

# Daily Market Strategy

## Market Strategy

### Market Strategy Team

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- MPC minutes & Fed FOMC decision ahead
- Dollar index falls below 76.0

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6391, €/£: 1.4807, \$/¥: 90.72

UK 5y sw: 3.39%, US 5y sw: 2.82%, EU 5y sw: 2.81%

#### Overnight

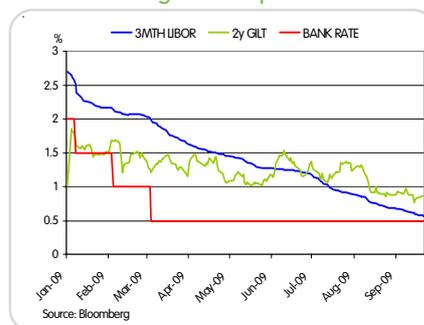
- US \$43bn, 2y auction attracts strong demand: bid/cover 3.23, indirects take 45.2%
- New Zealand Q2 GDP up 0.1% q/q
- G20 fret over priorities: stimulating economic growth vs financial system reform

A sharp USD reversal took place yesterday and dealers added to their short positions overnight on higher equities and a rebound in oil and gold prices. We have advocated our preference of being long USD in the run-up to today's FOMC meeting and whilst this strategy paid off until yesterday, we are forced on the defensive by strong demand for risk assets. We will let markets run their course over the next few hours, mindful of the possible influence of other events like the MPC minutes or the G20, where countries do not appear all that much in harmony over the list of priorities: stimulate economic growth first and subsequently reform and regulate the financial system, or vice versa? This is a fairly important point which may decide the short-term path for equities and the currency/bond market complex as a whole. We look for the Fed to present a more upbeat message on the economy tonight, and will find out whether some rate 'hawks' will press for a more forceful message on inflation as reported by sources. Comments on the Fed's balance sheet and with regard to Treasury and MBS/agency purchases could move markets before the \$300bn Treasury purchase scheme expires next month. With regard to the MPC minutes, some suspense has potentially been removed following governor King's comments last week on the subject of remunerating bank excess reserves.

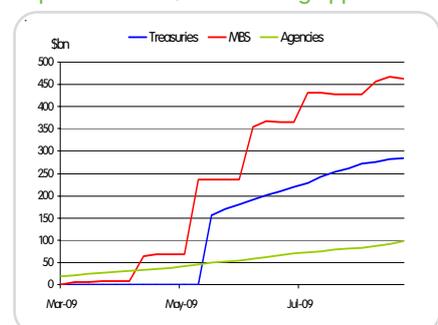
**FX:** EUR/GBP stabilised in a 0.9027-81 range over the last two days as dealers await the MPC minutes. Disappointing EU-16 PMIs could force EUR/GBP on the defensive and present a buying opportunity if the minutes show dissent over QE and considerations to cut bank deposit rates. The fall in the USD Index below 76.0 supports our call for a short-term move to 75.0.

**Rates:** UK 5y swaps breached technical resistance at 3.40% yesterday, hitting a 3.43% high. We rely on a dovish set of MPC minutes for rates to reverse, and look for 2y yields to slip back to 0.80% support, if the MPC discussed cutting bank reserve remuneration rates. The 2y/10y swap spread cleared 213bps and steepening trades favour a test of 215bps. The BoE will purchase £1.4bn of shorted-dated gilts. The US Treasury will auction \$40bn in 5y notes. Resistance for US 10y yields runs at 3.53%.

**Gilts await BoE minutes: did MPC discuss cutting bank deposit rate?**



**Fed FOMC may comment on Treasury purchases as \$300bn ceiling approaches**



	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.9042	-0.14%
GBP/USD	1.6359	0.88%
EUR/USD	1.4790	0.75%
USD/JPY	91.103	-0.90%
AUD/USD	0.8735	1.21%
<b>Bonds %</b>		
US 10Yr	3.445	-3.5
EUR 10Yr	3.395	1.6
UK10 Yr	3.765	2.5
UK 5yr Swap	3.387	2.3
<b>Equities</b>		
S&P500	1071.66	0.66%
FTSE100	5142.60	0.00%
Eurostoxx50	2881.60	0.00%
Shanghai Composite	2842.72	-1.89%
<b>Commodities</b>		
Crude Oil \$/bl	71.76	-0.39%
Gold \$/oz	1014.4	1.07%
Copper	286.5	2.85%
Baltic Dry	2246	-3.11%
<b>Other</b>		
VIX	23.08	-4.07%
iTraxx XOVER	572.47	-30.9

