



Daily Market Strategy

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Market Strategy

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- Bernanke introduces volatility, but no displacement, to the USD
- Inflation focus to dominate today

Market Outlook

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Opening levels (7.15am)

£/\$: 1.6845, €/£: 1.4965, \$/¥: 89.99

UK 5y sw: 3.27%, US 5y sw: 2.48%, EU 5y sw: 2.72%

Federal Reserve Chairman Ben Bernanke's comments certainly introduced intra-day volatility to the USD even though the total absolute displacement is currently close to zero. On balance, the comments "will formulate policy to guard against risks to our dual mandate to foster both maximum employment and price stability" are not suggestive of any immediate change in policy. In this context, benign neglect for the currency, until it has an effect on inflation (and inflation expectations), is likely to occur. Hence, with interest rates likely to remain low for an extended period, downside risks for the USD still remain.

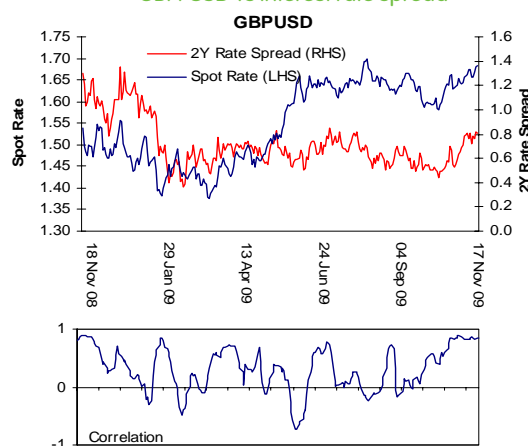
The break higher in the S&P500 (marking the first daily close above 1,100 since early October 2008), if sustained, is important. The continued upward trend, alongside a move higher in commodity prices and interest rate spreads (which are USD negative) would raise the risk of another leg lower in the USD, heading towards the 2008 low (in the USD DXY index this lies at 70.7, which is approx. 5.5% away).

The correlation between G-10 FX and interest rate spreads can be quite high – the charts overleaf plot the spread between 2-year interest rate swaps and the relevant spot rate. The charts show that for a number of currency pairs the correlation is close to one. In this context, today's inflation data (UK CPI and US PPI reports) are key. In both cases we look for a regular effect on the currency – i.e. a below market consensus outcome leading to a sell-off and vice-versa.

UK 5y swap rates have opened a touch lower this morning after yesterday's bullish flattening of the curve led to 5y rates dropping around 5bps. The 5yr (currently at 3.26%) is perched on its 50 day MA. The consensus (for the CPI report) ranges from 1.0% to 1.7% with the general view that last month's 1.1% marked the trough in the cycle. Should CPI come in at the lower end of expectations – and we think there is a chance of this given petrol prices were around 1% lower during October while the BRC shop price index was unchanged – sterling swap rates and gilt yields are likely to move lower. The 2y/10yr swap curve is slightly steeper this morning at 207bp.

Finally, the FX trend following model has not triggered any new positions this morning. The model's portfolio is 100% short USD against developed market currencies and only 20% short USD against the traded emerging market currencies. See table on page 2 for more details.

GBP/USD vs interest rate spread



	Close	Daily Change
FX		%
EUR/GBP	0.8901	-0.40%
GBP/USD	1.6818	0.85%
EUR/USD	1.4970	0.45%
USD/JPY	89.055	-0.67%
AUD/USD	0.9369	0.42%
Bonds %		bp
US 10Yr	3.334	-8.3
EUR 10Yr	3.323	-5.8
UK10 Yr	3.795	1.7
UK 5yr Swap	3.275	-3.8
Equities		%
S&P500	1109.30	1.45%
FTSE100	5382.67	1.63%
Eurostoxx50	2926.15	1.50%
Shanghai Composite	3282.89	0.24%
Commodities		%
Crude Oil \$/bl	78.90	3.34%
Gold \$/oz	1139.2	1.83%
Copper	312.9	4.30%
Baltic Dry	4220	2.65%
Other		
VIX	22.89	-2.01%
iTraxx XOVER	510.91	-7.8

Today's Data

UK CPI, Oct, y/y	09:30	1.4%	1.1%
UK RPI, Oct, y/y	09:30	-1.0%	-1.4%
EUR Trade Balance, Sep	10:00	n/a	1.0bn
US PPI, Oct, y/y	13:30	-1.8%	-4.8%
US Core PPI, Oct, y/y	13:30	1.4%	1.8%
US Net Long-term TIC flows, Sep, \$bn	14:00	30.0bn	28.6bn
US Industrial Production, Oct	14:15	0.4%	0.7%
US Capacity Utilization, Oct	14:15	70.8%	70.5%

