

**RATIONALE**

**MACRO**

- The USD has broadly weakened (DXY Trade Weighted index as proxy) due to doubts about Fed/Yellen resolve to raise rates. Please see attached 5 year DXY chart.
- JPY has strengthened partially on North Korea risk off threats, as well as some concerns that improvements in Japan's economy may lead BOJ to abandon ultra-accommodative monetary policy.

**ECONOMY**

- The US economy remains firm enough, and economic releases show unemployment, velocity of money, purchasing managers index reports, should lead to higher inflation and a higher USD (charts Included).
- The Japan economy, while improving still has not left the fear of deflation mindset.

**BOND MARKET**

- The US Govt bond market will sell off over the next 1 year+ as inflation increases, and money shifts towards more higher yielding assets.
- Sell of in bonds = higher bond yields, which will attract institutional/foreign money.
- The Japan Govt Yields will remain close to Zero, as the BOJ will continue to suppress yields to support a continued rise in the economy. This differential pulls money of out JPY and into USD.

**NORTH KOREA RISK**

- Our base case assumption is that cooler heads will prevail and that the North is stubbornly pushing its agenda, in order to preserve its regime survival. The US does not have any good military options, which we believe that they know.
- So far this talk has allowed USDJPY to weaken, as the JPY tends to strengthen in a risk off scenario.
- If a big increase in the potential of conflict results in a risk off mode - this will not be good for this trade (or other risk assets either).

**RISK OFF SCENARIO**

- If there is a broad based and deep sell down in global equities and a risk off scenario, this will support CHF and JPY, and so not be good for this trade.
- That said a moderate correction will only temporarily move the pair, and is not a major concern.

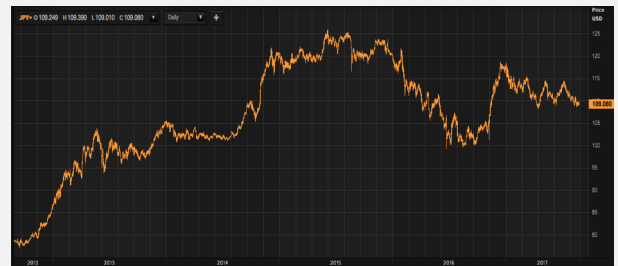
**TRADE POSITIONING**

- If we enter the trade, we look for a move of at least 500 bps (i.e. To USDJPY 114 levels+). This may take a number of months. Given so many push and pull factors, the currency pair can move either way over the short term.
- The important factor here is that economic fundamentals, as well as divergent Central Bank actions will cause investors to see fundamental value in USD vs. JPY and lend support to the trade, in our view.

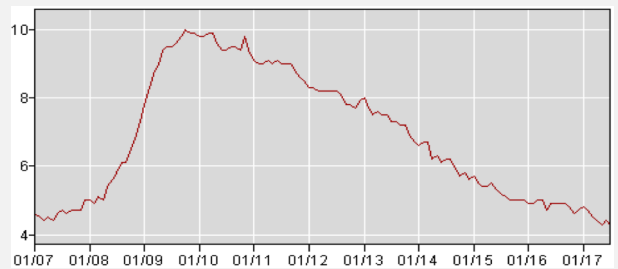
**DXY CHART - 5 YEARS**



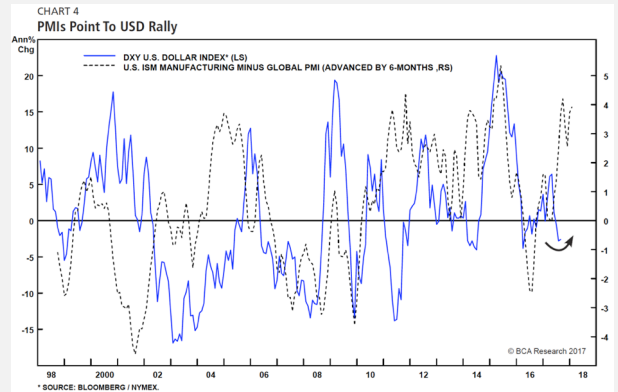
**USDJPY CHART - 5 YEARS**



**US UNEMPLOYMENT RATE - 5 YEARS**



**PMIs POINT TO USD RALLY**



**CYCLICAL INFLATION DYNAMICS**

