

Daily Market Strategy

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Market Strategy

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	Close	Daily Change %
FX		
EUR/GBP	0.8954	0.05%
GBP/USD	1.6744	-0.08%
EUR/USD	1.4993	-0.04%
USD/JPY	89.810	-0.13%
AUD/USD	0.9304	0.08%
Bonds %		bp
US 10Yr	3.472	-1.3
EUR 10Yr	3.280	-3.8
UK10 Yr	3.835	-5.0
UK 5yr Swap	3.381	-0.2
Equities		%
S&P500	1093.01	-0.01%
FTSE100	5230.55	-0.09%
Eurostoxx50	2856.44	-0.13%
Shanghai Composite	3175.19	-0.11%
Commodities		%
Crude Oil \$/bl	79.05	-0.48%
Gold \$/oz	1105.8	0.18%
Copper	296.2	-0.20%
Baltic Dry	3615	3.88%
Other		
VIX	22.84	-1.34%
iTraxx XOVER	512.53	1.6

- Sterling/gilts await BoE QIR
- Gold hits new record at \$1,015 as USD slips

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.6729, €/\$: 1.4984, \$/Y: 89.87

UK 5y sw: 3.37%, US 5y sw: 2.62%, EU 5y sw: 2.79%

Overnight

- Good US 10y auction: b/c 2.81, indirect bidders take 47.3%
- Fed member comments generally dovish (Yellen, Fisher, Rosengren, Lockhart)
- China Oct retail sales, IP data top forecast; fall in annual CPI slows to -0.5%

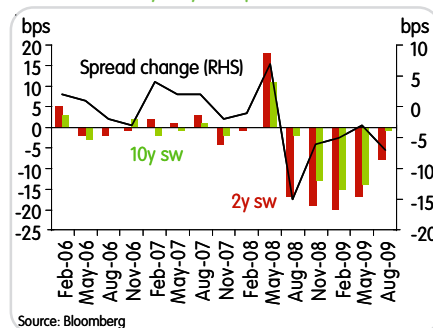
Trading ranges for UK swaps and GBP narrowed considerably at the last BoE QIR in August and there are grounds to believe that gilts/swaps and GBP will react in a fairly orderly fashion this morning when the MPC publishes its latest growth and inflation estimates at 10.30am. Chief economist Bean a few weeks ago hinted that the latest projections were unlikely to be materially different to August. This would imply that no major revisions are on the cards either to growth or inflation projections even after the disastrous Q3 GDP stats and last week's £25bn increase in QE. So with the scale of the numerical revisions likely to be modest, market reaction will come down to the tone of governor King during the Q&A and his answers to questions on QE. Considering the still murky outlook, the governor will want to keep his options open come February. For longer dated gilts and swaps, the challenge may come instead from government supply from the UK (£1bn, IL 2035), Germany (€10bn, 10y) and a steeper US curve ahead of tomorrow's 30y bond sale.

Ahead today: UK labour markets data are due at 09.30. Our economics team have pencilled in a claimant count increase of 25k and a rise in the ILO jobless rate to 8.1%.

FX: BoE statements have in the past been accompanied with falls in GBP so we are mindful of downside risk for GBP/USD and upside momentum in EUR/GBP for today's QIR. For GBP/USD, lower intra-days highs over the last two sessions show a reluctance to push the cross back over 1.68. For EUR/GBP, EU/UK 2y differentials widened overnight to 48bps, the highest since 20th Oct. We look for a bounce in EUR/GBP back over 0.90. USD/CAD pierced 1.05 overnight and brings key support at 1.0461 into play ahead of 1.04.

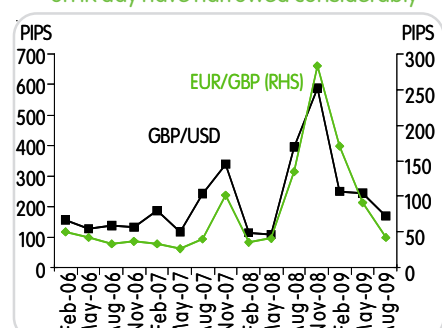
Rates: UK 5y swaps opened at 3.37%, with the 2y/10y swap spread steady at 209bps. Good UK and US 10y auctions yesterday squeezed UK 10y yields below 3.80%, causing the 2y/10y curve to flatten to 302bps. The outperformance of the front-end last week makes us cautious for an unwinding of curve steepeners in the context of minor BoE macro revisions this morning (support at 300bps). L-Bank Foerderbank priced a £300mn issue of 3y paper yesterday at 95bps over gilts. Germany will sell a new 10y bund. The €6bn size is smaller than usual €7bn.

Last five BoE Inflation Reports caused steeper 2y/10y swaps curve



Source: Bloomberg

Trading ranges in GBP/USD and EUR/GBP on IR day have narrowed considerably



Today's Data

China CPI, Oct, y/y	02:00	-0.5%A	-0.8%
China Industrial Production, Oct, y/y	02:00	16.1%A	13.9%
China Retail Sales, Oct, y/y	02:00	16.2%A	15.5%
UK Claimant Count, Oct	09:30	+20k	+20.8k
UK ILO Unemployment Rate, Sep	09:30	8.0%	7.9%
UK Average Earnings, Sep	09:30	1.4%	1.6%
BoE Inflation Report	10:30		
Japan Machinery Orders, Sep	23:50	0.5%A	0.5%

Time Consensus Previous Events

DMO sells £1bn, 1.25%, 2032 gilts
Germany sells €6bn, 10y bunds
Fed speakers: Fisher (00:30)
ECB speaker: Weber (17:00)

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The trend following model has increased its short USD position against developed market currencies. The model is now 100% short USD against developed market currencies, after it initiated new positions in AUD/USD and USD/CAD this morning. The previous trades have been closed with returns of -2.20% and +0.01% respectively.

