

# Daily Market Strategy

Tuesday, 27th October 2009

## Market Strategy

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- MPC's Posen hints at a further increase in QE
- US 2y Note auction ahead, consumer confidence may disappoint

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6351, €/£: 1.4909, \$/¥: 92.08

UK 5y sw: 3.31%, US 5y sw: 2.85%, EU 5y sw: 2.84%

#### Overnight

- MPC's Posen says QE will 'not lead to unacceptably high inflation at any time horizon'
- Very strong US 5y TIPS auction b/c 3.10; indirects take 47.8%
- Australian Q3 business confidence surges to 7-year high

Asian equities are shadowing US indices broadly lower overnight as concerns over the expiry of US first-time homebuyer tax credits is causing profit taking. The reaction in currencies and government bonds suggests that the ripples to other markets have (so far) been fairly contained, which is crucial to understanding the drivers of the price action over the coming days. For FX, pro-risk currencies stabilised overnight led by a surge in Australian business confidence to a 7-year high. Though we still have Australian CPI to contend with tomorrow, the strong data keeps the RBA in play for a rate hike to 3.50% next week. For bonds, longer duration paper continue to trade heavy, led by Treasuries. We are also witnessing the absence of a typical flight-to-quality bid in the front end, where price action is driven by positioning ahead of tonight's \$44bn US 2y supply.

Ahead today: The October CBI distributive trades survey is forecast to show a small rise to +5 from +3 previously. US consumer confidence (Conference Board) could track Michigan confidence lower (against consensus call). The annual rate of decline in US house prices (Case-Shiller) is forecast to have slowed in August to 11.8% from 13.3% in July. The US Treasury sells \$44bn of 2y notes.

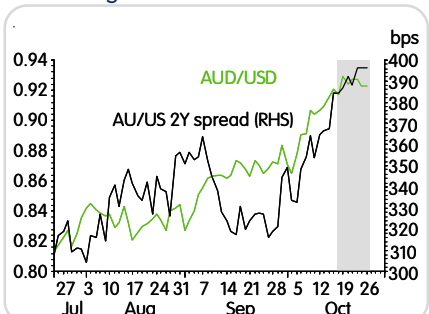
FX: Corporate demand, related to dividend flows, were credited for the resilience of GBP overnight, but we suspect that support will gradually fade as we approach the end of the month. We remain bullish on a one-week horizon for EUR/GBP and look for next week's MPC meeting to support our call for a move back up to 0.93. AUD/USD managed to stabilise above 0.92 overnight and we favour buying dips for a move back up to 0.93. The back up in US 10y yields to 3.55% is supportive of further gains in USD/JPY above 92.0, though we are mindful of possible profit taking if equities lose further ground.

Rates: UK 5y swaps were fairly rangebound overnight and have opened the session at 3.31%. Today should be a repeat of yesterday as rates drift in a 3.27%-3.34% range. US swaps are likely to dictate flows. The BoE will today purchase £1.4bn of 2036 to 2055 maturities.

US consumer expectations have been out of synch with employment for most of this year

Pullback in AUD/USD an opportunity to go long ahead of RBA next week

|                    | Close   | Daily Change % |
|--------------------|---------|----------------|
| <b>FX</b>          |         |                |
| EUR/GBP            | 0.9105  | -1.05%         |
| GBP/USD            | 1.6336  | 0.18%          |
| EUR/USD            | 1.4876  | -0.88%         |
| USD/JPY            | 92.190  | 0.14%          |
| AUD/USD            | 0.9162  | -0.68%         |
| <b>Bonds %</b>     |         | <b>bp</b>      |
| US 10Yr            | 3.554   | 6.4            |
| EUR 10Yr           | 3.354   | 0.6            |
| UK10 Yr            | 3.675   | -3.2           |
| UK 5yr Swap        | 3.316   | 1.9            |
| <b>Equities</b>    |         | <b>%</b>       |
| S&P500             | 1066.95 | -1.17%         |
| FTSE100            | 5191.74 | -0.97%         |
| Eurostoxx50        | 2834.82 | -1.78%         |
| Shanghai Composite | 3021.46 | -2.83%         |
| <b>Commodities</b> |         | <b>%</b>       |
| Crude Oil \$/bl    | 78.68   | -2.26%         |
| Gold \$/oz         | 1038.5  | -1.60%         |
| Copper             | 301.1   | -0.77%         |
| Baltic Dry         | 3044    | 0.03%          |
| <b>Other</b>       |         |                |
| VIX                | 24.31   | 9.16%          |
| iTraxx XOVER       | 500.47  | 1.6            |



