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iFlow® Weekly

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COMMENTARY

This week we revisit cross-border investor activity in the US, especially in the fixed income market. We then turn our attention to portfolio and currency flows in Asia, a region where central banks have also joined in attempts to lower borrowing costs and reflate their economies.

It is interesting to begin with looking at what has transpired in the past several days in US Treasuries. In the previous iFlow Weekly, we had pointed out how cross-border investors had begun unwinding their long-UST exposure in the run-up to the 6th February US labor market data release – as it turned out, the above-consensus reading on non-farm payrolls (three-month average at 336,000, the strongest since November 1997) vindicated their actions. Subsequently, the 10-year UST yield continued rising to above 2.15% last week from levels below 1.65% at the beginning of the month.

As Chart 1 illustrates, the UST outflows proved to be short-lived as cross-border investors turned into net buyers the week of 9th February onward. In other words, the back-up in Treasury yields was viewed as an opportunity to get back in at better-re-entry levels.

Of course, subsequent US data releases on January retail sales disappointed and January producer price inflation numbers came in well below consensus as well, both of which served to undermine bond-market bears. Overall, the consistent series of net UST purchases signposted by iFlow has led to renewed declines in UST yields this week.

In the bigger picture, the Federal Reserve's minutes (from the FOMC meeting last month) were decidedly dovish and included an acknowledgement that the US dollar's ascent over the past year could be "a persistent source of restraint." Janet Yellen reiterated these sentiments earlier this week. This tempering of investor expectations of "liftoff" and advocating a patient and gradualist approach to normalizing rates is key to understanding why the UST market remains underpinned by investor demand. Indeed, as Chart 2 shows, iFlow cumulative buying has resumed.

On the flip side, one could point out that with the pace of global FX reserves growth having moderated, there will presumably be less demand for US Treasuries, which would lead to yields grinding higher. Indeed, latest data confirm China's holdings of

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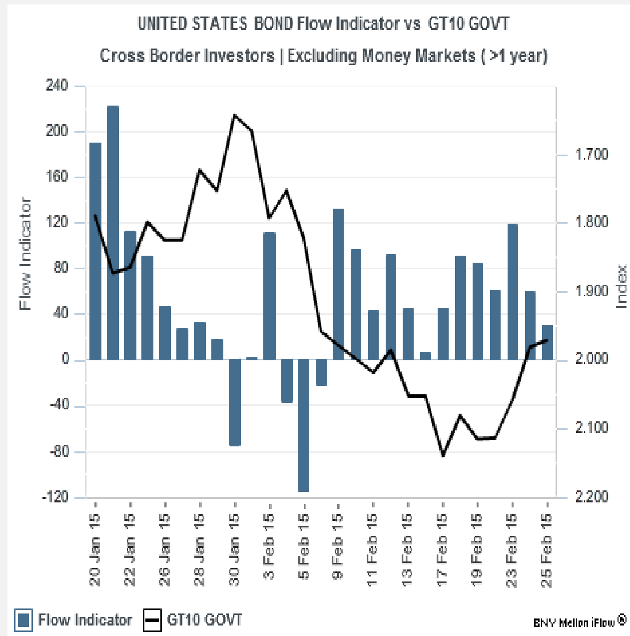

