Seven Days Ahead

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The Macro Trader's guide
To
Major Markets

21st - 27th December 2004

Short Sterling labours after stronger CPI & Retail sales.

Dollar rally runs out of steam.

Gold rebounds.

John Lewis

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About John Lewis

John Lewis has worked in the London financial markets for 28 years.
He joined Standard Chartered Bank London in 1976 trading the Sterling money markets.

He then trained as a floor trader with Holco Trading on the London Commodity Exchange specialising in cocoa and oil futures.

He began to trade off the floor with Drexel Burnham Lambert becoming Deputy Manager of their Money Desk in Europe responsible for all funding, money market trading and FX hedging for the European operation.

He rose to become Deputy Global Head of Proprietary Trading with Skandinaviska Enskilda Banken and thence Head of Proprietary trading Svenska Handlesbanken London.

After 1998 he moved into the hedge fund business as a senior fund manager of Weavering Capital UK.

Now in association with Sevendays*Ahead* he works with a wide variety of financial institutions and independent traders, utilizing his long experience and successful trading record.

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UK MARKETS

SHORT STERLING

WHAT HAPPENED LAST WEEK?

	Week of 13th December
Monday	PPI Output sa (ex FBTP) 3.0%y. **AS EXPECTED** CBI Mthly trends survey -6 **WORSE THAN EXPECTED**
Tuesday	CPI 0.2m, 1.5y **HIGHER THAN EXPECTED**
Wednesday	Unemployment rate 2.7% **AS** Change -3400 **WORSE** Avg Earnings 4.1% **HIGHER THAN EXPECTED**
Thursday	Retail sales 0.6m, 6.1y. **HIGHER THAN EXPECTED**
Friday	

Last week's calendar.
Last week's data showed inflation unexpectedly pushing up as CPI was higher than expected, retail sales too was a surprise for the market as it was stronger than consensus. The higher inflation was due to higher energy prices and air fares, which in turn, were caused by higher energy prices; this will correct as Oil prices have declined recently. The stronger retail sales showed there was life in the consumer yet and sent the market much lower. As I highlighted last week the recent retail surveys were out of sync with the real world and this problem does occur from time to time. The CBI survey released on Monday showed a weak manufacturing sector, but as manufacturing is a small part of the economy its significance was swamped by the retail sales data.

SEPTEMBER 05 SHORT STERLING

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SHORT STERLING
THE WEEK AHEAD

	Week of 20th December
Monday 9.30am	BBA Mortgage lndg n/f PSNB 7.5B PSNCR 6.0B M4 Stlg lendg 13.2B
Tuesday 9.30am	RICS House prices -43
Wednesday 9.30am	MPC Minutes. 9/0
Thursday 9.30am	GDP Q3 F 0.4%q, 3.1y. Current a/c Q3 -6.5B
Friday 9.30am	**NO DATA RELEASES** XMAS EVE **MERRY CHRISTMAS**

This week's calendar.
This week the market has a fresh look at Government borrowing, housing data, the latest MPC minutes and the final release of 3rd quarter GDP. The housing market data will be of particular interest because most predictions of the economy slowing are based on house prices falling, or at least slowing. The MPC minutes are unlikely to be controversial as they too have predicted slower house price inflation; GDP should be as previously stated. If the current account figures out on Thursday prove worse than expected this will, if by a large enough margin, reduce GDP which will suite the bulls.

MY TRADING STANCE: BULLISH.

Last time I was bullish of September 05.
This week I remain bullish of September 05
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Last week, I stayed bullish as I anticipated a more benign reading of retail sales, which would have sent the market higher; in the event the number was much stronger and served to push the market back down towards the lows visited and rejected a couple of weeks earlier. As we move into the Christmas break there will be little to enable the market to immediately recover, but neither do I expect it to move lower from here. When traders return after the break I expect the data to confirm a slowing economy with inflation well contained; benefiting from the recent retreat of Oil prices and Sterling's strength against the US Dollar which serves to restrain inflation. As it becomes apparent the MPC will indeed keep policy on hold for the first quarter, the market should bounce back. For now markets will be very thin and trading may become choppy; typical holiday markets.

