

Daily Market Strategy

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Market Strategy

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- Long JPY favoured ahead of Obama's China visit
- Bond yields drop ahead of US 30y auction

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6551, €/\$: 1.4999, \$/¥: 89.75

UK 5y sw: 3.31%, US 5y sw: 2.60%, EU 5y sw: 2.74%

Overnight

- Australia Oct employment up 24.5k, 2nd successive gain
- Economists at IMF urges lesser role for dollar (FT)
- Beijing hints at change of line on renminbi (FT)

It is hard to see sterling immediately regain its vigour after BoE governor King sent sterling bulls scrambling once again yesterday when he stated that a drop in the pound will help to smooth the rebalancing [of the economy]. We have been here before but sterling has managed to rebound in August and September though from lower lows (vs the USD). Next week's CPI data (off the cycle low?) and MPC minutes will offer a chance to make it three in a row if risk appetite stays intact. A 10th straight increase for the Baltic Dry and a 15-month high for AUD/USD do not imply that sentiment is about to turn over. However, selection is key and the outlook for GBP does not look all that promising against high yielders/commodity currencies as rate differentials drive performance. For rates, we expect gilts and swaps to play the ranges. The option the BoE took out in not ruling out additional QE should protect longer dated yields and swaps from a bearish breakout.

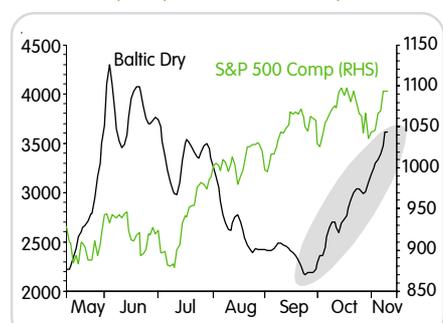
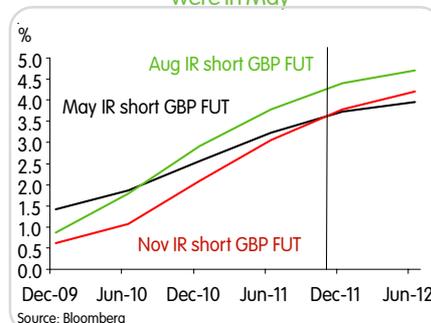
Ahead today: EU-16 Sep industrial output is forecast to rise for a 5th successive month. ECB president Trichet will speak after market close. US continuing claims are forecast to have fallen to 5.7mn, the lowest since March. The Treasury will sell \$16bn in 30y bonds.

FX: MNI says sources in China dismiss short-term plans for yuan rise - but the FT article and the visit to Beijing of US President Obama early next week justify being short USD/JPY and EUR/JPY, though for the latter this runs against the pro-risk environment. USD/JPY is offered below 90.0 this morning. We look for a test of yesterday's 89.29 low. For EUR/GBP, a rally overnight through the 50d MA (0.9046) and 0.9050 bodes well for a move up to 0.91. For USD/CHF, a rebound off yesterday's 1.0035 lines up a test of 1.01. Resistance at 1.0156. SNB's Jordan speaks at 17.00 on 'Challenges for monetary policy'.

Rates: UK 5y swaps fell through 3.31% on the BoE IR and have extended their decline to 3.28% in early trading. We now look for a test of 3.25%. We doubt there is a lot more downside momentum as stronger UK CPI looms next week. Following a test of 3.73% for 10y yields, we target a pullback to 3.70%. The 2y/10y swaps curve is steady at 211bps. For the US 30y auction, the share of indirects has dropped during the last three auctions, pointing to lower demand for ultra-long US paper. Bid/cover also disappointed in October and favours a defensive set-up.

