

# Daily Market Strategy

Thursday, 8th 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

- Equities set to extend gains on US earnings
- BoE to stand pat; ECB may comment on FX, one-year tender

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5987, €/\$: 1.4754, \$/Y: 88.32

UK 5y sw: 3.07%, US 5y sw: 2.55%, EU 5y sw: 2.67%

#### Overnight

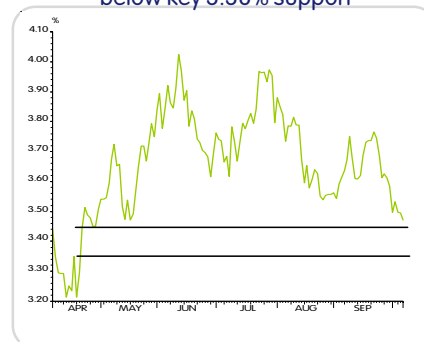
- US 10y auction: bid/cover 3.01, indirect bidders take 47.4%
- Australian employment jumps 40.6K in Sep, jobless rate falls
- Japanese investment flows positive in latest week, net inflows in stocks/bonds

Australian government bonds were crushed overnight and AUD/USD soared above 0.90 (GBP/AUD below 1.78) following good US earnings and the report of the biggest jump in Australian employment in nearly two years (+40.6K in Sep). This vindicates the RBA's rate hike to 3.25% and makes a follow-up move before year-end extremely likely. The dollar traded heavy in Asia with the USD index fast approaching 76.0. Gold is bid above \$1,050. Still ahead today, we are not buying into speculation that ECB president Trichet will try to talk down the EUR. The USD could find some reprieve if Trichet elaborates on G7 discussions of last weekend. On the other hand, USD supportive comments have not quite registered in currency markets where USD rallies are still viewed as opportunities to sell. Unless a coordinated response is put in place or a shift in fed funds policy becomes more realistic, the market will remain inclined to short the USD. Trichet's analysis of last week's one-year tender (€75.2bn) should prove insightful and may offer some indication about a possible change to the December procedure. Those looking for a policy change by the BoE risk being disappointed and we expect the MPC to put out exactly the same statement as last month, stating that it plans to complete the £175bn asset purchase programme whilst keeping the scale under review. German industrial output is expected to show a 1.6% rise in August. The US Treasury will complete this week's auction schedule with the sale of \$12bn in 30y bonds.

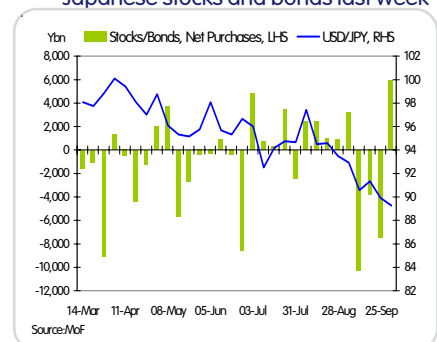
**FX:** The break of 0.90 in AUD/USD could spur fresh buying and favours a move up to 0.9250 - our next target. GBP/AUD fell overnight to 1.7700 - a new low. The ECB faces an uphill task in slowing the ascent of EUR/USD, where a rally up to the September 23 high of 1.4844 now looks inevitable as dealers trim USD holdings on higher risk appetite and rising gold/platinum prices. EUR/GBP is steady at 0.9220. Support runs at 0.9184.

**Rates:** Corporate GBP supply is quiet vs USD and EUR issuance despite the favourable rate environment and tight spreads. 10y gilt yields dropped to 3.37% and may target a breakout to 3.32%, followed by 3.20%. UK PPI data tomorrow (and CPI next week) are key to this bullish scenario. The US Treasury will tap the market for \$12bn in 30y bonds. We look for 2y/10y spread to re-flatten into next week, support at 230bps.