#### Today's Events

	Time	Consensus	Previous
New Zealand GDP, Q2, q/q	23:45	+0.1% A	-0.8% R
UK BBA Mortgage Loans, Aug	09:30	40,500	38,181
UK Business Investment, Q2 final	09:30	-10.4%	-10.4%
EU-16 Manufacturing PMI, Sep flash	09:00	49.7	48.2
EU-16 Services PMI, Sep flash	09:00	50.5	49.9
BoE MPC minutes (09:30)			
BoE MPC speaker: Barker (13:10)			
BoE buys £1.4bn of gilts: UKT_4.5_070313, UKT_8_270913, UKT_4.75_070915, UKT_8_071215, UKT_4_070916, UKT_8.75_250817, UKT_5_070318, UKT_4.5_070319, UKT_3.75_070919			
Fed FOMC decision (19:15)			
US Treasury Secretary Geithner testifies on regulatory reform (14:30)			

## Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- The consolidation in equities is taking on the form of another bullish phase- despite the heady levels of the current market. Whilst caution has risen up another notch, the technical scenarios have not reversed as yet and although minor retracements have activated stops, a fresh squeeze higher is possible. Key FTSE resistance is at 5,169, a breakthrough there is the signal for 5,338- which is the extended target. DAX index futures resistance is at 5,750- a break targets 6,000. Note stops are at 4,980 and 5,590- a break of these levels reverses the trend. Chinese stocks have failed to sustain gains and are looking neutral here- this is an added caution, but notably they have underperformed core equities of late. S&P 500 cash targets 1,106.
- Commodity currencies continue to squeeze the dollar as the DXY hits a key support level at 76.00 once again. (see chart below). The NZD is the strongest currency overnight and continues to trend towards the 0.7469 technical target (0.7248). EM and commodity currencies are broadly favoured against the dollar and sterling, the latter has potential to claw back some further losses towards 1.6500, but remains in a well marked range. A break through \$1,032 for gold would send the currency markets into a fresh buying spree of high yielders.
- Are we finally getting traction in the bearish bond view? US 2y yields have breached 1.00% with the 1.10% target now looking more reasonable. US 10y yields interestingly are lagging the rally as 3.50% is a strong resistance point. A break of this level should occur however for 3.75% and potentially 4.00% into year end. UK 10y yields continue to edge higher. 4.00% is the main target there, but UK 2 y yields remain subdued. A close over 0.90% would be the first indication of a reversal (the favoured view) with a break of 1.00% the main signal.

Chart of the day: Dollar Index



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
<b>R2</b>	1.4966	1.7044	95.15	0.9110	<b>1.1404</b>
<b>R1</b>	1.4865	<b>1.6746</b>	93.41	0.9088	1.1308
Current Spot	1.4794	1.6367	90.85	0.9040	1.1062
<b>S1</b>	1.4500	1.6113	90.30	0.8843	1.1004
<b>S2</b>	<b>1.4177</b>	1.5975	87.14	0.8769	1.0977

Spot prices as of: 07:49:10 Source: Bloomberg

Targets are at 75.00. 76.00 is key short term support as already seen, but a break of this level is expected and should trigger further losses.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4794	Bullish	1.4350	1.4950	1.4640	Stop hit, but targets at 1.4950 remain.
USD/JPY	90.85	Bullish	<a href="#">89.90</a>	96.00	89.30	
USD/CHF	1.0233	Bearish	-	1.0000	-	1.03 target close- 1.00 next objective
GBP/USD	1.6367	Bullish	<a href="#">1.6200</a>	1.7000	1.6125	
EUR/GBP	0.9040	Bearish	-	0.8500	-	
GBP/JPY	148.69	Bullish	-	156.00	-	
EUR/JPY	134.40	Bullish	<a href="#">133.50</a>	139.14	132.80	
CAD/JPY	84.98	Bullish	84.90	90.35	83.80	
AUD/USD	0.8738	Bullish	0.8305	0.9000	0.8637	
USD/CAD	1.0690	Bearish	-	1.0000	-	
NZD/USD	0.7251	Bullish	0.6860	0.7447	0.7035	
USD/BRL	1.7929	Bearish	1.8338	1.7000	1.8455	
USD/PLN	2.8287	Bearish	-	2.7000	-	
USD/HUF	183.41	Bearish	-	180.00	-	

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The USD DXY index has failed to break through resistance above 77 and has now regained its downward momentum, falling to a new low for the year this morning. Our in-house trend following model continues to hold a short USD position. The portfolio is 56% short against developed market currencies. Across emerging market currencies the USD negative trend is stronger. As such the model is positioned short of USDs against all five of our traded EM currencies.

