

Daily Market Strategy

Monday, 9th 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

- Pro-risk back on, trend set for remainder of Q4?
- GBP/USD targeting 1.70 area ahead of BoE QIR

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6736, €/\$: 1.4948, \$/Y: 90.12

UK 5y sw: 3.43%, US 5y sw: 2.68%, EU 5y sw: 2.84%

Overnight

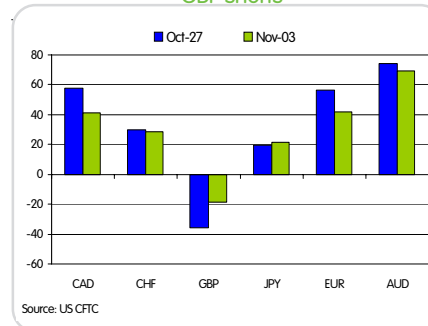
- G20 agree to keep stimulus measures in play, no mention of currencies
- Markets reveal growing inflation fears (FT)
- German Sep exports up 3.8% m/m

The remarkable ability of markets to climb a wall of worry was put in the spotlight again on Friday as equities and pro-risk currencies looked through the surge in the US jobless rate above 10%. The decision by G20 finance ministers this weekend to keep stimulus measures in place and not to comment on currencies has given fresh ammunition to the carry trade and the dollar funding of pro-risk strategies. GBP/USD cleared 1.6750 overnight and unless the BoE 'intervenes' with a dovish Inflation Report on Wednesday, it could be hard to stop the pair's ascent to 1.70. IMM short GBP positions dropped to a near two-month low last week and further short covering may result in further upside vs the USD ahead of Wednesday. For government bonds, the rally in equities - S&P futures are up 5.8 points - means upward pressure on yields and risk of further bear steepening into the US refunding. Ahead today: a fairly quiet day for economic data and with interest geared towards the BoE's first £1.7bn reverse auction of the 'new' £25bn of QE and the \$40bn US 3y note auction. German industrial output is forecast to show a fourth increase in five months in September. German export stats for September beat estimates earlier and this will buoy optimism for a positive Q3 GDP number next week.

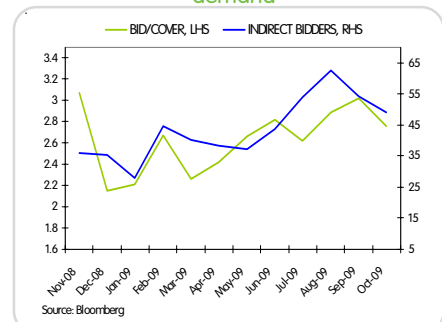
FX: GBP/USD cleared the Sep 11 high of 1.6742 overnight and from here there really is not much resistance to the 1.69-1.70 area last seen in early August. For EUR/USD, a move back over 1.49 materialised post payrolls on Friday and USD bears squeezed the cross over 1.4950 overnight in Asia following the G20. A cluster of targets around the 1.50 area are pinned at 1.5008 and 1.5033. For EUR/GBP, the cross is lining up a move to 0.89 but first needs to overcome 0.8912 support, the Oct 29 low. The decline comes despite an unchanged EU/UK 2y spread (44bps) and we therefore remain reluctant to call EUR/GBP much lower. GBP/CHF is bid in the 1.6935 area but needs to clear 1.6953 to line up a test if 1.70.

Rates: UK 5y swaps opened at 3.43%. We look for a move back to last week's highs at 3.49% ahead of the BoE QIR on Wednesday. Curve steepening is likely to be favoured but dovish BoE comments could resume some curve flattening in 2y/10y cash and swaps. The last US 3y auction was covered 2.76 times with indirect bidders taking 49.1%

Weekly IMM stats show 3rd straight drop in GBP shorts



We expect US 3y auction today to show solid demand



	Close	Daily Change %
FX		
EUR/GBP	0.8938	-0.33%
GBP/USD	1.6612	0.18%
EUR/USD	1.4847	-0.16%
USD/JPY	89.876	-0.92%
AUD/USD	0.9189	0.96%
Bonds %		
US 10Yr	3.497	-2.7
EUR 10Yr	3.364	2.0
UK10 Yr	3.885	3.1
UK 5yr Swap	3.421	-0.9
Equities		
S&P500	1069.30	0.25%
FTSE100	5142.72	0.33%
Eurostoxx50	2794.25	0.03%
Shanghai Composite	3175.59	0.36%
Commodities		
Crude Oil \$/bl	77.43	-2.75%
Gold \$/oz	1095.1	0.44%
Copper	295.3	-0.15%
Baltic Dry	3393	1.74%
Other		
VIX	24.19	-4.88%
iTraxx XOVER	530.46	2.5

Today's Data

	Time	Consensus	Previous
German Trade Balance, Sep	07:00	€10.6bnA	€8.1bn
German Industrial Output, Sep	11:00	1.2%	1.7%
France Business Sentiment, Oct	07:45	93	92
Canada Housing Starts, Oct	13:15	156.8k	149.3k

Events

BoE reverse auction (£1.7bn): UKT_4.75_070320, UKT_4_070322, UKT_5_070325, UKT_4.25_071227, UKT_6_071228, UKT_4.75_071230, UKT_4.25_070632
 US Treasury sells \$40bn, 3y notes
 BIS meeting (07:00)

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The trend following model has initiated a long position in USD/ZAR this morning. The previous short position has been closed and a profit of 1.2% booked. The model now holds only a 20% short USD position across emerging market currencies – see table below. The model has not initiated any new positions in developed market currencies this morning. It continues to hold a portfolio that is 56% short of USD.

