the technical analyst AWARDS 2011 FINALIST

20th October 2016

Market Update:

Has Sterling found a new equilibrium?

UPDATE
Technical
Fundamental

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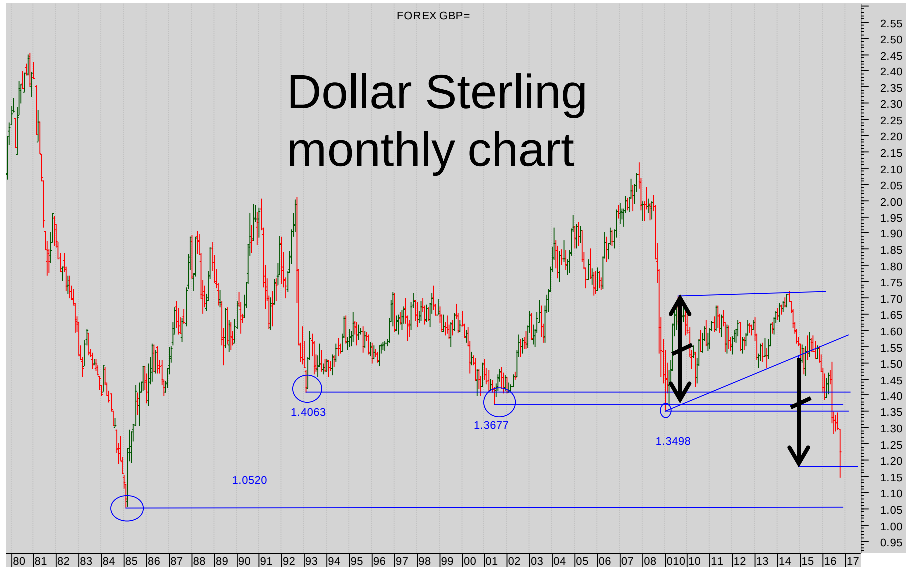
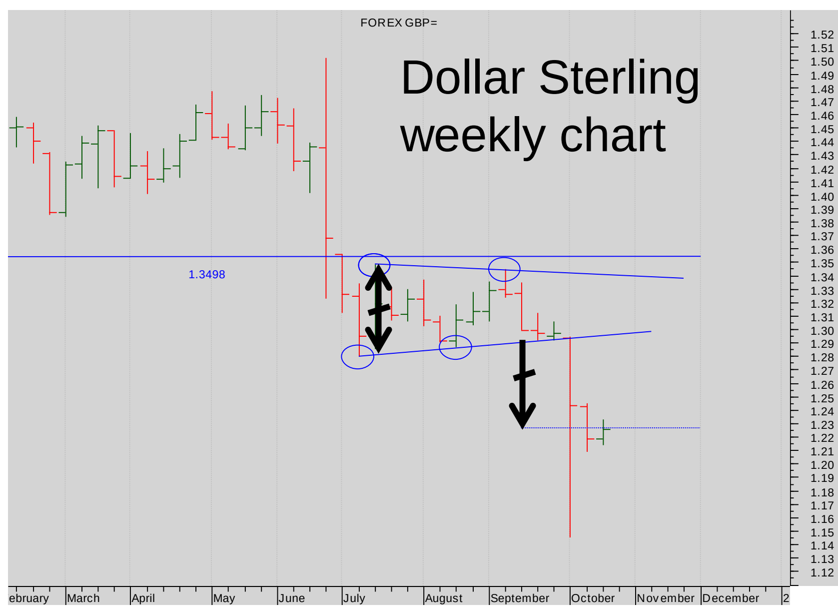


MONTHLY CHART

The long-term context of the market reveals a succession of lows above the market current level that should act as powerful resistance to any rally towards 1.35.

The bear influence of the bear continuation Triangle is measured by extending the depth of the triangle beneath the point of breakout.

1.18 was the minimum target for the Triangle and that target has been met.



WEEKLY CHART

The weekly chart reveals another smaller continuation Triangle that was not clear on the monthly chart. That had a minimum target of 1.2250.

So two bear Triangles contributed to the violence of the down move of the 7th October 'Flash crash'.

But at the same time the targets of both Triangles have been met.

Meeting those targets doesn't mean the end of the bear move, nor of volatility, but a lack of clear direction is likely for a period at least. A temporary equilibrium.

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Fundamental

FUNDAMENTALS:

On the 24th June, the day after the UK voted to leave the EU, the Pound suffered a steep sell-off, falling from a high of around 1.50 to a low on the day of 1.3227. Moving through the summer months, it settled into a trading range of 1.34 - 1.27 as traders sought to make sense of what the UK leaving the EU would mean in practical terms for the wider economy and the financial centre of the City of London.

The market had been wrong-footed by the result.

A period of relative calm thereafter was ruptured when the new Prime minister delivered her key note speech to the Conservative party conference in early October. The tone of it led many to believe the UK is heading for a so-called ‘hard BREXIT’, meaning the UK would leave the single market and customs union as she sought to forge a new bespoke trading arrangement with the remaining EU27.

As a result the Pound suffered a shock sharp sell-off, falling to its lowest level in over 31 years. Traders were reacting to the reality of what a hard BREXIT could mean not just for the wider economy, but to the financial district of the City.

The market had been wrong-footed again. Which is odd since both sides of the referendum had always argued that leaving the EU meant leaving the single market. And a key theme of the referendum campaign was the UK regaining full control of her boarders and levels of immigration.

The impact of the speech hit harder due to remarks made by the French President and the German Chancellor that seemed to ram home the point that there could be no access to the single market without free movement of people.

FUNDAMENTALS: CONTINUED

In recent days the Pound has regained some poise and edged up to around 1.2250, but it is clear that the Pound is now vulnerable to high levels of volatility.

Have we seen the worst of the Pound’s weakness and found a new equilibrium, or can it fall further?

We judge the Pound remains highly vulnerable to the downside. The EU refuses to enter into any preliminary talks with the UK before the formal triggering of Article 50. The UK government, for its part, refuses to disclose what it’s negotiating position is likely to be.

No one knows if the two sides will stick intransigently to their current positions, which for the EU is no freedom of movement, no access to the single market and for the UK is complete control of her borders and law-making.

Clearly some compromise is be likely. The UK is a big importer of EU goods, especially German made cars and runs a huge trade deficit with the EU, but by the same token leaving the EU has exposed the UK’s big Achilles Heel : her trade deficit. The UK has managed to finance the deficit by significant inflows of foreign investment as non-EU firms chose the UK as their gateway to the EU market, if the UK is no longer in the EU single market that direct foreign investment is likely to drop to a degree where the trade deficit could become a very real problem and that in its self will further undermine the Pound.

In summary, in the vacuum that currently exists concerning the arrangement the UK and EU will have when the “BREXIT” is concluded and given the rumour and counter rumour that is likely to fly around, we judge the current level of Sterling represents a limited correction and it will in all probability make new multi year lows.

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SEVEN DAYS AHEAD
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