UK 10y yields on the verge of breakout below key 3.38% support



Foreign investors were strong buyers of Japanese stocks and bonds last week



|                    | Close   | Daily Change % |
|--------------------|---------|----------------|
| <b>FX</b>          |         |                |
| EUR/GBP            | 0.9201  | -0.50%         |
| GBP/USD            | 1.5969  | 0.30%          |
| EUR/USD            | 1.4692  | -0.21%         |
| USD/JPY            | 88.610  | -0.24%         |
| AUD/USD            | 0.8912  | 0.11%          |
| <b>Bonds %</b>     |         | <b>bp</b>      |
| US 10Yr            | 3.182   | -7.3           |
| EUR 10Yr           | 3.118   | -4.0           |
| UK10 Yr            | 3.405   | 0.4            |
| UK 5yr Swap        | 3.070   | -3.1           |
| <b>Equities</b>    |         | <b>%</b>       |
| S&P500             | 1057.58 | 0.27%          |
| FTSE100            | 5108.90 | -0.57%         |
| Eurostoxx50        | 2852.17 | -0.47%         |
| Shanghai Composite | 2779.43 | 0.00%          |
| <b>Commodities</b> |         | <b>%</b>       |
| Crude Oil \$/bl    | 69.57   | -1.85%         |
| Gold \$/oz         | 1044.2  | 0.20%          |
| Copper             | 278.0   | -0.18%         |
| Baltic Dry         | 2546    | 4.30%          |
| <b>Other</b>       |         |                |
| VIX                | 24.68   | -3.97%         |
| iTraxx XOVER       | 572.95  | 7.0            |

#### Today's Events

Japan Trade Balance, Aug  
France Business Sentiment, Sep  
German Industrial Output, Aug  
BoE Rate Decision  
ECB Rate Decision  
Canada Housing Starts, Sep  
US Initial Claims, Oct-3  
US Treasury sells \$12bn, 30y notes  
Bank of Canada speakers: Jenkins (14:50)

| Time  | Consensus  | Previous  |
|-------|------------|-----------|
| 00:50 | +Y303.7bnA | +Y437.3bn |
| 07:45 | 92A        | 89        |
| 11:00 | +1.8%      | -0.9%     |
| 12:00 | 0.50%      | 0.50%     |
| 12:45 | 1.0%       | 1.0%      |
| 13:15 | 148.0K     | 150.5K    |
| 13:30 | 540K       | 551K      |

Paul Rodriguez, Senior Technical Analyst

- A positive showing from equities overnight should put Europe in a bullish mood this morning. Whilst the Nikkei continues to sit below the main 10,000 level (9,832 - underperformance due to yen strength), Dec. DAX index futures are trading within a whisker of the 5,764 prior high - a break targets a squeeze to 5,800. Dec. FTSE futures should take a run at 5,169 (also the contract high) which is the high water mark and my assumed top for the market. Given the positive sentiment in commodities, an equity squeeze may not be far behind, but this level still needs to be broken to change strategy. S&P cash also needs to take out 1,080 to imply another leg to the bull run. We should get a conclusion soon.
- In the FX space, the dollar remains under pressure against the commodity currencies with the AUD, CAD, NOK and NZD favoured buys. Emerging market currencies stay in demand with strength in the INR (completion of a major head and shoulders reversal) which targets 45.00. The ZAR is readying itself for a break through 7.29 - last month's low. The MYR is up sharply having breached a major H&S neckline at 3.44 and the pace of the move suggests 3.30 will be hit before year end. The broad pressure on the dollar has kept the DXY firmly below 77.20 - the main downward trendline - and risks puncturing prior support at 75.82 today. Dollar weakness should help cable to bounce given the lack of downside yesterday and failure to breach the technical trigger at 1.5820. A squeeze through 1.6050 today is the main buy signal for what could be a decent rebound for the beleaguered currency. EUR/USD resistance at 1.4844 is the main level to take out in the coming sessions and with gold screaming higher towards the \$1,080 target, there seems to be little to prevent further softening of the US currency.
- Bond yields remain steady at current levels, but if anything the pressure on a rebound should become compelling in the next few sessions. US 5 and 10-y yields continue to hug the 200 day m.a. and today's price action in the equity and commodity markets should nudge yields higher - even if the long term viability of this is currently uncertain.

Chart of the day: US 10 year yields



Key Levels

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

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

Yields continue to hold short term support around the 200 day m.a. at 3.17%. So far, the market has not closed below this key average line. However, resistance at 3.25% is the key level to breach.

