

Daily Market Strategy

Monday, 12th October 2009

Market Strategy

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- GBP selling pressure resumes
- Can Fed speak stabilise bond yields/swaps?

Market Outlook

Kenneth Broux

Opening levels (7.15am)

£/\$: 1.5827, €/£: 1.4711, \$/¥: 90.22

UK 5y sw: 3.14%, US 5y sw: 2.71%, EU 5y sw: 2.74%

Overnight

- Recovery for base metal prices falters (FT)
- The USD adrift (WSJ)
- UK to begin radical effort to sell assets (WSJ)

The brutal sell-off on Friday has changed the near-term set-up for government bonds and swap rates. Fed speak (reverse repo transactions), technically overbought conditions and a disappointing 30y Treasury auction were blamed for the spike in yields. Equities are holding up near the highs following an encouraging start to the US Q3 earnings season, making it hard to argue against a bearish short-term backdrop for bond yields as we look ahead to this week's calendar. With bonds braced for a spate of good US results from a selection of US banks, IBM and GE, hopes will rest on dovish economic data (UK CPI tomorrow, US CPI Thursday) and central bank speakers (today sees MPC's Bean and Fed's Dudley and Kohn) for yields to stabilise, though we are mindful of below-average trading volumes (today is a US public holiday, markets open). We detect some inflation jitters in UK breakeven rates - 5y up 17bps since Thursday though off the 2.16% high, but BoE gilt buying and prospects of lower UK CPI should help gilts/swaps to settle down.

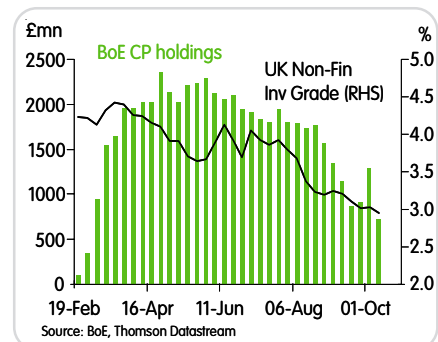
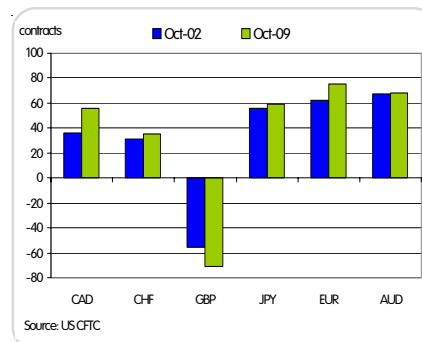
FX: Another bearish set of weekly stats for GBP and a dovish report on UK rates and the economy by the CEBR - officially due tomorrow - have taken the rug from under sterling first thing this morning. EUR/GBP traded over 0.9300 in Asia (GBP/EUR below 1.0752), putting the cross on course for a move up to 0.9350 (GBP/EUR 1.0695), as markets await comments from MPC's Bean. The dollar index climbed for a second straight session, despite the extensive bearish coverage in the WSJ and FT. Remarks by the Fed's Dudley and Kohn are awaited, though thin trading conditions could squeeze dollar shorts. GBP/USD slipped below 1.58 and needs to hold 1.5771 support to prevent a breakdown towards 1.55.

Rates: UK 5y swaps traded 4bps lower after opening at 3.14% this morning. The move last Friday was probably exaggerated and, though we remain fans of low yields, price action could favour the upper end of the range before CPI brings some relief tomorrow, (does Bean comment on QE today?). We were caught out by Friday's clear out in the Dec gilt future, but look for a bounce back above 120.0 if support at 119.78 can hold. Trendline resistance for US 10y runs at 3.40%. BTP/bunds narrowed 6bps last week. Support target runs at 80bps.

Weekly IMM update: 4th successive rise in net GBP short positioning

BoE CP stock lower on redemptions; but corporate credit rates are still falling

	Close	Daily Change
FX		%
EUR/GBP	0.9296	0.99%
GBP/USD	1.5844	-1.42%
EUR/USD	1.4732	-0.42%
USD/JPY	89.785	1.57%
AUD/USD	0.9037	-0.26%
Bonds %		bp
US 10Yr	3.380	13.3
EUR 10Yr	3.204	8.9
UK10 Yr	3.356	-2.9
UK 5yr Swap	3.129	9.2
Equities		%
S&P500	1071.49	0.56%
FTSE100	5161.87	0.14%
Eurostoxx50	2882.18	-0.19%
Shanghai Composite	2897.53	-0.49%
Commodities		%
Crude Oil \$/bl	71.77	0.11%
Gold \$/oz	1049.3	-0.55%
Copper	283.8	-2.09%
Baltic Dry	2695	1.81%
Other		
VIX	23.12	-4.38%
iTraxx XOVER	570.90	3.2



