

Daily Market Strategy

Tuesday, 6th October 2009

Market Strategy

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- RBA hikes 25bps; GBP/AUD threatens 1.80
- USD falls on talk to replace dollar with ccy basket in oil trading

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5986, €/\$: 1.4739, \$/¥: 88.97

UK 5y sw: 3.10%, US 5y sw: 2.59%, EU 5y sw: 2.67%

Overnight

- RBA first G10 central bank to move; Norway to follow later this month
- Strong US 10y TIPS auction (re-open): bid/cover 3.12; indirects get 44%
- Secret talks are held to replace the USD with a currency basket for oil trading (The Independent)

Some G10 central banks never hang about. The RBA set the example overnight and we expect Norway's central bank to follow in due course and make a start with reversing monetary policy from the emergency level as prospects brighten for a return to trend GDP growth next year. The RBA hike in the overnight cash rate to 3.25% increases the probability of a further move to 3.50% by year-end (AU Dec 90d Bank bill 4.04%), inflating the spread to 300bps above BoE base rate. No wonder GBP/AUD is in the verge of testing 1.80. GBP bulls were obviously disappointed yesterday after the rise in the UK services PMI to a two-year high failed to inspire a decent bounce. This underscores the prevailing and overwhelming bearish sentiment vis-a-vis sterling to which the weekly IMM data testify. Considering the market apathy towards stronger data, the bounce in EUR/GBP overnight above 0.92 on EUR/USD outperformance (related to the oil/currency story), could stretch to 0.9250 if UK August manufacturing output data disappoint at 09.30.

Ahead today: UK industrial output will be followed by the NIESR update for GDP in the three months to September (see chart for ONS comparison). The DMO auctions £0.5bn of 2013 gilts. It will be quiet elsewhere, with the Treasury auction of \$30bn in 3y notes billed as the main event in the US.

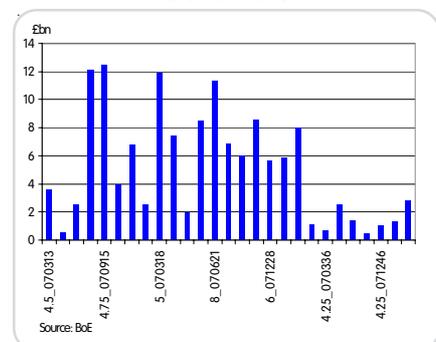
FX: For GBP/USD, the Independent report lifted the pair to 1.6005 overnight but profit taking deflated the cross back to 1.5970. Resistance runs at 1.6024, support at 1.5900. A 5th straight session of rising intra-day highs for EUR/GBP lifted the pair over 0.92. Weak UK data could squeeze the pair towards 0.9250. Support runs at 0.9152. AUD/USD was bid up to a 0.8876 high on the RBA. Our target is 0.90 on positive rate differentials. AUD/EUR is bid above 0.60.

Rates: UK 5y swaps opened at 3.10%, near the low end of the range. The DMO auction of £0.5bn, 2013 gilts is the first since January (1.66 b/c, 1bps tail). The 40bps drop in yield since then makes the issue expensive on an absolute basis but the issue is part of the BoE's APF so coverage should be decent. The US Treasury will offer \$39bn in 3y notes

NIESR may report first q/q UK GDP increase in five quarters



Distribution of BoE gilt purchases since QE start in March



| | Close | Daily Change % |
|--------------------|---------|----------------|
| FX | | |
| EUR/GBP | 0.9193 | 0.57% |
| GBP/USD | 1.5935 | -0.07% |
| EUR/USD | 1.4648 | 0.49% |
| USD/JPY | 89.535 | -0.30% |
| AUD/USD | 0.8779 | 1.46% |
| Bonds % | | bp |
| US 10Yr | 3.221 | 0.2 |
| EUR 10Yr | 3.124 | 0.2 |
| UK 10 Yr | 3.439 | -4.9 |
| UK 5yr Swap | 3.098 | -0.7 |
| Equities | | % |
| S&P500 | 1040.46 | 1.49% |
| FTSE100 | 5024.33 | 0.71% |
| Eurostoxx50 | 2790.78 | 1.09% |
| Shanghai Composite | 2779.43 | 0.00% |
| Commodities | | % |
| Crude Oil \$/bl | 70.41 | 0.66% |
| Gold \$/oz | 1017.3 | 1.45% |
| Copper | 272.7 | 1.70% |
| Baltic Dry | 2362 | 0.21% |
| Other | | |
| VIX | 26.84 | -6.42% |
| iTraxx XOVER | 587.72 | -20.8 |

Today's Events

Australia Trade Balance, Aug
RBA Rate Decision
Halifax House Prices, Sep
UK Industrial Production, Sep
UK NIESR GDP, Sep
UK New Car Registrations, Sep
Canada Ivey PMI, Aug
BoE purchases £1.4bn of gilts: UKT_4.75_071238, UKT_4.25_070939, UKT_4.5_071242, UKT_4.25_071246, UKT_4.25_071249, UKT_4.25_071255
DMO auctions £0.5bn, 4.5%, 2013 gilts
US Treasury sells \$39bn, 3y notes
ECB speakers: Ordonnez (11:00)

| Time | Consensus | Previous |
|-------|-------------|---------------|
| 00:50 | -A \$1.52 A | -A \$1.78 bnr |
| 03:30 | 3.25 % A | 3.0 % |
| 09:00 | +0.6 % | +0.8 % |
| 09:30 | +0.2 % | +0.5 % |
| 15:00 | +0.3 % | +0.2 % |
| TBC | | |
| 15:00 | 56.6 | 55.7 |

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The Reserve Bank of Australia becomes the first G-10 central bank to raise interest rates. Growth in Australia continues to improve, benefiting from the strong rebound in China. With economic growth likely to be close to trend in 2010, inflation close to target and the risk of serious economic contraction now having passed, the RBA can move to gradually reduce the stimulus provided by monetary policy.

