

## **„Myth and Reality About Trading on International Financial markets”**

*Analysis and predictions 2010  
by analysts from ELANA Trading and Saxo Bank*

### **The status of world economy – a process of recovery from the crisis**

Global economic recovery is in progress. The lowest point of the world stock markets was in March 2009, and on the Bulgarian Stock Exchange – in February 2009. Having over a year of decline, the US index Standard & Poor's 500 fell by 57.7% down to 666 points. From that moment on the US stock market saw a rise of over 70%.

#### ***Measures taken to recover economy:***

- **Significant state stimuli**

Stimulus programmes were implemented with enormous investment to motivate economic recovery: infrastructural investment; tax relief. Subsidy for residential homes, capitalizing banks to contribute to healthier financial system.

- **Monetary policy**

Central banks introduced 0-interest rates in order to stimulate lending; they bought out various financial assets from banks to clear out the financial system; they poured money into the banking system to relieve lending.

#### ***What's next if recovery is successful?***

- Reducing unemployment rate and improvement of labour market
- Recovery of bank lending
- Growth of investment by businesses

#### ***What are the results of stimulus programmes so far:***

- Still high unemployment is maintained and in some countries it is on the rise – e.g. measures have resulted in reducing negative impact but still not towards sustainable recovery.
- Bank lending still shrinking - banks in USA and Europe invest in treasuries but do not give new loans to individuals and small business. Governments and central banks

cannot pressure commercial banks to increase lending apart from motivating them through governmental agencies and special financing programmes. Such programmes managed to hold somewhat shrinking mortgages and car loans but could not be enough as measures to compensate for the decline of overall bank lending.

- Investments are still limited – investment in private sector depends on prospects for economy and long-term plans of the companies for production expansion. Currently, companies do not make investments due to significant free production capacity and most probably there will be a gradual recovery of investment.

**MYTH: ECONOMY WILL RETURN TO THE “GOOD OLD TIMES” – RECOVERY WILL MEAN FAST ECONOMIC GROWTH, QUICK AND CONSIDERABLE GROWTH OF CONSUMPTION, QUICK AND CONSIDERABLE GROWTH OF LENDING, BOOM IN CONSTRUCTION SECTOR.**

**Prediction by ELANA Trading: V-shaped recovery will not happen**

#### What are the reasons for this forecast:

Three crucial signs of recovery are missing – reduction in unemployment, growth in lending and investment. This leads to the prospect for the global economy to experience deleveraging – a period of economy focused on reducing debt. It means that consumers and business will be mainly savings-minded in the next 5 to 7 years in order to reduce debt. The accumulated enormous debt will be a burden for creditors thus resulting in limited consumption and investment as well as in introduction of new higher taxes. Looking back into the last 100 years, such stages of economy have lasted up to 7 years and have reduced Debt-GDP ratio by 25%. A typical example of similar periods is the years after the Great Depression in USA when debt was reduced by 34%, or the period after the Russian crisis in 1997 when the debt was two-fold decreased within 4 years.

The current economic growth in developed markets is mainly based on “filling up the stock” after the production decline during the crisis. The most affected industries in the long-term will be the ones that significantly relied on loans for expansion – construction sector, etc.

#### **The results of deleveraging:**

- Lower and gradual economic growth in the intermediate-term
- Lending interest rates will stay high and will not return to low levels – in Bulgaria lending rates will not get lower than levels in 2007.
- Citizens and companies will curb consumption focusing on returning debt.

- Interest rates of central banks will stay low to encourage functioning of financial system.

#### The impact on global economy:

- In 2010 all governmental stimuli will be concluded and opportunities for further governmental programmes will be restricted due to accumulated debt
- High level of unemployment will persist because the measures have not brought improvement of labour market
- In 2010 barriers will emerge in international trading to pressure China – the developed countries will try to limit Chinese production and export by influencing Chinese Yuan exchange rate
- New “mini financial asset bubbles” will come up as a result of the mythical expectations of China’s constantly growing demand for commodities; including in real estate in some regions with low interest rates.

