CitiFX Technicals

The 12 Charts of Christmas

December, 2010

A very warm Season's greetings to all our readers and best wishes for a healthy and prosperous 2011

The CitiFXTechnicals team

Please note that publications between now and the holiday period will be on an ad hoc basis.

We anticipate regular commentary to resume in the New Year

Overview

•In this note we give you our 12 charts of Christmas.

•These are the 12 most important charts (in our view) that establish a "starting point" for our views on markets in 2011.

•As always this is a continuing work in progress but the pages ahead give you a sense of our strongest core views as we head into next year.

The conclusions we draw as a starting point as we head to 2011 are:

•The DJIA/S&P to have an intra year drawdown of 20%+ and finish the year down a double digit percentage (13-17%)

•U.S. 10 year yields to rise to at least 4% and quite possibly back over 4.5%

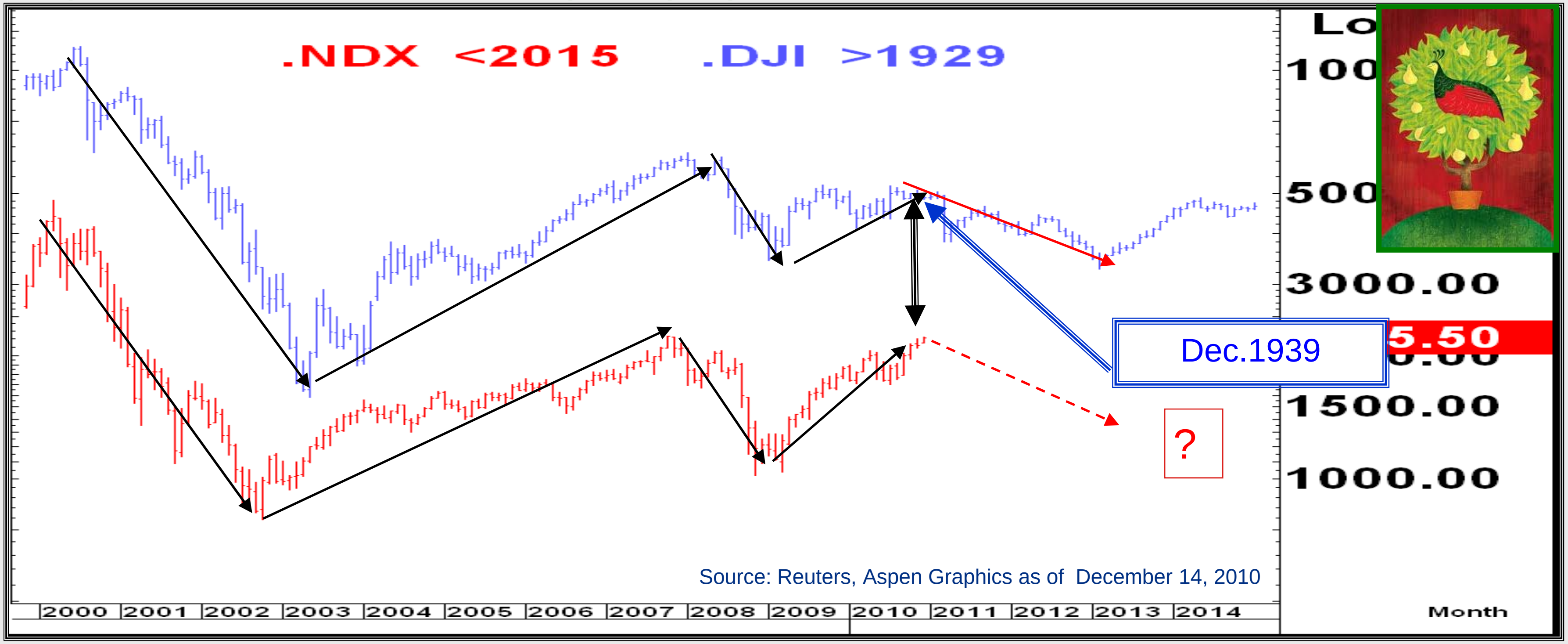
•Commodities to rally strongly with Crude heading back over $100 and Gold above $1,700

•EURUSD to rally double digit percentage (11%) and the USD-index to drop about 8%

Note: All expectations in this document for 2011 are the views of the CitiFXTechnicals team. They in no way constitute official Citigroup views.

The 1st chart of Christmas truly says to me, 2011 is not the year of E-quit-ies

Comparisons of DJIA 1929-1939 and NDX (Nasdaq 100) 2000-2010 has been our favourite for 7 years.

