SEVEN DAYS AHEAD

Key Trades 10th July 2007

We were squeezed last week when our timing was awry. But only the Eurodollar became too painful (and that was wrong to cut as we now see). Now all positions that were loss-making have come back to us - and we think they are going further. The problem has been that there are very big structures at work which we wish to profit from, but their size demands big pockets - or we risk missing the moves. However, our stances have been endorsed by the recent price action. The new positions in Gilts (yesterday) and Cable (today) are fairly tightly stopped. Oil, our new position of last week has gone well too and looks well-set.

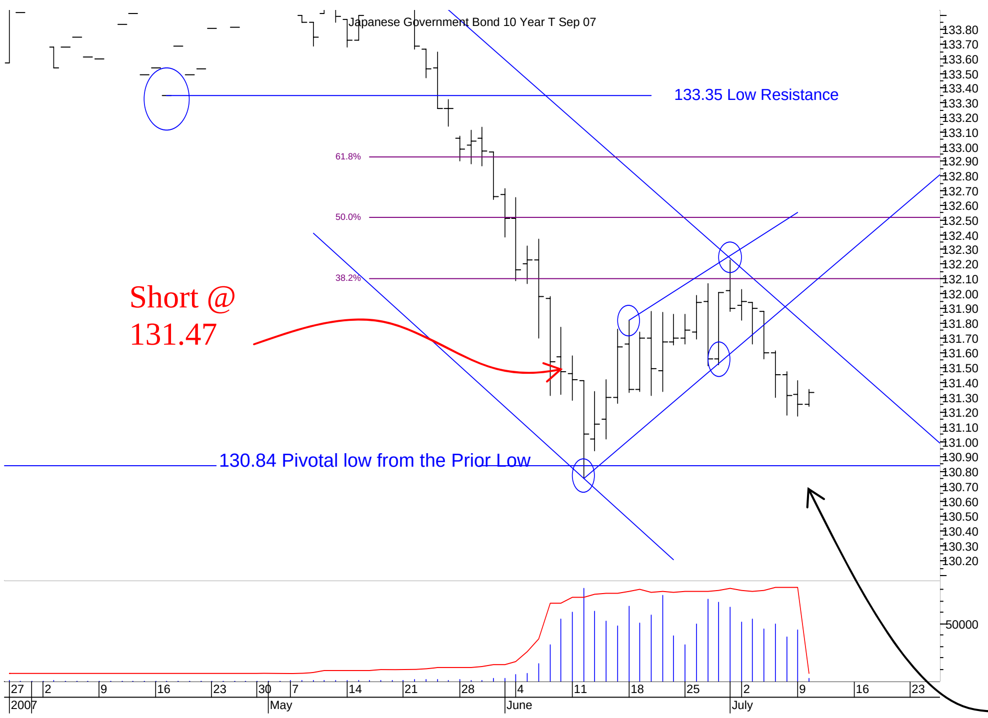
Open Positions

1. Japanese Government Bond

Short Sep 07 @131.47 (10th /06) Currently 131.35. Stop at 133.60.

Running profit 12 bps.

