MF Global Research
MFG Research Staff
440 S. LaSalle
20th floor
Chicago, IL 60605

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http://research.mfglobal.com

DEBT MARKETS: TYZ is expected to trade sideways to higher through October, and the 2/10 curve should have a bias toward flattening. The 10 year yield will be pressured by technical factors, loss of forward economic momentum, and low inflation, but the downside to the 10 year yield will be cushioned by massive Treasury issuance and the end of the Fed's purchase program. The yield curve will be pressured by Fed rhetoric which suggests that money ease will be reversed aggressively, and implies the fed funds target will be raised in 75 bp to 100 bp increments when the Fed starts to tighten. Given yields below 150 bps within 3 years, investors will start demanding a risk premium or protection, which will help to put a floor under yields. Although the economy is growing, the pace of activity is anemic. Same store sales excluding Wal-Mart are expected to rise 1.0% in the November to December period against a 5% contraction a year. Auto sales fizzed in September on the end of cash for clunkers and there is chatter new home sales have eased in recent weeks. Furthermore, there is plenty of slack in the labor market. Hours worked are not significantly expanding, and it appears that solid income growth and employment are a number of months away. One measure suggests that the unemployment rate is 17% if under utilized workers are combined with the unemployed. It was also reported that labor service firm Manpower believes the job market will not improve until Q2 2010. Slack in the labor and product markets will keep inflation low. Additionally, a still strained banking system will keep a high level of banks reserves and an expanded Fed balance sheet from generating inflation in the near term. The main bearish factors facing the 10 year market rest in balanced inventories and supply. Inventory burn is finished and production is likely to stabilize. The auto sector is one example, as production is rising despite still lackluster sales. Supply is large with the Treasury issuing about $165 bln in new cash. At the same time, the Fed is ending it purchase program and has bought more than 20% of this year's issuance. The market will have to find a new buyer for this debt and as a result auctions could find greater volatility. U.S. banks are a potential buyer of treasury paper given current holdings and the reduction in lending, but nominal yields are low and may need to rise to attract a bank bid. The 10 year yield is also narrow the JGB yield highlighting the U.S. market may not be attractive to foreign buyers.

~Kalivas/Hoversen

EQUITY MARKETS:
Equity prices are expected to move sideways in October. Look for early month weakness, but a recovery late month as the market feels more confident about Q4 earnings. Buying a hard break is suggested. Recent macro data points have the trade moderating the outlook for profit growth. The surprisingly weak ISM survey and lack of recovery in the labor market question the vibrancy of the economic recovery. Profit growth has been driven by cost cutting and recent macro indicators question the ability of firms to produce revenue growth. The market has been looking for a pick up in revenues to create a surge in earnings because of the low cost structure. Furthermore, investors will shift out of corporate debt to equity when they see revenue growth boosting net income, as debt owners are not entitled to the upside in earnings. Stocks

will be supported by mixed bottom up data and a global economy, which is still moving forward. Furthermore, equities remain cheap to cash and the repair in credit has helped to bolster valuation. Looking at industries, technology is most bullish. Semiconductor, contract manufacturers, and telecom equipment names continue to suggest improving conditions and this is confirmed by a rise in memory prices. Industrial names have been supported by the Asian recovery and the state of inventory relative to production, but more signs of revenue growth are needed to propel prices higher. Retailers are showing uneven results. Cost control has lifted profits, but demand looks soggy. Walgreens and Nike posted favorable results, but Darden Restaurants painted a poor outlook, and Wal-Mart is cutting toy prices aggressively for the upcoming holiday season. Moreover, there is talk that homebuilders have seen business stall in recent weeks. Transport names are seeing business increase from the lows, but FedEx's CEO indicated the recovery would not be a straight line. Financials continue to battle adverse commercial real estate conditions and the healing process in residential real estate. More write downs are likely, but narrower credit spreads have boosted profits, and year ago comparisons are easy making for a brighter profit picture. The steep yield curve is providing offset to trouble in real estate and generating favorable cash flow. Healthcare is frozen as legislation works through Congress. HMO's have eased in recent weeks highlighting the uncertainty and fear over a law which restrains industry profits. On the supply and demand front, M&A activity remains anemic, while new issue has been heavy. Companies have used the rally to bolster balance sheets, but the process has been dilutive and mopped up excessive liquidity. New issue should moderate from last month's $24 bln pace, but M&A is uncertain and has been relatively weak. Insider selling has been a drag and buybacks will be limited in the current environment. Insider selling will black out in the coming weeks due to earnings release. Companies have a lot of cash, but are moving slowly due to the uncertain recovery. The main bullish story rests in still high money market fund levels and lack of yield.