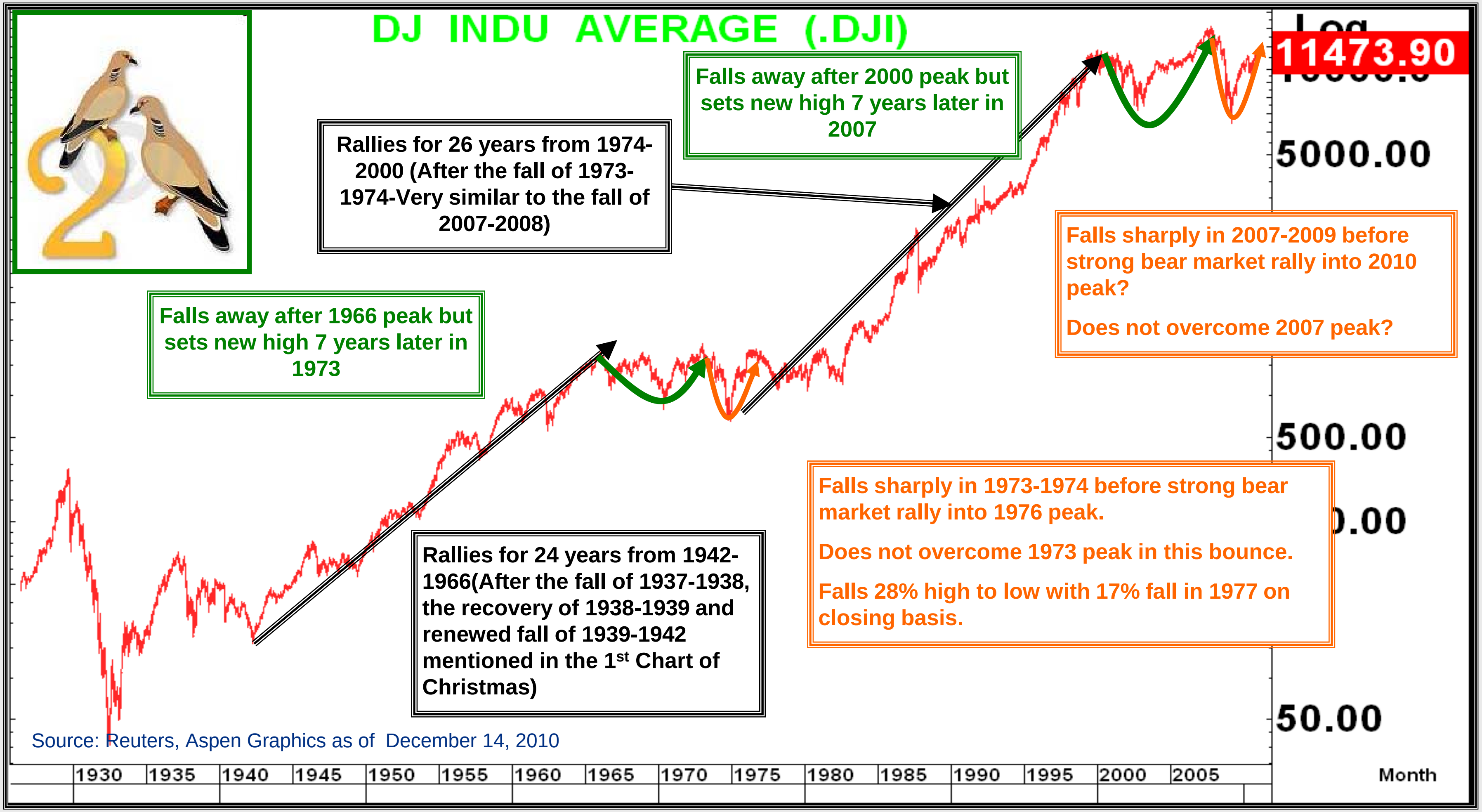


- DJIA drops over 80% from Sep’29 to July’32 (34 months) while NDX drops over 80% from Mar’00 to Oct’02 (31 months).
- DJIA posts bullish monthly reversal off trend low in July 1932. NDX posts bullish monthly reversal off trend low in October 2002.
- DJIA rallies for 56 months.(1932-1937) NDX rallies for 60 months(2002-2007).
- DJIA falls over 50% over12 months (1937-1938). NDX falls over 50% in 13 months (2007-2008).
- DJIA bounces 64% in 8 months. NDX bounces over 90 % in 13 months (2009).(Now up 118% off its low)
- **DJIA peaks and sees a renewed (choppy) bear market over the following 3 years (1939-1942) that ultimately loses over 40% from the 1939 high. The 1937 high was not re-tested until 1946 and was not “decisively” left behind until 1950.**

Note: The fall in 1940 began on 3rd January 1940 (a level never seen again that year). We saw a high to low fall by June of 28% and finished 1940 down 13%.

That move lower began in earnest 22 months after the strong bear market bounce that did not regain the 1937 peak.

The 2nd chart of Christmas truly says to me ,1977, this is the move that we may see

