

A Fundamental View

Seven Days Ahead 15/02/04

Short Sterling

When last I wrote Short Sterling had suffered a set back based on expectations of a rate increase from the MPC. This had been driven by strong upward revisions to GDP for both the whole of 2003 and especially the 4th Quarter together with, continued strength in the housing market. In the event rates were left unchanged. The data that week came and went without drama, however the Non-farm payroll report from the USA released on Friday 05/03/04 was much weaker than expected and the market was dragged higher by events in the US. Last weeks data was largely featureless and the market was drifting lower until Thursday's train bombs in Madrid. The market rallied strongly as it became clear that this was the work of Al Qieda and served to remind every one that a terrorist attack could be launched at any time with devastating results.

This week we have several key data releases; Cpi, the unemployment report, retail sales, MPC minutes for March and on Wednesday; the annual budget. All of these have the potential to move the market but perhaps the budget will be the most keenly watched. However barring any major surprises, I expect market sentiment to be influenced by the recent tragic events in Spain.

JUNE 04

Trade recommendation:- Neutral.

BULLS may feel that since the contract recently bounced off of support for a third time in as many months and that sentiment will be led by the Spanish bombs. It is worth remembering that the UK economy is performing very strongly, as evidenced by the recent trade data, and that the Bank of England is in the middle of a tightening cycle. Therefore any rally will, from here, be limited and short lived.

BEARS will be concentrating on the fact that the market has gone better on non UK news and will expect the contract to resume its downward path.

The fact is, both are at the same time right and wrong; the market rallied due to non UK news true but of this the events in Spain are important for the UK because these acts could so easily be carried out here. If such an event occurred on the tube can you imagine the economic impact on our economy? Thus until some time has passed and the images of those dreadful events fade, then this contract will not move materially lower.

JUNE 05

Trade recommendation:- Bullish.

Last time I wrote I advised caution because this contract had the potential to rally strongly if the MPC left rates unchanged and indeed over the period it has. Not withstanding what I have said above, this contract has further potential to the upside.

BULLS will want to remain long of this contract since any further revelations concerning the bombs in Spain and Al Qieda's involvement will be supportive. Further the markets will be alert to further attacks and will want to be long as a hedge against the possible economic effects of such an event. Therefore a move back towards 95.50 is now on the cards but as always run a close stop.

BEARS will see the up coming data as providing the impetus for the market to refocus on economics. However markets are traded by Human beings and at times such as these, feelings and sentiment over rule logic.

Although I still expect the MPC to continue to raise rates again, my long held view has been the peak of the cycle will be 4.75%. Thus this contract sits neatly amid the most benign outcome 4.5% and the extreme view of 5%

EURO DOLLARS

When I last put "pen to paper", the market was getting the jitters about the non-farm payroll report due at the end of that week and the ISM reports that also fell due. The ISM reports were both largely weaker than the market expected but it was left to the non-farm payroll report to lift the market; coming in much weaker than expected and with downward revisions to previous releases, the market made a spectacular rally. Since the FED has stated they need to see strong jobs growth, the market concluded no change in FED policy for some time ahead. Last weeks data did nothing to change that view and with the Spanish bombings reminding Americans of the 9/11 atrocities the market consolidated its move. This week sees some important data releases; Industrial production & capacity utilization, Cpi, Philadelphia Fed and the FOMC rate decision on Tuesday. The most important event is the FOMC. The Fed is expected to hold rates at 1% but the statement will be keenly watched. The Fed will not want to ruffle the markets feathers since it has laboured to convince that it is in no hurry to act. Especially after the recent tragic events in Spain the Fed will know that the markets nerves will be raw and now would not be the time to engage in subtle changes in the statement.

JUNE 04

Trade recommendation:- Bullish.

Last time I advised to be long for a take profit of 98.85. A lot of water has flown under the bridge since then and I am raising my take profit level to 98.90.

BULLS will be encouraged by the way the market has traded. The market has had good fundamental news to drive this contract higher. The events in Spain have merely underlined just how vulnerable the western democracies and thus their economies are to terrorist attacks of this type. Buy/hold this contract, confirmation from the Fed on Tuesday of its previous comments will support the market.

BEARS can only hope for a change to the statement released on Tuesday by the FOMC since without that the contract is set to edge higher. Wait until after the rate decision before attempting to go short. It will save you money.

JUNE 05

Trade Recommendation:- Bullish.

I have been cautiously bullish of this contract for a while, oscillating between being in profit taking mode and fully long. I am currently long. The market has traded well. Aside from the events in Spain which consolidated the market, it was US economic data which pushed the market higher. I don't see that particular data series; non-farm payroll improving any time soon.

BULLS will be greatly encouraged by the contracts performance and I expect more. However a note of caution, the recent high in this contract was not breached so from a technical perspective keep the close stop which you should have already moved up. That said, the market will be nervous of any further terrorist acts and if one were to occur on American soil then don't be caught short. Although not a political commentator I feel an attack on America is in the pipeline.

