Rohr Report

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Key Views, Overview,…
…Toxic Trichet, Still Dark, The Fiddler's Notion

Key Views

- **No secrets. Economics have been overshadowed by decisions and communication from central banks. The basic economic influences remain very weak in spite of the potential for recent moves on both stemming immediate crises and assisting at-risk home borrowers holding the potential to finally address the core of the rot that flows from weak US housing. However, central banks still seem to be less than sensitive to extensive weakness, as the title of our topical discussion implies. Obviously that toxicity is regarding the equity markets which provide a forward view of economies.**

- **That implies what we have noted previous about a "two-way street" developing in equities from the previous debacle into the near term basing actions three weeks ago. However, neither the stabilization of the equities (having held the bulk of their gains from the lows set into the mid-July FNMA/FHLMC possible failure terror) nor the strong inflation vigilance statements from the central banks have dissuaded the fixed income from rallying once again; and that now includes the short money forwards which seem to fly in the face of the central bank recalcitrance (more on that below.) It is all consistent with the recent historic fixed income form (since last summer's cycle lows) that the skepticism over the durability of the equities' rally leaves the debt market with a strong bid; and that has proved prescient other than during mid-April into June.**

- **The other factor which has come home to roost as a key to the return to pressure on the equities market is the weakness now more apparent in the European economy, joining the US and the UK. This was not something that President Trichet even attempted to refute anymore at his press conference yesterday. In fact, he made a point of noting the degree of weakness was prominent in the second quarter. Yet, as is the ECB's 'single needle compass' prerogative and preference, he basically also essentially said, "Not my problem, Mon Ami." With inflation due to remain elevated through the balance of 2008, he sounded more inclined to hike than cut. Which is why the action of the short money forwards is so interesting at present.**

- **That European weakness in addition to the risks already faced by the UK economy has done quite a bit to weaken commodity prices as well, and that is also finally weighing on the commodity economies like Canada and Australia. As we had anticipated, the strength of the euro notwithstanding, the likely last man standing against the US dollar was likely to be Australia, and their dollar has finally been decimated in the past several weeks after a final AUD/USD push above previous .9650 resistance failed. Which points to further US dollar strength on others' weakness.**

▪ On balance the technical picture remains the DJIA failure into the lower of the 11,635 and 11,750-800 resistances still leaves equities stabilized, with the next lower support at 11,350. However, its more important near term support is into the UP Closing Price Reversal (CPR) 11,100-10,975 signal/Tolerance range (likely to hold the first retest.)

▪ The rest of the equity market weekly UP CPR indications and associated Tolerances (i.e. previous week's lows) are in the S&P 500 future 1,240-1,225, DAX 6,153-6,140 and FTSE 5,261 (both signal and Tolerance due to the Closing at that low two weeks ago.) September S&P 500 has some interim support into the 1,258-62 January-March lows, with higher resistances at 1,278-81 and 1,295-1,300 violated daily Area Gap support levels; DAX interim resistance is at 6,520 with the more prominent resistance at which it just failed into the 6,620-40 range, and supports into 6,420, 6,320, and the UP CPR. FTSE has overrun resistance into 5,338, with 5,415 (January and March lows) above that (both now interim support), and higher resistance into 5,540 and the low-mid 5,600 area; lower supports are into 5,130-00 and 5,030-00. As the NIKKEI left no UP CPR, resistance is 13,400 and 13,600 from which it failed three weeks ago due to the weaker turn in its economic outlook, and supports into 13,000, 12,650, 12,200 and 12,000.

