

Daily Market Strategy

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Market Strategy

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- Scrambling for safety
- Stocks sell-off; USD, JPY, bonds rally

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.4329

€/\$: 1.2278

\$/Y: 89.62

UK 5y sw: 2.51%

US 5y sw: 2.28%

EU 5y sw: 2.06%

Overnight

- MPC's Posen says UK economy at low risk of 'turning Japanese', says UK, US deflation cannot be ruled out; says sound policy to declare a limit on fiscal stimulus
- Equity futures point to 2.5% drop, 10y gilt through 3.50%, AUD slumps
- EUR weakness to weigh on Italian auctions tomorrow/Thursday?

A brutal correction in Asian equities overnight put a firm bid under government bonds, the USD and the JPY, and points to another tormenting trading session for risk assets and high yield/commodity currencies. A late surprise sell-off in US stocks and follow-through selling in the S&P June futures (currently down 23 at 1,047) rocked the Nikkei by 3% and puts the FTSE on course for a clean break through 5,000. The key level to watch is 4,955, the October 2 low. Failing a relief bounce back through 5,000, the next danger zone is situated at 4,776, the September 1 low. This would spin the FTSE back to Q3-09 when the UK economy logged a 6th straight quarter of negative growth since 2008, before finally emerging out of recession in Q4. Though leading indicators still point to a steady expansion this summer, fears are growing that a collapse in confidence (watch US Conference Board a 3pm) could undo the positive growth impulses that are still present today, with tensions in money markets resulting in USD liquidity drying up.

Ahead today

- UK: for Q1 GDP (2nd est), an upward revision to 0.3% is priced in. The data should not be a mover for GBP or gilts unless GDP is unrevised or marked down.
- EU: new industry orders data for April are second-tier; the Netherlands sell 2bln eur of 2015, 2017 benchmark bonds
- US: consumer confidence may set the tone for the early part of the week; week claims hinted at stalling employment growth through May, so we could see labour market optimism wane in the latest survey from the Conference Board. The Treasury sells \$42bln, 2y notes.

FX:

GBP: the peak correlation with commodities and equities works against GBP as stocks and oil fade. GBP/USD shed 100pips overnight, sliding below 1.4350. Key support runs at 1.4231. GBP/AUD makes progress above 1.76 as long, though no longer overstretched, AUD positions are unwound. We reiterate our call for a move up to 1.80. GBP/CAD has its eyes set on 1.55, but the Bank of Canada meeting next week calls for more cautious positioning vs GBP/AUD. The obvious target to the upside is 1.55 as the cross firms through 1.5346, the 50d MA. EUR: drops below 1.23 vs the USD. From here, we target a move to 1.2144, the May 19 low. Our medium target is 1.20. The modest outperformance of the EUR vs high yield/commodity fx squeezes EUR/AUD through 1.50 and EUR/CAD through 1.32. EUR/GBP is rangebound in the 0.85-0.86 area. For EUR/CHF, a pullback through 1.4250 has undone gains of the last two sessions and means we could see a drift back to and below 1.42).

Rates: UK 5y swaps find no support below 2.50% as participants clear out of pro-risk positions. 10y gilts drop below 3.50%, putting 3.40%/3.36% (ambitious?) into play if the FTSE fails to bounce over 5k. Though valuation of 10y paper looks stretched vs the FTSE (see chart), it is hard to argue against bullish momentum considering the wider state of fear. The idea that the BoE will have to resume QE should keep the flattening bid intact. 2y/10y gilts flatten to 265bp, with swaps moving through 195bp. 10y Portugal, Spain and Italy are all marked 3-4bp wider over bunds.

