

Daily Market Strategy

Thursday, 10th September 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

- BoE to stand pat on rates and QE; what about 'excess' reserves?
- FTSE-100 above 5,000, long dated yields break higher

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6553, €/\$: 1.4582, \$/Y: 92.13

UK 5y sw: 3.37%, US 5y sw: 2.75%, EU 5y sw: 2.76%

Overnight

- US 10y note auction covered 2.58 times; indirects take 55.3%; strong
- Fed Beige Book says economic activity stabilising; reports flat retail sales, improvement in residential property, weak loan demand and soft labour market
- Japan July machinery orders plunge 9.3% m/m, 34.8% y/y; below f/cast
- Australia employment falls 27.1K; below f/cast
- RBNZ keeps Cash Rate Target unchanged at 2.50%
- 'Jump in gold is tied to Barrick de-hedging' (WSJ)

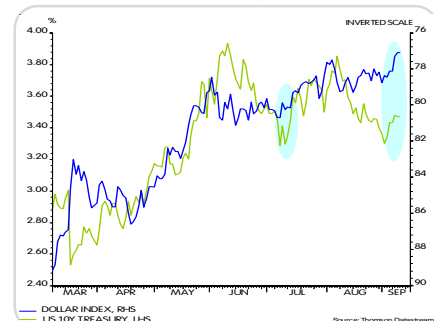
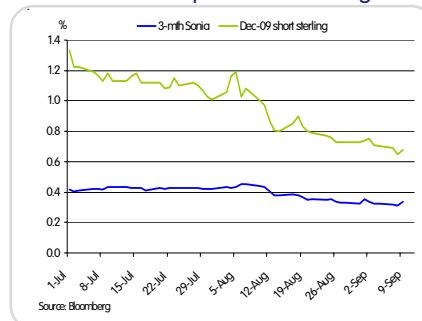
Markets are toying with the idea that the BoE could announce new measures today to bolster bank lending, although a back-up in short dated gilt yields (2y/10y curve unchanged at 279bps) suggests some dealers may have abandoned the idea (regardless of former MPC member's Blanchflower assertion that he expects more QE). We think such a rise in QE today would come too soon (front-end sell-off?) barely one month after the increase to £175bn, even though Governor King alongside Tim Besley and David Miles preferred a bigger increase. However, considering the MPC's rather low predictability rate compared to its G7 peers, you just never know. The proverbial 'rabbit out of the hat' (bond bullish/GBP negative) could be a decision by the Bank to penalise commercial bank 'excess reserves' (the targeting of these was suspended with the introduction of QE in March). Separately, we also expect the Bank of Canada to keep the overnight rate steady at 0.25% (CAD negative), although positive August employment/housing/PMI data could make the Bank think of publishing a more hawkish press statement (CAD positive).

FX: Broad-based USD weakness persisted overnight in Asia - dollar index below 77.0 - and helped the SEK to cement its position as strongest G10 currency of the week. Swedish August CPI is out at 8.30 (f/cast headline +0.1%), but may be overshadowed by the next move in equities on confidence that Swedish banks can cope with losses in the Baltics (Nyberg). We look for GBP/USD to extend towards 1.66 if the BoE makes no statement.

Rates: UK 5y swaps opened at 3.37%, taking cue from the back-up in gilt and Treasury yields. Resistance comes in at 3.39%. Rotation into equities, a concession in prices/higher yields ahead of the US 30y auction and net short positioning could see 10y gilts extend to 3.80%.

Dec-09 short sterling has rallied 51bps since the BoE expanded QE in August

Will USD weakness cause 10y yields to back-up?



	Close	Daily Change
FX		%
EUR/GBP	0.8801	0.21%
GBP/USD	1.6548	0.35%
EUR/USD	1.4557	0.54%
USD/JPY	92.041	-0.31%
AUD/USD	0.8624	0.09%
Bonds %		bp
US 10Yr	3.471	-1.1
EUR 10Yr	3.362	8.8
UK10 Yr	3.675	4.0
UK 5yr Swap	3.381	8.2
Equities		%
S&P500	1033.37	0.78%
FTSE100	5004.30	1.15%
Eurostoxx50	2820.58	1.23%
Shanghai Composite	2938.16	-0.27%
Commodities		%
Crude Oil \$/bbl	71.31	0.30%
Gold \$/oz	992.3	-0.31%
Copper	292.4	-1.08%
Baltic Dry	2491	1.18%
Other		%
VIX	24.32	-5.07%
iTraxx XOVER	586.32	-16.0

