



Currency Review

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USDCAD a trade waiting to happen

It's rare to see in these tumultuous times a trade when fundamentals and technicals line up, however buying the USD against the CAD just may be such a trade to focus on. The "looney" the nick name for the USD/CAD is termed a "commodity currency" and since it traded at US1.6190 on the 21 Jan 2002 until US0.9056 reached on the 29 October 2007 the USD has been weak and the trend consistent. Commodities and the USDCAD go hand in hand and with all the focus concerning the financial markets, commodities and the impending recession in the US it is about time we revisit the USDCAD as a trading opportunity.

Fundamental Scenario

The financial markets are calling for a recession in the US which is likely to extend into other countries economies. As a result of this commodities have come under pressure. General commodities, such as the base/precious metals and softs have all come off from their historic highs and players are set for a deeper correction as economic activity slows down. We suspect that the market will get ahead of its self, however at the moment we are not anticipating new highs for these commodities for a while. Given this slowdown we expect commodity currencies such as the USD/CAD to also come under pressure. Why?

In a nut shell, 80% of Canada's exports get absorbed by the US and exports account for one third of GDP. Canada is the US's largest foreign supplier of energy, including oil, gas, uranium and electric power. On the import side of the ledger, 54.9% of Canadian imports are also from the US. So it goes hand in hand if the US economy slows down or commodities come under pressure then so to would the currency.

It is interesting to note that a feature of the Canadian economy has been its ability for overall exports to remain resoundingly strong in the face of a strong currency. The weakness in the USD and strength in the CAD since 2002 has not seen a slow down in the strength of the export market nor the Balance of Payments (BoP), which are currently running at a CAD 28.46 billion surplus. This contradicts conventional economic thinking. The main reason for this has been that exports to the US for infrastructure and energy products have been the balancing item whilst other parts of the export market have been horribly weak. However, with a deterioration in the strength of the US economy we feel that this overriding factor will see a sudden turn around in sentiment and this will effect the economy as the Canadian Central Bank looks a monetary policy mix to help weaken the currency to help drive exports. As a result we feel that the CAD should weaken over time. This is not a sudden process rather a long term process however; it sets the tone for the currency to weaken as the US economy slows down.

Technical Scenario

As can be seen from the chart below the USD CAD has been in a down trend ie USD weakening since 2002 however, and has bucked the trend since October 2007. The strong impulsive move of the USD off the low indicates an exhaustive move, then following this a consolidating or holding pattern has emerged. During the same period we have seen other currencies such as the EUR and GBP remain firm against the US not so the CAD. The currency has managed to hold its level and technically because of this it looks firm. This consolidation has provided us with a support level that we can focus on, a level to tell us when we are wrong or a level to reduce positions.

USD/CAD Daily Chart



Just recently the USDCAD traded through resistance at 1.0030 and this signaled a move that should see the currency test major resistance at 1.0330. It also helped to confirm a low of significance at US 0.9750, which represents a good place from which to work stops. The next area of resistance is the trend line from the highs in January 2002 which comes in at 1.0660 and if this breaks on a daily close then we can suggest that the correction of the move from 1.6160 to 0.9770 is well on the cards. Working off Fibonacci retracement levels of the move we can see that the 38.2% levels comes in at 1.1870 which is out target.

Stops on the position go in at US0.9700.

The best way to trade this would be via a long Margin FX position or an at the money option with an expiry in 3 months

Cheers,

Jono

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