Trade Idea – Foreign Exchange
Promises to plans
13th January 2017

Time for action

- In 2017, the investment landscape will be dominated by the ability of politicians in the US and Europe to deliver on promises of change made last year. Next week, President Elect Trump will be inaugurated as the 45th president of the US and his landmark speech will be scrutinised by market participants for signs of what proposed policy measures will take priority at the start of his four year term. Meanwhile, the European Central Bank (ECB) will meet for the first time in 2017, placing market focus on the EUR/USD exchange rate which has recently rebounded from fifteen year lows. Our view is that in the short term the EUR/USD could tick modestly higher but will face technical resistance and in the longer term risks remain skewed to the downside. A better short term opportunity involving the EUR exists against the GBP, where negative sentiment has pushed the pair to expensive levels and a downward correction could be looming.

Inflation risks

- The USD has lost ground so far this year as US treasury yields have moderated (down approximately 30bps*) and the market pricing of interest rate rises for 2017 has fallen from three to two. The EUR/USD has accordingly risen to around 1.064 (see Figure 1), which is near its 23.6% Fibonacci retracement level*, a resistance established in December last year. With Trump expected to enact considerable fiscal stimulus measures, wage growth at the fastest rate since the recession and climbing energy prices, the risks to inflation are skewed to the upside. Over the next quarter, higher inflation risks have the potential to prompt the US Federal Reserve to pursue a more hawkish interest rate tightening cycle than is currently being expected which could see the EUR/USD fall back again towards the 1.04 level and potentially beyond.

Brexit clarity

- The EUR/GBP has recently climbed as Sterling has shown vulnerability to speculation over whether Brexit will entail an exit from the single market. Theresa May’s recent interview with Sky paid testament to this and highlighted the volatility we could expect from the currency in the coming two and a half months. However, the EUR is not insulated from its own political threats as elections in France, Netherlands and Germany this year raise the risks of a Eurozone break-up. In the near term, we

*All figures quoted are sourced from Bloomberg unless stated otherwise.

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believe the GBP could climb from current levels as negative speculation proves overdone and resilient economic performance continues. This dynamic could see the EUR/GBP fall back to its 50 daily moving average of 0.85, a fall of 2.8%.

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- **USD Base**
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  - ETFS Short GBP Long USD (SGBP)
  - ETFS Long EUR Short USD (LEUR)
  - ETFS Short EUR Long USD (SEUR)

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  - ETFS 3x Short GBP Long EUR (GBE3)
  - ETFS 3x Long GBP Short USD (LGBP3)
  - ETFS 3x Short GBP Long USD (SGBP3)
  - ETFS 3x Long EUR Short USD (LEUR3)
  - ETFS 3x Short EUR Long USD (SEUR3)
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  - ETFS 3x Short EUR Long GBP (GBEU3)

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  - ETFS 5x Short USD Long EUR (USD5)
  - ETFS 5x Long USD Short GBP (USP5)
  - ETFS 5x Short USD Long GBP (PUS5)

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