a DOWN Break below the 6,550 area, and unlike DAX is having trouble remaining above it. Yet, it is back above the previously violated 6,400-6,350 support, with major supports in the mid-6,100 area into 6,040 having held on the last break. Below there is can fall back as far as the 5,821 mid-August low, which is far more similar to the US than anything which is going on in Europe.

It is not necessarily a surprise in light of Japan's return to economic weakness exacerbated by political malaise that weak sister **NIKKEI** fell back below support on a serial basis below the 16,700 area as well as more major support in the 16,500 area, and 16,100-15,900 that all remain resistance on the way back up, even though it Closed today just above 16,100. While it had also fallen all the way below major levels in the 15,600-500 area, it is back above there now after slipping below the 15,250 area mid-August low (the only equity market to do that so far), yet not quite reaching ultimate support back in the 14,400-14,000 range last seen on the sharp downside reaction in June 2006.

LONG DATED FIXED INCOME

What a difference an FOMC meeting makes. In the wake of the temporary equity market post-FOMC strength back on October 31st, (as well as their tacit mention of inflation) the December **T-note** had slipped back from a test of its low 111-00 resistance to just about its previously Negated daily up channel 109-22 DOWN Break. In fact, even in electronic overnight trade it only made it down to the top of the 109-23/-18 daily gap higher buffer of support back below the 110-00 area, and that was only the most temporary of dips prior to putting on a much more extensive rally once it became clear form the equity market weakness that the Fed had not done nearly enough.

Sustained weakness of DJIA back below 13,500-350 (now somewhat critical once again, with a buffer to 13,250) was sufficient to have the T-note Close convincingly above the 111-12.5 Tolerance of the low 111-00 historic congestion; yet another reason the mid 111-00 area is critical to the March contract. That also ties right in with whether lead contract December can still maintain support at no lower than the 112-16 area to leave a chance that any equity market weakness will allow it to recover back above the major weekly down channel 113-00 area UP Break.

That said, after last week's weekly DOWN CPR, there is a question over whether the T-note can once again attempt to escape the low-to-mid 114-00 resistance. Obviously, that will be influenced to some degree by the market's reaction to this Friday's US CPI (NOV) release. Even if that report is no more pernicious than the 4.1 percent estimate, it may raise questions over whether long-term yields have dropped to low, especially if any equity market weakness forces the Fed into another rapid easing next week. We shall see.

If the March contract generally fails the 113-00 area, there are quite a few interim supports along the way. Those include the old mid-low 111-00 area, with various gaps, congestion and Fibonacci support into the upper-mid 110-00 area. Yet, any sustained failure back below 113-00 would actually indicate the likelihood of a move fully back to the 110-00/109-16 range across time. That would also be consistent with retesting lower major congestion, and major weekly oscillator thresholds that were overrun on the violent uptrend since the mid-June lows.

And if US long dated fixed income is week, it leaves that much more room for weakness in the European long ends, as we have seen since the late part of last week. The ECB (albeit not the OECD) tells us the European economy can remain robust in spite of US economic weakness, and that raises the spectre of further inflation. The key technical levels in the similarly recovered European long ends were the differentially weaker levels for the **Bund** lower supports back below 115.00 at 114.45-.55 and more convincingly into the 114.00 area.

Yet, even as the December Bund struggled above the 115.00 area at no better than the 115.50 resistance (except a week ago Monday when influenced by very extreme strength in the T-note), the rollover to the March contract last Thursday provided a lead contract boost of approximately 60 points. Yet, that also only left the March contract into that 115.50 area, and it failed miserably into the end of the week, knocking out both the mid- and low-114.00 area supports on its way to the mid-113.50 area. That reinstates the mid-114.00 area as major resistance, with even heftier congestion and DOWN CPR resistance in to the 115.00 area once again.

