

# Daily Market Strategy

Thursday, 15th October 2009

## Market Strategy

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- UK swaps through key resistance, target raised
- US CPI, Goldman and Citi earnings ahead

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6088, €/\$: 1.4962, \$/Y: 89.37

UK 5y sw: 3.14%, US 5y sw: 2.71%, EU 5y sw: 2.75%

### Overnight

- BoE's Fisher hints at QE pause in November
- FOMC minutes: more upbeat on H2 2009 growth outlook, sees further fall in core inflation, jobless rate at 9.25% at end 2010, some favour expanding/extending MBS purchases
- RBA signals further tightening, AUD/USD through 0.92

The Dow closed above 10,000 overnight, adding fuel to the pro-risk theme for currencies but leaving government bonds vulnerable. Equity futures are teeing up further gains this morning on earnings optimism and the Fed FOMC minutes. The RBA underlined its hawkish credentials overnight, sparking a sell-off in Aussie government bonds and boosting the AUD. In the UK, 10y yields are only 17bps away from the August 6 low when the BoE announced a £50bn increase in QE. Since then, the FTSE-100 is up 12% and UK 10y break-even inflation is up 27bps (2.59%). This could make it harder for the BoE to justify additional asset purchases. MPC member Fisher set the ball rolling yesterday inferring that the QE may be paused (not ended) next month as economic projections in the November QIR will not be dissimilar to August. The MPC minutes and the first estimate of Q3 GDP will offer more clues next week.

Ahead today: US September CPI is expected to reinforce the FOMC's inflation message, but could struggle to put a more bullish spin on government bonds as equities target further upside. Core CPI is forecast at +0.1% m/m. Weekly claims are expected to have stayed flat around 525K. The Philly Fed survey hit a 27-month high last month and may have slipped to 12.0. Goldman (12:30, f/cast \$4.18/sh) and Citi (13:00, f/cast -\$0.29cts/sh) report Q3 results.

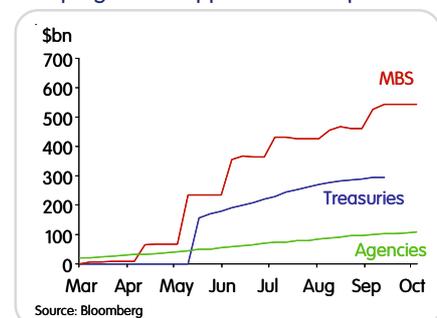
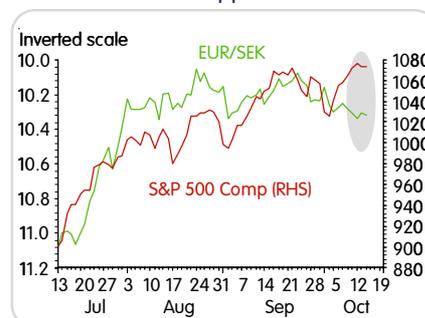
**FX:** AUD/USD trades above 0.92 and is fast approaching our 0.9250 target as a 25bps rate hike by the RBA on November 3 is priced in. Fisher's comments originally triggered selling in GBP crosses but suggestions that the BoE may pause QE plus solid gains for pro-risk currencies squeezed GBP/USD through 1.61 in Asia. From here, resistance is situated at 1.6150. For EUR crosses, we will be alert to remarks by ECB president Trichet later today. EUR/JPY breached trendline resistance at 133.66 and now has its sights set above 134.

**Rates:** Defensive strategies are favoured as yields breach key levels in the major currency zones. For 10y gilts, resistance runs at 3.53% followed by 3.60%. For 5y swaps, a move through 3.16% opens the door to 3.20-3.25%. UK 2y/10y swaps steepened through 200bps. Equities will set the tone and blow out numbers by GS could add momentum for a sell-off in fixed income. US 10y yields traded through 3.40% resistance. The Sep 23 high of 3.51% is the next target.

Waiting for EUR/SEK to catch up with rise in risk appetite

Fed \$300bn Treasury purchase programme approaches completion

	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.9342	0.12%
GBP/USD	1.5981	0.35%
EUR/USD	1.4925	0.48%
USD/JPY	89.445	-0.30%
AUD/USD	0.9150	0.67%
<b>Bonds %</b>		<b>bp</b>
US 10Yr	3.414	6.7
EUR 10Yr	3.227	6.3
UK10 Yr	3.402	2.1
UK 5yr Swap	3.138	6.1
<b>Equities</b>		<b>%</b>
S&P500	1092.02	1.75%
FTSE100	5256.10	1.98%
Eurostoxx50	2950.82	2.49%
Shanghai Composite	2975.79	0.18%
<b>Commodities</b>		<b>%</b>
Crude Oil \$/bl	75.18	1.39%
Gold \$/oz	1062.4	-0.18%
Copper	284.5	1.79%
Baltic Dry	2597	-1.85%
<b>Other</b>		
VIX	22.86	-0.57%
iTraxx XOVER	511.67	-34.5



