

Daily Market Strategy

Wednesday, 7th October 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

- Gold prints new high above \$1,040
- Alcoa to report Q3 earnings

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5886, €/\$: 1.4724, \$/¥: 88.56

UK 5y sw: 3.11%, US 5y sw: 2.62%, EU 5y sw: 2.68%

Overnight

- UK Sep consumer confidence highest since Apr-09 (Nationwide)
- Decent US 3y auction: bid/cover 2.76; strong direct bidding, indirects take 49.1%
- Latvia loan plans could hit Nordic bank sector (FT)
- 'Sterling looks ready to join the sick list' (WSJ)

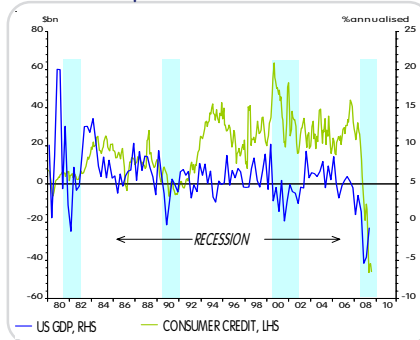
Familiar trading themes were observed overnight, with rising commodity prices and gains in Asian equities adding selling pressure on the USD through carry trades. Government bonds were generally flat following a decent US 3y auction. The RBA rate hike continues to cause some ripples but primarily appears to have instilled confidence about the rosier prospects for growth and investor returns in some pockets of the developed global economy. This morning's WSJ story that sterling is ready to join the 'sick list' does not overstate the headwinds facing the currency. We remember the day in March when the BoE's decision to embark on QE triggered the start of a sterling rally under the premise that QE would lead the UK out of recession. It seems more complicated than that. The NIESR yesterday reported that GDP was flat in the three months to September, whilst August industrial output fell at the fastest rate since the depths of the recession in January. Seven months on and with the positive correlation with equities having completely broken down and markets betting that the Bank may expand QE again in November, it is difficult to see where the rebound in sterling will come from.

Ahead today: Alcoa will be the first Dow component to report Q3 earnings (after NY close). Equity markets have factored in a fair amount of better corporate news so an earnings 'miss' or less upbeat revenue guidance for Q4 could trigger profit taking in the major indices. German factory orders are forecast to have jumped 1.2% in September.

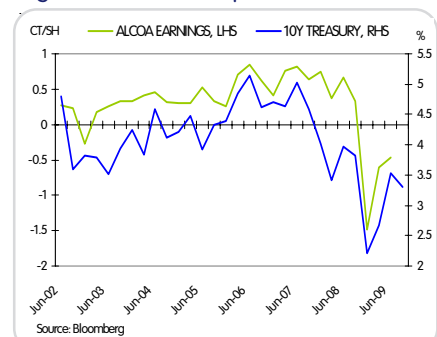
FX: AUD/USD marched towards 0.90 overnight, hitting a 0.8929 high. GBP/AUD touched a 1.7786 low. We have lowered our medium-term target range to 1.71-1.72. Ahead of the ECB tomorrow, we look for profit taking to drag EUR/USD lower towards 1.4641 support. USD/CAD approaches key support at 1.0550. Verbal intervention by the BoC looms.

Rates: We look for a rangebound session in rates. UK 5y swaps opened at 3.11%. The 2y/10y swaps curve is steady at 200bps. The DMO auctions £0.75bn of IL 2042 gilts and the US Treasury will sell \$20bn in 10y notes. 10y yields are down 21bps since the Sep 9 auction.

The current contraction in US consumer credit is unprecedented since the 1980s



Alcoa earnings vs US 10y yields. Aluminium giant is forecast to report a Q3 8ct loss/sh



	Close	Daily Change %
FX		
EUR/GBP	0.9248	0.59%
GBP/USD	1.5922	-0.08%
EUR/USD	1.4723	0.51%
USD/JPY	88.825	-0.79%
AUD/USD	0.8902	1.41%
Bonds %		
US 10Yr	3.255	3.5
EUR 10Yr	3.158	3.4
UK 10 Yr	3.401	-3.8
UK 5yr Swap	3.101	0.3
Equities		
S&P500	1054.72	1.37%
FTSE100	5137.98	2.26%
Eurostoxx50	2865.70	2.68%
Shanghai Composite	2779.43	0.00%
Commodities		
Crude Oil \$/bl	70.88	0.67%
Gold \$/oz	1042.1	2.44%
Copper	278.5	2.11%
Baltic Dry	2441	3.34%
Other		
VIX	25.70	-4.25%
iTraxx XOVER	565.99	-21.7