Today's Events

BoE MPC Rate Decision
French Industrial Output, Jul
French Trade Balance, Jul
US Trade Balance, Jul
US Weekly Claims, 5-Sep
Japan Machinery Orders, Jul
Australia Employment Change, Aug
Bank of Canada Rate Decision
US Treasury sells \$12bn, 30y notes
ECB speakers: Mersch (08:00), Liikanen (10:00), Nowotny (16:30)
Fed speakers: Lockhart (17:30), Kohn (17:30)
US Weekly Oil Inventories (16:00)

Time	Consensus	Previous
12:00	0.50%	0.50%
07:45	+0.4%	+0.3%
07:45	-€4.0bn	-€4.0bn
13:30	-\$27.3bn	-\$27.0bn
13:30	552K	570K
00:05	-9.3%A	+9.7%
02:30	-27.1KA	+32.2K
14:00	0.25%	0.25%

- The FTSE hit 5,000, in line with the bullish view on equities, with individual cyclical UK stocks continuing to look positive. Whilst 5,000 is a psychological resistance point, it is also a key barrier from a price action perspective. 5,338 resistance is the next objective. DAX index futures have breached key resistance at 5578, but continue to lag the FTSE as euro strength weighs. Prospects of a squeeze back over 3,000 in the Shanghai composite are adding to the positive mood, but this barrier has to be cleared soon. The S&P cash trend remains positive. 1,106 is the next main target once the year's high at 1,038 is cleared.
- Dollar weakness remains the core technical strategy. EM and commodity currencies remain favoured. AUD & NZD have consolidated over the past few sessions, but a continued squeeze should develop. ZAR strength is in line with this strategy - volatility is prohibitive, but target is at 7.20. Cable holds below key resistance at 1.6620, but a push upwards should be close. EUR/USD target remains at 1.4720.
- Core bond yields finally reacted to the upside with US 10y yields pushing back over a pivotal level at 3.50% with 3.75% the next objective. A general steepening of core yield curves looks set to unfold as momentum swings against bonds. UK 2y yields should push back over 1.00% soon with 10 year yields hitting targets at 3.75%. UK 5y swaps have pushed up from the 200 day m.a. (currently 3.2879%) having failed to register a close below this line. Big resistance at 3.40% awaits. Technical targets are back up at 3.50%.
- Gold price action is going to worry the bulls here as the metal has a tendency not to close over \$1,000 on a weekly basis. However the price action is still viewed as a consolidation before the next leg up and is allowing crude oil to play catch up. Cocoa futures cracked key resistance at \$3,000 and copper is still hovering below 300 c/lb - a breakout is still expected. Rice is set for a breakout.

Chart of the day: UK 10y yields



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4865	1.7044	95.15	0.8910	1.1905
R1	1.4720	1.6626	93.41	0.8845	1.1819
Current Spot	1.4577	1.6546	92.16	0.8811	1.1349
S1	1.4330	1.6113	91.61	0.8461	1.1306
S2	1.4177	1.5975	87.14	0.8400	1.1223

Spot prices as of: 07:10:02 Source: Bloomberg

UK 10 year yields surge and hit short term technical targets at 3.75%. Extended objectives and key resistance is at 4.00%

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4577	Bullish	1.4350	1.4720	1.4385	Stop raised.
USD/JPY	92.16	Bullish	92.60	97.80	91.35	
USD/CHF	1.0395	Bearish	-	1.0300	-	
GBP/USD	1.6546	Bullish	1.6480	1.7000	1.6290	Breakout expected through 1.6626 resistance.
EUR/GBP	0.8811	Bearish	0.8835	0.8400	0.8835	
GBP/JPY	152.48	Bullish	151.50	156.00	149.75	Stop moved to flat.- Small inverse h&S means add to long here.
EUR/JPY	134.33	Bullish	133.60	139.14	132.40	
CAD/JPY	85.50	Bullish	85.60	90.35	83.95	
AUD/USD	0.8607	Bullish	0.8305	0.9000	0.8530	
USD/CAD	1.07786	Bearish	1.0800	1.0000	1.0920	
NZD/USD	0.6982	Bullish	0.6860	0.7447	0.6860	Stop raised to flat
USD/BRL	1.8338	Bearish	current	1.8000	1.8455	Entry lowered.
USD/PLN	2.8243	Bearish	2.8638	2.7000	2.8555	Stop lowered.
USD/HUF	186.19	Bearish	188.00	180.00	188.00	183.32 is a big level- bias for a break.