#### **MYTH: US DOLLAR WILL FALL FOREVER**

**Reality:** USD Resurrection – strengthening of US currency

**Prediction by ELANA Trading:** 1.30 EUR/USD by the end of 2010

**Prediction by Saxo Bank:** 1.42 EUR/USD by the end of Jan 2010 ; 1.37 EUR/USD by Q1 end; 1.22 EUR/USD by H1 end

#### What are the reasons for this forecast:

- *Improved US economy*

First signs of US economy recovery are visible although we miss a couple of factors that can boost growth in the next few quarters. US dollar showed positive reaction to the news of economic recovery but the impact is mainly on Forex market because investors expected interest rates rise.

- *Massive close of “carry trades”*

Zero interest rates turned USD into the currency of investment last year. US dollar displaced the Japanese yen in this respect since investors were also motivated by the depreciating US currency. Higher interest rates and even only the expectations for that will be enough for growing USD demand and increase of capital flow to US. We do not expect it to be the sole

reason for strengthened dollar this year but it is possible to happen resulting in USD gaining even bigger strength than we predict.

- *Debt problems in Europe*

Some EU countries deficit, moreover the headlines with Greece, has negative impact on the euro. Weakening of EU currency will be joined also by the gradually slowing leading economies, especially Germany. Therefore we can expect cheaper euro in the first couple of months of 2010 while US stimulus support the strength of the dollar.

**Trading ideas:**

- Sell EUR/USD
- Buy USD/JPY
- Buy ETF – UUP (PowerShares DB US Dollar Index Bullish)

**MYTH: GOLD IS SAFE-HAVEN FOR INVESTORS BECAUSE ITS VALUE ALWAYS GOES UP IN CRISIS**

**Reality:** Falling price of gold in 2010 after the intermediate peak in 2009

**Prediction by ELANA Trading:** USD 950 per troy ounce by the end of 2010

**Prediction by Saxo Bank:** USD 870 per troy ounce

What are the reasons for this forecast:

- *Forex correlation*

Strengthening of USD will pressure downwards the value of gold. The correlation is very strong - euro strength was one of the reasons for rising gold price. Expectations for a stronger dollar cannot be read as continuing expensive gold. However, the rising dollar will postpone the gold diversification plans of the central banks.

- *Correction of most commodity prices*

There are two possible periods of commodities' prices decline that will compensate for the rally in 2009. Strengthening of USD will also be a factor as well as measures to cool down Chinese economy. Proofs of slow recovery of retail consumption in USA and Europe will also contribute to this.

- *Other factors for gold demand*

There are high inflation expectations but actually weak consumption and free production capacity in world industry will continue to maintain low price level. Usually inflation causes rising price of gold.

**Trading ideas:**

- Sell spot gold/ major Forex crosses
- Buy ETFs – shares of metal industry when metals' price go down

**MYTH: EVER-INCREASING OIL PRICE**

**Reality:** Dynamic oil price will be witnessed in 2010 but rocketing prices are not to be seen by the end of the year .

**Prediction by ELANA Trading:** USD 80 by the end of 2010

**Prediction by Saxo Bank:** USD 70-80

What are the reasons for this forecast:

- *Demand and supply*

Oil price will be on hold due to reduced consumption after the crisis and the price rise to over USD 70 in 2009, which preserved high supply. We expect slow recovery of the developed economies that still play significant role in oil demand. This will largely be compensated by the emerging markets in the next years. It is possible to see price fluctuations in the short-term as a reaction to news of strengthening or weakening of the global economy. Fast growth of China will be the core reason for maintaining high oil price.

- *Long-term view*

Lingering political risk in the Middle East and depletion of oil reserves will continue to cap oil prices in the long-term. Oil going down below USD 50 per barrel in 2009, led to a drop in investments in exploration of current and new oil fields. That poses a risk of a new sharp price increase of oil if supply shrinks.

- *Financial speculation*

Oil futures trade surpasses 4 times the actual daily commodity volume. This may increase price fluctuations during the year while downside risks include also oil floating storage – there are 135 mln barrels of oil that could be sold out at price fall and will lead to even lower prices.

