

# Daily Market Strategy

Monday, 26th October 2009

## Market Strategy

### Market Strategy Team

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- EUR/GBP gains upward traction
- US 10y yields break 3.50%, auctions loom

### Market Outlook

Kenneth Broux

Opening levels (7.15am)  
£/\$: 1.6307, €/\$: 1.5029, \$/Y: 91.88  
UK 5y sw: 3.30%, US 5y sw: 2.82%, EU 5y sw: 2.88%

#### Overnight

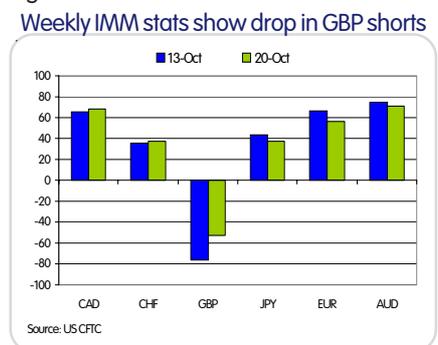
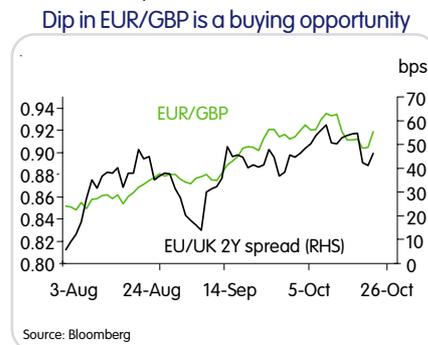
- East Asia warned on currency threat (FT)
- Germany to put growth ahead of deficit (FT)

The negative backdrop for global rates remains in place as trading gets underway this morning and US 10y yields have broken through 3.50%. Further upside probably lies ahead as markets prepare to digest \$123bn in supply (including TIPS) and dealers square up to the first estimate of US Q3 GDP (Thursday). For UK rates, disappointing data last week in theory should help gilts/swaps to outperform Treasuries and bunds, based on the fallout of still contracting output for spare capacity and inflation. Having said this, we are mindful of the positive correlation with US rates and the upward pressure from a bull market in equities. A quiet day for UK economic events features a speech by MPC member Posen tonight in London. Mr Posen has made no secret of his view on QE and a few weeks ago hinted he would support further asset purchases. Armed with the 0.4% q/q slump in Q3 GDP, we can't see how Posen would think differently ahead of next week's MPC meeting. Also today: the BoE will publish its APF Report at 9.30. Bank of Canada governor Carney is scheduled to speak at around lunchtime. The US Treasury sells \$7bn in 5y TIPS.

**FX:** At odds with the IMM GBP data, we see further upside for EUR/GBP above 0.92 both on a tactical and fundamental view. GDP growth and interest rate differentials between the UK and the EU-16 alongside demand for the EUR on global FX diversification puts EUR/GBP on track for a rally back up to 0.93 (GBP/EUR 1.0753) as we move along to the next MPC meeting. Key support runs at 0.9188. Comments from China propelled EUR/USD to a high overnight of 1.5063. Resistance runs at 1.5083. This week's US GDP data is unlikely to neutralise the upward trend as the Fed remains committed to keeping interest rates low.

**Rates:** UK rates bounced off key 3.27% support and opened firmer this morning along with rates in the US and the EU-16. US GDP is the main story later this week and until then we think UK rates are set to drift in a range. Key support for 5y swaps runs at 3.27% and 3.20%. We are mindful of 3.34% and 3.38% to the upside. US 10y yields took out 3.50% in Asia. A break of 3.53% would clear the way for 3.57% and 3.60%. Supply is likely to be a major factor this week and argues for defensive positioning going into Thursday's GDP release. For UK 10y yields, the trendline comes in around 3.68%. EU 5y swaps look ominous above 2.86%, where a test of 2.90% would bring 3.0% within reach.

