## Overview

### Sticking to regime change; dollar uptrend

2013 marked a fundamental regime change from the crisis-prone 2008-2012 period. The dollar's correlation to equities flipped, the euro-area avoided a crisis and the Fed announced a rolling back, rather than an expansion, of QE. If there was a locus of crisis it was in emerging markets, which felt the shock of Fed taper. This could hint that the 1990s dynamic of first half dollar weakness and developed market crises and second half dollar strength and emerging market crises could be repeating itself.

We therefore remain committed dollar bulls. If last year was all about the US long-end being re-priced on taper, 2014 will mark the re-pricing of the US short-end. December's Fed decision therefore represents only the thin end of the wedge for US interest rate normalization and its effect on markets. This should allow the USD to strengthen against the core European hold-outs to dollar strength, the euro, Swiss franc and pound. The equity flow picture should finally move in favour of the US as slow-moving capital adjusts to the new DM regime. Our favourite expression of dollar strength would be to buy it against the three most over-valued currencies in the world, the New Zealand Dollar, Swiss franc and Singaporean dollar.

### Yen trend still down

While we are looking for a reversal in core European currency trends, on the yen we remain firmly in the bearish camp and look for a trend extension from last year. What adds to our confidence is that major yen turns tend to see the yen move by 43% on average,and we're nowhere near such a move yet. On fundamentals, the BoJ is also conspicuous amongst the major central banks in ramping up QE, the basic balance of payments is heavily negative and foreigners have yet to unwind their safe-haven inflows to Japan that were accumulated in the crisis years.

### Rest of G10

We underestimated UK growth in 2013, but for 2014 we intend not to miss the changes in the UK economy. The starkest one will likely be the pick-up in inflation, which will only add to expectations of a more hawkish Bank of England. The pipeline for FDI into the UK also looks good. The main weakness for the pound remains the current account deficit, so as a FX trade we like to buy the pound against another current account deficit currency, the Canadian dollar. Helping the bearish CAD case is that expectations of a hawkish Bank of Canada appear overdone given the disconnect between the US and Canadian economy, the likely reversal of the surge of bond inflows seen since 2008 and a turn lower in commodity prices.

A neat way of playing the lead-lag between different segments of the market to the normalization in developed markets is to buy the Norwegian krone and sell the Swiss franc. The former saw a large unwind of post-crisis safe-haven inflows last year, while safe-haven flows to Switzerland have yet to be unwound. We should start to see this happen in 2014. Elsewhere in Europe, the Swedish krona should do well as the Swedish economy finally catches up to German and US economic strength.

### Asia-Pac winners and losers

In the Asia-Pacific region, one of the largest cross moves in 2013 was AUD/NZD, but we expect a major reversal this year. Aside from attractive valuations, the rates markets will likely price a more hawkish RBA compared to an already aggressively priced RBNZ. We'd look for the Korean won to outperform the Japanese yen on an improving current account, a pick-up in global growth and a robust domestic financial system. The Singaporean dollar will struggle as valuations are stretched, household debt is elevated and the currency is closely tied to the overall dollar trend. Finally, we'd still buy CNH as the current account, inflation and likely capital inflows are supportive, though we remain wary of the carry unwind dynamics seen in the currency.

### Fragile EM; strong EM

The Indian rupee is the only 'fragile five' currency we like to be long. Current account improvement, portfolio inflows after last year's reduction and beneficial policy action adds up to a bullish case. By contrast, the Turkish lira and South African rand should continue to struggle as their current account dynamics are poor. While both Indonesian rupiah and the Brazilian real also suffer from rickety current accounts and domestic dynamics, better valuations and high carry may prevent excessive weakness. Not all EM is bad. We like the Polish zloty, Israeli shekel and Mexican peso. The first on growth, the second on commodities and third on expected FDI and cyclical pick-up.

### Last year's Blueprint's Trades

Our trades from the last Blueprint were mixed. Our best trade was going long MXN/BRL (+7.1%) while our worst was being short TRY/ZAR (-3.6%). Overall, 6 of the themes made money while 4 lost money. Overall, our 10 themes made a 0.47% average return.

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