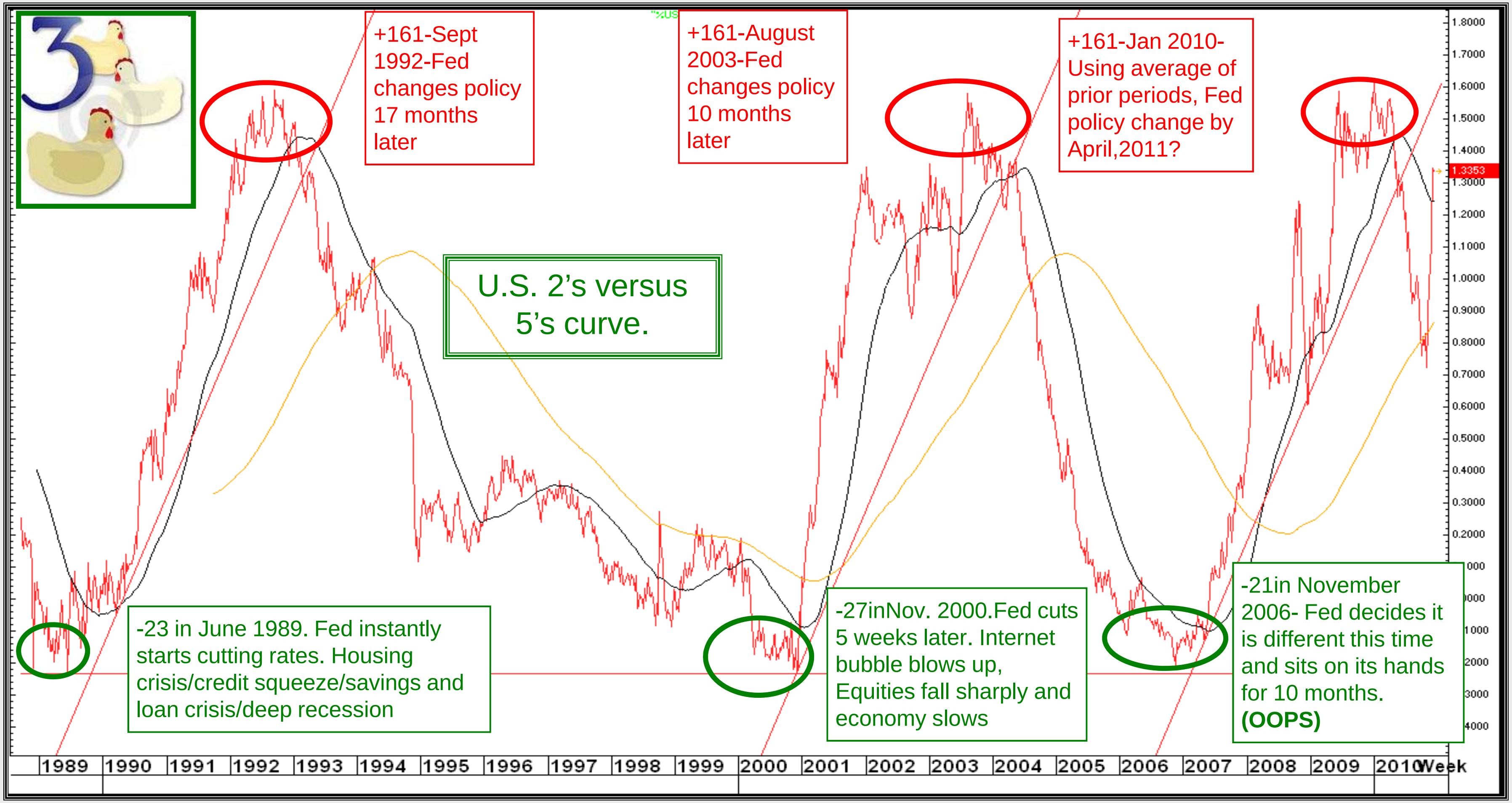


- This chart has been running a very close 2nd for some time and is close to becoming our number 1 choice.

Note: The next decisive move lower after the 1974-1976 rally (21 months bounce low to high) began on 3rd January 1977 (Just as it did on 3rd January 1940)

We saw a high to low move of 21% by October and finished the year down 17%

The 3rd chart of Christmas truly says to me that this could be 1993



Source: Reuters, Aspen Graphics as of December 14, 2010

- Over a period of 2 decades + this chart has seen 6 major pivot points.
- While the Fed reaction in 2007 was way slower than the prior periods, the unprecedented policy action that followed balanced this somewhat and the curve did exactly what it did in the prior 2 periods
- Historically a Fed policy change = a change in the Fed funds rate. Today it could be a language change (take extended period out of statement) or a change/suspension of Q.E. Given the housing/credit dynamic we are most focused on 1993-1994 here.

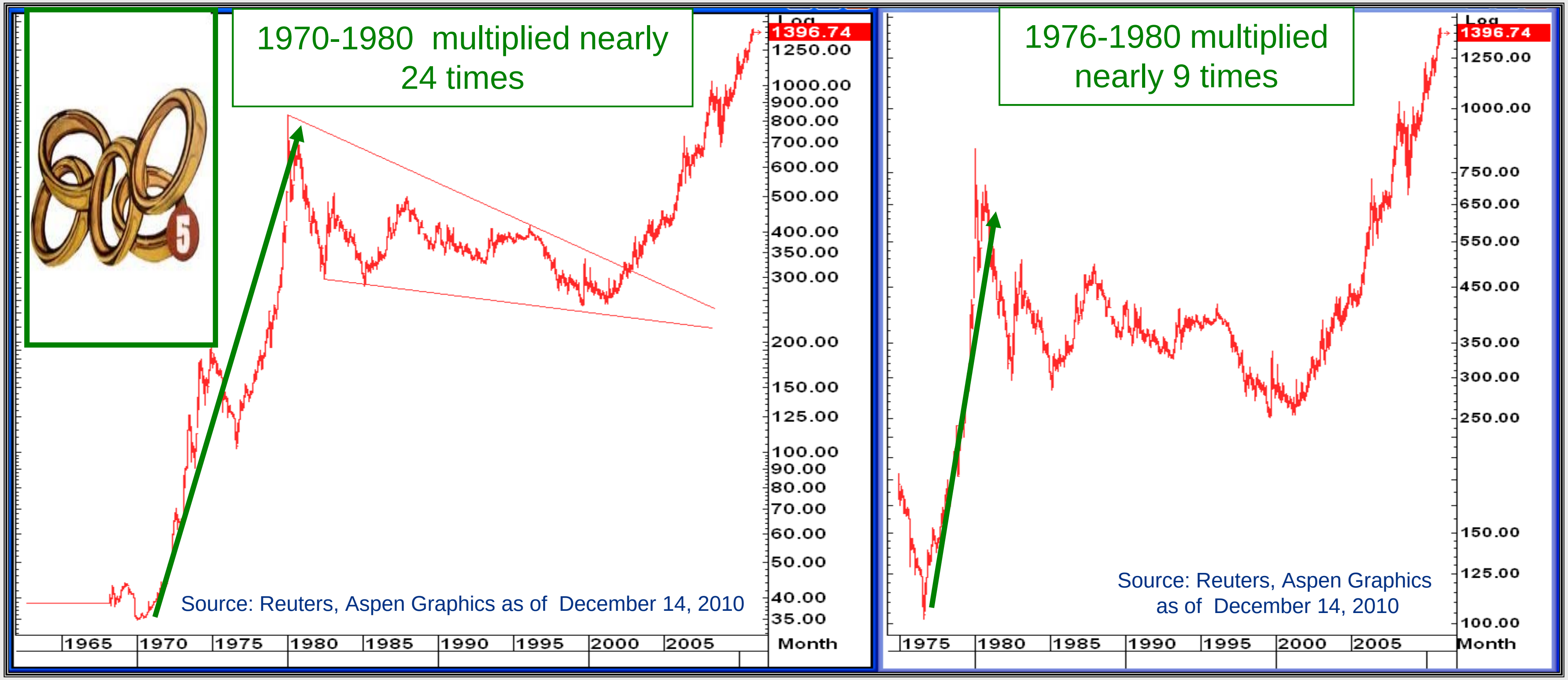
The 4th chart of Christmas truly says to me that in 2011 a bear market in bonds we'll see

