

Market Trends Event Risk

Alexander Chepurkó, Foreign Exchange Analyst

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Pair	Bias	Objective/Comments	Key Resistance	Key Support
EUR/USD	↓	Higher on short-covering, lack of sellers after downgrades	1.3200	1.3090
USD/JPY	↓	Rally into 200 day moving average sold	78.33	76.33
GBP/USD	↓	Technical picture still damaged after dipping below key support	1.5730	1.5625
AUD/USD	↓	1.0717 on deck to be tested	1.0688	1.0520
USD/CAD	↑	Testing parity, below would likely consolidate at 0.9909	1.0070	1.0000
USD/CHF	↑	USD weakness takes this pair lower	0.9205	0.9126

Headlines

- Market fixated on talks on Greek debt
- Greece needs a deal before March 20 when a bond payment is due, or else suffer a default
- Shorts hit another record at 171,347 on Jan. 24, further increasing the upside risk for Euro
- Equities and commodities lower on risk of Greek debt talk failure

Summary

The risk for disorderly swings in the US Dollar and major currency pairs is extremely elevated on this déjà vu of Greek bailout summits. Today we are awaiting a similar scenario where investors are supposedly required to take a 75% loss in Greek bond holdings.

Instead of ruminating over the many possibilities around the debt talks and the convoluted scenarios that are likely to take place, we would turn your attention to the underlying sentiment of the Euro FX market, where it looks like pain is awaiting both, bulls and bears.

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Key Economic Events

- European Summit in Brussels

The risk for disorderly swings in the US Dollar and major currency pairs is extremely elevated on this déjà vu of Greek bailout summits. The timing is reminiscent of October 27, 2011 when European leaders met to agree on a haircut for Greek bondholders. Today we are awaiting a similar scenario where investors are supposedly required to take a 75% loss in Greek bond holdings.

Athens has already rejected a German proposition to require enhanced EU oversight of Greek finances. The probability of the Portuguese government defaulting now is the second highest in the world after Greece, with the credit default swap market pricing in a 71% chance of default. Portugal's bond yield is over 16% (Figure 1) and reminiscent of the unstoppable Greek tragedy, where the market cut the nation off from being able to borrow at low enough interest rates to avoid defaulting.

Instead of ruminating over the many possibilities around the debt talks and the convoluted scenarios that are likely to take place, we would turn your attention to the underlying sentiment of the Euro FX market, where it looks like pain is awaiting both, bulls and bears. The market has been selling off since the Asian open on skittishness over the EU summit in Brussels that is already underway. In October, the conclusion of the summit spurred a 400 pip rally in Euro before it was retraced in its entirety a couple of days later.

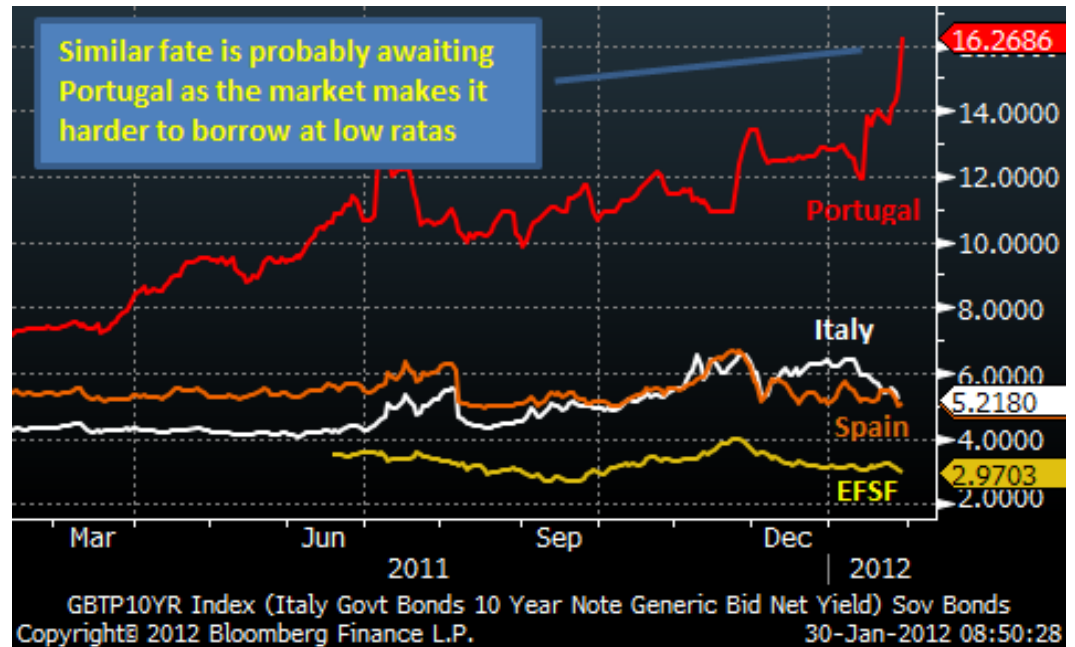


Figure 1: European sovereign bond yields

Source: FX Club Research and Bloomberg

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The age-old saying of “**sell the news and buy the fact**” (or “buy the news and sell the fact”) could be very well playing out before our eyes.

