# DrobnyGlobalMonitor

December 4, 2009

*3701 Highland Ave, Suite 302, Manhattan Beach, CA 90266* [andres@drobny.com](mailto:andres@drobny.com) *(310) 545-6996*

***Biases:***

EQUITIES:
BONDS:
FX: ****Bullish USD***
EMG: Bullish Asian EMG FX;

***Current Exposure:***

EQUITIES: Short BKX (Sept 25);
BONDS: Long IRZ0 vs EDZ0 (Sept 9);
FX: ****Long USD vs BRL (Dec 4);***
****Long USD vs JPY (Dec 1);***
Long TWD vs Euro (Sept 21);
COMMODS:

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

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It took longer than expected. But, it now looks like the effects of the fiscal expansion in the US are starting to take root. Falling unemployment claims signaled that the labor market is shifting to a better trend. Now the 'raw' data confirms this.

And, that has the potential to change many things. US rate expectations, most obviously. The popular argument has been that the FED traditionally waits for unemployment rates to fall before tightening.

Now, the data released today may not represent the big turn in the unemployment rate. Nevertheless, unlike in previous episodes that many draw upon, the FED eased very aggressively and early this cycle – faster than in previous episodes. And, accompanying the monetary easing this time has been a pretty hefty expansionary fiscal boost (which should have a much smaller import leakage than tax cut based expansions).

All this suggests the FED may well want to tighten policy earlier than in typical cycles. Sure, they may not want to tighten nearly as far as in previous cycles. But, in an environment of an expansionary fiscal policy, they could well want to move rates towards, say, 2% and see what happens from there.

Of course, these specifics are hard to predict. But, one thing seems pretty certain: the risk of FED tightening has increased and the timing seems to be moving forward.

And, that in and of itself, can be very important. In several ways.

First, it can change the trend in the USD. Sentiment is bearish, the popular assumption is that the FED is on hold indefinitely, and the much reduced trade deficit means there is a smaller USD financing need. That creates the potential for a pretty good USD pop.

It also means we can return from 'crisis' correlations to more 'normal' market correlations. During the crisis the pattern has been that USD rallies (falls) as equities and bond yields go down (up). A negative correlation.

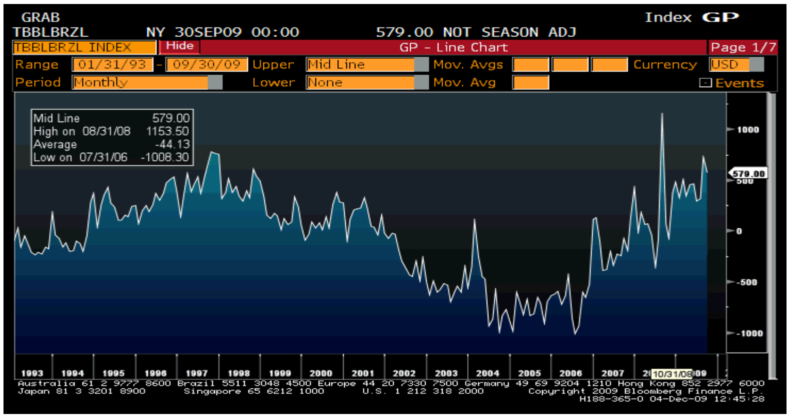
Yet, in more 'normal' times there is a positive relationship between the USD and bond yields. The prospect of sustained strong US data into 2010 combined with enhanced expectations of FED tightening means the USD can rally as US relative rates rise.

Now, what this means for equities is less clear. A strengthening of the US economy is a positive. The prospect of higher rates works against this. Maybe the USD/equity correlation goes to zero rather than to a positive.

There are other potential implications of all this. One is for commodity prices. Strengthening US growth seems a positive for commodity demand.

But, how much of the rally in commodities recently has been premised, at least in part, on expectations of a sustained fall in the USD? That certainly seems to be the case with gold. But, it could hold for commodity markets in general, which seem exposed to a potentially nasty correction in the thinning markets of December.

That also may hold true for EMG currencies, like the BRL. An SG recently mentioned the dangers of a drying up of liquidity for EMG over the coming month. That seems especially true if a USD rally emerges. And, the picture below shows the US trade position with Brazil, which has now turned to a surplus (though the BRL probably still



benefits from a surplus Brazil runs against several USD-block countries; eg, OPEC and China).

Nevertheless, the underlying flows are much less supportive of the longstanding downtrend in USD/BRL than in recent years. And, looking ahead to 2010, an election in Brazil looms. All this seems to increase the dangers for the BRL in the weeks ahead.

Andres Drobny

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