Moreso similar than previous for what was the strong sister **Gilt** that overran lower 108.83-.66 resistance, and sprinted above 109.50 initially to test the low end of its 110.50-.84 resistance in late November, and hit the high end of it into midweek last week, it fell apart after the Bund came under pressure into the later part of last week. Quickly back below the 109.50 level, it also slipped below the 109.20-.00 support, yet did not quite reach the next major lower support in the low 108.00 area. That said, any extreme weakness in the equities may cause the fickle betwixt and between Gilt to reestablish a strong bid back the mid 110.00 area, as there is really not much of the mid 109.00 area to restrain it.

SHORT MONEY

There is just not much to say about the short money forwards except that they are subject to all of the same forward looking economic implications of the US equity market activity while being constrained at the same time by the continued disruption in the interbank market and continued buoyant comments from the ECB on Europe. Those proved to be very telling in the past week, as even the Short Sterling did not respond very well to the 25 basis point easing from the Bank of England once it became apparent that the equity markets were going to remain buoyant. While more forward contracts also present some interesting implications, we continue to analyze the March contracts for now in light of the rather critical decisions which are likely from the various central banks.

The March **Eurodollar** recovery from its early October test of 95.25-.20 congestion left it quickly back above the previously violated September 18th 95.365 pre-FOMC trading low once it was clear more accommodation from the FOMC would be forthcoming at their last meeting. While that left a 95.40 UP Break above the associated congestion resistance, the holding action against higher 96.50 congestion a month ago indicated a strong bid, and that likely remain support on any near-term selloff. While that once again pushed above 95.65-.72 resistance recently, it has also stalled repeatedly into 96.75-.80 area oscillator resistance. If it escapes on the back of any equity market failure after the FOMC meeting, that will need to be on the back of an inter-meeting easing next week by the Fed. Further resistance remains into the low 96.00 area (i.e. around the June 2005 contract high.)

Once again, European instruments were that much weaker due to the perception that any economic weakness will spill out from the US leading the way down. Yet, the UK is more buoyant in the wake of the weak economic outlook contained in the BoE Quarterly Inflation Report and other recent weaker economic indications along with the recent rate cut. The key technical levels in European short money are March **Short Sterling** being below support in the 94.20-.17 range (now resistance), with lower support remaining in the 94.05-.00 area. Resistances remain at 94.40-45 and 94.55.

Similarly, albeit very much weaker due to the allegedly stronger economy in Europe, the March **Euribor** finally violated the lower supports in the interim level at 95.65 and the major 95.60-.55 area from which it was having trouble rallying very far from due to the hawkishness of the ECB that was reconfirmed at last week's post 'no action' rate decision. The higher resistances remain in the 95.78-.80 and 95.88-.92 areas, with next lower supports below recent multiple 95.52 trading lows (since mid-October) are 95.40 that is currently being tested, and again into the 95.32-.26 range. Ominously, barring a change of heart at the ECB or some further extensive improvement in the interbank lending markets, the December contract is trading below 95.20.

FOREIGN EXCHANGE

The US dollar picture has evolved from previous views, as pressure from everything from strongish Euro-zone economic indications to the pronouncements from various quarters that they may be becoming less partial to the US dollar have kept it under pressure below the previous anticipated support **US Dollar Index** in the .7650-00 range. Yet, it has now recovered back above the previous recent recovery highs in the .7615-20 area, which leaves a buffer of support into the .7570 area. Yet, current directional trend resistance (weekly MA 13 and aggressive down channel) have dropped into the mid .7600 area into this week.

Interesting the real test here will come in conjunction with the FOMC action after the Reserve Bank of Australia, ECB and Bank of England decisions last week. While the US dollar did gain on its Canadian counterpart after last Tuesday's Bank of Canada surprise easing, we doubt anything so benevolent will be forthcoming from other quarters.

