

# Daily Market Strategy

Wednesday, 26th August 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  
naemwahid@bostreasury.com

#### Altaz Dagha

Analyst  
0207 158 1747  
altazdagha@bostreasury.com

- UK swaps near 5-month low; Bean says BoE purchases 'moderately encouraging'
- German IFO survey to buoy EUR? USD shrugs off new US deficit projections

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6337, €/\$: 1.4313, \$/¥: 94.22

UK 5y sw: 3.40%, US 5y sw: 2.87%, EU 5y sw: 2.80%

#### Overnight

- Japanese July trade surplus shrinks ¥380.2bn; exports drop
- German July import prices drop 0.9%, more than forecast

Call it summer markets or technical flows, but the breach of key pivots for UK yields and swaps is remarkable considering the context of higher equities and stronger (global) economic data. With the trough in UK inflation potentially still a few months away and the BoE fully engaged in QE, we take the notion seriously that a new range is currently being established. Month-end buying of Treasuries is set to add a bid to longer duration paper over the next few trading sessions and could squeeze UK 10y gilts below 3.50%.

In FX, a strong German IFO survey this morning could whisk EUR/GBP closer to our 0.88 target after the pair cleared 0.8760 overnight in Asia. Four consecutive increases in the German IFO since March have been attributed to stronger overseas orders and construction/public sector spending. We doubt that the pace of IFO gains can be sustained into the autumn and time our forecast of a technical setback (bund bullish, EUR negative) for after the September general election (Merkel's CDU/CSU poll lead is 37%).

Ahead: a positive surprise for the German IFO could trigger profit taking in bonds and buoy EUR crosses. Strong US July new home sales and durable goods orders are forecast and could add a bullish element to stocks and commodity/high yield currencies. Key resistance for the S&P 500 runs at 1,049. The BoE will buy £1.4bn of shorter dated gilts (2013 to 2019 maturities). In the US, the Treasury will sell \$39bn in 5y notes.

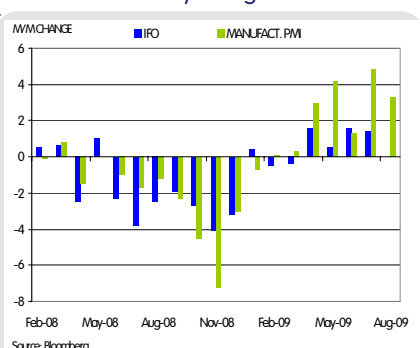
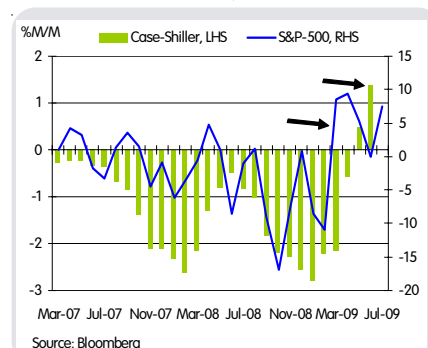
**FX:** GBP crosses continue to look heavy in general and fading pro-risk characteristics of GBP indicate that more downside could materialise. GBP/USD looks in danger of breaking below 1.63. Key support is situated around 1.6276. GBP/CHF hit an overnight low of 1.7305 and further GBP selling could drag the cross to 1.7260.

**Rates:** UK 5y swaps opened flat at 3.40% but a general bullish tone for bonds points to lower yields, supported by month-end extensions in the US. 10y swaps slipped below 4% and look set-up for a move to 3.90%, though German/US data poses upside risk. Resistance for the Sep gilt future runs at 120.33, the May 21 high. Support comes in at 119.57.

Are gains in US equities starting to spill over to house prices?

A fifth consecutive rise for the German IFO survey in August?

	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.8745	0.40%
GBP/USD	1.6349	-0.42%
EUR/USD	1.4297	-0.05%
USD/JPY	94.185	-0.40%
AUD/USD	0.8357	-0.39%
<b>Bonds %</b>		<b>bp</b>
US 10Yr	3.435	-4.1
EUR 10Yr	3.269	-3.6
UK10 Yr	3.631	-1.1
UK 5yr Swap	3.396	-7.0
<b>Equities</b>		<b>%</b>
S&P500	1028.00	0.24%
FTSE100	4916.80	0.42%
Eurostoxx50	2801.14	0.82%
Shanghai Composite	2915.80	1.94%
<b>Commodities</b>		<b>%</b>
Crude Oil \$/bl	72.05	-3.12%
Gold \$/oz	944.8	0.34%
Copper	287.4	-1.95%
Baltic Dry	2388	-2.01%
<b>Other</b>		
VIX	24.92	-0.88%
iTraxx XOVER	584.29	2.0