Across emerging market currencies, the model's portfolio remains at 60% short USD, however the internal composition of that position has changed. A long position in USD/TRY has been initiated, with the previous short position closed and a profit of 1.02% recorded. The model has sold USD against the South African rand this morning. Whilst the volatility may be high, USD/ZAR has effectively traded in a range (7.22-8.36) over the past five months.

The USD negative environment remains intact as equity and commodity markets continue to find strong support. Interest rate spreads are also, broadly, in favour of further USD weakness. The correlation between equities and G-10 FX is strong – see table 1 (the 1-month rolling correlation between the S&P500 and EUR/USD is currently 0.82). In this context, a daily close above 1101.36 would open the way for a move towards \$1.53 in EUR/USD.

Strong data from China (retail sales, industrial production and trade balance) provide further support for a risk positive and USD negative environment.

The most important release today is the Bank of England's Quarterly Inflation Report (QIR). The report should provide further insight into the Bank's quantitative easing programme. The outcome for the programme over the next 3-months could depend on the Bank's inflation forecast – an outcome below 2% (in 2-years time) could lead to the expectation of further QE and weigh on sterling. A higher outcome would have the opposite effect. Whatever the outcome, we suspect that the profile will be close to close to 2% in 2-years time and therefore lead to a further drop in 1-month implied volatility in EUR/GBP.

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2YRSPD	0.46	0.85	0.59	0.51	0.65	0.50	0.67
10YRSPD	0.40	0.70	0.50	0.90	0.38	0.63	0.76
S&P500	0.83	-0.78	0.82	0.04	-0.08	0.43	0.58
Gold	0.40	-0.06	0.37	0.52	-0.47	-0.11	0.04
Oil	0.51	0.28	0.51	0.82	0.60	0.73	0.72
CRB	0.54	0.00	0.58	0.54	0.67	0.82	0.78

Table 1: 1-month correlations

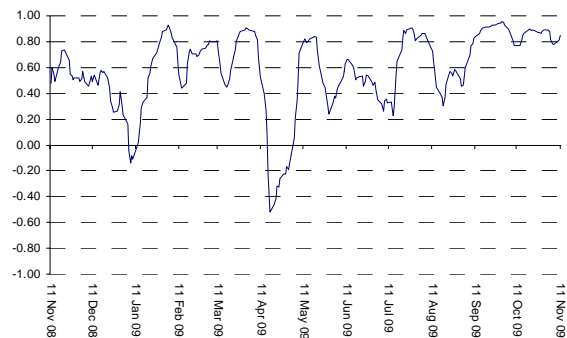


Chart 1: 1-month correlation between EUR/USD and S&P500

Trend following model signals

Trend Following Model Positions			
	Signal	Date	Entry Level
AUDUSD	long	11-Nov-09	0.9306
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	short	11-Nov-09	1.0495
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			-100%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	06-Nov-09	17.375
USDPLN	short	05-Nov-09	2.8609
USDSGD	short	10-Nov-09	1.3863
USDTRY	long	11-Nov-09	1.4769
USDZAR	short	11-Nov-09	7.3732
Net-USD portfolio position			-60%

Market Summary

	Close	Daily Change %		Close	Daily Change %
FX			Equities		
EUR/USD	1.4993	-0.04%	S&P500	1093.01	-0.01%
USD/JPY	89.81	-0.13%	DJIA	10246.97	0.20%
AUD/USD	0.9304	0.08%	FTSE100	5230.55	-0.09%
EUR/GBP	0.8954	0.05%	Eurostoxx50	2856.44	-0.13%
GBP/EUR	1.1168	-0.05%	Shanghai Composite*	3175.19	-0.11%
GBP/USD	1.6744	-0.08%	*latest price		
GBP/JPY	150.38	-0.21%	Commodities		
GBP/CHF	1.6873	-0.09%			%
GBP/AUD	1.7997	-0.16%	Crude Oil \$/bl	79.05	-0.48%
GBP/CAD	1.7573	-0.64%	Gold \$/oz	1105.8	0.18%
GBP/NZD	2.2519	-0.14%	Copper c/lb	296.2	-0.20%
GBP/NOK	9.3501	-0.11%	Silver \$/oz	17.35	-1.36%
GBP/ZAR	12.3520	-0.82%	Baltic Dry	3615	3.88%
GBP/CNY	11.4312	-0.09%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.472	-1.3	US 5yr	2.622	-2.3
EUR 10Yr	3.280	-3.8	EUR 5yr	2.781	-2.0
UK10 Yr	3.835	-5.0	UK 5yr	3.381	-0.2
Other			Official Rates %		
VIX	22.84	-1.34%	UK	0.50	
iTraxx XOVER	512.53	1.6	US	0.25	
DJ Agriculture Index	61.64	-0.38%	EU	1.00	
			Japan	0.10	

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