T-Bond: End of a 27 year bull market?- Is it 1976 again?

- Biggest bear market coming since surge in yields in 1977-1981? (When Fed kept interest rates too low for too long after severe housing, equity and economic downturn in 1973-1976.)
- Time will tell. Price action at the peak of this channel is almost identical (mirror image) to the price action seen at the lows in 1981-1984
- Below 113-113.50 would suggest an end to 27 year bull market

The 5th chart of Christmas truly says to me a $2000 Gold price will be E-Z

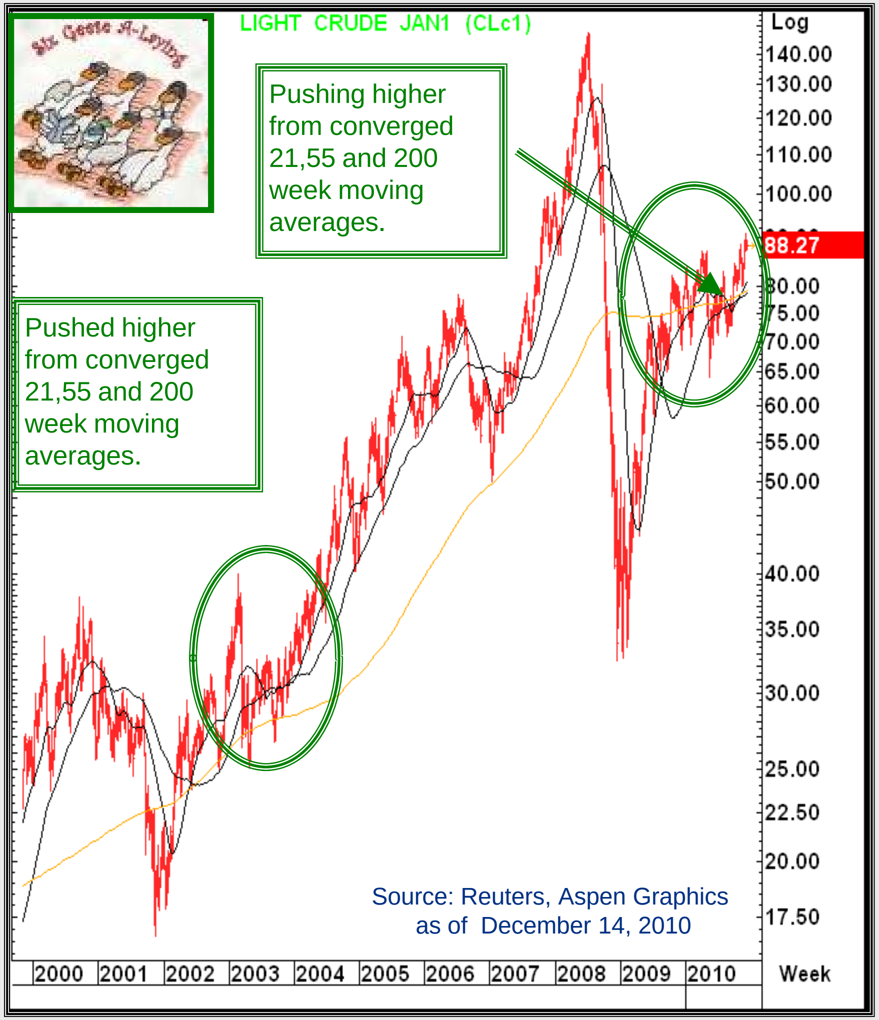
We remain medium term bullish – Bubble??? Not by historic standards

