

Daily Market Strategy

Friday, 28th 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
naeemwahid@bostreasury.com

Altaz Dagha

Analyst
0207 158 1747
altazdagha@bostreasury.com

- USD retreats as oil prices rebound
- Gilts and GBP await revised estimate of UK Q2 GDP

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6281, €/£: 1.4353, \$/¥: 93.75

UK 5y sw: 3.32%, US 5y sw: 2.86%, EU 5y sw: 2.78%

Overnight

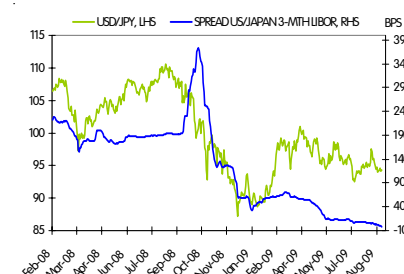
- UK GfK consumer confidence steady at -25 in August
- Strong US 7y auction: bid/cover 2.74, indirect bidders take 61.2%
- Japan July jobless rate hits record high (5.7%), core CPI falls to -2.2%
- Central banks could follow Riksbank and charge negative rates on deposits (FT)

Revised UK Q2 GDP data and US personal spending figures are unlikely to cause currency and bond markets to change gears on the final trading day of August (UK markets are shut on Monday). A much bigger than forecast 10.4% q/q contraction in UK Q2 business investment was reported yesterday (see chart) and will have tempered optimism of a possible upward GDP revision from the preliminary -0.8% q/q. The main themes of lower yields/swaps and softer sterling remain in place, though we would credit comments by the Fed's Lacker and Bullard on MBS purchases for the stabilisation in yields and higher mortgage bonds overnight (no flight-to-quality bid traction from the 2.5% drop in Chinese equities or the pick-up in Japanese deflation). A close below the 200-day MA for UK 5y swaps at 3.30% could be pivotal going into the UK PMIs and US non-farm payrolls next week. A strong month-end bid in government bonds, a lack of conviction in equities and tame US core PCE index for July this afternoon, forecast to slow to 1.4% y/y, should set the bond market up for a strong finish.

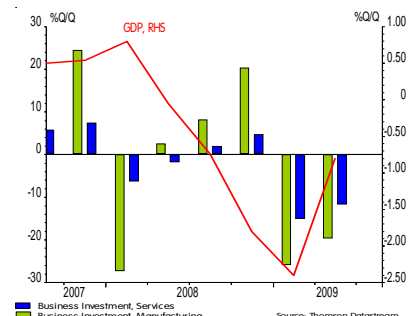
FX: The decline in US libor below the Japanese 3-month libor rate attracted sellers of USD/JPY yesterday. Though the cross stabilised above 93.50 overnight, a test of 93.10 - the July 22 low - is possible but may depend how markets react to the Japanese election this weekend where the Democratic Party is seen ousting the ruling Liberal Democrats of PM Aso. The pullback in EUR/GBP from yesterday's 0.8839 high could bring out buyers on dips and push the pair closer to 0.8850 if EU data surprises to the upside. The EU/UK 2y yield spread is steady at 36bps. Crude oil bounced from \$69.83 to a \$73.03 high overnight, causing the USD to retreat vs G10 majors.

Rates: UK 5y swaps opened lower at 3.32% and are seen staying under pressure ahead of the long weekend. 2y gilts continue to draw buying interest from the story that commercial banks may be tempted to switch their central bank deposits. A test of this weeks 0.83% low though may be ambitious if equities rally into the long weekend.

Decline in US below Japanese 3-month Libor: bearish or USD/JPY?



UK Q2 GDP: how soon will business investment recover?



	Close	Daily Change %
FX		
EUR/GBP	0.8807	0.41%
GBP/USD	1.6284	0.22%
EUR/USD	1.4341	0.60%
USD/JPY	93.520	-0.78%
AUD/USD	0.8392	1.30%
Bonds %		bp
US 10Yr	3.453	2.0
EUR 10Yr	3.245	1.0
UK10 Yr	3.547	-0.4
UK 5yr Swap	3.323	-3.5
Equities		%
S&P500	1030.98	0.28%
FTSE100	4869.35	-0.43%
Eurostoxx50	2777.62	-0.40%
Shanghai Composite	2946.40	-2.59%
Commodities		%
Crude Oil \$/bbl	72.49	1.48%
Gold \$/oz	948.2	0.27%
Copper	287.2	-0.17%
Baltic Dry	2425	-0.08%
Other		
VIX	24.68	-1.08%
iTraxx XOVER	602.03	8.1

