

Daily Market Strategy

Thursday, 24th September 2009

Market Strategy

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- G20 takes centre stage; German IFO set for one-year high
- NOK target raised

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6356, €/\$: 1.4733, \$/¥: 90.75

UK 5y sw: 3.41%, US 5y sw: 2.73%, EU 5y sw: 2.74%

Overnight

- Fed extends MBS/agency purchases to Q1-10, says rates to stay low
- US \$40bn, 5y auction covered 2.40 times, indirects take 44.8%, tail 3bps
- Japanese trade surplus falls to ¥185.7bn in August, exports drop 36.0% y/y
- G20 could shift dollar's outlook (WSJ)

A late reversal yesterday in US stocks from the highs to a negative close testifies to the unease amongst investors and bias to lock in profits ahead of the G20 meeting. Whilst the Fed acknowledged a rosier *current* economic backdrop, there is still tremendous uncertainty about the *outlook* for growth and corporate earnings in (early) 2010. The report by Moody's that US credit card defaults rose to a record in August testifies to the bleak consumer outlook.

Separately, the statement by Norges Bank gave a glimpse of what potentially lies ahead for G10 currencies as central banks inch closer towards exit strategies. Though G20 countries will lock horns today and tomorrow and discuss how and when to start unwinding the emergency fiscal stimulus and other guarantees, the statement by Norges Bank that it had considered raising interest rates from 1.25% puts beyond doubt the fact that in some countries the era of 'historically' low interest rates is drawing to a close. Up ahead today are US weekly claims and existing home sales. The German IFO survey is forecast to hit a one year high of 92.0.

FX: USD crosses bounced off the post-Fed lows overnight while Asian equities are mixed. The German IFO release could cause choppy trading conditions in major EUR crosses. Support for EUR/USD runs at 1.4695, resistance at 1.4750. We have raised our target for the NOK after the Norges Bank statement and now look for USD/NOK to fall towards 5.50 and GBP/NOK to complete a retracement towards the March lows around 9.15. We expect Norges Bank to hike rates on October 29.

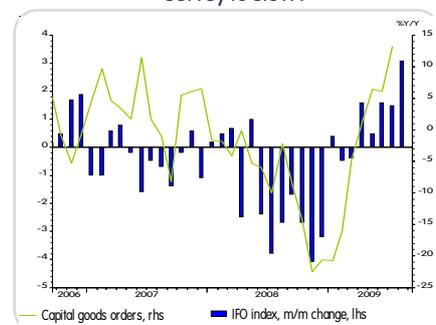
Rates: The upward pressure in UK 5y swaps fizzled out overnight and swaps dropped 5bps to 3.36% in the first minutes of trading, tracking US rates lower on flight-to-quality. Support runs at 3.32%. 2y gilts have dropped below our 0.80% support target. The US Treasury will auction \$29bn in 7y notes. The August 27 auction was covered 2.74 times and indirect bidders took up 61.2%. Over the last 3 weeks, 7y notes (-8bps) have shadowed the 2y (-8bps) but outperformed the 10y (-5bps).

	Close	Daily Change %
FX		
EUR/GBP	0.9015	-0.30%
GBP/USD	1.6341	-0.11%
EUR/USD	1.4735	-0.38%
USD/JPY	91.289	0.20%
AUD/USD	0.8697	-0.43%
Bonds %		bp
US 10Yr	3.418	-2.6
EUR 10Yr	3.373	-2.2
UK10 Yr	3.765	2.5
UK 5yr Swap	3.410	2.3
Equities		%
S&P500	1060.87	-1.01%
FTSE100	5139.37	-0.06%
Eurostoxx50	2887.24	0.20%
Shanghai Composite	2845.69	0.10%
Commodities		%
Crude Oil \$/bl	68.97	-3.61%
Gold \$/oz	1008.4	-0.59%
Copper	280.8	-1.97%
Baltic Dry	2175	-3.16%
Other		
VIX	23.49	1.78%
iTraxx XOVER	558.15	-14.3

GBP/NOK target lowered as Norges Bank prepares to raise rates



Monthly rate of increase in German IFO survey to slow?