The latest IMM data, for period ending Tuesday 3rd November 2009, were released on Friday 6th November – see charts overleaf. The data show that, on balance, speculators have moderated their short USD position. I believe that the data overstates the recent USD purchases given they do not contain the post-payroll currency movements.

The data indicate that speculative positioning is the most extreme in USD/CHF. Analysing positioning, over a 3-year period, shows that the current speculative position lies at below the 3rd percentile. This suggests that the currency pair is vulnerable to a squeeze higher. As such, we look for CHF underperformance this week. Given the further improvement observed in the latest round of global PMIs, I look for CHF underperformance against growth sensitive currencies, such as the AUD and CAD.

The correlation between interest rate spreads and G-10 FX remains high. Interest rate spreads are moving against the US, providing a bearish environment for the USD. EZ/UK interest rate spreads are breaking convincingly lower (see chart 1), continuing to suggest a move lower in EUR/GBP. A break below £0.8905 would suggest a move down towards £0.8840. We continue to hold our discretionary short position.

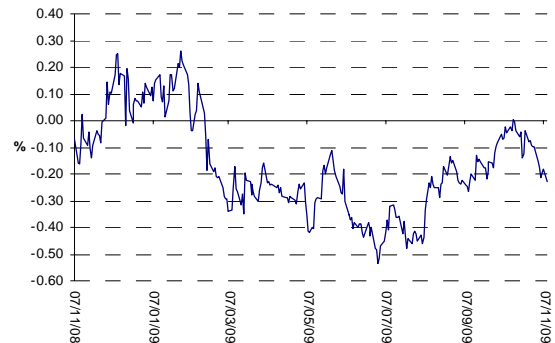


Chart 1: Spread in EZ/UK 2-year interest rate swaps heading lower - negative for EUR/GBP

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2YRSPD	0.53	0.85	0.61	0.80	0.43	0.42	0.75
10YRSPD	0.48	0.76	0.63	0.92	0.22	0.64	0.80
S&P500	0.76	-0.82	0.76	-0.19	0.06	0.46	0.55
Gold	0.21	0.05	0.22	0.40	-0.37	-0.13	-0.06
Oil	0.47	0.28	0.47	0.80	0.70	0.74	0.70
CRB	0.60	-0.04	0.62	0.57	0.69	0.81	0.77

