

## HIGHLIGHTS

- **Dollar softer against EUR after hawkish comments out of the ECB, but euro was unable to hang on to those gains as the day passed. EUR/USD facing tough resistance near 1.46, while 1.4311 likely to offer key support. For cable, 1.95 is proving tough to break decisively, and we still look for eventual test of the 1.9340 low from Jan. Yen was firmer across the board on some risk aversion, but dollar/yen rose later in tandem with firmer US equities. Worst major performers on the day vs. JPY were CAD, KRW, SGD, ZAR, and MXN. Holidays in Japan and China helped keep markets quiet Monday, while lack of much US data this week will keep markets searching for direction. Look for technicals to dominate trading as the week progresses.**
- **US equities were modestly firmer, helped by bullish equity call by well-known US equity analyst. Oil-related stocks outperformed on higher oil prices, which were due more to Delaware refinery closure than to Venezuela threats (see below). Financials underperformed after big insurer admitted problems in derivative valuations and UK bank reported big drop in SIV net asset value. Asian ADRs ended up in N. American trading, pointing to a good start for Asian regional stocks today.**
- **The US 2-year yield fell 1 bp, while 10-year yield fell 3 bp. European 10-year yields mixed, however, with UK up 7 bp, France up 1 bp, and Germany down 1 bp. Fed funds futures market still pricing in 50-75 bps cut in March.**

## CURRENCY MARKETS

**Speculative long euro positions held on the IMM were almost halved in the week ended Feb 5.** The data suggests speculators capitulated when the euro failed to benefit from weak economic news. In fact, total speculative euro longs slipped only modestly while total speculative short positions increased by about 15% or 7920 contracts. The euro's further slide in the week ending Feb 8 likely reflected some extension of these total short positions and reductions in long positions keeping open interest relatively unchanged. That may have contributed to the euro's slide late last week and suggests some market participants may share our view that the euro is carving out a top. Much negative US dollar news has been priced in with the Fed funds market now pricing in up to 100bp of additional Fed cuts over the next few months. The euro is now likely to consolidate early in the week in a \$1.4450-\$1.4640 range ahead of the retail sales data and Bernanke's testimony. Break of \$1.4450 opens a test of the lows around \$1.4300 while a move above \$1.4640 opens \$1.4750. We would need to see a clear break of the \$1.4300 level to convince us that the euro top was in place. Real money flows appear to have played less of a role though investors did sell both US equities. During the week ended Feb 6, equity mutual funds and ETFs investing in US stocks showed net outflows of \$9.2 bln and \$6.9 bln, respectively, according to TrimTabs. Funds also flowed out of non-US equity mutual funds (\$2.5 bln outflow) though there were flows into ETFs investing in non US equities (1.4 bln). Yen positions on the IMM remained around four year highs as of last Tuesday even as the dollar remains inside its recent JPY105.80-JPY108 range. Meanwhile, both Japanese and foreign investors remain net sellers of Japanese assets. If this continues and momentum to take the yen higher continues to slow, the dollar is likely to retest the JPY108.00 level. Speculators are now slightly short sterling, having reduced longs late last year. That's not enough to trigger a sharp sterling rally but technicals suggest there is potential for 1.9600 in the short run. We believe sterling has already put in a top vs. the buck in 2008 and will continue to head lower as the BOE cuts rates. Speculative short sterling positions likely to rise.

**Oil prices slightly lower despite Venezuela threatening "economic war" against the US over the weekend.** Chavez comments were in response to Exxon winning rulings last week in the US, UK, the Netherlands, and the Netherlands Antilles that will freeze more than \$12 bln of Venezuelan assets overseas. Exxon sought the freeze to prevent the country from shifting assets to other countries as the company seeks redress from international arbitration for the seizure of several oil-related joint ventures last year. We note that almost 50% of its total exports and almost 65% of its oil exports go to the US, so the US is a major influence on Venezuela. But the interesting thing about Venezuelan oil is that it is very sour (high sulfur content) and that not too many refineries worldwide are capable of handling this oil (most are located in the US). It would be virtually impossible for Venezuela to simply sell its oil elsewhere, and so Chavez is unlikely to follow through on this immediate threat. What else could Chavez do if he cannot use oil as a political weapon? Venezuela could default on its external debt obligation, which currently total about \$45 bln. Investors appear to be getting more concerned about default risk, as spreads on long-term Venezuelan dollar debt have widened out 40-45 bps over the past week, while credit default swaps on the country rose more than 100 bps during the same period. While we do not think that Chavez will resort to drastic measures, we acknowledge that the probability is non-zero. Indeed, there is the risk that with his popularity at home falling, Chavez may feel that declaring a debt moratorium is an easy way to deflect criticism. It's a very risky strategy to become a global pariah, however, and it is not our base case scenario. Look for Chavez to make more inflammatory comments in the coming days, but without actually following through on these threats. Either way, we do not think Venezuela (with GDP of only \$225 bln) is large enough to cause any sort of EM-wide selloff.

**Brazil Finance Minister Guido Mantega expects to obtain an investment grade rating this year.** He noted that Brazil has been unaffected by turmoil in the global markets, adding that current inflation is "comfortable" and remains "totally" in line to meet the central bank's 2.5-6.5% target. We think this may be too optimistic, though we fully admit that Brazil's fundamentals are very good and continue to improve. Indeed, market is already pricing Brazil as an investment grade credit; the spread on Brazil (BB+/Ba1/BB+) 10-year dollar bond is currently around +248 bps, which compares to +248 bps for Bulgaria (BBB+/Baa3/BBB), +239 bps for South Africa (BBB+/Baa1/BBB+), and +245 bps for Colombia (BBB-/Ba2/BB+). However, given the current risk averse environment and ratings agencies under fire for their part in the subprime mess, we wonder if the agencies will be more cautious across the board for the time being. That said, inflows continue into Brazil and the central bank just announced reserves jumped \$7.2 bln in January to \$187.5, despite the real weakening for much of the month. Near-term target for BRL is 1.7510, break of which targets the Feb low of 1.737 and then the Jan low of 1.7300.

