

# Seven Days Ahead

Authorized and regulated by the FSA

## The Macro Trader's guide To Major Markets

11<sup>th</sup> - 17<sup>th</sup> January 2005

Short Sterling looks a buy ahead of  
the MPC.

Dollar rally; has it run its course.

Gold struggles; Oil looks set to rally.

John Lewis

### *SevendaysAhead*

This information memorandum has been prepared solely for informational purposes for customers of **SevendaysAhead** and is based on publicly available information from sources believed to be reliable. It is not an offer, recommendation or solicitation to buy or sell, nor is it an official confirmation of terms. No representation is made as to the completeness or accuracy of any statements or forecasts contained herein and no responsibility or liability is accepted for losses arising from transactions undertaken or investments purchased, sold or held on its recommendation. Consequently, any persons acting on information contained herein do so entirely at their own risk. Although the opinions contained herein were considered valid at the time of release, financial markets are subject to rapid and unexpected movements. **SevendaysAhead**, its associated companies, their directors, employees, other customers or connected persons may from time to time undertake transactions or deal in investments mentioned in this information memorandum or have a material interest, relationship or arrangement in relation to them.

124 Regents Park Road London NW1 8XL +44 (0) 2074832375 jlewis@sevendaysahead.com

# 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 Handelsbanken London.

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

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

# CONTENTS

## UK MARKETS

Short Sterling	1
Gilts	3
Pound Sterling	4

## US MARKETS

Eurodollars	5
US Treasury Note	7
Dollar	8

## EURO 12 MARKETS

Euribor	9
Bunds	11
Euro	12

## COMMODITIES

Gold	13
Oil	14

# UK MARKETS

## SHORT STERLING

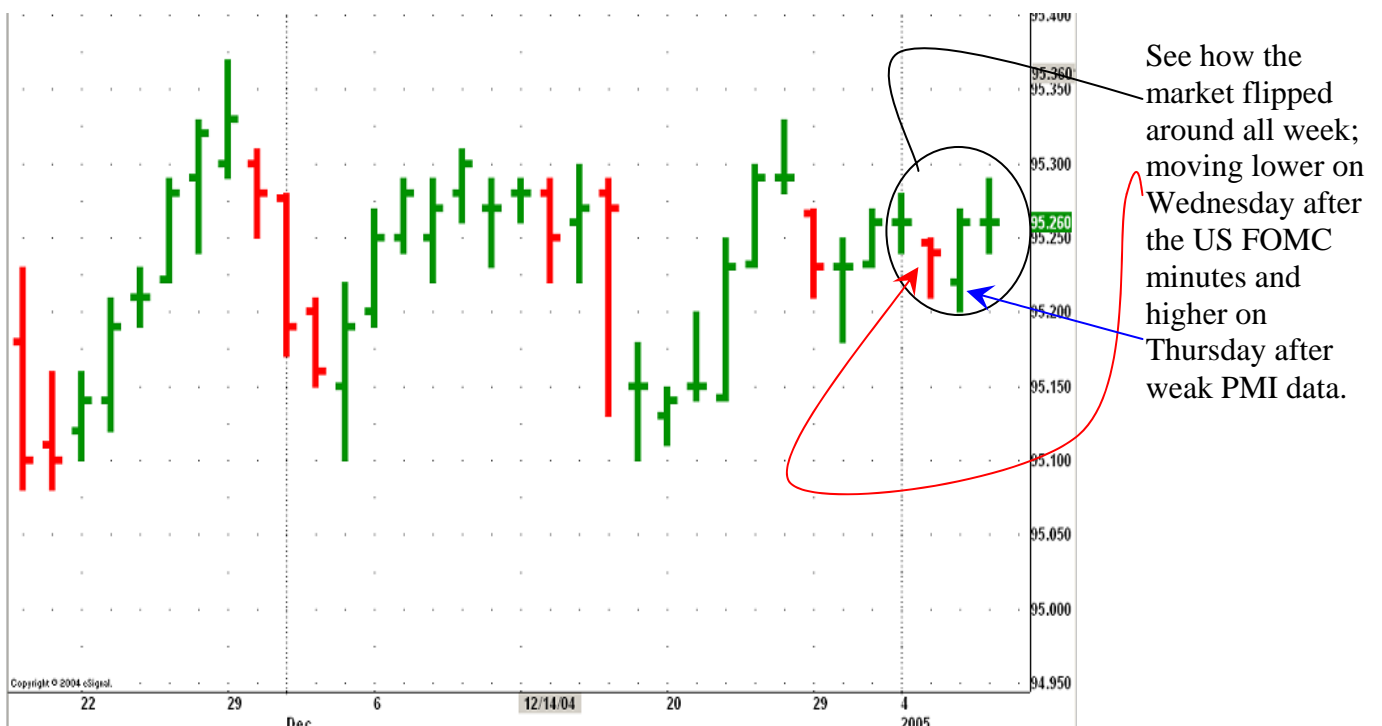
### WHAT HAPPENED LAST WEEK?

