The Lucrative Derivative REPORT

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Welcome to the Lucrative Derivative Report! In this report, we discuss the astonishing rise of the Japanese yen.The currency has performed very well in light of increased risk aversion in markets in the last month and half, however this is likely unsustainable going forward.

Market Summary
Commodities (Precious Metals)

Gold
Opening price: 27,703
Closing price: 27,155
Price change: -548
% Change: -1.98%
(Prices in Rs per 10 gms)

After two weeks of price increases, gold reversed direction and fell by 1.98% this week. The primary reason for the fall in gold was a decrease in market risk aversion. Central banks around the world stepped in this week to ease financial market concern about a Greek default, and this was positive for risk aversion, and thus negative for gold.

Silver
Opening price: 63,550
Closing price: 61,900
Price change: -1,650
% Change: -2.60%
(Prices in Rs/kilogram)

As with gold, after two weeks of price rises, silver reversed direction and fell by 2.60% this week. The fall in silver was motivated by the same factors as that for gold. Reduced risk aversion in markets led to a fall in safe haven demand, and a corresponding fall in the price of silver. Despite the falls, prices still remain at high levels, as markets are still volatile.

Market Summary
Commodities (Energies)

Crude Oil
Opening price: 4,112
Closing price: 4,277
Price change: 165
% Change: 4.01%
(Prices in Rs/barrel)

Crude oil has now risen for the fifth week in a row, this week rising by 4.01%.Crude oil prices were boosted due to rising stock markets and falling risk aversion in global markets, as Eurozone tensions eased. In addition, weekly inventories fell by greater than market expectation for the second week in a row, adding further upward pressure on the price.

Natural Gas
Opening price: 184
Closing price: 186
Price change: 2
% Change: 1.09%
(Prices in Rs/mmBtu)

After falling the previous week, natural gas reversed direction, and rose by the same amount this week, a rise of a 1.09%, leaving the price unchanged over the last two weeks. Natural gas had a volatile week, at one point futures rose to 195, before falling back down. There was little else in terms of specific news relating to natural gas that drove the markets.

Market Summary
Currencies

Dollar
Opening price: 46.38
Closing price: 47.47
Price change: 1.09
% Change: 2.35%
(Prices in USDINR (rupees/1 dollar))

After rising the previous week, the dollar continued its upward momentum and climbed by 2.35% this week.USDINR's rise was primarily due to rupee weakness. The rupee weakened against all its four traded counterparts, due to weak Indian industrial growth data and rising inflation. The RBI intervened in the currency markets this week to stem the fall in the rupee. The RBI also hiked interest rates by 25 basis points at the end of the week.

Euro
Opening price: 64.48
Closing price: 65.79
Price change: 1.31
% Change: 2.03%
(Prices in EURINR (rupees/1 euro))

After falling the previous week, the euro rebounded and rose by 2.03% this week. Again, this was due to rupee weakness rather than euro strength. The euro moved between gains and losses this week as central banks intervened in financial markets to reduce the volatility and fallout from the Eurozone debt crisis. The euro fell against the dollar and many other currencies this week.

Pound
Opening price: 74.01
Closing price: 74.96
Price change: 0.95
% Change: 1.28%
(Prices in GBPINR (rupees/1 pound))

After three weeks of price falls, the pound reversed direction and rose by 1.28% this week. This was due to rupee weakness. Globally, the pound was weaker against the dollar, euro, and yen. This was due to poor economic data, showing a larger than expected trade deficit, higher than expected inflation, and falling house prices.

Yen
Opening price: 59.87
Closing price: 61.81
Price change: 1.94
% Change: 3.24%
(Prices in JPYINR (rupees/100 yen))

The yen has now risen for the tenth week in a row, this week rising by 3.24%.The yen's rise occurred despite a reduction in risk aversion globally. Partially, the large rise is due to rupee weakness, but the yen also rose against most other traded currencies. The rise reflects continued market unease despite stock markets rising this week.