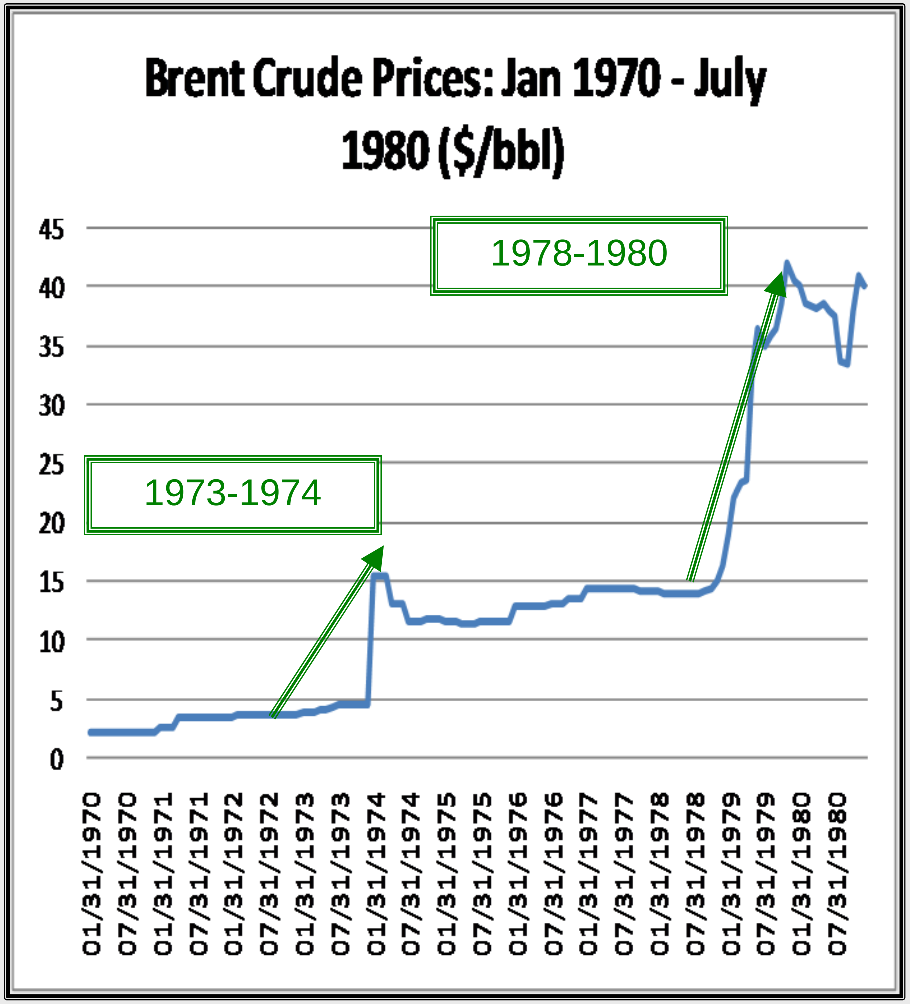


- Gold has multiplied less than 6 times since the 2000 turn. This follows a downturn from 1980-2000 (20 years). Considered opinion is that in those years we had declining inflation. That is partly true and patently false. While consumer inflation declined (productivity, cheap goods from developing world exporting disinflation to U.S, low wage settlements etc.) we had an explosion in inflation in credit, Fixed Income, Housing and Equities. You do not hedge this inflation with Gold. You hedge it through leveraged buying of assets - which is exactly what we did. Even the Central banks of the World fell in love with the efficient market/FIAT currency model and sold Gold at the low.
- Now as all these assets are deflating we need traditional inflation to devalue debt and restore some value in these assets. As a consequence Gold is now a hedge against the wings (we either relate/inflate or we keep printing money with no success and end up with a fiscal credibility problem.) **Either way Gold is a hedge against an uncertain outcome**

The 6th chart of Christmas truly says to me that Crude at $100+ in 2011,will be

Repeat of 2002/2003?- Price doubled between 2003 and 2004. It also surged twice in the 1970's