	Week of 3 <sup>rd</sup> January
<b>Monday</b>	BANK HOLIDAY Markets closed
<b>Tuesday</b>	M4 Sterling lending 7.837B. <b>HIGHER THAN EXPECTED</b> Net lending on Dwellings 6.45B Mortgage approvals 77K. PMI Mfg 53.7 <b>WEAKER THAN EXPECTED</b>
<b>Wednesday</b>	
<b>Thursday</b>	PMI Services 54.9 <b>WEAKER THAN EXPECTED</b> CBI Distributive trades survey 33 <b>STRONGER THAN EXPECTED</b>
<b>Friday</b>	

#### Last week's calendar.

Last week's data showed more evidence of housing market weakness; net lending on dwellings was below consensus and the number of mortgage approvals at 77K was the lowest number since September 1995. Additionally, both PMI surveys; manufacturing and services, were below consensus, leaving a picture of a slowly softening economy led by the housing market. The CBI survey was the trend breaker as it was stronger than expectations, leading traders to expect stronger retail sales later in the month. The market had a choppy week and was pushed lower on Wednesday in the aftermath of the US FOMC minutes released Tuesday evening, which caught the market off guard by their slightly hawkish tone. However domestic data refocused minds on Thursday and the soft PMI services report led the market higher.

### SEPTEMBER 05 SHORT STERLING



## SHORT STERLING

### THE WEEK AHEAD

	Week of 10 <sup>th</sup> January
<b>Monday</b> 9.30am	PPI Output nsa FTBT n/f
<b>Tuesday</b> 9.30am	BRC Retail sales n/f
<b>Wednesday</b> 9.30am	Trade Bal -5.1B Trade Bal non-EU -2.8B
<b>Thursday</b> 9.30am	Ind Prod 0.4m, -0.6y. Mfg Prod 0.3m, 0.2y. MPC Rate Decision. UNCH
<b>Friday</b> 9.30am	

#### **This week's calendar.**

This week the main focus will be Thursday's MPC meeting, the first of the year. After the minutes of the December meeting revealed some members considered a rate cut, the market will watch ever keener for the decision; it should be unchanged. Of the other data; PPI will illuminate the inflation outlook; which still appears benign, especially with Oil prices moving sideways recently. The release on Wednesday of the trade data will likely make unpleasant reading as the deficit widens further and Industrial production and manufacturing output are serial disappointers. The trade data is worth watching since a growing deficit is a subtraction from GDP and even though the Pound slipped back last week, not by enough to improve the terms of trade.

## MY TRADING STANCE: BULLISH.

**Last time I was bullish of September 05.**

**This week I remain bullish of September 05**

Last week the data was supportive of the bull case and I expect a similar outcome this week. If the MPC considered it prudent to visit the topic of rate cuts last month nothing has occurred since to invalidate that discussion. Indeed the slowing of the PMI surveys only serves to underline the comments they made in December about growth appearing a little weaker, but they will not ease yet, 4<sup>th</sup> quarter GDP is released towards the end of this month and the MPC will want to at least see that first, further barring any unexpected collapse, they will wait until the second quarter to see if the economy speeds up as we go through spring. I don't think it will as I expect the housing market to cool further

raising worries of a deeper slump in prices. I don't expect that either, since based on current evidence unemployment is still to low and employment to high to allow that development. The line though may prove fine and that will make for interesting MPC minutes as traders scan them for any hints of imminent policy changes. On balance I expect the market to rally over the coming weeks but don't expect a frantic charge; the move will be two steps forward, one step back.

