

# Daily Market Strategy

Thursday, 22nd October 2009

## Market Strategy

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- UK yields/swaps in corrective phase, retail sales ahead
- GBP outperforms G10, biggest gain vs CAD

### Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6584, €/\$: 1.4985, \$/¥: 91.46

UK 5y sw: 3.38%, US 5y sw: 2.72%, EU 5y sw: 2.80%

#### Overnight

- Fed Beige Book reports stabilisation/modest improvement in many sectors, albeit at 'depressed levels'; consumer spending/residential construction weak; loan demand weak/falling; labour markets weak/mixed
- China Q3 GDP up 8.9% y/y, Sep CPI -0.8% y/y, Sep ind output up 13.9% y/y
- Euro's woes may top the dollar's (WSJ)
- China warned on asset bubbles (FT)

Sterling and gilts are trading almost exactly like at the end of July, with a short squeeze and risk appetite (equity buying) sparking a breakout in GBP and bond yields/swaps, partly led by the idea that the BoE could pause QE next month. The notion that a pause in asset purchases would rattle risk assets does, so far, seem unjustified but the breakout in yields and swaps reveals a deeper discomfort. The interesting aspect of this week's price action is that it can hardly be traced back to fundamentals and is largely attributable to momentum and technicals. Some will argue that Governor King's decision not to comment on sterling and the MPC minutes carry some responsibility for the surge in both GBP crosses and short-dated yields. September retail sales and Q3 GDP may add to volatility over the next 48 hours. Strong retail anecdotes from the BRC and CBI suggest a bigger than 0.5% m/m consensus gain in sales is possible. A break of 3.40% has put 5y swaps on target for a move to 3.50%. Ahead today: UK retail sales and the BoE monthly Lending Report will be followed by the 2014 gilt auction (£4.75mn) and a speech by MPC member Tucker. Weekly claims - will continuing claims stay below 6mn? - and the leading indicators for September, plus a host of Fed speakers and Fed Treasury buying top the US calendar.

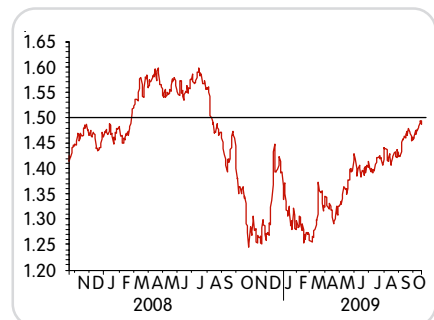
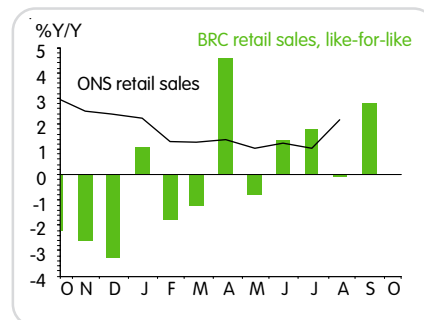
**FX:** Long vol strategies are still preferred for GBP over the next 48 hours. A gain in retail sales of more than 0.5% m/m could attract fresh GBP buying and line up a test for GBP/USD of 1.67. We expect limited knee-jerk selling on a weak number and look for better UK/US and UK/EU spreads to support. The Riksbank rate decision could impact SEK crosses.

**Rates:** We are troubled by the sell-off in gilts and swaps along the curve and see no merit yet at this stage to dip back in. As key resistance levels are breached, we are waiting for better levels to step in for a pullback in yields. Strong retail data could trigger a clearout.