Interest rate spreads (we have used 2-year interest rate swaps in our analysis) have been moving against the USD this week. The biggest shift has occurred in NZ/US, where the spread is now close to a nine month high, supporting the break higher in the NZD/USD spot rate. The New Zealand Q2 GDP report, released overnight, showed economic growth of 0.1%, finally marking an end of five consecutive quarters of economic contraction. The 14-day RSI is now elevated and approaching levels consistent with some consolidation or even trend reversal (see chart across) – as such we would warn against adding/building any new long positions at current levels.

The eurozone flash PMIs are the key economic data release this morning – the composite PMI has risen for six consecutive months and rose above 50 in July. Market expectations are quite high this morning (at 51.3) and these now need to be exceeded for further gains in the euro and commodity currencies. In the event of any weakness in the PMI we would favour trading a short EUR/GBP position – the currency pair has lost some momentum this week, sterling negative sentiment appears to be at an extreme and interest rate spreads have once again begun to move against the euro (see chart 2).

Chart 1: NZD/USD RSI warns against initiating new long positions

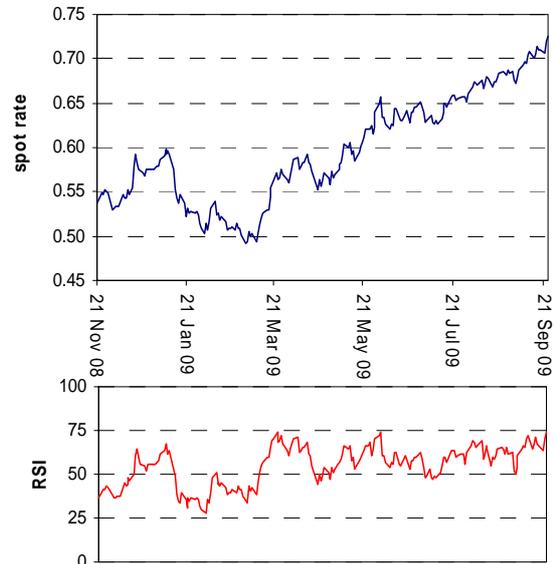
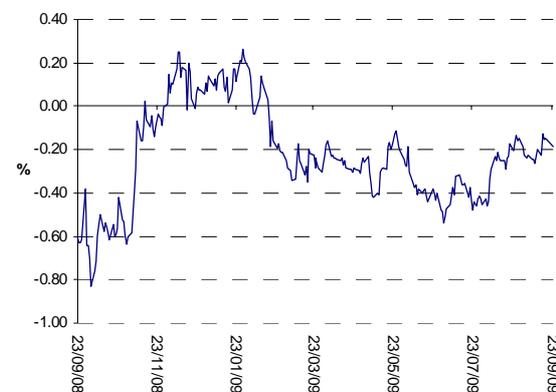


Chart 2: EZ/UK interest rate spread failed to break higher last week



## 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	short	23-Sep-09	1.0691
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	Close	Daily Change %	Equities	Close	Daily Change %
EUR/USD	1.4790	0.75%	S&P500	1071.66	0.66%
USD/JPY	91.103	-0.90%	DJIA	9829.87	0.52%
AUD/USD	0.8735	1.21%	FTSE100	5142.60	0.00%
EUR/GBP	0.9042	-0.14%	Eurostoxx50	2881.60	0.00%
GBP/EUR	1.1059	0.13%	Shanghai Composite*	2897.55	-1.89%
GBP/USD	1.6359	0.88%	*latest price		
GBP/JPY	149.04	-0.05%	<b>Commodities</b>		<b>%</b>
GBP/CHF	1.675	0.04%	Crude Oil \$/bl	71.76	2.94%
GBP/AUD	1.873	-0.36%	Gold \$/oz	1014.4	1.07%
GBP/CAD	1.749	-0.06%	Copper c/lb	286.5	2.85%
GBP/NZD	2.276	-0.82%	Silver \$/oz	17.14	1.78%
GBP/NOK	9.554	-0.23%	Baltic Dry	2246	-3.11%
GBP/ZAR	12.069	-0.42%	<b>Swaps %</b>		<b>bp</b>
GBP/CNY	11.170	0.87%	US 5yr	2.805	-3.8
			EUR 5yr	2.799	0.5
			UK 5yr	3.387	2.3
<b>Bonds %</b>		<b>bp</b>	<b>Official Rates %</b>		
US 10Yr	3.445	-3.5	UK	0.50	
EUR 10Yr	3.395	1.6	US	0.25	
UK10 Yr	3.765	2.5	EU	1.00	
			Japan	0.10	
<b>Other</b>					
VIX	23.08	-4.07%			
iTraxx XOVER	572.47	-30.9			
DJ Agriculture	58.36	1.62%			
Index					

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