**BULLS** should hold their positions and use these levels to add on.

**BEARS** remain square.

# THE GILT

## MY TRADING STANCE: BULLISH.

**Last time** I was cautiously bullish.

### GILT MARCH 05



See how the market endured some large trading ranges but managed to pick its way higher, aided by some disappointing domestic data.

**This week** I remain cautiously bullish.

Last week the Gilt inched higher but in the process was pulled around by several factors. The Currency was the most influential of these as it remained under pressure and gave up much ground against the US Dollar. Other factors were the surprisingly hawkish tone of the December US FOMC minutes and further speculation over the Blair/Brown rift. In the end the weakness in the week's key data releases supported the market and with some quite weak mortgage lending data the market could not ignore the fact that with new mortgage approvals standing at a 9 ½ year low, house prices look set to fall further, putting pressure on consumers to rein in their spending habits. The long Bull rally in the

housing market gave consumers the feeling of ever growing wealth, which they freely spent even though their only way of accessing it was to either sell up and live in a tent or borrow heavily against their homes. Obviously they did the latter. The market should continue to edge higher from here as data is likely to further support the bull case, with monthly interjections from the MPC.

**BULLS** who are already long hold positions, and add on gradually as the market rallies. **BEARS** stay square for now, as the General election looms larger and the debate over the Governments finances moves centre stage, your time will come; but not just yet.

# THE POUND STERLING

## MY TRADING STANCE: BULLISH.

Last time I was neutral the currency.

THE CABLE CHART



See how the correction hit my target of 1.86, almost on cue during Friday's trading. The retreat from the highs has been considerable over the last few weeks, but seems to have run its course.

THE STERLING/EURO CHART



Note how Sterling benefited from the Euros slump against the Dollar. When the US Dollar resumes its slide against the Euro; so will sterling.

**This week** I am cautiously bullish of Sterling. Last week the Pound continued the recent weak tone, almost hitting 1.86 against the US Dollar, a level I highlighted last week. The impetus behind the move was a combination of soft UK data and the expectation of better growth from the US, helped by the recent fall in Oil prices, with December's FOMC minutes, released Tuesday evening reiterating the Fed's intention to continue moving policy back to neutral as soon as economic developments allowed, whilst the MPC's most recent minutes sounded dovish, the comparison with the Fed could hardly be more pronounced. Against the Euro, however,

the Pound fared a little better as the European unit traded lower against the US Dollar after having made all time high's the previous week. The continued underperformance of the EU 12 economy compared to the US and UK ensures the Euro is hit hard during any Dollar rally; fitting as the Euro was bought because of Dollar weakness not Euro strength.

**BULLS** rebuild long positions from here; the Dollar correction has run its course. Look for a move back to 1.91 against the US Dollar. **BEARS** square up. The move was only a sharp correction.

## US MARKETS

### EURO DOLLARS

#### WHAT HAPPENED LAST WEEK?

	Week of 3 <sup>rd</sup> January
<b>Monday</b>	Construction spend'g -0.4 <b>WEAKER THAN EXPECTED</b> ISM Mfg 58.6 <b>AS EXPECTED</b>
<b>Tuesday</b>	Factory orders 1.2 <b>HIGHER THAN EXPECTED</b> Minutes Dec 14 FOMC. <b>MORE HAWKISH THAN EXP</b>
<b>Wednesday</b>	ISM Non-Mfg 63.1 <b>HIGHER THAN EXPECTED</b> EIA Crude oil stocks <b>HIGHER THAN EXPECTED</b>
<b>Thursday</b>	Jobless claims 364k <b>HIGHER THAN EXPECTED</b>
<b>Friday</b>	Non-farm payroll 157K <b>WEAKER</b> Unemployment rate 5.4% <b>AS</b> Avg weekly hrs 33.8 <b>AS</b> <b>THAN EXPECTED</b>