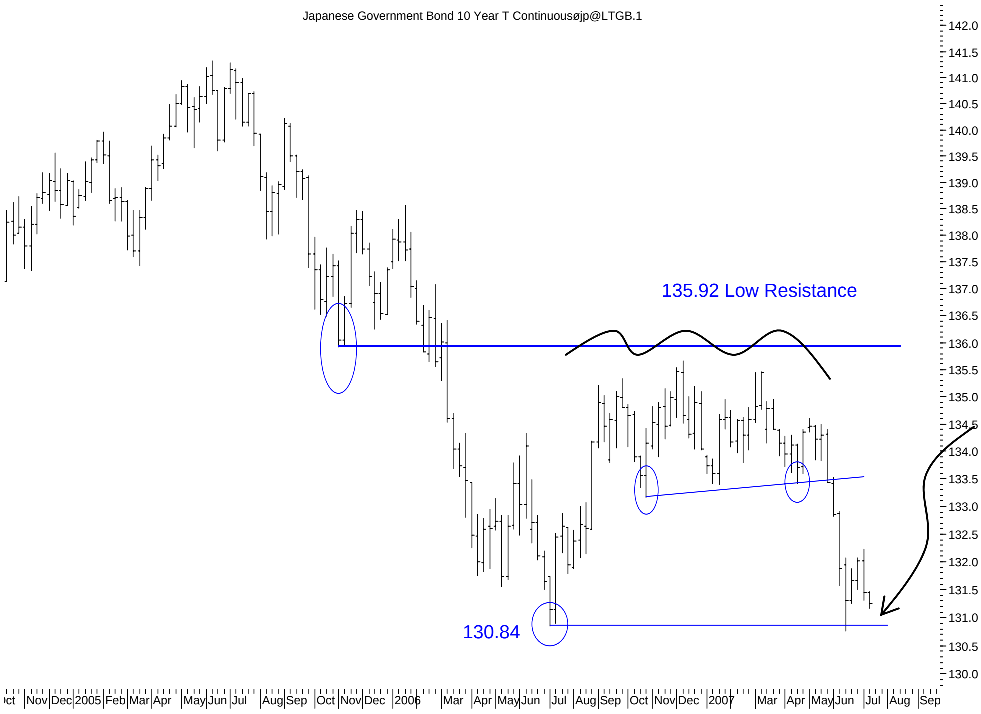
The Technical Trader's View:



Daily Bar chart

The market's rally has ended (as we anticipated with such powerful resistance above) by completing a bear rising wedge just beneath the Fib retracement resistance.

<u>Expect now a retest of the 130.84 Pivotal low.</u>



Weekly Bar chart

The bigger picture shows how the market has been driven down by a small Head and Shoulders Reversal beneath the massive resistance at 135.92 - to the crucial pivot and Prior Low at 130.84.

A breakdown through that would drive the market on down further by establishing good resistance above the market.

The Macro Trader's View:

Last week we advised staying the course with this position, and so far that advice has proved sound as the JGB reversed course in the middle of last week.

The optimism that had begun to build around bonds that perhaps global short term interest rates wouldn't need to rise that much further after all was shattered by a wave of stronger global economic data, especially from the US.

This revealed the US economy to be on track for a very solid rebound over the remaining quarters of this year and this will place an increasing strain on demand for recourses with obvious implications for inflation.

Given our bearish outlook for all government Bond markets we expect the JGB to sell off further and again advise staying with this position which we think has considerable long term potential.

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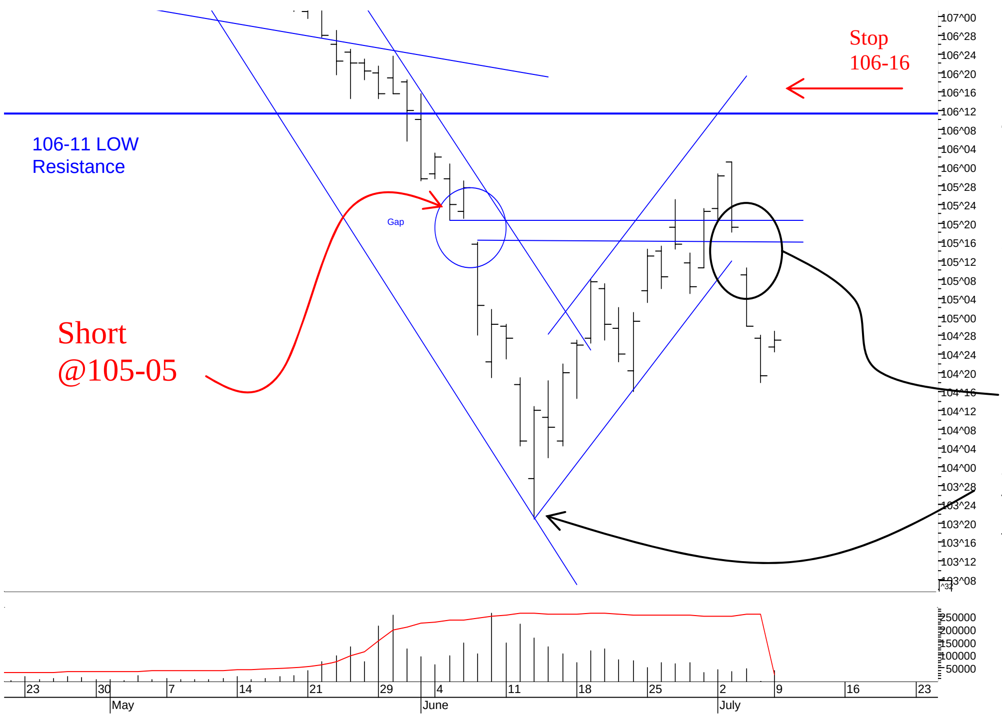
2. US T Note