**Strong BRC report suggests ONS Sep sales could surprise**

**Central bank rhetoric is falling on deaf ears as EUR/USD cruises above 1.50**

	Close	Daily Change %
<b>FX</b>		
EUR/GBP	0.9041	-0.89%
GBP/USD	1.6608	1.38%
EUR/USD	1.5016	0.48%
USD/JPY	90.972	0.22%
AUD/USD	0.9292	0.58%
<b>Bonds %</b>		<b>bp</b>
US 10Yr	3.385	4.5
EUR 10Yr	3.317	8.2
UK10 Yr	3.539	-6.6
UK 5yr Swap	3.380	15.8
<b>Equities</b>		<b>%</b>
S&P500	1081.40	-0.89%
FTSE100	5257.85	0.28%
Eurostoxx50	2936.83	0.40%
Shanghai	3058.58	-0.39%
Composite		
<b>Commodities</b>		<b>%</b>
Crude Oil \$/bl	81.37	2.88%
Gold \$/oz	1059.0	0.36%
Copper	303.6	3.55%
Baltic Dry	2917	3.00%
<b>Other</b>		
VIX	22.22	6.32%
iTraxx XOVER	497.13	-1.9



### Today's Data

	Time	Consensus	Previous	Events
China GDP, Q3, y/y	03:00	8.9%A	7.9%	BoE monthly report on Lending Trends (09:30)
China CPI, Sep, y/y	03:00	-0.8%A	-1.2%	DMO auctions £4.75mn 5, 2014 gilts (10:30)
China Industrial Output, Sep, y/y	03:00	13.9%A	12.3%	BoE MPC speaker: Tucker (16:30)
UK Retail Sales, Sep	09:30	0.5%	Zero	Fed speakers: Rosengren (15:30), Lockhart (17:00), Dudley (18:30), Evans (21:00)
French Business Confidence, Oct	07:45	87	85	Earnings: Credit Suisse, Amex
US Initial Claims, Oct-17	13:30	520K	514K	
US Leading Indicators, Sep	15:00	0.8%	0.6%	
Canada Retail Sales, Aug	13:30	0.2%	-0.6%	

## Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- Equity markets have done little in the very short term to convince either the bulls or the bears but, on balance, the price action in the FTSE futures and DAX index futures are beginning to look tired. Key support at 5,144 (5,146 traded) for the FTSE was tested (and the market had a good rebound from it) but this move was enough to initiate a technical sell signal for today, with a target of 5,040. Similarly in the DAX index, 5,732 is important support and will be watched carefully for a break today. Long stops below this point could propel the market into a tailspin if breached with the next major target at 5,560. Short stops are over 5,820. Asian markets are relatively flat, although the Hang Seng is off 1.00%. The Baltic Dry index is close to 3,000 - a key resistance point (2,917) and base metals have been trying to break higher (Copper has finally taken out 300 c/lb resistance) adding a counter-weight to the equity nervousness.
- I expect one more broad rally in the pound today before profit-taking into Friday, with EUR/GBP looking to break support at 0.8980 for a move up to 0.8910, and cable running to 1.6743 resistance (a massive level that is unlikely to break on a first attempt even if hit). UK yields (see chart below) remain bid with 10yr swaps pushing over 4.00% and the 2y UK/US yield spread moving into positive territory. However, my interest is taken by the potential for a USD rebound against the commodity currencies. This had mixed success yesterday with the sell level in AUD/USD hit at 0.9300, but my stop was hit in the NZD as the trend pushed to a new high (the CAD has already shown signs of reversing and this has been volatile). If equities retrace as anticipated above, the USD could have a broad rebound (GBP the exception). Similarly, the JPY has scope for broader weakness making USD/JPY another trade to watch today. Short-term resistance at 91.74 is key, but this should break for 92.54.

Chart of the day: UK 2y yields- Big barrier at 1.00%



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.5287	<b>1.6743</b>	95.15	0.9520	<b>1.1135</b>
R1	<b>1.4966</b>	1.6490	91.74	0.9482	1.1018
Current Spot	1.4938	1.6396	90.72	0.9112	1.0975
S1	1.4845	1.6125	87.14	0.9076	1.0546
S2	1.4407	1.5709	85.00	0.8981	1.0504

