Our Guides - the **Technical Trader's Guide** and the **Macro Trader's Guide** both deal with these and many other markets in much more detail over multiple time- frames. **Key Trades Bulletins** subscribers receive a detailed report on every trade we enter for our Key Trades Portfolio. More details about all these products: [CLICK HERE]

Market Update 16th December 2010

The Dollar out-muscles the Euro but both are in trouble

The Technical Trader's view:

MONTHLY CHART

The Dollar's strength has been clear against the embattled Euro since the beginning of November.

The pull-back through the ***triple*** support of

(1) the rising diagonal from June 2010 and

(2) the horizontal support from the Prior High at 1.3334 and

(3) the Fibonacci retracement support

is not yet quite certain on the weekly chart.

But look closer…

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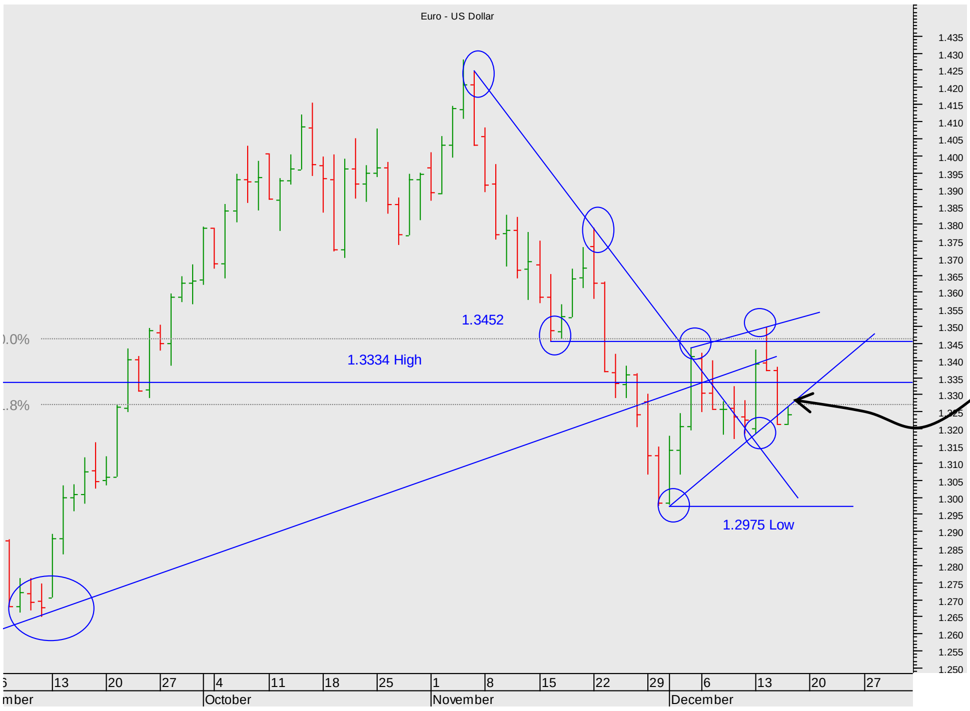


