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=0D=0A**Global FX Strategy 2012: Currencies during European recession &= ; global stagnation**

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Click=0D=0A**here**= for the full Note and disclosures=2E=0D=0A

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2012 Outlook: Currencies during European recession & gl= obal stagnation (John Normand)

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2012 presents a unique tension between an unprecedented mac= ro environment and very defensive investor positioning=2E The next 100 days= =0D=0A will be critical in avoiding a sovereign credit event and global rec= ession=2E Averting disaster and achieving stagnation should be sufficient t= o ease the dollar lower next year, but expect only a 2% trade-weighted decl= ine and another year of above-average volatility=0D=0A (12%-15% on VXY)=2E = Global recession would probably deliver 8% strength in USD, so less than Le= hman given existing USD longs=2E

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Five global macro themes a= nd top trades (Paul Meggyesi, John Normand, Matthias Bouquet)=0D=0A<= /b>

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Top five trading themes and recommendations: (1) implementation ris=

ks around Europe are huge (EUR/JPY put spreads , bullish USD/SEK fly);=0D= =0A (2) desperate times demand desperate action (short USD/JPY 1x2 put spre= ads, short GBP/JPY through seagulls, short 6-mo EUR/CHF puts; (3) no winner= s in European cage match (3-mo range binaries in EUR/GBP and EUR/NOK); (4) = some safe havens are safer than others=0D=0A (long NOK/SEK); and (5) valuat= ion re-asserts itself (short NZD/CAD)=2E

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Post-mortem on 2011= forecasts and trade recommendations (John Normand, Sunil Kavuri)=

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Forecast accuracy was better than the consensus for Q1 to Q3, but was = poor in Q4 when the dollar turned=2E On trade recommendations, returns=0D= =0A and success rates on options trades were

the highest in four years, whe= reas those on cash trades were average=2E

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FX Volatility: Her= e to stay (Arindam Sandilya, Matthias Bouquet)

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European rec= ession and G4 deficit consolidation will keep volatility and the vol-of-vol= high again in 2012 (12%-15% on VXY Global)=2E Systematic=0D=0A short gamma= strategies should prove ineffective; overlay long vega hedges through cale= ndar spreads=2E Risk reversals in high-beta currencies should outperform st= raddles as defensive plays=2E Optionalised carry should provide positive bu= t noisy returns=2E

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Long-term Technical Strategy: Is resista= nce futile? (Niall O'Connor, Thomas Anthonj)=0D=0A
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The USD ra= lly should continue into Q1 following reversal from key supports=2E Key res= istance on DXY is 80=2E00/81=2E44=2E EUR/USD has downside=0D=0A but could s= tabilize in 1=2E26/1=2E28 region=2E Yen enters another solid year even with= momentum slowing=2E Commodity currencies still look range-bound=2E Chart p= atterns for CEEMEA currencies are dire, whereas Latam and EM Asia should re= cover in Q2=2E

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Feature: ECB debt monetization–correct= ing a historic anomaly would lift euro (Ken Landon)=0D=0A

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Th= e ECB's prohibition against debt monetisation is a historical anomaly= =2E Allowing Fed/Bank of England-like activity would strengthen=0D=0A the e= uro by reducing sovereign default risk=2E

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Yen: USD/JPY to co= ntinue its downtrend, with risk of breaking 70 (Tohru Sasaki, Junya Tanase,= Anna Hibino)

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Even at all-time highs, the yen should benefit = from a year of low global rates, sovereign stress and reserve diversificati= on=2E The Bank=0D=0A of Japan cannot floor USD/JPY as the SNB did with the = Swiss franc=2E

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Euro: the make-or-breakup year (John Normand=)

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2012 will test what remains of euro resilience=2E The pivot= al issue isn't Europe's recession, which is guaranteed and disc= ounted=2E The question=0D=0A is whether 2012 delivers a Lehman-like soverei= gn event=2E ECB and IMF funding will be required to prevent this outcome=2E= If combined with structural reform, EUR/USD can remain in a 1=2E30s range,= even during a European recession=2E

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Sterling: Still dodg= ing the limelight (Paul Meggyesi)

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2012 should mark the fourt= h consecutive year of sterling consolidation, as the UK's slow-burnin= g economic malaise cannot compete for=0D=0A attention with the Euro area□=217;s rapidly-evolving fiscal and political drama=2E

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Swiss = franc: Check the dam for cracks (Paul Meggyesi)

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The fundamen= tal forces which drove record appreciation in 2011 – sizable current = account surplus, strong economy, massive overseas borrowing=0D=0A in CHF &#= 8211; are still intact=2E The SNB has infinite capacity to peg EUR/CHF, but= the cost in terms of inflation and excess credit growth will become more a= pparent next year=2E Expect the floor to hold at 1=2E20 before yielding in = 2013=2E

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Swedish and Norwegian kronas: Falling short of safe-= haven status (Paul Meggyesi)

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An assertive SNB and BoJ are sen= ding investors towards other, potential safe havens=2E NOK and SEK satisfy = only about half the criteria=0D=0A for safe harbors, with NOK preferred due= to the Norwegian economy's lower correlation to global growth=2E

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Commodity currencies: Risks loom large for Q1 (Kevin Hebner)

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Stronger fiscal positions, soaring terms of trade and ongoing= reserve diversification are no insulation from Europe=2E NZD/USD is the mo= st=0D=0A vulnerable given its internal and external imbalances=2E

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Long-term valuation: USD fiscal premium is modest (Justin Kariya)

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Fundamental fair value models suggest that the most expensive cu= rrencies are JPY, NZD and BRL while the cheapest are TRY, MXN and PLN=2E=0D= =0A The dollar is about 5% undervalued=2E

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Model-driven strat= egies in 2012 (Sunil Kavuri)

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Carry and price momentum will st= ruggle again in 2011 if markets remain trendless but

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Global FX carry trade
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Currency managers
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average shorts in G-10
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($66bn) in yen shorts,
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($= 24bn) and AUD
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Q1 should see USD strength follo= wed by a re-weakening=2E Baseline targets by Q4 on the benchmarks are DXY 7= 6, JPMQUSD 80, USD/JPY 72, EUR/USD=0D=0A 1=2E38, GBP/USD 1=2E58 and AUD/USD= 1=2E04=2E

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Risk scenarios to accompany 2012 FX forecasts

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Risks around the baseline are asymmetric for some currencies=2E = This section highlights biases, targets under alternative scenarios and=0D= =0A trigger events for a change in view=2E

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Paul Meggyesi

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