JOHN LEWIS
9,PANTILE COTTAGES,
BIRD LANE
UPMINSTER
ESSEX
RM14 1TZ

johnlauralewis@btinternet.com

+44 (0) 1708 641553 +44 (0) 7776 181843

A FUNDAMENTAL VIEW

7DAYS AHEAD

26/04/2004

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Short Sterling

Last week I highlighted several key data releases all of which produced interesting results. PPI came in higher, although the core was in line. CPI showed a surprise fall to 1.1% which is just 0.1% away from the lower parameter of the inflation target which the Bank of England is mandated to meet and is required to explain, via a public letter to the Chancellor, should it fail to achieve. MPC minutes, revealed an 8/1 vote in favour of unchanged rates at the April meeting; as expected. GDP came in weaker than expected and although the year on year measure looked strong; 3.0%, the quarterly rate was noticeably weaker at 0.6%. When this number is viewed on an annualised basis, 2.4% it shows that 1st quarter GDP was marginally below the economies assumed speed limit of 2.5%. Last of all retail sales came in surprisingly stronger than consensus but even here there is a story; the strength was in goods categories which reported strong price discounting. All this means that the MPC may not increase rates at the May meeting in spite of comments from Tucker and Large in the last few days.
This week the calendar is somewhat lighter; CBI quarterly Industrial trends survey, being the major release, the others being BBA mortgage lending figures and Gfk consumer confidence. The market will therefore focus on the May MPC meeting next week.
Last time I became bullish the front contract but remained neutral the longer dates.
This week I am maintaining that stance and repeat my trade suggestion of last week. Should the Bank of England hold rates steady then an interesting convergence play comes sharply into focus. Even if they do nudge policy higher the convergence trade still works.
BULLS may wish to try the suggested convergence trade below.
BEARS may, in the light of the Tucker/Large comments want to push the June 05 contract lower, however Governor King will I am sure, remind his colleagues of the importance of the inflation target and where inflation is currently in relation to that target..

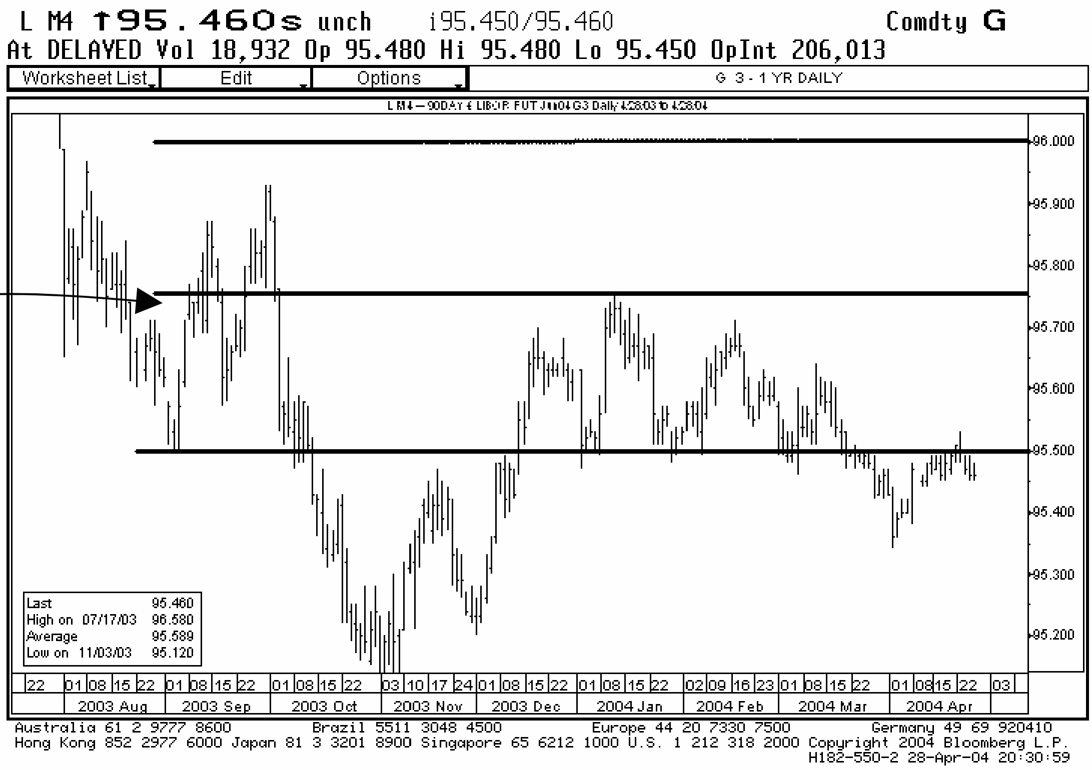
JUNE 04 95.47

Trade recommendation: - **Bullish**. **SUGGESTION; -** Buy the 95.50, 95.75, 96.00 call butterfly for 2.5 ticks. If contract settles at 95.62 as expected then profit would be 8.5 ticks, the maximum loss if wrong is the premium paid; 2.5 ticks. See chart below….

