

Daily Market Strategy

Wednesday, 9th September 2009

Market Strategy

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- **Moody's to reaffirm UK credit rating, warn of risks**
- **Fed's Beige Book, US 10y auction ahead**

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6541, €/\$: 1.4503, \$/Y: 92.39

UK 5y sw: 3.31%, US 5y sw: 2.74%, EU 5y sw: 2.71%

Overnight

- UK August consumer confidence highest since May 2008 (Nationwide)
- UK employment posts first rise in 17 months (KPMG)
- UK shop price inflation turns negative in August (BRC)
- US consumer credit plunges \$21.6bn in July, biggest on record
- US 3y note auction covered 3.02 times; indirects take 54.2%; strong
- German August CPI revised down to 0.3% m/m, -0.1% y/y

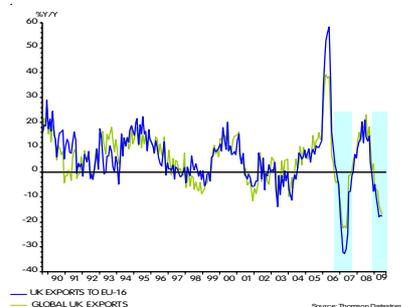
The BoE starts its two-day MPC meeting today and will take note in its discussions of the report by Moody's, expected later this morning, that a downgrade to the UK's credit rating is unlikely (FT front page). Moody's optimism is based on signs that the economy is slowly emerging from recession and on the common view in Downing street that only cutbacks in public spending will make the rise in public debt affordable. Positive economic surveys were released overnight, echoing the report by the NIESR yesterday that the economy expanded by 0.2% in the three months to August. Up ahead today, we will find out to what extent exports are contributing to the improved Q3 GDP profile. Fed speakers, the Beige Book and the 10y auction dominate the US calendar.

FX: Better UK July trade data this morning could support GBP crosses, though positions are likely to stay fairly tight as dealers look ahead to the MPC decision tomorrow. The USD index stabilised at 77.205, above yesterday's 77.047 low (gold steady around \$1,000). Our target is for a near-term move to 75.0. Fed speakers, the Beige Book and good overseas participation at the 10y Treasury auction may help the USD to recover some ground. EUR/GBP has been fairly rangebound, and for lack of clear direction, the pair is seen oscillating in a 0.8750-0.88 range.

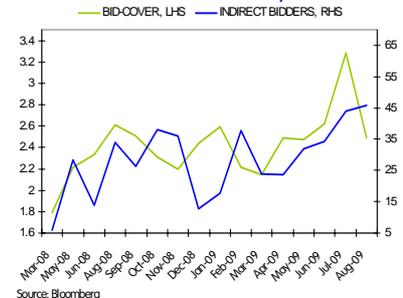
Rates: UK 5y swaps opened a touch firmer this morning at 3.31%, reacting to stronger data anecdotes released overnight. One of the main stories in rates is the compression in EU 2y spreads over Treasuries. The strength in EUR/USD and disappointing German industry data bolstered the front-end of the bund curve yesterday and the case for further narrowing in spreads can be made on the ECB rate outlook. This could dissuade some buyers at the €7bn Schatz auction, though sizeable coupon repayments and redemptions have to be put to work. The EU/US 2y spread narrowed to 12bps yesterday. The BoE will conclude this week's purchases and will be in the market for £1.4bn of shorter dated paper.

| | Close | Daily Change % |
|----------------------|---------|----------------|
| FX | | |
| EUR/GBP | 0.8783 | 0.17% |
| GBP/USD | 1.6490 | 0.86% |
| EUR/USD | 1.4479 | 1.02% |
| USD/JPY | 92.325 | -0.81% |
| AUD/USD | 0.8617 | 0.70% |
| Bonds % | | |
| US 10Yr | 3.482 | 4.1 bp |
| EUR 10Yr | 3.274 | 4.2 bp |
| UK10 Yr | 3.635 | 1.1 bp |
| UK 5yr Swap | 2.773 | 4.0 bp |
| Equities % | | |
| S&P500 | 1025.39 | 0.88% |
| FTSE100 | 4947.34 | 0.29% |
| Eurostoxx50 | 2786.25 | 0.09% |
| Shanghai Composite | 2930.48 | 0.20% |
| Commodities % | | |
| Crude Oil \$/bl | 71.10 | 4.53% |
| Gold \$/oz | 995.4 | 0.02% |
| Copper | 295.6 | 3.12% |
| Baltic Dry | 2462 | 1.32% |
| Other | | |
| VIX | 25.62 | 1.43% |
| iTraxx XOVER | 602.31 | -6.9% |

No sign yet of a rebound in UK exports



Will fledgling USD turn away overseas bidders at the 10 Treasury auction?