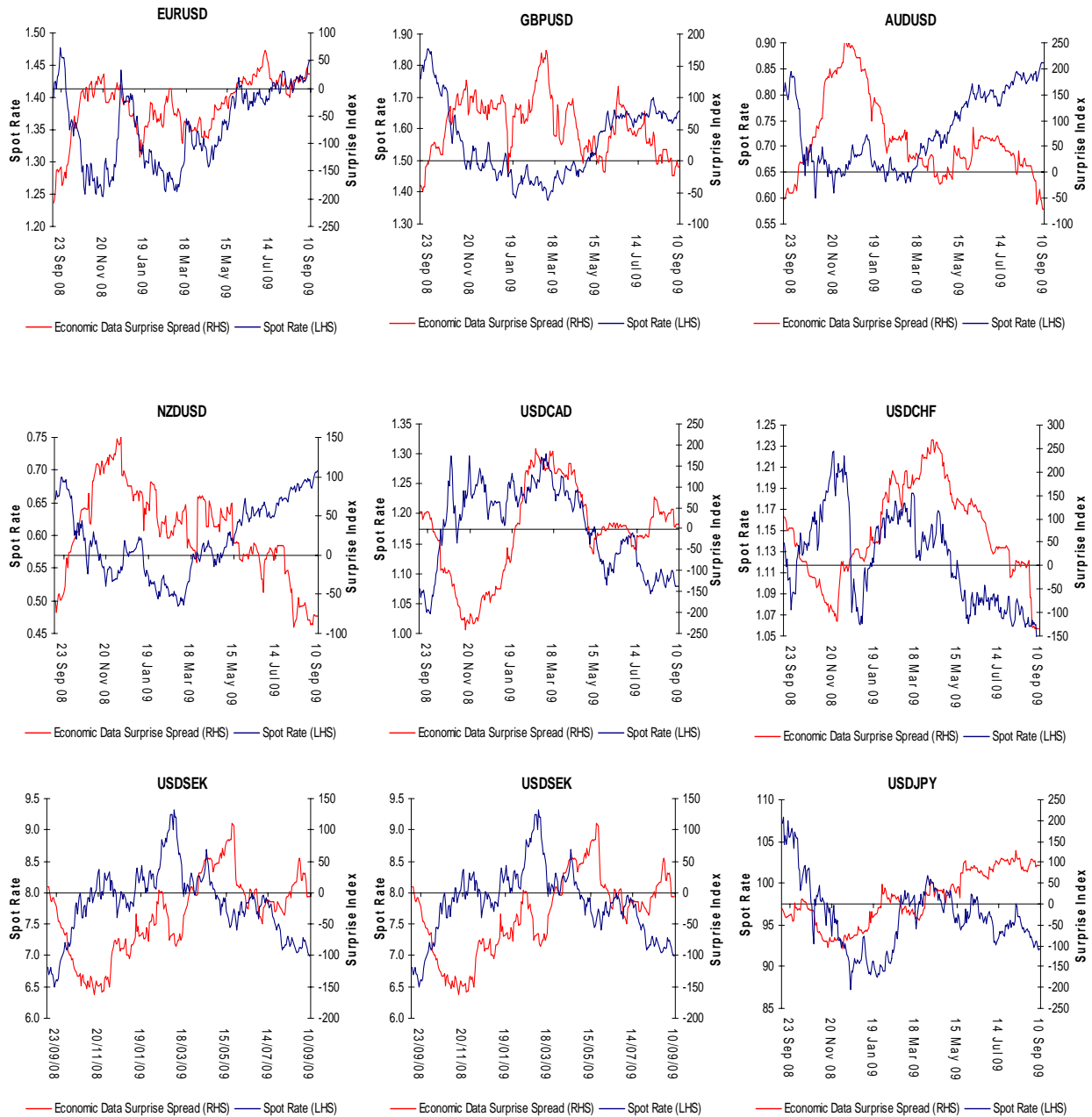
Spot prices source: Bloomberg

ENTRY - Targetted

ENTRY - Active

Quantitative Market Analysis

Economic Data Surprise Spreads vs Spot Rates



Source: Bloomberg, Citigroup

Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	short	17-Aug-09	0.8327
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	09-Sep-09	1.448
GBPUSD	long	09-Sep-09	1.6490
USDCHF	short	17-Jul-09	1.0730
USDCAD	short	08-Sep-09	1.0780
USDSEK	short	09-Sep-09	7.0444
USDNOK	short	21-Jul-09	6.3025
USDJPY	short	20-Aug-09	94.07