JUNE 05 94.81

Trade recommendation: - **Neutral.**

1A



At expiry, point of maximum profit.

Area of profit erosion.

EURO DOLLARS

Last week I highlighted speeches by Fed Chairman Greenspan and the Feds Beige book as the key events. When Greenspan spoke on the Tuesday the market panicked because he told us how deflation, as a threat to the economy had all but vanished and that the expansion was broader based, employment was improving and that spare capacity was being eroded. When he spoke again on Wednesday he eased those concerns by emphasising that inflation was still low and expected to remain low thus enabling the Fed to remain patient whilst vigilant. The Beige book largely echoed these themes. The other releases; PPI came in showing moderate inflation but the show stopper was durable goods. This was much stronger and together with upward revisions to last months data, show a strengthening trend.
This week sees a somewhat heavier schedule of data releases. Of these I am highlighting consumer confidence, GDP and employment cost index, then on Friday university of Michigan confidence and Chicago purchasing managers index. These are all important numbers but I think the BIG one is the 1st Quarter GDP. The market is looking for 5% I think, given the strength of retail sales, the number could be higher. Also within this release is the price deflator, this to is key since it is a broad based gauge of inflation. If the GDP release turns out to be materially stronger than consensus then the market will suffer another sell off.
Last week I remained neutral the market, since I wanted greater clarity. **This week** I am remaining neutral the front contract but am now **Bearish** the further out contracts. Should the economy build on the recent strong data releases seen thus far this year into the summer then the Fed will surely begin raising rates in the 3rd quarter. They have a long way to go to reach neutrality. **BULLS** should again stand easy and await the GDP numbers. **BEARS** may like to try my recommendation below. It is low cost with potentially high return and given the jury is still out on the sustainability of the economies strength, affords plenty of room for manoeuvre.