Today's Events

Japan, Unemployment Rate, Jul	00:30
Japan, National CPI, Core, Jul	00:30
UK GfK Consumer Confidence, Aug	00:01
UK Q2 GDP, 2 nd estimate	09:30
EU-16 Consumer Confidence, Aug	10:00
EU-16 Industry Confidence, Aug	10:00
US Personal Income, Jul	13:30
US Personal Spending, Jul	13:30
US PCE Index, Core, Jul	13:30
University of Michigan Confidence, Aug, final	15:00
Canada IPPI, Jul	13:30
Canada RMI, Jul	13:30

Time	Consensus	Previous
00:30	5.7% A	5.4%
00:30	-2.2% A	-1.7%
00:01	-2.5 A	-2.5
09:30	-0.8%	-0.8%
10:00	-2.1	-2.3
10:00	-2.8	-3.0
13:30	+0.1%	-1.3%
13:30	+0.2%	+0.4%
13:30	+0.1%	+0.2%
15:00	64.5	63.2
13:30	-0.5%	+0.7%
13:30	-3.0%	+6.2%

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- The consolidation in equities is ongoing, but interestingly, a profit-taking phase did little to dent the main upward trend. S&P cash tested the upward breakout point at 1,018, using it as support to bounce towards 1,030 with the FTSE futures touching the base of the range at 4,849 before bouncing. This increases the prospect of a push towards 5,000 today, despite the expectation of a profit-taking Friday. The Shanghai index once again failed to extend through 3,000 resistance, but for now the impact on core equities is muted.
- The dollar is coming under increasing pressure as the DXY index (see below) continues to look technically bearish. Although vols. are compressing and positions light, the commodity markets continue to project higher prices and, other than cyclical nervousness, there seems little to suggest the dollar will have anything other than minor rallies. The commodity and EM currencies are favoured with the AUD and NZD looking to break the top of their recent ranges into new highs. Sterling has put a floor under the recent sell off, but the margin remains thin and sentiment has yet to turn significantly. The long term bullish view is unchanged however.
- US 2y yields are now eyeing resistance at 1.10% (1.0564) having rejected price action below 1.00%. US 10y yields are still between two major levels at 3.40%/3.60%. A break of the latter is favoured and would be a strong signal, although it remains some distance from the current 3.46%.
- Oil bounced back strongly with copper following suit. Sugar is pressing the top of its recent consolidation. Another upward phase is on the cards. Gold continues to range trade but the price action is compressing and should not be far off a breakout (bullish direction is favoured).

Chart of the day: Dollar Index (DXY)



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4572	1.7044	98.90	0.8910	1.1905
R1	1.4446	1.6626	97.80	0.8845	1.1819
Current Spot	1.4359	1.6282	93.71	0.8819	1.1339
S1	1.4005	1.6156	93.42	0.8461	1.1306
S2	1.3748	1.5982	91.78	0.8400	1.1223

Spot prices as of: 07:04:02 Source: Bloomberg

The trend in the dollar index remains to the downside and the core technical view continues to be bearish. Target is at 75.00.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4359	Bullish	1.4230	1.4500	1.3940	One-Month vols. Break key support- Single digits beckon.
USD/JPY	93.71	Bullish	-	97.80	-	Range remains.
USD/CHF	1.0585	Bearish	-	1.0300	-	Range -bound.
GBP/USD	1.6282	Bullish	1.6270	1.7000	1.6080	Some support found.
EUR/GBP	0.8819	Bearish	0.8835	0.8400	0.8855	
GBP/JPY	152.56	Bullish	152.64	156.00	151.35	Tight stop hit, but bounce is in prospect.
EUR/JPY	134.57	Bullish	133.00	139.14	132.90	
CAD/JPY	86.12	Bullish	85.00	90.33	84.35	84.40 is key support- consider short if breached.
AUD/USD	0.8400	Bullish	0.8305	0.8520	0.8165	
USD/CAD	1.08815	Bearish	1.0860	1.0000	1.1155	Danger zone has potentially passed for USD shorts.
NZD/USD	0.6876	Bullish	0.6860	0.7447	0.6710	
USD/BRL	1.8668	Bearish	1.8789	1.8000	1.8865	
USD/PLN	2.8652	Bearish	2.8600	2.8000	2.9135	Break of 2.8266 would be a bearish USD signal.
USD/HUF	188.25	Bearish	188.00	180.00	193.10	

Spot prices source: Bloomberg

ENTRY - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

Equities have struggled to make further headway this week. The S&P500 is only 0.5% away from Friday's close whilst Chinese equities are around 1% lower on the week. With equity markets relatively stable, the one month correlation between the S&P500 and G-10 FX (against the USD) has fallen this week. However, interest rate spreads continue to remain a prominent driver of FX this week.