BULLS should hold their positions.
BEARS stay square.

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THE GILT

MY TRADING STANCE: BULLISH.

Last time I was cautiously bullish.

DECEMBER 04 GILT

See how the Gilt maintained the rally as the Pound regained lost ground against the US Dollar, seemingly ignoring the stronger UK data; only retreating when the Oil price spiked on Friday.

This week I remain cautiously bullish.

Last week the Gilt continued the rally even as the UK published higher CPI and Retail sales data which had the potential to shake the markets belief that the economy was slowing. However, on closer inspection the CPI spike was almost entirely energy driven; either directly through higher fuel costs or indirectly; through higher air transport costs. This will correct lower over the coming months as the price of Oil is US$10.00 per barrel below the high recorded only a few weeks ago. Traders understood this and the market was little affected. The key to the trajectory of the economy is the housing market; this has been slowing in recent months as evidenced by lower house price surveys and mortgage lending figures; as confirmed by today's release of the BBA mortgage lending data. It is this development which will determine whether the economy slows and currently the evidence suggests it will. Faced with a decelerating economy investors are factoring in lower yields and that is what fuels the current rally, aided by the strength of the currency which also guaranties inflation will remain becalmed.

BULLS who are already long hold positions, otherwise wait until after the Christmas break as markets are thin and choppy this time of year.
BEARS stay square.

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THE POUND STERLING

MY TRADING STANCE: BULLISH.

Last time I was bullish the currency.

THE CABLE CHART

See how the Pound regained much lost ground as higher CPI and Retail sales caused traders to question the recent view that the next move by the MPC will be an ease.

THE STERLING/EURO CHART

Against the Euro too, the Pound has built on the young rally as traders reappraised the relative strengths of the UK and EU 12 economies in the UK's favour. See how retail sales on Thursday added to the rally.

This week I remain bullish of Sterling.
Last week the Pound, aided by unexpectedly higher CPI and Retail sales, resumed the now well established rally against the US Dollar. More recently though, the Pound has found new life against the Euro as the EU 12 economies continue to struggle and have failed to match the strength of the UK economic recovery. This together with a relatively stable Government and pro-business environment coupled with an interest rate differential firmly weighted in Sterling's favour, means investors have re-visited the merits of holding the Pound. This phenomena is likely to continue until either the Euro zone economy begins performing or interest rate reductions in the UK become a racing certainty; the later not occurring until at least the 2nd quarter.

BULLS stay long and continue to run stops at 1.90 the figure to protect profits; the target is at least US$2.00 to the Pound.
BEARS should stay square for now as there is no clear trade.

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US MARKETS

EURO DOLLARS

WHAT HAPPENED LAST WEEK?

	Week of 13th December
Monday	Retail sales +0.1 Retail sales ex-Autos 0.5 **BOTH STRONGER THAN EXP**
Tuesday	Trd Bal -$55.6B **WORSE THAN EXP** Ind Prod 0.3%, **HIGHER THAN EXP** CAP U 77.6% **LOWER THAN EXP** FOMC Rate Decision, +25BP **AS EXPECTED**
Wednesday	Empire Mfg 29.9 **HIGHER THAN EXPECTED**
Thursday	C/A Bal Q3 -$164.7B **LESS THAN** Housing starts 1771k **LESS THAN** Permits 1988k **LESS THAN** Jobless claims 317k **LESS THAN** Philly Fed 29.6 **HIGHER THAN EXPECTED**
Friday	CPI 0.2m **AS EXPECTED** CPI Ex F&E 0.2m. **AS EXPECTED**

Last week's calendar.
Last week's data painted a complex picture; retail sales were stronger, industrial production was stronger, Jobless claims and the Philly Fed survey also showed much improvement, however, the trade balance was much worse, Cap U was weaker than consensus, Q3 current account balance; although below consensus, was still a record deficit. The only data meeting consensus was CPI which fitted in with the statement released by the FOMC when, as expected, they tightened policy by another 25 basis points. The statement was almost unchanged and to the disappointment of many in the market failed to flag any worries over inflation over the next few quarters. The market chose to focus on the strong data and moved lower, supporting my decision last week to square up.