#### Last week's calendar.

Last week's data was generally bullish for the economy, both ISM surveys were either in line or stronger, as too were factory orders. The employment data painted a picture of steady as she goes, with a surprise increase in jobless claims as retailers shed labour in the Christmas run up. The main employment report; non-farm payroll, was mainly in line. Although the headline number was weaker than expected, taken together with upward revisions to the two previous reports, the data would have pleased the Fed, with the average over the three months a little over 200K. The market reacted by trading lower, especially after the FOMC minutes were released on Tuesday, as these took traders by surprise with their hawkish tone. The Fed said more rate hikes are needed to stem inflation, as the recovery is firmly established and the labour market would strengthen. To be fair most of this had already been said, but it seemed to jar against the Fed's original statement at the time of their December meeting.

### SEPTEMBER 05 EURO DOLLARS





## EURO DOLLARS

### THE WEEK AHEAD

	Week of 10 <sup>th</sup> January
<b>Monday</b>	Wholesale Inventories 0.7 Wholesale sales 0.8.
<b>Tuesday</b>	
<b>Wednesday</b>	Trade Bal -53.9B
<b>Thursday</b>	Import price Indx -0.2m. Retail sales 1.0% Less Autos 0.4. Jobless claims 340K
<b>Friday</b>	PPI -0.2m, PPI Ex-f & e 0.2m. Business inventories 0.6 Ind Prod 0.5 Cap U 78.9.

#### **This week's calendar.**

This week traders will be focused on Wednesday's trade data. If this is another hefty number, the Dollar will resume its decline as investors fret over the sustainability of the twin deficits. Retail sales on Thursday and on Friday; PPI, industrial production and capacity utilisation will give a solid feel for how the economy performed over the final stages of the 4<sup>th</sup> quarter. Retail sales is expected to be strong, so if it is below consensus the market will have room to rally, as it has given up a lot of ground over the last couple of weeks. PPI is harder to call; Oil prices have eased lately but Gas prices haven't. The market is currently pricing in a further 150 basis points of tightening by December 05 which at the current pace represents 6 rate increases, this does not appear aggressive and fits with the Fed's stated intention to move at a measured pace.

## MY TRADING STANCE: NEUTRAL.

**Last week I was neutral of September 05.**

**This week I remain neutral of September 05.**

This week the market will have to search for fresh clues, last week's non-farm payroll report was unusually near enough to consensus, when the revisions are included, to have limited effect over trading through the remainder of the month. This will allow traders the luxury of analysing other data and taking a more rounded approach to the market. All too often non-farm payroll dictates the pace for the month, released as it is at the beginning, but pay rolls react to economic activity as companies tailor their work force to meet demand. The reaction in the market on Friday was interesting, since after first selling off ahead of the number, as nerves jangled, and the sharp rally after the

release, the market eventually settled close to where it had been most of the week. With the market already pricing in a string of future rate increases, traders will have to believe the Fed is going to up the pace if more bearish price action is to be seen. Given the nature of the recovery thus far I would expect the market to bounce on any numbers which undershoot consensus, the first opportunity for this could be retail sales due on Thursday.

**BULLS** continue to remain square until retail sales on Thursday; if weak, go small long. **BEARS** square up. The market showed on Friday it has no clear intent at present and requires fresh negative data to move lower.

## THE US TREASURY NOTE (10 yr)

### MY TRADING STANCE: BEARISH.

Last week I was neutral.