### Today's Data

|  | Time  | Consensus | Previous | Events   |
|--|-------|-----------|----------|--|
| France Consumer Confidence, Nov        | 07:50 | -35       | -36      | ECB speakers: Stark (08:45)  |
| EU-16 M3, Sep                          | 09:00 | 2.2%      | 2.5%     | Bank of Canada speakers: Carney (15:00)  |
| UK CBI Distributive Trades Survey, Oct | 11:00 | +5        | +3       | US Treasury Secretary Geithner speaks (20:30)  |
| US House Prices, Case-Shiller, Sep     | 13:00 | -11.8%    | -13.3%   | BoE purchases £1.4bn gilts: UKT_4.25_070336, UKT_4.75_071238, UKT_4.25_070939, UKT_4.5_071242, UKT_4.25_071246, UKT_4.25_071249, UKT_4.25_071255 |
| US Consumer Confidence, Oct            | 14:00 | 53.5      | 53.1     | US Treasury sells \$44bn, 2y notes   |

- The bearish technical scenario for equities continues as the Asian stock indices take up the lead from Wall Street. The Shanghai composite index is currently 2.83% lower and rapidly approaching the 3,000 level (3,021) which has been pivotal to the market. The market is braced for a further easing of equities, although a short term rebound today is possible. FTSE futures' outperformance has been notable with support at 5,136 remaining intact compared with the break in DAX index futures of yesterday's trigger line at 5,714. A retest of 5,680/ 5,700 is possible, but the next target is 5,500 from here.
- Commodity currencies remain the favoured sell against the USD, although the AUD & NZD are putting up a decent fight against this. Cracks are appearing in the commodity markets, but so far the moves have been relatively minor. Copper has eased back below 300 c/lb, but softs continue to hold up and gold is still near it's peak (although looking somewhat tired). Crude oil keeps hitting a brick wall over \$81.00, which may encourage some further profit-taking and revitalise the dollar further (note that the CAD has been weak despite oil's recent strength). This should broadly pressure the EM currencies and weigh on the euro. A bounce back towards 1.4950 in EUR/USD is a chance to reverse euro longs and go short given that there is a possible topping pattern underway (head and shoulders - similar picture in EUR/GBP). The DXY index popped back over 76.00 (see chart below) and hasn't quite breached the downward trendline. I would be looking to use any indecision by the market as a chance to buy dollars. The outlook for cable is unclear. Sterling may benefit from the commodity currencies' retracement and hence cable could be sidelined for the moment. An oversold bounce is due, but this may come from another downward leg below 1.6300.
- Despite the market jitters, US bond yields continue to push higher and are showing little sign of reversing short term. Look for further curve steepening from a short term perspective as US 2y yields edge back towards 1.00%.

Chart of the day: DXY Index



Key Levels

|              | EUR    | GBP           | JPY   | EUR/GBP | GBP/EUR       |
|--------------|--------|---------------|-------|---------|---------------|
| <b>R2</b>    | 1.5287 | <b>1.7050</b> | 95.15 | 0.9520  | <b>1.1364</b> |
| <b>R1</b>    | 1.5063 | <b>1.6743</b> | 92.54 | 0.9306  | 1.1135        |
| Current Spot | 1.4908 | 1.6358        | 92.05 | 0.9114  | 1.0972        |
| <b>S1</b>    | 1.4845 | 1.6125        | 87.14 | 0.8981  | 1.0746        |
| <b>S2</b>    | 1.4407 | 1.5709        | 85.00 | 0.8800  | 1.0504        |