### Today's Events

German Import Prices, Jul  
German IFO Survey, Aug  
US Durable Goods Orders, Jul  
US New Home Sales, Jul  
BoE buys £1.4bn gilts; maturities: 2013, 2014, 2015, 2016, 2017, 2018, 2019  
US Weekly Oil Inventories (15:30)  
US Treasury sells \$39bn of 5y notes  
US Fed member Lockhart speaks on the economy (17:00)

Time	Consensus	Previous
07:00	-0.9% A	+0.4%
09:00	88.9	87.3
13:30	+3.0%	-2.5%
15:00	390K	384K

## Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- The pro-risk theme continues as equity markets remain in upward trends, in line with the core technical view. However, the market is approaching an over-bought status implying a level of caution. Despite this, FTSE futures could still extend to 5,000 as Chinese equities ready for a break above 3,000 key resistance. DAX index futures finally hit target of 5,500 with 5,750 the next objective. S&P cash targets are at 1,049 and then 1,104. Stops are now below 1,020.
- Sterling remains the fly in the ointment in the FX markets as soft bond yields continue to weigh on the currency against the EUR and USD. Resistance in EUR/GBP comes in at 0.8785 and then at 0.8845 from a key downward trendline. Although further weakness in the pound could occur, this is still seen in the context of a larger range. The preferred trades remain to buy the commodity and EM currencies against the dollar and yen, the PLN being favoured in the EM space. EUR/USD one-month option vols continue to drop. A move into single digits is expected in September as volatility broadly declines.
- Considering the rally in equities and commodities, bond yields remain soft - particularly in the UK. US yields are edging back upwards and further firming is expected technically. US 2y yields target 1.36% while US 10y yields target 3.88% - although resistance at 3.60% continues to be a considerable barrier.
- The CRB index continues to consolidate, but year-end objective remains at 300. The upward follow-through from oil, having breached resistance at \$73.50, has been relatively weak, but this does not negate the bullish view. Target remains at \$81.00.

Chart of the day: Copper, Dec, 09 futures.



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
<b>R2</b>	1.4572	1.7044	98.90	0.8800	<b>1.1905</b>
<b>R1</b>	1.4446	1.6626	97.80	0.8785	1.1819
Current Spot	1.4313	1.6338	94.20	0.8761	1.1414
<b>S1</b>	1.4005	1.6220	93.67	0.8461	1.1383
<b>S2</b>	<b>1.3748</b>	1.5982	91.78	<b>0.8400</b>	1.1364

Spot prices as of: 07:05:16 Source: Bloomberg

Resistance at 300 c/lb remains the target and represents key resistance. When this level broke in Sept. 08, it accelerated the downward trend.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4313	Bullish	<a href="#">1.4230</a>	1.4500	1.3940	
USD/JPY	94.20	Bullish	<a href="#">93.60</a>	97.80	93.70	
USD/CHF	1.0614	Bearish	-	1.0300	-	
GBP/USD	1.6338	Bullish	<a href="#">1.6270</a>	1.7000	1.6080	Stop hit at 1.6340. Buy lower down.
EUR/GBP	0.8761	Bearish	0.8750	0.8400	0.8780	
GBP/JPY	153.81	Bullish	155.12	163.11	154.00	Stop hit.
EUR/JPY	134.77	Bullish	133.00	139.14	132.90	
CAD/JPY	86.85	Bullish	85.00	90.33	84.35	Stop raised.
AUD/USD	0.8372	Bullish	<a href="#">0.8305</a>	0.8520	0.8120	
USD/CAD	1.08426	Bearish	<a href="#">1.0860</a>	1.0000	1.1155	Sell level lowered.
NZD/USD	0.6876	Bullish	<a href="#">0.6860</a>	0.6900	0.6588	Buy level raised.
USD/BRL	1.8616	Bearish	1.8500	1.8000	1.8730	
USD/PLN	2.8473	Bearish	<a href="#">2.8600</a>	2.8000	2.9550	Sell level lowered from 2.90.
USD/HUF	186.23	Bearish	<a href="#">188.00</a>	180.00	193.10	Sell level lowered.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The trend following model has closed its short USD/ZAR position this morning, booking a 3.77% profit. In USD/CAD, the model is beginning to suffer from the classic “whipsaw” problem. This occurs when markets stop trending and ranges start to hold. As such, when a new position is taken, the model is caught out when the market moves back into the range. A new long USD/CAD position has been signalled this morning, meaning that the model has lost 0.98% on the short position previously held.

Overall, the model continues to hold a broadly net short USD portfolio, as the DXY index remains close to its 2009 low (77.43). In most G-10 currencies (against the USD), the slow stochastic indicator continues to favour further USD weakness.

