

Daily Market Strategy

Friday, 6th November 2009

Market Strategy

Paul Rodriguez

Senior Technical Analyst

0207 158 1744

paul.rodriguez@lloydstsb.co.uk

Kenneth Broux

Market Economist

0207 158 1750

kenneth.broux@lloydstsb.co.uk

Naeem Wahid

Quantitative Strategist

0207 158 1741

naeem.wahid@lloydstsb.co.uk

Altaz Dagha

Analyst

0207 158 1747

altaz.dagha@lloydstsb.co.uk

- Curve steepeners squeeze UK 2y/10y near 300bps
- AUD and CAD top G10 performers, US NFP awaited

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6612, €/\$: 1.4873, \$/¥: 90.52

UK 5y sw: 3.43%, US 5y sw: 2.72%, EU 5y sw: 2.84%

Overnight

- Overseas investors sell Y2448bn of JPY securities, mostly JGB's; Japanese investors sell Y157.6bn in overseas equities/bonds (weekly MOF flows)
- How to fill the gaps left by the dollar decline (El-Erian, FT)

Equity markets resumed their upward trend overnight boosted by a close for the Dow above 10k and for the S&P above the 50d MA (1,066). We are not convinced that today's US Oct non-farm payrolls data will cause a major reversal of the pro-risk skew only two days after the Fed reiterated that interest rates will stay low for a prolonged period. In other words, only if payrolls are exceptionally weak, i.e. fall more than 250k or the unemployment rate jumps to or over 10%, we suspect selling USD to fund carry in FX and long equity will be favoured. This should help to underpin the AUD and the CAD, the two best G10 performers vs the USD this week. The re-coupling of GBP with risk assets, supported by the smaller than expected £25bn increase in QE to £200bn by the BoE, means GBP/USD is well positioned to cement this week's gains. For bonds, the story is all about a bearish steepening of yield curves in the G3 with gilts notably underperforming Treasuries and bunds. Barring an NFP shock, we see no reversal of the steepening trend as next week's US refunding and signs of a gradual unwinding unconventional CB credit measures offer a perfect excuse to push prices lower/yields higher on longer term paper.

Ahead today: UK PPI for October is expected to come in stronger on the input and output measures due to higher energy prices. German factory orders are forecast to show a 6th successive gain in September. The G20 finmin meeting gets underway in St Andrews.

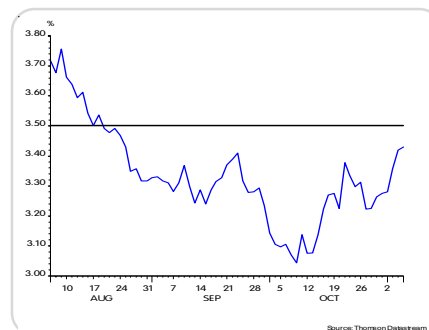
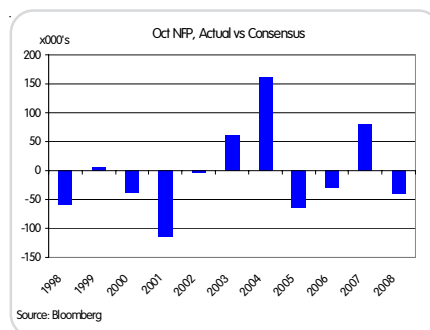
FX: GBP/USD was bid overnight but ran into resistance in the 1.6624 area. Good M&A support should keep the pair underpinned, though danger lurks for a reversal towards 1.65 if US payrolls disappoint. For EUR/USD, a move over 1.49 on the ECB's liquidity comments stalled at 1.4917 and the cross settled in a tight 1.4858-83 range in Asia. Only weak US payrolls data appears capable of stopping the cross from extending over 1.49.

Rates: UK 5y swaps edged up 3bps to 3.46% in early trade. Upward pressure has been evident all week and marks a shift in the 3mth trading range. A test of 3.48% yesterday puts 3.50% on the radar. A breakout would clear the path to the 3.55%-3.60% area. For 10y yields, we look for the underperformance vs Treasuries to wane going into next week's US refunding.