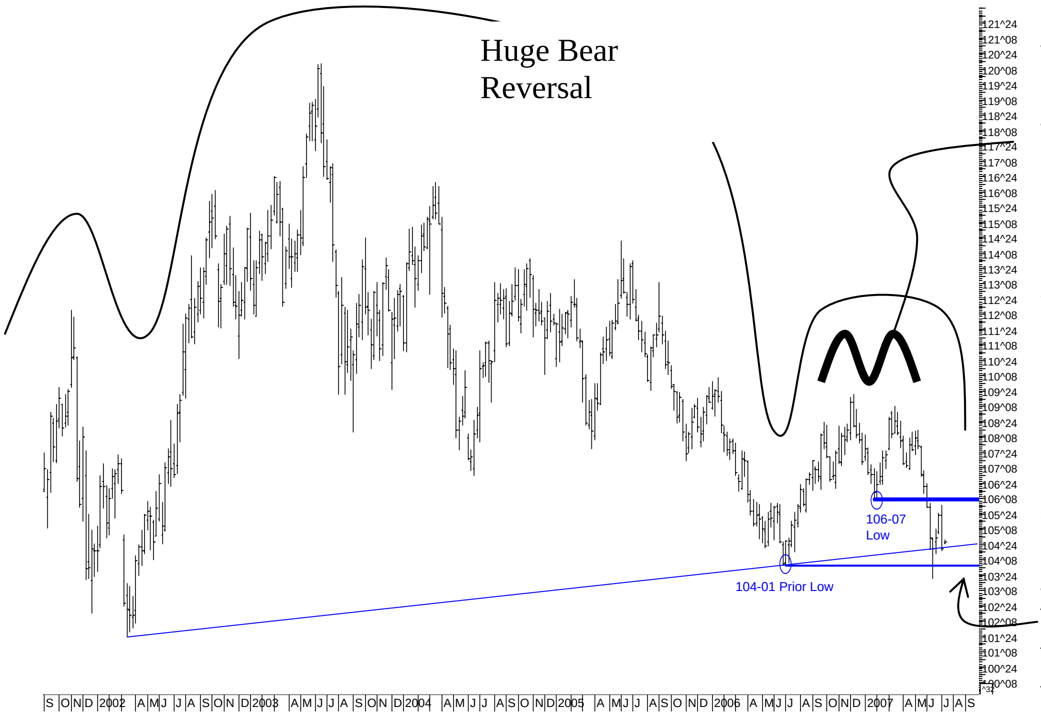
SHORT Sep 07 US TNote at 105-25 (5th /06). Currently 104-27. Stop raised to 106-16. Running profit 30/ 32nds



Daily Bar chart

The market has broken back down as we anticipated - note the falling volume on the rally, and also the pent up bear energy revealed by the Breakaway Gap.

<u>We expect a retest of the near lows.</u>



Weekly Bar chart

The market is being driven down by the small Double Top …

And in so doing, the larger, huge bear Reversal is being completed and will send the market on down a great deal further yet!

