

Market outlook for 2009

By Richard Olsen

2008 was a watershed for the financial markets: equity markets experienced a massive sell off and credit markets stopped functioning with bank lending coming to a standstill. Central banks had to intervene on an unprecedented scale.

Will the government and central bank interventions reverse the tide? Based on our analysis worse is to come: our biggest fear is that one of the governments of the G6 will default on its debts and that confidence in the financial system will plummet.

Olsen measures tick by tick market volatility: today, the short-term market volatility in currency markets is approximately 10 times higher than in previous years. This indicates that liquidity has declined by roughly 80 percent. At the same time, global capital flows have continued at the original pace or worse are actually increasing, because companies and investors have to rebalance their international exposure. In previous years, it was safe to assume that currency moves would be contained within a range of plus minus 20 percent. Based on our quantitative analysis, we expect price moves of 50% and more for G6 currencies in 2009. We expect that AUD, CAD, CHF and JPY will be beneficiaries and USD, GBP and EUR will be the losers.

In the recent months, large corporations have reported massive declines of turnover, not just 5 or 10 percent as in previous recessions, but large scale declines of 30% and more. Even the strongest companies that have excellent balance sheets will be stretched to the limit to weather economic upheavals of this scale.

We expect that there will be massive layoffs in 2009 due to corporate bankruptcies and decisive cost cutting programs. Deflation will accelerate rapidly, while government deficits will skyrocket, as they try to stem the tide.

In 2008, governments and central banks have been firefighting to unlock the credit markets and prevent the worsted from happening. In doing so, they are risking their own solvency. Keynes, who originally argued for counter-cyclical government intervention, would not have condoned this strategy – if it fails and one of the governments goes bankrupt, there is systemic failure that undermines the foundation of the financial system.

What are the implications for the private and institutional investor and corporate treasurer? In broad brushes, we expect the following market events:

Due to the rapid slow down of the real economy, equity markets will resume their decline in 2009. Governments will try to do everything in their power to boost the economy through spending programs and putting pressure on the central banks to keep interest rates as low as possible and even reduce them further.

Governments and central banks will face increasing skepticism of investors and further plummeting of confidence of the public opinion. This will ultimately result in rapid increases of medium and long-term interest rates. Investors are advised to choose short-term and liquid investments.

Return enhancement will have to come from investment strategies that provide liquidity and contribute to market stability: The high volatility environment of currency and other mature markets, caused by a lack of market liquidity, are ideally suited for counter-trend liquidity provision strategies as designed by Olsen. Our models identify market opportunities, when buying and selling interest is out of balance and take counter-trend positions until the market is back in equilibrium. Investors, who allocate assets to these strategies contribute to overcoming the draught in market liquidity, will be rewarded with good performance.

In this environment, corporate treasurers will have to take a pro active role, because they cannot hope on currency moves to revert to the mean. They will have to implement dynamic overlay strategies as offered by Olsen that insulate their companies from the cost of the wide currency swings.

International investors face the same predicament. They need to take an active stance on currency management to counter-act the impact of the expected shocks in the currency markets. We suggest that they do this by leveraging the power of the Olsen product suite.

We have painted a bleak picture for 2009. Having said this, every upheaval offers opportunity. Market participants, retail or institutional, who take a pro-active stance, have every opportunity to generate significant profits in 2009.

Richard Olsen is founder and chief executive of Olsen Ltd and the Chairman of OANDA, a leading foreign exchange broker and market maker.

OLSEN

Olsen Ltd is a research and development company and investment manager based in Zurich, Switzerland. Olsen has yielded practical applications and managed accounts and third-party products, investing in currencies as a separate asset class or as an overlay to an existing currency exposure.

Copyright © 2009 by Olsen Ltd

All rights reserved. No part of this work may be reproduced or transmitted in any form by any means, electronic or mechanical, including photocopying and recording, or by any information storage or retrieval system, without permission in writing from the publisher.

Olsen Ltd
Seefeldstrasse 233
8008 Zürich, Switzerland

Phone +41 44 386 4848
Fax +41 44 422 2282

www.olsen.ch