



June 22, 2009

HIGHLIGHTS

THIS WEEK

Not much on the data front this week...

- **Monday @ 08:30:** After global equity markets bottomed in March, cross-border stock purchases likely picked up the month after at the expense of bond buying. Look for this theme in April's data on **Canadian investment in foreign securities and foreign purchases of Canadian securities**.
- **Tuesday @ 08:30:** **Bank of Canada Governor Carney** will participate in a Washington D.C. conference on "Stable Banks, Stable Finance: The Canadian Experience" along with other Canadian officials. The session ends at 11:00.
- **Thursday @ 08:30:** In April, all of the Labour Force Survey increase in jobs was due to self-employed workers, so the **establishment survey of employment** should show a roughly flat reading. Meantime, there are also signs that wages are cracking amid the back-up in the unemployment rate, and we look for **average weekly earnings** to ebb to a 2% y/y pace from 2.4% in March.

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CANADIAN ECONOMY

Bank of Canada Governor Carney, in a speech and press conference this week, **reiterated the central bank's conditional commitment to keep its policy rate unchanged at 0.25% until June 2010**. Emerging economic "green shoots" have been stoking market speculation that this interval could be shortened. Indeed, this week saw May existing home sales rise for the fourth month in a row, pushing volumes above their year-ago levels for the first time since 2007. Year-on-year average home prices also pushed into positive territory for major markets, after suffering double-digit deflation as recently as January. Elsewhere, the leading indicator dipped only 0.1% in May, the smallest fall in nine months. Even May's CPI readings were higher than expected, running slightly above the BoC's Q2 projections.

However, the policy rate commitment can only achieve its maximum impact, in terms of downward pressure on yields along the entire curve because of arithmetic and attractive carry, if the market believes the commitment will stick. Not surprisingly, Mr. Carney was quick to dismiss the latest CPI reading, as far as having implications for its policy rate commitment. He also reiterated the prior week's message: *"We shouldn't presume that green shoots today guarantee a bumper crop tomorrow"*. Conveniently emphasizing this message the next day, retail sales were reported much weaker than expected (nominally -0.8% m/m in April or -0.6% in real terms... both the worst results so far this year). Although this was an April data point, May/June output metrics are going to sour owing to the Chrysler and GM shutdowns. The market might find it a bit easier to believe the Bank's commitment as these figures are released during the weeks ahead.



TRADE RECOMMENDATION

Generally summer months in the FX market prove to be less volatile and despite the recent market turmoil we do not see a distinct direction for USD/CAD in the short term. However, fundamentally, we believe the USD will weaken based on multiple reasons which will be magnified by the historically large money supply the Fed has recently produced.

To capitalize on this we suggest the following partial barrier double knock out structure:

Buy a 1 year, USD put/CAD call at 1.0000 that knocks out if USD/CAD trades outside the range of 1.0800 to 1.1600 in the next month. The structure will cost 69 CAD pts.

Using the knock out feature dramatically reduces the cost of premium for this option (69pts) when compared to a vanilla 1 year USD put struck at parity (256pts). If spot does not move during the next month this option structure essentially becomes an 11month USD put which theoretically, at current spot levels, would be worth a premium of 217pts; *a gain of 148pts for holding this option for the first month.* As USD/CAD moves lower this option will increase in value and is not necessarily intended to be held until maturity.





TECHNICALS

SUPPORT LEVELS		RESISTANCE LEVELS	
1.1183	Low last week.	1.1450	High last week.
1.1142	21 day m.a.	1.1545	3 week old channel top.
1.1125	3 week old ascending channel bottom.	1.1572	76.4% fib of the 1.1815/1.0785 fall.
1.1118	50% fib of the 1.0785/1.1450 rally.	1.1627	86 cent level.
1.1039	61.8% fib of the 1.0785/1.1450 rally.	1.1656	38.2% fib of larger 1.3066/1.0785 fall.

Mixed signals with weekly stochastic pointing higher from oversold territory while daily studies begin to turn lower following with solid rejection of the 1.1450 high seen mid week. As a result expect continued wide choppy range trading with an early risk to the downside based on the daily chart. Key will be a break of 1.1220/25 which would signal deeper losses to 1.1100/50 where better buying interest should be met. Rally into the latter part of the week will need to see price action reclaim 1.1380 to restore bullish momentum and open up 1.1422/77 (61.8% fib of the 1.1815/1.0785 fall/May 11 daily base), 1.1655 (38.2% fib of entire 1.3066/1.0785 fall) and 1.1714 (daily resistance line off 1.3066/1.2507 with a slope of -20 points /day) – all good levels to buy C\$ on any brader weakness. Suggested range this week 1.1100/1.1600.

USD/CAD Daily Chart:





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