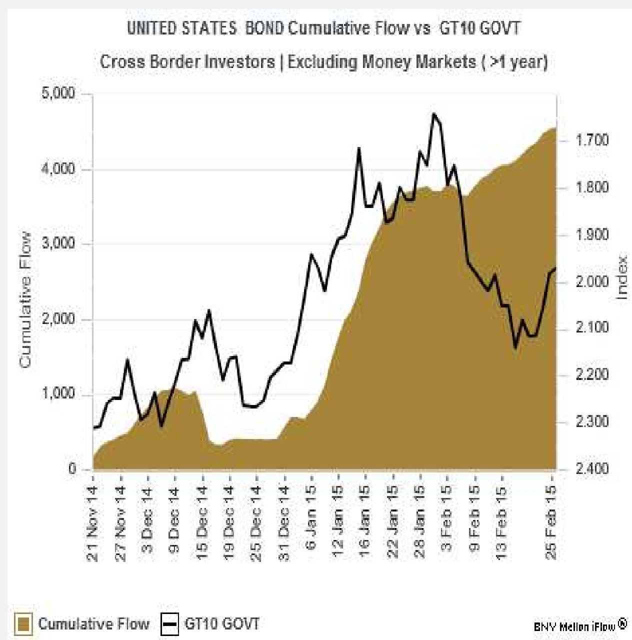

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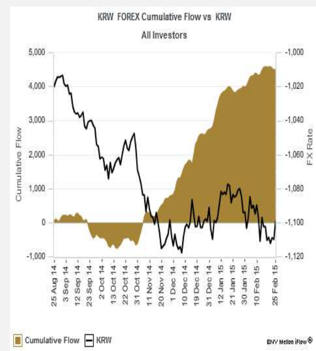
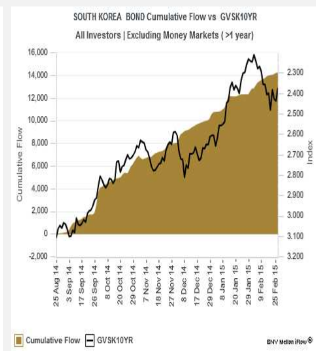
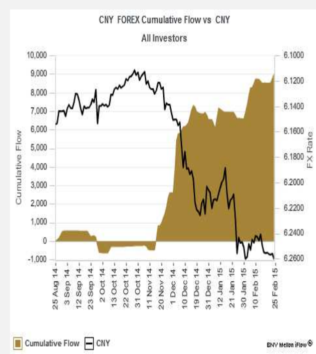
US government debt declined for the fourth consecutive month in December as total FX reserves declined by $4 bln during the month to $3.84 trn, down from a record $3.99 trn in June. However, we would counter with two arguments in favor of US Treasury demand likely remaining robust going forward: 1) undercurrents of risk aversion persist, 2) the iFlow-based observations that select emerging markets including China have continued to attract asset market inflows in recent weeks from investors looking for yield.

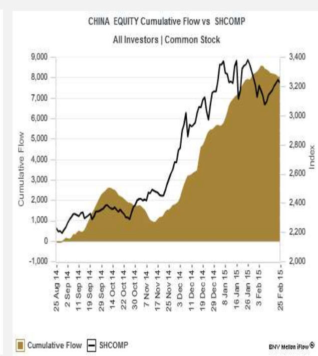
We focus on Asia to elaborate on this second point. In general, Asian currencies have also been on the back-foot over the past year vs a stronger US dollar. In addition, the monetary policy bias of the region's central bankers (Chart 3 shows benchmark rates in the region) has also contributed toward weaker local currencies. However, iFlow confirms global investors are viewing cheaper FX in Asia as an opportunity to increase allocations at better entry levels. While a portion of these net inflows are attributable to currency market participants looking for Asian exchange rates to stabilize, the rest is due to asset market purchases. The last four weeks have seen a pause in the DXY Dollar Index's climb, as a result of which Asian central banks would have had every incentive to stem their local currency's strength in light of portfolio inflows. Thus, we suspect FX reserve managers will continue to accumulate US Treasuries in an environment where the "diversification into Euros" storyline has weakened given the ECB's QE initiative, and thus, exposure to the greenback is preferred.



