CRI's Special Report - The Australian Dollar

The Canadian Rational Investor

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www.the-rational-investor.com

Recession, what recession…

Here is an excerpt from the May edition of The Canadian Rational Investor Newsletter: *"If there was one are of the world that seems to still be growing it would be Asia and China in particular. Recently the country reported quarterly growth that was indeed below previous quarters… China is still growing and coupled with the recently announced government funded stimulus package, its growth will only accelerate in the coming years. The problem we face (as potential investors) is that China itself is a totalitarian dictatorship with no legal recourse for investors and extreme corruption. This problem is so big; it makes direct investment into the country a dangerous idea at best. So the question becomes, is there any proxy for this growth where we can have some faith in the free market coupled with a reliable legal system? There is one market that because of its commodity asset base and a solid free market platform makes it ideal – Australia. Just as the suppliers of parts fueled the Dot.com boom, so too will Australia's natural resources be in high demand as China continues its economic expansion."*

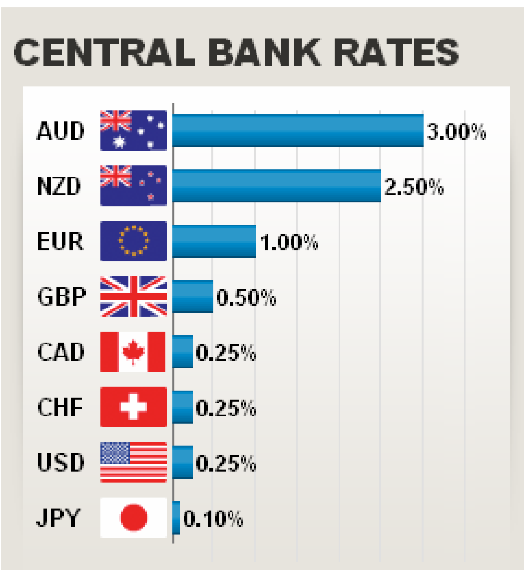


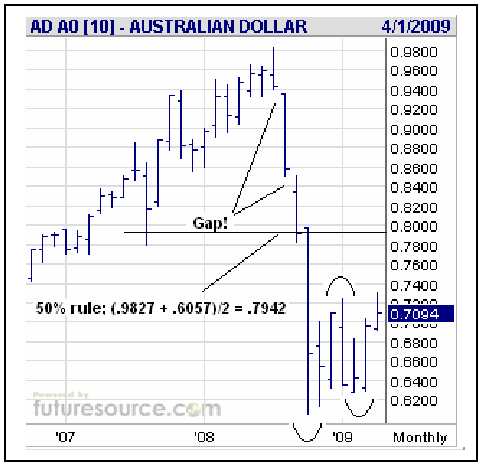
Chart courtesy of FX360.com

Does the Data support this argument – YES

On Wednesday of this past week Australia released it employment figures for the month and they surpassed even the most bullish expectations (registering a gain of 27.3K versus expectations of a loss of -24.9K). One financial web site reported "*The Australian employment news was a genuine shock to the market that was anticipating further contraction in the labor market….not only did the Australian economy generate more jobs, but the overall unemployment rate declined to 5.4% from 5.7% the period prior – far lower than the 5.9% pre release estimates. In fact today's enthusiastic reaction to the employment data, suggest that the currency market believes that Australian rates may have bottomed. If that were the case than the Aussie would be the only currency amongst the G10 to maintain a 3% yield making it very attractive investment in an environment where the rest of the industrialized world has moved to a near zero interest rate policy.**

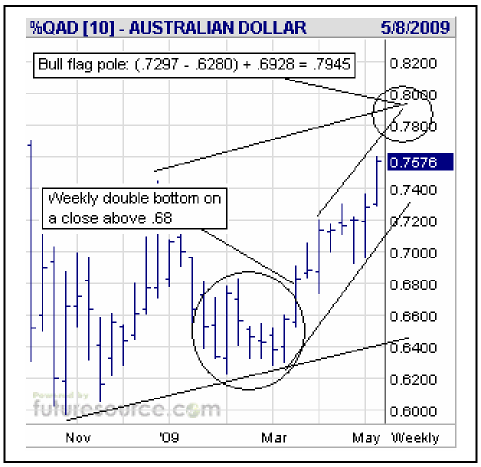
*http://www.fx360.com/commentary/boris/1138/shock-australian-employment-rises-as-audusd-soars-past-7500.aspx

Fundamental Summary: Asia has economies that continue to grow while Europe and North America may not. This is reflected in Central Banks Short term interest rate policy. Because investors seek to maximize returns, money managers around the world have a huge incentive to move their short term deposits to Australia. That increased demand for Australian Dollars will inevitably lead to higher prices. Currently, the fundamental situation for the currency is very bullish….



Monthly double bottom…

Very rarely does one see such a well defined double bottom in price. The double bottom was formed when the market sold off to a low of .6057 in October, 2008. The market then rallied away from the low to reach a counter trend high of .7249 in January of this year. The market subsequently sold off and tested the lows when it traded down to .6279 in February 2009. The market confirmed the bottom when it moved back up through the .7249 just this month. Consider pull-backs into the .70 area as buying opportunities going forward with firm risk just below support at .64.



Weekly bull flag to test upper end of range…

Over the past six months the Australian dollar has traded in a wide range between a high of .76 and a low near .60. But as time has progressed, the currency has registered higher lows and higher highs. The market confirmed a weekly double bottom when it closed above .68 the week of March 20, 2009. This trade is up more than $.07 or $7,000 per contract so chasing this trade now would be a little dangerous. Regardless, the market has bottomed and has a great deal of support in the .68 area. Any pullbacks into this area should be considered low risk entry points with a firm risk just below key support near .64.

Option Analysis

When ever we consider an option trade one underlying rule must be met: *The current option price must be ½ half of what we think the option will be worth (intrinsic value) once the underlying market hits our target.* If our target on the Australian dollar is the .79 area, we could only consider purchasing (the .75 call for example) if it was less than .02 points (at our target option intrinsic value would be .79 - .75 = .04) Having said that, we should also give ourselves enough time so that the trade can work itself out. I personally like to focus on options that have six to eight months of life (In this case the December, 2009 call options are a good candidate). Below then is the option chain for the December .75 calls.

Future	Option	Strike	Type	Bid	Ask	Open	High	Low	Last	Chg	Time	Settle	Prev Settle	Volume	Open Interest	DTE
AD Z9	AD Z9	0.7500	Call								14:30:14		0.03770	0	0	210
			Put								14:30:14		0.04580	0	0	

Conclusions

The fundamental data points to a recovery in Asia before North America or Europe. Technically the market is getting over bought as we approach a short term target. Call premiums are currently too expensive to consider purchases. Don't chase the market right now. Use corrections over the coming months to take positions in the currency. Should we get a pull back into the .70 area, one ought to consider buying Australian dollars outright, buying the ETF, or buying futures contracts. For a more leveraged play one may even consider Call options. Regardless, watch for Technical Trading Alerts from The Canadian Rational Investor for when I think its time to pull the long trigger….