US NFP: Oct 10y avg forecast 'miss' is only 3k, but with a standard dev of 78k

UK 5y swaps: test of 3.50% lurks

	Close	Daily Change %
FX		
EUR/GBP	0.8968	-0.10%
GBP/USD	1.6583	0.18%
EUR/USD	1.4871	0.06%
USD/JPY	90.713	-0.01%
AUD/USD	0.9102	0.03%
Bonds %		
US 10Yr	3.524	0.0
EUR 10Yr	3.344	2.6
UK10 Yr	3.792	7.0
UK 5yr Swap	3.430	1.0
Equities %		
S&P500	1066.63	1.92%
FTSE100	5125.64	0.35%
Eurostoxx50	2793.44	1.09%
Shanghai Composite	3164.04	0.28%
Commodities %		
Crude Oil \$/bl	79.62	-0.97%
Gold \$/oz	1090.3	-0.17%
Copper	296.8	-0.85%
Baltic Dry	3335	1.21%
Other		
VIX	25.43	-8.26%
iTraxx XOVER	527.93	4.0



Today's Data

UK PPI Input, Oct	09:30	1.5%	-0.5%
UK PPI Output, Oct	09:30	0.3%	0.5%
UK PPI Output Core, Oct	09:30	0.2%	0.5%
German Factory Orders	11:00	1.0%	1.4%
Canada Employment Change, Oct	12:00	+10k	+30.6k
Canada Unemployment Rate, Oct	12:00	8.5%	8.4%
US Non-Farm Payrolls, Oct	13:30	-17.5k	-26.3k
US Unemployment Rate, Oct	13:30	9.9%	9.8%
US Average Earnings, Oct, m/m	13:30	0.1%	0.1%
US Wholesale Inventories, Sep	15:00	-1.0%	-1.3%
US Consumer Credit, Sep	20:00	-\$10.0bn	-\$12.0bn

Time Consensus Previous

Time	Consensus	Previous
09:30	1.5%	-0.5%
09:30	0.3%	0.5%
09:30	0.2%	0.5%
11:00	1.0%	1.4%
12:00	+10k	+30.6k
12:00	8.5%	8.4%
13:30	-17.5k	-26.3k
13:30	9.9%	9.8%
13:30	0.1%	0.1%
15:00	-1.0%	-1.3%
20:00	-\$10.0bn	-\$12.0bn

Events

- RBA Quarterly Monetary Statement
- ECB speaker: Gonzalez-Paramo (04:30)
- Fed speakers: Evans (14:45), Duke (16:30)

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The trend following model has been very active this morning. In emerging market currencies, the model has initiated a short USD position in USD/CZK. The previous long position has been closed and a profit of 0.66% booked. The model is now 60% short of USD against traded EM currencies – see table below. In developed market currencies, the model has initiated a short USD/SEK position and a short AUD/USD position. The previous long positions have been closed for profits of 0.23% and 5.26% respectively. Overall, the model's net short USD position is unchanged at 56%.

The most important data release today is the US non-farm payroll report. Market consensus lies around a loss of 175k jobs in October. A simple regression of the headline non-farm payroll report against the ADP, ISM employment components (both manufacturing and services) and initial jobless claims would suggest an outcome closer to 200k (jobs lost). With economist estimates lying in the 105k-250k range, an outturn of around 200k should have little impact on FX - most likely just a small short-lived dip in USD/JPY.

EZ/UK interest rate spreads (we calculate using 2-year interest rate swaps) continue to move lower (following the BoE's decision to extend the QE programme by only £25). This spread provides a bearish background for EUR/GBP and we continue to hold our short position (with a stop above the October 2009 high).

The latest Japanese portfolio flow data was released by the Ministry of Finance overnight. The data suggest that in equities, Japanese investors sold foreign equities (Y8bn) whilst foreign investors bought Japanese equities Y46.5bn. This results in a net-inflow into Japan of Y54.5bn. In bonds, Japanese investors sold foreign bonds (Y138.5bn) alongside foreign investors selling Japanese bonds (Y346.8bn). This resulted in a net outflow of Y208.3bn). In combination, equity and bond flows totalled a net outflow from Japan of Y153.8bn. The data can be seen charted overleaf.

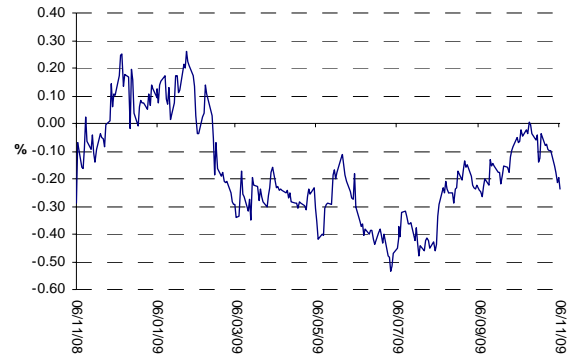


Chart 1: Spread in EZ/UK 2-year interest rate swaps heading lower - negative for EUR/GBP

