

Daily Market Strategy

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Market Strategy

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- Risk of disappointing US ISM to support USD
- Yield curves continue to flatten

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5957, €/\$: 1.4566, \$/¥: 89.99

UK 5y sw: 3.23%, US 5y sw: 2.65%, EU 5y sw: 2.70%

Overnight

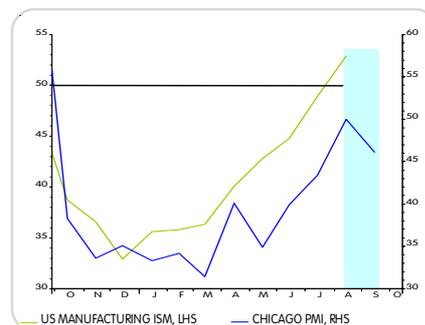
- German retail sales fall 1.5% in Aug
- Japan Tankan survey -33 in Q3 vs -48 in Q2

A reversal in rates below key support levels stalled overnight but disappointing US ADP/Chicago PMI data and the Q3 Tankan survey caused follow-through selling of Asian stocks (ex-China, Shanghai closed for 60th anniversary of the CP). 10y gilts are steady below 3.60% and UK 5y swaps opened flat at 3.23%. Support levels are situated at 3.50% and 3.20%, respectively, targets that realistically should prove within reach as risk appetite moves down a gear ahead of tomorrow's US NFP report. A rise in US weekly claims back over 550k and disappointing manufacturing PMIs (UK/EU-16) and US ISM (0.6 correlation over the last 12 months with the Chicago PMI) could add to risk aversion trades (USD positive) and set equity benchmarks up for a test of the September lows. The FTSE-100 has failed to test 5,200 in the last nine trading sessions and yesterday's intra-day move below 5,100 could encourage bears to make a push for 5,050 (S&P through 1045, 20d MA). For illustration purposes, we have inserted a chart below showing how seasonals tend to favour lower UK swaps across the curve in October. The average decline in 5y swaps is 12.5bps. In 10y swaps, the average drop is 7bps.

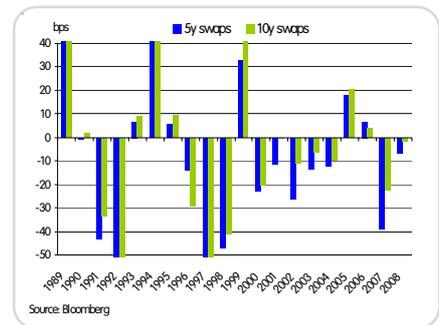
FX: Norges Bank's Gjedrem yesterday reinforced expectations that Norwegian rates will rise at the end of the month. With the RBA in the same hawkish frame of mind, we reiterate our strategy of buying dips in USD/NOK and AUD/USD. GBP/AUD pierced 1.81 and a retracement to 1.80 is achievable as the AU/UK 2y benchmark spread clears 265bp. A disappointing UK PMI - forecast 50.1 - should attract GBP bears and lift EUR/GBP towards 0.92 (GBP/EUR 1.0870). We have moved out targets for GBP/CAD to 1.70.

Rates: UK 5y swaps opened flat at 3.23%, near the lows of the trading range. Better receiving and bullish influence from month-end buying in cash and lower stocks resulted in an 12bps reversal from 3.35%. A flat/weaker UK PMI could squeeze rates to 3.20%. The EIB launched a £600mn issue priced at 100bps over gilts. 10y BTP/bunds approaches 80bps.

Will US Sep manufacturing ISM surprise to the downside?



Seasonals tend to favour lower UK swap rates in October



	Close	Daily Change %
FX		
EUR/GBP	0.9159	0.22%
GBP/USD	1.5982	0.13%
EUR/USD	1.4640	0.36%
USD/JPY	89.705	-0.43%
AUD/USD	0.8828	1.43%
Bonds %		bp
US 10Yr	3.305	1.5
EUR 10Yr	3.220	-0.3
UK 10 Yr	3.614	-1.3
UK 5yr Swap	3.237	-5.6
Equities		%
S&P500	1057.08	-0.33%
FTSE100	5133.90	-0.50%
Eurostoxx50	2872.63	-0.68%
Shanghai Composite	2779.43	n/a
Commodities		%
Crude Oil \$/bl	70.61	5.85%
Gold \$/oz	1007.7	1.54%
Copper	281.9	3.30%
Baltic Dry	2220	1.60%
Other		
VIX	25.61	1.67%
iTraxx XOVER	569.80	4.7