SEPTEMBER 05 EURO DOLLARS

See how the market initially took Tuesday's FOMC decision and statement as bullish; only to sell off on Thursday and Friday as investors focussed on the much better Jobless claims data and Philly fed survey.

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EURO DOLLARS
THE WEEK AHEAD

	Week of 20th December
Monday	
Tuesday	
Wednesday	GDP 3Q F 3.9% Personal consump 5.1% GDP Price deflator 1.3%
Thursday	Personal income 0.3, Personal spndg 0.3. PCE Deflator 2.5%y/y PCE Core 1.5%y/y Durable goods 0.6, less Transp't 0.7. Jobless claims 335K U of Michigan 95.7 New home sales 1200K
Friday	**NO DATA RELEASES** XMAS EVE **MERRY CHRISTMAS**

This week's calendar.
This week all the data is bunched into Wednesday and Thursday as the markets will close early on Friday for Christmas Eve. GDP could see a revision based on the current account data for Q3 which was a record deficit; on Thursday the eye catching numbers are the PCE Deflator and PCE core which are two measures of inflation favoured and used by the Fed for policy making decisions, Durable goods; because it is so volatile any outcome is possible and Jobless claims for evidence of improvement in the labour market; so key to the further strengthening of the US economic recovery. By the time University of Michigan and new home sales are released most traders would have already squared up for Christmas if they haven't already done so.

MY TRADING STANCE: NEUTRAL.

Last week I was neutral of September 05.
This week I remain neutral of September 05.

This week, I am staying square as I see no point in opening up new positions during thin, and sometimes volatile, holiday markets. Any data releases even only slightly away from consensus are liable to cause exaggerated moves which will correct after the Christmas and New Year break's are over. Better then to wait until January to take a fresh look. On recent data releases and based on the Fed's own assessment it looks likely that policy is in for a very long and slow period of upward adjustment. Although the GDP numbers appear solid, they are not as robust as one would expect at this point in a recovery. The labour market is still too erratic to conclude that enough new jobs are being created to provide the extra consumers needed to further entrench the recovery and insure its durability. There are presently too many imbalances which need correcting; the budget deficit and its current account cousin. This job is being done slowly, by the weakening of the currency.

BULLS stay square.
BEARS should remain square for now and look for opportunities after the holiday season.

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THE US TREASURY NOTE (10 yr)

MY TRADING STANCE: BEARISH.

Last week I was bearish.

US 10yr NOTE DECEMBER 04

See how like Eurodollars, the Treasury market initially rallied on the FOMC rate increase and accompanying statement; only to sell-off after Thursday's strong jobless claims and Philly Fed.

This week I remain bearish.

Last week the market tried to take something positive out of the FOMC meeting and rallied when the Fed left its accompanying statement virtually unchanged; it felt the risks to the economy were balanced and its assessment of inflation was benign. Ahead of the announcement traders had anticipated a changed text, putting more emphasis on inflationary worries thus meaning a quickening of the pace in the tightening cycle, but it wasn't to be. The Fed is still relaxed about inflation pressures and it is right as Friday's CPI revealed. The bullish mood did not last as traders latched onto lower jobless claims data and a much stronger Philly Fed survey released on Thursday which, together with a Dollar once more in decline, pulled the rug out from under the treasury market. The market is torn between a seemingly torpid recovery and twin deficits of historic proportions. The deficits will ultimately prove the major factor and the market will decline further. For now Christmas is upon us and it is not the time to take fresh positions. In the sober light of the New Year traders will be faced with a recovery, which although less robust than expected, is becoming more entrenched and the need to tackle the twin deficits will loom larger on trader's radar's. The Administration is unlikely to oblige and the Dollar and the treasury market will pay the price.

BULLS stay square.
BEARS run small short positions until after the holiday season.

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THE DOLLAR

MY TRADING STANCE: BEARISH.

Last week I was bearish the Dollar.

EURO/DOLLAR CHART

See how the Dollar swung around last week until a spike in the Oil price on Friday combined with other factors to push the US Dollar lower.

This week I remain bearish of the Dollar.