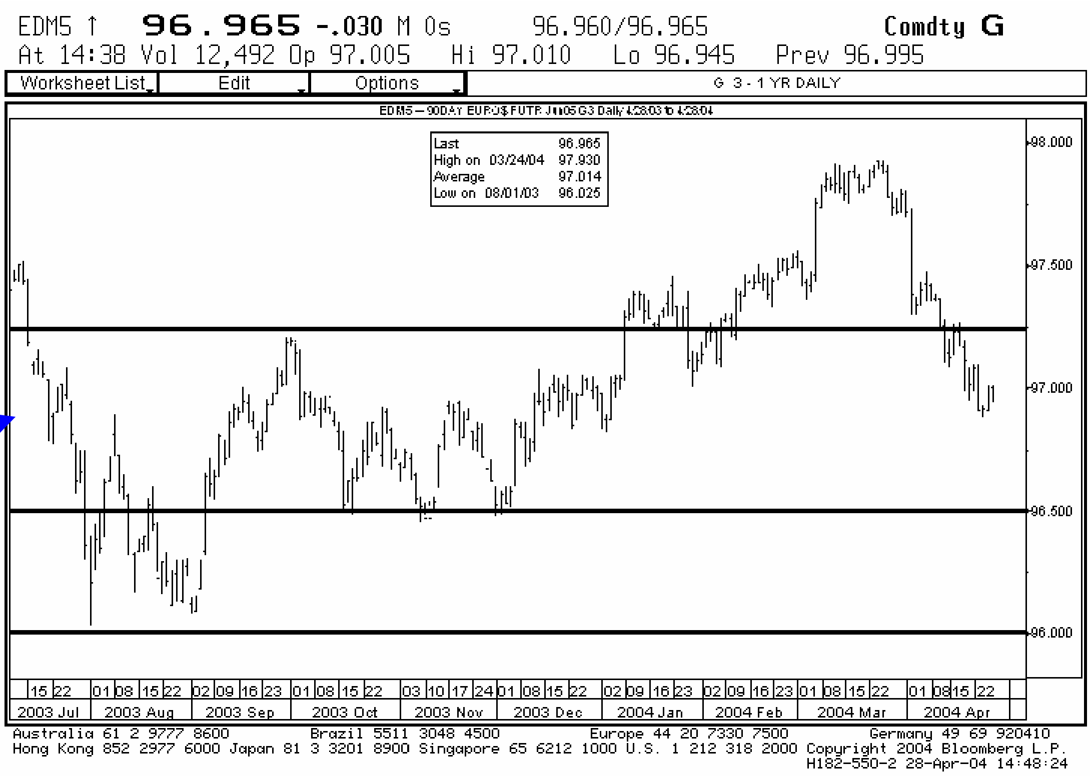
JUNE 04 98.67

Trade recommendation: - **Neutral.**

JUNE 05 96.905

Trade Recommendation: **- Bearish.** **SUGESTION** Buy 96.50/96.00 put spread v selling the 97.25/97.50 call spread. Net cost 3.5 ticks. If the fed starts to tighten in 3rd quarter Euro dollars will price in a tightening cycle that sees Fed Funds at 5% or more since the Feds initial aim will be return policy to neutrality. See chart below…..

2A



Were the contract to settle in this area then the maximum loss would be the cost of putting on the trade.

Were the contract to settle here this is the point of maximum profit.

If the market rallied above this area, then point of maximum loss,

EURIBOR

Last week I flagged French current a/c and consumer spending together with German PPI as the most noteworthy releases. Of the French data the consumer spending came in much weaker the German data; - PPI was a little higher than expected but still low. Nothing changes in Euro land. Will it ever? Not until the ECB lowers rates anyway.
This week there are several heavy weight numbers out these being; French GDP and unemployment data together with German IFO Index and German retail sales.
Last time I was bullish the curve and **so I remain**. As difficult as it is to remain committed when the market moves against one, it is important to remain focused on the fundamentals. The Euro land economy is weak and underperforming its peers, Trichet at the weekend G7 meeting left the door open for lower rates and the IMF has downgraded its estimate of Euro land GDP growth for this year. Although it has moved against us I am still committed to and repeat last week's trade recommendation. However from a technical view point the market needs to hold around this level.
BULLS should try to hang on to their positions. The ECB needs to lower rates.
BEARS have had the market move their way recently but for how much longer. Be safe and run a close stop.

JUNE 04 97.945

Trade Recommendation: **- Bullish**

JUNE 05 97.225

Trade Recommendation: - **Bullish.**

SUGGESTION; - Sell the June 04/June 05 spread for a flattening of the curve.

BONDS

The Gilt 106.85

Trade Recommendation: - **Bearish.**

I am still **BEARISH** of the Gilt and expect to see it lower. Although the Governments borrowing figures were mildly better than projected in the recent budget they were not that much better and with the next general election beginning to appear on the radar don't expect Brown to take any corrective action. He will hope that the economy expands enough to shrink the problem.
BULLS should refrain.
BEARS should hold their position for a move to 106.00.

The US Treasury Note (10 yr) 110.23

Trade recommendation: - **Bearish.**

Last time I advised being short of this contract and it moved our way.
This week I am maintaining my short position for a move initially to 110.00 then lower but more of that next time.

BULLS should stay out of this market. It is very bearish and with a large budget deficit, respectable growth and strong retail sales, the market will remain nervous of higher interest rates and more recently higher inflation, although historically; still low even though Greenspan did his best to avoid spooking the market.
BEARS who took my advice last time are still making money. But as always run a stop. We don't want to give it back.

The Bund 113.83

Trade Recommendation: - **Neutral.**

Last time I was a committed bull and although I still believe every thing I have said about this contract, sometimes you have to stand aside, reassess and await a new opportunity. That is what I am doing now and am adopting a neutral stance.

BULLS should square up and await fresh data and a new opportunity.
BEARS have had a good run and may get more, but since I have been bullish for so long and am only going neutral to avoid further losses I will not be joining in. However given the fundamentals in Euro land do run a close stop since this market will again awaken to the problems and weaknesses of the economy and resume its bull run.

CURRENCIES

Last time I was long the Dollar against the Euro, neutral Cable and long sterling against the Euro.

This week I am holding to last weeks recommendations. I don't see that very much has changed. The US Dollar has gained strength from the recent strong US data and this has rippled through to affect Sterling. I believe the Dollar will resume its downward path if and when we see new evidence of weakness in the labour market. So for now be long the dollar, but run a stop. However with GDP data due later this week and in all likely hood it will be strong approx 6%, it is worth staying long the dollar.

Sterling is still fundamentally a buy but it is suffering a technically driven set back. So for now stay out of Cable. Sterling Euro is an other issue, the UK economy is strong with very low inflation while the Euro land economy is weak and not recovering. Then there is the matter of the interest rate carry. Need I say more.

Recommendation: - Buy the Dollar against the Euro.

. Neutral Cable

Buy Sterling against the Euro.
Eventual target 0.625