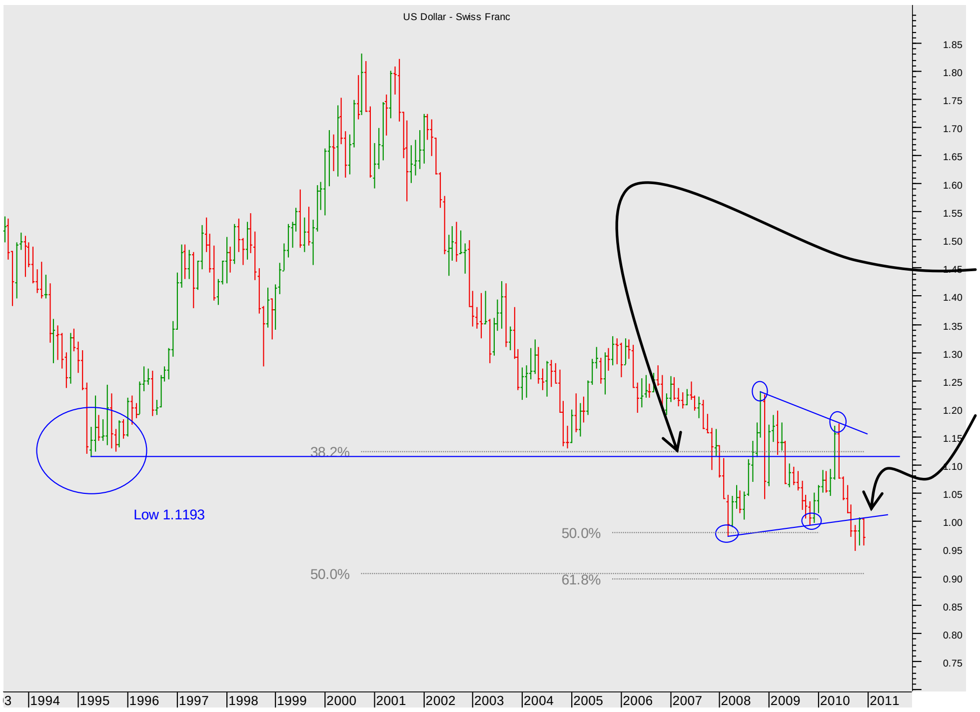
DAILY CHART

The pull back certainly paused at the 1.3334 level.

But that pause has created an additional continuation pattern - a Bear rising wedge – which has completed.

In short, the bear Euro, bull Dollar trend <u>is intact and looks like continuing</u>.

But the Dollar Euro is misleading: <u>both</u> look vulnerable against other currencies. Take the Dollar Swiss: first the long-term context



MONTHLY CHART

The breakdown of the Dollar against the Swiss has been a long time in the making.

But the push beneath the Prior Pivotal Low at 1.1193, in conjunction with the completion of a continuation Triangle sets up the Dollar bears nicely.

And not surprisingly the Euro is under <u>even worse pressure</u> against the Swiss:

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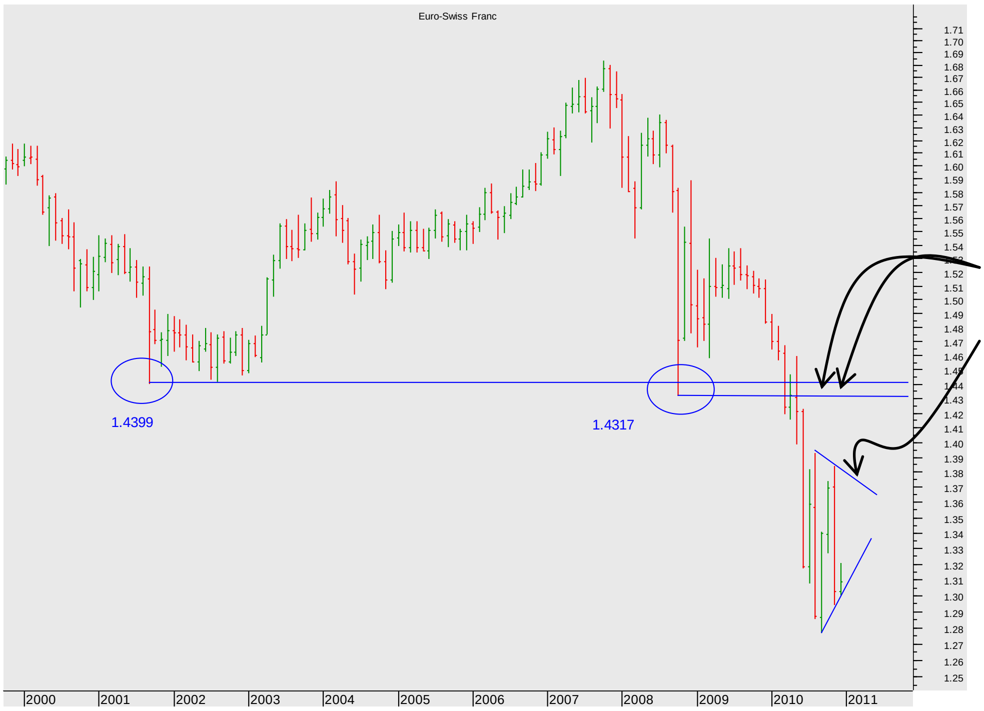