▪ On the expectation of further equities weakness back into a test of those lower weekly UP CPR levels, the T-note is looking to post a weekly Close back above 115-00 again even though we felt initially that might be a bit of a stretch. However, with the trading back into the upper 115-00 area in spite of the DJIA remaining up into the 11,500 area on the recent recovery and even being only back to no worse than 11,350 this morning, it is possible the T-note can even push back above the low 116-00 area once again for a move to either 117-16 congestion or the 118-00 area weekly continuation aggressive UP Channel DOWN Break from back in mid-April. That is consistent with Bund finally pushing back above the 113.30 Tolerance of its 112.50-113.00 resistance, which leaves the door open for a push to at least 114.00, and possibly either of higher 'even money' levels (115.00 and 116.00.) The firmer Gilt has also pushed above 106.50-.70 resistance after holding 105.30-.00 support, as well as higher resistance in the 108.00-.30 area seemingly on its way to the low 109.00s or higher. While we remain very skeptical of the long dated government bonds lack of real yield in the long run, the equities selloff implication of further economic weakness and credit market problems seems to be reinstating the 'haven' bid in these most impeccable of fixed income securities. There is still a rightful preference for the surety of buying the debt securities of the folks who own the printing presses rather than any who might have a refinancing problem.

▪ Technical levels for short money forwards are geared to March 2009 contracts, and those have remained considerably strong in spite of central banks' hawkish comments. This is likely due to the anticipatory nature of the beast in the face of anticipated equity market weakness due to central banker insensitivity on the current weakness. It is important to note that this is in spite of there not necessarily being any actual incentive to believe the central banks will cut rates, as the forwards are surely at least as much a psychological animal as any form of 'prediction (as we have cautioned in past cases over many years.) As such, March 2009 short money futures are a very good 'clearinghouse' for investor sentiment, and less reliable a guide to what central banks will actually do. Yet, in that regard, they are also a very good guide to just how weak the 'street' expects equities to become under the influence of misguided central bank influences.

- Eurodollar resistance remains 97.00-.10 with a Tolerance to the 97.10 area it failed at into the mid-July equities weakness. Any violation would be very interesting for the degree to which it reinstates anticipation of FOMC easing tightening into the end of this year that is inconsistent with all recent Fed communication. Lower support is 96.70-.65 and 96.55-.45. Short Sterling overran it obvious resistance at 94.30, and has now pushed well above 94.50 that implies a 25 basis point easing into late this year, with next resistance into 94.85-.90. Euribor pushed above resistance at 95.00-.05 last week and remained above it right into the ECB meeting and press conference yesterday. Then a most interesting thing occurred: in spite of the signals of a continued steady hand with a bias toward firming from überhawk J.C. Trichet at the ECB post-rate decision press conference, the March 2009 contract shot above some fairly prominent 95.20 resistance on the acknowledgement of economic weakness. It finished the day at 95.30, and is maintaining its bid today, with next resistance not until the 95.50-.60 area.

- Again, while it is not necessarily a sign of what the ECB either must or will do in reality, that implies the potential for one of two alternatives. Either credit market conditions are going to ease to a degree that will see a natural shrinkage of premiums while the ECB holds the base rate steady (unlikely if the equities and economies remain soft), or the economic and equity market conditions will remain weak enough to convince the ECB that they must ease first, even if they must allow a bit more inflation. Of course, as we have seen so many times previous, the futures are more likely to come back to the ECB reality than vice versa; yet, the price action is interesting nonetheless in the context of its timing right into the ECB meeting and still hawkish press conference yesterday.

- All foreign exchange projections are evolving rapidly, with the cautionary word that recent US dollar strength is to respected yet handled in a flexible manner. It is important to recall once again that the euro did not so much bottom in October 2000 as the US Dollar topped in the face of the secondary failures of the US equity markets as the NASDAQ 100 slid below 3,300(!!). Considering whether the US Dollar bottom will continue to generate extensive strength is as much an exercise in whether other economies are weakening fast enough to leave the euro, pound, Aussie dollar and the like under extensive pressure in the wake of ECB vigilance.

- As we suspected, that had already confused the 'interest rate differential' camp that saw EUR/USD drop sharply from above 1.6000 in the near term, and now slip below the interim lows (May-June) in the 1.5300 area. That is now a Double Top DOWN Break, and should represent some fairly formidable resistance on any near term retest (with a Tolerance to 1.5450-1.5500 congestion.) Yet, next shoe to fall will be whether it violates the 1.5000 and 1.4850 congestion supports, as the lower of those two is the Tolerance of the very major weekly up channel (from the EUR/USD cycle low into November 2005) that comes in at 1.4950, which is also the Fibonacci 0.25 retracement of that entire rally.