UK implied rates for Q4-11: back to where they were in May

Batic Dry is up 72% from the Sep-29 low



| | Close | Daily Change % |
|--------------------|---------|----------------|
| FX | | |
| EUR/GBP | 0.9042 | 0.98% |
| GBP/USD | 1.6574 | -1.02% |
| EUR/USD | 1.4987 | -0.04% |
| USD/JPY | 89.870 | 0.07% |
| AUD/USD | 0.9298 | -0.07% |
| Bonds % | | |
| US 10Yr | 3.483 | 1.1 |
| EUR 10Yr | 3.343 | 6.3 |
| UK10 Yr | 3.792 | -4.3 |
| UK 5yr Swap | 3.318 | -6.3 |
| Equities | | |
| S&P500 | 1098.51 | 0.50% |
| FTSE100 | 5266.75 | 0.69% |
| Eurostoxx50 | 2881.01 | 0.86% |
| Shanghai Composite | 3172.95 | -0.07% |
| Commodities | | |
| Crude Oil \$/bl | 79.28 | 0.29% |
| Gold \$/oz | 1117.4 | 1.05% |
| Copper | 299.1 | 0.17% |
| Baltic Dry | 3748 | 3.68% |
| Other | | |
| VIX | 23.04 | 0.88% |
| iTraxx XOVER | 505.43 | -7.1 |

Today's Data

| | Time | Consensus | Previous | Events |
|-------------------------------------|-------|-----------|------------|-------------------------------------|
| Australia Unemployment Rate, Oct | 00:30 | 5.8%A | 5.7% | US Treasury sells \$16bn, 30y bonds |
| Australia Employment Change, Oct | 00:30 | 24.5k | 39.8k | ECB speaker: Trichet (19:00) |
| EU-16 Industrial Output, Sep | 10:00 | 0.5% | 0.9% | ECB Monthly Bulletin (09:00) |
| US MBA Mortgage Applications, 6-Nov | 12:00 | n/a | 8.2% | US Weekly Oil Inventories (16:00) |
| US Initial Claims, 7-Nov | 13:30 | 510k | 512k | |
| US Treasury Statement, Oct | 19:00 | -\$150bn | -\$155.5bn | |
| Canada New Housing Index, Sep | 13:30 | 0.2% | 0.1% | |

Quantitative Market Analysis

| | AUDUSD | USDCAD | EURUSD | GBPUSD | USDJPY | EURJPY | AUDJPY |
|----------------------|-------------|--------------|-------------|--------------|--------|-------------|--------|
| 2 YR SPD | 0.45 | 0.83 | 0.53 | 0.38 | 0.70 | 0.49 | 0.62 |
| 10 YR SPD | 0.36 | 0.66 | 0.50 | 0.87 | 0.37 | 0.60 | 0.73 |
| S&P500 | 0.87 | -0.79 | 0.86 | 0.04 | -0.15 | 0.40 | 0.60 |
| Gold | 0.47 | -0.14 | 0.39 | 0.47 | -0.56 | -0.18 | 0.05 |
| Oil | 0.46 | 0.23 | 0.44 | 0.80 | 0.55 | 0.69 | 0.69 |
| CRB | 0.46 | -0.08 | 0.52 | 0.45 | 0.65 | 0.81 | 0.75 |
| Relative Yield Curve | 0.40 | 0.71 | 0.00 | -0.75 | 0.38 | 0.03 | 0.32 |

