QUARTERLY REVIEW

a quarterly market analysis from Travelex Global Business Payments

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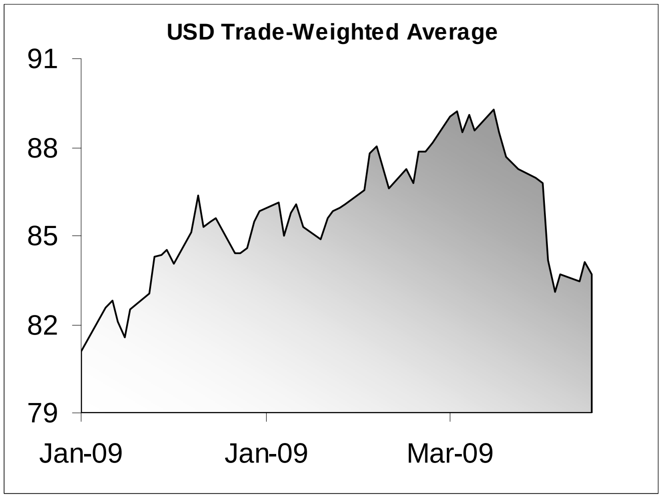
USD Q2 Summary

Month:	-3.91%	Quarter:	+4.94%	YTD:	+4.94%



The trade-weighed U.S. dollar index fell to its lowest level in six months late in the second quarter as investors, encouraged by nascent signs of stability in the global economy, unwound safe-haven trades in USD-denominated assets that were accumulated during the height of the crisis. Trillions of dollars of stimulus-related new government debt raised serious concerns about America's longer-term fiscal outlook.

The moderating of financial market uncertainty and budding signs that the worst of the crisis may have passed, tempted investors out of safe-haven dollar assets and back into higher yielding and riskier assets abroad. The dollar also suffered from worries surrounding America's burgeoning debts and its ability to attract the foreign capital needed to finance them. Reserve diversification by central banks out of dollar assets remained a key liability for the greenback.

USD Outlook

Given the Federal Reserve's ultra-accommodative policy stance, which is not likely change in the near future, and Washington's historic spending and borrowing spree, the dollar will face an up-hill journey in the remaining months of 2009. Moderating investor demand for dollar assets and talk of central bank reserve diversification will likely see the USD remain under pressure. But given its steep declines in Q2, the still long list of potential headwinds to the global economy and the likelihood for America to lead any global recovery, the dollar will likely surprise many of its detractors and outperform most of its major rivals.

Positive Factors

- Continued worries about the health of global economy along with ongoing dislocations in global financial markets should keep safe-haven dollar assets in relatively high demand, especially if market uncertainty reverts back to levels seen in Q4 2008 and Q1 2009.
- Signs of stabilization across various sectors of the economy have fostered optimism that the U.S., having responded earlier and more aggressively to the crisis than many of its counterparts, will lead the world out of recession.
- The Federal Reserve's slashing of borrowing costs and its implementing of quantitative easing and numerous other creative and aggressive programs to foster the flow of credit have markedly improved conditions in credit markets and have lowered (albeit temporarily) mortgage rates.
- The Obama Administration's massive stimulus spending, while detrimental to America's fiscal position, is widely seen as contributing to positive economic growth.
- Because the dollar remains the world's reserve currency, it should fair better than most of its major rivals in an environment of zero interest rates and unconventional policy easing measures.

Negative Factors

- The nascent signs of stability evidenced throughout the global economy have raised risk appetite and have tempted investors out of the relative safety of dollar assets that were accumulated during the height of financial market and economic uncertainty.
- Hundreds of billions of dollar's worth or bailouts and increased government spending and the needed issuance of new debt to finance them, suggests a worsening of an already dismal U.S. fiscal position, which threatens to dampen demand for U.S. assets
- Worries about the longer-term fiscal standing of America threaten to see capital inflows dry up and dampen a key source of funding of the U.S.'s massive deficits.
- The Federal Reserve's benchmark lending rate remains at just 0.0%-0.25%, its lowest level to date.
- Given that lending rates are essentially at zero, the Fed has been forced to resort to unconventional methods of easing monetary policy. Quantitative easing, or the purchase of longer-term government securities with newly created money, threatens to flood the market with dollars and could potentially spark massive inflationary pressures down the road.
- The U.S. economy contracted by over 6.0% on an annualized basis in the fourth quarter of last year and by over 5.0% in the first quarter of 2009.
- Housing prices continue to fall, keeping the precipitous downward cycle of sliding home prices, mounting defaults,

falling asset prices, tight credit conditions and depressed consumer spending in tact.

- The U.S. economy continues to hemorrhage jobs. Since the start of the recession in 2007, over six million jobs have been lost. While the pace of job losses as slowed, the unemployment rate, currently at a 26-year high of 9.4%, is likely to rise to over 10% in the coming months.
- Plummeting global growth and a stronger dollar threaten to depress demand for America's exports.

Conclusion

The U.S. dollar, which benefited greatly from its status as a safe harbor during the height of the financial market meltdown late last year, succumbed to selling pressure in Q2 as nascent signs of stabilization in the global economy tempted investors out of safe-haven Treasuries and back into riskier assets abroad. The greenback also suffered from mounting worries about America's longer-term fiscal standing and the potential for significant inflationary pressures amid a backdrop of soaring government spending and debt. While serious questions about the U.S. currency's longer-term outlook have been raised by the trillions of dollars in government spending and new debt issuance needed to fund it, calls for the greenback's demise will prove ill placed. Indeed the dollar will face an uphill battle in the months and years ahead, but the current level of dollar bearishness and negative sentiment appear to be overdone. As a result, the U.S. currency should find support at current levels and likely push higher against most of its major rivals, especially as investors come to see that the global economy, while stabilizing, remains far from recovery. Ongoing demand for safe-haven assets amid continued market uncertainty and increasing signs that the U.S. will eventually lead the rest of the world out of recession should overshadow many of greenback's longer-term liabilities.