- Similar tendencies are apparent in the other currencies against the US dollar, even as they remain relatively stable against each other. That highlights the nature of the current swing as secular US dollar strength, even if based moreso on weakness elsewhere as opposed to any reasons to get euphoric about the US fiscal deficit or balance of payments prospects. In fact it is of note that the least radical weakness against the US currency today is the Japanese yen, which highlights the influence of softer Crude Oil prices. Yet, as usual, it all averages out in the US dollar Index that has pushed above its congestion and its own major weekly down channel resistance from the November 2005 high (reciprocal of the EUR/USD) above .7500-30, and whether it holds will be critical.

- **While it certainly can recover after a failure back below .7500, that would temporarily represent the potential to swing back down for a test of the .7400 area, or even lower; such as .7300-.7250. That reinforces the important of EUR/USD failing below the 1.5000 and 1.4850 levels to sustain the upward US dollar momentum. In that regard, it will also still revert back to whether any equities weakness is led by the US markets, which can still have the ability to weigh on the buck in spite of the weakness now ostensibly spreading elsewhere. In the meantime next US dollar Index resistances are into the .7700 and .7800 areas (November-February congestion and major Fib 0.382 retracement.)**
- **Equivalent levels for the other major currency US dollar relationships are:**

GBP/USD: RES: 1.9280-1.9240; 1.95; 1.9750-1.9800 SUPP: 1.91-1.90; 1.8600-1.8550

AUD/USD: RES: .8950-.9000; .9150; .92750 SUPP: .8750; .8675; .8500

USD/JPY: RES: 110.00-.50; 113.00; 114.50-115.00 SUPP: 108.60; 107; 106-105

USD/CHF: RES: 1.0860; 1.1000-50 (major channel and Fib); SUPP: 1.06; 1.05

USD/CAD: RES: 1.0675-1.0725; 1.0865-1.0920; 1.1050 SUPP: 1.05 (UP Break); 1.0350-00

- **The continuing energy weakness saw September Crude Oil chew back through previous hefty congestion and September contract aggressive up channel support in the 140-138 area and lower supports at 132-128 (now all resistances.) Now it is also below the 122-120 more important trend support. That is partially why the recent recoveries back above 120 were not very impressive: without a weekly Close above the 122 area, there is still room for the market to move down to lower supports. However, there are various reasons that support in the 110-107 range (actually down to the weekly continuation Area Gap Close at 106.23 back in April) or the 100 area at worst likely hold. Partially that will be demand reinvigoration (after recent demand destruction on very high gasoline prices) and likely some disciplinary talk from the OPEC hawks. Much like the central banks, that may not mean much in practice, but it will give the market a psychological boost; as will US gasoline at the pump that appeared horrific at $3.80 per gallon on the way up looking like a bit of a bargain again on the way back down. Whatever else transpires, human nature still rules in short term economics.**

Overview

We can be much more concise this week, as all of our views were either already presaged in the market discussion, or are glaringly apparent from the titles of the topical themes.

Central bankers seem to have some sort of death wish for any attempt of the equity markets and economies to bottom out. Part of that might be belief in what they read in the financial press about the likelihood of a bottom, and the rest is likely a defensive reaction to their previous failures.

Whatever the case, Monsieur Trichet provided a more hawkish than healthy view yesterday, which is similar to Fed Chairman Bernanke's misstep in June. That is reviewed in **Toxic Trichet**, with the follow up on our previous expectations for continued weak economic news to weigh on the equity markets in **Still Dark**. There is further follow up as well on our view that higher food prices are more than a passing nuisance for developed economies, and **Fiddler's Notion** revisits the implications for sourcing of strategic resources.

