

Daily Market Strategy

Friday, 9th 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

- Shanghai resumes trading with a 4.3% rally
- Will UK 5y swaps test 3.0%?

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6010, €/£: 1.4720, \$/¥: 89.25

UK 5y sw: 3.04%, US 5y sw: 2.60%, EU 5y sw: 2.70%

Overnight

- Weak US 30y auction (re-open): bid/cover 2.37, indirects take 34.5%
- Smaller than expected rebound in Japan Aug machinery orders (+0.5% m/m)
- German Aug trade surplus narrows, exports drop
- Asian central banks try to slow dollar's fall (FT)

Chinese markets resumed trading with a bang overnight, marking a return from a one-week break with a 4.3% rally in the Shanghai composite. This is primarily China catching up and thus the move has not registered in UK or US equity futures. The Economist magazine incidentally prints a 'leader' today in its weekly questioning whether Chinese asset prices have entered bubble territory, and calls for Beijing to apply greater flexibility on the yuan to head off the risk of a bigger adjustment from ultra-loose (US) monetary policy. This comes right on cue of Fed chairman Bernanke's overnight comments on monetary policy. Talk of Asian central bank intervention and reports of the Fed conducting reverse repo 'tests' - a cash draining exercise - lifted the USD off its lows and gold retreated below \$1,050. With regards to the UK, 5y swaps are rapidly approaching 3.0%, completing a near 80bps retracement since August. Releases of tame PPI data this morning and CPI next week could lead rates to test the May 1 low of 2.97%. The same bullish pattern applies to the long end of the gilt curve, where a break below 3.37% in the 10y, supported by BoE buying, puts 3.30% on the radar.

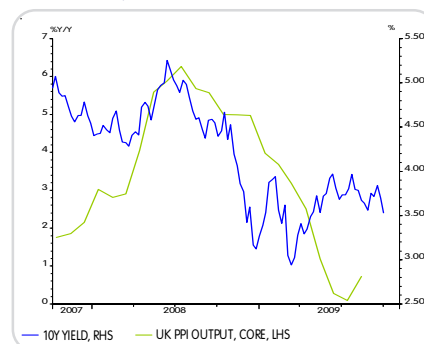
FX: The DXY bounced off a two-week low overnight to a 76.343 high, despite broad based rallies in equity markets in the Far East. AUD/USD and NZD/USD were stopped in their tracks and look set to consolidate below the highs on what should be a fairly uneventful final trading day of the week. EUR/SEK is bid above 10.3150, ignoring comments from Latvia that an agreement with its international lenders is near. Latvia will have a budget session on Monday. CAD crosses could be choppy on the Canadian jobs report. CAD/JPY beached trendline resistance at 84.0 and strong data could push the cross over 85.0.

Rates: UK 5y swaps were caught in a downward spiral yesterday but have bounced 5bps from the open this morning to 3.09%. Resistance runs at 3.14%. Our target of 3.0% remains in play and we now await UK PPI and CPI for the latest read on inflation. Weak data favours a move up to 121.0 for the Dec gilt future and a break below 3.35% in 10y gilts.

Tame UK PPI could trigger drop in 10y yields towards 3.30%

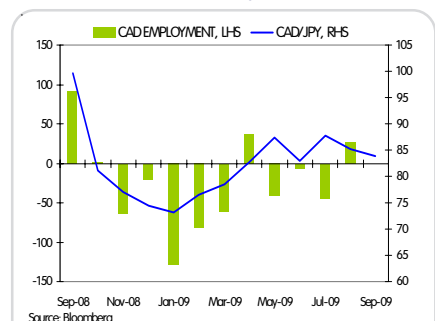
CAD/JPY to vault 85.0 on stonger Canadian jobs data?

	Close	Daily Change %
FX		
EUR/GBP	0.9206	0.05%
GBP/USD	1.6072	0.64%
EUR/USD	1.4795	0.70%
USD/JPY	88.393	-0.24%
AUD/USD	0.9062	1.68%
Bonds %		
US 10Yr	3.248	6.6
EUR 10Yr	3.115	-0.3
UK 10 Yr	3.385	-2.0
UK 5yr Swap	3.037	-3.3
Equities		
S&P500	1065.48	0.75%
FTSE100	5154.64	0.90%
Eurostoxx50	2887.61	1.24%
Shanghai Composite	2910.94	4.73%
Commodities		
Crude Oil \$/bl	71.69	3.05%
Gold \$/oz	1055.1	1.04%
Copper	289.9	4.28%
Baltic Dry	2647	3.97%
Other		
VIX	24.18	-2.03%
iTraxx XOVER	567.71	-5.2