|         | Spot   | Bias    | Entry                  | Target | Stop   | Comment/Levels                     |
|---------|--------|---------|------------------------|--------|--------|------------------------------------|
| EUR/USD | 1.4726 | Bullish | <a href="#">1.4650</a> | 1.4844 | 1.4595 |                                    |
| USD/JPY | 88.42  | Bearish | current                | 85.00  | 89.20  |                                    |
| USD/CHF | 1.0279 | Bearish | <a href="#">1.0360</a> | 1.0000 | 1.0426 |                                    |
| GBP/USD | 1.5879 | Bearish | <a href="#">1.5965</a> | 1.5500 | 1.6020 |                                    |
| EUR/GBP | 0.9257 | Bullish | <a href="#">0.9225</a> | 0.9400 | 0.9190 |                                    |
| GBP/JPY | 140.18 | Bearish | <a href="#">142.00</a> | 143.10 | 137.71 | Stop hit.                          |
| EUR/JPY | 129.79 | Neutral | -                      | 133.00 | -      |                                    |
| CAD/JPY | 83.61  | Neutral | -                      | -      | -      |                                    |
| AUD/USD | 0.8919 | Bullish | 0.8888                 | 0.9000 | 0.8845 |                                    |
| USD/CAD | 1.0577 | Bearish | <a href="#">1.0650</a> | 1.0000 | 1.0715 |                                    |
| NZD/USD | 0.7348 | Bullish | <a href="#">0.7290</a> | 0.7468 | 0.7225 |                                    |
| USD/BRL | 1.7596 | Bearish | 1.8338                 | 1.7000 | 1.8025 | Cautious as USD starts to rebound. |
| USD/PLN | 2.8397 | Bearish | 2.8721                 | 2.6000 | 2.8840 |                                    |
| USD/HUF | 180.98 | Bearish | <a href="#">182.09</a> | 165.00 | 183.10 |                                    |

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

A solid labour market report from Australia (where the unemployment rate has fallen alongside a rise in the participation rate) has propelled the AUD/USD overnight. The implied yield from interest rate futures contracts has risen by around 14bp as the market moves to discount further interest rate increases from the central bank – the Reserve Bank of Australia became the first G-10 central bank to raise interest rates this week. GBP/AUD continues to lurch lower, trading at its lowest since 1985. Having broken below A\$1.80, the most obvious target on the chart now appears to be A\$1.60.

In addition to the risk positive sentiment provided by Australian data overnight, the Q3 earnings season has opened strongly in the US with a number of companies (including Alcoa) providing upside surprises. This should continue to support equity markets, weigh on the USD (the DXY index is close to recording a new low for the year) and provide support for commodity currencies.

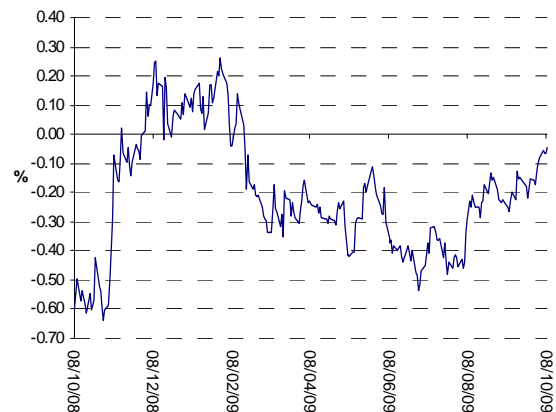
The latest portfolio flow data from the Japanese Ministry of Finance, for week ending 2<sup>nd</sup> October 2009, were released overnight - the data are charted on page 4. The data show that Japanese investors bought foreign equities (Y104.2bn) whilst foreigners sold Japanese equities worth Y69.7bn. This results in an equity related outflow of Y173.9bn from Japan. Over the same period, Japanese investors were net sellers of foreign bonds (Y1288.6bn) whilst foreigners were net buyers of Japanese bonds (Y663.3bn). This resulted in a bond related inflow of Y1951.9, dwarfing the net-equity outflows and accounting for some of the recent strength observed in the yen.

The trend following model continues to hold a short USD position. The model holds a portfolio that is fully short against EM currencies and 78% short USD against developed market currencies. The major exception in the model's positioning is GBP/USD where the model is short GBP and long USD, highlighting the weakness observed in the currency pair.