The U.S. dollar fell to its lowest in level in 2009 against a basket of major currencies as investors became increasingly optimistic in the second quarter that the worst of the financial crisis and recession had passed. Upside surprises to economic data showed that indeed, many sectors of the economy, which had been hard-hit by the recession, were finally showing nascent signs of stabilization. Many gauges of growth, which fell to record or multi-decade lows in the wake of the global economic meltdown, have slowly returned to levels seen just before the collapse of Bear Stearns and Lehman Brothers. Factory activity, as measured by the ISM index, rose to its highest level since September 2008, consumer confidence saw its biggest rise in nearly six years and the services sector saw activity rebound to its highest level since October 2008 in May. Even the employment market is showing budding signs that the frightful pace of job losses of the winter months is slowing. May saw the world's largest economy shed 345,000 jobs, the smallest monthly decline in non-farm payrolls since August 2008.

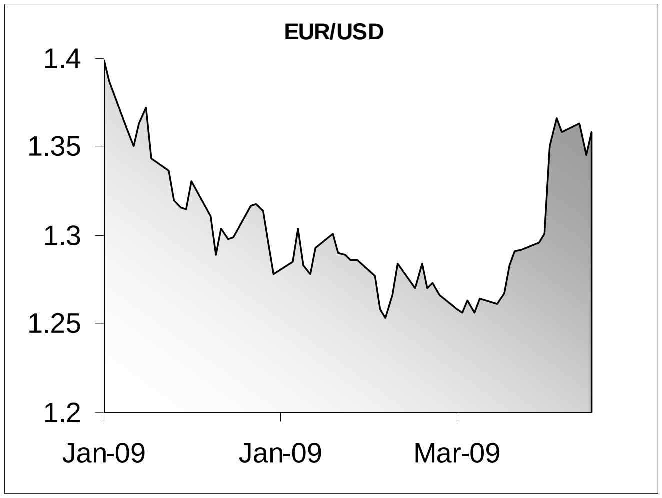
While the nascent signs of stabilization are encouraging, it remains far too early to talk meaningfully about a recovery. The overall state of the economy remains extremely weak and at levels that are still deeply recessionary. Moreover, most of the improvement that has been seen in recent data has been in sentiment indicators, not in gauges of the real economy. The improvement in sentiment is largely reflective of the fact that the world's economy was potentially facing an "Armageddon scenario" in the wake of the Bear Stearns and Lehman collapses, and that worst case scenario has largely been averted. While the pace of job losses appears to be slowing, the overall level of unemployment, which is currently at its highest since 1983, is likely to continue rising, well into the double digits. That very prognosis will keep any recovery a very slow and gradual process. Rising joblessness, combined with ongoing household de-levering, will keep aggregate demand soft and keep consumer spending, housing, and other key areas of the economy under pressure, even as other sectors show signs of rebounding. Industrial production continues to fall and capacity utilization in the manufacturing sector fell to its lowest level on record. The long list of headwinds still facing the economy suggests that the recent rally in risk assets and selloff in the greenback have been overdone. As investors pare back their optimism about a recovery to more realistic levels, the dollar stands to benefit from renewed demand for safe haven instruments.

The key risks to the greenback's longer-term outlook remain the potentially inflationary impact of the Federal Reserve's ultra-simulative policies and Washington's skyrocketing spending and burgeoning debt. The Federal Reserve has slashed its benchmark lending rate to essentially 0.25%, a record low and has been forced to resort to unconventional policy tools like quantitative easing as traditional monetary measures became exhausted. Quantitative easing, or the Fed's asset purchase program, aims to keep longer-term lending rates low and at the same time, keep the monetary base expanding in order to encourage bank lending and consumption. The Fed's purchases of assets include agency bonds issued by Fannie Mae and Freddie Mac, as well as longer-term government securities, or Treasury bonds. The program has helped to lower mortgage rates to record low levels, which has been credited with spurring purchasing and refinancing activity in the mortgage market. However, the impact of the Fed's quantitative easing has been short-lived. Worries about the longer-term fiscal outlook and the sheer supply of new debt being issued by the government have actually pushed lending rates higher in recent weeks. Traditional reserve nations like Russia and China have grown increasingly uncomfortable with Washington's ballooning spending and the Fed's loose monetary policies. Declining investment in the U.S. by foreign central banks and talk of reserve diversification out of dollar assets will remain an Achilles heal for the dollar and could potentially lead to a longer-term decline in the greenback.

Diminished demand for safe-haven assets amid an improving global economy and waning decline for dollar assets or central bank reserve diversification out of the greenback will keep the U.S. currency's longer-term outlook clouded. However, because an imminent global recovery remains far less likely than financial markets are currently pricing in, the inevitable disappointment will likely see renewed demand for the safety of dollar deposits. Moreover, while central bankers from China and Russia continue to talk tough on the dollar, their actions will speak louder than their words. So far, Treasury auction figures show that their buying of Treasury securities has not significantly moderated. The U.S. dollar remains the world's reserve currency and U.S. markets are still the deepest, most liquid and most transparent in the world. Consequently, the dollar should continue to benefit from improved demand that will likely see it outperform most of its major rivals over the near-to-medium term.