The AUD/USD has pushed to a new (2009) high this morning, followed by the NZD/USD. The fact that the RBA is set to raise interest rates gradually, highlights their concerns about derailing the recovery. In this context FX carry trades should continue to perform well.

Service sector PMIs have provided some upward surprises globally and importantly in the UK and US (where the data showed slight dips in the manufacturing PMIs). On balance, global leading indicators have continued to move higher (albeit some were slightly below market expectations). Equities have followed suit with the S&P500 turning higher without fully testing the upward trend line from the March 2009 low. The latest round of leading indicators has not suggested an immediate pullback in growth (leading to the second down leg of the widely expected "W" shaped recovery) – as such the pro-risk trades (long equities, long FX carry trades, short USD (against commodity and EM currencies)) should continue to perform well for another month.

UK industrial and manufacturing production data are due for release this morning. Regressing manufacturing production data against the manufacturing PMI suggests further upside risks lie ahead for this morning's production data.

Finally, the trend following model has sold the USD against the Polish Zloty this morning. The previous long USD/PLN position has been closed with a small clearing loss of 0.07%. The new short USD/PLN follows the overall (pro-risk) positioning of the portfolio. The model is now fully short of USDs against emerging market currencies.

Table 1: 1-month correlations

| | AUDUSD | USDCAD | EURUSD | GBPUSD | USDJPY | EURJPY |
|-----------|--------|--------------|-------------|--------|--------|-------------|
| 2 YR SPD | 0.02 | -0.11 | 0.54 | 0.59 | 0.21 | 0.18 |
| 10 YR SPD | 0.13 | -0.43 | 0.55 | -0.12 | 0.75 | 0.82 |
| S&P500 | 0.48 | -0.41 | 0.82 | -0.02 | -0.26 | 0.35 |
| Gold | 0.63 | -0.87 | 0.59 | 0.05 | -0.30 | 0.11 |
| Oil | 0.24 | -0.79 | 0.26 | 0.44 | 0.09 | 0.31 |
| CRB | 0.62 | -0.82 | 0.72 | 0.09 | -0.28 | 0.25 |

Chart 1: S&P500 turning higher without fully testing trend line



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 | short | 28-Sep-09 | 89.64 |
| Net-USD portfolio position | | | -56% |

| Trend Following Model Positions | | | |
|---------------------------------|--------|-----------|-------------|
| | Signal | Date | Entry Level |
| USDCZK | short | 19-May-09 | 19.709 |
| USDPLN | short | 06-Oct-09 | 2.868 |
| USDSGD | short | 08-Sep-09 | 1.4337 |
| USDTRY | short | 15-Sep-09 | 1.4939 |
| USDZAR | short | 31-Aug-09 | 7.7525 |
| Net-USD portfolio position | | | -100% |

Market Summary

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|----------------------|--------|----------------|-------------------------|---------|----------------|
| FX | | | Equities | | |
| EUR/USD | 1.4648 | 0.49% | S&P500 | 1040.46 | 1.49% |
| USD/JPY | 89.535 | -0.30% | DJIA | 9599.75 | 1.18% |
| AUD/USD | 0.8779 | 1.46% | FTSE100 | 5024.33 | 0.71% |
| EUR/GBP | 0.9193 | 0.57% | Eurostoxx50 | 2790.78 | 1.09% |
| GBP/EUR | 1.0878 | -0.56% | Shanghai Composite* | 2779.43 | 0.00% |
| GBP/USD | 1.5935 | -0.07% | *latest price | | |
| GBP/JPY | 142.69 | -0.36% | Commodities | | |
| GBP/CHF | 1.645 | -0.35% | Crude Oil \$/bl | 70.41 | 0.66% |
| GBP/AUD | 1.815 | -1.54% | Gold \$/oz | 1017.3 | 1.45% |
| GBP/CAD | 1.705 | -1.00% | Copper c/lb | 272.7 | 1.70% |
| GBP/NZD | 2.181 | -2.07% | Silver \$/oz | 16.64 | 2.91% |
| GBP/NOK | 9.136 | -1.21% | Baltic Dry | 2362 | 0.21% |
| GBP/ZAR | 11.913 | -2.18% | Swaps % | | |
| GBP/CNY | 10.878 | -0.06% | US 5yr | 2.581 | 1.3 |
| Bonds % | | | EUR 5yr | 2.665 | 1.7 |
| | | bp | UK 5yr | 3.098 | -0.7 |
| US 10Yr | 3.221 | 0.2 | Official Rates % | | |
| EUR 10Yr | 3.124 | 0.2 | UK | 0.50 | |
| UK10 Yr | 3.439 | -4.9 | US | 0.25 | |
| Other | | | EU | 1.00 | |
| VIX | 26.84 | -6.42% | Japan | 0.10 | |
| iTraxx XOVER | 587.72 | -20.8 | | | |
| DJ Agriculture Index | 57.50 | 0.82% | | | |

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