Today's Events

BoE buys £1.4bn of gilts: UKT_4_070322, UKT_5_070325, UKT_4_25_071227, UKT_6_071228, UKT_4_75_071230, UKT_4_25_070632, UKT_4_5_070934
BoE speakers: Bean (14:00)
ECB speakers: Tumpel-Gugerell (10:00)
Fed speakers: Dudley (18:15), Kohn (18:45)
US Public Holiday: Columbus Day (markets open)

Technical Analysis

Paul Rodriguez, Senior Technical Analyst

- DAX index futures finally breached key resistance at 5,764 (implying FTSE futures will do the same through 5,168 shortly). Yet there is still a sense of caution in equity markets. Perhaps this is a good thing. Compared with sentiment in the US dollar which has become polarised, the caution in equities is bullish for the trend. My view that we had seen the top has been proved wrong (or will do shortly in the FTSE) and, for now, I am cautiously bullish. I am cautious due the consolidation in base metals and the fact that Asian equities have been treading water for a few weeks now. However, with prices pushing into new highs in Europe, the scope for a continued upward trend has to be explored.
- Sterling once again is at risk of a further downside squeeze against the US dollar and euro, despite the oversold nature of the currency. Support at 1.5830 has been breached in cable, implying a push towards 1.5500, although 1.5755 is a key interim barrier that could provide a reaction. EUR/GBP is at the top of a range where the price action resembles a bullish ascending triangle. Having backed away from resistance on Friday, the risk for a push through to 0.9400 has increased this morning. In a change of sentiment, the euro and dollar look to be a buy against EM currencies from here, although the move is not broad based yet. EUR/SEK is one to watch today, having completed a major double bottom base and with EUR/ PLN in the throws of a head and shoulders reversal.
- From a broader perspective, the resoundingly bearish sentiment in the dollar is a warning sign. Profits have been taken in the NZD and the AUD may not be far behind. Unless the DXY can get through 76.00 in the next couple of sessions, the market will start talking about a base.

Chart of the day: Sugar# 11



Key Levels

	EUR	GBP	JPY	EUR/GBP	GBP/EUR
R2	1.4845	1.6300	95.15	0.9482	1.1135
R1	1.4764	1.611	91.80	0.9300	1.1018
Current Spot	1.4719	1.5854	90.19	0.9284	1.0771
S1	1.4450	1.5724	87.14	0.9076	1.0753
S2	1.4407	1.5455	85.00	0.8981	1.0546

Spot prices as of: 07:04:28 Source: Bloomberg

Sugar finally gives a 'breakout' signal - completing a topping formation through 21.95. Whilst below this level, the target is at 18.00.

	Spot	Bias	Entry	Target	Stop	Comment/Levels
EUR/USD	1.4719	Bullish	1.4650	1.4844	1.4595	
USD/JPY	90.19	Bearish	91.74	88.00	92.20	
USD/CHF	1.0321	Bearish	1.0360	1.0000	1.0426	USD bears get nervous near lows.
GBP/USD	1.5854	Bearish	1.5920	1.5500	1.6020	Break of 1.5830 is bearish, but range support near 1.5800.
EUR/GBP	0.9284	Bullish	0.9225	0.9400	0.9190	Ascending triangle means an upward squeeze.
GBP/JPY	142.99	Bullish	-	144.00	-	Key resistance at 144.57. Trying to base?
EUR/JPY	132.75	Bullish	-	133.00	-	
CAD/JPY	86.47	Bullish	85.34	92.00	84.80	Buy at 100 day m.a.
AUD/USD	0.9025	Bullish	0.8888	0.9291	0.8940	
USD/CAD	1.0430	Bearish	1.0650	1.0000	1.0510	Lowered stop- seems a risk of a bounce may be close.
NZD/USD	0.7294	Bullish	0.7360	0.7468	0.7225	NZD buy level hit, but signs of weakness?
USD/BRL	1.7410	Bearish	1.8338	1.7000	1.7550	Stop lowered.
USD/PLN	2.8931	Bullish	current	3.0000	2.8670	Inverse H&S implies euro strength.
USD/HUF	183.93	Neutral	-	185.00	-	Considering a reversal of trend- but for the moment neutral.