Last week the Dollar resumed its decline after having attempted a rally the week before. As the catalyst for this waned; threats of Central Bank intervention, traders again began re-instating short positions. The week saw some volatility as the market chose to focus on stronger jobless claims and Philly Fed on Thursday. The key to Thursday's price action though was the 3rd quarter current account deficit. Although at an all time record; it was less than market consensus and amazingly, traders took this as good news and bought the US Dollar. In the end common sense prevailed and with the help of a spike in the Oil price, the Dollar found its self back under pressure. It will have to get use to the scenario, as it will undoubtedly decline further from here in the new year as the current a/c will take time to correct; the familiar J curve effect, and as the Bush Administration will continue to use the large and growing budget deficit., to finance the hardware needed to enact their foreign policy objectives; democratising the Middle East. This is a policy fraught with all sorts of pitfalls and will test the patience and staying power of the American public as opinion in the Arab World views American policy towards them, as a new crusade. This will ensure no end of willing suicide bombers prepared to die for their mistaken cause.

BULLS stay square.
BEARS stay short and continue to use any pull back to add on.

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EURO 12 MARKETS

EURIBOR

WHAT HAPPENED LAST WEEK?

	Week of 13th December
Monday	IT Ind Prod 0.5m, -0.2y. **WEAKER THAN EXPECTED**
Tuesday	IT CPI (F) 0.1m, 1.9y **AS EXPECTED**
Wednesday	IT C/A 990M **LESS THAN EXPECTED**
Thursday	FR C/A -1.2B. **WORSE THAN EXPECTED** FR Non-farm payrolls 0.2% q/q **HIGHER THAN EXPECTED**
Friday	IT Ind ordrs 0.4m, -1.1y. **LESS** IT Ind sales 2.3m, 0.4y. **LESS** IT Trade Bal 664M, EU 125M. **LESS THAN EXPECTED** DM IFO Survey 96.2 **HIGHER THAN EXPECTED**

Last week's calendar.
Last week most of the data underperformed consensus with the notable exception of; French non-farm payrolls and German IFO business survey. The market chose to focus on these two releases and sold off, even though the over all picture in the Euro zone remained unchanged. The short lived US Dollar rally on Thursday didn't help either and over the two sessions the market priced back in nearly a full 25bp interest rate increase. Given how the economy has underperformed all year and how the Euro has over performed; that seemed excessive. All the Italian data were disappointing and the French Current account deficit widened; an event which will only worsen with the strength of the Euro.

SEPTEMBER 05 EURIBOR

See how the market sold off heavily on Thursday and Friday on the back of two numbers, one; French and the other; German, which alone displayed a degree of strength.

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EURIBOR
THE WEEK AHEAD

	Week of 20th December
Monday	DM PPI -0.3m, 3.0y. IT Unemployment Rate 8.1%
Tuesday	FR Consumer spend'g 0.1m, 4.7y. IT Consumer conf 104.1 DM Ind prod n/f
Wednesday	FR PPI -0.1m, 3.2y. FR CPI 0.0m, 2.0y IT Trade bal non-EU 270M
Thursday	FR Bus conf 105. IT Retail sales 0.2%m, -1.0%y IT CPI 0.1m, 1.9y. DM CPI 0.8m, 1.9y.
Friday	**NO DATA RELEASES** XMAS EVE **MERRY CHRISTMAS**

This week's calendar.
This week the calendar is full of PPI and CPI data coupled with consumer and business confidence figures. On Thursday we get an update of Italian retail sales. The inflation data over the last few quarters have been inflated by the bloated Oil price and its effects along the price chain. Since the French, Italian and especially the German economies, which together are over 50% of the EU12 GDP, rely mainly on manufacturing and exports, albeit at the value added end of the spectrum; any large and sustained increase in any of the factors of production are unwelcome. Oil has suffered this fate and although the strength of the Euro has sheltered these economies from higher oil prices to a degree, it has also made their exports less competitive too. Even though the price of Oil has declined recently it is still at a level which causes discomfort to say the least.

MY TRADING STANCE: NEUTRAL.

Last week I was neutral of September 05.
This week I remain neutral September 05.