G-10 interest rate spreads against the US (the analysis is based on the spread between 2-year interest rate swaps) can be divided into 3 categories. The spreads for commodity producing countries (Australia, New Zealand, Canada and Norway) are continuing to widen in their favour. As such, these currencies remain firm against the USD. The NZ/USD spread has broken to a new high for the year, as NZD/USD probes resistance around \$0.69. The spreads for the eurozone and Japan against the US remain stable, which is also being observed in the range bound nature of EUR/USD and USD/JPY. Finally the spread between the UK and US has drifted to the low observed in June. It is therefore not surprising that sterling has been the weakest G-10 currency this week. Looking forward, another move higher in PMI reports next week (which appears likely following the strength in eurozone flash PMIs and US regional PMIs) should continue to provide a favourable environment for commodity currencies.

The trend following model has left its positions unchanged this morning. In emerging market currencies the model is holding a 60% net long USD portfolio whilst across G-10 currencies the model remains net short of USD. This largely reflects the higher volatility in emerging market currencies, where price action has triggered long positions.

Chart 1: Trend Strength

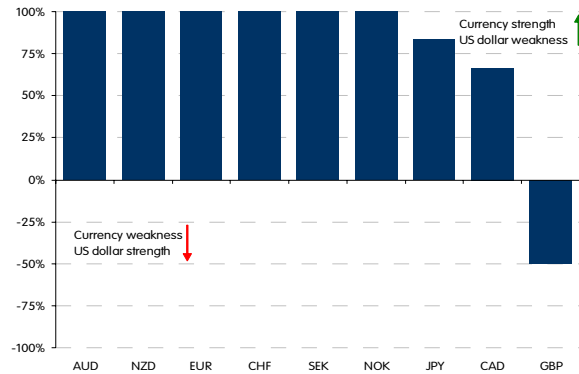


Chart 2: Spread between NZ-US 2-year interest rate swaps breaking to a new high for the year

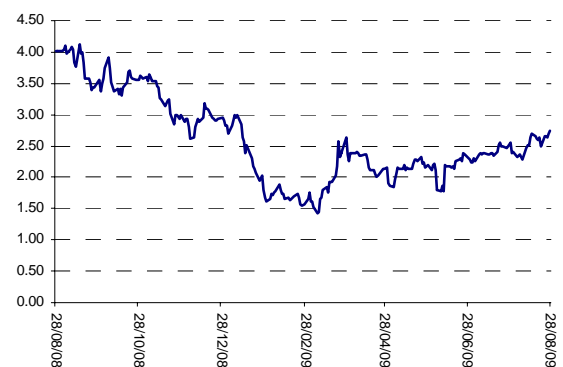


Table 2: Trend following model signals

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	long	27-Aug-09	1.5093
USDZAR	long	26-Aug-09	7.8223

Market Summary

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.4341	0.60%	S&P500	1030.98	0.28%
USD/JPY	93.520	-0.78%	DJIA	9580.63	0.39%
AUD/USD	0.8392	1.30%	FTSE100	4869.35	-0.43%
EUR/GBP	0.8807	0.41%	Eurostoxx50	2777.62	-0.40%
GBP/EUR	1.1352	-0.41%	Shanghai Composite*	2946.40	-2.59%
GBP/USD	1.6284	0.22%	*latest price		
GBP/JPY	152.30	-0.57%	Commodities		
GBP/CHF	1.725	-0.60%			%
GBP/AUD	1.940	-1.08%	Crude Oil \$/bl	72.49	1.48%
GBP/CAD	1.771	-0.67%	Gold \$/oz	948.2	0.27%
GBP/NZD	2.369	-0.65%	Copper c/lb	287.2	-0.17%
GBP/NOK	9.829	-0.29%	Silver \$/oz	14.31	-0.24%
GBP/ZAR	12.679	-0.79%	Baltic Dry	2425	-0.08%
GBP/CNY	11.124	0.22%	Swaps %		
Bonds %					bp
		bp	US 5yr	2.844	0.6
US 10Yr	3.453	2.0	EUR 5yr	2.775	2.6
EUR 10Yr	3.245	1.0	UK 5yr	3.323	-3.5
UK10 Yr	3.547	-0.4	Official Rates %		
Other					
VIX	24.68	-1.08%	UK	0.50	
iTraxx XOVER	602.03	8.1	US	0.25	
DJ Agriculture Index	59.41	-0.19%	EU	1.00	
			Japan	0.10	

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.