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2YRSPD	0.55	0.83	0.64	0.83	0.40	0.50	0.78
10YRSPD	0.50	0.74	0.60	0.92	0.34	0.68	0.84
S&P500	0.76	-0.85	0.78	-0.07	0.18	0.48	0.54
Gold	0.20	-0.11	0.26	0.36	-0.02	0.10	0.10
Oil	0.70	0.16	0.62	0.89	0.84	0.86	0.85
CRB	0.83	-0.03	0.75	0.80	0.81	0.90	0.91

Table 1: 1-month correlations

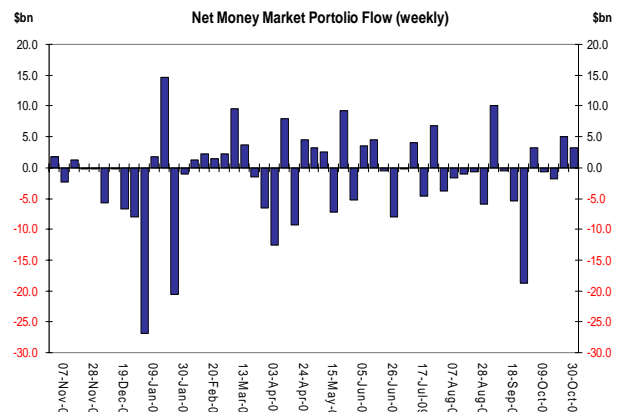
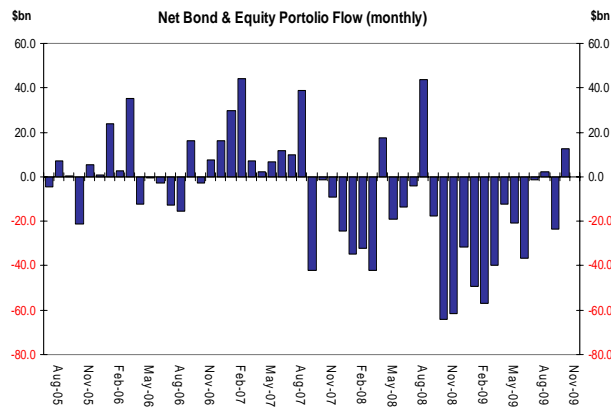
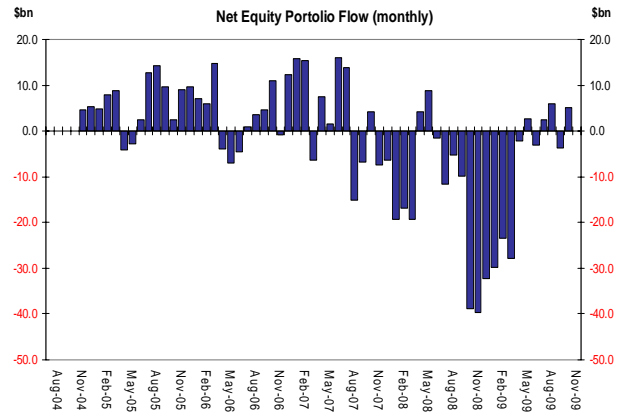
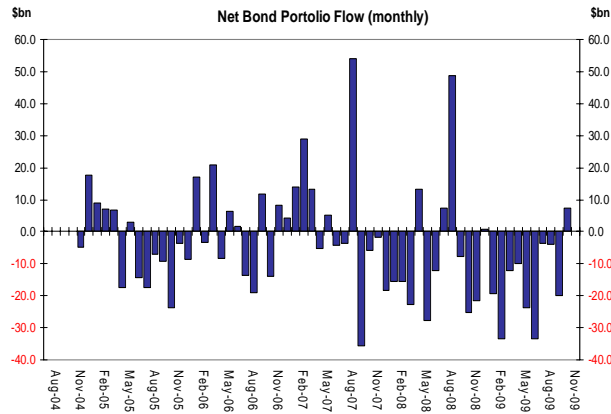
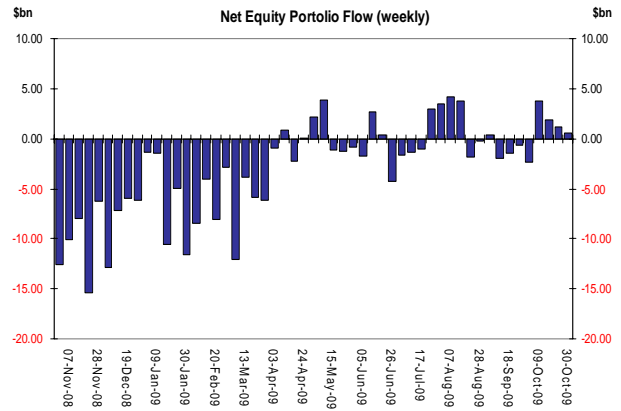
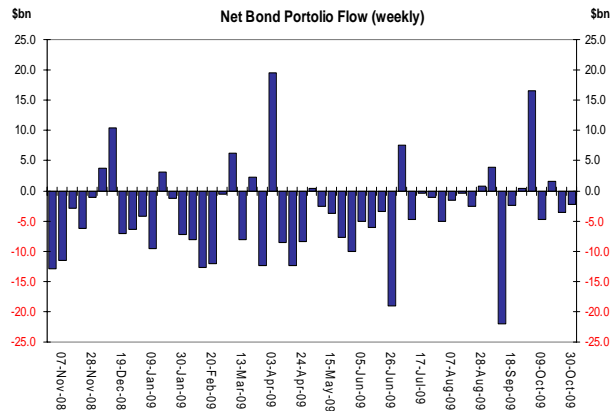
Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	short	06-Nov-09	0.9101
NZDUSD	long	10-Jul-09	0.6298
EURUSD	long	09-Sep-09	1.4480
GBPUSD	long	30-Oct-09	1.6547
USDCHF	short	17-Jul-09	1.0730
USDCAD	long	21-Oct-09	1.0494
USDSEK	short	06-Nov-09	6.9900
USDNOK	short	21-Jul-09	6.3025
USDJPY	short	02-Nov-09	90.10
Net-USD portfolio position			-56%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	06-Nov-09	17.375
USDPLN	short	05-Nov-09	2.8609
USDSGD	long	29-Oct-09	1.4037
USDTRY	short	05-Nov-09	1.4920
USDZAR	short	05-Nov-09	7.6250
Net-USD portfolio position			-60%