The recent rally was stopped in its tracks last week as in the absence of any intention from the ECB to reduce rates, the market had no where else to go. This is precisely the reason I have avoided trading this market because although all the fundamentals point to an economy which is seriously underperforming by any body's measure and a currency which is over valued by any reckoning of the economies performance; the ECB is still reticent in its opposition to any further reduction of interest rates and frets about the relative levels of inflation when, absolute levels are acceptable. The principle reason inflation is stubborn in the EU 12 area is because the economy is too rigid and in need of reform, as more than adequately embodied by the rigid and inflexible ECB, the hapless central Bank charged with overseeing all things economic in that blighted economic zone. Until, not only the ECB, but also the EU 12 officials learn to think out of the box the status quo will pertain and the market will perform ever thus.

BULLS stay square.
BEARS stay square while the Euro remains strong.

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THE BUND

MY TRADING STANCE: BULLISH.

Last week I was bullish of the bund.

THE BUND DECEMBER 04

See, how after making new highs mid week, the Bund succumbed to the same fate as Euribor and spent Thursday and Friday in retreat.

This week I remain bullish of the Bund.

Last week I anticipated further gains for the Bund and over the first half of the week it did indeed make new highs. However it spent Thursday and Friday in retreat as French non-farm payrolls and German IFO exceeded expectations, taken together with a powerful if short lived Dollar rally on Thursday, the Bund gave up the gains made that week. However, I am unperturbed and remain bullish of the market. Other data released last week was mainly weaker and we have seen the IFO survey produce positive readings on other occasions this year only for reality to disappoint and the IFO index to slip back over succeeding months. The EU 12 economy remains week and the Euro has, once again, resumed its rally. In these circumstances the Bund will do what it has done for most of this year; rally. All the speculators buying the Euro have to put their funds somewhere and the interest rate differential works against them so they buy Bunds.

BULLS stay long and keep stops at 118.50 on half the position to protect profits. Run a stop at 118.10 on the rest.
BEARS stay square while the market trades above 115.90; a long way away and not likely to be seen anytime soon.

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THE EURO

MY TRADING STANCE: BULLISH.

Last time I was bullish the Euro.

EURO/YEN CHART

Last week after decisively breaking out of the long established range, the market looked like slipping back within it. This currency pair is complex as it represents two weak economic areas, so it is impossible to say which way the market should go. Both Japan and the Euro zone have their own particular well entrenched, intractable problems.

THE EURO/DOLLAR CHART

See how the Euro largely consolidated the rally over much of last week, falling fowl of a Dollar recovery, albeit short lived, on Thursday as relief buying set in when the US 3rd quarter current account deficit came in under consensus, even though it was at a record high. Fortunes were reversed though when the Oil price spiked on Friday.

This week I remain bullish.

Last week I said I expected the Dollar to move lower once again and over the week it did. The reasons for shorting the US Dollar are powerful fundamental economic reasons and they are still very much in place. Although US 3rd quarter current account data was better than consensus it was still a record and earlier in the week, the latest monthly US trade data was much worse than expected. As is usually the case with trade induced devaluations, even though the decline of the Dollar has already been significant, it needs to go much further and will probably over shoot before the J curve affect fully plays out and we see improvement in the US current account. The Dollar will move lower yet in the New Year to at least 1.40.

BULLS Should remain long. The target is 1.35-1.40 at least.

BEARS stay square.