Two things are worth looking at; number one, Friday’s Commitment of Traders report again showed a record short position of 171,347 (up from 160K the week prior). The more Euro goes up, [the bigger the chance of a snap higher](#) as these short-positioned traders are forced to cover.

Number two, we are seeing an increased skew in the options pricings traded for EUR/USD. Traders are starting to price in more volatility relative to the actual volatility that is occurring thus far. Since Euro is headed higher, this is probably indicative of a market that is pricing in the risk of falling. Figure 2 shows what happens when there is a spike in the spread of implied and historical volatility. The market tends to exhaust its current trend and sometimes reverse completely.

Currently we’re seeing a potential spike in the spread developing, which we can interpret as higher prices for the time being, but an ultimate failure of the rally 1 to 3 weeks down the line.

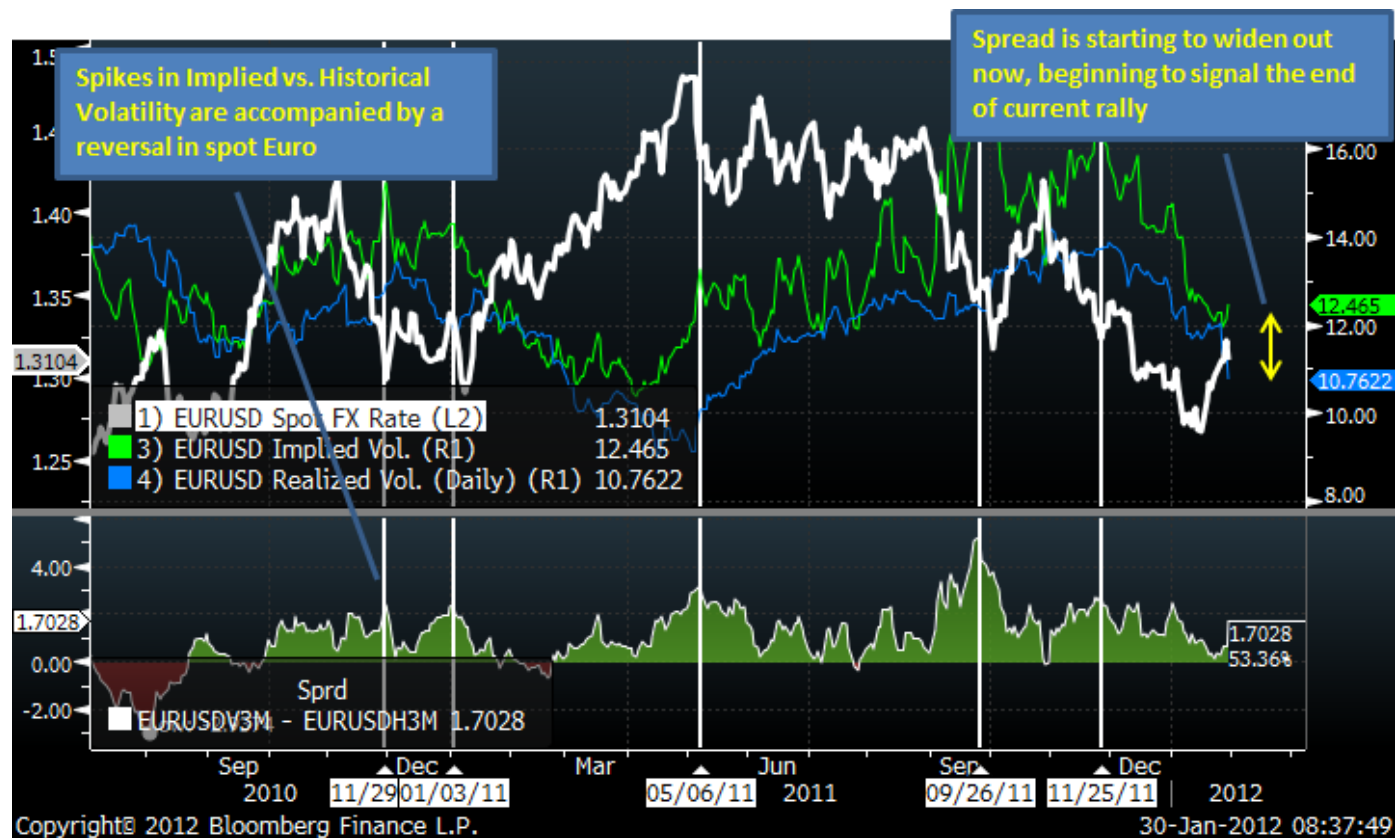


Figure 2: EUR/USD (white) and Implied vs. Historical Volatility Spread (bottom). Vertical lines show trend reversals. Source: FX Club Research and Bloomberg

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