Spot prices as of: 07:31:39 Source: Bloomberg

Whilst the price action has shown signs of reversing (after a number of false signals) 1.00% represents the main barrier as it is technically very significant resistance, not just psychologically.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4983	Bullish	1.4650	1.5287	1.4875	Gains over 1.500 could be challenging.
USD/JPY	91.39	Bullish	90.50	94.00	90.20	91.74 key resistance- stop raised.
USD/CHF	1.0083	Bearish	1.0360	1.0000	1.0185	Target close- stop lowered.
GBP/USD	1.6601	Bullish	1.6125	1.6750	1.6535	Stop raised. Further squeeze expected.
EUR/GBP	0.9026	Bearish	0.9112	0.8800	0.9075	Stop revised downwards.
GBP/JPY	151.77	Bullish	143.71	153.27	146.10	Continuation pattern implies a push higher today.
EUR/JPY	136.96	Bullish	136.00	138.74	134.90	Entry raised (again).
CAD/JPY	87.20	Bullish	current	92.00	86.30	Yen to weaken more than CAD to strengthen.
AUD/USD	0.9231	Bearish	0.9300	0.9000	0.9654	Trend to turn negative- sell level hit.
USD/CAD	1.0482	Bullish	1.0450	1.0800	1.0340	Reversing commodity currency trades.
NZD/USD	0.7535	Bearish	0.7585	0.7200	0.7610	Stop hit on NZD short. Re- enter.
USD/BRL	1.7345	Bullish	1.7250	1.8000	1.7190	Trying for a reversal of trend.
USD/PLN	2.7879	Neutral	-	-	-	Not sure where this is going- stand aside- tempted by possible USD long - but being whip-sawed.
USD/HUF	176.98	Bullish	current	182.00	180.65	Reversing position.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

## Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The trend following model has not initiated any new positions this morning. The model holds a portfolio that is 56% short USD in developed market currencies and 20% short USD in emerging market currencies.

The discretionary long GBP/JPY position, which we announced on Friday 9<sup>th</sup> October, hit its take profit level of Y150 yesterday. This position has now been closed, booking a profit of 5.3%.

Whilst the USD fell sharply against developed market currencies – the USD DXY index briefly traded below 75, marking a new 14-month low – it strengthened, albeit marginally, against Asian and other emerging market currencies. Hence, the long USD/CZK and USD/ZAR positions, triggered by the trend following model yesterday, are in-the-money.

Matters are somewhat further confused by the divergence in equity and commodity markets. Whilst the S&P500 recorded a key day reversal formation yesterday (signalling a rise in probability of a correction lower), commodities – in the form of the CRB – have broken higher. NYMEX WTI crude oil, closing above \$81 per barrel, is at its highest since October 2008.

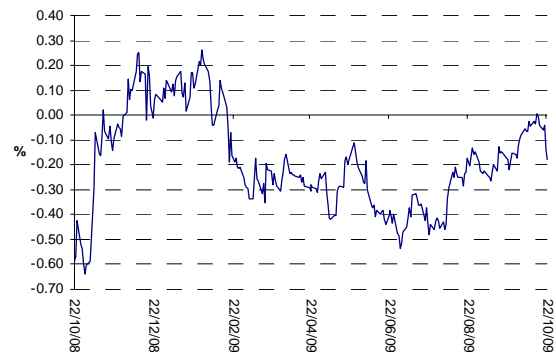
With the exception of industrial production, Chinese data, released overnight, have largely been close to consensus. The higher-than-expected outcome in industrial production should continue to provide medium-term support for commodities and commodity currencies.

The latest Japanese portfolio data for the period ending 16<sup>th</sup> October 2009 have been released by the Ministry of Finance. In equities, Japanese investors sold foreign stocks (Y54.5bn) and foreign investors bought Japanese stocks (Y109.1bn) – resulting in a net inflow into Japan of Y54.6. In bonds, Japanese investors sold foreign bonds (Y378.7bn) and foreign investors sold Japanese bonds (Y197.5bn) - resulting in a net inflow into Japan of Y181.2bn. The data are shown in the charts on the next page.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2 YR SPD	<b>0.95</b>	<b>0.93</b>	<b>0.81</b>	0.74	0.48	<b>0.84</b>	<b>0.96</b>
10 YR SPD	0.69	0.72	-0.43	0.36	0.44	0.57	<b>0.92</b>
S&P500	<b>0.82</b>	<b>-0.80</b>	<b>0.88</b>	0.54	0.33	0.72	<b>0.87</b>
Gold	<b>0.93</b>	<b>-0.95</b>	<b>0.82</b>	0.32	-0.10	0.42	<b>0.82</b>
Oil	<b>0.90</b>	<b>-0.79</b>	<b>0.89</b>	0.70	0.31	0.72	<b>0.95</b>
CRB	<b>0.95</b>	<b>-0.82</b>	<b>0.93</b>	0.68	0.28	0.73	<b>0.98</b>