(Opening prices are as of 9th September, and closing prices are as of 16th September)

Recommendation Summary

Position:	Short JPYINR (Oct Future)
Current Price:	Rs. 61.70
Target Price:	Rs. 60.70
Stop Loss:	Rs. 62.70
Time Frame:	Short Term

Recommendation Rationale

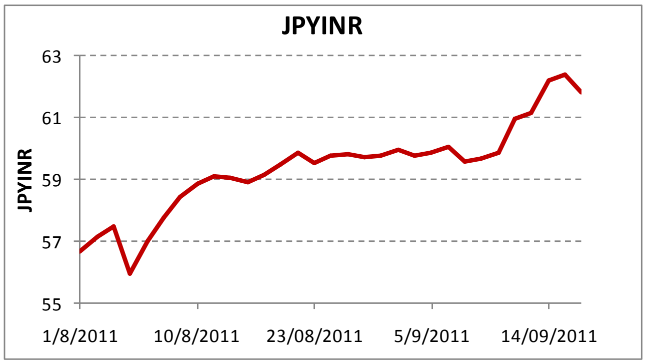
This week, market turbulence reduced globally, as stock markets rose and risk aversion fell. The main issue facing markets this week was the Eurozone debt crisis and the risk of a Greek default. Central banks intervened to provide additional dollar funding to banks, and put out a potential liquidity crunch. The RBI also intervened to prop up the rupee.

Most markets behaved in a fairly predictable way to the fall in the risk aversion. Stock markets were up, oil was up, and precious metals were down. One exception has been in the currency market, where the Japanese yen rose substantially despite a fall in risk aversion. The yen was the best performing currency against the rupee this week, and rose against all other major currencies.

The yen's rise is interesting, because it is quite unexpected, and does not make sense given the fall in risk aversion. If we try and decompose the fundamental reasons for the yen's rise, it is difficult to come up with anything specific. As usual, the yen's rise had little to do with the economic situation in Japan. Japanese economic data was minimal this week, and did not impact the currency.

The normal driver of the yen is risk aversion and safe haven demand in markets, even if this week that was not the case. However, there is a limit to safe haven demand for a currency. At some stage, the country's fundamental situation must also come into play. The fundamentals of the Japanese economy are not good.

Japanese economic growth is stagnant, and the country has a debt to GDP ratio close to 200%, one of the highest in the world. Japan's economy is heavily dependent on exports, and as the currency has risen considerably, the risk of the economy slowing further has increased. Furthermore, there are political problems in Japan due to continually changing prime ministers. Let us now take a look at the chart for JPYINR over the last month and half.



As we can see from the chart, over the last month and a half, the yen has performed very well due to turbulence in global markets. Since the 1st of August, the yen is up by 9% against the rupee. The yen has been breaking records against the rupee (it had previously never crossed 60), and against the dollar as well.

The yen remained just below and around the 60 level from mid August to early September, before breaking out upwards. In the last couple of days, the yen has shown signs of weakness, and thus a new downtrend is developing. Thus, from a technical perspective, likely move is downward.

Given the issues we have discussed, we believe that the yen's rise is unsustainable going forward. Furthermore, the large rise in the yen this week provides a good shorting opportunity, as the rise is difficult to substantiate from a fundamental perspective.

The primary risk to this trade is that the yen keeps rising due to additional safe haven demand. Of course, it is quite possible that markets continue to suffer in the coming weeks and safe haven demand will exist. However, the likelihood the yen will rise in a significant way to safe haven demand is much lower. This is because continuous rises in a currency are unsustainable over such periods. As a result, we believe this is a good opportunity to take a short position and benefit from a likely reversal in the yen.

Trading Mechanics

Moving on to the mechanics of the trade, the execution process is identical to taking a position in any currency contract. Rather than take a position in the September contract that will expire very soon, we recommend taking a position in the October contract that expires on 25th October.

The contract specifications for JPYINR are as follows: One contract is worth 1,00,000yen. Prices are quoted in rupees per 100 yen, so therefore a 1 rupee move in the price is equivalent to a 1000-rupee change in the value of the contract. At current prices, a 1% change in JPYINR is worth around 619 rupees per contract.

The stop loss for this trade is Rs. 62.90 and the profit target is Rs. 60.90. This is based on the current futures price of Rs. 61.90. As usual, the trade should be closed out if either the profit target or stop loss level gets hit, and the trade should remain open otherwise. We can change this later as we see fit.

If on the day of execution, if the price has moved significantly from the levels specified in this report, then we should pursue the following strategy: If JPYINR is between 61.40 and 62.40 then go ahead and execute the trade. So if the price movement is less than 0.5 in either direction, then we should still trade. Based on the actual execution price, set the stop loss and profit target level accordingly. The stop loss should be 1 rupee above the execution price, and the profit target 1 rupee below the execution price.

The margin requirement for this trade will be around Rs. 2000-3000. Given the amount we are risking on the trade, the margin requirement will be sufficient to cover this.

The time frame for this trade is short-term. Despite the recent fall in market volatility and risk aversion, it is possible that it could return anytime soon. Most investors are still wary and fearful of what will happen with the debt crisis in Europe and elsewhere.