Today's Events

Japan Trade Balance, Aug
German IFO, Sep
US Initial Claims, 24-Sep
US Existing Home Sales, Aug
BoE MPC speaker: Dale (13:15)
Fed speaker: Evans (15:30)
ECB speaker: Stark (16:00)
US Treasury sells \$29bn, 7y notes
G20 meeting in Pittsburgh (to Friday)

Time	Consensus	Previous
00:50	+Y185.7bnA	+Y377.9bn
09:00	92.0	90.5
13:30	546K	545K
15:00	5.35mn	5.24mn

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- Equity markets failed to capitalise on the potential squeeze to the upside yesterday and are once again hovering over key support levels. In FTSE futures, the support level at 5,075 is close - a break would complete a double top formation - with the equivalent level in the DAX index at 5,617. Further stops are likely to be at 4,980 and 5,590. The market is balanced here hence the cautious view. My main bias is still bullish for a further squeeze, but the exits are being monitored with increasing interest. The VIX index breached 23.00 key support (one positive factor), but failed to hold below - bouncing back up to 23.49. The trend there remains bearish with 18 the next objective.
- The market feels like it is 'back to square one' on commodity and EM currency trades. The NOK, SEK, NZD, AUD and CAD are all favoured trades against the US dollar with the dollar index targeting 75.00. EUR/USD should squeeze to 1.4950 and cable to 1.6500, but neither are primary trades. The FX market continues to tread carefully, taking its cue from the equity and commodity markets where gold seems determined to test the bulls' patience. Oil and copper are flirting with breakouts, but continue to consolidate. The upward trend is favoured, however the lack of traction is causing some concerns - especially with the Baltic Dry index falling for the ninth consecutive session and approaching 2,144 (50% drop from the peak of 4,291). It stands today at 2,175.
- The bullish yield scenario seemed to fold from a short term perspective, but the longer term charts still indicate bases are being formed. A break of 3.80% in UK 10y yields (Tuesday's high) and 3.50% in US 10 year yields (yesterday's high) would be key signals. Also 0.50% in UK 1 year yields is a stand-out level as a potential double bottom forms. US 2 year yields have turned around sharply from the high at 1.05% to the current 0.96%, but broadly speaking the market is still range-bound.

Chart of the day: UK 5 year swaps

Key Levels



	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4966	1.7044	95.15	0.9110	1.1404
R1	1.4865	1.6746	93.41	0.9088	1.1308
Current Spot	1.4735	1.6370	90.74	0.9002	1.1109
S1	1.4500	1.6113	90.30	0.8843	1.1004
S2	1.4177	1.5975	87.14	0.8769	1.0977

Spot prices as of: 07:23:09 Source: Bloomberg

This weekly chart highlights the potential base being formed. 3.45% is a pivotal level and the preferred bias is for a break to the upside.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4735	Bullish	1.4675	1.4950	1.4630	(initial entry 1.4350)
USD/JPY	90.74	Bullish	89.90	96.00	89.30	
USD/CHF	1.0264	Bearish	-	1.0000	-	
GBP/USD	1.6370	Bullish	1.6200	1.7000	1.6125	
EUR/GBP	0.9002	Bearish	0.9042	0.8500	0.9110	
GBP/JPY	148.53	Neutral	-	156.00	-	
EUR/JPY	133.70	Bullish	133.50	139.14	132.80	
CAD/JPY	84.51	Bullish	84.90	90.35	83.80	
AUD/USD	0.8736	Bullish	0.8305	0.9000	0.8637	
USD/CAD	1.0736	Bearish	1.0800	1.0000	1.0925	
NZD/USD	0.7219	Bullish	0.6860	0.7447	0.7035	
USD/BRL	1.7980	Bearish	1.8338	1.7000	1.8455	
USD/PLN	2.8451	Bearish	2.9000	2.7000	2.9110	
USD/HUF	184.28	Bearish	188.00	180.00	190.20	

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

Despite intra-day volatility there has been little change in the absolute level of the USD DXY index. Having recorded a marginal new low for the year yesterday, the USD found some support after the FOMC decision. Given this, the trend following model has only one position change this morning. The model has initiated a long position in USD/CAD. The engine in the trend following model, for USD/CAD, is relatively fast, hence it can often be the first to signal a shift in the trend. However the high speed can also leave it vulnerable to “whipsaw” in some cases.