<u>The clear confirming break down level is 104-01.</u>

The Macro Trader's View:

Last week we remained bearish of this market, expecting the previous week's short covering rally to fizzle out, and we advised traders to monitor the following:

- on Monday; the ISM Mfg survey was crucially stronger than expected,
- on Tuesday; Factory orders were stronger than expected,
- on Thursday; Jobless claims were higher than consensus and the ISM non-mfg survey was much stronger than expected, and
- on Friday; non-farm payroll including revisions, was stronger than expected and the unemployment rate was in line with consensus.

The Market responded to the <u>unambiguously strong data</u> and sold off. The message that came through last week was clear; the US economy is recovering and that recovery could prove stronger than expected. The mixed data that preceded last week's numbers was likely typical of an economy reversing direction and should largely be ignored.

With both ISM surveys well above the 50 level, especially the non-manufacturing survey, bond traders are likely to become increasingly bearish as they re-asses the outlook for inflation. The small improvements to core inflation so far seen have been achieved with the economy only just missing a recession; clearly if growth bounces back as most will now have to accept as a reality after last week's data, inflation will come under renewed upward pressure and **<u>this will send bond yields very much higher over the medium/long term.</u>**

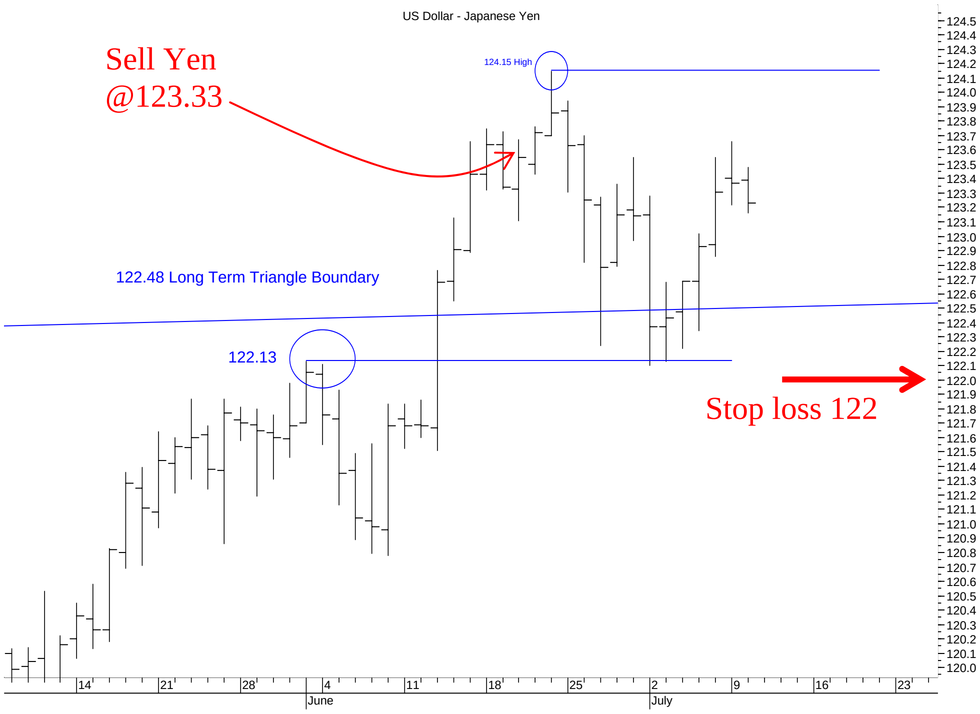
Looking ahead there are several key releases this week, and we advise traders to monitor the following:

- On Tuesday; Wholesale inventories and a speech by Fed Chairman Bernanke on inflation,
- On Thursday; the trade balance, Jobless claims and the monthly budget statement, and
- On Friday; import prices, retail sales, University of Michigan confidence and business inventories.

The key reports for this week are highlighted red, and although we expect the trade data and retail sales to weigh on this market, Bernanke's speech on Tuesday has the potential to move this market a long way, but with the recovery only just getting underway, he will likely choose his words carefully so as not to disturb the current market assessment which is for a further period of unchanged rates.