Table 1: 1-month correlations

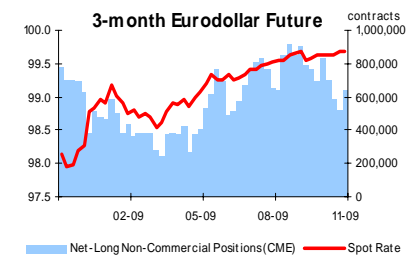
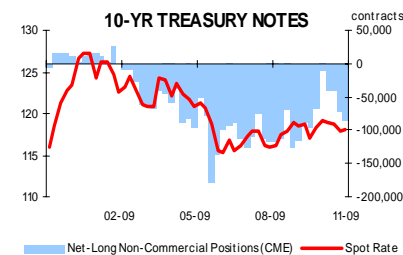
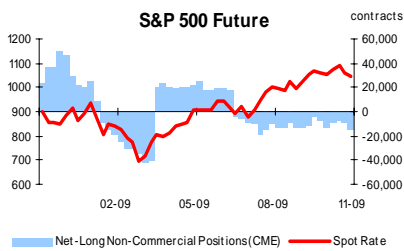
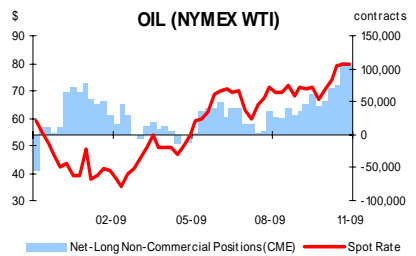
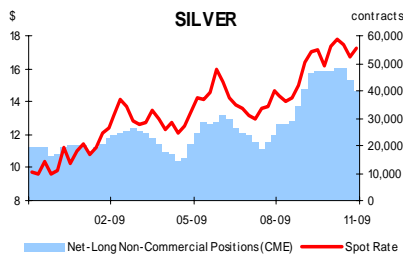
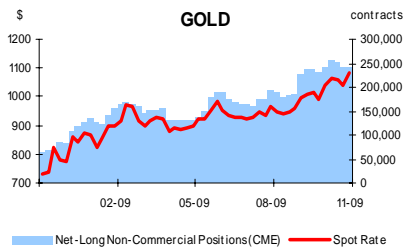
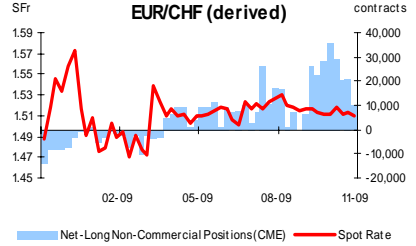
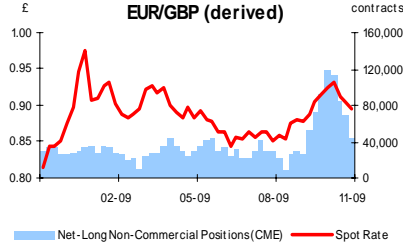
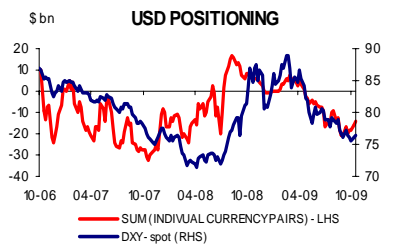
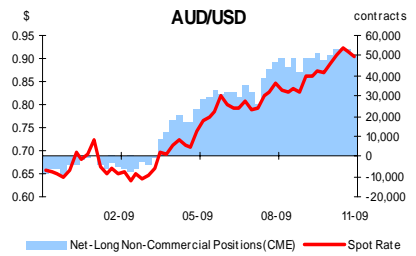
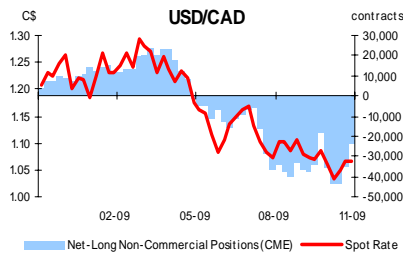
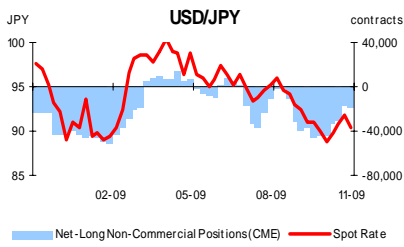
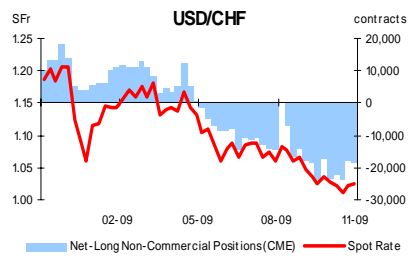
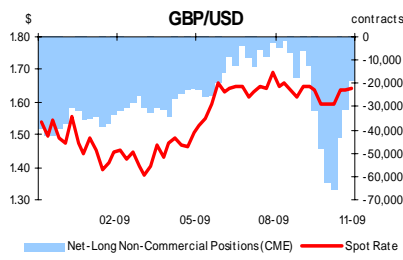
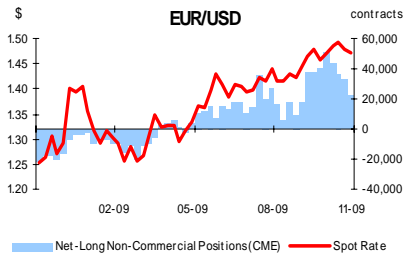
Trend following model signals

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	long	09-Nov-09	7.5359
Net-USD portfolio position			-20%



FX & Commodity Futures Positioning



Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4847	-0.16%	S&P500	1069.30	0.25%
USD/JPY	89.88	-0.92%	DJIA	10023.42	0.17%
AUD/USD	0.9189	0.96%	FTSE100	5142.72	0.33%
EUR/GBP	0.8938	-0.33%	Eurostoxx50	2794.25	0.03%
GBP/EUR	1.1188	0.32%	Shanghai Composite*	3175.59	0.36%
GBP/USD	1.6612	0.18%	*latest price		
GBP/JPY	149.31	-0.74%	Commodities		
GBP/CHF	1.6902	0.29%	Crude Oil \$/bl	77.43	-2.75%
GBP/AUD	1.8079	-0.78%	Gold \$/oz	1095.1	0.44%
GBP/CAD	1.7865	1.15%	Copper c/lb	295.3	-0.15%
GBP/NZD	2.2910	-0.36%	Silver \$/oz	17.39	-0.11%
GBP/NOK	9.4561	0.42%	Baltic Dry	3393	1.74%
GBP/ZAR	12.5187	-0.54%	Swaps %		
GBP/CNY	11.3420	0.18%	US 5yr	2.658	-5.5
Bonds %			EUR 5yr	2.845	1.9
		bp	UK 5yr	3.421	-0.9
US 10Yr	3.497	-2.7	Official Rates %		
EUR 10Yr	3.364	2.0	UK	0.50	
UK10 Yr	3.885	3.1	US	0.25	
Other			EU	1.00	
VIX	24.19	-4.88%	Japan	0.10	
iTraxx XOVER	530.46	2.5			
DJ Agriculture Index	60.49	-1.92%			

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).