

# Daily Market Strategy

Friday, 4th September 2009

## Market Strategy

### Market Strategy Team

**Paul Rodriguez**  
Senior Technical Analyst  
0207 158 1744

**Kenneth Broux**  
Market Economist  
0207 158 1750

**Naeem Wahid**  
Quantitative Strategist  
0207 158 1741  
naeemwahid@bostreasury.com

**Altaz Dagha**  
Analyst  
0207 158 1747  
altazdagha@bostreasury.com

- Positive surprises for US NFP in August are the exception; G20 meets
- Gold approaches \$1000; USD weak ahead of payrolls

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6334, €/\$: 1.4262, \$/Y: 92.61

UK 5y sw: 3.32%, US 5y sw: 2.69%, EU 5y sw: 2.73%

#### Overnight

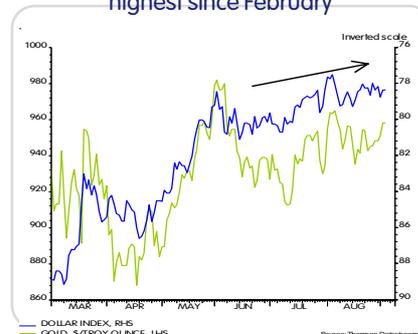
- Fed's Fisher says deflation, not inflation, is the biggest risk; sees no reason to halt MBS purchases, worried about US economy beyond Q3/Q4
- ECB's Trichet and US Treasury's Geithner discuss exit strategies/financial market reforms in the FT; G20 maps first steps towards withdrawal of emergency support

The G20 finmin meeting and US non-farm payrolls will drive price action in major asset markets and could trigger choppy trading conditions ahead of the long US weekend. Gold and silver remain strikingly bid around \$990 and \$16, respectively, as markets fret about the USD and talk of diversification resurfaces in emerging Asia. Stronger ISM employment indices, though still below 50, are up against the more bearish ADP report (-298K) and the tendency of NFP to surprise to the downside in August by an average of 45K (see chart). Adding this to the consensus for -225K drop gives us a number closer to -270K. We doubt whether a surprise on this small scale can trigger a (bullish) breakout for bonds and swaps ahead of \$128bn of new Treasury supply next week (incl. bills). A stronger outcome would help the cause of pro risk but may not take the shine of precious metals.

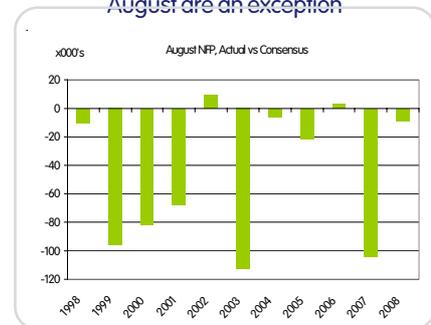
**FX:** Short CHF positions could be squeezed if Swiss CPI comes in above consensus of +0.2% m/m (-0.7% y/y). Speculative CHF longs more than doubled according to last week's IMM positioning, setting up the market for some CHF selling if CPI comes in weak. A stronger outcome may not necessarily herald the start of a trend, but could make the SNB more tolerant of CHF strength (as the G20 considers first steps towards exit). In any case, with EUR/CHF flirting with key 1.5125 support, today's trading session should be interesting. USD/CHF adding a separate angle to the US payrolls data. GBP/USD showed its resilience overnight and is steady above 1.6330. Failure to rally up to 1.6413 would be a bearish signal. EUR/GBP is offered below 0.8750.

**Rates:** Gilts continue to underperform Treasuries and bunds especially at the front-end where 2y yields are up 6bp on the week vs -8bp for the US and -12bp for the EU. UK 5y swaps opened a shade lower at 3.32% this morning and could target a test of 3.29% support if US payrolls disappoint. Resistance runs at 3.39%. Upside for Treasuries could be capped, although the long weekend may bring out safe haven buying and challenge short positioning ahead of supply next week. The Greek/German 10y spread spiked to 117bp overnight, capping a 26bp move on the week.

Gold looks set for a move above \$1000, highest since February



Positive surprises for US non-farm payrolls in August are an exception



	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.8730	-0.38%
GBP/USD	1.6319	0.28%
EUR/USD	1.4252	-0.09%
USD/JPY	92.635	0.45%
AUD/USD	0.8403	0.78%
<b>Bonds %</b>		<b>bp</b>
US 10Yr	3.344	3.8
EUR 10Yr	3.243	1.2
UK10 Yr	3.546	-1.4
UK 5yr Swap	3.322	-1.0
<b>Equities</b>		<b>%</b>
S&P500	1003.24	0.85%
FTSE100	4796.75	-0.43%
Eurostoxx50	2699.22	-0.17%
Shanghai Composite	2845.02	0.72%
<b>Commodities</b>		<b>%</b>
Crude Oil \$/bl	67.96	-0.13%
Gold \$/oz	991.9	1.36%
Copper	286.5	1.38%
Baltic Dry	2414	0.04%
<b>Other</b>		
VIX	27.10	-6.23%
iTraxx XOVER	620.30	-0.8

