CitiFX® Technicals – Bulletin

Technical Developments in the Foreign Exchange and Asset Markets

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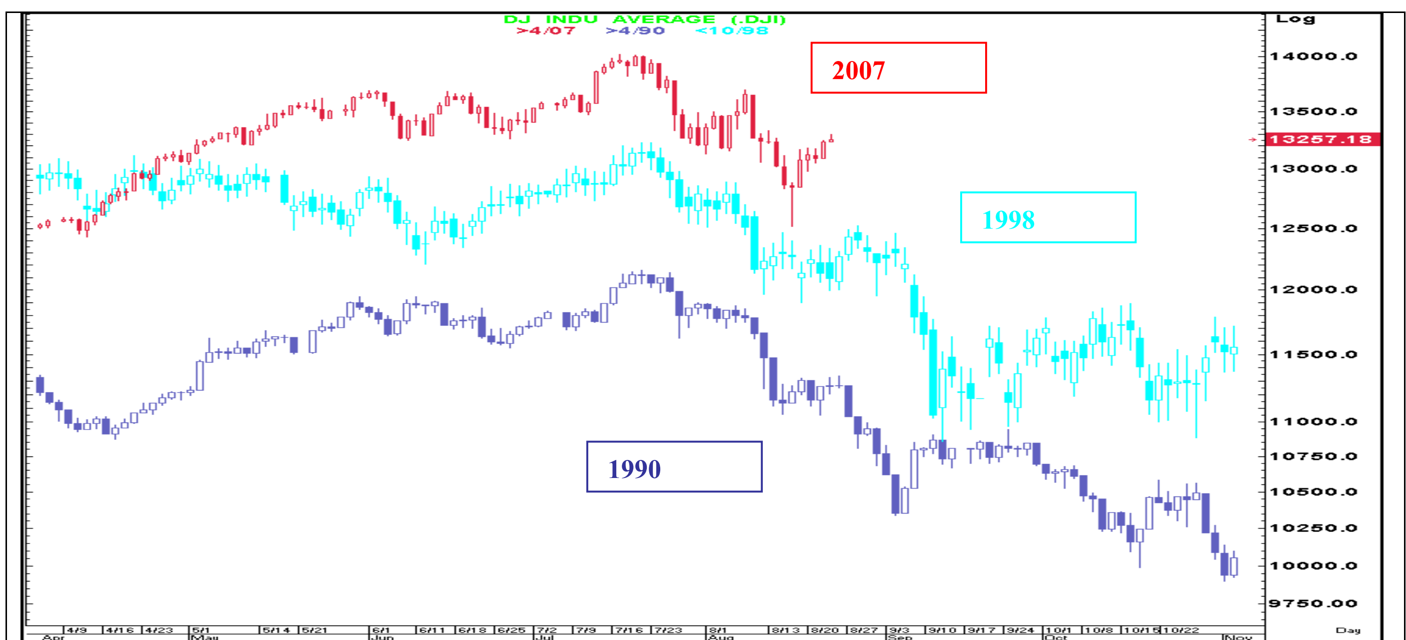
We hold with our freaky chart scenario on DJIA…..BUT

It would be remiss of us not to draw attention to a scenario that is not our base case and that could be a danger
Before you all jump up and down saying here it comes- "the attempt to water down the bearish view with the bullish alternative" that is not what we are looking at. What we are looking at is a scenario (not our base case at this stage) that is worse than our base case.

First let us once again revisit the "freaky chart redux" with 1998 now added into the fray along with 1990 and 2007. This remains our core expectation.



- 1990: The Djia peaks on 17th July 1990 and turns. This is the start of a correction that takes it down 21.8% over 63 trading days over shooting the 200 week moving average by 0.5%
- 1998: The Djia peaks on 17th July 1998 and turns. This is the start of a correction that takes it down 21.6% over 31 trading days
- 2007: The Djia peaks on 17th July 2007 and turns. This is the start of a correction at a time when the 200-week moving average was sitting 21.50% below the peak.
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With the 2 prior occasions averaging 21.7% down over 47 trading days the sweet spot (If this correction goes according to plan) would be to see the DJIA at just below 11,000 on or around 19 Sept 2007 and no later than 11 Oct 2007.