Today's Events

Japan Tankan Survey, Q3	00:50	-33 A	-48
German Retail Sales, Aug	07:00	-1.5% A	+0.7%
UK Manufacturing PMI, Sep	09:30	50.1	49.7
EU-16 Manufacturing PMI, Sep	09:00	49.0	49.0
EU-16 Unemployment Rate, Aug	10:00	9.6%	9.5%
US Personal Spending, Sep	13:15	+1.1%	+0.2%
US Personal Income, Sep	13:30	+0.1%	zero
US PCE Deflator, Core, Sep	13:30	+0.1%	+0.1%
US Weekly Claims, 26-Sep	13:30	535K	530K
US Construction Spending, Aug	15:00	-0.1%	-0.2%
US Manufacturing ISM, Sep	15:00	54.0	52.9
BoE publishes Quarterly Credit Conditions Survey (09:30)			
DMO sells £2.25bn, 4.75%, 2030 gilts			
Fed speakers: Bernanke (14:00), Lockhart (22:30), Pianalto (22:30)			

Time	Consensus	Previous
00:50	-33 A	-48
07:00	-1.5% A	+0.7%
09:30	50.1	49.7
09:00	49.0	49.0
10:00	9.6%	9.5%
13:15	+1.1%	+0.2%
13:30	+0.1%	zero
13:30	+0.1%	+0.1%
13:30	535K	530K
15:00	-0.1%	-0.2%
15:00	54.0	52.9

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- The equity bulls look battle fatigued as the broad consolidation continues. December FTSE futures once again failed to take out the key resistance at 5,169 - which I have taken as a key potential turning point. A break of 5,005 would complete evidence of a top and target 4,913 in the first instance. Similarly, the DAX index resistance at 5,764 sits as the main challenge level for the bulls, but the risk of a top is ever increasing as price action stalls. The Dow and S&P were modestly lower overnight, but more significantly the Nikkei has breached the 10,000 level, elevating the sense that a greater retracement could be afoot. Fears that the equity trends in the final quarter may not be as benign as the strong showing for Q3 will weigh on investors' minds.
- Broadly speaking there is a mixed backdrop for the FX market and traders will look to tread carefully around the current themes. Whilst equities are stalling, gold has pushed back over \$1,004 and oil has made a valiant attempt to break \$70. However, the dollar Index is hovering below an important downward trendline - a break of which would signal further strength for the currency (see chart below). Coupled with a potential head and shoulders reversal pattern in EUR/USD (if 1.4525 is breached) the probability of a dollar bounce has increased. Sterling has got its losses in early hence the downside could be limited, but once again the commodity currencies will be in the spotlight as they are the most exposed to good news right now. Our economists are awaiting leading indicators to determine further support for this theme, making the coming weeks a potentially critical time for the markets. Pressure on EM currencies could start to increase. The rand has weakened 0.98% overnight followed by the PLN, down by 0.86%. A reduction of risk seems the sensible near term strategy.

Chart of the day: Dollar index



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4865	1.6300	95.15	0.9482	1.1135
R1	1.4728	1.611	91.80	0.9300	1.1004
Current Spot	1.4573	1.5941	90.03	0.9142	1.0938
S1	1.4450	1.5802	87.14	0.9088	1.0753
S2	1.4407	1.5724	85.00	0.8981	1.0546

Spot prices as of: 07:08:33 Source: Bloomberg

Key resistance is at 77.27 - a break targets 78.33. This will be worth watching for in the next couple of sessions as the market pauses at an important juncture.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4573	<i>Bearish</i>	1.4635	1.4450	1.4665	Head shoulders top strengthens case for a dollar bounce. Sell revised lower.
USD/JPY	90.03	<i>Neutral</i>	-	92.00	-	
USD/CHF	1.0403	<i>Bullish</i>	1.0310	1.0500	1.0260	Buy level revised higher.
GBP/USD	1.5941	<i>Bullish</i>	-	1.6000	-	Volatile but upside has the edge.
EUR/GBP	0.9142	<i>Bearish</i>	0.9170	0.9000	0.9210	Failed to close below 0.9088, but price action creating a bigger top.
GBP/JPY	143.51	<i>Bullish</i>	143.20	150.00	143.20	146.76 is the next key resistance point.
EUR/JPY	131.19	<i>Bullish</i>	-	133.00	-	
CAD/JPY	83.94	<i>Bearish</i>	-	78.55	-	
AUD/USD	0.8792	<i>Bullish</i>	0.8797	0.8950	0.8640	Could struggle to extend gains given weakening equity backdrop.
USD/CAD	1.0724	<i>Bullish</i>	1.0800	1.1200	1.0715	Stop hit.
NZD/USD	0.7192	<i>Bearish</i>	0.7200	0.6700	0.7255	Stop hit.
USD/BRL	1.7670	<i>Bearish</i>	1.8338	1.7000	1.8025	Could be ready to break lower today- worth watching
USD/PLN	2.8959	<i>Bearish</i>	2.9000	2.7000	2.9110	PLN could come under further pressure.
USD/HUF	184.95	<i>Neutral</i>		180.00		Move to neutral view.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