3. *Dollar Yen*

Long Dollars Short Yen at 123.33 19th/06. Stop 122. Current level 122.46. Interim target 130. Running loss 87 bps.



Daily Bar chart

The market has struggled since we bought it. But it's clear that the support are still solid.

Refer to the wider context …

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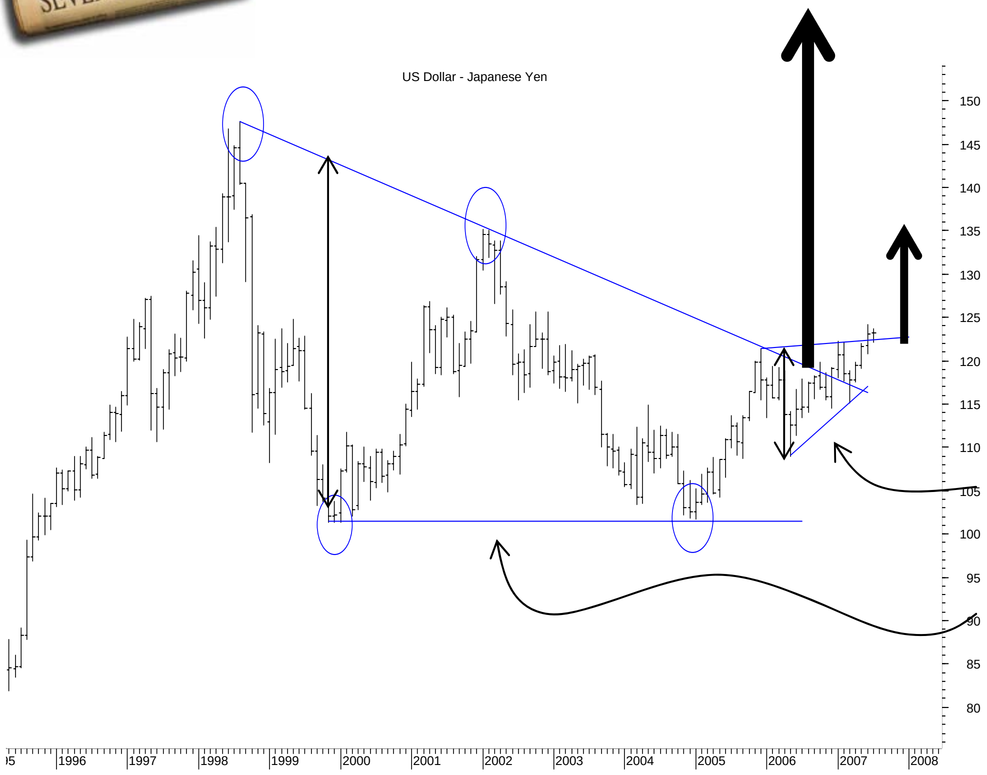


Monthly Bar chart

The reason for the long Dollar trade is clear - two triangles have completed both driving the market in the same direction.

The smaller suggests a move to 135.

<u>The larger one very much higher indeed.</u>

The Macro Trader's view:

Last week we repeated our often stated view that the Yen is weak against the Dollar and other major currencies for one overwhelming reason; <u>the yawning interest rate gap that is stacked against the Yen.</u>

With no immediate threat of a policy change from the Bank of Japan, traders continue to use the FX market as a funding vehicle for buying assets in the US, UK and Euro zone.

