Rohr Report

TrendView

GENERAL UPDATE - II (follow up on Tuesday): FOREX/FIXED INCOME

Wednesday, March 24, 2010 (14:00 CDT; 15:00 EDT; 19:00 GMT)

Key Views

▪ **EU leaders trying to downplay Greece dissension now stuck with Portugal downgrade. While the most obvious impact is in foreign exchange that has seen the euro drop to new recent lows against the US dollar, there has been pointed fixed income reaction as well.** The extended importance of all of this relates back to broader issues of global imbalances, and self-serving policies by some significant surplus economies. Yet, a short-term view of immediate market influences reinforces how much things remain much the same as noted in yesterday's *TrendView* **GENERAL UPDATE**. To wit, "However much European powers-that-be would like us to believe Thursday's EU Summit is not about the Greek sovereign debt issue, that stubborn irritant for financial markets and especially the euro currency remains too prominent to avoid at such a high profile get-together. That is especially the case in light of the rest of the group now ganging up on Germany to secure more overt support which it has been hesitant to provide." How much German Chancellor Merkel's victory (which may end up being very Pyrrhic) in convincing the rest of the EU to deny greater direct aid to Greece was a factor in the downgrade of Portugal's sovereign debt is an imponderable. What we do know is that the latter has been a key factor in pointing out the problems in Europe, and re-invigorating all of the sovereign debt concerns that had temporarily been in abeyance. And as important as it is to revisit those major themes, a brief word on specific technical implications we will review at length below (including observations and projections on both the previously strong commodity currencies as well as the weak sisters euro and British pound) is more important right now; especially the euro.

▪ **In the first instance, it is very important to understand that weakness in EUR/USD below the mid-February and early-March multiple tests of the 1.3450 area only neared the real major support at 1.3400. As such, it is very important not only whether the Euro finishes below those previous lows but by what degree, also especially regarding the 1.3250 area.** However bad **EUR/USD** may look below 1.3400 support, it will be interesting to see whether it finishes the week below that major level, and the interim support in the 1.3250 area to confirm a significant breakdown. Technical areas are often a matter of contingencies which point toward the decree of an ensuing trend extension. And the dilemma for any of the those who are still hopeful on Europe or attempting to be bearish on the US dollar is that below 1.3250 the next support for the euro is not until the 1.3000-1.2900 range. And in the scheme of things that is also more so an interim level (albeit an important one) on the way toward a retest of the more major historic 1.2500-1.2400 congestion (with a Tolerance to extreme December 2008 trading low at 1.2329.) And as is typical for significant technical signals, that might sound far-fetched to casual observers. However, within a very unstable fundamental context the worst aspects of EUR/USD daily MACD turning DOWN (with weekly already very much so), and weekly and daily oscillators failing below significant thresholds, the projections at 1.3000-1.2900 and even the 1.2500-1.2400 area are not necessarily extreme. Possibly somewhat scary; but not extreme.

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▪ **Even though those re-invigorated sovereign debt concerns are now weighing on all government bond markets, the more major ones will likely still be okay in spite of the June T-note (balanced trend between strong and weak sisters) failing once again from below the lead contract 117-16/-10 area Negated DOWN Break to the mid 116-00 area.** However, as noted previous, even if it were to weaken all the way to 116-00/115-16 area (that it missed testing on weakness after the very strong US Retail Sales), that would only be a retest of its own Negated DOWN Break and other significant underlying support back near the lead contract lows seen at the end of last year. Similar considerations are at work in both the strong sister **June Bund** and weaker sister **June Gilt**; albeit with the latter threatening to slip back below its recent 115.00 area UP Break. And on balance the fixed income activity (including the short money forwards as well) remains very much consistent with our extended observations in yesterday's ***TrendView*** **GENERAL UPDATE (http://bit.ly/btHxbn.)** On balance we still expect them to hold and recover, especially if the equities are topping out overall. In fact, the activity in the previously strong commodity currencies leaves us with some questions (already noted at length in many previous discussions) over whether the general context of the global economy is indeed supportive of the very optimistic expectation in some quarters? Which in turn leads back to the same question we had yesterday regarding what happens to the other asset classes if equities do indeed go into some sort of broader decline (whether a correction toward February lows or the start of a broader break)? For the specific technical considerations on that we refer you back to yesterday's ***TrendView*** **GENERAL UPDATE**, and now revisit some of those broader fundamental, global imbalances considerations.