In any event, the greater focus right now seems to be on the weakness of the British pound, which had been rekindled by its relatively weaker CIPS Services PMI last Wednesday, and the subsequent easing by the Bank of England. The pound had already become a co-weak sister with the US dollar and Japanese yen after the Bank of England Quarterly Inflation Report pointed out the fragility of the UK economy. That resulted in a failure of **GBP/USD** below the entire 2.07-2.10 resistance range, as well a drop back below 2.0550-00 congestion. While that was mitigated to some degree by a recovery back above the 2.0550 DOWN Break below in that area (below the up channel support from the mid-August low), the reinstatement of that signal today is a very bad sign. As noted above

Of course, what remains more telling is pound weakness against remaining European strong sister euro. As we noted in *TrendView* **MARKET ALERT**: **FOREX** a month ago, **EUR/GBP** Closing above the .6980 down Break Tolerance at .7000 was likely the trigger for more extensive strength. That was the case, as it demonstrated timely technical follow through above previous .7020-50 recent and historic congestion (recent strong congestion and daily MA support, as well as critical near term resistance in the .7120-50 area.

While it washed out below that early last week, it was back above it later in the week, and held it at the blow of the setback today. The next obvious resistance is at the .7254 May 2003 high (also oscillator resistance.) Much above that extended targets for the overall trend are not until the extended congestion and Fibonacci levels as well as weekly oscillator thresholds at .7350, .7550 and .7700-.7800 (the latter of which are also consistent with extended weekly oscillator thresholds at MA 41 plus 0.0750 and 0.0900.)

EUR/USD also attempted a failure on a DOWN CPR a month ago, yet acted as expected in violating it by returning to and overrunning the 1.4300 area in short order. Violation of the 1.4300 area resistance left the market up through its historic 1995 all-time *de facto* all-time high for the 'synthetic' basket of the component currencies. The inferred level of that high is 1.4535. However, that is an approximation, as nobody can no for certain if the 'synthetic' history of the trade weighted 'basket' indicates where a true trade would have occurred.

Yet, it's a pretty fair estimate, and works very well with the violated US Dollar Index projected .7650-00 area resistance. EUR/USD also ran into major weekly oscillator resistance initially by the 1.4600 area that has now been exceeded, and is now held very nicely late last week right back into the 1.4535 area. While the inability to get back above the near term channel DOWN Break at 1.4750 (right into the previous 1.4800 resistance) has constrained the market for now, all of the same supports are still in place at 1.4535, 1.4400 and the 1.4300-1.4250 area. We suspect that act above 1.4800 on a daily Close, EUR/USD will be ready to push for at least the 1.5000 area once again.

As also noted in our ***TrendView* MARKET ALERT**: **FOREX** a month ago, the US dollar finally failed against the yen on the violation of the 112.00 Tolerance of the previous major weekly H&S UP Break and lower congestion in the 113.50-112.50 range. That leaves those levels as formidable resistance, with next key support at the May 2006 110.00-109.30 weekly Up Closing Price Reversal (also very important Fibonacci 0.618 support) also violated, and now reinstated. Lower support remains in the 107.00-106.50 range that the market neared on the selloff last week prior to a weekly UP CPR from 108.30.

However, in considering whether this has any implications for the long anticipated carry trade 'crisis' it is evident from the relative activity of **EUR/JPY** and **GBP/JPY** that the extensive technical pressure on USD/JPY below previously tenacious key support is just another manifestation of secular US dollar weakness. That is even still true in light of the British pound, even though it has demonstrated weakness against the euro. Which is not to say there was no emotional buying in the yen on the back of such an obvious previous failure of the US dollar against it, as well as the equity market weakness.

As we have also noted in the past regarding the selloff in the European currencies against the Japanese yen, EUR/JPY has support at 159.00 and GBP/JPY 228.00 support was violated, with slippage below secondary support at 225.00 congestion for what is now the weak sister. In the event, EUR/JPY is still held 159.00 support, even though it failed on initial recoveries back into fresh resistance in the 164.00 area, with extended resistance is as early as 165.00 and 167-168. That is even moreso the case for the British pound, as GBP/JPY first holding into 225.00 left it weak into interim resistance in the 132.00 area, and it still feels challenged on rallies. Extended resistance is back in the 235.00 area, and every 2.50 up from there.