	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.9202	1.75%
GBP/USD	1.6306	-1.91%
EUR/USD	1.5008	-0.17%
USD/JPY	92.060	0.84%
AUD/USD	0.9224	-0.48%
<b>Bonds %</b>		<b>bp</b>
US 10Yr	3.490	7.7
EUR 10Yr	3.348	4.3
UK10 Yr	3.707	0.0
UK 5yr Swap	3.298	-3.8
<b>Equities</b>		<b>%</b>
S&P500	1079.60	-1.22%
FTSE100	5242.57	0.68%
Eurostoxx50	2886.08	-0.56%
Shanghai Composite	3109.57	0.06%
<b>Commodities</b>		<b>%</b>
Crude Oil \$/bl	80.50	-0.85%
Gold \$/oz	1055.4	-0.44%
Copper	303.5	1.22%
Baltic Dry	3043	1.40%
<b>Other</b>		
VIX	22.27	7.64%
iTraxx XOVER	498.86	-6.5



### Today's Data

German Consumer Confidence, Nov 07:00  
US Chicago Fed Nat Activity Index 12:30

### Time Consensus Previous Events

4.0A ▲ 4.2 ECB speakers: Stark (08:45)  
n/a -0.90 BoE speakers: Posen (18:35)

Bank of Canada speakers: Carney (12:55)  
BoE purchases £14bn gilts: UKT\_4.75\_070320, UKT\_4\_070322, UKT\_5\_070325, UKT\_4.25\_071227, UKT\_6\_071228, UKT\_4.75\_071230, UKT\_4.25\_070632, UKT\_4.5\_070934  
US Treasury sells \$7bn, 5y TIPS

- Equity markets are braced for more volatility this week as European indices continue to oscillate within a two-week range without a clear direction. The technical view remains bearish on stocks as DAX index futures appear to be in the process of completing a head and shoulders reversal. This explains the current volatility and projects a downward trend once the 'neckline trigger' at 5,714 is hit. FTSE futures traded within a whisker of contract highs on Friday, but failed to go the small extra step into new territory for the Dec. contract and, given that sterling weakness seems to have a loose benefit on UK equities, the trading health of the pound will be watched carefully this week also. 5,136 and 5,274 mark the range with positions likely to be guided by a break of either level. As mentioned, my bias is to the downside for now. Asian stocks have performed reasonably well on the back of weaker session New York session on Friday. The Hang Seng has shrugged this off to push 1.70% higher although the Nikkei is only a small positive at +0.77%. Another positive print on Friday for the BDY index may have helped (+42 @3,043), but there is a slightly nervous start to trading this morning.
- Have sterling bulls been mugged by a rogue Economic number? Whilst a short term pullback was due, the retracement was not what I had in mind. Whilst a further leg downwards is possible, this does not sit with the current position of the asset markets, hence I am looking for an oversold short term condition to re-enter the GBP long (see table below). However, the pound may have to share the stage with the commodity currencies, which appear to be in the process of topping out. This is a particularly tricky call here as base and precious metals are so close to their recent highs and seem intent on trending higher. However, the CAD appears to be gradually weakening against the USD and the AUD and NZD should make a decisive move soon. A broad move into the USD cannot be fully justified until 76.00 is breached in the DXY, even though support at 74.94 has halted USD weakness for now.

Chart of the day: US 10y yields - Big barrier at 3.50%



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.5287	<b>1.7050</b>	95.15	0.9520	<b>1.1364</b>
R1	1.5063	<b>1.6743</b>	92.54	0.9306	1.1135
Current Spot	1.5040	1.6316	91.85	0.9218	1.0849
S1	1.4845	1.6125	87.14	0.8981	1.0746
S2	1.4407	1.5709	85.00	0.8800	1.0504

Spot prices as of: 07:15:48 Source: Bloomberg

US 10-year yields key resistance is at 3.50%. Whilst the technical view has been bullish. This level is sufficiently strong to cap gains in the short term.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.5040	Bullish	1.4650	1.5287	1.4920	Cautiously USD bearish
USD/JPY	91.85	Bullish	90.50	94.00	90.70	
USD/CHF	1.0058	Bearish	1.0360	1.0000	1.0185	
GBP/USD	1.6316	Bullish	<u>1.6225</u>	1.6750	1.6140	
EUR/GBP	0.9218	Bearish	0.9112	0.8800	0.9075	Stop hit at 0.9075
GBP/JPY	149.86	Bullish	<u>147.50</u>	153.27	146.80	
EUR/JPY	138.13	Bullish	<u>136.90</u>	138.74	135.80	
CAD/JPY	87.34	Bullish	87.20	92.00	86.30	
AUD/USD	0.9254	Bearish	0.9300	0.9000	0.9355	Lack of downside break is a concern. Tighten stops.
USD/CAD	1.0517	Bullish	1.0450	1.0800	1.0340	Reversing commodity currency trades.
NZD/USD	0.7547	Bearish	0.7585	0.7200	0.7610	
USD/BRL	1.7173	Bullish	1.7000	1.7665	1.6870	Possible USD bounce?
USD/PLN	2.7788	Neutral	-	-	-	Looking heavy again- but sidelined for now.
USD/HUF	176.89	Bullish	176.98	182.00	174.30	