EUR Q2 Summary

Month:	+5.36%	Quarter:	-5.28%	YTD:	-5.28%



The single currency put in a mixed performance in the second quarter of 2009, rising to an eight-month peak against the yen and a six-month high against the greenback, but falling to a seven-month trough against the broadly stronger British pound. Nagging concerns about the state of the 16-member bloc's economy and the health of its banks kept the euro's upside limited.

Euro zone economic data, while improved from the previous quarter, suggested that the bloc's economic recovery will lag most of its industrialized rivals. Sovereign credit downgrades to a number of euro zone economies highlighted the plight of the bloc and kept the euro's gains against the broadly weaker USD and JPY in check and saw the pound's value soar against the euro. Depressed global demand for euro zone exports and banks' exposure to troubled emerging markets remained the single currency's largest liabilities.

EUR Outlook

The single currency's upside is likely to remain very limited by growing evidence that the 16-member bloc's economic recovery will lag most of its major rivals'. The ECB's reluctance to aggressively address the euro zone's economic slowdown in the early days of the crisis is likely to keep its recovery very subdued. Moderating price pressures and continued slack in the economy should keep ECB lending rates at record lows and could see the bank increase the quantity and or scope of assets it purchases, a EUR-negative scenario. Euro zone bank's exposure to troubled emerging markets will keep investors nervous of holding EUR-denominated assets.

Positive Factors

- While euro zone lending rates have fallen to a record low of just 1.00% in the wake of the worst financial crisis in generations, the euro still enjoys a healthy yield advantage over its G7 counterparts.
- The ECB reluctantly followed the Federal Reserve and the Bank of England down the path of unconventional policy easing by implementing a 60 billion euro asset purchase plan. However, the size of the ECB's QE program remains substantially smaller than most of its counterparts'.
- Improved market sentiment or increased signs that the pace of declines in the global economy is slowing buoys investors' appetite for risk and boosts demand for the euro.
- Fiscal restraint on the part of E.U. finance ministers contrasts the unprecedented pace of spending in the U.S. and U.K.
- Talk of central bank reserve diversification out of dollar assets benefits the euro.

Negative Factors

- The ECB was forced to cut its key lending rate to a record low of just 1.00% and to implement unconventional policy easing measures through the purchase of longer-term covered bonds. Lending rates could fall further or the bank could widen the scope of assets purchased in the event of renewed economic deterioration.
- The fact the ECB was late in responding to its economy's downturn with the needed policy stimulus has exacerbated its recession and made it more likely that any eventual recovery will be very lackluster in nature. The 16-member bloc is expected to underperform its industrialized counterparts.
- Because markets have become overoptimistic in pricing in a global economic recovery, the euro is vulnerable to losses as risk appetite falls back down to levels that are consistent with a more realistic economic prognosis. Disappointing macro data that suggests a more subdued pace of recovery will undermine demand for the single currency.
- Massive exposure on the part of euro zone banks to crumbling economies in Eastern and Central Europe leaves them vulnerable to a potential flood of loan defaults.
- The growing need for fiscal aid to poorer countries within the EU, the bulk of which is shouldered by richer nations within the bloc, continues to raise objections and expose rifts between member states. Bickering within the EU undermines confidence in the bloc and the single currency.

Conclusion

The single currency's recent gains against the greenback and the Japanese yen have been largely fueled by the broad improvement in risk appetite associated with an upgraded outlook for the global economy. Upside surprises to global economic data helped further the notion that the worst of the financial crisis and recession has passed and that a worst case "great depression" scenario had been averted. The subsequent improvement in demand for riskier assets saw investors scale back defensive positions in safe-haven USD and JPY assets that were accumulated during the height of the market uncertainty. Because much of the euro's positive sentiment in the second quarter was based on an overly optimistic outlook for the global economy, it remains vulnerable to an across the board pullback, especially as the pace of global recovery underperforms market expectations. Data will continue to highlight the lagging nature of the 16-member bloc's economy, which will add to the single currency's heavier tone. Finally, nagging worries about the health of euro zone banks and potential knock-on effects of mounting defaults from troubled emerging economies will keep market demand for the single currency under pressure.

The euro rose to a six-month high against the U.S. dollar and to a one-month peak against the Japanese yen late in the second quarter as upside surprises to economic data fueled nascent optimism that the worst of the financial crisis was in the past. Data from the U.S., the U.K. the euro zone and even China showed marked stabilization in key sectors that had been hard-hit in the wake of the financial crisis. Euro zone manufacturing and services sector PMI surveys both rose to their highest levels in seven months in May. Consumer sentiment bounced from a record low in April, its first rise in nearly a year. German consumer confidence rose to a one-year high in July, while business sentiment and investors' morale also rose their highest levels in a year. Combined with similar improvements globally, the figures encouraged investors to tentatively abandon the safe-haven trades that were accumulated during the height of the market chaos in the fall and the winter. The euro benefited as the USD, the JPY and to a lesser extent, the CHF were sold in favor of higher yielding assets abroad. While ECB lending rates have fallen to a record low of just 1.00%, they still maintain a healthy yield advantage over their G7 counterparts, a fact that benefits the euro during times of improving market sentiment.