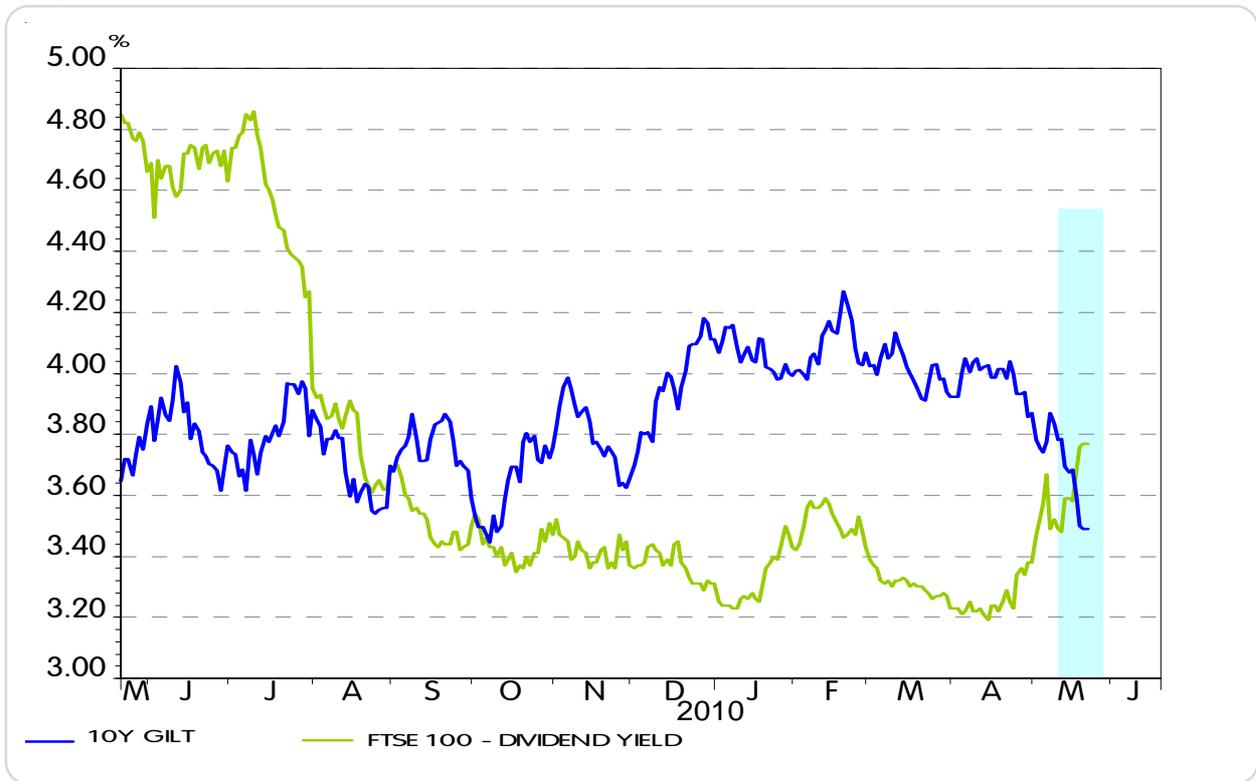
	Close	Daily Change %
FX		
EUR/GBP	0.8576	-1.35%
GBP/USD	1.4425	-0.24%
EUR/USD	1.2372	-1.58%
USD/JPY	90.290	0.32%
AUD/USD	0.8265	-0.64%
Bonds %		bp
US 10Yr	3.194	-4.4
EUR 10Yr	2.655	-1.1
UK10 Yr	3.546	-0.4
UK 5yr Swap	2.513	4.5
Equities		%
S&P500	1073.65	-1.29%
FTSE100	5069.61	0.00%
Eurostoxx50	2558.27	0.00%
Shanghai Composite	2622.63	-1.90%
Commodities		%
Crude Oil \$/bl	70.21	0.24%
Gold \$/oz	1191.7	1.24%
Copper	314.8	2.83%
Baltic Dry	3943	2.58%
Other		
VIX	38.32	-4.44%
iTraxx XOVER	587.40	0.1

Today's Data

	Time	Consensus	Previous	Events
UK GDP, Q1 rev, %q/q	09:30	0.3%	0.2%	Queen Speech
UK BBA Mortgage Loans, Apr	09:30	37k	34.9k	Fed speakers: Bullard (16:15)
EU-16 New Orders, Apr	10:00	2.5%	1.5%	US Treasury sells \$42bln, 2y notes
S&P House Prices, Comp %y/y	14:00	2.5%	0.6%	
US Consumer Confidence, May	15:00	58.5	57.9	