Our base case view has for some time been the 1990 focus as equities got hit in the crossfire of housing and Kuwait while the credit crunch of 1998 also caught equities in the crossfire. As a consequence we believed (and still do) that the Equity move is the sideshow again not the main event.
This obviously differs from 1987 and 2000 when equities were on the centre stage.

If this is the case then there is something quite important that we should focus on. Both in 1990 (On the back of housing, high oil prices, an early summer squeeze higher in long term yields and ultimately Saddam's misguided Kuwait incursion) and in 1998 (On the back of the LTCM credit

crunch and the Russian crisis) the Federal reserve under Alan Greenspan moved quickly with interest rate cuts to diffuse the situation. This gave the Equity market confidence that the FED was "all over it" and ready to do whatever was needed. As a consequence the falls in Equities, although quite deep at 21.8% and 21.6% respectively (High to low moves in the DJIA) were arrested and we were re-testing the highs by early 1991 and late 1998 respectively.

So let us head to our much less desired/favoured scenario……1987

First we will repeat a note below that was sent out on 21 June 2007

Take with a pinch of salt…..BUT ***(21 June 2007 Re-print)**********

- The last 2 years have been very good years for the stock market in an extremely strong bull market that began 5 years ago.
- This has been fuelled by leverage buyouts/merger mania
- Massive amout of money raised by packaging low quality fixed income securities that have high interest rate due to high risk of loss
- Large IPO issuance
- Inflation concerns have become elevated
- We have a new leader at the helm of the Federal reserve.
- USD has been declining amid concerns about the trade and budget deficits
- U.S. long end yields have started to push up sharply again to new high in the move having corrected back for a number of months

A good summation of 2006-2007????

