Our Guides - the **Technical Trader's Guide** and the **Macro Trader's Guide** both deal with these and many other markets in much more detail over multiple time- frames. **Key Trades Bulletins** subscribers receive a detailed report on every trade we enter for our Key Trades Portfolio. More details about all these products: CLICK HERE

Market Update 10th September 2009

UK Gilt market's uncertainty

The Macro Trader's view:

'*The Gilt is a government bond market that is dogged by an unprecedented build of peacetime debt, supported by the Central Bank.*' Discuss.

Since the highs made at the end of August, fuelled mainly by the Bank of England's series of QE policy surprises, the gilt has corrected lower during September. This has been due in part to the release of further data which has emphatically supported the UK economic recovery argument but also it has fallen because of raised questions over the need for QE.

Indeed, only this week UK manufacturing output, industrial production and the NIESR GDP estimate have all pointed towards the UK finally emerging from recession after the disappointment of the Q2 GDP data earlier in the summer. And yesterday's NIESR estimate fuelled a heavy sell off in the Gilt as it turned positive. Though that was reversed today.

Why, you may ask, would the NIESR estimate cause a selloff? Surely if the build up of debt has been a function of the recession, any sign that it is now ending, will result in the deficit coming back under control and thus eventually restrain debt levels.

The problem is that the debt build-up has been so large that any recovery cannot cure the problem by itself. If correction was left only to recovery, inflation would result, with much higher yields, further compounding the problem.

What is needed is a clear plan to cut spending supplemented by some tax increases, but that isn't likely until after the next general election due in 9 months time.

But for now, traders are unwilling to aggressively sell the Gilt, due to the Bank of England's presence in the secondary market, holding it up. That is in spite of the normal response to

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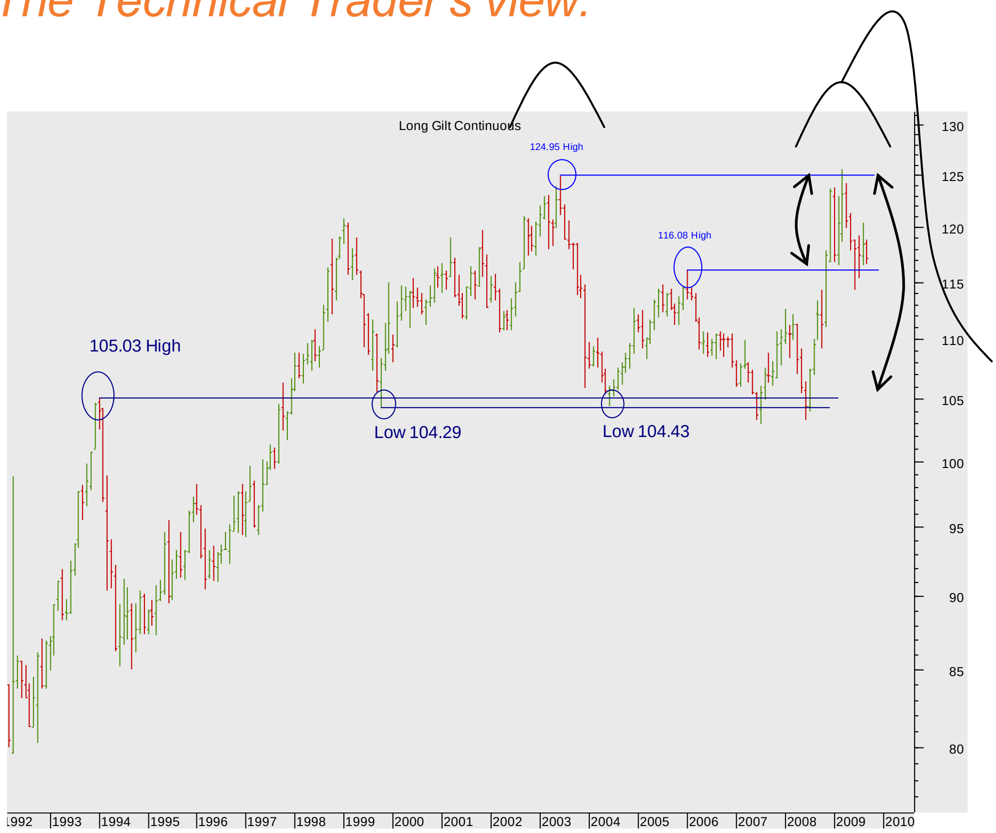
economic recovery accompanied by low interest rates, expansion of the monetary base (QE) and an enormous fiscal stimulus would be to begin driving yields higher in anticipation of inflation.