Spot prices as of: 07:34:46 Source: Bloomberg

|         | Spot   | Bias           | Entry                  | Target | Stop   | Comment/Levels  |
|---------|--------|----------------|------------------------|--------|--------|---|
| EUR/USD | 1.4908 | <i>Bearish</i> | <a href="#">1.4950</a> | 1.4700 | 1.5025 | Potential H&S reversal- Buy USD.  |
| USD/JPY | 92.05  | <i>Bullish</i> | 90.50                  | 94.00  | 91.35  | May pull back at 92.54, but bias is bullish.Stop raised.                  |
| USD/CHF | 1.0163 | <i>Bullish</i> | 1.0080                 | 1.0450 | 0.9975 | Buying USD.   |
| GBP/USD | 1.6358 | <i>Bullish</i> | <a href="#">1.6225</a> | 1.6750 | 1.6140 | May rebound further , but still looking for lower levels before entering. |
| EUR/GBP | 0.9114 | <i>Bearish</i> | 0.9180                 | 0.8800 | 0.9255 | H&S reversal. Sell euros .  |
| GBP/JPY | 150.58 | <i>Bullish</i> | <a href="#">149.50</a> | 153.27 | 148.70 | Entry raised  |
| EUR/JPY | 137.25 | <i>Bullish</i> | 136.90                 | 138.74 | 135.80 | Entry hit although the trade is less favoured.                            |
| CAD/JPY | 86.16  | <i>Bullish</i> | 87.20                  | 92.00  | 86.30  | Stop hit @ 86.30. Stand aside.  |
| AUD/USD | 0.9206 | <i>Bearish</i> | 0.9300                 | 0.9000 | 0.9300 | Reversal pattern unfolding. 0.9180 support breached. Stop lowered.        |
| USD/CAD | 1.0684 | <i>Bullish</i> | 1.0450                 | 1.0800 | 1.0340 | Reversing commodity currency trades.                                      |
| NZD/USD | 0.7505 | <i>Bearish</i> | 0.7585                 | 0.7200 | 0.7610 |   |
| USD/BRL | 1.7328 | <i>Bullish</i> | 1.7000                 | 1.7665 | 1.7000 | Decent USD bounce. 1.7665 key resistance. Stop to flat.                   |
| USD/PLN | 2.8157 | <i>Bullish</i> | <a href="#">2.8000</a> | 2.9500 | 2.7880 |   |
| USD/HUF | 179.90 | <i>Bullish</i> | 176.98                 | 182.00 | 174.30 |   |