#### US 10yr NOTE MARCH 05



**This week** I am bearish.

Last week the market appeared hardly to know which way to turn. After Tuesday's FOMC minutes the market moved lower as traders fretted the Fed may be about to up the pace of the tightening cycle, then on Friday the market got its self completely in a spin as first it sold off as traders worried non-farm payroll would be strong, then when the number was released and the headline data was weaker than consensus, the market panicked in the other direction and rallied. However as we always used to say, the devil is in the revision and sure enough the revisions made the data look stronger and the market sold off ending the day not far from where it had begun. Now we know the Fed

sees the recovery as well entrenched and they have voiced concerns over inflation for the first time, they will not hesitate to increase the size of the policy moves if required. We also know that barring any unforeseen disaster, rates are moving relentlessly higher in the US; hardly a bond friendly environment, especially with the US Government deficit continuing at record levels. Unless we see some unexpected weakness in the numbers this week I expect to see this contract move lower, as investors demand higher yields.

**BULLS** stay square.

**BEARS** establish short positions and add on if the data throughout the week is strong.

# THE DOLLAR

## MY TRADING STANCE: BEARISH.

Last week I was bearish the Dollar.

EURO/DOLLAR CHART



This week I remain bearish of the Dollar.

Last week I remained bearish of the Dollar, but it carried on correcting higher. Against the Pound the reasons were clear enough; domestic UK data was looking weak and the currency bore the brunt of the disappointment that interest rates may well have peaked. Against the Euro the reasons were all to do with the Dollar its self. Having made all time lows against the Euro the previous week, traders fretted the move may have been over done as US data began to look stronger. Oil prices largely maintained their softer tone and with the FOMC minutes making the Feds feelings and intentions perfectly clear, traders took profits which allowed the Dollar recovery to bounce further. The thought of non-farm payroll at the end of the week producing an unexpectedly strong number was the final piece in the jig saw. In the event, the pay roll data was broadly in line. This

week the most interesting piece of data for the Dollar is the trade data out on Wednesday. If this number is worse than consensus the Dollar will resume its slide. The market has prematurely concluded the Dollar may have fallen by enough; wrong. It will take a prolonged and sustained Dollar fall to correct the over bloated current account deficit, Americans have become accustomed to cheap imports after a decade of Dollar strength and it will be difficult to break their habits. The record Government deficit is another reason to remain bearish as here there is no plan to reduce it. The Pentagon may be looking to cut back on some weapons programs but only because the money is needed for Iraq.

**BULLS** stay square.

**BEARS** stay short and sell into the Dollar's fall as it resumes.

## EURO 12 MARKETS

### EURIBOR

#### WHAT HAPPENED LAST WEEK?

	Week of 3 <sup>rd</sup> January
<b>Monday</b>	IT PMI Mfg 48.6 <b>AS EXPECTED</b> FR PMI Mfg 52.5 <b>STRONGER</b> DM PMI Mfg 51.7 <b>STRONGER</b> <b>THAN EXPECTED</b>
<b>Tuesday</b>	FR GDP 3Q 0.0 q/q, 2.0% y/y <b>WEAKER THAN EXPECTED</b> DM Unemployment rate 9.9% <b>AS EXPECTED</b> IT CPI 0.2m, 2.0y. <b>HIGHER THAN EXPECTED</b>
<b>Wednesday</b>	IT PMI Services 52.7 <b>WEAKER</b> FR PMI Services 54.9 <b>WEAKER</b> DM PMI Services 51.0 <b>WEAKER</b> <b>THAN EXPECTED</b>
<b>Thursday</b>	DM retail sales -2.5m, 0.1y. <b>WEAKER THAN EXPECTED</b> FR Consumer conf -25 <b>WEAKER THAN EXPECTED</b>
<b>Friday</b>	DM Factory orders -2.3m, 5.9y <b>WEAKER THAN EXPECTED</b>

#### Last week's calendar.

Last week's data painted a clear picture for the EU 12; the manufacturing PMI'S all performed as expected or slightly stronger. The service side of the economy was weak; all the services PMI reports were below consensus, French GDP was weak with an unchanged quarterly reading, German retail sales was a disaster and on Friday; German factory orders were surprisingly weak, both domestic and foreign which continues the now all too familiar story about the EU 12 economy; weak, weak, weak!!!

The market reacted predictably and rallied strongly on Wednesday, Thursday and Friday; but will the ECB react; NO.