Spot prices source: Bloomberg

[ENTRY](#) - Targetted

ENTRY - Active

Quantitative Market Analysis

Naeem Wahid, Quantitative Strategist

The latest IMM data, released last Friday, show speculative positioning for the period ending Tuesday 6 October – see charts on page 4. The latest IMM data show speculators have further increased their net-short GBP/USD position. At 62,106 contracts, the net-short position is the largest on record – our data go back to 1992. Hence, in that context, speculative positioning data suggest that the currency pair is extremely oversold and therefore vulnerable to a corrective bounce higher. On Friday, we highlighted that GBP/USD and USD/JPY had become oversold on RSI measures. We still hold the preference of trading a long GBP/JPY position with a stop below Y139.50. A break through Y144.75 would pave the way for a move towards Y150. The long GBP/JPY trade is also favoured by speculative positioning in USD/JPY. Speculators are holding a net short position which is at the 12th percentile, highlighting the risk of a squeeze higher.

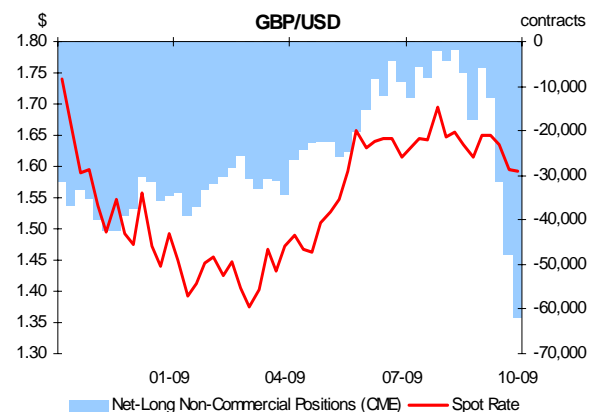
With the exception of GBP/USD, the data show speculators holding a net short USD position. In USD/CHF, speculative positioning is also at an extreme, with the net short position lying at the 1st percentile. Again, this leaves USD/CHF vulnerable to a corrective rally higher.

The recent bounce in the USD has begun to weaken the recent downward trend. Our in-house trend following model has taken a long USD position in GBP/USD and USD/PLN this morning. We are somewhat cautious, however, regarding the GBP/USD position, given the latest IMM data.

Table 1: 1-month correlations

	AUDUSD	USDCAD	EURUSD	GBPUSD	USDJPY	EURJPY	AUDJPY
2YRSPD	0.85	0.78	0.23	0.47	0.66	0.54	0.66
10YRSPD	0.34	0.40	-0.10	0.25	0.76	0.92	0.52
S&P500	0.43	-0.55	0.72	0.08	0.23	0.49	0.77
Gold	0.91	-0.94	0.58	-0.27	-0.49	-0.22	0.75
Oil	0.41	-0.74	0.42	0.20	0.01	0.17	0.56
CRB	0.70	-0.88	0.68	-0.02	-0.16	0.12	0.78