Table 1: 1-month correlations

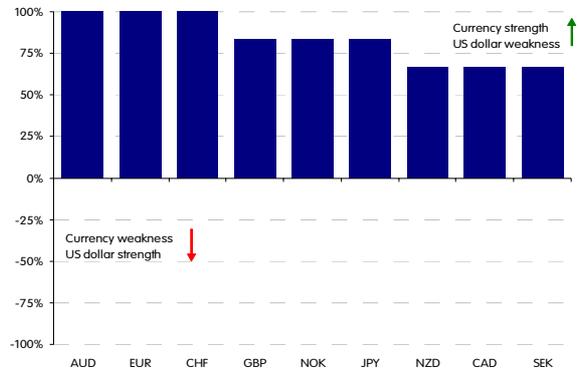


Chart 1: Trend strength indicator

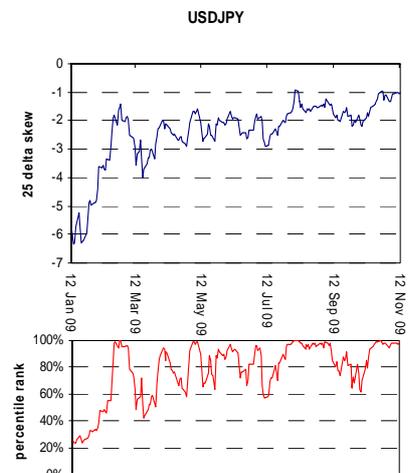
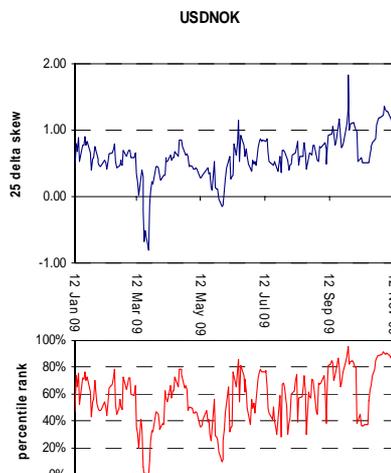
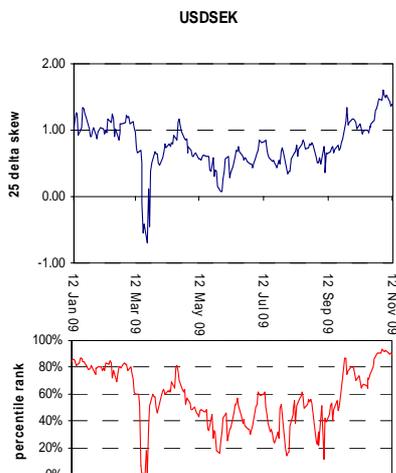
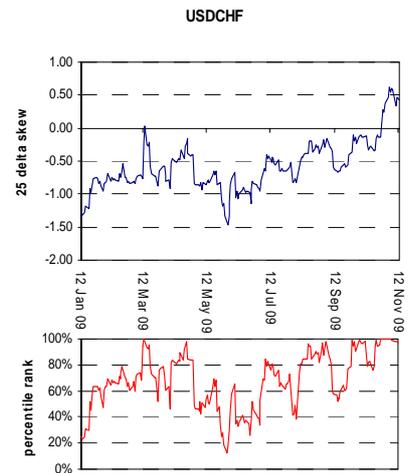
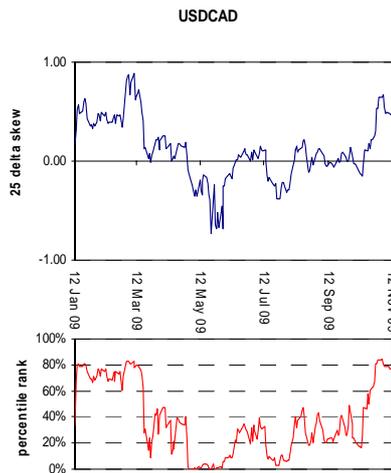
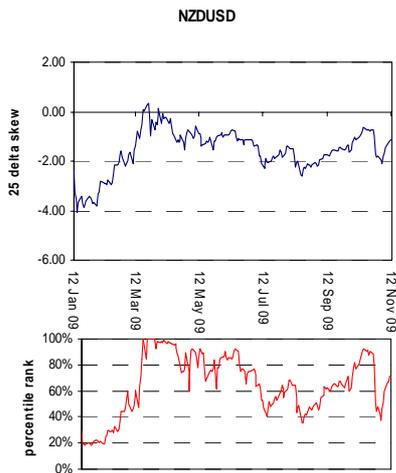
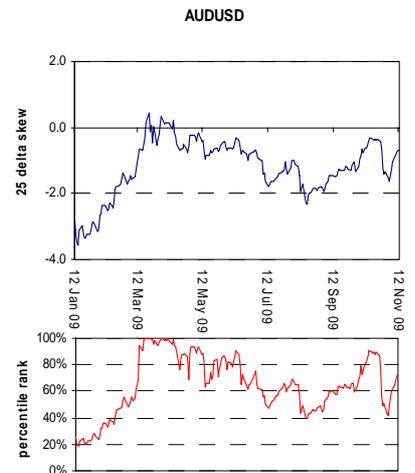
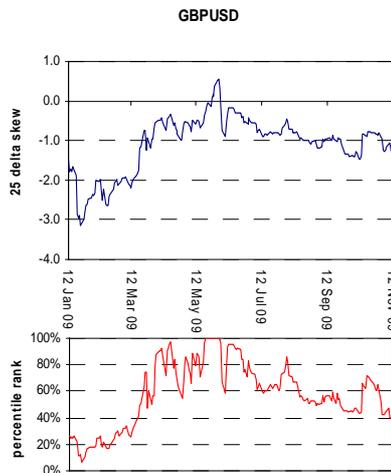
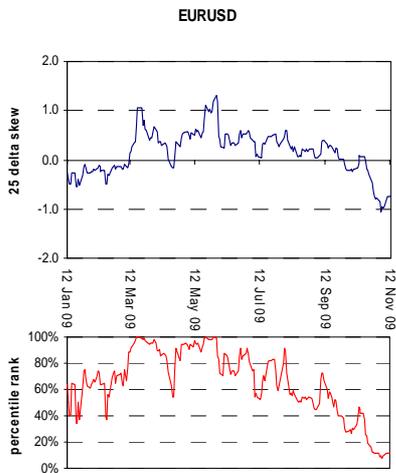
Trend following model signals