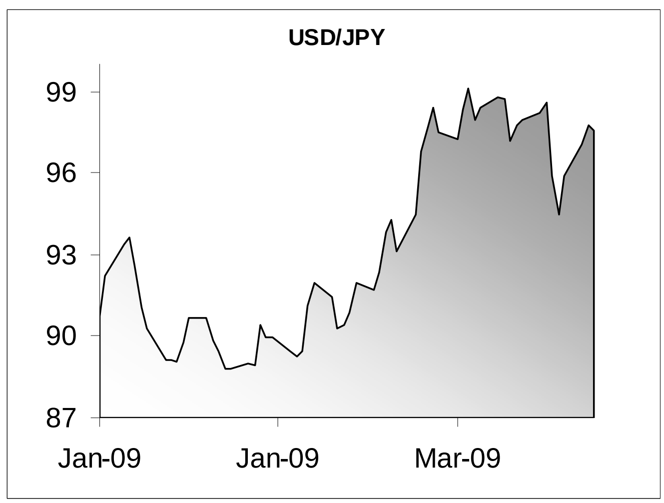
The fact that the single currency's steep gains in the second quarter were largely due to the improvement in sentiment, leaves it vulnerable to a sharp correction lower, especially in the likely event that the actual pace of global recovery underperforms market expectations. Indeed, the marked improvement in many sectors of the economy is encouraging. However, the overall level of activity in the euro zone economy remains in deeply recessionary levels. Industrial production continues to fall at a record pace. Unemployment jumped to its highest level in a decade in April and is likely to continue rising in the months ahead. The continued rise in joblessness should keep consumer-related activity in the economy under pressure and should ensure that deflationary fears outweigh concerns about inflation. Moreover, because the euro zone depends so heavily on global demand for its key exports, it will remain vulnerable to still very weak conditions abroad. Exports in the 16-member bloc fell by 27%(year-over-year) in April. As market participants rebalance their global economic outlook to more accurately reflect the likelihood of a very long and protracted recovery, risk assets will inevitably underperform safe-haven instruments. The U.S. dollar, the Japanese yen and the Swiss franc will outperform the euro in an environment of deteriorating sentiment.

In addition to the outlook for increased market demand for safe-haven assets that should sap the single currency of much of its recent appeal, the euro will suffer from nagging worries about the health of its banking sector. Banks in the 16-member bloc have a disproportionately high exposure to economies in hard-hit Central and Eastern Europe. Euro zone banks' liabilities to emerging markets are estimated at between 20% and 25% of its total GDP compared to about 5% for U.S. and Japanese banks. The vast majority of the debt issued in previously high-flying economies like Hungary and Poland was in euros, which presents a significant risk of defaults considering the single currency has firmed by nearly 30% against the HUF and nearly 35% against the PLN since mid-2008. Additional signs of deterioration in emerging European economies will remind investors of the fragile state of euro zone banks and will further dent the appeal of the single currency.

While the euro's upside will be severely limited in the months ahead, further declines in the single currency are in no way guaranteed. The potential for the global economy to surprise to the upside in the pace of its recovery remains a key factor that could keep demand for higher risk assets high. The euro would stand to benefit from further improvement in macro global data and from signs that a global recovery will be more robust than expected. Talk of central bank reserve diversification out of USD assets will continue to be EUR-supportive, as will mounting concerns about America's longer-term fiscal outlook. However, given its steep gains over recent months and the likelihood that the markets have become overly optimistic for a recovery, the euro will remain under pressure as investors favor safer assets in the months ahead.

JPY Q2 Summary

Month:	-1.82%	**Quarter:**	-9.08%	**YTD:**	-9.08%



The Japanese yen briefly rose to a two-month high against the broadly softer U.S. dollar, but succumbed to selling pressure late in the quarter. The yen also fell to eight-month lows against the euro and the Australian dollar amid a wide-scale unwind of safe-haven bets that were accumulated during the peak of financial market and economic uncertainty in the fall. The yen's low yields left it vulnerable to selling as investors' appetite for risk slowly returned.

The yen's status as a safe harbor during times of economic and financial market uncertainty benefited it during the peak of the crisis-induced market volatility. However, the yen suffered across-the-board selling pressure as investors, encouraged by nascent signs that the worst of the crisis had passed, sold the JPY in favor of higher returns abroad. Dismal economic data from the world's second largest economy further undermined demand for the yen.

JPY Outlook

The Japanese yen's long-standing status as a safe refuge during times of elevated economic and financial market uncertainty left it vulnerable to selling pressure against higher yielding assets as safe-haven trades, accumulated during the height of the financial crisis, were unwound. The yen will likely regain its footing in the months ahead as the global economic recovery is likely to fall short of elevated financial market expectations. The renewed demand for safe-haven assets amid the backdrop of moderating recovery expectations should favor the yen. However, its upside could become limited as data continues to highlight the lagging nature of the world's second largest economy.

Positive Factors

- While some of the yen's relationship with the overall level of risk aversion has broken down recently, it will still draw support from the still elevated state of global economic and financial market uncertainty.
- The rebalancing of the market's global economic outlook to a more realistic level should see risk appetite moderate and demand for safe-haven yen assets rise.
- Japan's banks have historically had significantly less exposure to the "toxic", mortgage-backed assets that have wreaked havoc on institutions in the U.S, U.K. and euro zone.
- Japan's massive current account surplus acts as a draw during times of heightened financial market turmoil.
- Signs of stabilization in the U.S., China and Western Europe will boost demand for Japan's exports, the lifeblood of its economy.

