PRO COMMentary

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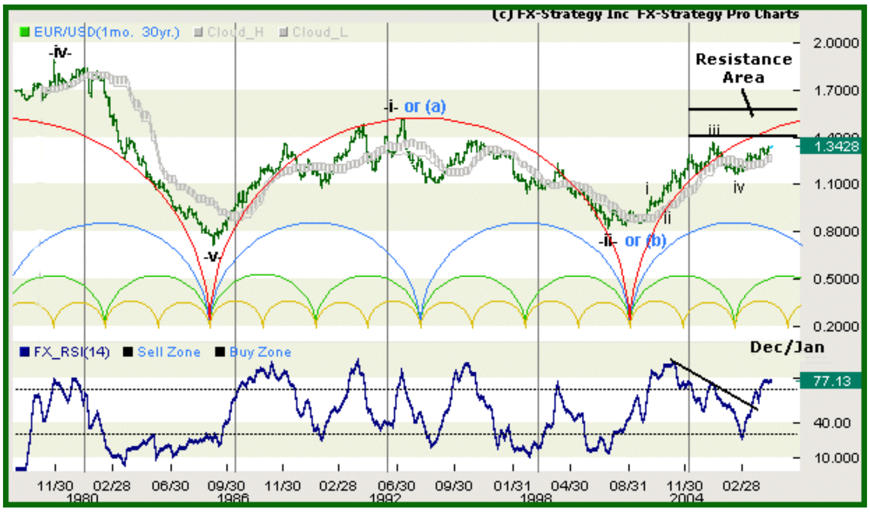
# Euro vs U.S. Dollar – Long Term Outlook

The Euro has seen a long rally from the 1.1640 low in November of 2005 – that's almost 18 months of pretty consistent gains and the long term there still appears to be further to go. However, there are signs of exhaustion raising the chance of a significant correction before it can break cleanly above 1.3666.

Let us look at the factors that lead me to that conclusion.

First we should take a look at the very long term picture represented in the monthly chart. The data used dates back to before 1980, obviously before the Euro was born. The data prior to the launch on the 1st January 1999 was calculated using each of the constituent counties currencies and weighted according to the percentage of trade with external countries. This can only achieve an approximation of what the Euro *may* have looked like if it had been traded as a real currency and at best it can only be used as a guideline though the cycles should be moderately accurate.




What is immediately clear is the accurate correlation between price and the underlying cycles with the green, blue and red cycles all matching major price lows.

The last green and yellow cycle low matched the 1.1640 low on the18th November 2005 and it is the combined pressure from the rising red, green and yellow cycles that have maintained the persistent rally. The blue cycle during this period was still high and thus also provided support for the uptrend.

At the point of writing the yellow cycle is pointing strongly lower, backed up by a declining blue cycle while the green cycle is finding a high. The yellow cycle is due to find a low around the turn of the year. FXS-RSI is overbought and while it has broken above the prior line drawn across the peaks in what may have been taken to be a bearish divergence, unless there is a strong pick up in momentum – which seems unlikely given the position of the cycles – the threat is for FXS-RSI to react from its current overbought position.

The previous (synthetic) peak in Wave –iii- is at 1.5231 and this may be in danger of being tested at some point before the implied decline into the end of this year.



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Although this shouldn't make much difference to what we should expect for this year, it should be noted that while a recovery in price will be expected in the early months of next year, by that time the blue and green cycles will be declining and thus we could find that we shall see a larger correction develop into the convergence of the blue, green and yellow cycles which is expected to occur by Q1 2010.

Moving next to the weekly chart we can see the position of the weekly cycles matching those of the monthly cycles with the blue cycle firmly pointing lower, the green cycle coming to a peak and the yellow not too far from a low.


It provides an expectation of a decline that we should see quite soon of a price correction into the yellow cycle low which looks to find a low some time in late May. Following this the likelihood appears to be for a further rally that could see a new high with the dominant red cycle still providing an upward influence that should be assisted by the yellow cycle.

If our wave count is correct we should expect a minimum test of 1.3666 being the previous peak in Wave iii while we can generate further targets at:
A 61.8% projection @ 1.3932
A 66.6% projection @ 1.4016
A 76.4% projection at 1.4184

Most likely the lower of these is probable as we would not expect a strong break of 1.3666 and thus we will expect over the summer months to see a test of 1.3932-1.4016.

This should complete Wave –a- of Wave –v- and this should then generate a larger correction to the entire rally from 1.1640 – again the first major low being expected at the turn of the year. Note the potential for FXS-RSI to form a bearish divergence.


Finally, turning to the daily chart we can begin to fine-tune the nearer term picture.

The daily cycles are highlighting the risk of losses with the downward pointing blue, green and yellow cycles already quite mature into the down-cycle. This suggests a low around the end of April. Here we have to be a little flexible with the weekly cycles suggesting a low several weeks later.

It should be remembered that cycles are approximate timing guides only and thus we should be aware of the downside risk that could find a low in May at some point. If this is the case, then it would be unreasonable to suggest that we shall see a correction of the entire rally from 1.1640 and therefore it is possible that it could just correct the rally from 1.2865 only. We have seen a rally to 1.3575 as of yesterday and the risk is therefore still towards 1.3616-60 in Wave a of Wave v. This should generate a correction in Wave b of approximately 50% of the rally from 1.2865 to the coming peak but from there we can expect a rally to the 1.3932-1.4016 area over the subsequent few months.

Note the bearish divergence forming in FXS-RSI while price has remained above the Pivot Cloud for most of the rally from 1.2865. A break of this cloud would suggest that we shall see a deeper pullback.

Thus in summary the Euro still looks bullish for several months to come but with an initial risk, it would appear, of a shorter term pullback over the coming month. However, by the time we reach the 1.3932 area we should be ready for a much larger reversal that will be maintained into the end of this year.