▪ **Back in late 2006 we were already quite concerned about unsustainable excesses in developed economies, and especially the way in which those were feeding significant global imbalances. While the crisis which we suspected might be brewing did not hit with full force until mid-late 2008, that was only the major extension of the economic and equity market top which we projected from July 2007, remaining bearish until last March.** Even though that entailed a period where the technical signals remained strong enough in early 2007 that we quickly allowed it was time to "love the bubble", we were wary enough of the broader economic dislocation potential that we were on guard for signals of technical failures such as finally occurred in July of that year. However, what we know about the major cyclical turns is that they go through phases which are significantly too lengthy to be readily digested.

And this is true in part because portfolio managers operate under comparative performance pressure (the much discussed 'herd mentality'), individual investors have a hard time focusing on longer-term economic horizons, and the research departments that serve each of them (or the wealth management community that is directing many individual investors decisions) must serve up analysis consistent with nothing more than a short- to intermediate-term investment and trading perspective. Therefore, when the market enters one of the distended corrections such as the major credit deleveraging, which it is now obvious is continuing across public and private domains, they have a hard time dealing with such a major (possibly decade-long) adjustment that may experience significant multi-year phases.

As we have noted in both our analytic reports and in other forums (see the Opalesque Futures Intelligence articles trilogy on our website at **http://bit.ly/a0NTjl**), the major imbalances that built up into 2007 have not resolved themselves just because there was a credit crisis and equity market meltdown. In fact, quite a few of the drivers for the problems which we (among many others) noted back at that time remain significant barriers to solving those problems through effective long-term rebalancing of trade and current account distortions.

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As we noted back in ***Capital Markets Observer*** **II-48** (Wednesday, December 6, 2006) under the primary article title **“Smooth Rebalancing? …or… The Crash of ’07?”** (available for your full review at **http://bit.ly/bsS29s**), the imbalances that were substantially fed by the chimera of US housing wealth and conspicuous consumption were not only ***not*** going to be easily addressed; they were going to call for significant social and economic adjustments not only by debtors, but on the part of the select number of surplus countries as well. Sound familiar?

To wit (lower half page 2), "Confident views abound on how no one area can derail the overall global economy into next year, in no small measure because of the robust nature of the Asian and Russian growth. However, by comparison those economies are not the sort of demand drivers that can replace weakness in the US if it is combined with the other major developed economies. Quite a few observers that include governments, central banks and NGOs as well as market participants are concerned about the impact if the risk factors prove more unwieldy than they are hoping. In any analysis of this type there is an edge beyond which the situation takes on a psychology of its own that is hard to reverse: the proverbial 'tipping point.'

"As present international economies have domestic and linked sensitive areas that are subject to very active adjustment, the combined effect of how these unfold becomes even more important than the impact on any one economy. Chaos Theory has long postulated that overt dysfunction or even perceived failures in combination across different economies has been a key component of previous economic crises. Considering all of the major economic readjustments in process, this is not a case of a lone butterfly in the Sea of Japan providing the ‘tipping’ air current that ripples out into a major storm front in the Great Plains; there are plenty of elephants bouncing off of each other in the current jungle that allow for some major damage at the watering hole if a couple of them trigger a bit of mass hysteria.

"The largest acknowledged risks are global current account and currency reserve imbalances, and how their rebalancing plays out is critical; will the adjustments be very smooth or radical?"

And while concerns that were raised over three years ago would hopefully seem a rather dated view in light of the keen awareness of both the global financial community and governments on those issues, not much is changed. In some cases overtly mercantilist tendencies have been criticized by the offenders close compatriots. That was the case as recently as two weeks ago, when French Finance Minister Christine Lagarde launched into a scathing criticism of the way in which Germany was encouraging policies that would maintain its significant trade surplus via weak domestic demand (as reported by the Financial Times **http://bit.ly/9Wafku**.)

That might not have been so bad when general global economic tendencies were more upbeat. However, it is no secret that with the debtor nations attempting to rebalance the books that is not at all helpful. And, of course, they are joined by the other substantial mercantilist offender in the Far East, namely China. Certainly one must have some sympathy for the Chinese as they attempt to exercise what is not just a successful commercial regime, yet rather more so than other surplus nations are hard-pressed to continue rapid development in such a radical transformation of their previous politico-economic culture. However, even though that may appear to be a necessity from their perspective, as the Editor at the Financial Times recently noted (**http://bit.ly/cvZH3U**) this combined form of a global 'beggar-thy-neighbor' approach is most likely to lead to a more dramatic global recession (as an extension of what is occurring in most real economies versus the equity markets) as the debtor nations find it impossible to effectively rebalance. It will be the natural result of lower economic turnover and higher taxes.