Negative Factors

- Signs that the worst of the financial crisis has passed lifted optimism about a near-term economic recovery and saw investors unwind much of the long USD and JPY positions accumulated during the height of the market chaos in the fall and winter.
- Japan's economy tumbled by over 14% in the first quarter of 2009 as demand for its key exports evaporated, while domestic activity came to a screeching halt. The shocking decline in the world's second largest economy overshadowed some of its status as a safe harbor, a pillar of its previous strength.
- The Bank of Japan has revamped its quantitative easing program of buying JGB's (Japanese Government Bonds) with newly printed money. Such measures have historically had little positive impact on growth in Japan.
- Plummeting global demand pushed Japan's balance of trade into its deepest deficit in 10 years earlier this year. Exports have declined by over 35%(y/y) in every month since January.
- The collapse of household spending and business investment has severely disrupted the domestic economy at a time when declining global demand has undermined Japan's dominant export sector.
- Japanese officials are in favor of a stable decline in the value of the yen as tool to help spur demand for its struggling exports.

Conclusion

The Japanese yen has, since the start of the financial crisis in 2007, benefited from its strong, negative correlation with risk appetite. The yen's low yield made it the favorite funding currency for trades in higher yielding riskier assets during times of relative stability and calm. The collapse of America's subprime mortgage market and subsequent global credit crisis, sent risk aversion soaring and prompted a broad unwinding of the carry trades originally funded by selling the yen. Since then, the Japanese currency has benefited from spikes in risk aversion and the ensuing flight to safety across financial markets. However, an improving global economic prognosis in the second quarter of 2009 sapped the Japanese yen of much of its allure as investors sought higher returning investments in equities, commodities and emerging market currencies.

For much of the past year, the most intense period of the worst global financial crisis in generations, the market has ignored Japan's underlying economic fundamentals. Investors had instead focused on the yen's perceived status as a safe-harbor, a status it earned as carry trades in higher yielding assets were unwound amid the soaring economic and financial volatility. Indeed the yen's rise to a 13-year peak against the greenback and record highs versus the euro and the Australian dollar early in the first quarter of 2009 was no reflection of the Japanese economy's performance. Rather, investors were forced to buy back their JPY, which was originally sold in favor of higher yielding assets. The inverse coloration between the yen and risk appetite that was the driving force behind its steep declines in Q2. Upside surprises to economic reports from the U.S., the U.K., the euro zone and China helped foster budding optimism that the worst of the financial crisis had passed. Risk assets like stocks and commodities saw 40% gains since their mid-March lows amid the backdrop of an improving global prognosis. Indeed, the recent signs of stabilization in the global economy have been encouraging and have suggested that a worst case scenario had been averted. However the subsequent rise in risk appetite and resulting rally in higher yielding assets appears, by most measures, to have been overdone. The inevitable disappointment when the actual recovery underperforms elevated market expectations should see risk assets underperform and safer instruments like the yen regain their footing.

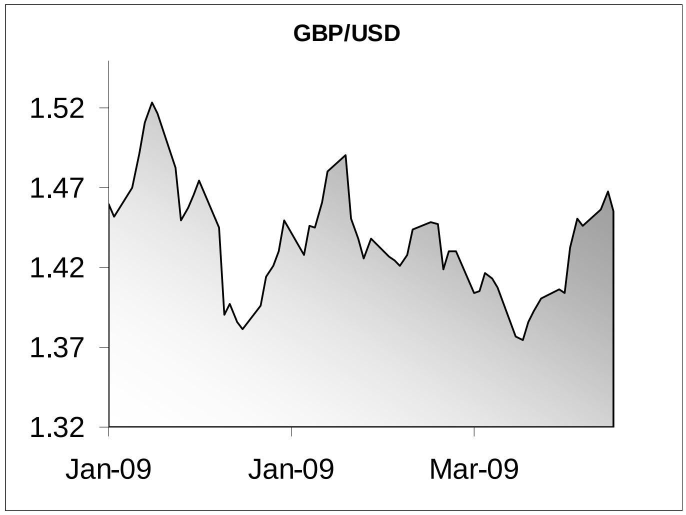
While some of the yen's close correlation with risk appetite broke down in the past months, the key driver of the JPY will remain day-to-day shifts in investor sentiment. Data in Q1 and Q2 highlighted the extent to which Japan's economy has suffered in the wake of the crisis and briefly saw its deteriorating fundamentals overshadow fluctuations in sentiment. Japan's fourth quarter GDP contracted by 14.4%, while its Q1 GDP fell by 14.2%. The shocking declines in the world's second largest economy in the past two quarters became too much for investors to ignore. The decline in GDP, its largest in 35 years, sent global equity markets *and* the Japanese yen tumbling. Subsequent economic reports painted a similarly dreary picture of Japan's economy. The Tankan survey, a closely watched gauge of future economic activity, fell to its lowest level on record, the unemployment rate rose to five and a half-year high and industrial production tumbled at its fastest pace on record. Retail sales in Japan have declined in every month since September 2008 while total household spending has declined for 12 months straight. Manufacturing activity also fell at a record pace while capital spending declined by over 17%. Price pressure have also returned to negative territory in recent months, fanning fears of a return to Japan's decade-long battle against deflation. The recent figures, across every sector of Japan's economy are staggering in their negativity and are not likely to improve dramatically in the near future.

