the technical analyst AWARDS 2011 FINALIST

19th April 2012

Market Update:

UPDATE
Technical
Fundamental

Is buying Sterling the best way to register bearishness for the Euro?

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The Euro's vulnerability re-surfaces

UPDATE
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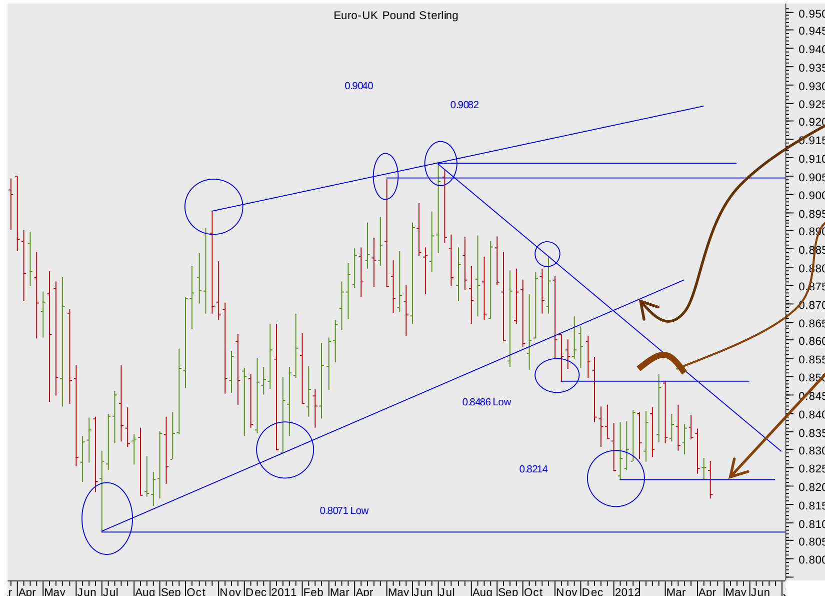
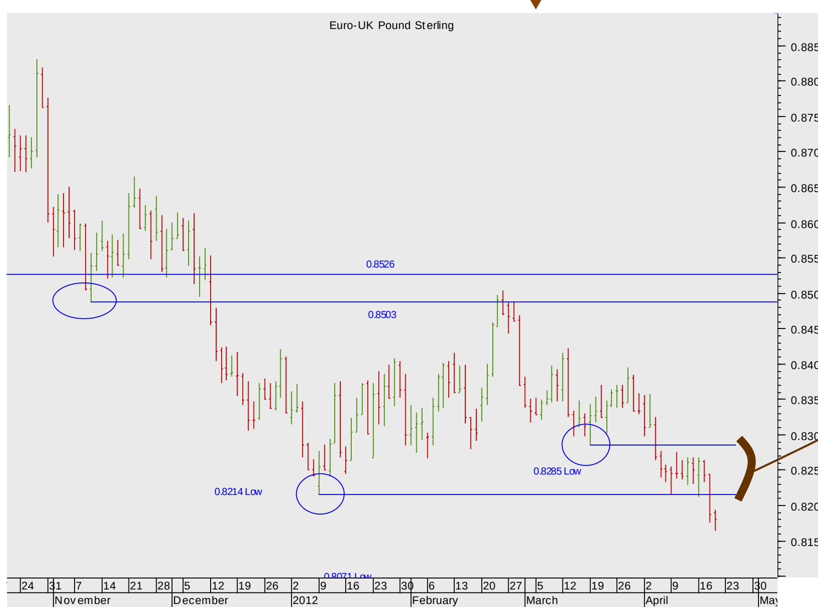


WEEKLY CHART

Note the completion of the bear Rising Wedge that has been driving the bear trend from June 2011.

Prior Lows are acting as good resistance…

and also, the market has now driven down through the 0.8214 Prior Pivotal low.



DAILY CHART

The **market's** failure at the band of resistance 0.85-0.8526 is clear.

After hesitation, the break of 0.8214 now establishes (with 0.8285) powerful resistance above the market and likely to ratchet it on down further still.

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FUNDAMENTALS:

When the financial crisis originally hit, driven by a crisis in US Sub-prime mortgage lending, the Pound suffered a steep correction against the US Dollar and the Euro; that was before the Euro zone Sovereign debt crisis hit.

As the UK government was forced to bail out several high street Banks with tax payer money and the Bank of England swiftly cut rates down to their present level of 0.50%, the Pound slumped.

And although the UK Banking sector is now relatively stable, albeit with state investment, the Pound remained the ugly duckling of the foreign exchange markets even though the Euro zone crisis has been a major event for roughly the last two years.

The main problem for Sterling has been the persistently high inflation rate. Since the crisis hit the Bank of England decided the downside risks to growth far out-weighed the upside risks to inflation and so not only cut official rates virtually to zero, but embarked on a policy of quantative easing which has left the Bank holding about 1/3 of the UK government's stock of debt.

Despite numerous quarterly inflation reports that have forecast a sharp decline in the CPI, the UK's targeted measure of inflation**, the correction failed to materialise**. Indeed CPI recently peeked just above 5.0%.

However, as the economy threatened to slip back into recession this year, after a weak Q4 2011 GDP report, in response to the government's unprecedented austerity drive, the CPI measure did at last begin to correct lower.

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FUNDAMENTALS: CONTINUED

However, that correction may now have come to a halt as **the CPI report released on Tuesday of this week showed an unexpected rise to 3.5%, still way above the official target of 2.0%**, when a decline was expected.

The next day the Bank of England released the MPC minutes for the meeting held earlier this month and despite fears of a possible technical recession, policy makers had turned slightly more hawkish.

The most consistently dovish member of the committee; Adam Posen, who had over recent months, consistently voted for expanding the QE program, even beyond the current parameters, voted for no change.

Other policy members also registered their concern that inflation may not fall as far as previously thought even though some thought a technical recession was still possible despite several key PMI surveys strengthening over recent months.

The impact on Sterling was almost immediate as it strengthened against both the Dollar and Euro, **but our focus is on how Sterling could rally against the Euro now that it looks highly unlikely that the Bank will extend its QE/Asset purchase program any further.**

The Euro has until this week held up quite well against the Pound despite the long-running debt crisis which has seen many Euro zone member states implement debilitating austerity measures and although the Pound has strengthen marginally over the period, it is the Bank’s policy focus and persistently high inflation that has prevented a more broad-based recovery.

Now the Bank of England has shifted its stance, **the Pound could at last stage a more serious recovery. The Bank isn’t about to hike rates, but its change of tone shows it is at last becoming less relaxed about inflation and that is Sterling positive.**

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SEVEN DAYS AHEAD
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