Close but 20 years off

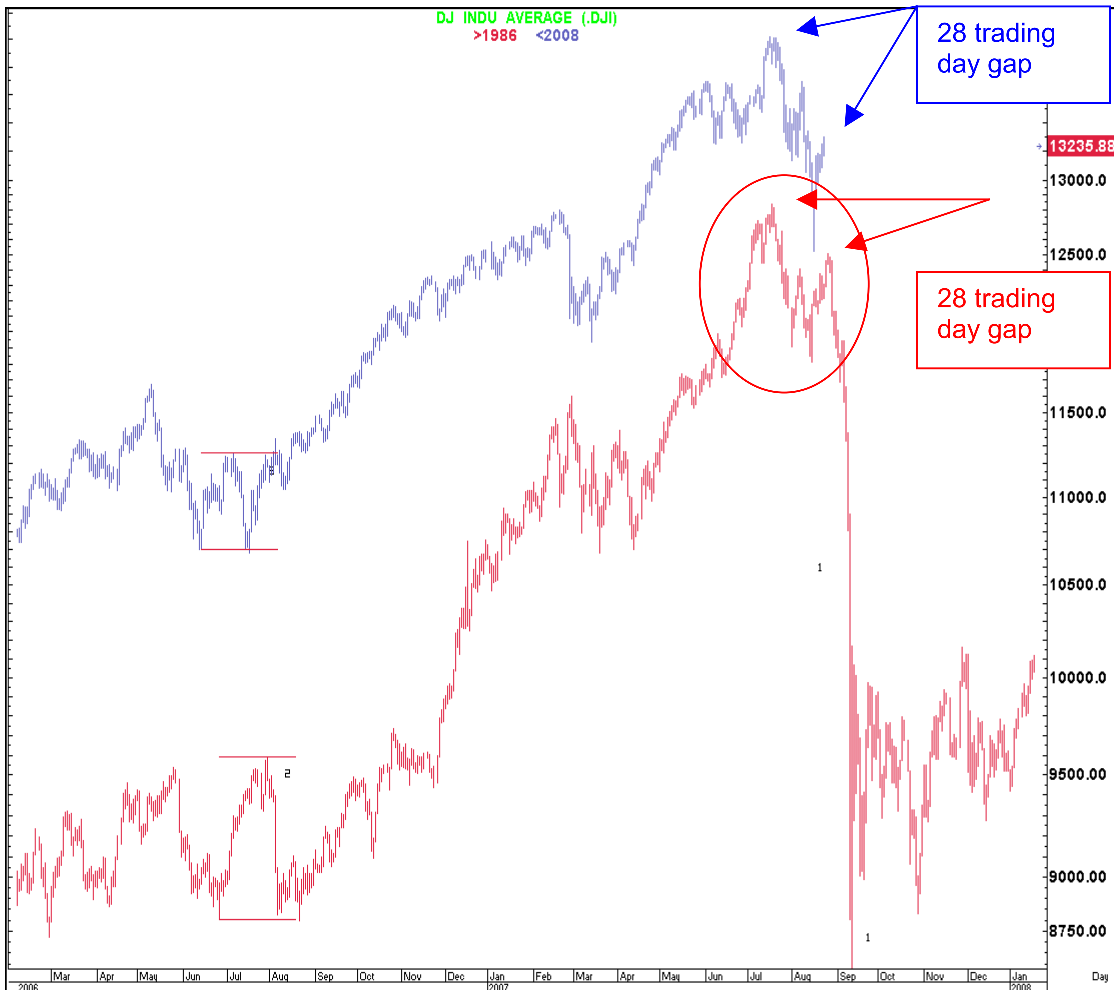
The above refers to 1986-1987

Please see the chart on page following.

Comparison of the price action in the DJIA between August of 1986 until the peak in August 1987 and June of 2006 to the high this month

Now let us look at this chart today

Update of 21 June chart above



- After the initial downturn in 1987 from the 25th August peak the DJIA had a good bounce of 7.1% peaking on 02 October. This was **28 trading days after the** 25th August **peak.**
- After this the real down move began with a 10-trading day down move into Friday October 16th 1987 and on Monday 19th October 1987 the DJIA dropped 22.6% in one day.
- The peak set in this rally, as we know was 17 July 2007 (Just like our favoured scenario of 1990 and also identical to 1998). Today is **28 trading days since that peak** and the rally so far is 6.24% (7.1% would take us to 13,407)

As we have continued noted this is not our base case scenario, but smarter people than us who we respect have articulated concerns about a 1987 dynamic. What therefore would be the concerns we could articulate that this more negative scenario could develop?

- In 1990 we had a domestic housing downturn, higher oil price and external event to deal with(Kuwait) while in 1998 we had a domestic credit issue (LTCM) and the external event of the Russian debt crisis.
- This time we have a potential double whammy with 2 domestic issues- Housing and Credit crunch intertwined together.
- As detailed above 1987 had a new FED who held a firm line on monetary policy and did not capitulate until the market did crash.
- The present FED seems to be trying to give a good repeat of that attitude. Call us cynical but last Friday's move looks to us all the hallmarks of a move to try and avoid a Fed funds cut rather than a precursor to one. If that is the case then there has got to be a real danger that we soon hear some noises to that effect. Given the cuts still priced in to the market that rhetoric if it comes would not be well received.
- On that note another observation. Despite continued rhetoric from the Fed over the course of this year that sub-prime and all associated with it was contained what have we had in recent days? We have heard from Poole and Lacker pretty much the same message. Don't panic …everything is fine (1998/2000 anyone?). In the U.K there is a well known children's storybook character that has the moniker "Where's Wally' and in the U.S. it is "Where's Waldo". Do we need to invent a new one??? Where's

Ben?. If there is one thing in the last few weeks that strikes us more than anything is that at a time when confidence/leadership are key (A la J.P. Morgan) we have not had a peep from Mr. Bernanke. Are we the only ones who think this is amazing????

Bottom line we hold our view that these are trying times and that the worst is not over. We also hold our view that lower yields will be seen in the months ahead on the back of credit, housing, the economy and equities.

We believe that as this develops the Fed **WILL** show leadership, will cut rates as necessary and will ultimately stabilise the situation.

If we are wrong in this assessment then as we have said previously, without the Bernanke PUT we may have to entertain the idea of the Bernanke crash.

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