In addition to the domestic headwinds facing the world's number two economy, global pressures will continue to severely undermine its economic prognosis. Japan's dominant export sector has suffered as a result of the collapse in international demand. Recession in most of the world's industrialized and emerging economies has seen demand for Japanese exports plummet. Unemployment, the largest determinant in demand, tends to lag the rest of the economy. Consequently, global unemployment should continue to rise for five to eight months even after the economy's trough, keeping demand depressed for the foreseeable future. Japanese exports have fallen in by at least 35%(year-over-year) in every month since January. The outlook for continued global headwinds should keep Japanese exports trending lower and its economy in contraction for the foreseeable future.

Despite the outlook for continued Japanese economic headwinds, the yen should fare better than the prognosis of its underlying fundamentals would suggest. Given the steep rise in risk assets over recent months and given expectations for a pullback in market optimism, the yen should benefit from a broad rebalancing of expectations to more realistic levels and the resulting rise in demand for safer harbors. It could however, remain subjected to renewed selling pressure if the global economic recovery turns out to be more robust than expected.

GBP Q2 Summary

Month:	+1.90%	Quarter:	-3.73%	YTD:	-3.73%



Sterling was one of the market's best performing currencies in the second quarter as investors bought back the GBP from what appears to have been significantly oversold levels. The massive BOE and government stimulus appear to have helped the economy show nascent signs of stabilization. Sterling also benefited from the broad improvement in risk appetite.

The broad improvement in investors' sentiment and the upgraded outlook for Britain's dominant financial services sector helped the pound recover from a 23-year trade-weighted low late last year to trade at its highest levels for 2009 late in the second quarter, despite the U.K.'s worst recession in 50 years.

GBP Outlook

The British pound, having been the G7's best performing currency in the second quarter, will be vulnerable to a pullback, especially if the pace of Britain's economic recovery undershoots the market's lofty expectations. A series of upside surprises to British economic figures helped foster the notion that the worst of the recession had passed. Combined with improved sentiment towards Britain's dominant banking sector, the upgrade outlook helped push the pound to its highest in 2009. However, the recent pace of GBP appreciation will be hard to maintain given that expectation for a U.K. recovery appear to a have become overly optimistic.

Positive Factors

- The Bank of England's aggressive policy easing and foray into the realm of quantitative easing, while negatives for sterling over the near-term, should ultimately lay the groundwork for further stabilization in the economy and eventually, growth.
- The broad improvement in the outlook for the global economy helps improve the appeal of currencies, like the pound, which are generally seen as riskier investments.
- The improvement in the prognosis of Britain's dominant banking sector helps the overall economy and the pound.
- The BOE's aggressiveness in addressing its recession could eventually be rewarded, especially against currencies of more reactionary central banks like the European Central Bank.

Negative Factors

- Given the pound's impressive rally in the second quarter, it looks increasingly vulnerable to a pullback, especially if the pace of Britain's economic recovery falls short of the market's elevated expectations.
- Britain's housing-lead economic downturn prompted the BOE to lower lending rates to a record low of just 0.50% and forced it to resort to unconventional policy measures once traditional policy tools became exhausted.
- Quantitative easing, or the BOE's purchasing of up to £125 billion worth of long-term government bonds, threatens to flood the market with sterling and has severely inflationary implications for the economy. Recent data raises doubts about the program's effectiveness.
- Britain's economy officially slipped into its first recession since the early 1990's in the fourth quarter of 2008. Q1 2009 saw the British economy contract at its fastest pace in 30 years.
- British home prices have tumbled at their fastest pace in over a decade, dragging the broader economy down with them. Still restrictive credit conditions and mounting unemployment are likely to keep demand for homes and prices depressed for the foreseeable future.
- Rising unemployment, months of manufacturing and services sector contraction and cooling consumer spending keep the outlook for the overall economy, and sterling bleak.

Conclusion

Britain's housing-led economic meltdown accelerated markedly in the first quarter, resulting in the nation's sharpest recession in over 30 years. The across-the-board deterioration in the U.K. economy saw the Bank of England slash it key lending rate and eventually resort to unconventional policy easing as traditional monetary tools became exhausted. Sterling subsequently fell to its lowest level in 26 years against a basket of its major trading partners. However, the second quarter saw the overall tone of British economic reports improve such that investors began to look at the pound's selloff in Q1 as overdone. The combination of upside surprises to British economic reports and an improved outlook for its dominant financial services sector saw the pound rise to its highest level in 2009. The pound could become vulnerable to near-term profit taking as market participants become disappointed with the actual pace of Britain's recovery compared to what has been priced into the pound's value. Sterling' downside will however, remain protected by the outlook for its economy to outperform its euro zone counterpart.

Britain's economy showed marked signs of stabilization in the second quarter of 2009. Both the manufacturing and services sector PMI surveys, which had fallen to record lows in the first quarter, rose to their highest levels in 12 months in May. Retail sales showed signs of stabilization after plummeting in the beginning of the year while both manufacturing and industrial production saw a slowdown in April in the annualized pace of declines, which had been at record levels. Consumer confidence rose to a one-year high in May, based largely on the rise in London's FTSE share index to its highest level in 2009 in June. Even Britain's trade deficit, which widened to its largest level since 1697 in November, benefited as the steep decline in sterling made British exports more competitively priced on the global market. Investors were encouraged by the budding signs that perhaps the worse of Britain's recession has passed, and rushed to buy back the GBP as the subsequent realization that the pound's aggressive selloff in the first quarter now appeared to be overdone.