**Trading ideas:**

- Long IXC (Energy ETF) in H1
- Oil CFD trading within USD 65 – 85

**MYTH: US STOCKS ARE CHEAP**

**Reality:** US stocks come close to overvaluation – in 2010 US stock market will register moderate growth of 5-10%.

**Prediction by ELANA Trading:** S&P 500 – 1200 points by the end of 2010

**Prediction by Saxo Bank:** S&P 500 - 950-1250 points in 2010

What are the reasons for this forecast:

- *Zero interest rates support the stock market*

Therefore any bad news is accepted positively by the market – zero interest rates preserve cheap loans and motivate investment.

- *Market participants are bullish*

The majority of investors believe stock market growth will continue and they expect indices to rise. Such a high level of positive expectations usually faces short-term correction or is followed first by rocketing growth on the threshold of overheated stock market which leads to a stronger decline in the short-term. There are no reasons to believe a new stage of strong stock market decline is expected in USA and Western Europe.

- *High P/E ratios compared to companies' profits*

P/E ratios show that US stocks are close to overvaluation. This comes from the high expectations for profit growth and is the reason to believe stock markets growth from 2009 will not be repeated.

The expected range for S&P 500 in 2010 is 950 - 1250 points.

Similar period of slow stock price growth we saw in 2004-2005 in the US just after the rally in 2003.

**Trading ideas:**

- Buy and sell ETF on US companies or CFD futures on S&P 500 within 1000/1250 points
- Buy ETF GWX/sell NASDAQ

**MYTH EMERGING MARKETS: CHINA WILL BUY COMMODITIES AT ANY PRICE FOREVER**

**Prediction by ELANA Trading:** Recent growth rates are hard to sustain but emerging markets will better than Europe and USA as long as governmental stimuli and low interest rates continue.

**Prediction by Saxo Bank:** Although a correction in US and EU stock markets will lead to correction in emerging markets, they will continue outperforming US and European markets in 2010.

What are the reasons for this forecast:

- Government stimulus programme in China resulted in the stock and real estate prices rise. Shrinking measures will restrict higher value of these assets in the short term. Strengthening of USD and correction of main commodities' prices will have a negative impact on the stocks of economies that export materials.
- Expensive commodities will pressure China to increase interest rates and cool down economy, which will have its impact on all markets due to expectations for inflation and reducing global growth.
- Positive expectations for a growth in Brasil and Russia derive from the huge currency reserves and lower level of debt in emerging markets. This speaks that the governments of those countries will have better opportunities to encourage internal growth in the next years ahead, especially while we see slower growth in USA and Europe. Therefore we can expect emerging markets stocks to perform better than developed stock markets.

**Trading ideas**

- Buy futures, commodities' CFD
- Buy ETF EEM/sell NASDAQ

**ANALYSTS**

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Tsvetoslav Tsachev headed the Research and analyses department of ELANA trading in 2005. He joined the team of the brokerage of ELANA back in 2003 as analyst. Previously he had worked as a journalist covering financial markets at Pari Daily (financial daily).



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Tsvetoslav Tsachev holds a Masters degree in Macroeconomics from the University of National and World Economy in Sofia. He is also certified by the Bulgarian Financial Supervision Commission for investment consultant.

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As Senior Manager his role is to advise clients (High Net Worth individuals) on stocks and stock indices mainly in Europe (Eurostoxx 600) and the US (S&P500).

Didier Abbato has 13 years experience in trading: He started his career in 1996 in London by trading emerging market debt with Sumitomo Mitsui Banking Corporation and a specialist broker called London Forfaiting Company In 2003 he moved to Denmark and joined Saxo Bank where he first advised clients on several asset classes and later got the position of market maker for CFDs which he held for a couple of years before moving to his current position.

Didier Abbato holds a Masters in Finance from the University of Bordeaux in France and is CFA charter-holder from the CFA Institute since 2007 (Chartered Financial Analyst). He is a French national.