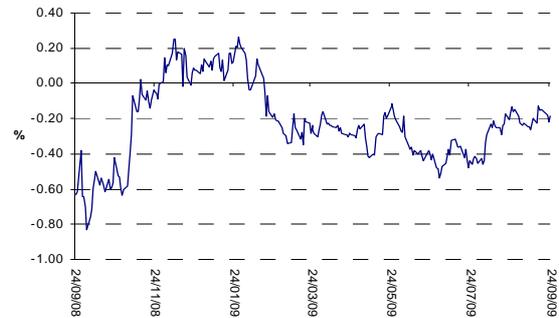
The S&P500 recorded a key day reversal (KDR) formation yesterday, which can often signal a potential turn in the existing trend. Given the outcome from KDR signals can be mixed (we prefer the use of weekly reversal patterns), we refrain from calling an outright turn in equities at this point (especially given that the Federal Reserve has reiterated its call for the Fed Funds Target Rate low for an extended period). However a close below 1057.5 (the week’s low) would signal the rising risk of a corrective move in the current upward trend.

The correlation between commodity currencies and equities remains high – see table 1. As such the bearish price action in NZD/USD yesterday (alongside our long USD/CAD trend signal this morning), where the currency pair gave up all of its intra-day gains is consistent. The key data release today is the German Ifo report. Market expectations (business climate expected at 92.0) must now be exceeded for further gains in the EUR/GBP (where the spread between EZ/UK interest rate swaps continues to narrow in the UK’s favour) and commodity currencies.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY
2 YR SPD	-0.60	0.01	0.58	0.34	0.13
10 YR SPD	-0.48	-0.36	0.58	0.30	0.17
S&P500	0.83	-0.86	0.93	0.29	-0.66
Gold	0.89	-0.65	0.82	0.44	-0.91
Oil	0.08	-0.44	0.17	0.16	0.22
CRB	0.36	-0.63	0.52	0.08	-0.15

Chart 2: Spread between EZ/UK 2-year interest rate swaps moving in sterling’s favour



Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	long	15-Sep-09	0.8622
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	09-Sep-09	1.4480
GBPUSD	short	21-Sep-09	1.6270
USDCHF	short	17-Jul-09	1.0730
USDCAD	long	24-Sep-09	1.0745
USDSEK	short	09-Sep-09	7.0444
USDNOK	short	21-Jul-09	6.3025
USDJPY	long	22-Sep-09	91.93

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	short	15-Sep-09	1.4939
USDZAR	short	31-Aug-09	7.7525

Market Summary

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.4735	-0.38%	S&P500	1060.87	-1.01%
USD/JPY	91.289	0.20%	DJIA	9748.55	-0.83%
AUD/USD	0.8697	-0.43%	FTSE100	5139.37	-0.06%
EUR/GBP	0.9015	-0.30%	Eurostoxx50	2887.24	0.20%
GBP/EUR	1.1090	0.28%	Shanghai Composite*	2842.72	0.15%
GBP/USD	1.6341	-0.11%	*latest price		
GBP/JPY	149.16	0.08%	Commodities		
GBP/CHF	1.678	0.20%			
GBP/AUD	1.879	0.31%	Crude Oil \$/bl	68.97	-3.61%
GBP/CAD	1.756	0.39%	Gold \$/oz	1008.4	-0.59%
GBP/NZD	2.270	-0.23%	Copper c/lb	280.8	-1.97%
GBP/NOK	9.481	-0.77%	Silver \$/oz	16.83	-1.78%
GBP/ZAR	12.166	0.80%	Baltic Dry	2175	-3.16%
GBP/CNY	11.155	-0.13%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.418	-2.6	US 5yr	2.745	-6.0
EUR 10Yr	3.373	-2.2	EUR 5yr	2.779	-2.0
UK10 Yr	3.765	2.5	UK 5yr	3.410	2.3
Other			Official Rates %		
VIX	23.49	1.78%	UK	0.50	
iTraxx XOVER	558.15	-14.3	US	0.25	
DJ Agriculture Index	58.18	-0.31%	EU	1.00	
			Japan	0.10	

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