#### SEPTEMBER 05 EURIBOR



See how the market rallied on the much weaker news in the second half of the week. Sadly hopes will be dashed by ECB inactivity.

## EURIBOR

### THE WEEK AHEAD

	Week of 10 <sup>th</sup> January
<b>Monday</b>	DM C/A 6.3B DM Trade bal 12.5B
<b>Tuesday</b>	DM WPI 0.1m, 4.2y. FR Trade bal -1.85B FR Ind prod 0.2m, 2.3y. DM ZEW 18. DM Ind prod -0.1m, 1.8y.
<b>Wednesday</b>	DM CPI 0.8m, 1.9y.
<b>Thursday</b>	FR CPI 0.0m, 2.0y. DM GDP Annual 2004 1.7%. ECB Rate Decision. UNCH
<b>Friday</b>	

#### **This week's calendar.**

This week the calendar is heavy on German data, we get a look at the trade a/c, industrial production, wholesale price index and annual GDP. French data focuses on the trade a/c, industrial production and CPI. Sadly I expect the data to confirm what we already know; the EU 12 economy just isn't working. More likely than not the German trade data will be good but that has been the case for some while now but the overall economic picture is very weak, to say the least. On Thursday the ECB discusses interest rates, but despite all the economic gloom they will keep rates on hold, as they continue to worry about inflation while the economy withers away.

## MY TRADING STANCE: NEUTRAL.

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

The market reacted favourably to last week's data and no doubt if this week shows weakness the market will rally further. However as we have repeatedly seen, the market can only go so far, before reality sets in. Reality for Euribor is the ECB will not reduce rates, they continue to fret about inflation being marginally above target when growth is massively underperforming its own long term potential. The ECB argues it is for the politicians to reform the way the economy works; of course they are right. The truth is

the politicians will do little or nothing as the nature of the ruling elite in Europe is to be suspicious of anything market oriented, as they see it as pandering to the Anglo/Saxon model of the world which really means America. We all know there is no love lost there.

**BULLS** could hold small positions looking for 97.65.

**BEARS** stay square because the fundamentals do not support the bear case.

# THE BUND

## MY TRADING STANCE: BULLISH.

Last week I was bullish of the bund.

### THE BUND MARCH 05



See how the market reacted to the weak Euro land data; only easing back after the confusion caused by Friday's US non-farm payroll data.

This week I remain bullish of the Bund.

Last week the Bund showed the true extent of its bullishness, even as the Euro was being sold against both the UK Pound and the US Dollar, the Bund pushed back up to pre-Christmas levels. The Euro zone data has continued to be weak and in the absence of any chance of a rate reduction from the ECB the Bund rallies. When the Dollar resumes its fall, pushing the Euro to even higher levels and further damaging the Euro zone economy, the Bund will move even higher; depressing long term yields even further. Alone among the major Government bond markets the Bund has continued to be bullish, suffering only small corrective pull backs as traders took profit as foreign events temporarily took centre stage. Looking ahead we know inflation is likely to remain sticky for

sometime, but it will not move far above target. On the other hand growth, on current evidence, **will** continue to under perform. The Europeans are unable to adapt to the shift that has taken place in global economic power. For now America remains the dominant global economy, but Europe has fallen well behind and China and India are in the ascendancy. The USA will ultimately struggle to keep pace with these to emerging giants; Europe has no chance with current policies and attitudes.