Japanese Yen FX Flows



Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4871	0.06%	S&P500	1066.63	1.92%
USD/JPY	90.71	-0.01%	DJIA	10005.96	2.08%
AUD/USD	0.9102	0.03%	FTSE100	5125.64	0.35%
EUR/GBP	0.8968	-0.10%	Eurostoxx50	2793.44	1.09%
GBP/EUR	1.1152	0.12%	Shanghai Composite*	3164.04	0.28%
GBP/USD	1.6583	0.18%	*latest price		
GBP/JPY	150.42	0.17%	Commodities		
GBP/CHF	1.6852	0.19%			%
GBP/AUD	1.8220	0.16%	Crude Oil \$/bl	79.62	-0.97%
GBP/CAD	1.7661	0.38%	Gold \$/oz	1090.3	-0.17%
GBP/NZD	2.2993	0.65%	Copper c/lb	296.8	-0.85%
GBP/NOK	9.4167	0.11%	Silver \$/oz	17.41	-0.29%
GBP/ZAR	12.5872	-0.26%	Baltic Dry	3335	1.21%
GBP/CNY	11.3217	0.16%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.524	0.0	US 5yr	2.713	-3.5
EUR 10Yr	3.344	2.6	EUR 5yr	2.827	-1.1
UK10 Yr	3.792	7.0	UK 5yr	3.430	1.0
Other			Official Rates %		
VIX	25.43	-8.26%	UK	0.50	
iTraxx XOVER	527.93	4.0	US	0.25	
DJ Agriculture Index	61.68	0.00%	EU	1.00	
			Japan	0.10	

This document is confidential, for your information only and must not be distributed, in whole or in part, to any person not involved with the proposed transaction without the prior consent of Lloyds TSB Bank plc ("LTSB"). Whilst LTSB has exercised reasonable care in preparing this document and any views or information expressed or presented are based on sources it believes to be accurate and reliable, no representation or warranty, express or implied, is made as to the accuracy, reliability or completeness of the information contained herein. In particular, whilst we have sought to identify appropriate products and to provide guidance as to how those products might operate under various accounting standards we are not, and should not be considered to be, giving an accounting opinion or advice and you should conduct your own independent enquiries and seek your own professional advice in this respect. Any transaction which you may enter into with us will be on the basis that you have made your own independent evaluations based on your own knowledge and experience and any professional advice which you may have sought in relation to all aspects of the transaction including legal, regulatory, tax or accounting. All terms contained herein, including pricing, are indicative only and subject to change without notice. This material has been prepared for information purposes only and LTSB, its directors, officers and employees are not responsible for any consequences arising from any reliance upon such information. If you receive information from us which is inconsistent with other information which you have received from us, you should refer this to your LTSB Sales representative for clarification.

Lloyds TSB Corporate Markets is a trading name of LTSB. LTSB's registered office is at 25 Gresham Street, London EC2V 7HN and it is registered in England and Wales under no. 2065. LTSB is authorised and regulated by the Financial Services Authority. (11.07).