

Daily Market Strategy

Friday, 2nd October 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

- UK 5y swaps target reduced to 3.0%
- VIX at one-month high ahead of US NFP

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5931, €/\$: 1.4555, \$/¥: 89.47

UK 5y sw: 3.14%, US 5y sw: 2.51%, EU 5y sw: 2.63%

Overnight

- UK Nationwide house prices rise 0.9% m/m in Sep, flat y/y
- Ireland votes on EU referendum, Irish/German 10y spread widens to 163bps

Equity markets traded heavy in Asia in the wake of aggressive last half hour selling in the US where a close for the S&P below 1,030 added to flight-to-quality and boosted the VIX to a one-month high. Equity markets haven't made the best start to October - following a record Q2 gain for the FTSE - and this week's run of weaker economic data gives enough reasons to doubt whether a) the scale of the rally in risk (equities/credit) from March is justified and b) the levelling off in forward-looking indicators is signalling a Q3 GDP bounce running out of puff in Q4/Q1. The US Q3 earnings season hasn't even started so making a judgement on the near-term outlook for equities must wait. However, fading rallies in risky assets and sticking to flattening curve plays in fixed income are our recommended strategies for now. Key breaks to the downside in yields/swaps ahead of NFP suggest the market may have moved ahead of itself, so an 'as expected' NFP and unemployment rate (-200K, 9.8%) could actually trigger a relief rally in equities and profit-taking in bonds. For the record, we note that NFP has surprised to the downside in September in seven of the last ten years, with an average 'miss' of -41k. This would put today's outcome on -216K vs the -175K forecast, with a skew to the downside taking into account labour market anecdotes.

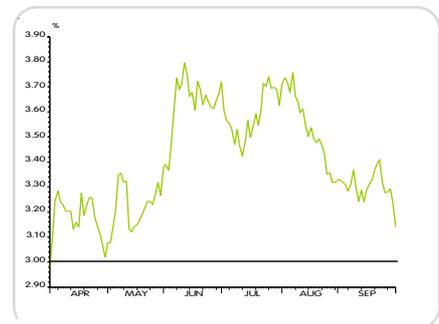
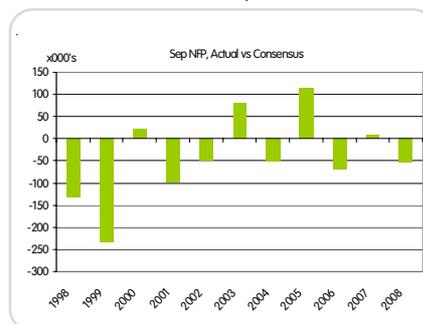
FX: GBP/USD failed to extend above 1.5940 despite the stronger Nationwide data. This exposes downside risk. We look for a pullback below 1.59 to be followed by a retracement towards this week's low below 1.58. UK construction PMI and BoE MEW data are due at 9.30 and could add to bearish sterling sentiment. We look for the dollar index to test 77.333 resistance and rally towards 77.50. A bigger indication perhaps of the breakdown in risk appetite is the breakout in USD/ZAR above 7.75 despite the fairly steady price action in gold (\$999).

Rates: UK 5y swaps traded as low as 3.08% this morning, helped by flight-to-quality. The break below 3.15% support has opened the door for a move to 3.0%. US 10y below 3.15% - 2y/10y spread below 230bps - clears the way for a pullback to 3.0%, though pre-auction concession could drag yields back up if NFP does not disappoint. Resistance at 3.25%.

Average rate of surprise for Sep NFP since 1998 is -41,600K

UK 5y swaps set to complete retracement to 3.0% from June high of 3.87%

	Close	Daily Change %
FX		
EUR/GBP	0.9117	-0.46%
GBP/USD	1.5956	-0.16%
EUR/USD	1.4545	-0.65%
USD/JPY	89.605	-0.11%
AUD/USD	0.8697	-1.48%
Bonds %		bp
US 10Yr	3.179	-12.6
EUR 10Yr	3.157	-6.3
UK10 Yr	3.592	-2.2
UK 5yr Swap	3.143	-9.5
Equities		%
S&P500	1029.85	-2.58%
FTSE100	5047.81	-1.68%
Eurostoxx50	2810.46	-2.16%
Shanghai Composite	2779.43	0.00%
Commodities		%
Crude Oil \$/bl	70.82	0.30%
Gold \$/oz	999.2	-0.84%
Copper	273.7	-2.91%
Baltic Dry	2284	2.88%
Other		
VIX	28.27	10.39%
iTraxx XOVER	592.00	22.2



