DrobnyGlobalMonitor

May 23, 2003

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Biases:

EQUITIES:	Bearish; Bearish US vs rest of the world; Bearish financials;
BONDS:	Bullish; Bullish 10yr Bunds; Bearish JGB's
FX:	Bullish Volatility; Bearish USD; Bullish Euro/Yen;
EMG:	Bullish Lat Am;
CMDTY:	Bullish Precious Metals

Current Exposure:

EQUITIES:	
BONDS:	****Short 10yr T-bond (May 23);***
	Long Dec03 Euribor (May8);
	Long 10yr Bund (Apr 14);
FX:	****Short Euro/NOK (May 23);***
	****Short USD/KRW (May 16);***
	Short USD vs GBP (April 22);
	Short USD vs BRL 1 Yr Fwd (Feb 26, revised Apr 22);
	Long Euro vs SFr (Feb 18);
EMG:	Short Brazilian 'C' bond (Apr 10);
	Short Saudi vs USD 1yr fwd (July 29);
CMDTY:	

US Fiscal Policy; Norwegian Hedge?

****Please note latest changes to biases and/or exposure***

Well, after all the flim flaming, the US fiscal boost has been passed. And, although the headline figure is lower than originally expected, the total near-term boost is likely to be seen by the experts as bigger than the original Bush proposals.

All those tricks with so-called sunset provisions. And, with the thing backdated to Jan 1, the delayed passage of the tax cuts means there may be a pretty good initial bang with the cuts.

Meanwhile, the USD continues to move lower. And, inflation in Euroland, as in pretty much all the countries whose currencies have been appreciating pretty strongly, seems to be coming down at a pretty good pace now.

All this adds up to nice potential for the old long Bunds/short T-bonds idea (and other spreads against Treasuries). The trade failed earlier in the year due to the bull market in bonds generally.

T-bonds are typically higher volatility instruments than Bunds, so can outperform when duration pays. Especially when the surprise so far this year has been the failure of the US economy to recover.

And, it's certainly not clear that the recovery will emerge. There hasn't been the purge that sets the economy up for a decent rebound in activity.

Nevertheless, the passage of these tax cuts means the ***probability of a summer recovery in the US has increased.*** And, if it does, I suspect that any cyclical bounce in the US economy will ultimately end in tears.

But, for now, any signs of recovery could prove a jolt to perceptions of the US outlook. Especially after this after a period of pretty good T-bond outperformance.

The other development that looks interesting was the announcement by the Norwegians that they will be repatriating their oil revenues. These are largely held in overseas currencies, so the effect of this may well lead to a rebound in the Norwegian currency.

Boy, that is reminiscent of what happened with another famous country with a C/A surplus. Back in the early 90's, the Japanese private sector started repatriating assets to help cover losses when domestic assets were deflating. And, we all know what happened to the Yen between 1990 and 1995!

In Norway's case, it's the Government that is bringing money home. A weakening economy has produced a widening budget deficit; these funds are supposed to help fill the gap.

The first thought with this, of course, is to sell USD/Nokky. Oil is still largely priced in USD's. (Of course, that doesn't mean these assets are all held in USD's, I simply don't know.)

But, USD/Nokky is down a long way already; down from a high of 9.6 to 6.6. And, it has appreciated some 10% or so against the USD in the last month.

But, it has lost a similar amount against the Euro as well. And, with the Euro having a much larger weight on the TWI, this means that Norway's TWI is down considerably despite making good gains against the USD (and Yen).

So, if this policy shift does lead to a recovery in the NOK TWI, it can well lead to a further drop in USD/Nokky. But, it should also generate a rebound against the Euro as well. Especially after the losses it has sustained recently.

And, the levels for selling Euro/Nokky look pretty good. It's been consolidating in a rough 7.75-7.95 range after having moved up strongly from the 7.20-7.30 area.

So, selling Euro/Nokky, with a stop just over the 8 area looks to offer pretty nice risk/reward. And, the position seems to offer a pretty nice hedge to a short USD portfolio.

If a USD correction were to emerge, a resulting unwind in Euro cross strength could send this particular cross rate down sharply. And, with the Norwegian government repatriating oil revenues, further USD weakness may not end up pushing up the Euro/Nokky cross at all.

Andres Drobny