Today's Events

Japan Machinery Orders, Aug
German Trade Balance, Aug
German Current Account, Aug
German CPI, Sep final y/y
France Industrial Output, Aug
UK PPI Input, Sep
UK PPI Output, Core, Sep
UK Trade Balance, Sep
Canada Employment Change, Sep
Canada Unemployment Rate, Sep
US Trade Balance, Sep
Fed speakers: chairman Bernanke, Hoenig (01:45), Lockhart (13:30), Bullard (19:00)
ECB speakers: president Trichet (10:30)



Time	Consensus	Previous
00:50	+0.5% A	-9.3%
07:00	+€8.1bn A	+€14.1bn R
07:00	+€4.6bn A	+€11.4bn R
07:00	-0.3% A	-0.3%
07:45	+1.8% A	+0.3% R
09:30	-0.8%	+2.2%
09:30	+0.2%	+0.2%
09:30	-£6.3bn	-£6.5bn
12:00	+5.0K	+27.1K
12:00	8.8%	8.7%
13:30	-\$33.0bn	-\$32.0bn

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- The positive tone to Asian equity markets as we enter the final day's trading of the week feels like déjà vu. Whilst a rebound (+4.31%) in the Shanghai index following the 7 day public holiday is a relief to the bulls, at this stage it doesn't change the short term range that encloses the recent 2,600/ 3,000 range. Notably, however, the Baltic dry index has been posting a decent run of gains with yesterday's print of 2,647 the sixth consecutive rise. The next challenge level is at 3,000, but for the moment the 'risk-on' traders may be looking for excuses to take profits as the extent of recent rises become compelling. Dec. FTSE futures still remain below 5,168 - despite yesterday's strong tone. Admittedly, this major resistance is looking under threat and holding the bearish nerve is not easy. For the moment this is still assumed to be the market top, but a move through 5,064 short term support would assist this strategy. Note if this resistance is taken out, the move will be sharp - similarly 5,764 in the DAX index represents the equivalent resistance.
- An easing of dollar shorts overnight looks to be temporary, but not insignificant. The DXY managed to break the September low at 75.82, trading to 75.76, before momentum reversed back to 76.26. This mirrored the temporary top in gold where the market sunk back from the high at \$1,061.55. Technical targets in gold are approaching at \$1,080 implying further dollar weakness against the preferred high yielding currencies. Sterling continues to act as a problem child of the currency markets. Resistance in cable at 1.6125/ 30 is key and until this level is breached, sterling will be shunned as a pro-risk trade. Indeed, UK 5y swaps collapsed towards a low of 3.03% and UK 2y yields careered towards 0.70% underscoring the duality of the current markets' risk and defensive attitude.

Chart of the day: Shanghai Composite



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4865	1.6300	95.15	0.9482	1.1135
R1	1.4764	1.611	91.80	0.9300	1.1018
Current Spot	1.4730	1.6010	89.19	0.9201	1.0868
S1	1.4450	1.5724	87.14	0.9076	1.0753
S2	1.4407	1.5455	85.00	0.8981	1.0546

Spot prices as of: 07:14:18 Source: Bloomberg

Traders return from a seven day holiday in a bullish mood. Key technical support at 2,641 has held, although a break through 3,000 is required to eject the market from the wider range.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4730	Bullish	1.4650	1.4844	1.4595	
USD/JPY	89.19	Bearish	88.54	85.00	89.20	Stop hit
USD/CHF	1.0308	Bearish	1.0360	1.0000	1.0426	USD bears get nervous near lows.
GBP/USD	1.6010	Bearish	1.5965	1.5500	1.6020	Stop hit- in neutral zone- Buy through 1.6125 key resistance.
EUR/GBP	0.9201	Bullish	0.9225	0.9400	0.9190	Stop hit. Sideline awaiting major signal, 0.9318/0.9080.
GBP/JPY	142.78	Bullish	-	144.00	-	Key resistance at 144.57.
EUR/JPY	131.38	Bullish	-	133.00	-	
CAD/JPY	84.64	Neutral	-	-	-	
AUD/USD	0.9039	Bullish	0.8888	0.9291	0.8940	Stop raised.
USD/CAD	1.0537	Bearish	1.0650	1.0000	1.0650	Stop moved to flat.
NZD/USD	0.7393	Bullish	<u>0.7360</u>	0.7468	0.7225	Entry raised.
USD/BRL	1.7364	Bearish	1.8338	1.7000	1.7550	Stop lowered.
USD/PLN	2.8803	Bearish	-	2.6000	-	Stop hit- downside tentatively favoured.
USD/HUF	183.75	Bearish	182.09	165.00	183.10	Stop hit as trend stalls.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

GBP/USD has finally managed to record its first daily close above \$1.60, over the past 10-days. The upward price action has resulted in the trend following model initiating a long position in the currency pair this morning. This completes the short USD portfolio for the model – it is now fully short USD against developed market currencies. The model already holds a 100% short USD portfolio against emerging market currencies.