Today's Events

| Event | Time | Consensus | Previous |
|--|-------|-----------|----------|
| German CPI, final, Aug | 07:00 | +0.3% A | -0.1% |
| UK Global Trade, Jul | 09:30 | -£6.3bn | £-6.5bn |
| Canada Housing Starts, Aug | 13:15 | 135K | 134.2K |
| BoE to purchase £1.4bn of gilts: UKT_4.5_070313, UKT_8_270913, UKT_2.25_070314, UKT_4.75_070915, UKT_8_071215, UKT_4_070916, UKT_8.75_250817, UKT_5_070318, UKT_4.5_070319 | | | |
| US Treasury sells \$20bn, 10y notes | | | |
| Germany sells €7bn 2y notes | | | |
| ECB member Gonzalez-Paramo speaks (15:15) | | | |
| Fed member Evans speaks (13:00) | | | |
| Fed member Fisher speaks (18:55) | | | |
| Fed publishes Beige Book (19:00) | | | |
| President Obama speech on healthcare (01:00) | | | |

- Although US equities closed higher last night, a bout of profit-taking looks inevitable and a short term correction in equities could be at hand. However, I expect this to be a light retracement as the main trends continue to be positive. FTSE futures are circling below the main 5,000 level and the prospects for short stops to be hit above that key level continue to build. Major resistance in the Hang Seng at 21,200 should be breached soon adding to the argument of a light retracement with 25,000 the next significant target. Strength in the euro is weighing on DAX index futures as it remains below major resistance (capped for three days) at 5,578 (5,466) . Targets remain at 5,750, but the tendency to lag core equities could continue. S&P cash resistance is at 1,038 - a break opens the way for major resistance at 1,106.
- The pressure on the dollar continues although volumes remain light, keeping a healthy level of scepticism in the move. Short term technical patterns continue to indicate further losses for the dollar with commodity and EM currencies the favoured vehicle to express this view. Despite this, the potential for short term UK yields to push higher could see a further bout of short covering in cable as it plays catch-up to the main currencies that benefit from risk appetite. DXY target remains at 75.00.
- US bond yields are starting to hold firm and the curve is starting to see upward pressure once again. Resistance at 3.60% in the US 2-30's yield spread is massive and a break above could cause a large move to 4.00%. UK yields are also under the spotlight. UK 10's are ready to break towards 3.75% with 4.00% year end technical target. UK 2's (see below) are carving a minor base below 1.00%.
- Gold volatility is on the rise. Having traded as high as \$1,008, it collapsed to \$995 in late London trading, only to recover back over \$1,000 (\$1,002). Expect another squeeze higher today. \$1,032 is the short term target. Crude oil targets \$81.00 into year end and copper is set to break the 300 c/lb level in the coming sessions.

Chart of the day: UK 2y yields



Key Levels

| | EUR | GBP | JPY | EUR/GBP | GBP/EUR |
|--------------|---------------|--------|-------|---------------|---------------|
| R2 | 1.4720 | 1.7044 | 95.15 | 0.8910 | 1.1905 |
| R1 | 1.4572 | 1.6626 | 93.41 | 0.8845 | 1.1819 |
| Current Spot | 1.4501 | 1.6546 | 92.36 | 0.8764 | 1.1411 |
| S1 | 1.4330 | 1.6113 | 92.00 | 0.8461 | 1.1306 |
| S2 | 1.4177 | 1.5975 | 87.14 | 0.8400 | 1.1223 |

Spot prices as of: 07:12:59 Source: Bloomberg

A potential minor reversal pattern is building below 1.00% - this key level is the main trigger to push yields higher and with commodities rising, the risk is developing in the short term. My expectation is that 0.81% will be a major low.

| | Spot | Bias | Entry | Target | Stop | Comment/Levels |
|---------|---------|---------|---------------|--------|--------|--|
| EUR/USD | 1.4501 | Bullish | 1.4350 | 1.4720 | 1.4240 | Target raised |
| USD/JPY | 92.36 | Bullish | 92.60 | 97.80 | 91.35 | |
| USD/CHF | 1.0457 | Bearish | - | 1.0300 | - | |
| GBP/USD | 1.6546 | Bullish | <u>1.6480</u> | 1.7000 | 1.6290 | Entry raised. |
| EUR/GBP | 0.8764 | Bearish | 0.8835 | 0.8400 | 0.8835 | |
| GBP/JPY | 152.83 | Bullish | 151.50 | 156.00 | 149.75 | Stop moved to flat.- Small inverse h&S means add to long here. |
| EUR/JPY | 133.93 | Bullish | <u>133.60</u> | 139.14 | 130.85 | |
| CAD/JPY | 85.70 | Bullish | 85.60 | 90.35 | 83.95 | |
| AUD/USD | 0.8606 | Bullish | 0.8305 | 0.9000 | 0.8530 | |
| USD/CAD | 1.07785 | Bearish | <u>1.0800</u> | 1.0000 | 1.0920 | Entry lowered. |
| NZD/USD | 0.6966 | Bullish | 0.6860 | 0.7447 | 0.6860 | Stop raised to flat |
| USD/BRL | 1.8296 | Bearish | <u>1.8445</u> | 1.8000 | 1.8620 | Entry lowered. |
| USD/PLN | 2.8235 | Bearish | 2.8638 | 2.7000 | 2.8638 | Stop moved to flat. |
| USD/HUF | 186.24 | Bearish | 188.00 | 180.00 | 188.00 | Stop moved to flat. |