Toxic Trichet

The degree to which the equities have stabilized is indeed welcome. As noted previous, even the most successful traders we know do not relish the idea of being rich in the midst of a general depression; and neither do we. So, thank goodness once again that through the pressure applied by 'facts on the ground' the additional bit of support to address the US housing problem is finally in place as the Congressional at-risk borrower support. That was jammed down the throats of the US administration and the Fed by the need to get the GSE reform measures and funding that were (cleverly) part of the same bill passed (Please see the previous topical discussion of the **Malleable Mind Frame Minuet** from mid-July for the full review.)

However, as noted previous, that does not necessarily neither means the economy recovers in a heartbeat, nor that the equity markets go back to a cheery bubble that brings joy to all. Quite the contrary, the secondary effects of the combined inflation pressures and credit crunch are just about to kick into gear, with depressing effect on the economy and a restraining influence on whatever basing tendencies the equity markets might want to exhibit.

While quite a few folks are once again talking about the potential for immediate economic improvement, there is more likely a very good chance the any basing of economy and markets will take some time. While the Congressional at-risk borrower relief does lay the foundation to address the worst personal and systemic aspects of the US housing crisis across time, as the late, great comedian George Carlin was fond of noting, "Every silver lining has a dark cloud."

And part of that is continued recalcitrance of central bankers who largely failed to move forcefully enough in the face of continued asset price inflation during the credit bubble (as we noted the Fed should have done as early as late 2006 when the DJIA push above 11,750 (a new all-time high) kindled overly aggressive expectations throughout much the world on the back of assumptions regarding continued US strength.)

Yet, now that those chickens have come home to roost, there seems a rather pernicious tendency to take a hawkish tack at the worst times. Yesterday's return to a more aggressive stance by Monsieur Trichet reminds us of the misguided foray by Mr. Bernanke into a very unusual exposition on the US dollar back into early June that implied a very hawkish stance on the part of the Fed, as the only lever they have (as opposed to the US Treasury normally being more so the shepherd of the buck) is the crude influence of the Federal Funds rate.

We all recall how well that worked out for the US dollar and equity markets. As the US equities were poisoned by what was a very ill-conceived attempt to…

…come to think of it, we were not clear at the time, and remain clueless as to what Mr. Bernanke could have possibly been thinking to venture into an area that most Fed Chairman rightfully avoid like the plague. It was very apparent that in spite of the somewhat sustained relief rally in the wake of the Bear Stearns mid-March capitulation that neither the overall economic outlook nor credit markets (which had indeed already deteriorated again just prior to Mr. Bernanke's ill-advised remarks) were ready for an overtly more hawkish Fed.

We believe that similar conditions are the case right now for Europe, and that is the reason the acknowledgement of weakness yet fixation on inflation has the fixed income markets so well bid. ECB press conference and FOMC statements are attached.

Still Dark

Among the various aspects that weigh on consumer sentiment already burdened by high energy and food price as well as watching the equity in their homes drop every month is the deterioration of the job market throughout this year. And that still maintains in spite of last week's 'somewhat better than expected US Employment report that showed a loss of ***only*** 51,000 jobs instead of the 65,000-75,000 job losses that had been expected.

Yet, that is hardly very encouraging in light of the more recent 'facts on the ground." Those include more problems not only with jobs, yet in other areas as well. The first of those this week was the Challenger Job Cuts report for July. As reported by Bloomberg.com (see attached), "Job cuts announced by U.S. employers soared last month,… …increased to 103,312…, up 141 percent from 42,897 in July 2007,…" However, that does not even take into account that instead of a reversal of last week's US Weekly Initial Jobless Claims from the 448,000 that some considered a 'blip', those actually increased this week to 455,000 new claims.

All of which compounds the availability and desire to extend credit for any US home purchases, another negative indication of which surfaced this week in a most sensitive area: wholly worse than expected earnings and outlook from US GSE's FHLMC first, followed by FNMA this morning.

In spite of the passage of the reform legislation noted previous, there are still major issues regarding their public/private status that will compound any of the further US housing weakness they acknowledge is most likely to occur into late this year and possibly even early 2009.