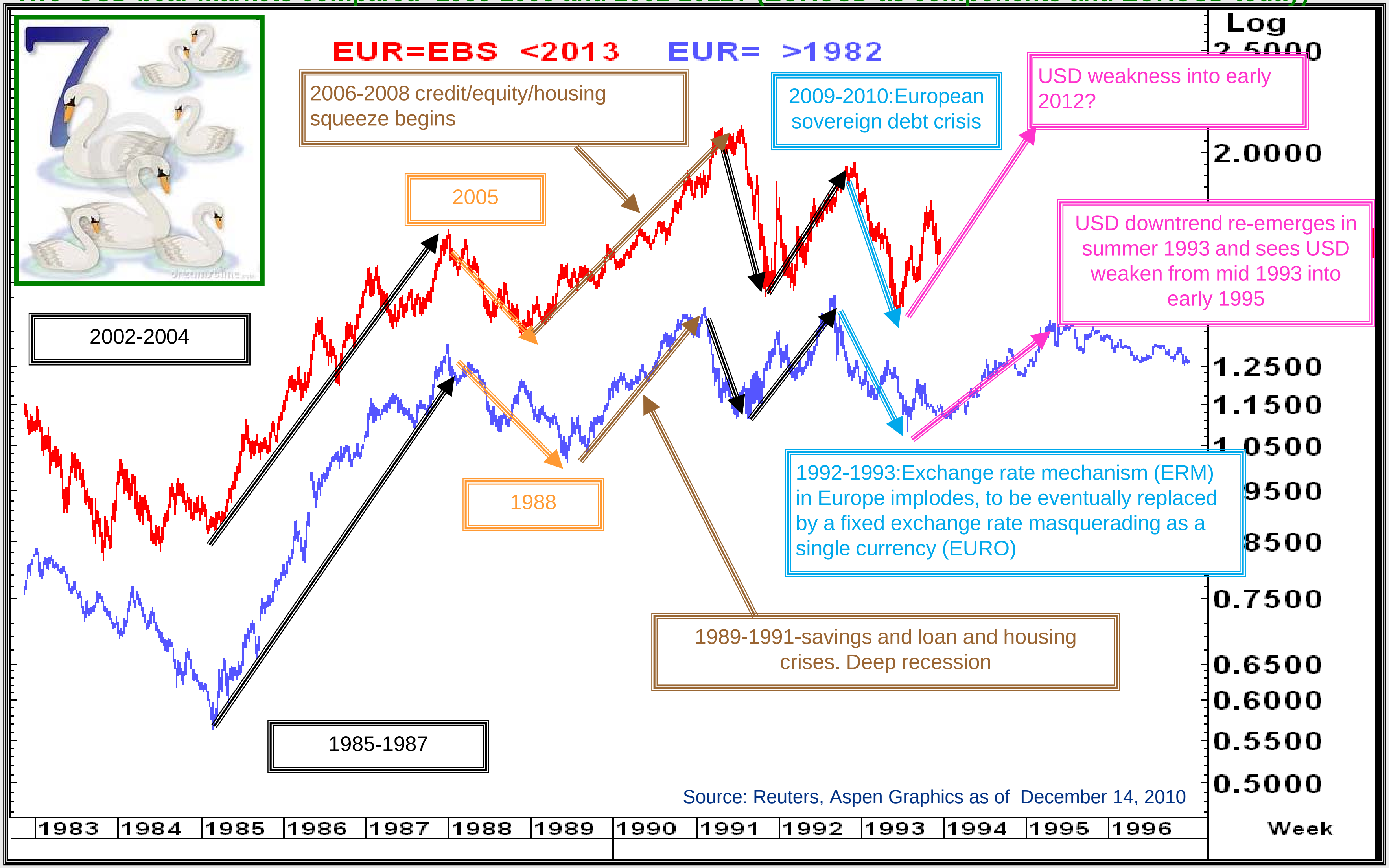


Source: Global Financial Data as of December 14, 2010

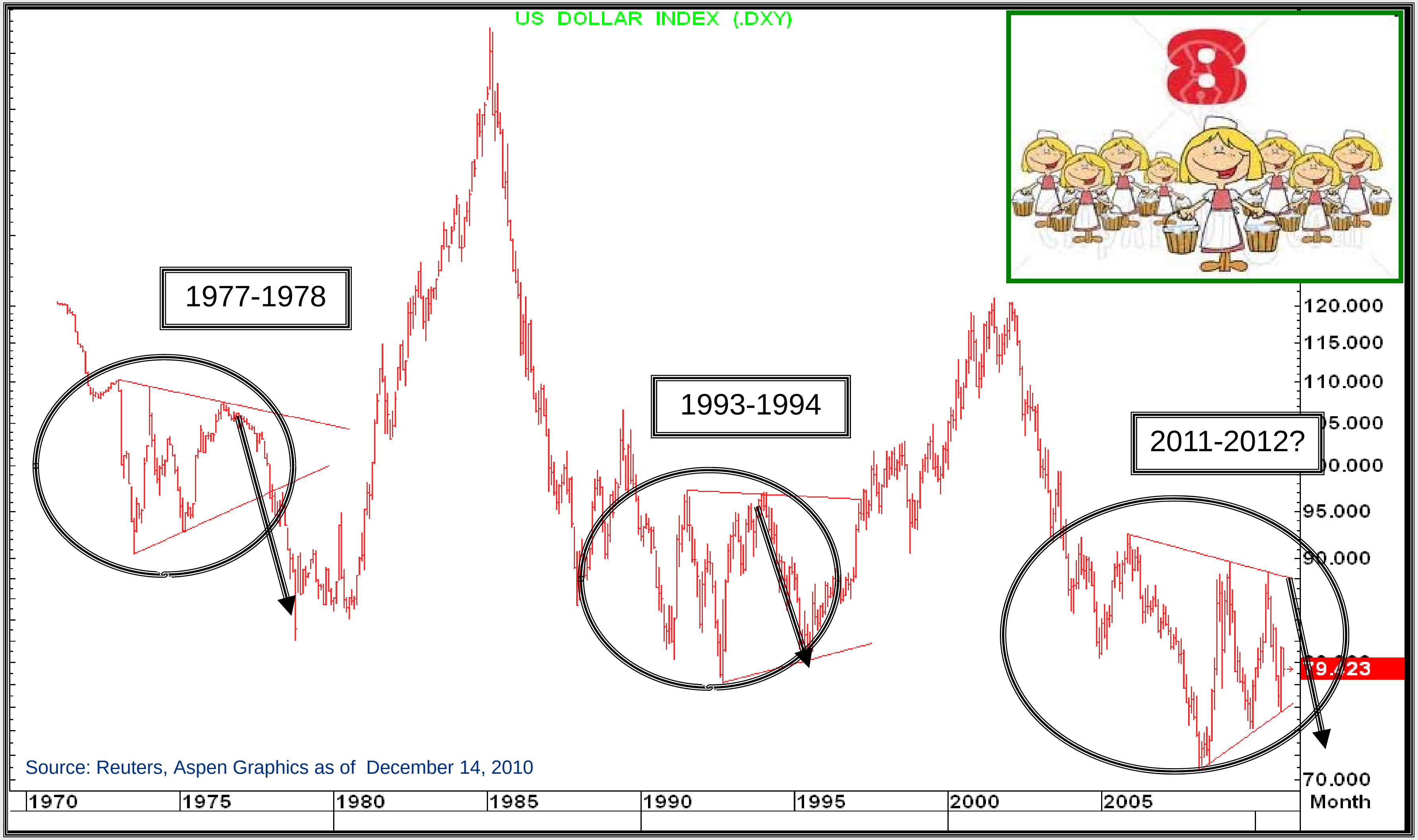
- Fed eventually changed policy in June 2004.
- Inflation picked up sharply in 1978-1980 leaving us with 20% nominal interest rates,13% inflation and 7% real rates.

The 7th chart of Christmas truly says to me that the EURO will not cease to be

Two USD bear markets compared- 1985-1995 and 2002-2012? (EURUSD as components and EURUSD today)



The 8th chart of Christmas truly says to me that from USD-Index the market will flee



- The USD Index fell nearly **8% in 1977** (housing recovery and a bear market in bonds)
- The USD Index fell just over 8% in 1994 (17 years later when we also saw a bear market in bonds)
- Same again for 2011 (17 years later) with a bear market in bonds again?