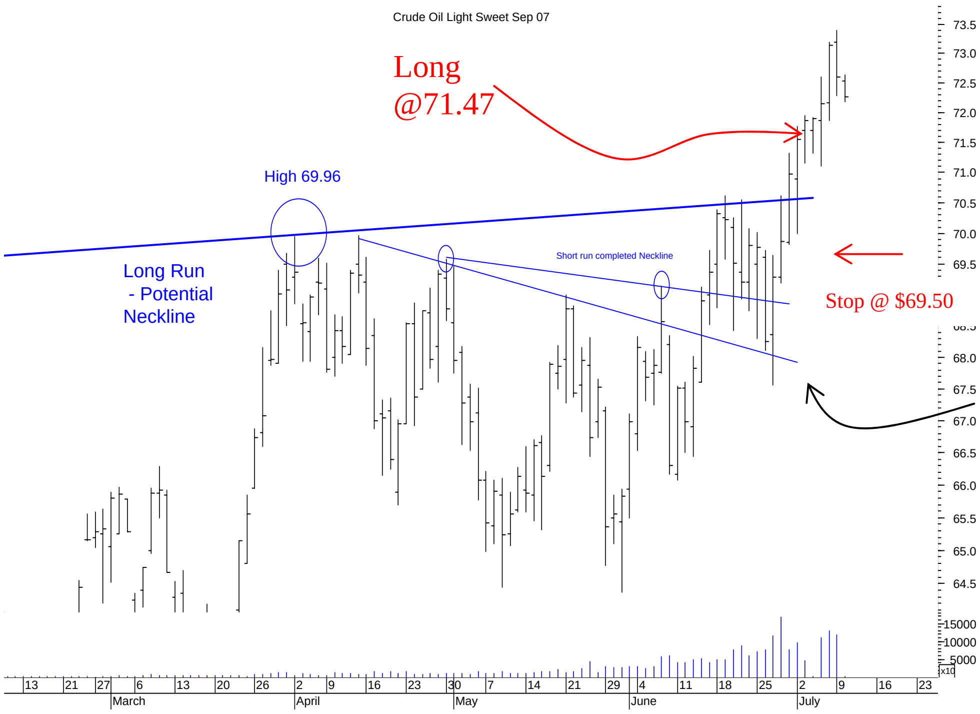
This is again proving the case as equity markets staged a recovery last week, the Dollar remained under pressure against both Sterling and the Euro, but the Yen remained weak against them all; including the Dollar.

With the US S&P holding up better than the other major indices during the last correction, and looking to stage an assault on the recent highs ahead of the others, we judge remaining short of the Yen against the Dollar to be our preferred trade, and expect to see further Yen weakness.

4. Oil Light Sweet (Nymex)

Long Sep 07 @71.47 (3rd /07). Currently 72.26. Stop at 69.50 Running Profit 0.79bps.

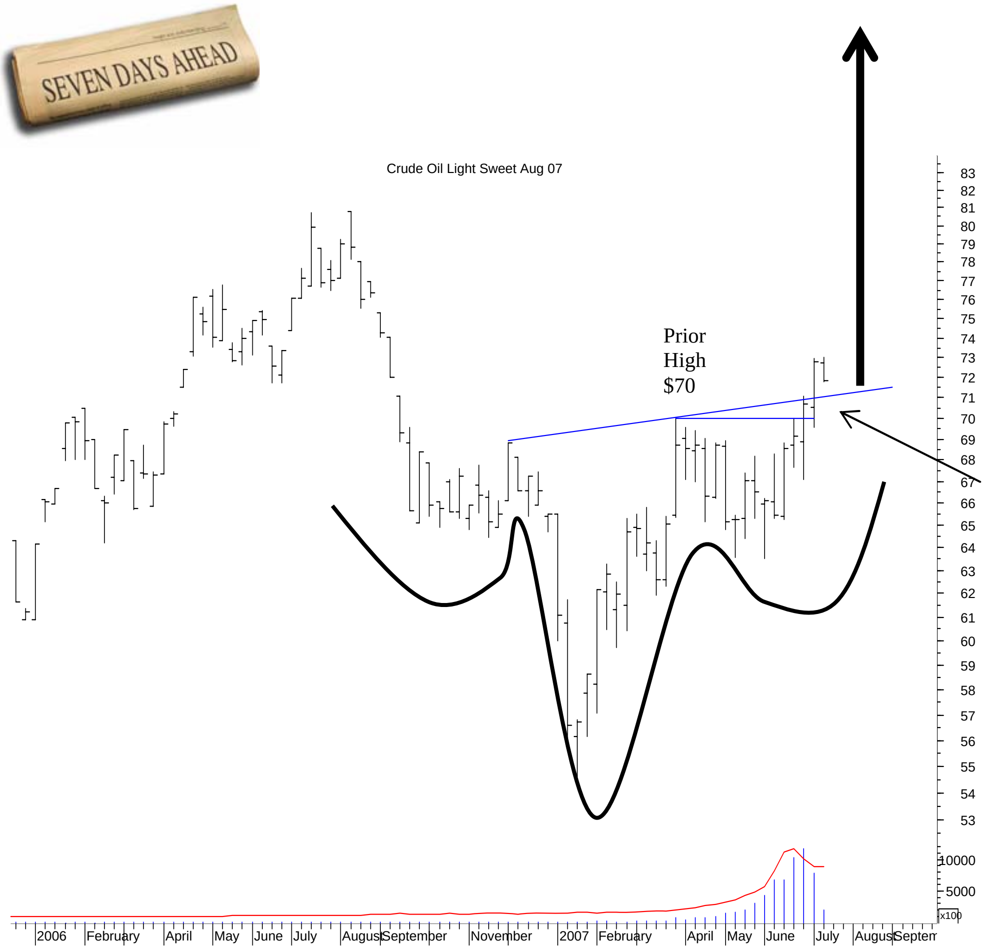
The Technical Trader's View:



