12th December 2014

the technical analyst
AWARDS 2011
FINALIST

Market Update:

UPDATE
Technical
Fundamental

Which way for US Notes?

Full performance of our Key Trades recommendations 2006-14 here

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Are UK bonds vulnerable?

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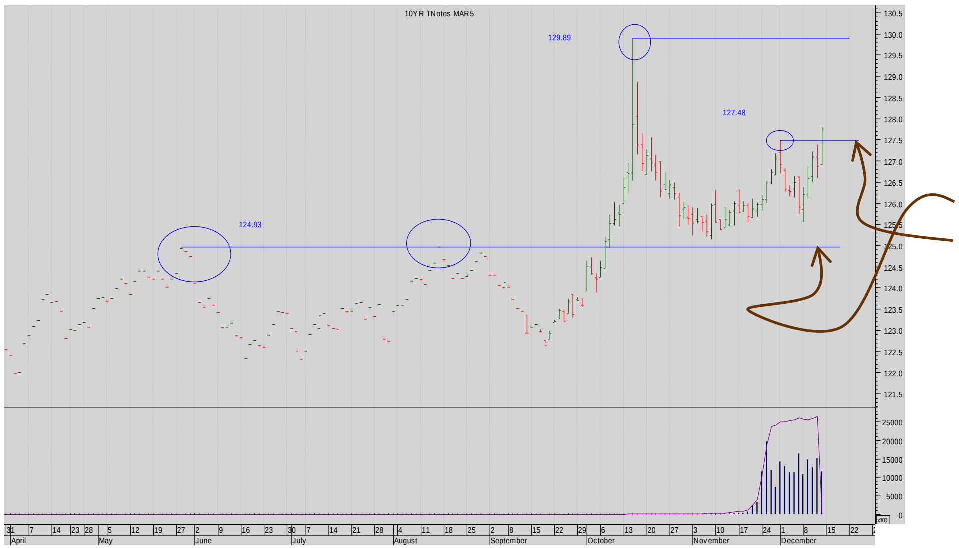
Weekly iShares $ 7-10 yr EFT line chart

The market is poised some way below the Prior pivotal Highs established back in 2008,2012 and 2013.

It's not clear whether it can breakl those levels.



Daily March 15 Gilt futures chart

In the short term, the market is set to go higher: there is massive support beneath the market at 125, and the recent High 127.48, now overcome, will be additional support, ratcheting the market higher still.

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FUNDAMENTALS:

Since the end of the Fed's tapper and QE3 policies, the 10 year Note has for the last two months traded in a clearly defined 2 point range. During that time the debate about when the US Federal Reserve will begin raising interest rates has heated up.

At the same time the US economy has moved up through the gears and developed a more robust self-sustaining recovery, recent evidence of which has been:

1. **The two stronger ISM surveys released last week,**
2. **The much stronger than expected non-farm payroll report released last Friday, and**
3. **A strong Retail sales report released just yesterday.**

What these reports tell us is that both the manufacturing and service sectors of the economy are growing at a solid pace. The non-farm payroll report went further; it showed job creation at it's strongest in several years. The labour market has been and remains a key indicator for Fed policy makers.

Following last week's data the interest rate debate heated up further, with analysts and traders alike beginning to focus on a first rate hike during the first half of next year. But despite this increased speculation and faster growth the US 10 year note seems unfazed. Why?

There are several reasons for this and they are a mix of both domestic and foreign factors, economic and geopolitical.

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FUNDAMENTALS: CONTINUED

In the US, although the pace of growth has clearly quickened and job creation along with it, inflation has remained very benign. Moreover earlier public spending fights between the Administration and Congress which resulted in so called sequestration cuts have seen the budget deficit reduced.

Further more, the US has energetically developed its shale oil and gas reserves which have resulted in imports of OPEC crude dropping to their lowest level in 30 years and given the US a degree of energy independence and security that many of Obama’s predecessors could only dream of.

This Shale bonanza has clear benefits for the US economy:

- It reduces the cost of energy for consumers and business,
- It helps over time reduce the trade deficit, and
- Through lower production costs, has begun to lure outsourced manufacturing jobs back to the US.

But there are other supporting factors for this market and these are weak economic activity in China, Japan and the Euro zone. In Japan the economy continues to under perform despite serial monetary and fiscal stimuli, and in the Euro zone the ECB seems unable to get ahead of events, as it constantly tries to catch up with the latest negative development. Then there is China; an economy that has for so long been a byword for economic strength is now suffering her own slow down.

Add in the geopolitical dimension; the Ukraine/Russia crisis which has plunged East/West relations back to the depths of the Cold war and it isn’t to difficult to see why a strong US economy hasn’t so far heralded a bond market sell-off.

So where from here? We judge this market is experiencing a unique set of circumstances which are a hangover from the financial crisis, meaning when the Fed does start to hike, <u>don’t automatically bet on a bear market in Bonds</u>..

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