## UPCOMING ECONOMIC RELEASES

**Philippines, Malaysia Dec trade out, followed by Taiwan Jan trade, and Korea Jan consumer confidence. UK Jan CPI, Iceland Jan jobs data, and Germany Feb ZEW sentiment survey out. South Africa and India Dec IP out, followed by Poland Dec trade and current account. No US data scheduled for release, but Fed's Yellen speaks.**

RATES AND RANGES -- at 16:00 ET/21:00 GMT

FROM NY OPEN			INTRADAY RANGES	
MAJORS	16:00/20:00	% Change	LOW	HIGH
EUR/USD	1.4524	0.1%	1.4482	1.4577
USD/JPY	106.91	-0.4%	106.35	107.65
USD/CHF	1.1018	-0.1%	1.0948	1.1048
GBP/USD	1.9510	0.3%	1.9403	1.9532
EUR/JPY	155.27	-0.3%	154.33	156.38
EUR/GBP	0.7444	-0.2%	0.7439	0.7509
EUR/CHF	1.6000	0.0%	1.5944	1.6026

COMMODITY CURRENCIES	% Change	LOW	HIGH	
AUD/USD	0.9042	1.0%	0.8952	0.9059
NZD/USD	0.7890	0.1%	0.7865	0.7916
USD/ZAR	7.7828	-0.1%	7.7401	7.8543
USD/CAD	1.0017	0.3%	0.9958	1.0034

FROM NY OPEN			INTRADAY RANGES	
OTHER ASIA	16:00/20:00	% Change	LOW	HIGH
USD/TWD	32.00	0.0%	32.00	32.00
USD/PHP	40.90	0.8%	40.56	40.91
USD/THB	31.80	1.3%	31.26	32.12
USD/IDR	9265	0.2%	9237	9278
USD/MYR	3.2430	0.4%	3.2315	3.2448
USD/SGD	1.4183	0.1%	1.4165	1.4198

FROM NY OPEN		% Change	INTRADAY RANGES	
LATIN AMERICA & NON EU EUROPE			LOW	HIGH
USD/MEX	10.7636	0.1%	10.7498	10.7810
USD/BRL	1.7578	-0.7%	1.7555	1.7720
EUR/CZK	25.68	-0.3%	25.62	25.88
EUR/PLN	3.6111	-0.3%	3.6103	3.6302
EUR/HUF	264.43	-0.8%	263.54	267.40

MONEY MARKETS (3 MTHS)	LEVEL	SPREAD
U.S.	2.97%	---
Euro	4.29%	132bp
Japan	0.83%	-214bp
U.K.	5.58%	261bp
Canada	3.91%	94bp
Australia	7.50%	453bp
New Zealand	8.84%	587bp
Switzerland	2.66%	-31bp

BENCHMARK EQUITY INDICES				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
MSCI - World*	358	-0.1%	-4.5%	-4.5%
MSCI - Europe*	506	-0.6%	-7.0%	-7.0%
MSCI - EAFE	1948	-0.7%	-8.3%	-8.3%
MSCI - Asia Pacific	139	-1.1%	-2.9%	-2.9%
MSCI - Emerging Mkts	1085	-0.9%	17.4%	17.4%

AMERICAS EQUITY MARKETS				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
Dow Jones Industrials	12239	0.5%	-2.7%	-2.7%
S&P 500 Index	1339	0.6%	-6.9%	-6.9%
Nasdaq Composite	2320	0.7%	-5.7%	-5.7%
Canada Toronto TSE	13125	1.0%	0.3%	17.7%
Mexico Bolsa Index	28755	2.0%	3.0%	5.7%
Brazil Bovespa Index	60643	2.7%	36.9%	64.6%

EUROPEAN EQUITY MARKETS				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
Eurotop (FTSE)	2712	-0.9%	-15.2%	-5.0%
FTSE Index	5708	-1.3%	-10.6%	-10.4%
German DAX Index	6744	-0.4%	-2.4%	9.3%
French CAC 40 Index	4683	-0.6%	-17.7%	-7.9%
Italy MIB30	33091	-0.8%	-22.6%	-13.3%
Swiss MP Index	7348	-1.3%	-20.9%	-10.0%

COMMODITY MARKETS	Level	Previous	Change
NYMEX crude (near future)	\$93.60	\$91.77	\$1.83
Gold (near future)	\$923.60	\$918.40	\$5.20

BOND MARKETS	Level	Previous	Change
US 2-yr Note	1.91%	1.92%	-0.01%
US 10-yr Note	3.62%	3.64%	-0.03%
US 30-yr Bond	4.40%	4.42%	-0.01%
German 10-yr Bund	3.86%	3.86%	0.00%
UK 10-yr Gilt	4.50%	4.43%	0.07%
Canada 10-yr Bond	3.79%	3.83%	-0.04%

MARKET INDICATORS	Level	Previous	Change
VIX Index	27.53	28.01	-0.48
EMBI+ Sov. Spread (prior close)	285bp		

Source: Bloomberg. \*These are the 'All Country' World & 'All Country' Europe indices, which cover developed and emerging markets for the respective regions.

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