Today's Events

Event	Time	Consensus	Previous
UK Nationwide Consumer Confidence, Sep	00:01	71A	63
UK BRC Shop Price Index, Sep, y/y	00:01	-0.1%	-0.1%
Japan Leading Index, Aug	06:00	83.3A	82.5
EU-16 GDP, Q2 final, q/q	09:00	-0.1%	-0.1%
German Factory Orders, Sep	11:00	+1.1%	+3.5%
US MBA Mortgage Applications, Oct-2	12:00	n/a	-2.8%
US Consumer Credit, Aug	20:00	\$10.0bn	-\$21.6bn
BoE purchases £1.4bn of gilts: UKT_8_270913, UKT_2_25_070314, UKT_4_75_070915, UKT_8_071215			
UKT_4_070916, UKT_8_75_250817, UKT_5_070318, UKT_4_5_070319, UKT_3_75_070919			
DMO auctions £0.75bn, 0.625%, 2042 gilts			
US Treasury sells \$20bn, 10y notes			
Fed speakers: Hoenig (02:45)			
US Weekly Oil Inventories (15:30)			

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- 'Risk-on' has been enjoying a rebound in the last few sessions with commodities (particularly gold in case you hadn't noticed!) squeezing back upwards. There is a sense of caution in the markets' new found optimism. The year's highs for equities remain a key barrier to breach before the market will relax about the prospect for further gains. Dec. FTSE futures resistance at 5,169 is still assumed to be the high, but naturally a break of this key level effectively ends the corrective view. The year's high for S&P cash at 1,080 is still key resistance, but this week should see whether there is anything more than a last gasp to this current bout of equity strength.
- Given the short term back-drop, the dollar look set for further pressure against the yen, euro and swiss franc. Whilst the Nikkei starts to underperform, a move to the key January low at 87.15 looks set to unfold with the risk this could turn into a more dramatic fall. Naturally, the commodity currencies have bounced once again, although oil's reluctance to join the party is noted, together with a consolidation (read lack of upside) in base metals. The 'sell du jour' seems to be sterling once again and technically I have been mulling over a revisit to parity for the euro/GBP, but the contrarian side of me thinks this could be too obvious. However, the strategy is to sell sterling until the technicals say otherwise - albeit cautiously. A break of 1.5820 in cable would complete a continuation pattern for 1.55 with GBP/JPY eyeing key support at 140.00. A break targets 139.03 and then 135.76.

Chart of the day: Gold- weekly bar chart



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4865	1.6300	95.15	0.9482	1.1135
R1	1.4764	1.611	91.80	0.9300	1.1018
Current Spot	1.4714	1.5874	88.54	0.9269	1.0789
S1	1.4450	1.5724	87.14	0.9076	1.0753
S2	1.4407	1.5455	85.00	0.8981	1.0546

Spot prices as of: 07:11:10 Source: Bloomberg

Golden shot - the yellow metal finally breaks through the nominal resistance high at \$1,032. A squeeze to \$1,080 is expected.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4714	<i>Bearish</i>	1.4650	1.4844	1.4595	
USD/JPY	88.54	<i>Bearish</i>	current	85.00	89.20	
USD/CHF	1.0281	<i>Bearish</i>	1.0360	1.0000	1.0426	
GBP/USD	1.5874	<i>Bearish</i>	1.5965	1.5500	1.6020	
EUR/GBP	0.9269	<i>Bullish</i>	0.9225	0.9400	0.9190	
GBP/JPY	140.56	<i>Bearish</i>	142.00	143.10	137.71	Stop hit.
EUR/JPY	130.29	<i>Neutral</i>	-	133.00	-	
CAD/JPY	83.67	<i>Neutral</i>	-	-	-	
AUD/USD	0.8910	<i>Bullish</i>	0.8888	0.9000	0.8845	
USD/CAD	1.0582	<i>Bearish</i>	1.0650	1.0000	1.0715	
NZD/USD	0.7351	<i>Bullish</i>	0.7290	0.7468	0.7225	
USD/BRL	1.7596	<i>Bearish</i>	1.8338	1.7000	1.8025	Cautious as USD starts to rebound.
USD/PLN	2.8433	<i>Bearish</i>	2.8721	2.6000	2.8840	
USD/HUF	181.31	<i>Bearish</i>	182.09	165.00	183.10	