Spot prices source: Bloomberg

ENTRY - Targeted

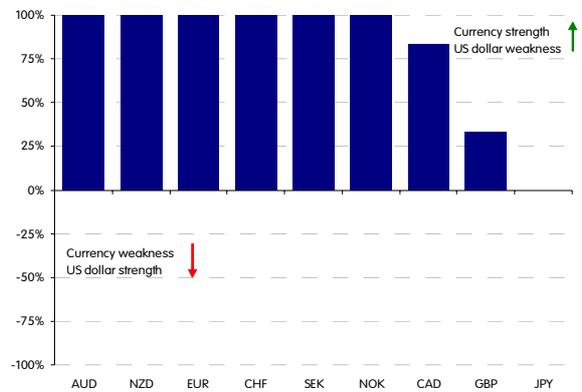
ENTRY - Active

## Quantitative Market Analysis

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2 YR SPD	0.95	0.93	0.76	0.74	0.44	0.84	0.98
10 YR SPD	0.72	0.58	-0.46	0.28	0.55	0.65	0.94
S&P500	0.90	-0.81	0.87	0.63	0.52	0.76	0.87
Gold	0.92	-0.93	0.83	0.50	0.30	0.62	0.81
Oil	0.93	-0.71	0.93	0.86	0.76	0.92	0.97
CRB	0.97	-0.75	0.96	0.85	0.73	0.92	0.99
Relative Yield Curve	0.92	0.92	0.73	0.21	-0.29	0.53	0.85