Today's Events

Japan, Unemployment Rate, Aug
 UK Nationwide House Prices, Sep
 UK Construction PMI, Sep
 UK BoE Housing Equity Withdrawal, Q2
 EU-16 PPI, Sep
 US Non-Farm Payrolls, Sep
 US Unemployment Rate, Sep
 US Average Earnings, Sep
 US Factory Orders, Aug
 Fed speakers: Rosengren (13:15), Fisher (21:35)

Time	Consensus	Previous
00:50	5.5% A	5.7%
00:01	+0.9% A	+1.4%
09:30	48.1	47.7
09:30	n/a	-£8.1bn
10:00	+0.4%	-0.8%
13:30	-175K	-216K
13:30	9.8%	9.7%
13:30	+0.2%	+0.3%
15:00	0.0%	+1.3%

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- Dec. FTSE futures continue to signal a top with the expected breach of 5,005 marking a medium-term high. Whilst a straight line move may not be forthcoming, the first target for this retracement remains at 4,913. DAX index futures continue to mirror this outlook with a break of key support at 5,554 targeting a move towards 5,268 (although a retest of this support as resistance today could give the market another chance to sell). S&P 500 cash breached an important support point at 1,041 (1,029) skidding 2.58% overnight with the NASDAQ composite down 3.00%. This has encouraged the bears to push the Nikkei below the 10,000 level (9,731) where significant support doesn't arrive until 9,100. Chinese stock traders will be eyeing the declines nervously as the market remains closed. Admittedly, the Hang Seng has held-up relatively well, but a break of the major 20,000 level in the coming sessions should be considered.
- The strategy of moving back into the dollar as equities falter remains the key theme in FX, although positions may be light ahead of the key data later today. From a technical perspective, the previously favoured trades of EM and commodity currencies against the US dollar look set for further reversals and yesterday's strategy to ease dollar shorts in that space is stepped up a gear to go long dollars. The sharp move in the ZAR (down 3.95% overnight) could set tone for today and unless equities can stabilise, the pressure remains on any currency where good news has been 'baked in' to the price. EUR/USD should continue to ease with 1.4500 the main support level to break. 1.44 is the short term target. Cable continues to trade in a neutral zone. The market is looking for a break of 1.5775 or 1.6125 to determine direction, but the main focus will be on unwinding risk trades in favour of the dollar.
- Further compression of yields is likely given the backdrop with US 10y yields breaching the key 3.25% point that effectively ends the bullish strategy -3.10% is the next target. UK 5 year swaps target 3.00% (see below), with UK 2y swaps plunging to new lows at 1.73%.

Chart of the day: UK 5year swaps



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	1.1018
Current Spot	1.4545	1.5925	89.49	0.9133	1.0949
S1	1.4450	1.5975	87.14	0.9076	1.0753
S2	1.4407	1.5724	85.00	0.8981	1.0546

Spot prices as of: 07:08:26 Source: Bloomberg

A key trendline has been breached here at 3.21% - a test of 3.00% should be a formality, although this is a major support point.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4545	<i>Bearish</i>	1.4635	1.4450	1.4665	
USD/JPY	89.49	<i>Neutral</i>	-	92.00	-	
USD/CHF	1.0410	<i>Bullish</i>	1.0310	1.0500	1.0260	
GBP/USD	1.5925	<i>Bullish</i>	-	1.6000	-	Volatile but upside has the edge.
EUR/GBP	0.9133	<i>Bearish</i>	0.9170	0.9000	0.9210	Failed to close below 0.9088, but price action creating a bigger top.
GBP/JPY	142.51	<i>Neutral</i>	143.20	150.00	143.20	Stop hit.
EUR/JPY	130.16	<i>Neutral</i>	-	133.00	-	
CAD/JPY	82.65	<i>Bearish</i>	-	78.55	-	
AUD/USD	0.8701	<i>Neutral</i>	0.8797	0.8950	0.8640	Concerns over the breakout remain.
USD/CAD	1.0827	<i>Bullish</i>	1.0800	1.1200	1.0715	
NZD/USD	0.7134	<i>Bearish</i>	0.7200	0.6700	0.7265	
USD/BRL	1.7866	<i>Bearish</i>	1.8338	1.7000	1.8025	Cautious as USD starts to rebound.
USD/PLN	2.9360	<i>Bullish</i>	2.9000	3.0000	2.8840	Switch to bullish as a breakout is in prospect.
USD/HUF	186.37	<i>Bullish</i>	185.00	200.00	181.70	Switch to bullish as a breakout is in prospect.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

Economic data overnight from Japan have continued to provide some positive surprises. The jobless rate fell to 5.4% in August and household spending rose to an annual rate of 2.6% - the highest since January 2008. In the UK, the Nationwide house price index (released this morning) showed a 0.9% increase in September.