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The Australian dollar has been the clear out-performer over the past 24-hours. This isn't surprising given that the Reserve Bank of Australia has become the first G-10 central bank to begin moving interest rates away from current extreme accommodative levels. Interestingly, Australia-US interest rate spreads have not moved significantly since the rate decision and as such we begin to look for some short-term consolidation in AUD/USD – the currency pair should find resistance around A\$0.8950.

The Latvian government is proposing to limit the amount lenders can collect from mortgage holders. This move would make it easier for Latvia to devalue its currency and protect mortgage (and other loan) holders whose loans are denominated in foreign currency. The net effect would be to potentially trigger losses for foreign banks that have lent money in Latvia. As such this issue should be monitored over the coming period as this is a major potential negative factor for the Swedish krona.

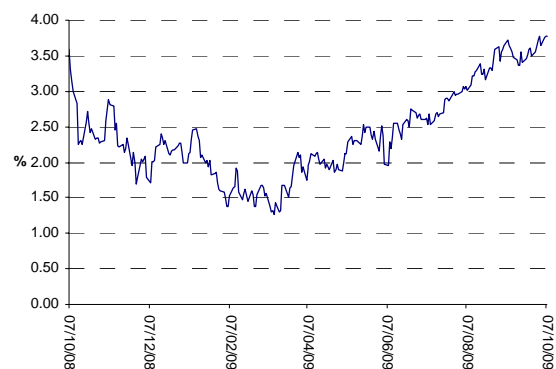
The economic calendar is relatively light today (German factory orders are the major highlight) following the latest round of leading indicators. This should allow some consolidation in the USD DXY index, which is now close to the 2009 low recorded last month.

The trend following model continues to hold a broadly short USD position. The model is fully short against emerging market currencies. In developed market currencies, the model has initiated a short USD position against the Canadian dollar this morning. The model now holds a portfolio which is 78% short USD.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY
2 YR SPD	0.31	0.34	0.29	0.42	0.28	0.25
10 YR SPD	0.24	-0.16	0.52	0.10	0.75	0.78
S&P500	0.48	-0.41	0.82	-0.02	-0.26	0.35
Gold	0.63	-0.87	0.59	0.05	-0.30	0.11
Oil	0.24	-0.79	0.26	0.44	0.09	0.31
CRB	0.62	-0.82	0.72	0.09	-0.28	0.25

Chart 1: AU-US interest rate spread yet to track break higher in AUD/USD



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	21-Sep-09	1.6270
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	06-Oct-09	2.868
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

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.4723	0.51%	S&P500	1054.72	1.37%
USD/JPY	88.825	-0.79%	DJIA	9731.25	1.37%
AUD/USD	0.8902	1.41%	FTSE100	5137.98	2.26%
EUR/GBP	0.9248	0.59%	Eurostoxx50	2865.70	2.68%
GBP/EUR	1.0814	-0.59%	Shanghai Composite*	2779.43	0.00%
GBP/USD	1.5922	-0.08%	*latest price		
GBP/JPY	141.43	-0.89%	Commodities		
GBP/CHF	1.635	-0.60%			%
GBP/AUD	1.788	-1.45%	Crude Oil \$/bl	70.88	0.67%
GBP/CAD	1.687	-1.06%	Gold \$/oz	1042.1	2.44%
GBP/NZD	2.168	-0.61%	Copper c/lb	278.5	2.11%
GBP/NOK	9.060	-0.83%	Silver \$/oz	17.36	4.33%
GBP/ZAR	11.829	-0.70%	Baltic Dry	2441	3.34%
GBP/CNY	10.867	-0.10%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.255	3.5	US 5yr	2.619	3.8
EUR 10Yr	3.158	3.4	EUR 5yr	2.675	1.0
UK10 Yr	3.401	-3.8	UK 5yr	3.101	0.3
Other			Official Rates %		
VIX	25.70	-4.25%	UK	0.50	
iTraxx XOVER	565.99	-21.7	US	0.25	
DJ Agriculture Index	58.88	2.40%	EU	1.00	
			Japan	0.10	

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