**BULLS** stay long and use any pull back to add on.

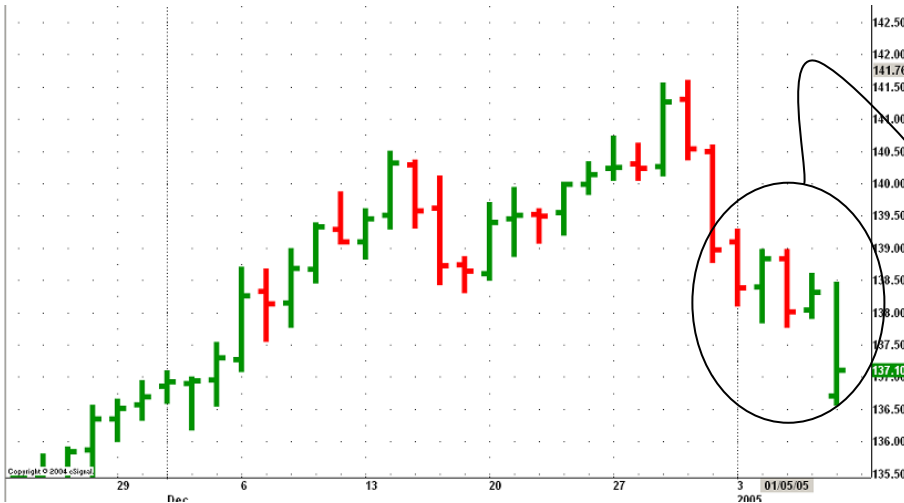
**BEARS** stay square while the market trades above 115.90; a long way away and not likely to be seen anytime soon.

# THE EURO

## MY TRADING STANCE: BULLISH.

Last time I was bullish the Euro.

EURO/YEN CHART



The main beneficiary of the recent Dollar bounce has been the Yen. See how it has made back all the recent losses and firmly re-entered the range.

THE EURO/DOLLAR CHART



See how the Euro lost ground on Tuesday as the FOMC minutes sounded hawkish and then again on Friday after non-farm payroll.

**This week** I remain bullish.

This week I remain bullish of the Euro as I view the recent Dollar move as a corrective short covering rally. This started as traders squared up for the Holidays, it gathered pace as the benefits of lower oil prices caused traders to anticipate faster growth moving forward as consumers found themselves with more money to spend. This was given a further push on Tuesday as the FOMC minutes took investors off guard. The statement released at the time of the meeting in December when the Fed increased rates

was very much the same as the wording used in several of the preceding meetings, so when the minutes had a hawkish tone traders wrongly concluded the Fed was about to up the pace. Not so, they were merely reiterating their intentions and assessment of the economy as previously communicated to the market.

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

**BEARS** stay square.

# COMMODITIES

## GOLD

### MY TRADING STANCE: NEUTRAL.

Last week I was neutral of gold.

#### THE GOLD CHART



#### This week I remain neutral.

Last week I advised remaining square whilst the Dollar was engaged in a corrective bounce. The main driving force behind the rally in the Gold market has been the weakness of the US Dollar and the unsatisfactory quality of the alternatives. As I have said before this represents something of a general devaluation against Gold. Now as the Dollar attempts a recovery Gold fades away. For now I advise standing aside, when it becomes clear that the Dollar has resumed its fall and that may occur later this week after the trade data is released, then it will be time

to rebuild long positions and there will be plenty of time to do it. For now be pleased we exited the market with most of our profits in tact able and willing to take full advantage when the fundamentals re-assert them selves, as they will.

**BULLS** stay square for now. When the US Dollar resumes its fall then we can buy again.  
**BEARS** Stay square until the market breaks US\$390.00 an ounce; which isn't likely anytime soon.



# OIL

## MY TRADING STANCE: BULLISH.

Last time I was neutral of oil.

### THE CRUDE OIL CHART



This week I am bullish of oil.

Last week the market again tried to rally even as the US reported further increases to its distillate inventories. The reason behind this is clearly the upcoming elections in Iraq. This is an event which will test the coalition's ability to maintain security during this momentous event. It will be the first free election held in that country and is alien to the politics of the region. Many, not just the insurgents, would love to see them fail and forces will be at work trying to undermine this important process. The coalition needs them to succeed and more troops will likely be sent to help keep the peace to enable relatively fair and intimidation free elections.

If the insurgents succeed in badly derailing the process it will be even harder for the Americans and her allies to extricate themselves, as they would risk seeing Iraq become a safe haven and breeding ground for all those who hate our way of life and would commit further terrorist suicide atrocities. That is why it is important these elections succeed; the stakes are high and if the coalition fails, so will be the price of Oil

**BULLS**, now is the time to go long for a move back to US\$50.00 a barrel.

**BEARS** stay square.