However, even if recent supports are violated in each case, the major lower supports remain in the EUR/JPY 150.00 area, with GBP/JPY (not surprisingly) much closer in the 220.00 area. While they will have broken their major up channel supports (from the late 2003 consolidation pullback lows in each case) somewhat above those *de facto* Tolerance levels, those levels also remain major Fibonacci 0.50 retracement and congestion supports.

Any US equity market weakness could once again be a driver for further weakness in the yen after the FOMC meeting, with even more telling implications for the British pound if it breaks GBP/USD 2.00-1.99. Yet, that may all be short lived if the equity market weakness is expensive enough to foment a further Fed easing into next week.

What is obvious is that while the USD/JPY failure fomented some residual yen strength, no major carry trade 'crisis' seems to be in the cards with the Japanese economy reverting back to the weakest sister of the lot. That is especially so now that it also seems a major number of carry trade financed speculative asset holdings have been liquidated on the various recent selloffs of the equity markets. While there are any number of reasons that could change at any time, any post-FOMC decision Major equity market weakness which impacts the US markets would seem to have equally as pernicious implications for the Japanese economy, and that may limit any rapid appreciation of the yen.

ENERGY

January **Crude Oil** has been so orderly below 89.00, we are not surprised that it rebounded smartly from the top of the lower support at 86.50-.00, even though it could have dropped to as low as 85.00-83.50, 82.00, or even the major support in the 79.00-78.00 in the context of an overall intermediate term up trend. Yet, with a good deal of geopolitical pressure waning in the wake of renewed Middle East peace efforts and the electoral defeat of Mr. Chavez' power grab, there is admittedly quite a bit of resistance back up at 93.50 and 95.00.

Santa Who?

As we have covered quite a few considerations regarding the potential for the Fed to provide additional easing if the equity markets did not respond to what ever they decide today, we can be very brief regarding further insights on the highly pressurized nature of the trend decisions through the balance of this week into next. One of the key aspects which many people expect to be critical at this time of year is whether or not there will be a classical 'Santa Claus' rally into the end of the year.

Of course, there is a question of whether anyone believes in Santa Claus exists in a market context in the first place, regardless of their personal life desire to believe or not. In fact, the idea that there is a Santa Claus which visits the broad market indices in December is a bit of a misnomer in any event. In truth, any benefits to the broader market in the later part of the year is more so due to 'Santa Portfolio Manager', and whether he decides to provide joy from his cash hoard to the other market participants.

And his tendencies in that regard are fully self-serving, insofar as he must assess whether it looks smarter to be holding cash or holding none. And that in turn, has to do with the relative position of the market indices to their highs in the year. The closer the indices are to their highs of the year, the moreso Santa Portfolio Manager is inclined to provide cash to the market so that he looks fully invested at the calendar year-end, regardless of whether his overall returns for the year have been second-rate or spectacular. The further below their highs of the year the indices rest into the middle of December, the less inclined Santa is to provide gifts to the other participants in the form of further purchases.

The DJIA remains the ostensible trend leader (if not the most volatile) of the equity markets on the upside, and is currently a mere 3.5 percent below its mid-October all-time high in the 14,200 area. Should it hold after today's FOMC decision, and not be bothered by the strong headline US CPI number on Friday, then any sustained strength (either just holding in the current area or especially any further improvements from these levels) will encourage Santa Portfolio Manager to disgorge his rather substantial cash hoard into share purchases prior to the end of next week.

Conversely, if the equity markets decide the FOMC action is insufficient to further mitigate the more pernicious aspects of the subprime mortgage reset and debt securities problems which are looming for next year, then Santa Portfolio Manager is more likely to play Scrooge instead of satisfying the market's desire for late year cash infusions. Which means that in addition to the existing critical balance between strong current economic data and the obvious problems which still plague the outlook, the near-term activity in the equity markets will create a bit of its own self-fulfilling prophecy into the end of next week.

And that means that in spite of any amount of tension and pressure which attended previous meetings, this one is clearly an...

