

The tricky decision of whether to pyramid euro yen (EURJPY)

The gist: Whether or not to further pyramid EURJPY on a bullish breakout (we will) is a nice example of multi-level decision making.

Actions: Will add further to multi-leg bullish EURJPY position on an upside breakout from current consolidation.

We are long the euro across three separate currency pairs, two of them with pyramids already in place. The best of the three is EURGBP, with the euro hitting an eight-year high against the pound (as the folly of Brexit starts to sink in). EURCAD was off to a red hot start on its breakout from the channel (where we bought) but now threatens a u-turn, perhaps because commodities are going nuts (lending strength to the loonie). EURJPY has been strong but is now coming off a bit.

If EURJPY breaks down further, violating the sanctity of the 50 day by more than a modest amount, we'll close out the multi-legged position and protect profits. (Similar with EURCAD initial if it threatens to round-trip.)

But what happens if EURJPY breaks out to the upside? The pattern of congestion into 50 day support (see upper chart) is fairly classic, possibly telegraphing another leg of the trend (similar to the last) if a move higher occurs.

This is where situational factors come in, especially for a position that has been added to already. The pattern is only the green light for a more nuanced decision-making process.

With regard to EURJPY, the case AGAINST adding on a breakout would highlight the fact that the position has already been added to, and note the "risk off" dangers that now seem to mount. If the world is seized by a risk-off episode, the yen, like the USD, will probably strengthen against the euro. Things seem headed that way, which argues for lightening up and not pyramiding.

But at least three other factors argue in favor of adding on the breakout: First, we have built up hefty exposure on the bearish side, which makes a bullish tilt on EURJPY more attractive for the sake of rebalancing. Second, if the market pivots back towards a bullish-euphoric mood, the yen will likely weaken and EURJPY could go a lot higher (this could happen). And third, a EURJPY bullish breakout would be a signal in itself a new bull wave is happening. All told, a nice example of situational decision-making by way of multiple intersecting factors: Price pattern, macro scenarios, portfolio positioning. The decision is an emergent property born of combining these.