The gilts have a Teflon quality, bestowed upon them by the Bank of England's Quantum Easing program which resists such moves. So the government is afforded the luxury of lower yields than would otherwise be expected.

<u>Our view of the gilt is that it is a market waiting to be sold</u>. The selling in earnest will begin once the Bank's QE program is concluded. By then, recovery will have become an established fact and the outlook for inflation clearer.

And that will pose a significant and premature threat to the economic recovery because the Bank of England is not prepared to tighten in a timely and aggressive manner so as to counter a loose fiscal stance.

The Technical Trader's view:



MONTHLY CHART

The long-term chart has very clear parameters.

The second failure at the 124.95 High is clear.

And the support from the 116.08 Prior High sets the range.

For the moment the smaller range remains intact.

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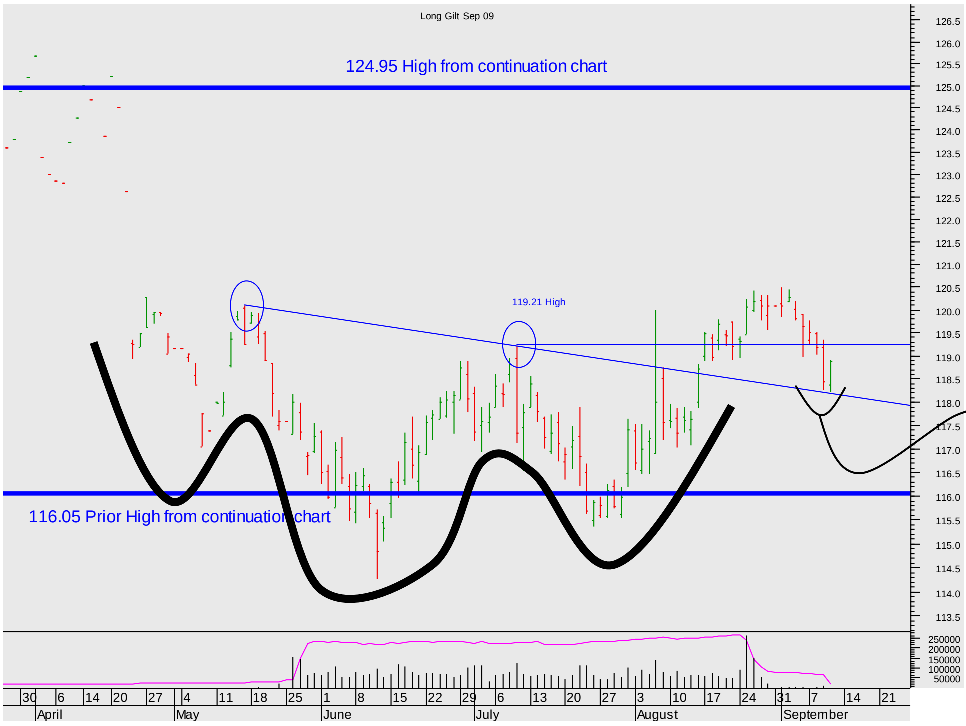

DAILY CHART

But when the daily chart is examined subject to those parameters, some uncertainty enters.

The double bounce of the 116.05 Prior High was bullish.

But the short-term test will be the support from the two prior Highs where – we are right now.

That is of course a possible neckline of a Head and Shoulders Reversal.

Watch carefully to see if it holds. If it doesn't, expect a rapid retest of the 116.05 lower boundary. Watch and wait for clarity.

Mark Sturdy

John Lewis

Seven Days Ahead

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