



## Daily Market Strategy

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## Market Strategy

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- **GBP: caught between gilt dividend flows and equity bounce**
- **Libor/Ois spreads drive risk sentiment, Fed mulls action**

## Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.4394

€/£: 1.2287

\$/¥: 90.30

UK 5y sw: 2.46%

US 5y sw: 2.37%

EU 5y sw: 2.08%

## Overnight

- average US 2y auction; b/c 2.93, indirects take 36.2%; direct gets 15.2%
- US Treas Sec Geithner visits Europe; bank stress tests, EU/ECB policy may be discussed
- Fed's next move could be reduced rate on Dollar-Euro swaps (WSJ); reducing the penalty charged on USD loans through the ECB to EU commercial banks may relieve MM strains
- Italy announces 4bln eur budget cuts, first of three auctions today

Markets calmed down overnight, drawing confidence from a late rally in US equities on decent volume and a 34pt bounce off the intra-day low for the S&P to a positive close at 1,074. A bounce in commodity stocks in Asia lured buyers to reverse short AUD/JPY and CAD/JPY positions and profit taking in government bonds (gilt curve steeper) but follow-through buying has so far failed to materialise and hints at very prudent positioning. The market continues to show a distinct apathy for economic data and with only the volatile US durable goods orders to contend, we look for trends in libor/Ois spreads and the reception of the Italian bond 2012 auction to assert a principal influence over the day ahead. The correlation of the US libor/Ois spread with the S&P-500 dived to -0.9 overnight (vs -0.6 for the UK equivalent vs FTSE), implying a still very risk averse set-up stocks if spreads continue to widen. The idea that the Fed could reduce the interest rate charged on USD loans to EU commercial banks may help to spur a relief bounce in risk and EUR crosses led through EUR/JPY (bearish flattening in bunds) if improved terms for US liquidity can be agreed.

## Ahead today

- UK: no data
- EU: eyes on the Italian and German bond sales, ECB member Paramo is scheduled to speak on 'Managing credit risk: lessons learnt from the crisis'.
- US: the volatile durable goods orders (April) are expected to paint a robust picture of capex at the start of Q2. Treasury sells \$40bln, 5y notes (previous b/c 2.75, indirects 48.9%).

**FX:** GBP: a fairly quiet start to the trading day, but with GBP/USD sitting on early lows around 1.4350. Roughly £1.6bln in gilt dividend flows could weigh on GBP crosses this morning, though better buying on dips could emerge later on as the FTSE makes its way back over 5,000. The last time dividend payments were made in Feb, GBP dropped 0.9% vs the USD and EUR.

The underperformance of EUR/USD vs GBP/USD is a key factor for EUR/GBP along with the widening in UK/EU 2y spread. The spread widens to 39bp in early trade and this should keep the cross near the lower end of the 0.8550-0.86 range. A decision by the Fed to lower the cost of dollar funding would obviously negate this view and boost EUR crosses, with EUR/JPY setting the pace.

**Rates:** UK 5y swaps are static at 2.46%, trying to put in a base four a 4th successive trading session. For gilts, a modest back-up in yields is observed along the curve as the FTSE returns over 5,000 and participants prepare to take down EU and US supply. We see a potential 10bp to the upside in the short-term (3.60%) for 10y paper if risk appetite manages to stick. The 2y/10y swaps curve steepens to 197bp, targeting 200bp. The cash curve steepens up to 265bp. Considering the very prudent set-up vis a vis risk assets, we doubt that the upper end of recent ranges will be tested or violated. With the exception of Spain, peripheral EU spreads are fractionally wider over bunds. 10y gilts/bunds are steady at 90bp. UK 10y swap spreads flatten 3bp to -8bp, with US and EU spreads also a flatter by about 2bp.

	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.8568	-0.09%
GBP/USD	1.4409	-0.11%
EUR/USD	1.2345	-0.22%
USD/JPY	90.230	-0.07%
AUD/USD	0.8278	0.16%
<b>Bonds %</b>		
US 10Yr	3.158	-3.6
EUR 10Yr	2.578	-7.7
UK10 Yr	3.546	-0.4
UK 5yr Swap	2.468	-4.5
<b>Equities</b>		
S&P500	1074.03	0.04%
FTSE100	4940.68	-2.54%
Eurostoxx50	2488.50	-2.73%
Shanghai Composite	2628.74	0.23%
<b>Commodities</b>		
Crude Oil \$/bl	68.75	-2.08%
Gold \$/oz	1204.3	1.06%
Copper	304.2	-3.35%
Baltic Dry	4187	6.19%
<b>Other</b>		
VIX	34.61	-9.68%
iTraxx XOVER	625.61	38.2