Chart 1: Trend strength model

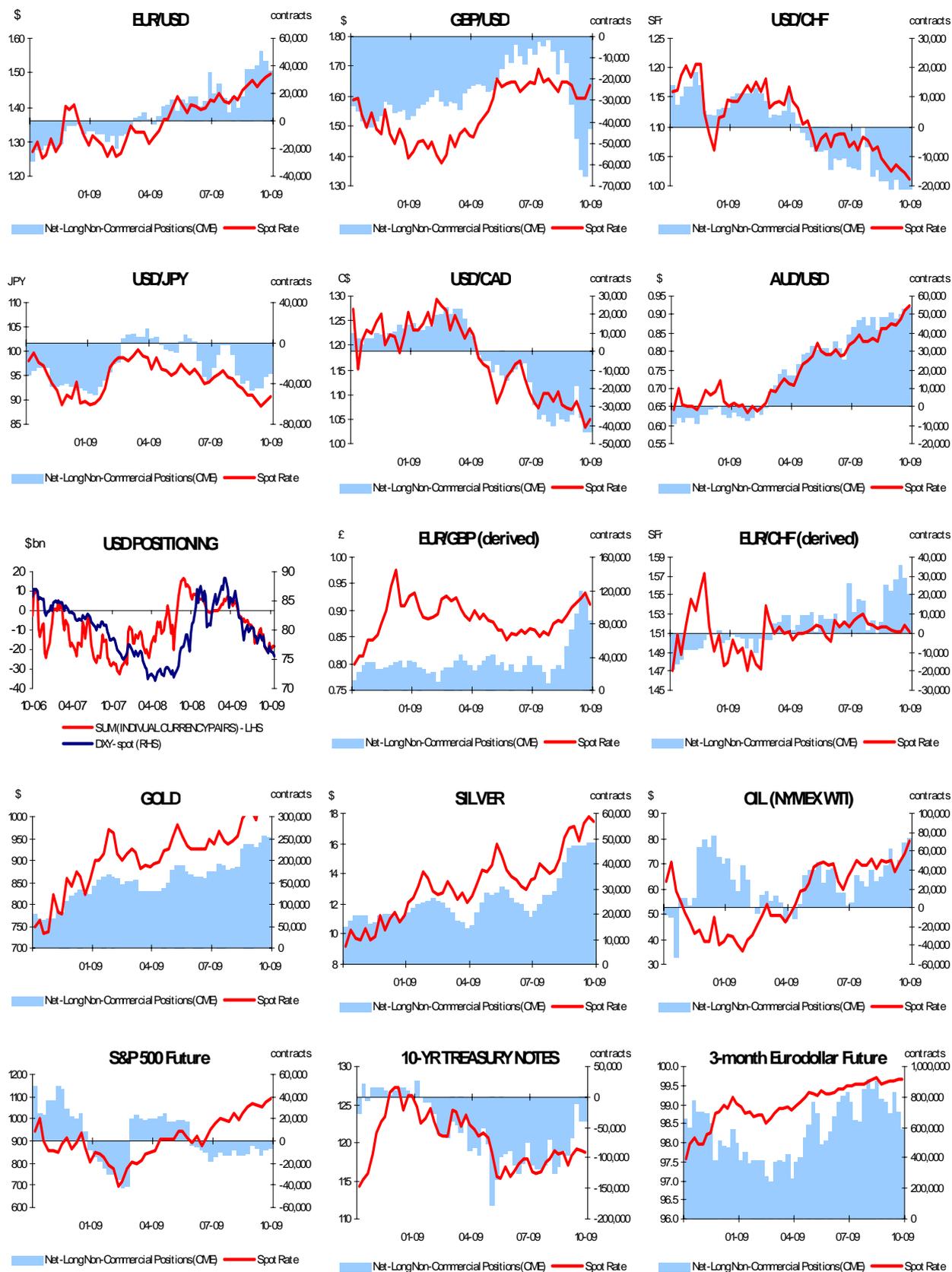


## Trend following model signals

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	long	22-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
<b>Net-USD portfolio position</b>			<b>-56%</b>

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	long	21-Oct-09	17.260
USDPLN	short	15-Oct-09	2.8237
USDSGD	short	08-Sep-09	1.4337
USDTRY	short	15-Sep-09	1.4939
USDZAR	long	22-Oct-09	7.3665
<b>Net-USD portfolio position</b>			<b>-20%</b>

## FX & Commodity Futures Positioning



## Market Summary

	Close	Daily Change %		Close	Daily Change %
<b>FX</b>			<b>Equities</b>		
EUR/USD	1.5008	-0.17%	S&P500	1079.60	-1.22%
USD/JPY	92.06	0.84%	DJIA	9972.18	-1.08%
AUD/USD	0.9224	-0.48%	FTSE100	5242.57	0.68%
EUR/GBP	0.9202	1.75%	Eurostoxx50	2886.08	-0.56%
GBP/EUR	1.0866	-1.73%	Shanghai Composite*	3109.57	0.06%
GBP/USD	1.6306	-1.91%	*latest price		
GBP/JPY	150.11	-1.09%	<b>Commodities</b>		
GBP/CHF	1.6450	-1.49%	Crude Oil \$/bl	80.50	-0.85%
GBP/AUD	1.7675	-1.46%	Gold \$/oz	1055.4	-0.44%
GBP/CAD	1.7181	-1.33%	Copper c/lb	303.5	1.22%
GBP/NZD	2.1611	-1.49%	Silver \$/oz	17.69	0.14%
GBP/NOK	9.0678	-1.36%	Baltic Dry	3043	1.40%
GBP/ZAR	12.1680	-1.04%	<b>Swaps %</b>		
GBP/CNY	11.1341	-1.91%	US 5yr	2.810	8.3
<b>Bonds %</b>			EUR 5yr	2.828	2.3
		bp	UK 5yr	3.298	-3.8
US 10Yr	3.490	7.7	<b>Official Rates %</b>		
EUR 10Yr	3.348	4.3	UK	0.50	
UK10 Yr	3.707	0.0	US	0.25	
<b>Other</b>			EU	1.00	
VIX	22.27	7.64%	Japan	0.10	
iTraxx XOVER	498.86	-6.5			
DJ Agriculture Index	63.34	-1.05%			

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