DrobnyGlobalMonitor

September 12, 2011

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Biases:

EQUITIES:
BONDS:
FX:
EMG: Bullish Asian EMG FX; Bearish Asian EMG interest rates;

Current Exposure:

EQUITIES:
BONDS:
FX: ***Long Euro/SFr (Sept 12);***
COMMODS: ***Short HGZ1 (Sept 12)***

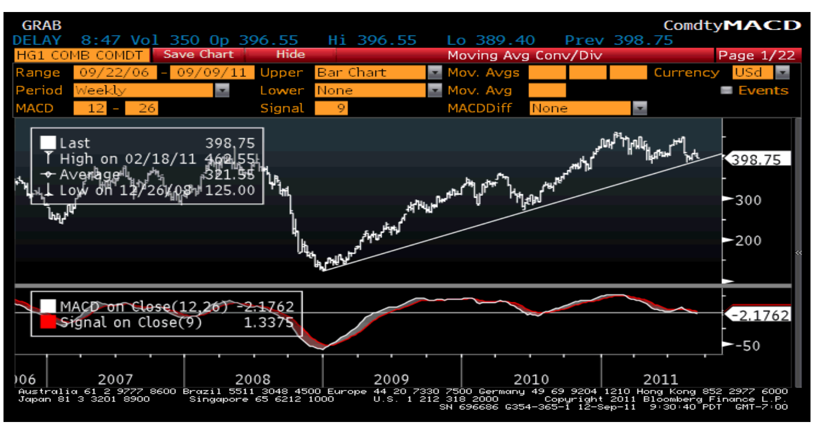
Copper Puts & Deflation

Please note latest changes to biases and/or exposure

Global growth has weakened and the pressures in Europe are making matters worse, not better. In response to this, equities are down sharply over the past 7 weeks. And, now the Asian currencies have started to give.

Yet copper, which is sensitive to global growth patterns, is down a bit recently but is still trading near all time highs (below). And, the forward curve is flat. Copper seems to build in a rather benign and optimistic outcome to the current global turmoil.

The same seems true with copper vol. It is up since July, of course. But, but is still low



in a historical context. That allows for the potential to gain good leverage to the downside should the copper price break down.

Meanwhile, a few questions have emerged. Why have the scandies been hit so hard? Simple: the run into them post SNB action was wrong and both the Nokkie and Stockie are sensitive to global growth patterns. It's kind of like copper.

Another, more important question is what would change current trends. And, two come to mind. They don't include passing the Obama jobs plan, however. Unless it's passed almost in its entirety, it doesn't look enough to counter fiscal tightening next year. The US looks unlikely to fall off a cliff on its own since there's plenty of liquidity around to defend against a financial accident. But, there isn't enough fiscal stimulus out there to help turn the world around.

Instead, a breakdown of the Euro could do it. As with the gold standard in the early 1930's, abandoning the Euro or at least losing several of its debtor members, would remove a big deflationary impulse on the global economy.

The problem with this, of course, is that increased acknowledgement of this raises rates in those countries. The dynamic is all wrong as initial resistance to such a prospect adds pressure on those countries to come up with even more austerity policies. As some wrongly believe, austerity isn't inevitable when debt is high. Instead, it's the result of a currency regime that forces it on debtor countries.

Thus, pressures for a Euro breakdown increase global deflationary tendencies. But, when such an event happens, it would likely produce a potentially powerful unwind of deflationary pressures.

What could change things immediately would be a big fiscal stimulus out of China, akin to what happened in late 2008 into 2009. That has the potential to provide a decent antidote to deflationary pressures elsewhere. And, China has the ability to do this and, importantly, to implement such a policy quickly and effectively (especially if geared to boosting consumer spending). That's the one to keep a close eye on.

Finally, the drop in Euro/SFr today has pushed even the 3mth forward to below the 1.20 floor level. That builds in near term failure of the SNB's new policy. That seems to assume further big trouble ahead; the opposite of copper. And, it's historically never been a good idea to bet against the SNB.

Andres Drobny

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