Table 1: 1-month correlations

|           | AUDUSD      | USDCAD       | EURUSD      | GBPUSD | USDJPY      | EURJPY      |
|-----------|-------------|--------------|-------------|--------|-------------|-------------|
| 2 YR SPD  | 0.71        | 0.49         | 0.00        | 0.57   | 0.53        | 0.73        |
| 10 YR SPD | 0.44        | 0.02         | 0.14        | 0.09   | <b>0.81</b> | <b>0.93</b> |
| S&P500    | 0.41        | -0.38        | <b>0.84</b> | -0.06  | -0.23       | 0.22        |
| Gold      | <b>0.87</b> | <b>-0.90</b> | 0.54        | -0.25  | -0.60       | -0.36       |
| Oil       | 0.11        | -0.61        | 0.19        | 0.44   | 0.15        | 0.28        |
| CRB       | 0.57        | <b>-0.78</b> | 0.70        | 0.02   | -0.30       | 0.07        |

Chart 1: Spread in EZ/UK 2-year interest rate swaps heading higher - positive for EUR/GBP

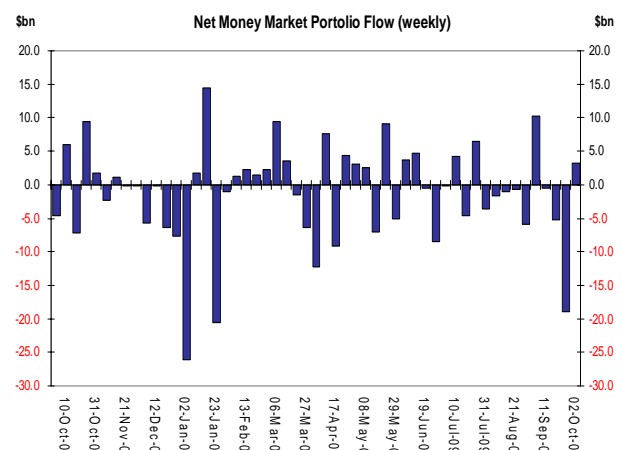
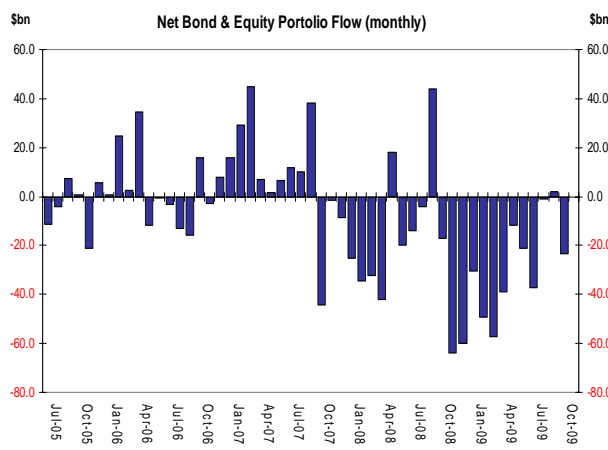
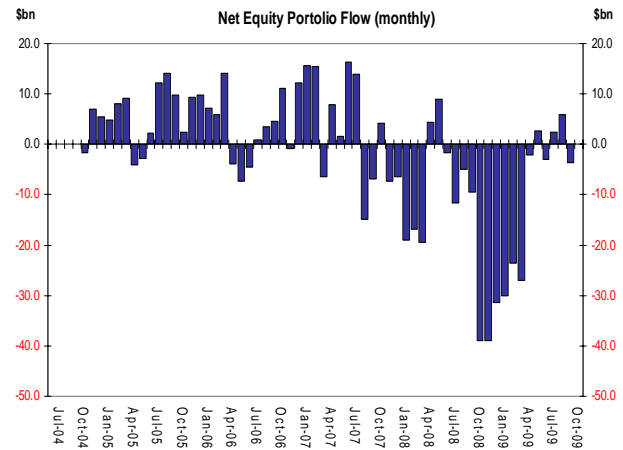
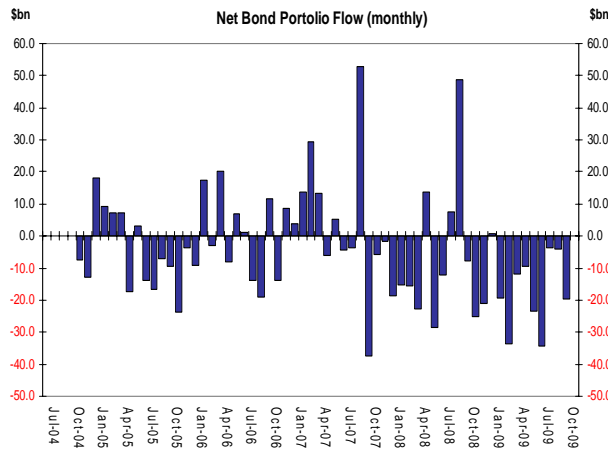
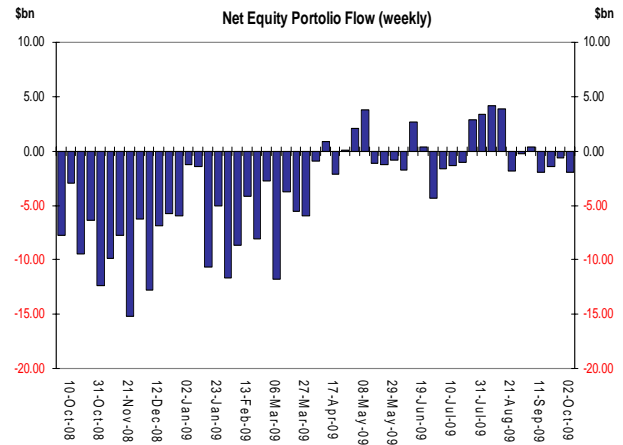
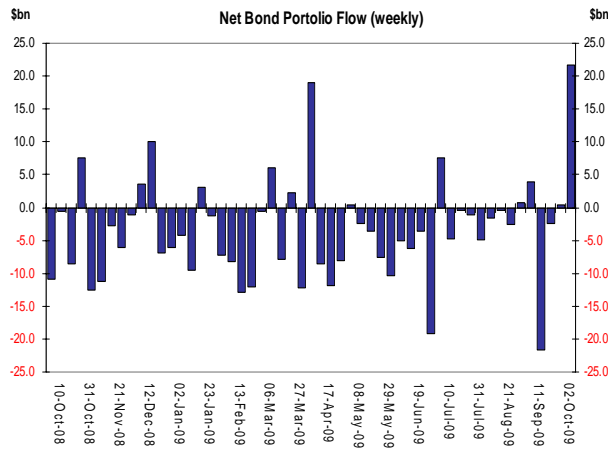