Spot prices source: Bloomberg

[ENTRY](#) - Targeted

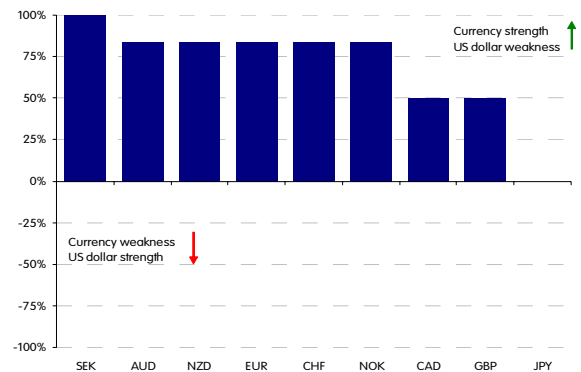
ENTRY - Active

## Quantitative Market Analysis

Table 1: 1-month correlations

|                      | AUDUSD | USDCAD | EURUSD | GBPUSD | USDJPY | EURJPY | AUDJPY |
|----------------------|--------|--------|--------|--------|--------|--------|--------|
| 2 YR SPD             | 0.94   | 0.91   | 0.75   | 0.75   | 0.60   | 0.81   | 0.98   |
| 10 YR SPD            | 0.69   | 0.64   | -0.47  | 0.27   | 0.65   | 0.67   | 0.94   |
| S&P500               | 0.87   | -0.80  | 0.86   | 0.59   | 0.41   | 0.69   | 0.81   |
| Gold                 | 0.90   | -0.91  | 0.83   | 0.48   | 0.24   | 0.58   | 0.77   |
| Oil                  | 0.93   | -0.62  | 0.92   | 0.87   | 0.75   | 0.92   | 0.96   |
| CRB                  | 0.97   | -0.68  | 0.96   | 0.86   | 0.71   | 0.92   | 0.98   |
| Relative Yield Curve | 0.91   | 0.85   | 0.77   | 0.19   | -0.38  | 0.47   | 0.86   |

Chart 1: Trend strength indicator



## 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  | 26-Oct-09 | 1.6292      |
| 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       |

| Trend Following Model Positions |        |           |             |
|---------------------------------|--------|-----------|-------------|
|                                 | Signal | Date      | Entry Level |
| USDCZK                          | long   | 21-Oct-09 | 17.260      |
| USDPLN                          | long   | 27-Oct-09 | 2.8254      |
| USDSGD                          | short  | 08-Sep-09 | 1.4337      |
| USDTRY                          | short  | 15-Sep-09 | 1.4939      |
| USDZAR                          | long   | 22-Oct-09 | 7.3665      |

## Market Summary

| FX                   |         |                | Equities            |         |                |
|----------------------|---------|----------------|---------------------|---------|----------------|
|                      | Close   | Daily Change % |                     | Close   | Daily Change % |
| EUR/USD              | 1.4876  | -0.88%         | S&P500              | 1066.95 | -1.17%         |
| USD/JPY              | 92.19   | 0.14%          | DJIA                | 9867.96 | -1.05%         |
| AUD/USD              | 0.9162  | -0.68%         | FTSE100             | 5191.74 | -0.97%         |
| EUR/GBP              | 0.9105  | -1.05%         | Eurostoxx50         | 2834.82 | -1.78%         |
| GBP/EUR              | 1.0982  | 1.07%          | Shanghai Composite* | 3021.46 | -2.83%         |
| GBP/USD              | 1.6336  | 0.18%          | *latest price       |         |                |
| GBP/JPY              | 150.59  | 0.32%          | Commodities         |         |                |
| GBP/CHF              | 1.6632  | 1.11%          |                     |         | %              |
| GBP/AUD              | 1.7832  | 0.88%          | Crude Oil \$/bl     | 78.68   | -2.26%         |
| GBP/CAD              | 1.7465  | 1.65%          | Gold \$/oz          | 1038.5  | -1.60%         |
| GBP/NZD              | 2.1849  | 1.10%          | Copper c/lb         | 301.1   | -0.77%         |
| GBP/NOK              | 9.1841  | 1.28%          | Silver \$/oz        | 17.08   | -3.45%         |
| GBP/ZAR              | 12.3982 | 1.89%          | Baltic Dry          | 3044    | 0.03%          |
| GBP/CNY              | 11.1539 | 0.18%          | Swaps %             |         |                |
| Bonds %              |         |                |                     |         | bp             |
|                      |         | bp             | US 5yr              | 2.868   | 5.8            |
| US 10Yr              | 3.554   | 6.4            | EUR 5yr             | 2.837   | 0.9            |
| EUR 10Yr             | 3.354   | 0.6            | UK 5yr              | 3.316   | 1.9            |
| UK10 Yr              | 3.675   | -3.2           | Official Rates %    |         |                |
| Other                |         |                |                     |         |                |
| VIX                  | 24.31   | 9.16%          | UK                  | 0.50    |                |
| iTraxx XOVER         | 500.47  | 1.6            | US                  | 0.25    |                |
| DJ Agriculture Index | 62.06   | 0.00%          | EU                  | 1.00    |                |
|                      |         |                | Japan               | 0.10    |                |

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