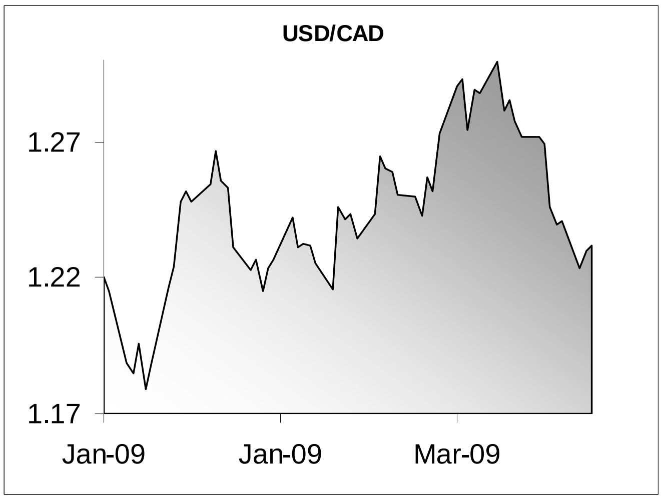
However, while many sectors of the economy have indeed shown marked signs of stabilization, they still remain at levels consistent with a deep recession. Moreover, the nascent signs of a slowdown in the pace of contraction in the economy remain well short of the full recovery in the U.K. economy that financial markets appear to be pricing in. The pound has risen by nearly 20% against the dollar since its early March lows and roughly 15% against the euro in that same time period, a move that appears to be ignoring potentially significant headwinds still facing the British economy. Unemployment continues to rise at an alarming pace and is likely continue to increase even after other sectors of the economy begin to recover. Since January 2008, Britain's economy has shed almost 800,000 jobs, which has pushed the unemployment rate to its highest level since 1997. Mounting joblessness is likely to keep aggregate demand under pressure for the foreseeable future, which will in turn keep consumer spending, housing market activity and overall activity more subdued than markets are currently pricing in. Even BOE Governor Mervyn King recently warned optimistic investors that any recovery in the economy will be a "long, hard slog", despite recent encouraging signs of stabilization. Consequently, sterling looks likely to trend lower in the months ahead, given that market expectations and the resulting price action in risk assets like the pound, appear largely over optimistic.

Another potentially damaging development for the pound is the possibility that the Bank of England may increase the quantity or scope of its non-conventional policy measures in the months ahead. The BOE launched its foray into quantitative easing with the purchase of £75 billion in longer-term government securities, or gilts. The BOE later upped its target to £125 billion and could increase it further if credit markets fail to show meaningful signs of improvement. May's data showed that mortgage lending and consumer credit both rose at the slowest pace since the early 1990's, a clear sign that despite the BOE's best efforts, credit is not flowing to areas of the economy damaged by the financial crisis. Additional quantitative easing threatens to increase the supply of pounds in the financial system, an inherently negative outlook for the pound.

While profit taking and the realization that the market has become largely overly optimistic in pricing in a near-term British recovery will likely see the pound give up some of its recent gains, it is unlikely to experience sharp selling pressure against the greenback. Indeed, increased worries about the global economic outlook will see investors abandon riskier positions in the pound in favor of safer assets like the USD, CHF or JPY. However, the BOE's aggressive and bold policy response to its economy's recession should see the U.K. continue to outpace most of its major rivals in recovery. Specifically, the pound should continue to outperform the euro, especially as upcoming data highlights the lagging nature of the euro zone's economy.

CAD Q2 Summary

Month:	-5.66%	**Quarter:**	+6.65%	**YTD:**	+7.11%



While Canada's economy officially slipped into recession in the second quarter, posting its worst quarterly performance since 1991, the Canadian dollar recovered from a four-year trough against the greenback hit in early March. The broad improvement in global economic sentiment helped growth-dependant currencies like the CAD. The steep rise in commodity prices also boosted the appeal of the loonie.

The Canadian dollar rose to a new eight-month peak against the greenback and a seven-month peak versus the euro late in the quarter as nascent signs that the worst of the recession has passed broadly improved the global prognosis and helped badly beaten currencies like the CAD recovery their footing. Higher commodities helped fuel the loonie's rally throughout much of the second quarter.

CAD Outlook

The Canadian dollar gained over 10% against the greenback in the second quarter as a broad improvement in the global outlook boosted growth-dependant commodity currencies like the loonie. The subsequent rise in commodity prices added to the appeal of the Canadian dollar for much of Q2. However, because the Canadian economy remains heavily dependant on global demand for its exports, it is vulnerable to a pull back in market optimism for a global recovery. The realization that any recovery in Canada and the global economy will be very subdued should suggest steady, low BOC rates, which will also undermine the appeal of the Canadian dollar.

Positive Factors

- The Canadian dollar has benefited from the broad-based improvement in market sentiment and the subsequent rise in investors' appetite for risk. Further evidence that the worst of the financial crisis is over would boost the value of CAD.
- Canada's resource-rich economy benefits during times of elevated commodity prices. More signs of stabilization in the macro economic data would support the notion that the recession is abating and would put upward pressure on commodity prices.
- The potential for additional U.S. dollar weakness would boost commodity prices and add to the loonie's upward momentum.
- Canadian banks have fared better than banks in the U.S. and U.K. in terms of their exposure to illiquid, toxic mortgage-backed assets.
- While the Bank of Canada has slashed it key bank rate to a record low 0.25%, it has avoided following the Fed, the ECB and the BOE down the path of unconventional policy easing or, quantitative easing.