Chart 1: EZ/UK interest rate spreads suggest further downside risks building for EUR/GBP



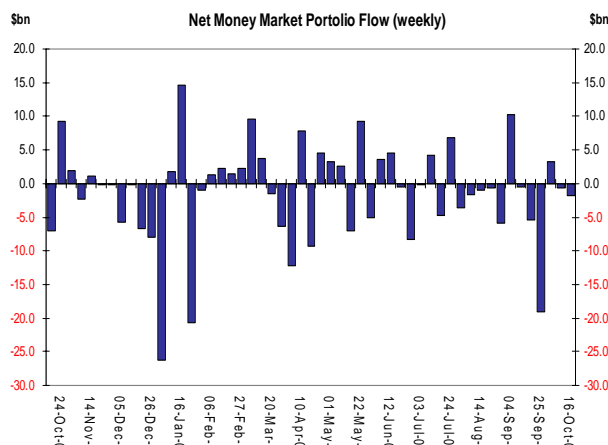
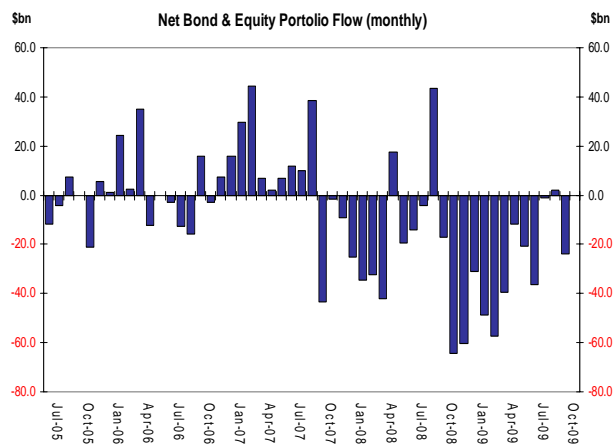
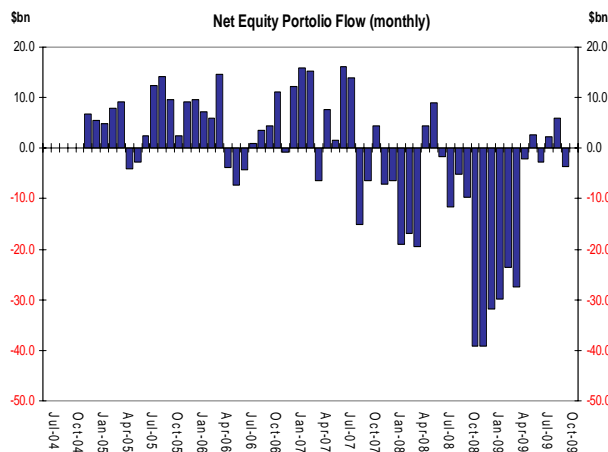
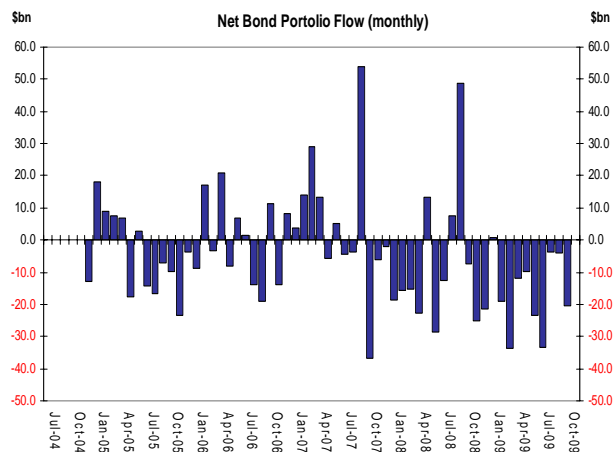
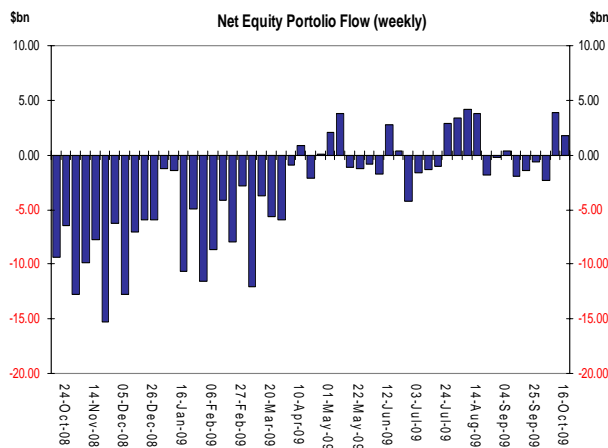
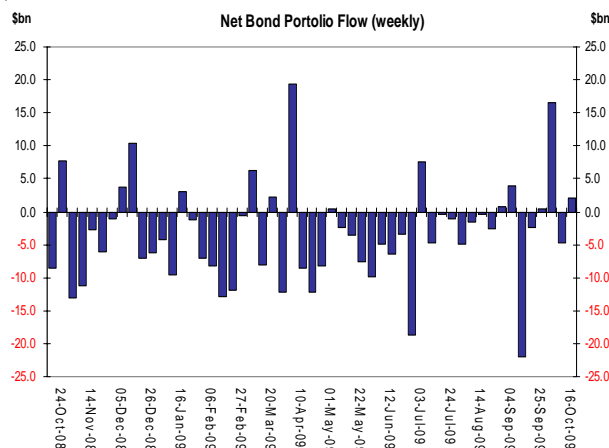
The release of the October MPC minutes has triggered a rise in UK market interest rates. EZ/UK interest rate spreads (the chart across shows the spread in 2-year interest rate swaps) has lurched lower, indicating further downside risk for EUR/GBP. This is another bearish signal, following on from our key-week reversal (technical) warning yesterday.