These data are positive, however market focus remains firmly on US data which have recently underperformed expectations, suggesting that the pace of recovery is now slowing. The US manufacturing ISM dipped slightly to 52.6 (expected at 54). Commodity and emerging market currencies have been worst affected with AUD/USD completing a bearish engulfing formation (a technical suggesting an increased risk of further downward pressure). EUR/USD and GBP/USD have been least effected highlighting where the volatility and risks lie in foreign exchange.

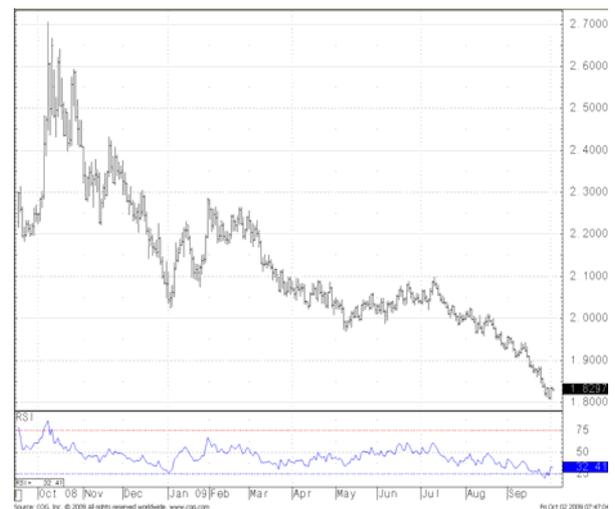
US labour market data are the key releases today. Market expectations for the non-farm payrolls report will now have dropped below the printed consensus of around -190k. A regression of NFP against the ADP, ISM employment components and initial jobless claims suggests an outcome close to -240k. We suspect a headline report below -275k is now required to trigger further negative sentiment.

A weak report is likely to weigh on commodity currencies (this is where we expect most movement to occur). As such, we find the bullish engulfing formation in GBP/AUD of most interest. Additionally, the daily RSI reached a level consistent with a major turning point earlier this week. Finally, the trend following model has not initiated any new positions this morning.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY
2 YR SPD	-0.47	-0.22	0.59	0.54	-0.08	0.19
10 YR SPD	-0.20	-0.43	0.51	-0.47	0.65	0.79
S&P500	0.85	-0.79	0.95	-0.02	-0.55	0.40
Gold	0.79	-0.86	0.75	0.26	-0.36	0.40
Oil	0.35	-0.69	0.36	0.47	-0.03	0.37
CRB	0.67	-0.80	0.75	0.11	-0.43	0.33

Chart 1: GBP/AUD provides bullish technical signals



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

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FX			Equities		
EUR/USD	1.4545	-0.65%	S&P500	1029.85	-2.58%
USD/JPY	89.605	-0.11%	DJIA	9509.28	-2.09%
AUD/USD	0.8697	-1.48%	FTSE100	5047.81	-1.68%
EUR/GBP	0.9117	-0.46%	Eurostoxx50	2810.46	-2.16%
GBP/EUR	1.0968	0.47%	Shanghai Composite*	2779.43	n/a
GBP/USD	1.5956	-0.16%	*latest price		
GBP/JPY	142.97	-0.29%	Commodities		
GBP/CHF	1.661	0.27%	Crude Oil \$/bl	70.82	0.30%
GBP/AUD	1.835	1.34%	Gold \$/oz	999.2	-0.84%
GBP/CAD	1.729	1.18%	Copper c/lb	273.7	-2.91%
GBP/NZD	2.232	1.00%	Silver \$/oz	16.35	-1.77%
GBP/NOK	9.279	0.57%	Baltic Dry	2284	2.88%
GBP/ZAR	12.300	2.48%	Swaps %		
GBP/CNY	10.891	-0.17%	US 5yr	2.532	-11.8
Bonds %			EUR 5yr	2.648	-6.3
		bp	UK 5yr	3.143	-9.5
US 10Yr	3.179	-12.6	Official Rates %		
EUR 10Yr	3.157	-6.3	UK	0.50	
UK10 Yr	3.592	-2.2	US	0.25	
Other			EU	1.00	
VIX	28.27	10.39%	Japan	0.10	
iTraxx XOVER	592.00	22.2			
DJ Agriculture Index	58.28	-1.36%			

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