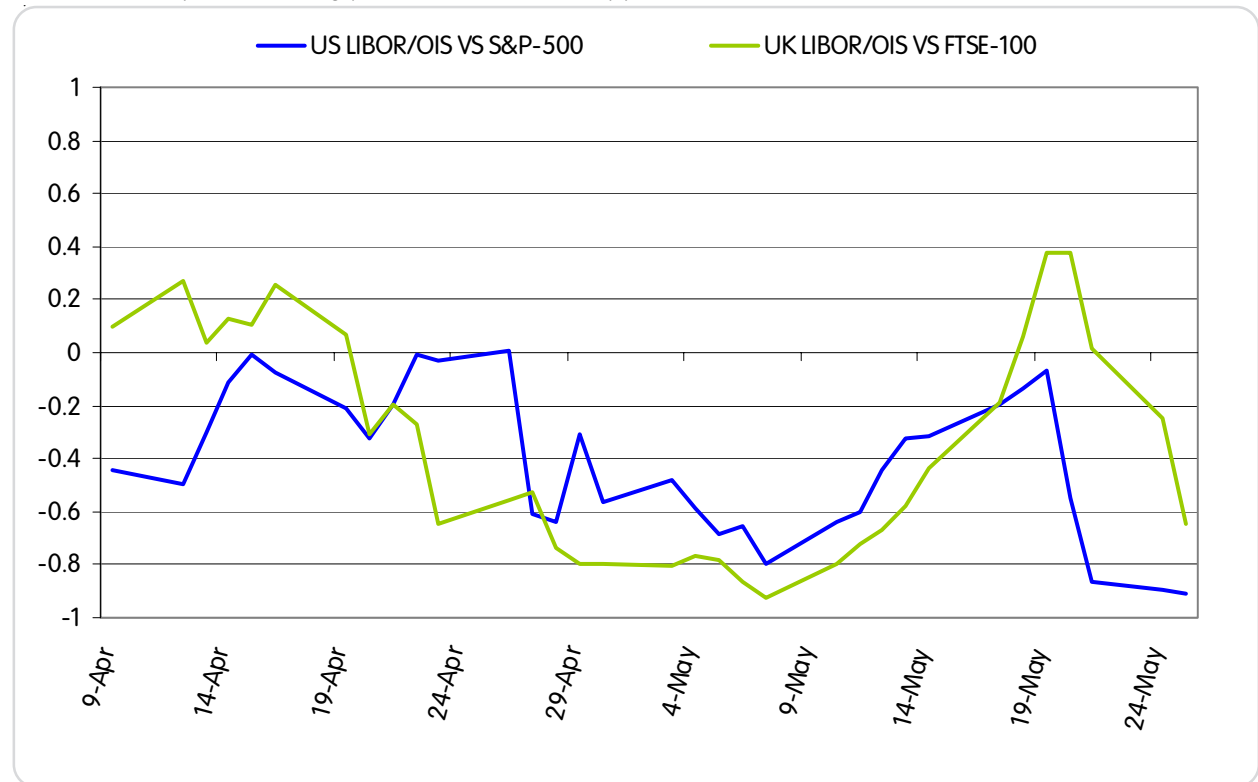
Today's Data	Time	Consensus	Previous	Events
German Consumer Confidence, Jun	07:00	3.5A	3.7R	Italy sells 2.5bln eur 2012 zero coupons
UK BBA Mortgage Loans, Apr	09:30	37k	34.9k	Germany sells 7bln eur, 5y notes (tap)
US MBA Mortgage Apps, May 21	12:00	n/a	-1.5%	US Treasury sells \$40bln, 5y notes
US -- Durable Goods Orders, Apr	13:30	1.4%	-1.3%	ECB speakers: Paramo (08:40)
-- Ex-transport, Apr	13:30	0.5%	2.8%	Fed speakers: chairman Bernanke (01:00) Plosser (03:00), Lacker (21:15)
US New Home Sales, Apr	15:00	425k	411k	

