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FX TALKING

FX Talking: Too much of a good thing

We think this USD rally is a bear market bounce and are invested in a 2Q story of a global recovery, which should lift all currencies – including the EUR. Our call is that the current correction will provide some attractive entry levels for rejoining core bull trends against the USD given that the reflation story and equity & commodities gains have further to run



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Executive summary

Supreme confidence in the global recovery and central banks in no hurry to tap the breaks have combined to deliver a sizeable bond market sell-off. The adjustment has erred to the disorderly and prompted some adjustment in positioning – especially in FX markets. The currencies most susceptible to this correction have been the low-yielding JPY and CHF – both currencies the least positively correlated with a global recovery.

While March could prove a rocky month for risk assets as US Treasury yields try to find their 'right level', [our macro team do not buy into the permanence of the much-discussed inflation threat](#). This means that at some point, a sufficient inflation premium will be priced into bond yields and pro-cyclical currencies allowed to advance again.

In short, this means we regard the current dollar rally as a bear market bounce and

remain fully invested in a second-quarter story of a broadening global recovery, which should lift all currencies – including the EUR. A corrective dip in EUR/USD to 1.17/18 should still be followed by a recovery to 1.25 this summer. In Europe, we very much like GBP and CZK.

In the emerging market space, [the high yield world looks better placed](#) to withstand a bond tantrum than it did in 2013. Here, the Indonesian rupiah and the Mexican peso are perhaps the most exposed to a further US yield rise in March.

Yet our call is that the current correction is going to provide some attractive entry levels for rejoining core bull trends against the dollar – given that the reflation story, including equity and commodity gains, have much further to run.

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