### Today's Events

EU-16 CPI, Aug, y/y  
US CPI, Sep  
US CPI, Core, Sep  
US Weekly Claims, Oct-10  
NY Fed Manufacturing Survey, Sep  
Philly Fed Survey, Sep  
ECB publishes Monthly Bulletin (09:00)  
ECB speakers: President Trichet (12:25)  
Fed speakers: Bullard (14:45)  
Treasury Secretary Geithner speaks in NY (21:15)  
US Q3 earnings: Goldman Sachs, Citigroup, IBM

Time	Consensus	Previous
10:00	-0.3%	-0.2%
13:30	+0.2%	+0.4%
13:30	+0.1%	+0.1%
13:30	525K	521K
13:30	+18.0%	+18.9%
15:00	+12.0	+14.1

Source: Bloomberg

- Once again the main outlook this morning is for a continued squeeze in equities with the DJI hitting 10,000 and S&P cash pushing through the main resistance at 1,080. There is a brick wall of resistance at 1,106 in the S&P - this is the next target and gains beyond that level may well prove difficult. The bullish equity wave was well flagged as European equities rallied past the main prior resistances in a wave of short covering. Whilst FTSE futures target 5,400 and DAX index futures should hit 6,000, this is still seen in the context of a bear market bounce, despite the prospects for further gains. With the Hang Seng breaking into fresh high's for the year (22,250 the day's high) and the Nikkei putting some distance between 10,000 (10,281 currently - although this is still lagging due to yen strength), the wave of optimism is difficult to counter. The view remains cautiously bullish.
- Sterling continues to recover from it's oversold status and should have more to go in the FX markets, but the main story and trends are concentrated on selling the dollar against high yielding EM and commodity currencies. Dollar sentiment is running heavily negative, but until there are signs of short covering there is little reason to reverse the strategy reflected in the table below. DXY support at 74.80 is the next main target (75.30 currently) and as the VIX index plumbs new lows, the dollar bears continue to dominate. Gold targets at \$1,080 have come close with \$1,070 hit before easing back to \$1,061 with silver hitting \$18.00 - back into the trading zone of the summer of 2008 before the big commodity sell off. The short-term outlook stays bullish on precious metals although the market may start to seek other undervalued commodities. Note the DJ AIG index (agricultural index) is close to an important resistance level at 133.00 - a break should be at hand with 140 the next significant level. The CRB index is also at a major resistance point at 269 and should extend gains to 300 into early 2010. This will help US 10y yields to break 3.50% and keep

Chart of the day: Crude Oil



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.5287	<b>1.6300</b>	95.15	0.9520	<b>1.1135</b>
R1	1.4966	<b>1.6125</b>	91.80	0.9482	1.1018
Current Spot	1.4964	1.6072	89.41	0.9311	1.0741
S1	1.4845	1.5683	87.14	0.9076	1.0546
S2	1.4407	1.5455	85.00	0.8981	1.0504

Spot prices as of: 07:08:49 Source: Bloomberg

Oil's well, but not the dollar - prices continue to trend higher. \$81.00 is the year end target. Fibonacci level at 76.07 is a short term hurdle.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4964	Bullish	1.4650	1.5287	1.4650	Target hit- raised to 1.5287.
USD/JPY	89.41	Neutral	=	90.00	-	Unsure what is driving this.
USD/CHF	1.0122	Bearish	1.0360	1.0000	1.0365	Stop moved to flat.
GBP/USD	1.6072	Bullish	1.6000	1.6300	1.5930	Bullish through 1.6120/30- Oversold bounce to continue
EUR/GBP	0.9311	Bearish	current	0.9200	0.9355	GBP set to bounce further.
GBP/JPY	143.71	Bullish	current	144.57	139.75	Basing- buy level not hit yesterday.
EUR/JPY	133.80	Bullish	133.00	135.00	131.75	Buy level came close- raised.
CAD/JPY	87.56	Bullish	87.20	92.00	86.30	Entry raised.
AUD/USD	0.9223	Bullish	0.8888	0.9291	0.9120	Stop raised.
USD/CAD	1.0211	Bearish	1.0650	1.0000	1.0375	Stop lowered.
NZD/USD	0.7484	Bullish	0.7360	0.7600	0.7375	Stop raised.
USD/BRL	1.7010	Bearish	1.8338	1.7000	1.7175	Target close. Stop lowered.
USD/PLN	2.8102	Bearish	2.8100	2.7000	2.8230	2.8266 break triggers PLN long.
USD/HUF	178.38	Bearish	179.20	175.00	180.65	

Spot prices source: Bloomberg

ENTRY - Targetted

ENTRY - Active

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

US equities have roared higher following the strong Q3 earnings results from JP Morgan. The bank reported earnings of \$0.82 per share, against a market expectation of \$0.51. The positive sentiment provided a boost for equity markets globally, resulting in the Dow closing over the psychological 10,000 barrier for the first time since October 2008. Today's earnings reports from Goldman Sachs (at 12.30pm) and Citigroup (at 1pm) are now important. Strong reports will be required from these banks to maintain the upward momentum in equities. For the broader economy, Google's results (after the market close) will be keenly awaited.