Negative Factors

- The Bank of Canada slashed its benchmark lending rate to a new record low of just 0.25% and could be forced to adapt quantitative easing measures if domestic economic conditions deteriorate further in the months ahead.
- The steep rise in the value of the CAD in the second quarter leaves it vulnerable to a pullback, especially if the actual pace of global economic recovery falls short of the market's elevated expectations.
- The increase in the loonie's value in the second quarter threatens to choke off budding signs of a recovery. Bank of Canada officials have expressed concern with its rise and could ramp up verbal interventions if its upward trend continues.
- The global economic slowdown and declining demand from the U.S. pushed Canada's GDP to its lowest level in 18 years in the first quarter.
- The final destination for nearly 80% of Canada's exports is the U.S, which is now a year and a half into the deepest recession in nearly three decades.
- Canada's housing market, which had remained relatively resilient amid the global economic slowdown and credit crisis,

has shown increasing signs of slowing rapidly. Housing starts have fallen steadily since October while new home prices fell at their fastest pace in 17 years in April.

Conclusion

The Canadian dollar enjoyed its best quarterly performance against the greenback since the beginning of 1982 in the second quarter of this year, boosted by the overall improvement in market sentiment and budding signs the worst of the recession had passed. The subsequent rise investors' risk appetite tempted investors out of the relative safety of dollar-denominated assets and back into assets regarded as higher risk. The Canadian economy's close dependence on global growth left the CAD vulnerable during the height of the market chaos and ensuing recession, but benefited it as investors became more optimistic about a recovery. The rise in commodity prices associated with the upgraded view for a global recovery added to its upward momentum. However, because Canada's domestic economic fundamentals remain weak and expectations for a global recovery appear to be over ambitious, the CAD should see some of its recent allure dulled by the shortfall of the real economy's performance versus the market's elevated expectations.

Canada's economy has fallen victim, like nearly every major industrialized nation, to the sharp downturn in global growth in the wake of the worst financial crisis in generations. While the initial shock of the financial crisis had a comparatively lower impact on Canada's financial system, given its smaller exposure to the toxic mortgage-backed assets at the heart of the meltdown, the second round impact, or the macro economic impact, did undermine some of the key pillars of Canada's growth. Slower global growth hit Canada's massive oil, natural gas, lumber, minerals and metals exports to the industrialized world and to previous engines of the global economy like India and China. The drop in its natural resource exports, as well as the steep drop in the price of the commodities themselves (crude oil has fallen by over 50% from its peak last summer), severely undermined the windfall of capital that Canada had enjoyed for the better part of the past three years. Demand from the U.S in particular dried up, as the world's largest economy's worst recession in decades pushed its GDP to contract by over six percent in the final quarter of 2008 and over five percent in Q1 2009. The slumping U.S. economy, the final destination for roughly 80% of Canadian exports, hit its auto and industrial sectors particularly hard. The result was a drop in Canadian exports to their lowest level in 10 years in April. Manufacturing shipments, a key gauge barometer of U.S. demand for Canadian industrial goods, have fallen in eight out of the past nine months to a 10-year trough in April.

Despite the still soft state of Canada's domestic fundamentals, its currency rallied in the second quarter after budding signs of stabilization in the global economy helped foster the notion that the worst of the financial crisis had passed. Upside surprises to U.S., U.K., euro zone and Chinese economic reports suggested that the second derivative, or the pace of declines in the economy, had slowed. Investors' improved sentiment and increasing hope for a near-term global recovery boosted commodity prices which had fallen sharply in the wake the financial crisis. As measured by the Commodity Research Bureau (CRB), resource prices rose by nearly 25% between March and June. The rising value of commodities boost revenues from Canada's key exports and underpins the outlook for it broader economy.

However, while the nascent signs of stabilization in the global economy are certainly encouraging, they are still far from concrete confirmation of recovery. Recent price action in the Canadian dollar and in risk assets like equities and commodities suggest a much more optimistic near-term outlook than actual conditions would imply. Mounting global unemployment is likely to persist long after many sectors of the economy have bottomed. The resulting pressure on already depressed aggregate demand should keep any recovery much more subdued than markets appear to be pricing in. As investors come to terms with the reality that the global economic rebound will likely undershoot expectations, the loonie along with other growth-dependant currencies and risk assets will be vulnerable to selling pressure.

The Bank of Canada has responded to the steep downturn in its economy by slashing borrowing costs by 425 basis points since December 2007 to a record low of just 0.25%. With traditional policy tools all but exhausted, further domestic weakness could force the BOC's hand into unconventional policy measures like quantitative easing, or printing money buy longer-term government assets. The flood of CAD into the financial system, along with the potentially inflationary effects of quantitative easing is inherently negative for the currency. Additionally, the BOC has become increasingly uncomfortable with the rally in the CAD's value and its potential to choke off already weak demand for the nation's exports. Officials have warned against excessive currency appreciation and could do so again if the loonie continues its upward trend. Increased verbal intervention would cap some of the Canadian dollar's upside. However, the improved global economic data and elevated commodity prices would likely see the CAD's downside remain underpinned into the second half of 2009.

Upcoming Central Bank Meetings

July

2	ECB Governing Council Meeting
8-9	Bank of England Monetary Policy Committee Meeting
14-15	Bank of Japan Policy Board Meeting
21	Bank of Canada Monetary Policy Meeting

August

5-6	Bank of England Monetary Policy Committee Meeting
6	ECB Governing Council Meeting
10-11	Bank of Japan Policy Board Meeting
11	U.S. Federal Open Market Committee Meeting

September

3	ECB Governing Council Meeting
9-10	Bank of England Monetary Policy Meeting
10	Bank of Canada Monetary Policy Meeting
16-17	Bank of Japan Policy Board Meeting
22	U.S. Federal Open Market Committee Meeting