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	short	09-Sep-09	2.8278
USDSGD	short	08-Sep-09	1.4337
USDTRY	long	27-Aug-09	1.5093
USDZAR	short	31-Aug-09	7.7525

Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4557	0.54%	S&P500	1033.37	0.78%
USD/JPY	92.041	-0.31%	DJIA	9547.22	0.53%
AUD/USD	0.8624	0.09%	FTSE100	5004.30	1.15%
EUR/GBP	0.8801	0.21%	Eurostoxx50	2820.58	1.23%
GBP/EUR	1.1366	-0.18%	Shanghai Composite*	2938.20	-0.27%
GBP/USD	1.6548	0.35%	*latest price		
GBP/JPY	152.31	0.04%	Commodities		
GBP/CHF	1.723	-0.24%	Crude Oil \$/bl	71.31	0.30%
GBP/AUD	1.919	0.26%	Gold \$/oz	992.3	-0.31%
GBP/CAD	1.785	0.31%	Copper c/lb	292.4	-1.08%
GBP/NZD	2.378	0.37%	Silver \$/oz	16.31	-0.73%
GBP/NOK	9.758	-0.21%	Baltic Dry	2491	1.18%
GBP/ZAR	12.479	0.67%	Swaps %		
GBP/CNY	11.302	0.38%	US 5yr	2.733	-4.0
Bonds %			EUR 5yr	2.774	6.9
		bp	UK 5yr	3.381	8.2
US 10Yr	3.471	-1.1	Official Rates %		
EUR 10Yr	3.362	8.8	UK	0.50	
UK10 Yr	3.675	4.0	US	0.25	
Other			EU	1.00	
VIX	24.32	-5.07%	Japan	0.10	
iTraxx XOVER	586.32	-16.0			
DJ Agriculture Index	56.51	-0.16%			

This document has been prepared for information purposes only and is based on information believed to be reliable. This information is provided as a courtesy to you and does not create an obligation for Bank of Scotland Treasury ("BoS Treasury") or another Group company within Lloyds Banking Group to notify you of any changes to this data or to do so in the future. Changes in rates of exchange or rates of interest may have an adverse effect on the value or price of these investments. Spot and forward foreign exchange transactions generally are not 'designated investments' as defined in the UK Financial Services & Markets Act 2000 ("the Act") and therefore do not benefit from any of the protections contained either in the Act or in the rules of the FSA. Past performance is not necessarily a guide to future performance. This document has been written with market professionals in mind and recipients should seek guidance and advice from a suitably qualified professional if they find anything contained herein confusing or unclear. The distribution of this document in other jurisdictions may be restricted by local laws and recipients into whose possession this document comes should inform themselves about, and observe any such restrictions. This information has been provided for the use of the recipient only and must be treated as proprietary and confidential information. It may not be passed on or reproduced in whole or part under any circumstances without express written consent from BoS Treasury. Although the information contained herein is believed to be correct, Lloyds Banking Group does not guarantee its reliability or its accuracy. Opinions expressed are subject to change without notice, as are prices and availability, which are indicative only. In preparing this publication we have not considered your objectives, financial situation or needs. Appropriate independent advice should be obtained before making any such decision. Lloyds Banking Group specifically disclaims liability for any loss, claim or damage suffered by you or any third party resulting directly or indirectly from any use you may make from this data without limitation. Provision of this information does not constitute either a bid or offer to undertake any transaction or commitment by any Lloyds Banking Group company to make such an offer. Lloyds Banking Group or its employees may own or build positions or trade in such securities and derivatives and may also sell them whenever considered appropriate. Lloyds Banking Group may also provide banking or other advisory services to any company mentioned herein.

Bank of Scotland Treasury is a division of Bank of Scotland plc which is part of Lloyds Banking Group. Registered Office: The Mound Edinburgh EH1 1YZ. Registered in Scotland. Registered No SC 327000. Authorised and regulated by The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS. Australian residents please note: In Australia, Bank of Scotland plc is registered as a foreign company, Australian Registered Body Number 126 955 557. The liability of its members is limited.