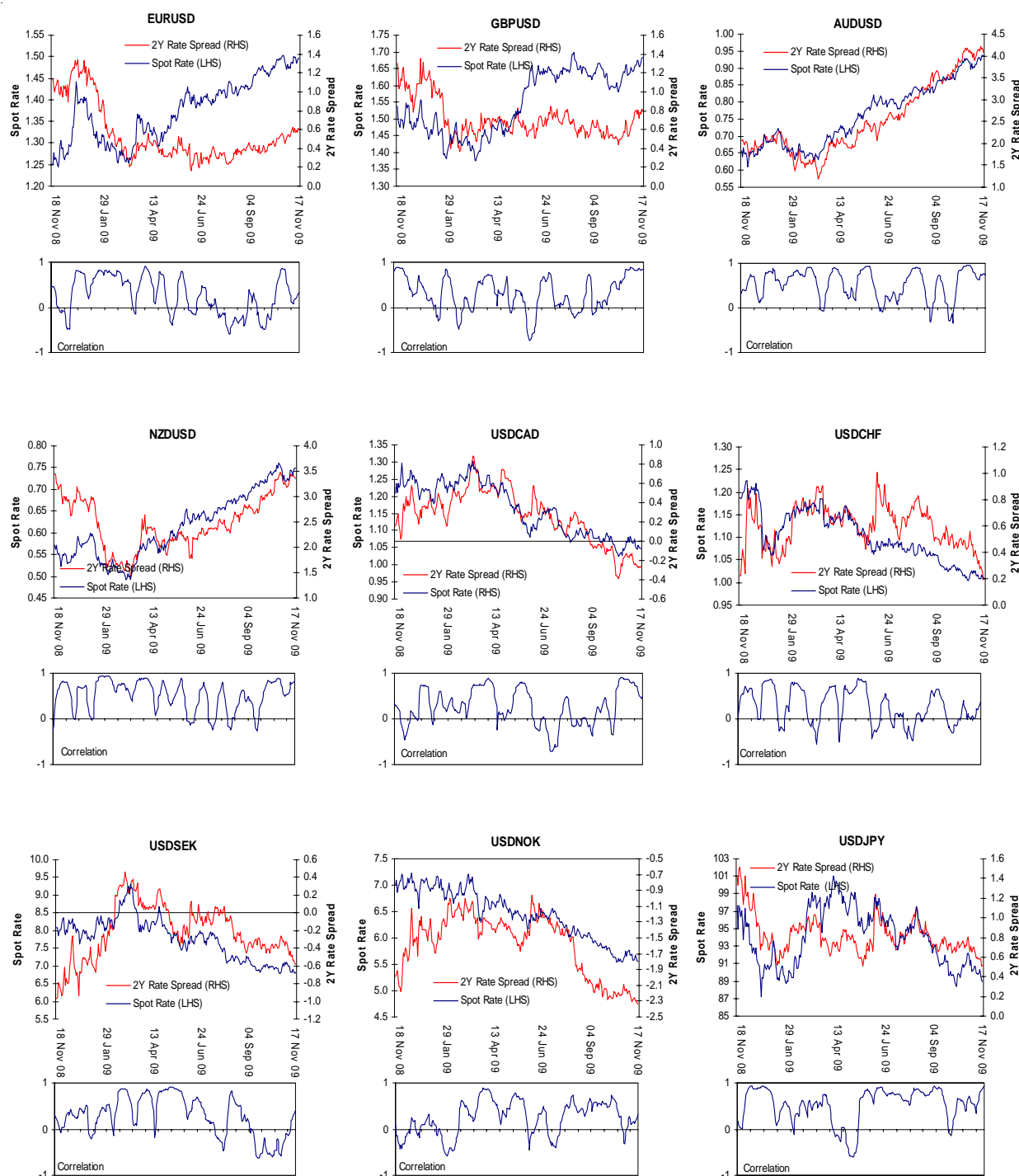
Time	Consensus	Previous
09:30	1.4%	1.1%
09:30	-1.0%	-1.4%
10:00	n/a	1.0bn
13:30	-1.8%	-4.8%
13:30	1.4%	1.8%
14:00	30.0bn	28.6bn
14:15	0.4%	0.7%
14:15	70.8%	70.5%

Events

ECB speakers: Stark (14:30), Tumpel-Gugerell (16:00), Trichet (17:00)
Fed speakers: Yellen (10:30), Lacker (15:15), Pianalto (17:30)



2yr Interest Rate Spreads vs Spot Rate - 1-m correlations



Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	long	16-Nov-09	0.9330
NZDUSD	long	16-Nov-09	0.7389
EURUSD	long	09-Sep-09	1.4480
GBPUSD	long	30-Oct-09	1.6547
USDCHF	short	17-Jul-09	1.0730
USDCAD	short	11-Nov-09	1.0495
USDSEK	short	06-Nov-09	6.9900
USDNOK	short	16-Nov-09	5.6091
USDJPY	short	02-Nov-09	90.10
Net-USD portfolio position			-100%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	06-Nov-09	17.375
USDPLN	short	05-Nov-09	2.8609
USDSGD	short	10-Nov-09	1.3863
USDTRY	long	11-Nov-09	1.4769
USDZAR	long	12-Nov-09	7.3638
Net-USD portfolio position			-20%



Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4970	0.45%	S&P500	1109.30	1.45%
USD/JPY	89.05	-0.67%	DJIA	10406.96	1.33%
AUD/USD	0.9369	0.42%	FTSE100	5382.67	1.63%
EUR/GBP	0.8901	-0.40%	Eurostoxx50	2926.15	1.50%
GBP/EUR	1.1235	0.40%	Shanghai Composite*	3282.89	0.24%
GBP/USD	1.6818	0.85%	*latest price		
GBP/JPY	149.77	0.20%	Commodities		
GBP/CHF	1.6947	0.38%			%
GBP/AUD	1.7951	0.45%	Crude Oil \$/bl	78.90	3.34%
GBP/CAD	1.7617	0.45%	Gold \$/oz	1139.2	1.83%
GBP/NZD	2.2476	0.21%	Copper c/lb	312.9	4.30%
GBP/NOK	9.3471	-0.13%	Silver \$/oz	18.39	5.45%
GBP/ZAR	12.3656	-0.05%	Baltic Dry	4220	2.65%
GBP/CNY	11.4808	0.85%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.334	-8.3	US 5yr	2.480	-9.2
EUR 10Yr	3.323	-5.8	EUR 5yr	2.718	-6.0
UK10 Yr	3.795	1.7	UK 5yr	3.275	-3.8
Other			Official Rates %		
VIX	22.89	-2.01%	UK	0.50	
iTraxx XOVER	510.91	-7.8	US	0.25	
DJ Agriculture Index	64.12	2.85%	EU	1.00	
			Japan	0.10	

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