## 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	12-Oct-09	1.5842
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
Net-USD portfolio position			-56%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	long	21-Oct-09	17.260
USDPLN	short	15-Oct-09	2.8237
USDSGD	short	08-Sep-09	1.4337
USDTRY	short	15-Sep-09	1.4939
USDZAR	long	22-Oct-09	7.3665
Net-USD portfolio position			-20%

## Japanese Yen FX Flows



## Market Summary

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.5016	0.48%	S&P500	1081.40	-0.89%
USD/JPY	90.97	0.22%	DJIA	9949.36	-0.92%
AUD/USD	0.9292	0.58%	FTSE100	5257.85	0.28%
EUR/GBP	0.9041	-0.89%	Eurostoxx50	2936.83	0.40%
GBP/EUR	1.1060	0.90%	Shanghai Composite*	3054.55	-0.52%
GBP/USD	1.6608	1.38%	*latest price		
GBP/JPY	151.09	1.61%	Commodities		
GBP/CHF	1.6709	0.82%			%
GBP/AUD	1.7875	0.80%	Crude Oil \$/bl	81.37	2.88%
GBP/CAD	1.7321	0.76%	Gold \$/oz	1059.0	0.36%
GBP/NZD	2.1839	-0.08%	Copper c/lb	303.6	3.55%
GBP/NOK	9.2316	0.80%	Silver \$/oz	17.69	1.13%
GBP/ZAR	12.3107	2.02%	Baltic Dry	2917	3.00%
GBP/CNY	11.3387	1.39%	Swaps %		
Bonds %			bp		
US 10Yr	3.385	4.5	US 5yr	2.706	5.0
EUR 10Yr	3.317	8.2	EUR 5yr	2.801	5.8
UK10 Yr	3.539	-6.6	UK 5yr	3.380	15.8
Other			Official Rates %		
VIX	22.22	6.32%	UK	0.50	
iTraxx XOVER	497.13	-1.9	US	0.25	
DJ Agriculture Index	64.29	2.73%	EU	1.00	
			Japan	0.10	

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