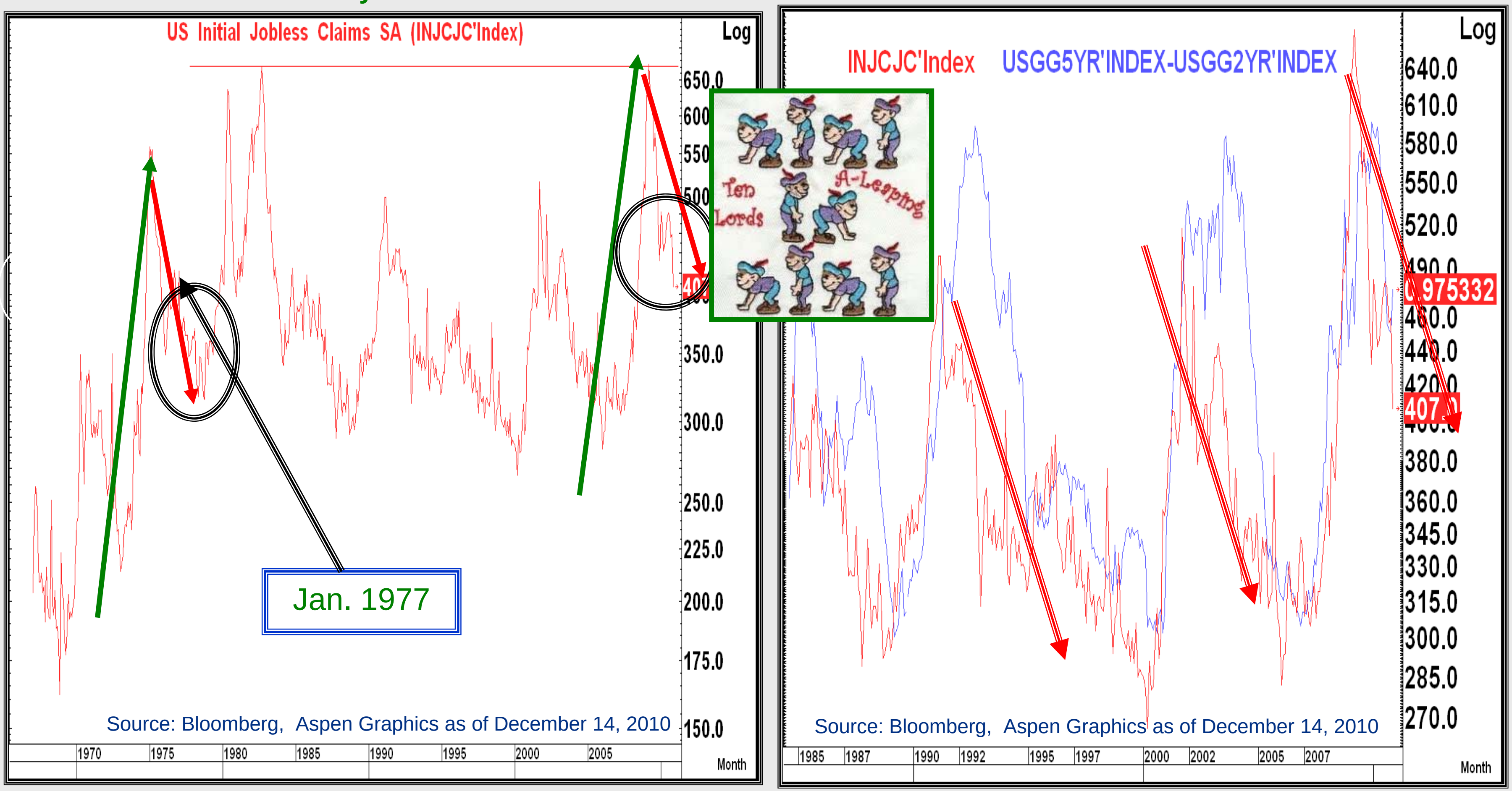
The 9th chart of Christmas truly says to me that a housing move like this we did before see

Is 1972-1975 the best comparison to 2006 - 2009?

- Housing could be going back to a more range bound dynamic similar to that seen between 1975-1990
- While there are significant headwinds to recovery here (especially if yields do start to rise), increased growth/inflation/employment expectations could stimulate activity if people start to fear they could lose out on the opportunity with housing at historically good affordability levels.

The 10th chart of Christmas truly says to me that soon this may not be a jobless recovery