BEARS can only hope that the recent rally will have run its course and that other stronger data series will take the markets attention. I advise caution. The Fed has told us what it is watching and those indicators are not about to trigger a change of policy for several months yet. Stand aside for now.

EURIBOR

The ECB never fails to disappoint. However with the Dollar having rallied so strongly over the past few weeks the ECB will be even more dogged in maintaining policy levels. Although the data out of euro land still points largely to weakness, the ECB will be hoping that now that the steam has come out of the EURO'S sails, economic activity can respond. I don't see it. The retracement in the currency market is in my opinion, short term. This week's data releases to watch are; German factory orders and producer prices together with several other minor releases.

JUNE 04

Trade Recommendation: - Neutral.

The contract is currently consistent with official rates. So if the ECB are, for the time being, to remain on hold then further upside is blocked.

BULLS should take profit and stand back.

BEARS don't get involved. Worries of terrorist activity will support the contract and any way, the ECB are not about to raise rates.

JUNE 05

Trade Recommendation: - Neutral.

The contract has come along way on the hope of a rate cut backed by weak economic activity and a very strong currency. The currency for now has lost its strength, but the economy is still weak. The ECB stood pat in the face of the Euros rally, it will not alter at the moment.

BULLS will feel like hanging on for many of the reasons I have argued elsewhere. However the market failed at this level last time and if the ECB does not want to help by cutting rates then don't be the last one out of the position. That said the time will come again soon to be long of this contract.

BEARS will feel like shorting the contract here. It has failed at this level before and if the ECB is going to stand firm then profit taking will set in. That said the downside should be limited because of the fear of further terrorist attacks. So if you do go short; run a close stop.

BONDS

The Gilt

Trade Recommendation: - Neutral

Last time I advised standing aside because the contract was stuck in a range. This was broken by the weak US non-farm payroll report followed by the events last Thursday in Spain. Although these events will remain supportive, the UK budget is due on Wednesday of this week and the focus will return to fiscal matters; which are not that rosy.

BULLS may feel that the safe heaven attraction of Government debt will offer further gains as investors shy away from equities. However I think we have, barring further terrorist attacks, seen this trade largely played out.

BEARS will have their eye firmly on the budget for any nasty surprises. But with the UK General Election starting to come into focus, Chancellor Brown is unlikely to do anything to rock the boat.

The US Treasury Note (10 yr)

Trade recommendation: - Short

When last I wrote I had advised staying short unless the 115.00 level was successfully broken. It was and the movers, as in so many other markets were 1st non-farm pay roll and 2nd the tragic events in Spain. The fundamentals though have not changed; the fiscal account is a mess and it will not be sorted out this side of the Presidential election in November and there after if Bush wins not even then; if Kerry wins by not as much as is needed.

BULLS should be careful here, the market has run a long way and a couple of strong numbers will push it lower. The economy is strong at the moment, but without sufficient job creation, for how long is the big question. We will not know for sometime yet, so job creation will be expected to burst through. If you are inclined to be long run a close trailing stop.

BEARS having been on the receiving end recently will feel that in light of the background fundamentals this contract has gone to far and I agree. Go short here for a profit taking retracement, but with terrorism on every ones minds run a close stop. If there were to be any more attacks turn the position.

The Bund

Trade Recommendation: - Bullish

Like all the other bond markets, this contract received a huge boost from the US jobs report on 5/03/04 and the events in Madrid last Thursday. However, unlike the other bond markets, this contract has strong fundamental reasons to be bullish. The economy is performing badly and the central Bank refuses to act. Even in the face of persistent currency strength they remained unmoved.

BULLS will be greatly encouraged by the strength of this market even in the face of the recent loss of strength in the currency market. Stay long of this contract for an eventual move to 118.00. But as always run a stop.

BEARS may feel that after such a strong rally and with Germany's finances in no better shape than either the US or the UK then this rally may have run its course. NOT SO. The key difference here is the weakness of the economy against the other two and a rigid Central Bank. Here the only relief is lower long term rates. Stand aside and save money.

CURRENCIES

The dollars recent strength has continued for longer than I expected. Although I still think that this move is a profit taking retracement, there are other factors starting to come into play.

Cable is now labouring under the weight of some dreadful trade data which have shown how Sterling's recent strength has hit the current a/c performance. However with strong jobs growth over the last few years in the public sector, the economy was surely going to display this kind of performance anyway.

Dollar/Euro has been hit by several factors. Initially verbal intervention by the Central Bank, expectation of further economic strength in the US and now the Dollars safe heaven status in the light of renewed terrorist attacks and worries of more to come.

MY VIEW is stand aside from these markets for the time being. The situation is less than clear. We could see further weakness in both Cable and the Euro. I feel the Dollar has not broken out of its bear move but this rally could go a little further before the market refocuses on why they sold the Dollar in the first place; namely a very weak current a/c and a huge fiscal deficit with no prospect as yet of improvement. I would want to see a period of consolidation around these levels with the market starting to make a pattern of higher lows before I would want to re engage. So stay patient and keep your powder dry.

If a US Dollar bull then the short term trend is with you but it could end at any time so although Cable at 1.75 is not out of the question. Run a close trailing stop.