DAILY CHART:
The market has gone well directly from our level of purchase.

This complex Reversal pattern is working hard.

Cont'd…



Weekly Bar chart

But this is the tremendous underlying force driving the market better.

The weekly neckline comes in at $71 or so.

<u>The minimum target implied by the pattern? $85</u>.

The Macro Trader's View:

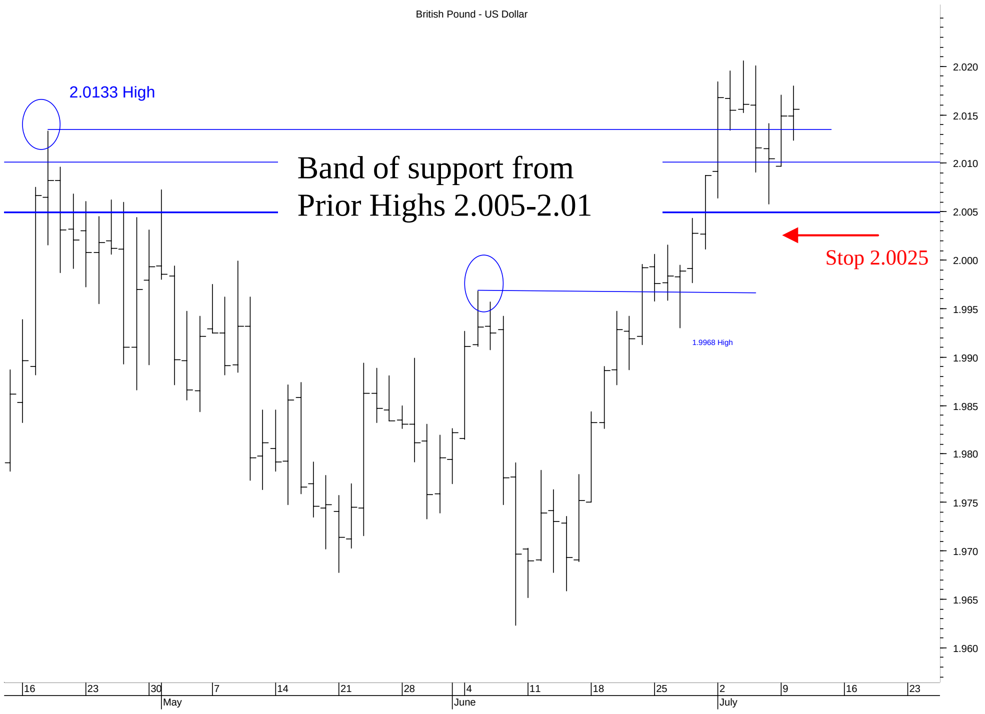
We highlighted last week the UK'S intention to introduce new sanction proposals against Iran into the UN Security Council and that seems to be moving towards centre stage.