FOMC Knife Edge

That gets us back to our opening indication that while the FOMC decision and statement today will certainly be quite important, the extended market activity is very likely not so much about the FOMC at all. In fact, it is likely to be much more about the additional data we shall see, and ensuing market activity. Especially insofar as the equity markets are concerned, much more emphasis is likely to be placed upon the evolving fortunes of the Bush-Paulson subprime borrower Hybrid Adjustable Rate Mortgage rescue plan.

As we have already reviewed a major portion of the background on that in the Overview and Equities analysis above, suffice to say that the fortunes of the equity markets (and to a lesser degree the fixed income) will rest with their perception of whether the Bush-Paulson plan is moving to fruition, or moving toward the legislative trash bin as Congress seeks to adjourn for the holiday next week. And to not create an untoward impression that the Fed is skeptical it can succeed, the idea that the plan is at the least nominally viable creates further constraint on the Fed. It all boils down to it likely only providing 25 basis points of easing at today's meeting, and in the broader scheme of central bank credibility that is no bad thing.

Along with concerns about the fate of the dollar, and not wanting to appear to bail out bad bets in a way many suspected might have been the case when they eased 50 basis points back in September, the Fed has left itself latitude to ease further if markets become disorderly in the recent stance that it will indeed "do what is necessary." As we have noted previous, there are quite a few folks who'd feel that a 'surprise' move in between regular meetings would belie Mr. Bernanke's commitment to transparency. Yet, it is something to which he alluded extensively in his October 19th *Monetary Policy under Uncertainty* speech; and is in any event reasonable and practical central bank policy. While it occurred at the beginning of the last easing cycle, and was really moreso based on forecasts than fact, nobody would now decry Mr. Greenspan's 'surprise' full half point easing from 6.50 percent in January 2001, which was followed by another half point on the final day of the month.

Silver Lining

As comedian George Carlin once famously quipped, “Every silver lining has a dark cloud."

And, indeed, a further inter-meeting easing next week would be the ‘silver lining’ to perception that the Fed was being less accommodative than necessary. If there are further problems with the equity market in the wake of what is likely to be only a 25 basis point easing today, then the Bernanke Fed would be both fulfilling recent major policy perspectives that it provided, and also demonstrating a deft hand at market support.

In its way, that would be a triumph for both transparency and troubled markets. While the transparency will moreso take the form of Mr. Bernanke's own variation of the now famous Greenspan Bamboozle, his *Monetary Policy under Uncertainty* speech could readily be seen as a robust framework under which he and fellow Fed governors can respond to conditions in an *ad hoc* manner. That is by far preferable to the previous ostensible ‘data dependent’ form of transparency that was never really a credible central bank policy in the first place; they are all realistically driven to a major degree by forecasts, rather than facts.

It is also a triumph for troubled markets, insofar as they want to see the Fed act whenever conditions become disorderly. In that regard as well, preserving more latitude to move rates lower when necessary is another compelling reason why a 25 basis point easing today makes more sense than a greater degree of accommodation on the way to what are still likely much lower rates across time.

This will all be a ‘silver lining’ for Mr. Bernanke as well if it transpires as we suspect it might. There was a goodly degree of suspicion, amply shared by us, that the early phase of his regime as chairman of the Fed was plagued by what were still professorial instincts instead of prime mover presence. Recent timely activity which extends back to leaking the pending discount rate easing and discount window operations adjustments on Thursday, August 16th speaks of a sense of the markets which some had doubted Mr. Bernanke possessed.

While there will be quite a few additional tests across time during the upcoming serial burdens on the US economy, at least it seems that Bernanke & Co. are now committed to “do what is necessary” in a way that speaks of market savvy as well as an intellectual grasp of their brief. Only time will tell how the markets respond to what ever the FOMC decides today. Yet, we have more confidence than previous that the Fed will respond timely to any disorderly activity that threatens the general economy. Any perceived problems with the Bush-Paulson rescue plan may mean the next test of that comes as early as next week.

We look forward to providing further comments as the situation warrants, and hope you have found these perspectives helpful.

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