

FX Strategist

FX Strategy

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Leveraging core views

Worst Of: USDCHF ATMS call, USDSGD ATMS put, USDJPY ITMS put

The Fed's decision to extend its contingent commitment to low rates into late 2014 reinforces our bullish view on the yen and the case for continued outperformance of EM currencies (see "FX Strategist – Weekly update: after the Fed" 26 Jan 2012). At the same time, we expect CHF to weaken versus the USD over the near term, representing a combination of EUR weakness and risk of SNB intervention with EURCHF only a touch above the official floor.

We view the JPY as a natural beneficiary of policy easing in the rest of the G10, as a lack of attractive yield opportunities overseas complicates current account recycling efforts. With the Fed on hold through 2014, and the ECB, BOE, Riksbank, Norges Bank, and Reserve Bank of Australia likely to ease further, G10 front-end and mid-curve rates continue to converge at Japan-like levels. (see "FX Strategist – JPY after the FOMC announcement", 26 Jan 2012).

We continue to expect EM to outperform G10 through 2012. We believe a combination of easing in funding stress in the wake of the ECB's LTRO, a dovish Fed, and stronger than expected global growth data are the key cyclical macro drivers for Asia. They combine with the US ISM to signal Asia's export cycle has troughed, and this has historically been a consistent leading indicator of trend Asian currency appreciation. The SGD remains one of our preferred longs within the Asian FX complex.

However, we remain cautious on the EUR with sovereign solvency still a source of potential instability in the weeks ahead, as we near key peripheral maturity deadlines. Our technical analysts have entered a tactical EURUSD short, targeting a move lower to 1.2750. With EURCHF trading close to the 1.20 floor, and the negative-implied CHF rates, we think USDCHF longs look attractive as a proxy for EURUSD shorts.

The correlation structure between the different pairs provides good savings on the structure. As shown in Exhibit 1, the USDCHF/ USDJPY and USDCHF/ USDSGD implied correlations are both positive. The structure is effectively short USD volatility, consistent with our view that as the Fed remains on long-term hold, the dollar is unlikely to move due to yield-driven reasons over the period ahead.

USDJPY put, USDSGD put, USDCHF call – Worst-Of Option

Three-month expiration

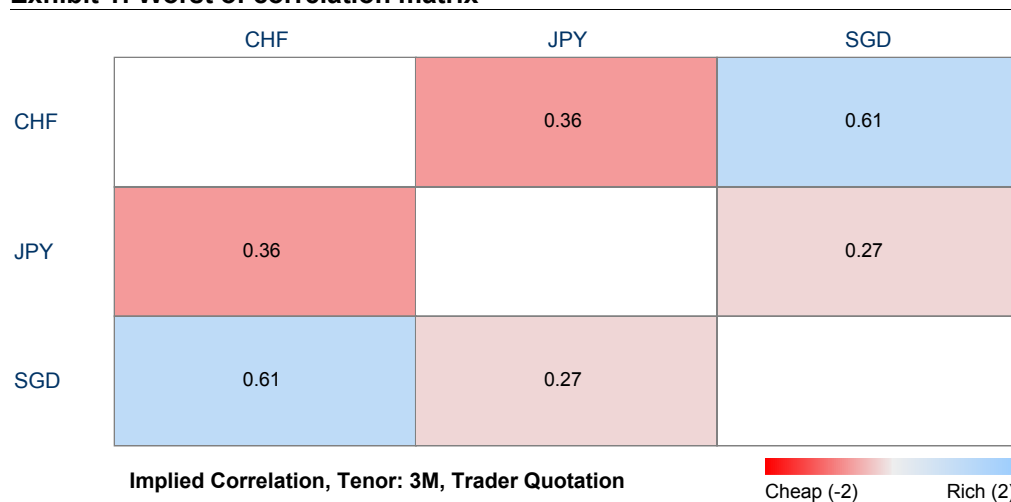
USDJPY 77.70 put (1.5% ITMS, spot ref: 76.60)

USDSGD 1.26 put (ATMS, spot ref: 1.26)

USDCHF 0.92 call (ATMS, spot ref: 0.92)

Premium = 0.23% of USD notional

Average offered price of three vanilla options is approximately 2.23%, while the cheapest option (USDSGD put) is offered at roughly 1.72%. The buyer of the option receives the worst of the three payouts from each of the individual options. The risk of the trade is a complete loss of premium if one of the underlying options is out of the money at expiration.

Exhibit 1: Worst of correlation matrix

Source: Credit Suisse Locus

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