\*All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, DataStream &amp; CQG

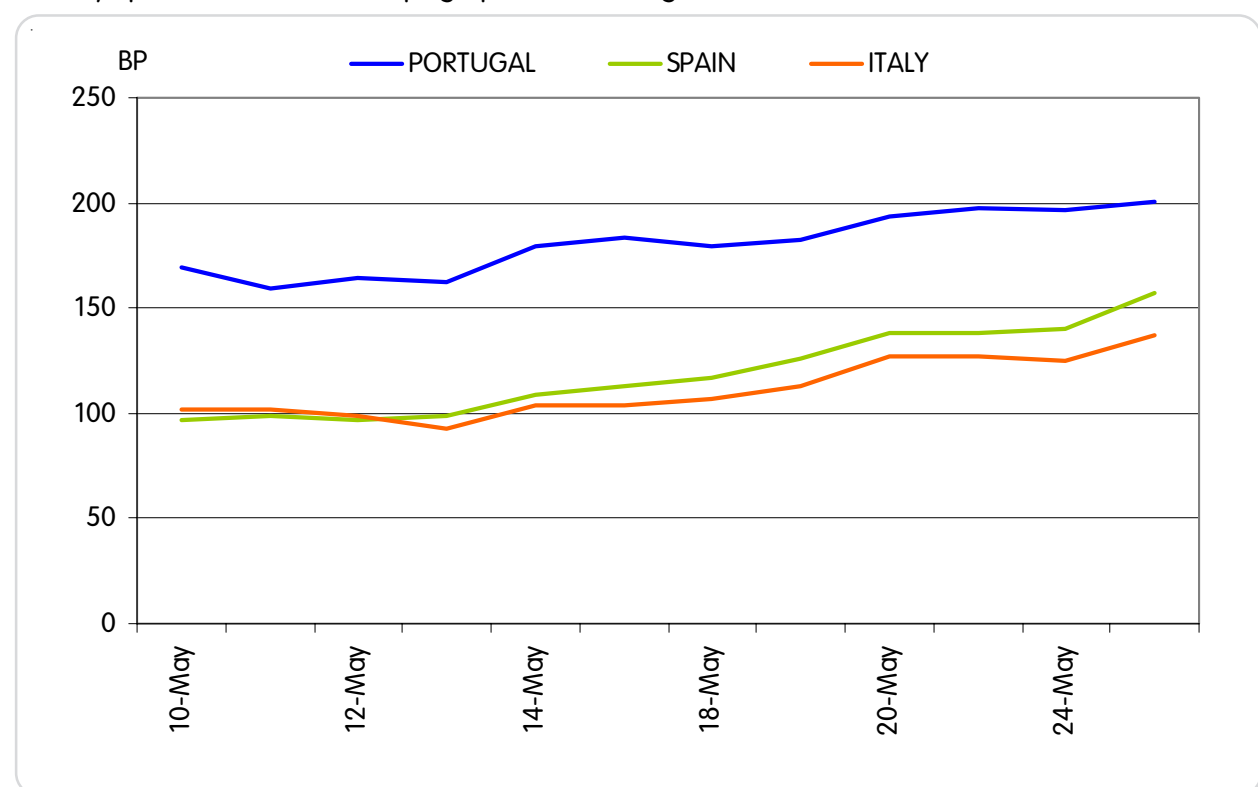
Lloyds TSB Corporate Markets Economic Research, 10 Gresham Street, London, EC2V 7AE, Switchboard: 0207 626 1500.

Bloomberg page: LLOY&lt;GO&gt;

US Libor/Ois spread: strongly directional for risk appetite (-0.9) vs UK (-0.6)



EU 10y spreads over bunds, sloping upwards once again





## Market Summary

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.2345	-0.22%	S&P500	1074.03	0.04%
USD/JPY	90.23	-0.07%	DJIA	10043.75	-0.23%
AUD/USD	0.8278	0.16%	FTSE100	4940.68	-2.54%
EUR/GBP	0.8568	-0.09%	Eurostoxx50	2488.50	-2.73%
GBP/EUR	1.1671	0.09%	Shanghai Composite*	2628.74	0.23%
GBP/USD	1.4409	-0.11%	*latest price		
GBP/JPY	130.01	-0.18%	Commodities		
GBP/CHF	1.6672	-0.28%			
GBP/AUD	1.7408	-0.26%	Crude Oil \$/bl	68.75	-2.08%
GBP/CAD	1.5381	0.36%	Gold \$/oz	1204.3	1.06%
GBP/NZD	2.1499	-0.28%	Copper c/lb	304.2	-3.35%
GBP/NOK	9.4645	0.74%	Silver \$/oz	17.95	0.22%
GBP/ZAR	11.2863	-0.22%	Baltic Dry	4187	6.19%
GBP/CNY	9.8422	-0.07%	Swaps %		
Bonds %					
		bp	US 5yr	2.340	-0.6
US 10Yr	3.158	-3.6	EUR 5yr	2.063	-6.3
EUR 10Yr	2.578	-7.7	UK 5yr	2.468	-4.5
UK10 Yr	3.546	-0.4	Official Rates %		
Other					
VIX	34.61	-9.68%	UK	0.50	
iTraxx XOVER	625.61	38.2	US	0.25	
DJ Agriculture	55.84	-1.01%	EU	1.00	
Index			Japan	0.10	

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