DAX at a Key Area

Trade Idea

18 March 2013

Summary

- The DAX rally above 8000 over the last few weeks opens up opportunities for further gains to 8151, an all time high from.
- A sustained turn above 8151 would leave swing targets to 9000
- The long term chart shows that the DAX has balked at holding gains above 8100 in the past though, and even gains above 7600 seem difficult to hold
- The bail-in of Cyprus depositors and junior creditor implies less political risk in Germany as its taxpayers are kept off the hook, The reaction to the news that Cyprus may need to 'bail in' bank depositors in order to secure a 10 bn euro bailout loan from the EU/IMF may reignite Eurozone 'crisis' trading though if contagion spreads to Spain and Italy again

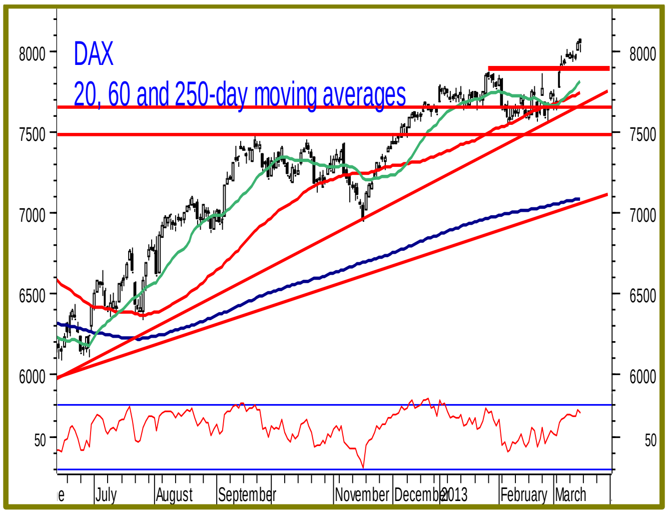
The **DAX** rally is at a critical juncture as the 8151 high from 2007 is within striking distance. Bulls will note the continued monetary support offered by the ultra-low rate policy that the European Central Bank seems committed to, as well as the 'back stop' that the ECB's commitment to keeping the Eurozone intact seems to offer to 'troubled' sovereign bonds. The DAX has rallied over 35% from the 05 June 2012 low and over 15% from the 16 November 2012 low, which suggests that sentiment has improved sharply over recent months. Economic data has been mixed though as signs that factory orders are slipping haven't tied in to the continued strength in sentiment surveys. Both the ZEW and IFO surveys are out this week (Tuesday and Friday, respectively) and will offer some further clues as to whether or not sentiment continues to hold up.

The bigger focus though may be on the fallout (if any) from the announcement that Eurozone Finance Ministers are seeking to impose a potential 'bail in' on the bailout deal with Cyprus. The idea of 'sharing the risk' has been made before by key Eurozone states (Germany) and has recently been applied in the Netherlands after the Dutch government nationalised SNS Bank and imposed losses on junior bond holders The Cyprus proposal though is that a potential levy of up to 9.9% on bank deposit accounts in excess of EUR 100,000 may be made in order to allow for the release of a EUR 10 bn loan from the EU and IMF. While this may seem reasonable to the lenders, the long lines at ATM bank machines as depositors sought to withdraw their cash suggests that those affected have a different view. While this is important, for the markets the bigger impact(Cyprus is a tiny percentage of Eurozone economic activity) will be whether or not there is some 'contagion' with Spanish and Italian markets as the confiscation of a percentage of bank deposits could be the new standard for future bailouts. The fundamentals for German equities are obvious: with less German tax money held hostage, its fiscal budget is expected to remain strong and unlikely to burden the corporate sector. Yields on German bunds and spreads on German corporates should remain low as a result.

The chart below points out the strong rally seen over the last few months with upside momentum to 8151 near term. Short term support is at 7930 and 7870 ahead of 7530/7500. The risk is that losses are seen below 7500 which would leave congestive support at 7400 to 7200 under pressure.

* Source: Boost, Bloomberg. The prices used for the returns are primary market closing prices from 18 Oct 2012 to March 15th 2013, and are given in the base currency of each index. The returns may rely in part on back-tested prices prior to the inception of some ETPs. Past performance and back-tested performance are not indicators of future performance. Back-tested prices are those which precede 4 Dec 2012 for ETPs referencing the FTSE 100, 7 Dec for the DAX, Dec 10th for EURO STOXX 50, Russell 1000 or NASDAQ-100, and 17 Dec for the commodities.

** Calculated as annualised standard deviation over the past 3 months of daily returns (some of which are based on back-tested prices.



The long term chart is worth keeping in mind as the DAX faltered above 8100 in 2000 and 2007 already. In fact, gains above 7600 have tended to be fleeting in the past. This time could be different, of course, and the risk is that gains above 8151 will leave the door open for long term swing targets to 9000. If the DAX does turn sharply lower then the 50-week moving average (7084) and even the 16 November 2012 low at 6950 would be at risk. This area may mark the long term 'floor' for many investors, as a break would leave a 'sea shift' in sentiment to extend with some risk of seeing a return to the 2012 summer lows below 6000 increasing then.

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