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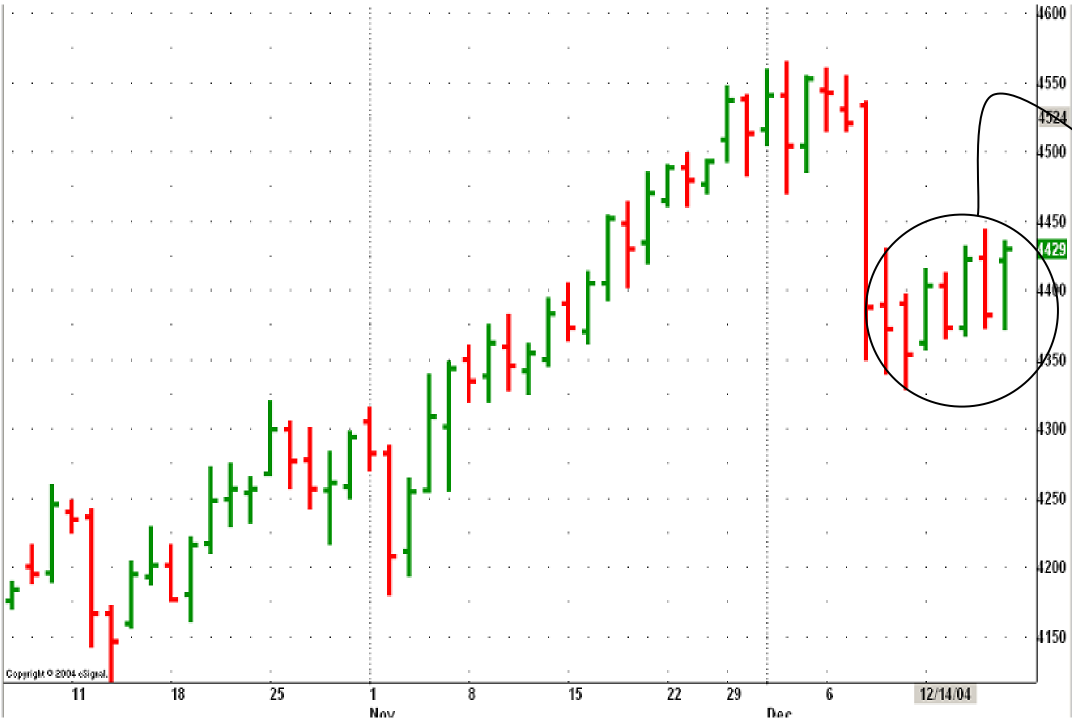
COMMODITIES

GOLD

MY TRADING STANCE: BULLISH

Last week I was bullish of gold.

THE GOLD CHART



See how the Gold price gradually edged higher over the week as the FOMC failed to highlight any additional concerns over inflation. With the US recording record trade deficits the stage was set for the Dollar to move lower yet.

This week I remain bullish.
Last week the market moved higher although it was a choppy affair. The rally remains linked to the fortunes of the Dollar and after the FOMC singularly failed to amend their statement to reflect any concerns over inflation, all eyes returned to the fundamentals; the twin deficits and in particular the US trade deficit which on two measures last week hit new record levels. As the US Dollar is again sold lower in an attempt by the market to rationalise the imbalance, Gold will again rally. For now, though we are too close to the Christmas and New Year break to begin taking new positions; if long, stay with it. If square; wait for the New Year. Most market participants have already either made their money and are square, or can't afford to lose anymore and are also square.

BULLS, if not long stay square until after the holidays. There is nothing to be gained for now.
BEARS Stay square until the market breaks US$390.00 an ounce; which isn't likely anytime soon.

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OIL

MY TRADING STANCE: NEUTRAL.

Last time I was neutral of oil.

THE CRUDE OIL CHART

Last week the market rallied off the lows as Saudi Arabia announced it was cutting production in view of a better supply/demand balance.

This week I remain neutral of oil.

Last week I maintained my neutral position after the market had moved so much away from the highs. Even though it rallied back over the course of the week, I still feel the stance is correct. What moved the market up last week were largely transitory factors, these being; news of colder weather in the US, news of lower than expected increases to US stocks and an announcement that Saudi Arabia was trimming output in response to an apparent improvement in the Supply/Demand equation. The first and second factors can and will change week by week. However the Saudi news is a little more enduring, but if there reasons are genuine, then the price may indeed correct a little lower yet; only time will tell. In any event, if they are wrong they can and will re-open the taps. As we are so close to Christmas I prefer to observe, since I am not currently involved and will look afresh in the New Year. I suspect there is another leg to the rally and we will have ample opportunity to participate after the holiday season is passed. Don't forget there is to be an election in Iraq in January; that is sure to guaranty some excitement in the markets.

BULLS square up, if not already.
BEARS don't be short just yet; stay square.

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