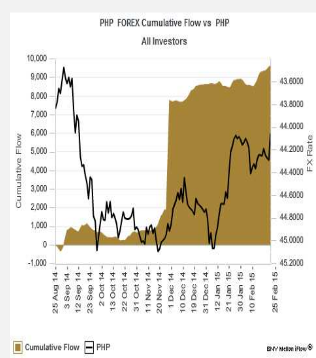


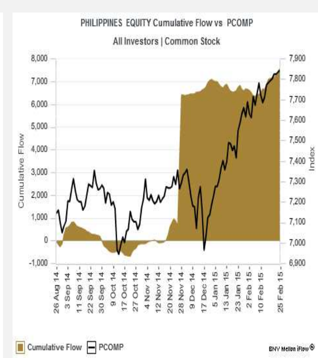
To illustrate this second point, Charts 4 and 5 show cumulative purchases of the South Korean won and net inflows into local bonds. The central bank has been maintaining an easing bias. As a result, government bond yields have trended lower in the wake of investor inflows, with the three-year yield dipping briefly this month below the 2% benchmark rate, while AA-rated corporate yields reached a record low of 2.24% earlier this month. In a similar vein, Charts 6 and 7 show cumulative purchases of the Chinese renminbi and net inflows into local equities, while Charts 8 and 9 show cumulative purchases of the Philippine peso and net inflows into the local stock market.





We will continue to monitor our iFlow charts in emerging markets across regions to determine how cross-border investor activity is likely to impact both asset prices and exchange rates as policy-makers strive to be proactive in a low growth and disinflationary environment. In the meantime, it is these continuing asset market and FX inflows (apart from Asia, we have examples from other EM regions as well) which are likely to underpin demand from FX reserve managers for US Treasuries.





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iFLOW METRICS

In the signal grid below as of 25 February 2015 (compared to the previous week's signal grid as of 18 February), CAD remains in its Long position opened on 12 February with about a 0.6% gain, CHF has closed its Short position opened on 6 February with about a 1.2% gain, GBP remains in its Long position opened on 5 February with about a 1.3% gain, JPY changed to Flat from Short, NOK remains in its Long position opened on 30 January with about a 2.4% gain, NZD remains in its Long position opened on 17 February with about a 0.2% gain, SEK opened a Short position, and others remain the same. In emerging markets, MXN closed its Short position opened on 8 January with about a 2.9% gain and reversed to Long on 23 February, this Long position was closed on 25 February with a small gain, BRL has closed its previous Long position and opened a Short position on 24 February which has registered a 1.4% gain so far, SGD closed its Short position opened on 4 February with about a 0.5% gain, and re-opened a Short position on 24 February , TWD opened a Short position, INR remains in its Long position opened on 10 February with about a 0.4% gain, IDR changed to Short from Flat, and others remain the same. Amongst equities, SPX changed to Flat from Short. The US10Y bond remains in its Long position opened on 18 February with about a 11 bps gain

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If you would like a daily update of these models or others, please contact one of our Global Markets Sales professionals in Boston (+1 617 722 6800), New York (+1 212 815 7166), London (+44 207 570 0892) or Hong Kong (+852 2840 6693). (jiangang.dou@bnymellon.com)

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BNY Mellon iFlow-Metrics 25-Feb-2015

Note: All FX Signals are against the USD, e.g., Long AUD means long AUD/USD, Long CAD means short USD/CAD, etc.

1	2	3	4	5	6	7	8
CURRENCY	SIGNAL	SIGNAL DATE	ENTRY PRICE	STOP	CURRENT PRICE	OPEN P&L (%)	12-Month Total Return (%)
AUD	Flat	****	****	****	0.7887	****	-1.12
CAD	Long	****	****	****	1.2436	****	3.96
CHF	Flat	****	****	****	0.9484	****	0.50
EUR	Flat	****	****	****	1.1361	****	0.55
GBP	Long	****	****	****	1.5528	****	0.45
JPY	Flat	****	****	****	118.86	****	9.47
NOK	Long	****	****	****	7.5450	****	-7.61
NZD	Long	****	****	****	0.7555	****	4.84
SEK	Open Short	****	****	****	8.3014	****	-4.14
MXN	Close Long	****	****	****	14.93	****	13.71
BRL	Short	****	****	****	2.8691	****	10.14
KRW	Long	****	****	****	1099.1	****	-4.07
SGD	Short	****	****	****	1.3532	****	5.93
TWD	Open Short	****	****	****	31.442	****	2.27
INR	Long	****	****	****	61.9675	****	0.10
THB	Short	****	****	****	32.5200	****	1.21
MYR	Flat	****	****	****	3.6055	****	4.13
IDR	Short	****	****	****	12856.00	****	7.56
PHP	Flat	****	****	****	44.0600	****	1.11