| Trend Following Model Positions | | | |
|-----------------------------------|--------|-----------|--------------|
| | Signal | Date | Entry Level |
| AUDUSD | long | 11-Nov-09 | 0.9306 |
| NZDUSD | long | 10-Jul-09 | 0.6298 |
| EURUSD | long | 09-Sep-09 | 1.4480 |
| GBPUSD | long | 30-Oct-09 | 1.6547 |
| USDCHF | short | 17-Jul-09 | 1.0730 |
| USDCAD | short | 11-Nov-09 | 1.0495 |
| USDSEK | short | 06-Nov-09 | 6.9900 |
| USDNOK | short | 21-Jul-09 | 6.3025 |
| USDJPY | short | 02-Nov-09 | 90.10 |
| Net-USD portfolio position | | | -100% |

| Trend Following Model Positions | | | |
|-----------------------------------|--------|-----------|-------------|
| | Signal | Date | Entry Level |
| USDCZK | short | 06-Nov-09 | 17.375 |
| USDPLN | short | 05-Nov-09 | 2.8609 |
| USDSGD | short | 10-Nov-09 | 1.3863 |
| USDTRY | long | 11-Nov-09 | 1.4769 |
| USDZAR | long | 12-Nov-09 | 7.3638 |
| Net-USD portfolio position | | | -20% |



FX Options: Risk Reversal Skews



Market Summary

| | Close | Daily Change % | | Close | Daily Change % |
|----------------------|---------|----------------|-------------------------|----------|----------------|
| FX | | | Equities | | |
| EUR/USD | 1.4987 | -0.04% | S&P500 | 1098.51 | 0.50% |
| USD/JPY | 89.87 | 0.07% | DJIA | 10291.26 | 0.43% |
| AUD/USD | 0.9298 | -0.07% | FTSE100 | 5266.75 | 0.69% |
| EUR/GBP | 0.9042 | 0.98% | Eurostoxx50 | 2881.01 | 0.86% |
| GBP/EUR | 1.1059 | -0.98% | Shanghai Composite* | 3172.95 | -0.07% |
| GBP/USD | 1.6574 | -1.02% | *latest price | | |
| GBP/JPY | 149.00 | -0.92% | Commodities | | |
| GBP/CHF | 1.6705 | -0.99% | | | % |
| GBP/AUD | 1.7824 | -0.96% | Crude Oil \$/bl | 79.28 | 0.29% |
| GBP/CAD | 1.7318 | -1.45% | Gold \$/oz | 1117.4 | 1.05% |
| GBP/NZD | 2.2431 | -0.39% | Copper c/lb | 299.1 | 0.17% |
| GBP/NOK | 9.2775 | -0.78% | Silver \$/oz | 17.61 | 1.50% |
| GBP/ZAR | 12.2047 | -1.19% | Baltic Dry | 3748 | 3.68% |
| GBP/CNY | 11.3129 | -1.03% | | | |
| Bonds % | | | Swaps % | | |
| | | bp | | | bp |
| US 10Yr | 3.483 | 1.1 | US 5yr | 2.625 | 0.3 |
| EUR 10Yr | 3.343 | 6.3 | EUR 5yr | 2.773 | -0.8 |
| UK10 Yr | 3.792 | -4.3 | UK 5yr | 3.318 | -6.3 |
| Other | | | Official Rates % | | |
| VIX | 23.04 | 0.88% | UK | 0.50 | |
| iTraxx XOVER | 505.43 | -7.1 | US | 0.25 | |
| DJ Agriculture Index | 62.10 | 0.74% | EU | 1.00 | |
| | | | Japan | 0.10 | |

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