#### Today's Events

Switzerland CPI, Aug,	08:15	+0.2%	-0.7%
US Non-Farm Payrolls, Aug	13:30	-225K	-247K
US Unemployment Rate, Aug	13:30	9.5%	9.4%
US Average Earnings, Aug	13:30	+0.2%	+0.2%
Canada Employment Change, Aug	12:00	-20K	-44.5K
Canada Ivey PMI, Aug	12:00	54.0	51.8
G20 Finance Ministers meeting starts (London)			
ECB president Trichet speaks (15:15)			

Time	Consensus	Previous
08:15	+0.2%	-0.7%
13:30	-225K	-247K
13:30	9.5%	9.4%
13:30	+0.2%	+0.2%
12:00	-20K	-44.5K
12:00	54.0	51.8

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

- **USD DXY index holding in triangular formation**

The rise in the latest services ISM report (headline report registered 48.4, reaching at a 10-month high) has helped to stabilise equities. The S&P500 closed back above 1000, following the sharper falls earlier in the week. Trading in most financial markets has been subdued, the Shanghai composite index is little changed (+0.6%) this morning and the CRB commodity index is stable at its 100-day moving average. The USD DXY index continues to hold in its 1-month triangular formation – see chart 1.

The most important economic data release for financial markets today is the US non-farm payrolls (NFP) report. Economist's estimates range between -100k and -365k, highlighting the volatility around modelling this labour market report. Median market consensus lies at -230k and LTSE economists look for an outcome of -260k. Given the large range of estimates, we suspect that an outcome below -300k would be required to produce a significant, risk negative, market reaction, reinstating equity market weakness and triggering a bout of USD strength.

The range-bound nature of the USD over the past month means that volatility (implied and historical) continues to drift lower. A neutral NFP report would likely support a further move lower in volatility over the coming period as the current round of leading indicators comes to an end this week.

The trend following model has not signalled any new positions this morning, holding on to its broadly short USD position. The lack of position changes over the recent period is symbolic of the range-bound USD. As such, the risk of "whipsaw" is now building - an environment which is not favourable for trend following models.

Chart 1: USD DXY index in triangular formation



Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY
2 YR SPD	0.14	-0.37	-0.39	0.30	<b>0.93</b>
10 YR SPD	0.03	-0.43	0.14	-0.59	<b>0.92</b>
S&P500	0.49	-0.43	0.52	-0.24	-0.08
Gold	0.51	0.05	0.40	0.03	-0.42
Oil	0.34	<b>-0.77</b>	0.53	0.27	0.21
CRB	0.31	<b>-0.78</b>	0.21	<b>0.79</b>	<b>0.82</b>
Relative Yield Curve	0.19	0.35	-0.27	0.65	-0.17

## Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	short	17-Aug-09	0.8327
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	17-Jul-09	1.4146
GBPUSD	short	10-Aug-09	1.6684
USDCHF	short	17-Jul-09	1.0730
USDCAD	long	26-Aug-09	1.0868
USDSEK	short	21-Jul-09	7.7211
USDNOK	short	21-Jul-09	6.3025
USDJPY	short	20-Aug-09	94.07

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	short	10-Jul-09	3.1049
USDSGD	long	18-Aug-09	1.4522
USDTRY	long	27-Aug-09	1.5093
USDZAR	short	31-Aug-09	7.7525

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EUR/USD	1.4252	-0.09%	S&P500	1003.24	0.85%
USD/JPY	92.635	0.45%	DJIA	9344.61	0.69%
AUD/USD	0.8403	0.78%	FTSE100	4796.75	-0.43%
EUR/GBP	0.8730	-0.38%	Eurostoxx50	2699.22	-0.17%
GBP/EUR	1.1450	0.36%	Shanghai Composite*	2845.02	0.72%
GBP/USD	1.6319	0.28%	*latest price		
GBP/JPY	151.17	0.74%	<b>Commodities</b>		
GBP/CHF	1.734	0.44%			%
GBP/AUD	1.942	-0.50%	Crude Oil \$/bl	67.96	-0.13%
GBP/CAD	1.798	-0.01%	Gold \$/oz	991.9	1.36%
GBP/NZD	2.408	-0.41%	Copper c/lb	286.5	1.38%
GBP/NOK	9.885	-0.24%	Silver \$/oz	16.12	4.68%
GBP/ZAR	12.475	-1.75%	Baltic Dry	2414	0.04%
GBP/CNY	11.147	0.28%			
<b>Bonds %</b>			<b>Swaps %</b>		
		bp			bp
US 10Yr	3.344	3.8	US 5yr	2.684	4.3
EUR 10Yr	3.243	1.2	EUR 5yr	2.723	0.8
UK10 Yr	3.546	-1.4	UK 5yr	3.322	-1.0
<b>Other</b>			<b>Official Rates %</b>		
VIX	27.10	-6.23%	UK	0.50	
iTraxx XOVER	620.30	-0.8	US	0.25	
DJ Agriculture Index	57.96	-1.03%	EU	1.00	
			Japan	0.10	

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