In commodities, NYMEX WTI crude oil and the CRB index have broken up and out of their triangular consolidation formations. From a technical perspective this suggests further upside risks in commodities. From a fundamental perspective, the rally should continue whilst global leading indicators maintain an upward trajectory. Northbound trends in equity and commodity markets should continue to provide a USD negative backdrop.

Overnight there have been a number of developments in foreign exchange. The minutes from the September FOMC meeting highlight that the Federal Reserve is unlikely to change the fed funds target rate any time soon. This has left short-term interest rate spreads somewhat wider against the US, weighing on the USD. The USD DXY index has fallen to a new 2009 low overnight, its lowest since August 2008.

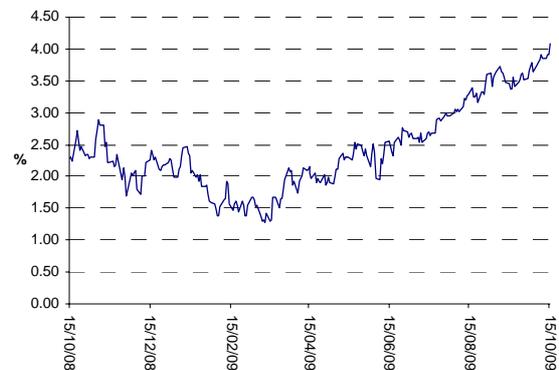
The Reserve Bank of Australia's Governor Stevens, has reiterated that interest rates will need to move to more normal levels and that the high level of the Australian dollar reflects strength in the economy. Short-term interest rate futures contracts have moved to price in another 20bp of tightening. The currency should continue to outperform its G-10 peers over the coming months, benefiting from cyclical support.

GBP/USD continues to squeeze higher, due to the extremely large build up in short positions by the end of last week. The downward trend line (from the August high (\$1.7043) provides resistance towards \$1.6450. We continue to hold our long

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2YR SPD	<b>0.90</b>	<b>0.90</b>	0.48	-0.01	0.64	0.33	0.72
10YR SPD	0.46	0.55	-0.46	0.52	0.43	<b>0.83</b>	0.73
S&P500	0.55	-0.64	<b>0.77</b>	-0.02	0.09	0.48	<b>0.80</b>
Gold	<b>0.94</b>	<b>-0.96</b>	<b>0.77</b>	-0.35	-0.54	-0.11	<b>0.85</b>
Oil	0.65	<b>-0.79</b>	0.46	-0.13	-0.25	0.00	0.67
CRB	<b>0.82</b>	<b>-0.93</b>	<b>0.82</b>	-0.18	-0.28	0.16	<b>0.88</b>

Chart 1: Further cyclical support for the AUD/USD overnight



GBP/JPY position (trade recommended on Friday). The currency pair is now testing resistance at \$144.05 (the downward trend line from August) – the positive equity and commodity market backdrop should support this currency pair further.

Finally, our in-house trend following as initiated a short USD/PLN position this morning. The model is now fully short of USD against emerging market currencies.

### 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	12-Oct-09	1.5842
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			-78%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	short	15-Oct-09	2.8237
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

	Close	Daily Change %		Close	Daily Change %
<b>FX</b>			<b>Equities</b>		
EUR/USD	1.4925	0.48%	S&P500	1092.02	1.75%
USD/JPY	89.445	-0.30%	DJIA	10015.86	1.47%
AUD/USD	0.9150	0.67%	FTSE100	5256.10	1.98%
EUR/GBP	0.9342	0.12%	Eurostoxx50	2950.82	2.49%
GBP/EUR	1.0703	-0.14%	Shanghai Composite*	2976.38	0.20%
GBP/USD	1.5981	0.35%	*latest price		
GBP/JPY	142.94	0.06%	<b>Commodities</b>		
GBP/CHF	1.622	-0.31%			%
GBP/AUD	1.747	-0.33%	Crude Oil \$/bl	75.18	1.39%
GBP/CAD	1.636	-0.45%	Gold \$/oz	1062.4	-0.18%
GBP/NZD	2.161	0.30%	Copper c/lb	284.5	1.79%
GBP/NOK	8.855	-0.92%	Silver \$/oz	17.88	0.53%
GBP/ZAR	11.564	-0.88%	Baltic Dry	2597	-1.85%
GBP/CNY	10.909	0.36%			
<b>Bonds %</b>			<b>Swaps %</b>		
		bp			bp
US 10Yr	3.414	6.7	US 5yr	2.697	4.5
EUR 10Yr	3.227	6.3	EUR 5yr	2.744	7.9
UK10 Yr	3.402	2.1	UK 5yr	3.138	6.1
<b>Other</b>			<b>Official Rates %</b>		
VIX	22.86	-0.57%	UK	0.50	
iTraxx XOVER	511.67	-34.5	US	0.25	
DJ Agriculture Index	61.90	0.35%	EU	1.00	
			Japan	0.10	

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