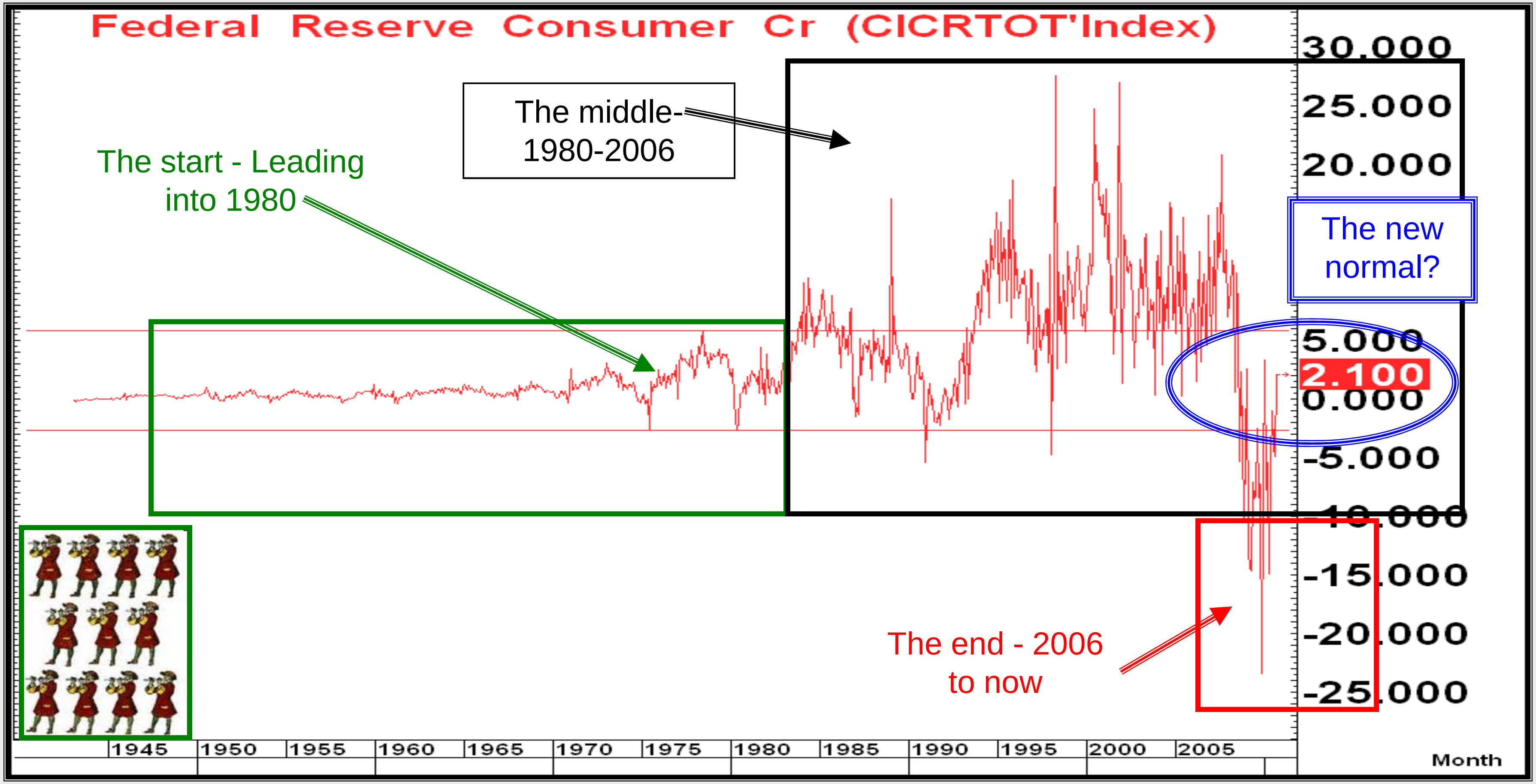
Initial claims remain the key- 1975-1978? /1993/2003?



- The improvement in initial claims is not that different to other cycles and the initial claims versus yield curve dynamic suggest that a move below 400k may be the "heads up" for a more sustained improvement in the unemployment rate and non farm payrolls in 2011
- Getting back to 4% to 5% levels anytime soon will be a stretch, however, given that those levels were achieved in a leveraged economy that is now deleveraging.

The 11th chart of Christmas truly says to me consumer credit is returning to normalcy

Consumer credit- 1976 on steroids?

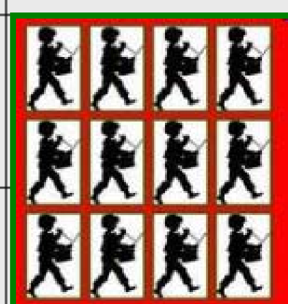


Source: Aspen Bloomberg, December 14, 2010

- Not a pretty picture and the core of the problem. The balance sheet. (Consumer/financial institution and Government)
- The pre 1980 range may be the new normal for some time to come
- Lower credit/leverage likely ensures sub par growth and employment picture. Therefore the question is - Will we take the pain? Our guess is that, no, we will not. Instead we will continue to look to reflate/inflate without showing monetary or fiscal responsibility.

The 12th chart of Christmas truly says to me that 2011 will give us lower Bonds, lower Equities, higher commodities and a lower USD.

What year is it? When we look at our 12 charts of Christmas we see that one period in particular shows up consistently (1976-1978) with the 1993-1994 period a distant 2nd. We know what happened in 1977 and also what happened 17 years later in 1994. We now head into 17 years later again (2011) and our bias is that history gives us a good guide to what may happen next year. The <u>*1976-1977*</u> period is the only one that shows up across ALL of our instruments / markets analysed

What period is today most like?			1977	1994	2011 expectations
Equity market	**1939-1940** Intra year bear market (high to low move over 20%). Closed down 13%	***1976-1977***	•Intra year bear market (high to low move over 20%). •Closed down 17%		•Intra year bear market (high to low over 20%). •Close 2011 down +-15%
Fixed income	***1976-1977***	**1993-1994**	•U.S. 10 year yields rose 100 basis points in 1977 and 800 basis points in 1978-1981	•U.S. 10 year yields rose over 290 basis points	•Sharp move higher in 10 year yields back to and likely above 4% and possibly 4.5%+
Crude/Gold	***1976-1978***	**1993-1994**	•Crude surged in the late 70's and Gold multiplied by a factor of 9 between 1976 and 1980. •Gold rose 22% in 1977	•Crude doubled in price in the 1994-1996 period	•Gold could easily head to $1,700+ and likely extend thereafter towards $2000 •Crude to $100+ and possibly a lot more
USD	***1976-1977***	**1993-1994**	•USDDEM fell over 11% •USD-index fell nearly 8%	•EURUSD (components) rose over 11% •USD-Index fell just over 8%	•EURUSD to rally 11% •USD-Index to fall 8%
Fundamentals	***1976-1977***		•ISM, consumer confidence, initial claims etc. have a very similar dynamic to that seen in 1973-1976		•Data to improve but a struggle to get strong trending growth. Inflation concerns could start to materialise towards the latter part of the year
Housing	***1976-1977***		•Performed well in 1977-1978 before getting crushed in 1979-1981 as Volcker raised interest rates to 20%		•Credit overhang may make any recovery here more subdued than 1976-1978

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