The key important economic data due for release today are the German IFO and US new home sales. Upside risks exist for the IFO, given the recent improvements in the German PMIs and eurozone economic data (the latest being the Belgium business confidence survey which rose to a nine month high). A further rise in the IFO would be positive for EUR/USD and euro crosses (particularly EUR/GBP, which is trading at a two month high) as well as commodities and equities.

Interest rate spreads generally remain negative for the USD, particularly against commodity currencies (AUD, NZD & CAD). Improving economic data, bullish equity markets and interest rate spreads suggest further upside for commodity currencies. In this context, NZD/USD strength is not surprising – the currency pair continues to record new highs and is now probing options barriers that lie around \$0.69.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY
2 YR SPD	0.17	-0.03	-0.26	-0.11	<b>0.83</b>	<b>0.80</b>
10 YR SPD	-0.17	-0.44	-0.54	-0.30	0.67	-0.04
S&P500	<b>0.88</b>	-0.59	0.35	0.53	0.73	<b>0.79</b>
Gold	0.61	-0.61	<b>0.91</b>	<b>0.80</b>	0.21	0.71
Oil	<b>0.87</b>	-0.66	0.60	0.71	0.59	<b>0.83</b>
CRB	<b>0.91</b>	-0.58	0.60	0.72	0.65	<b>0.88</b>
Relative Yield Curve	0.26	0.49	0.32	0.16	0.29	0.73

Table 1: Spread between NZ-US 2-yr interest rate swaps

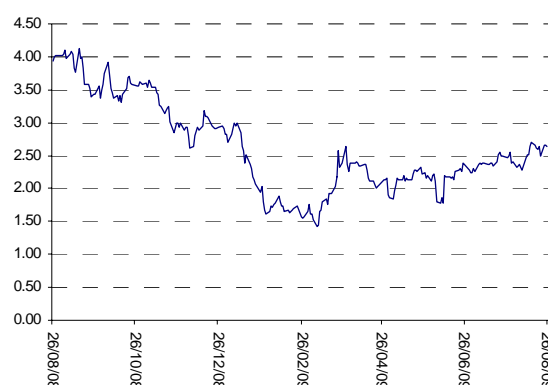


Table 2: Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	short	17-Aug-09	0.8327
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	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	short	13-Jul-09	1.5504
USDZAR	long	26-Aug-09	7.8223

This document has been prepared for information purposes only and is based on information believed to be reliable. This information is provided as a courtesy to you and does not create an obligation for Bank of Scotland Treasury ("BoS Treasury") or another Group company within Lloyds Banking Group to notify you of any changes to this data or to do so in the future. Changes in rates of exchange or rates of interest may have an adverse effect on the value or price of these investments. Spot and forward foreign exchange transactions generally are not 'designated investments' as defined in the UK Financial Services & Markets Act 2000 ("the Act") and therefore do not benefit from any of the protections contained either in the Act or in the rules of the FSA. Past performance is not necessarily a guide to future performance. This document has been written with market professionals in mind and recipients should seek guidance and advice from a suitably qualified professional if they find anything contained herein confusing or unclear. The distribution of this document in other jurisdictions may be restricted by local laws and recipients into whose possession this document comes should inform themselves about, and observe any such restrictions. This information has been provided for the use of the recipient only and must be treated as proprietary and confidential information. It may not be passed on or reproduced in whole or part under any circumstances without express written consent from BoS Treasury. Although the information contained herein is believed to be correct, Lloyds Banking Group does not guarantee its reliability or its accuracy. Opinions expressed are subject to change without notice, as are prices and availability, which are indicative only. In preparing this publication we have not considered your objectives, financial situation or needs. Appropriate independent advice should be obtained before making any such decision. Lloyds Banking Group specifically disclaims liability for any loss, claim or damage suffered by you or any third party resulting directly or indirectly from any use you may make from this data without limitation. Provision of this information does not constitute either a bid or offer to undertake any transaction or commitment by any Lloyds Banking Group company to make such an offer. Lloyds Banking Group or its employees may own or build positions or trade in such securities and derivatives and may also sell them whenever considered appropriate. Lloyds Banking Group may also provide banking or other advisory services to any company mentioned herein.

Bank of Scotland Treasury is a division of Bank of Scotland plc which is part of Lloyds Banking Group. Registered Office: The Mound Edinburgh EH1 1YZ. Registered in Scotland. Registered No SC 327000. Authorised and regulated by The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS. Australian residents please note: In Australia, Bank of Scotland plc is registered as a foreign company, Australian Registered Body Number 126 955 557. The liability of its members is limited.