The US earnings season has opened strongly and is providing support for equity markets. The S&P500 is close to testing the 2009 high (1060.39) and the VIX index is resuming its downward trend, closing at a 10-day low (24.2). Commodity prices are also finding support, alongside equities, as earnings provide upward surprises. The CRB (our favoured, broad based commodity price index) has moved to its highest since mid August. As such, it is no shock to see that commodity currencies (AUD, NZD, CAD and NOK) have been the biggest gainers against the USD so far this week – we look for this to continue as we push further into the earnings season.

RSI measures had reached over-sold status in GBP/USD and USD/JPY earlier this week. With equity and commodity markets likely to be supported as earnings surprise higher, we look for a sharp upward move in GBP/JPY. The currency pair has clear support around Y140, and a break above Y144.60 would open the way for a corrective move towards Y150.

Chart 1: Spread in AU/US 2-year interest rate swaps heading higher - argues for further gains in AUD/USD

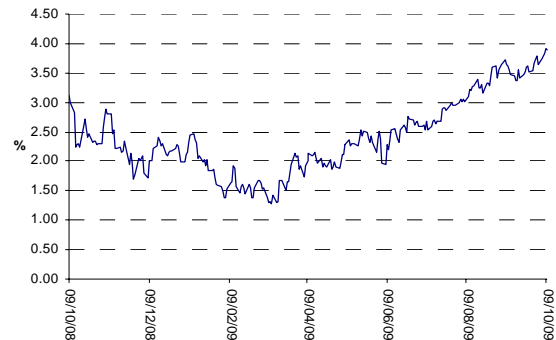


Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY
2 YR SPD	0.81	0.67	0.16	0.54	0.58	0.62
10 YR SPD	0.35	0.18	-0.07	0.13	0.75	0.92
S&P500	0.42	-0.47	0.81	-0.05	-0.13	0.24
Gold	0.90	-0.92	0.63	-0.25	-0.63	-0.37
Oil	0.25	-0.69	0.18	0.40	0.13	0.21
CRB	0.71	-0.90	0.68	-0.02	-0.31	-0.01

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	long	09-Oct-09	1.6071
USDCHF	short	17-Jul-09	1.0730
USDCAD	short	07-Oct-09	1.0593
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			-100%

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

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.4795	0.70%	S&P500	1065.48	0.75%
USD/JPY	88.393	-0.24%	DJIA	9786.87	0.63%
AUD/USD	0.9062	1.68%	FTSE100	5154.64	0.90%
EUR/GBP	0.9206	0.05%	Eurostoxx50	2887.61	1.24%
GBP/EUR	1.0863	-0.06%	Shanghai Composite*	2910.15	4.70%
GBP/USD	1.6072	0.64%	*latest price		
GBP/JPY	142.06	0.39%	Commodities		
GBP/CHF	1.649	-0.04%			%
GBP/AUD	1.774	-1.02%	Crude Oil \$/bl	71.69	3.05%
GBP/CAD	1.690	-0.26%	Gold \$/oz	1055.1	1.04%
GBP/NZD	2.164	-0.24%	Copper c/lb	289.9	4.28%
GBP/NOK	9.059	-0.25%	Silver \$/oz	17.79	1.25%
GBP/ZAR	11.785	-0.71%	Baltic Dry	2647	3.97%
GBP/CNY	10.971	0.64%	Swaps %		
Bonds %					bp
		bp	US 5yr	2.571	3.1
US 10Yr	3.248	6.6	EUR 5yr	2.680	3.8
EUR 10Yr	3.115	-0.3	UK 5yr	3.037	-3.3
UK10 Yr	3.385	-2.0	Official Rates %		
Other					
VIX	24.18	-2.03%	UK	0.50	
iTraxx XOVER	567.71	-5.2	US	0.25	
DJ Agriculture	59.24	1.21%	EU	1.00	
Index			Japan	0.10	

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