*All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, DataStream & CQG

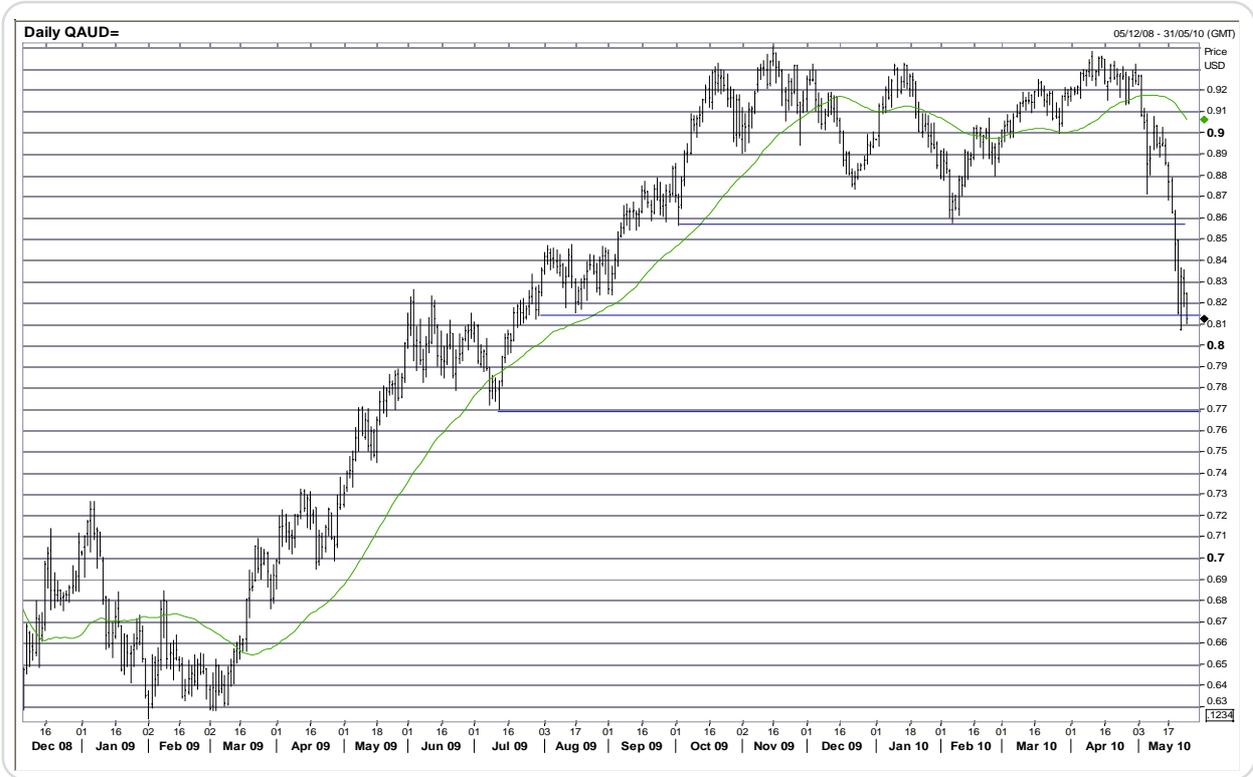
10y gilts, expensive vs the FTSE ...



... but FTSE can get cheaper still as 5k gives way



AUD/USD: support at 0.80?



US consumer confidence (May): surprise drop as stocks fade?



Market Summary

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FX			Equities		
EUR/USD	1.2372	-1.58%	S&P500	1073.65	-1.29%
USD/JPY	90.29	0.32%	DJIA	10066.57	-1.24%
AUD/USD	0.8265	-0.64%	FTSE100	5069.61	0.00%
EUR/GBP	0.8576	-1.35%	Eurostoxx50	2558.27	0.00%
GBP/EUR	1.1661	1.37%	Shanghai Composite*	2622.63	-1.90%
GBP/USD	1.4425	-0.24%	*latest price		
GBP/JPY	130.25	0.01%	Commodities		
GBP/CHF	1.6719	0.61%			
GBP/AUD	1.7453	0.45%	Crude Oil \$/bl	70.21	0.24%
GBP/CAD	1.5326	0.03%	Gold \$/oz	1191.7	1.24%
GBP/NZD	2.1560	1.20%	Copper c/lb	314.8	2.83%
GBP/NOK	9.3953	0.64%	Silver \$/oz	17.91	1.42%
GBP/ZAR	11.3109	-0.42%	Baltic Dry	3943	2.58%
GBP/CNY	9.8495	-0.22%			
Bonds %			Swaps %		
		bp			bp
US 10Yr	3.194	-4.4	US 5yr	2.347	4.1
EUR 10Yr	2.655	-1.1	EUR 5yr	2.126	0.6
UK10 Yr	3.546	-0.4	UK 5yr	2.513	4.5
Other			Official Rates %		
VIX	38.32	-4.44%	UK	0.50	
iTraxx XOVER	587.40	0.1	US	0.25	
DJ Agriculture Index	56.40	-0.14%	EU	1.00	
			Japan	0.10	

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