Chart 1: IMM data show record short speculative GBP/USD position

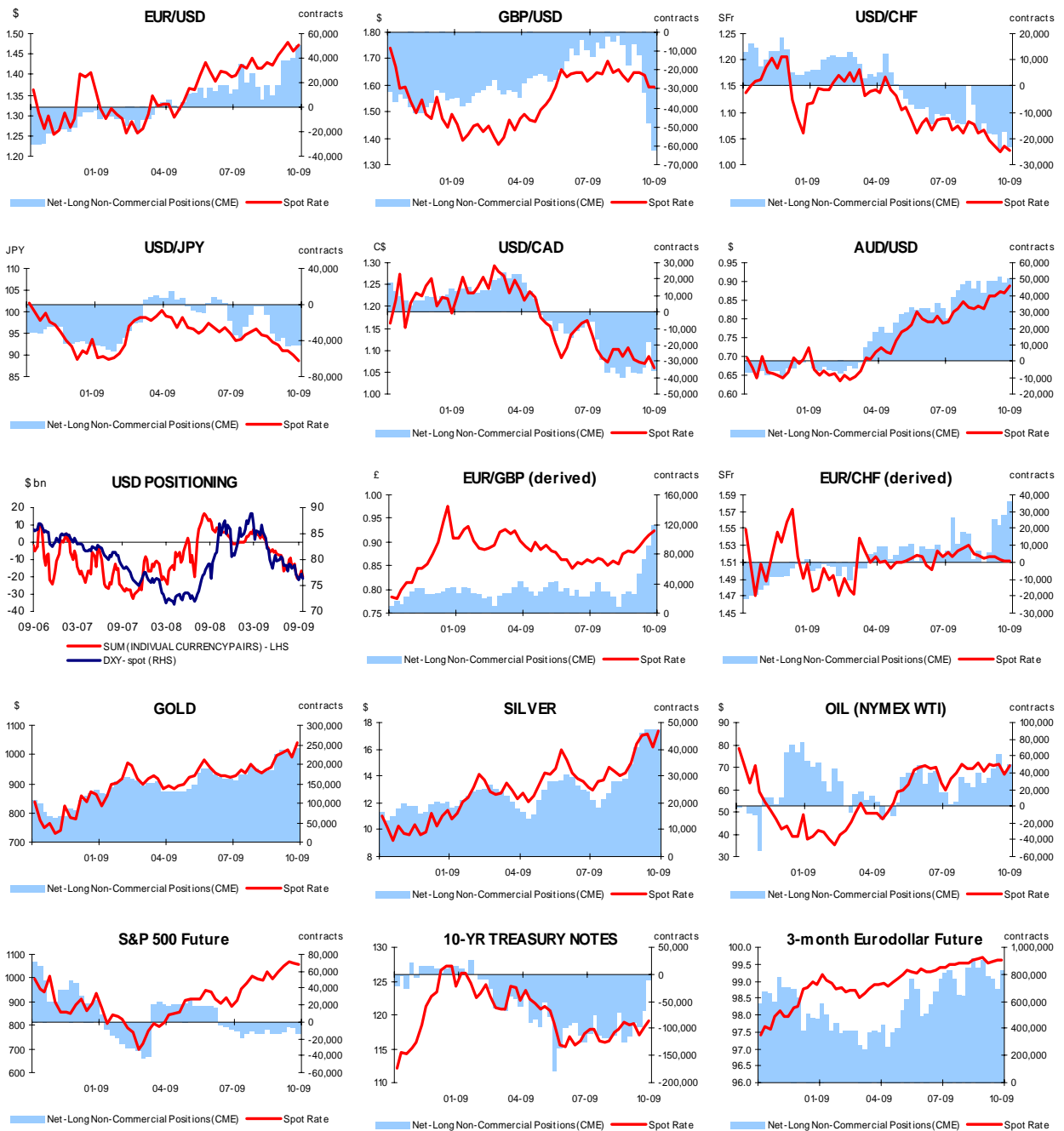


Trend following model signals

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
USDCHE	short	17-Jul-09	1.0730
USDCAD	short	07-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			-78%

Trend Following Model Positions			
	Signal	Date	Entry Level
USDCZK	short	19-May-09	19.709
USDPLN	long	12-Oct-09	2.8965
USDSGD	short	08-Sep-09	1.4337
USDTRY	short	15-Sep-09	1.4939
USDZAR	short	31-Aug-09	7.7525
Net-USD portfolio position			-60%

FX & Commodity Futures Positioning



Market Summary

FX			Equities		
	Close	Daily Change %		Close	Daily Change %
EUR/USD	1.4732	-0.42%	S&P500	1071.49	0.56%
USD/JPY	89.785	1.57%	DJIA	9864.94	0.80%
AUD/USD	0.9037	-0.26%	FTSE100	5161.87	0.14%
EUR/GBP	0.9296	0.99%	Eurostoxx50	2882.18	-0.19%
GBP/EUR	1.0756	-0.99%	Shanghai Composite*	2899.69	-0.41%
GBP/USD	1.5844	-1.42%	*latest price		
GBP/JPY	142.25	0.13%	Commodities		
GBP/CHF	1.634	-0.88%			%
GBP/AUD	1.753	-1.17%	Crude Oil \$/bl	71.77	0.11%
GBP/CAD	1.652	-2.29%	Gold \$/oz	1049.3	-0.55%
GBP/NZD	2.157	-0.29%	Copper c/lb	283.8	-2.09%
GBP/NOK	8.937	-1.35%	Silver \$/oz	17.71	-0.42%
GBP/ZAR	11.730	-0.46%	Baltic Dry	2695	1.81%
GBP/CNY	10.813	-1.43%	Swaps %		
Bonds %					bp
		bp	US 5yr	2.707	13.6
US 10Yr	3.380	13.3	EUR 5yr	2.723	4.3
EUR 10Yr	3.204	8.9	UK 5yr	3.129	9.2
UK10 Yr	3.356	-2.9	Official Rates %		
Other					
VIX	23.12	-4.38%	UK	0.50	
iTraxx XOVER	570.90	3.2	US	0.25	
DJ Agriculture Index	58.82	-0.71%	EU	1.00	
			Japan	0.10	

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