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We do not relish the role of equity market Cassandra, especially in light of how well the central banks' risk asset reflation effort has worked to improve the markets. Indeed, that has succeeded to a degree which has even astounded most of the equity market bulls. Yet, as noted above, these intermediate-term phases of major cyclical adjustments tend to work out on a multi-year basis that is hard for most public investors (and even quite a few among the professional asset management class) to effectively manage. Lest anyone forget, the equity market crash in 1987 and subsequent real estate market weakness did not filter through into a pronounced general economic recession until 1990-1992. While the current major cyclical deleveraging is a completely different beast, if anything it is far more pernicious and likely to have a secondary general economic impact much as we saw then.

And that is not just a seat-of-the-pants guess in light of the continued weakness of US housing that was amply reinforced by the much worse than expected data released in the past couple of days on both Existing Home Sales and New Home Sales for February. Whereas the previous perception was that the extensive number of foreclosures included in Existing Home Sales was cannibalizing a certain number of New Home Sales, with both weak last month there is little doubt that this area is still struggling. And that is in spite of relatively attractive mortgage rates; with slippage to lower rates than back in February not helping the last two weeks' applications.

The received wisdom from informed parties in the real estate business is unless an expected secondary surge in home purchases begins soon to counter the very real continued increase in foreclosures, there will be even more significant pressure on prices once again. Of course, that also puts us right back into considerations of how the banks that had so diligently bolstered their balance sheets are going to fare if there is another significant US home price slide. All of the enlightened current efforts at principal reduction and other forms of owner assistance can only succeed if prices are stabilized, and the economy is firm enough to encourage employment. Otherwise, in addition to the immediate pressure on balance sheets from those lower asset prices, the long-hidden issue of the mortgage-backed securities problem will likely resurface.

So even though current weakness in the government bond market is not driven by any fears of inflation (and therefore may be stemmed into technical supports), it is an overt driver of further US housing weakness. The US is unique in mortgage rates linked to long-term government bond yields, so that also remains important for general global (as the central bankers like to say) "final demand." That is only the very natural conclusion which flows from previous observations on the degree to which surplus countries refuse to stimulate domestic demand. Evidently they missed the memo on the lack of ability of the hugely indebted (as in federal, state, municipality and individual) US being unable to continue to pick up the tab for the global party.

While once again not wishing to take on the role of crazy Cassandra, those who either do not recall or were not involved in the markets back in the mid-1980s may not be aware at this juncture that a significant portion of that dislocation in the equities sense of well-being was due to a contentious debate between Germany and the US over the deutschemark exchange-rate and... the degree to which it was assisting in running a mercantilist regime. Not necessarily something which is a meaningful analog for the current situation, where central banks are still primed to buffer any overt crisis; yet interesting food for thought on the fact that these sorts of problems can escalate at times, and backlash years later in the real economy. Especially now that we have a dual Chinese-German aspect, it points toward a compounding of the negative psychology if any greater problems come to light among the debtor nations that the successful surplus economies are unwilling to address with some meaningful respective form of largess (i.e. currency revaluation or closely related domestic economic stimulation.) We shall see.

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▪ **With all of that now fully articulated, it seems time to return to technical considerations of the foreign exchange market. What is most interesting in light of the euro leading the way down is the relative weakness of the previously very resilient commodity currencies.** While the **EUR/USD** certainly looks bad below 1.3400 support, with the equities still holding up fairly well above January highs in the upside leaders it is rather interesting that this sort of anticipation of continued economic strength is not being reflected in the continued strength as well of the Canadian dollar and Australian dollar against their US counterpart. Of course, it may just be a matter of the US dollar attracting such heavy flows out of Europe and to a lesser degree the UK (due to Mr. Darling's clever bit of budget adjustment today) that it is temporarily weighing on those otherwise strong sisters.

That is just one more good reason to remain on the path we suggested recently, and watch the technical activity for signs of the markets' own ideas of what they think of these developments. In other words, it is likely another one of these major crosscurrent imponderables whether the weakness of commodity currencies is indeed just so much overwhelming US dollar inflow, or a sign that the equities are out of step by trading in a manner which seems to point to continued economic strength that may not materialize. If the latter is the case, it must of course soon be reinforced by some sort of failure that takes the **June S&P 500 future** below the initial 1,147 support which it so readily held on Monday. In fact, a failure to back below 1,142 and the likely more trend-decisive 1,134 support are necessary to indicate the equities are actually reversing their very impressive recent upward trend. If that should occur, it would be the sort of thing that buffers the current weakness in govvies, and will likely drive even greater weakness in the euro and commodity currencies as well as the **Gold** market (see yesterday's analysis of that for the key lower technical levels below the 1,100-1,090 range.)