Spot prices source: Bloomberg

ENTRY - Targetted

ENTRY - Active

Quantitative Market Analysis

Table 1: 1-month correlations

| | AUDUSD | USDCAD | EURUSD | USDJPY | AUDJPY | EURJPY |
|----------------------|-------------|--------|-------------|-------------|--------|-------------|
| 2 YR SPD | 0.44 | 0.12 | -0.69 | 0.88 | 0.40 | 0.70 |
| 10 YR SPD | -0.05 | -0.15 | 0.06 | 0.74 | 0.56 | 0.71 |
| S&P500 | 0.60 | -0.72 | 0.76 | -0.21 | 0.27 | 0.15 |
| Gold | 0.80 | -0.28 | 0.64 | -0.60 | 0.04 | -0.40 |
| Oil | 0.09 | -0.62 | 0.38 | 0.14 | 0.22 | 0.39 |
| CRB | -0.29 | -0.24 | -0.34 | 0.86 | 0.63 | 0.89 |
| Relative Yield Curve | 0.62 | 0.38 | -0.38 | 0.28 | -0.14 | 0.62 |

Chart 1: Trend Strength

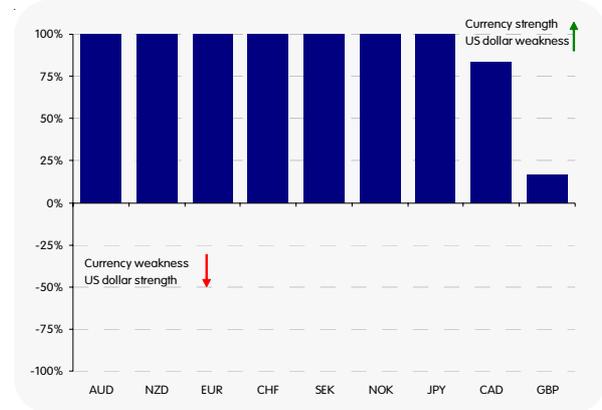


Table 2: Trend following model signals

| Trend Following Model Positions | | | |
|---------------------------------|--------|-----------|-------------|
| | Signal | Date | Entry Level |
| AUDUSD | short | 17-Aug-09 | 0.8327 |
| NZDUSD | long | 10-Jul-09 | 0.6298 |
| EURUSD | long | 09-Sep-09 | 1.448 |
| GBPUSD | long | 09-Sep-09 | 1.6490 |
| USDCHF | short | 17-Jul-09 | 1.0730 |
| USDCAD | short | 08-Sep-09 | 1.0780 |
| USDSEK | short | 09-Sep-09 | 7.0444 |
| 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 | 09-Sep-09 | 2.8278 |
| USDSGD | short | 08-Sep-09 | 1.4337 |
| USDTRY | long | 27-Aug-09 | 1.5093 |
| USDZAR | short | 31-Aug-09 | 7.7525 |

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| USD/JPY | 92.325 | -0.81% | DJIA | 9497.34 | 0.59% |
| AUD/USD | 0.8617 | 0.70% | FTSE100 | 4947.34 | 0.29% |
| EUR/GBP | 0.8783 | 0.17% | Eurostoxx50 | 2786.25 | 0.09% |
| GBP/EUR | 1.1387 | -0.17% | Shanghai Composite* | 2930.48 | 0.20% |
| GBP/USD | 1.6490 | 0.86% | *latest price | | |
| GBP/JPY | 152.25 | 0.05% | Commodities | | |
| GBP/CHF | 1.727 | -0.35% | | | |
| GBP/AUD | 1.914 | 0.16% | Crude Oil \$/bl | 71.10 | 4.53% |
| GBP/CAD | 1.779 | 0.93% | Gold \$/oz | 995.4 | 0.02% |
| GBP/NZD | 2.369 | 0.39% | Copper c/lb | 295.6 | 3.12% |
| GBP/NOK | 9.778 | -0.20% | Silver \$/oz | 16.43 | 0.61% |
| GBP/ZAR | 12.396 | 0.03% | Baltic Dry | 2462 | 1.36% |
| GBP/CNY | 11.259 | 0.84% | | | |
| Bonds % | | | Swaps % | | |
| | | bp | | | bp |
| US 10Yr | 3.482 | 4.1 | US 5yr | 2.773 | 4.0 |
| EUR 10Yr | 3.274 | 4.2 | EUR 5yr | 2.706 | -0.1 |
| UK10 Yr | 3.635 | 1.1 | UK 5yr | 3.299 | 1.7 |
| Other | | | Official Rates % | | |
| VIX | 25.62 | 1.43% | UK | 0.50 | |
| iTraxx XOVER | 602.31 | -6.9 | US | 0.25 | |
| DJ Agriculture Index | 56.60 | -0.15% | EU | 1.00 | |
| | | | Japan | 0.10 | |

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