INDEX	SIGNAL	SIGNAL DATE	ENTRY PRICE	STOP	CURRENT PRICE	OPEN P&L (%)	12-Month Total Return (%)
SPX	Flat	****	****	****	2113.86	****	18.33

BOND	SIGNAL	SIGNAL DATE	ENTRY YIELD	STOP	CURRENT YIELD	OPEN P&L (bps)	12-Month Total Return (bps)
US10Y	Long	****	****	****	1.9688	****	8.28

* STOP– Each new signal carries a predetermined "overlay" stop designed to provide broad latitude of price movement, and defined risk. The multiple model integration of iFlow Metrics provides a structure highly sensitive to price change, and as a result, the vast majority of signals exit the market in advance of the overlay stop being elected.
* The current price/yield is the 5pm EST closing price on Bloomberg
* The model takes 5pm EST closing price of the signal out day as entry/exit price.
* Please be aware that data revisions may cause signals to be revised occasionally, see below for details.
* The bond yield index is Bloomberg USGG10YR Index, long equals falling yields, short equals rising yields.

NOTES:

"Signal" as used in this document refers to model output information only and should not be relied upon as a direction or instruction to take a specific market position or any action whatsoever.

All trading models could experience periods of drawdown that may last for protracted periods of time, which is why single asset performance is generally more volatile than a diversified portfolio of assets that can provide a more balanced overall performance thereby reducing the depth and time of drawdown periods that otherwise could be experienced in a single asset portfolio. Past performance is not indicative of future results. There is risk in all trading.

WEEKLY TECHNICALS

Whether it was due to reserve management, or simply global economic imbalances, the backup in US 10-Year yields that ended last week was unable to clear critical technical hurdles. Similarly, several Asian currencies that weakened substantially during the second half of 2014 haven't made much headway lately. The following charts point up some important levels that may be instructive and should play a role in how markets trade, going forward.

The **U.S. 10-Year Yield** failed to take out key resistance **~2.177%** (38.2% Fibonacci retracement of its 2014/2015 drop from ~3.052% to ~1.636%) and has retraced roughly 50% of its gains. In the bigger picture, a break and close above **~2.177%** will open up **~2.396%/~2.416%** (2012 high and 13-month downtrend, respectively). Support remains **~1.862%** (2014 low).

U.S. 10-Year Yield Weekly Chart:

USD/CNY 'filled the gap' that it left in late January, so it is technically in a position to head higher, but for critical resistance **~6.2600** (61.8% Fibonacci retracement of its 2012/2014 drop from ~6.3965 to ~6.0395). A break and close above this level will find initial resistance **~6.2675** (2014 high) in front of **~6.2770** (May 2012 low/pivot), after which there will be significant room to run (2012 high ~6.3965). The 'gap fill' level ~6.2312 should now act as good support).

USD/CNY Weekly Chart:

Similarly, **USD/SGD** is bumping up against resistance in the **~1.3620/90** region (42-month channel-top and Spring 2010 plateau, respectively). A break and close above ~1.3690 will open up **~1.4210** (61.8% Fibonacci retracement of its 2009/2011 drop from ~1.5580 to ~1.1990). **~1.3450** (2008 low) should now be good support.

USD/SGD Monthly Chart:

USD/KRW, too, is having trouble breaking higher from current levels. Though it just pushed to a new 2015 high above 1112.00, it still needs to clear a plethora of resistance starting **~1119.60** (40-month downtrend), and including **~1122.20** (2014 high) and **~1127.40** (August 2013 plateau) before the path clears toward **~1162.90** (2013 high). **~1078.00** (38.2% Fibonacci retracement of its July/December run-up from ~1008.40 to ~1122.20) remains solid support.

USD/KRW Weekly Chart:

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