MONTHLY CHART

This is clearly a more advanced bear scenario.

The breakdown through the Prior Lows, and the emergence of a possible Bear continuation Triangle (albeit not completed) far beneath the 1.4399-1.4317 band.

The Dollar may be outperforming the Euro, but they are both in trouble elsewhere.

The Macro Trader's view:

The Dollar currently presents an interesting case because of the following macroeconomic scenario:

- The Fed remains committed to QE2 since it still judges the economy is not growing fast enough to generate sufficient new jobs,
- Inflation remains low and the Fed is concerned it could go lower,
- Obama has performed a Tax cut U turn which has now won Senate approval, and
- Data is mixed.

Does this argue for Dollar strength or weakness? Currently we are seeing both strength and weakness depending on which major currency one measures the Dollar against.

The Dollar/Euro rate is testimony to Dollar strength. The Euro remains under pressure as the Euro zone Sovereign Debt crisis remains unresolved. Ireland has voted in favour of the EU/IMF rescue deal, but questions remain unanswered about other troubled Euro zone economies.

The rating agency Moody's has placed Spain on negative watch, as it judges a bail out is unlikely; the Spanish economy is too big for the others to support, and in any event the German Government seems to have little stomach for funding any more costly rescues, which has led German opposition MP's to claim Merkel is not pro-European.

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This lack of agreement between Euro zone member governments serves to further undermine the Euro and highlight the enormity of the task in front of them, since the most obvious answer; issuing Euro Zone debt in place of individual Sovereign Euro denominated debt has been ruled out by the Germans.

But against the Swiss Franc the Dollar looks less sure-footed. The trend has been Dollar bearish over a long period and while traders may prefer the Dollar to the Euro, the Swiss Franc has the edge over the Dollar. When Bernanke announced QE2 there was criticism from several quarters, but most accepted the Fed had to act. The US economic recovery had slowed to a crawl, unemployment wasn't coming down, and already weak inflation was edging uncomfortably close to deflation.

However, last week Obama suddenly changed policy and agreed to support an extension of soon-to-expire Bush tax cuts. His change of stance is purely political; he wanted a 2nd stimulus, but Congress refused and in a couple of weeks a republican controlled House will make it even less likely he would be able to win support for increased spending, so he has taken the only option available; supporting the renewal of the tax cuts. Although not his preferred route, it still pumps money into the economy and is a de facto second stimulus.

Traders are mainly unhappy with what they see as a further substantial erosion of fiscal health as the measure will add at least US$1.0T to the national debt in less than two years. The US debt to GDP ratio was already on course to hit 100% in a few short years, cutting tax without addressing the deficit is Dollar negative.

But before rushing out to sell the Dollar, activity data has started to turn a little stronger. Although the most recent non-farm payroll report was weak, both recent ISM surveys were stronger. More recently the trade deficit sharply narrowed and retail sales beat consensus. And only yesterday industrial production reported a stronger than expected increase. So suddenly data has started to turn Dollar positive. The FOMC met earlier this week and some analysts wondered if they would alter their QE2 policy in the light of the Obama U turn, but they didn't.

We judge the Dollar remains vulnerable against all the other majors with the exception of the Euro. But if the current small improvement in the data accelerated, the Fed might need to review its QE2 policy, only then would we see a stronger Dollar.

Mark Sturdy

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Seven Days Ahead

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