

Eye on the yen

As summer reaches its zenith, the world economy and its central banks do not take vacations. The appeal of the forex market is that it continues to flow through the seasons. Prices move in alternating waves of bullish and bearish sentiment and through seasons, marked not by time, but by economic cycles. At this midpoint of 2007 it is still summer in the world economy. While the U.S. economy is more tentative than others, Europe, led by Germany, is experiencing growth, and with it fears of untamed inflation. The European Central bank on June 6 increased interest rates to 4% to help manage growth, but the bank also voiced concern about inflation levels exceeding the official 2% target. Asia, with China and India, is generating double-digit gross domestic product (GDP) growth but its equity markets are overheated. Yet, it is the

billion worth of yen are residing in carry trade investments where yen are borrowed and the money is placed in higher earning currency instruments. The challenge facing the Japanese economy is to be able to stimulate consumer demand to offset much of the economic growth that depends on a weak yen stimulating exports.

But if fundamentals are viewed as leading indicators, the forex trader could be in the best of all situations. While technically the yen is weak, the trend may soon be at an end. The tipping point for the Japanese economy may very well be based on exogenous factors. If U.S. growth is better than expected, Japanese growth will benefit, as it is a significant trading partner of the United States.

If European interest rates are expected to top out at current levels, a weaker euro currency will tend to shift demand towards the yen. Also, if the Chinese continue to allow their currency, the renminbi, to increase, the demand for yen will concomitantly increase. In any case, in the coming months the yen presents traders with some significant opportunities. Let's explore how to shape what many call a set-and-let strategy in response to the current market moves.

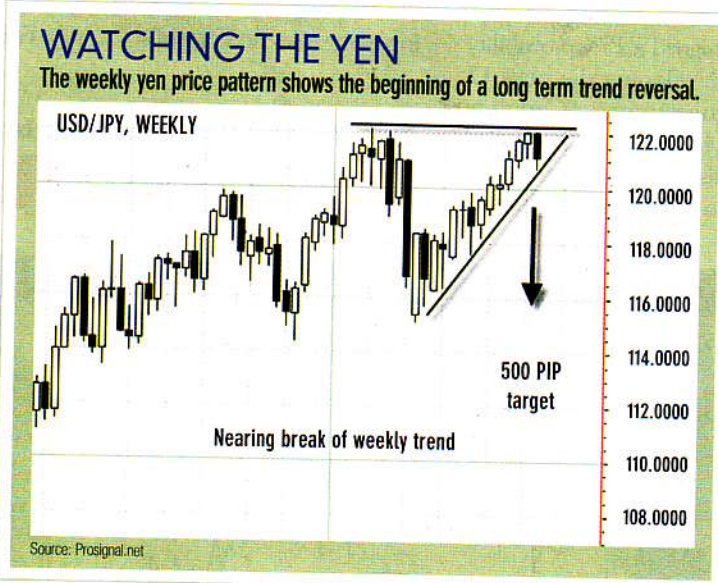
A set-and-let trade is becoming feasible with a short on the USD/JPY. The question becomes "What is a good location for such a short and when?" A return of the price under the psychological barrier of 122 would be a first signal to permit to sell this pair.

Another useful indicator, for timing the entry for buying a longer term position on the yen, often overlooked by traders who ignore fundamentals, is to examine the yen Trade Weighted Index (TWI). The TWI reflects the trading relationship of Japan and as a result provides a measure of how strong or weak the yen is against a basket of currencies.

The TWI basket is weighted as follows: USD (61%), EUR (26%), GBP (6.3%), AUD (3.67%), and CAD (3.20%). We can see that the yen has broken support and entered a period of global weakness. If the yen TWI moves back above support, the value of the yen, from a global trading point of view, would be showing an important retracement and would be a fundamental buy signal.

Traders should also keep in mind that the EUR/JPY, the GBP/JPY and the AUD/JPY also are likely to provide related trading opportunities. We are not yet there, but good position trading requires a lot of patience.

Abe Cofnas is president of learn4x.com LLC and author of *Understanding Forex: Trading to Win*. E-mail: learn4x@earthlink.net.



Japanese economy, the second largest of the developed world, that is presenting the most uncertainty, and as a result the best trading opportunities.

The most recent economic data releases coming from Japan provide the chemistry for impending large moves. Inflation remains at a 0.0% rate, yet unemployment levels are at their lowest rates of a decade. Additionally, recent capital expenditure data showed an increase above expectations. Still The Bank of Japan (BoJ), which declared that it will encourage the uncollateralized overnight call rate to remain at around 0.5%, is looking for the first opportunity to raise rates. If the BoJ does increase its overall call rate, Japanese consumers will be able to earn more interest income and keep more capital at home. It is estimated that nearly \$500