For one thing, there is a question of the extensive and now explicit guarantees provided by the American taxpayer. Given that, the reduction of the FNMA dividend to preserve capital looks more than a bit specious if the administration's free market approach is real. Why in the world are organizations that are being guaranteed funding in extremis by the taxpayers still paying out anything at all during a phase where they allow there will be further extensive draws on the capital they so desperately need to preserve?

Of course, the answer (like it or not) is that unless they maintain some attraction for equity holders, it will be impossible to maintain their equity value at a time when there needs to be some rationale for raising still more of it other than from the public purse. In other words, it is a lesser of evils to maintain organizations so intrinsic to the health of the US housing market while the latter stabilizes. Fair enough; especially in light of the housing outlook remaining very weak, with foreclosures falsely buoying the overall stats (attached NAR assessment.)

Yet, the other signs of that continued weakness from the initial failures of US housing continue to take on a life of their own in the overall economies. The attached Financial Times' articles note that weak sister Japan is actually back to contraction, and that corporate debt defaults "could hit 10%." What is incredible about that last article is the 'shock' headline is noted as being predicated upon the US sinking into a protracted recession. Yet, the article also notes that the "…Moody's default rate hit 10.4 per cent in 2002 and the all-time peak was 11.9 per cent in 1991." Does anyone actually believe this downturn will be any milder than 2001-2002? And why wouldn't a real estate crunch mimic 1991?

The Fiddler's Notion SM

The Fiddler on the Roof is part of eastern European folklore. His essence was beautifully captured in the late nineteenth century book by Sholem Aleichem, *Tevye the Dairyman*. Yet, the popular name taken by the musical production is based on the quasi-cubist painting by Marc Chagall. 'The Fiddler' is a metaphor for survival in an uncertain world that is very apt for capital markets participants at all times; especially during the more volatile, erratic phases. As luck would have it, about ten years ago I came across a unique, purple palette print of him. My wife was extremely hesitant to even allow the green-faced man in the house. He ended up on my office wall. I now realize this is just as it was meant to be, as he looks over my shoulder in the rear view mirror on my computer monitor. The Fiddler's Notion SM is devoted to observations on risk that may not correlate with some of the typically market trend oriented factors in our other analysis. It is fitting that one involved in such a risky pursuit is looking over my shoulder. Whether or not you like to think about it, he is likely looking over yours as well. So welcome up to the rooftops, where you can share the Fiddler's perspective.

Sourcing Strategic Resources

This is a direct follow up on the previous Fiddler's Notion discussion of the high food and energy price implications for the developed world's **Rare Metal Sources**. Back at that time we noted the degree to which the US using feed corn (that is not even a very high energy content feeder stock for ethanol production) as fuel might be poorly received in places where food costs represent a much higher percentage of living costs.

The negative from a geopolitical standpoint is the way it is perceived that Americans are happy to save a few bucks filling up the gas guzzler on the backs of the world's poor, who spend so much more of their annual income on food. As noted at the time, some of the most important strategic metals the developed world uses in their advanced technology come from some of the poorest countries; or in other cases, from the not so very stable developing world.

As we noted two weeks ago, the scary part is the degree to which the very ways in which some of the solutions to achieving more efficient fuel usage are tied into rare metals. We suggested consideration of how the poor of the Congo or South Africa view the higher food prices (that are soon set to escalate), and what that might mean if social unrest is the ultimate cost of the ethanol benefits. Well, the fallout from all that is occurring right on schedule.

Financial Times' articles noted problems. New African oil producer Mauritania has just had a military coup. Which is ironic in the wake of "…the return to democratic rule last year, hoping that it marked the start of a new phase of pluralism in the country following a bloodless coup that toppled the former president, Maaouya Ould Sid'Ahmed Taya, in 2005."

Events in far more established yet still youthful democracy South Africa are more troubling, given its geopolitical influence on the rest of the southern part of the continent and more prominent role as a source of strategic metals. As the attached article notes, "Cosatu, the trade union federation that called the strike, is demanding government action to lower prices and has attacked steep rises in interest rates." In each case the lack of address of rising food and energy prices are very prominent.

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

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