Additionally the IEA in a report out yesterday warned of a looming supply crunch in the oil market. While it remains several years away, given the time scale required to bring new production on line, this is a forecast that will increasingly dominate the oil market, and provide yet another crucial level of support.

In summary oil prices look like moving higher from here for several reasons, whether to do with geopolitical tension, acts of terrorism linked to the Middle East or now, worries over the adequacy of supply and we advise remaining long.

5. Spot Dollar Sterling

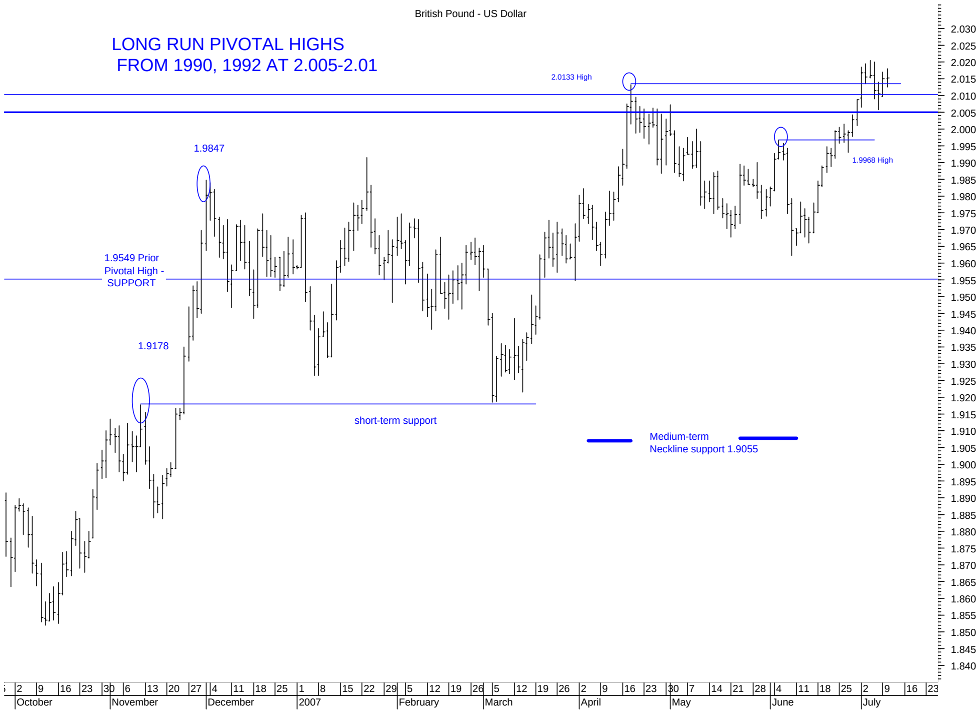
Buy today @2.0166. Stop at 2.0025



Daily Bar chart

The market Stop Loss is beneath the band of support that has already proved itself - hence so close.

Look wider for the big rationale :



Daily Bar chart

The market has broken up through those Prior Highs adn they should act as good support from hereon...

The Macro Trader's View:

As expected the MPC hiked rates last Thursday in a week characterised by stronger data, but so widely expected was the event; traders took profit.

However the Price action last week revealed something of the Pounds true strength, as data released in the US was unambiguously strong with both ISM surveys and the non-farm payroll report coming in much better than expected.

The Dollar should have rallied strongly on this data, but a 1 cent recovery was all that occurred.

If the Dollar is unable to rally after such favourable numbers, its outlook is clearly negative.

What is holding the Dollar back is the sense the Fed is unlikely to change policy in either direction in the medium term, as they simultaneously seek stronger growth and lower inflation, and judge the current policy stance should produce that result.

By comparison the Bank of England seeks to tame growth and inflation and it sounds increasingly hawkish over its prescription for achieving those aims.

Traders should buy Cable as we judge Sterling is set to move higher in the coming weeks and months as the interest rate differential moves further in the Pounds favour.

Mark Sturdy
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Seven Days Ahead