As far as the specific projections for the currencies, in addition to that immediate **EUR/USD** resistance back in the 1.3400 area extending to the 1.3450 congestion, the previous interim support in the 1.3550 area is now a fresh DOWN Break with a Tolerance to 1.3600 area (the higher of which also represents key moving average and trend resistance over the near term.) Of course, even if the market should avoid melting down below 1.3254 and then swing down to the 1.3000-1.2900 range (or even lower) in the near term, any recovery back above the 1.3450 area might still only be part of attempting to form a broader bottom. And that would still likely be very much constrained by the now prominent resistance where we have been very skeptical of the market of late in the 1.3750-1.3850 range. It is important to recall that this is not only a major historic congestion, but also a significant major Fibonacci retracement confluence. And now we can add to that effect that weekly MA 13 will be in that area over the next several weeks.

The other weak sister of interest to most observers due to its attendant sovereign debt concerns is of course British pound. Looking at the most salient aspect, it is interesting that in comparison with a truly demoralized euro it has not fared so badly; still at risk, but on the cusp. In the event, **GBP/USD** is only now getting back down to the truly critical support it managed to defend on previous selloffs early this month. As we've noted regarding many previous technical situations, much emphasis is often put on the 'Big Penny'; the major round numbers that attract so much psychological concern. Yet, as is often the case, while 1.5000 is indeed some historic GBP/USD congestion, it has more so than not been the case that the market has churned around it than treated it as an overt signal level that can be relied upon. The more critical Tolerance below it has consistently been 1.4850; and that is amply reinforced in this phase due to it also being the Fibonacci 0.618 retracement of the entire January-August 2009 rally. Much below that interim support is 1.4400, with major support not until the 1.4000 area and below. Much as in the **EUR/USD**, this is all very consistent with historic oscillator tendencies.

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With those two dispatched, it's time to consider what various influences might be weighing on the previously strong commodity currencies as well; from strong flows into the US dollar to the degree to which equity markets are gradually deteriorating during the day (even if the latter would seem to be driven by the weakness of government bond markets that we highlighted was a potential problem in the discussion above.) Rather than worry about whether there is indeed any other structural economic driver for weakness in those commodity currencies (such as any weakness in China that might be behind the Australian dollar underperforming the Canadian dollar of late), we are going to keep this strictly technical as well.

The Australian dollar had been the hands-down leader on the way up late last year, and has experienced another significant rally from its .8578 trading low engendered by the equity market weakness back into early February. While that rally has managed to carry **AUD/USD** back above very heavy congestion and moving average trend resistance in the .9000 area, the .9135 UP Break (out of its overall downward channel since last November's high) two weeks ago has not fared very well; stalling repeatedly at no better than the nearby .9200-50 next congestion resistance. This is often a sign that the latest signal is suspect, and it has now indeed fallen back below .9135 for what could be a Negation of the UP Break.

While it would need to drop back below the .9000 area to really look shabby once again, it is most interesting that it had failed to push its weekly MACD back into positive ground at all on this recent rally. That lack of confirmation from trend signals is a significant indication in many instances of a major trend reversal in progress. And given the even greater strength of the Canadian dollar against the US dollar of late, that tendency is even more telling on that particular relationship. While the **USD/CAD** weekly MACD did indeed drift modestly into a DOWN signal on the second consecutive weekly Close back below last October's 1.0205 trading low, the fact that it is now back above that low puts the market in a critical state.

As the market Broke DOWN out of its five-month Symmetrical Triangle below the 1.0235 level just two weeks ago, a significant improvement back above near-term congestion in the 1.0300 area would bring the efficacy of that DOWN Break out into some question. Much like with the Australian dollar, that was a big enough signal with little enough follow-through that it might speak of a broader trend reversal, even though at a minimum USD/CAD would likely need to get back above the more major congestion and moving average resistance in the 1.0400 area to fully confirm any reversal of the US dollar down trend against the current strong sister (also very similar to the indication that AUD/USD would need to fail the .9000 area once again.)

▪ With the background and technical perspective for those major relationships already fully articulated, the rest looks fairly clearly technical from here.

USD INDEX: RES: .8200-50; **.8380-.8420; .8600; .8700 SUPP: .8150;** .8075; .8000; **.7950**

USD/JPY: RES: 92.35; **93.00;** 94.00; **95.00; 96.50 SUPP: 91.80; 91.00-90.70; 89.75;** 89.00

USD/CHF: RES: 1.0800; **1.0900; 1.1000;** 1.1150 **SUPP:** 1.0650; **1.0500;** 1.0350; **1.0250-00**

We hope you find this helpful.

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