## Trend following model signals

| 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%       |

## Japanese Yen FX Flows



## Market Summary

|                      | Close  | Daily Change % |                         | Close   | Daily Change % |
|----------------------|--------|----------------|-------------------------|---------|----------------|
| <b>FX</b>            |        |                | <b>Equities</b>         |         |                |
| EUR/USD              | 1.4692 | -0.21%         | S&P500                  | 1057.58 | 0.27%          |
| USD/JPY              | 88.610 | -0.24%         | DJIA                    | 9725.58 | -0.06%         |
| AUD/USD              | 0.8912 | 0.11%          | FTSE100                 | 5108.90 | -0.57%         |
| EUR/GBP              | 0.9201 | -0.50%         | Eurostoxx50             | 2852.17 | -0.47%         |
| GBP/EUR              | 1.0869 | 0.51%          | Shanghai Composite*     | 2779.43 | 0.00%          |
| GBP/USD              | 1.5969 | 0.30%          | *latest price           |         |                |
| GBP/JPY              | 141.51 | 0.06%          | <b>Commodities</b>      |         |                |
| GBP/CHF              | 1.649  | 0.88%          | Crude Oil \$/bl         | 69.57   | -1.85%         |
| GBP/AUD              | 1.792  | 0.21%          | Gold \$/oz              | 1044.2  | 0.20%          |
| GBP/CAD              | 1.695  | 0.49%          | Copper c/lb             | 278.0   | -0.18%         |
| GBP/NZD              | 2.169  | 0.03%          | Silver \$/oz            | 17.57   | 1.21%          |
| GBP/NOK              | 9.083  | 0.25%          | Baltic Dry              | 2546    | 4.30%          |
| GBP/ZAR              | 11.869 | 0.33%          | <b>Swaps %</b>          |         |                |
| GBP/CNY              | 10.901 | 0.31%          | US 5yr                  | 2.540   | -7.9           |
| <b>Bonds %</b>       |        |                | EUR 5yr                 | 2.642   | -3.3           |
|                      |        | bp             | UK 5yr                  | 3.070   | -3.1           |
| US 10Yr              | 3.182  | -7.3           | <b>Official Rates %</b> |         |                |
| EUR 10Yr             | 3.118  | -4.0           | UK                      | 0.50    |                |
| UK10 Yr              | 3.405  | 0.4            | US                      | 0.25    |                |
| <b>Other</b>         |        |                | EU                      | 1.00    |                |
| VIX                  | 24.68  | -3.97%         | Japan                   | 0.10    |                |
| iTraxx XOVER         | 572.95 | 7.0            |                         |         |                |
| DJ Agriculture Index | 58.52  | -0.60%         |                         |         |                |

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