Economic data overnight, released in Australia, Japan and China, continue to suggest improvements in the global economy. The Australian manufacturing PMI (reported at 52) indicates expansion. In China, the manufacturing PMI has risen to 54.3 (below market expectations of 55), maintaining its upward trend and marking seven consecutive months of growth in the sector. In Japan, the Tankan survey was broadly stronger than consensus expectations. These data should continue to help sentiment improve across financial markets – in this context it is vital that today's US manufacturing ISM also improves further.

EUR/USD and euro crosses have come under pressure this morning following comments by EU Commissioner Almunia. He indicated that the euro's appreciation will be discussed at the Eurogroup meeting to prepare their position for the G7 meeting. For now, we suspect that this will not have any long lasting impact on the euro. More important will be the outcome of the Eurogroup meeting.

The EZ/UK interest rate spread (the spread between 2-year interest rate swaps is plotted in chart 1) is at a key pivotal point now. A failure here would indicate increased downside risk for EUR/GBP, hence this will be followed closely over the coming days.

The latest portfolio data, from the Japanese Ministry of Finance, for week ending 25th September were released overnight. The data indicate that Japanese investors sold foreign equities (Y18.7bn) whilst foreigners sold Japanese equities to the tune of Y125bn. This results in a net (equity related) outflow of Y16.3bn. In bonds, Japanese investors sold foreign bonds (Y678.9) whilst foreigners sold Japanese bonds (Y628.3bn). This results in a net (bond related) inflow of Y50.6bn. On balance, this results in a net outflow of Y55.7bn. A continuation of such flows over the coming period would help to reverse the current JPY strength that is being observed.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2 YR SPD	-0.53	-0.28	0.58	0.52	-0.54	0.25	0.05
10 YR SPD	-0.39	-0.43	0.48	-0.39	0.46	0.66	0.21
S&P500	0.89	-0.80	0.95	-0.13	-0.72	0.23	0.57
Gold	0.77	-0.82	0.74	0.21	-0.50	0.10	0.63
Oil	0.32	-0.70	0.34	0.55	0.05	0.29	0.56
CRB	0.67	-0.80	0.72	0.08	-0.45	0.22	0.52

Chart 1: Spread between EZ/UK 2-year interest rate swaps at key pivotal level



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

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	long	29-Sep-09	2.8701
USDSGD	short	08-Sep-09	1.4337
USDTRY	short	15-Sep-09	1.4939
USDZAR	short	31-Aug-09	7.7525

Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4640	0.36%	S&P500	1057.08	-0.33%
USD/JPY	89.705	-0.43%	DJIA	9712.28	-0.31%
AUD/USD	0.8828	1.43%	FTSE100	5133.90	-0.50%
EUR/GBP	0.9159	0.22%	Eurostoxx50	2872.63	-0.68%
GBP/EUR	1.0917	-0.23%	Shanghai Composite*	2779.43	n/a
GBP/USD	1.5982	0.13%	*latest price		
GBP/JPY	143.38	-0.30%	Commodities		
GBP/CHF	1.656	0.13%	Crude Oil \$/bl	70.61	5.85%
GBP/AUD	1.810	-1.30%	Gold \$/oz	1007.7	1.54%
GBP/CAD	1.709	-1.27%	Copper c/lb	281.9	3.30%
GBP/NZD	2.210	-1.11%	Silver \$/oz	16.65	3.03%
GBP/NOK	9.227	-1.14%	Baltic Dry	2220	1.60%
GBP/ZAR	12.002	1.19%	Swaps %		
GBP/CNY	10.909	0.11%	US 5yr	2.650	-0.4
Bonds %			EUR 5yr	2.711	0.6
		bp	UK 5yr	3.237	-5.6
US 10Yr	3.305	1.5	Official Rates %		
EUR 10Yr	3.220	-0.3	UK	0.50	
UK10 Yr	3.614	-1.3	US	0.25	
Other			EU	1.00	
VIX	25.61	1.67%	Japan	0.10	
iTraxx XOVER	569.80	4.7			
DJ Agriculture Index	59.09	1.56%			

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