~Nick Kalivas

CURRENCIES: The debate on the global recovery will likely continue through year-end. The disappointing round of global ISMs coupled with the poor US non-farms underscores the reality that the recovery process will be glacial and will not continue at the pace witnessed in Q2. However, the Asian trade data was better-than-expected which suggests that the macro repair will be syncopated. It is this debate that will allow the FX markets to gracefully move into a paradigm where traditional fundamentals are the conductors of direction. Growth differentials and rate hike expectations will be the main focus and the market's direction will be a function of the anticipation. On the policy front, MFGR favors the Norges bank and the RBA to be the first to hike rates. This expectation is reflected in central bank rhetoric and in the OIS curves. These currencies will not only benefit from imminent rate hikes but additionally from commodity exposure. MFGR likes playing the NOK away from the dollar however and would look to sell EUR/NOK. While MFGR sees the AUD gaining in the long run, it is breaking down technically versus a lot of the G-10s. Additionally, keep in mind that Australia is still a China play and signs of wavering growth in the east would challenge the strength in AUD$. Finally MFGR believes that the market needs to digest that the recovery is slowing. AUD is likely to undergo a pull-back and then move higher as the market continues to look for yield. If looking to play commodity crosses, sell AUD/CAD or buy CAD/EUR. MFGR favors Canada over Australia in the short term.

Looking at the BOE, ECB and Fed, it is clear that these three central banks will err on the side of easy policy for a considerable amount on time. Keep in mind that after the recession in the early ‘90s in the US, the Fed did not hike rates for 35 months after industrial production Y/Y bottomed. Exit strategies will be in question and currencies will acutely focus on central bank rhetoric. The Fed has already started to articulate some of these exit strategies. They have provided definitive ends to their QE program and Fed officials have started to state that they will hike rates with the same alacrity in which they eased. Bernanke and Geithner’s recent public addresses have also been favorable for the dollar. Geithner denounced excessive spending and Bernanke agreed that a strong dollar is a good policy. While these comments will help the dollar but there are greater challenges for the currency that will cause headwinds. There is still uncertainty in Washington and US LIBOR is still the lowest of all the G-10s. Additionally the economic data has not been stellar and the upcoming Q3 earnings may present an unfortunate bottom-up picture. While the initial reaction to negative data will be dollar bullish on risk aversion, the combination of low LIBOR and deterioration in the economic conditions would put the dollar back in its downward trend. Moving into Europe, ECB officials, the historical inflation vigilantes, continue to state that now is not the time to exit and will gradually work through their corporate bond purchase program. This lack of terminal end to their alternative facilities coupled with the recent stealthy rhetoric of the ECB, EU Commission and even the IMF to talk down the euro is bearish the currency. Balancing out the negatives, the ECB’s most recent operation with their 12-month unlimited refi showed that only E75.2B was allotted, a far cry from the E442B in June. This suggests that the EU banking sector, is stable, for now. While the European bank stress tests indicated that banks are sufficiently capitalized and could withstand a deeper recession, they do not mean that the losses are over. Though data in the Euro-Zone has been mixed, the drop in German unemployment will help encourage euro bulls. Finally, if the market can successfully navigate through Q3 earnings, the dollar carry trade will also provide the euro with tailwinds. The risks to the Euro-Zone including Eastern Europe and the syncopated recovery are not a concern of the market right now but do provide long-term headwinds. The BOE’s credibility is being challenged as they vacillate on their decision over reserve remuneration. The data releases in the UK, housing prices and the CBI, argue for fundamental gains but sterling needs to break through 1.6134 to argue for a leg higher. Keep an eye on M4 figures and consumer credit numbers. If they continue to show deterioration, the BOE may look to expand their QE program which will have long-term negative implications for the pound. Keep in mind the imbalances in the UK economy. The BOE data showed that consumers paid down a record amount of unsecured debt which means they aren’t spending. Additionally, the Office of National Statistics announced that the savings rate increased to +5.9% from 3.9% in Q1. Despite this, the current account widened to –GBP11.4B in Q2. The combination of these factors suggests that the weaker pound may help to build a healthier British economy.

Finally, it must be mentioned that fundamentals will take a back seat if global equities robustly set back. Third quarter earnings will be in focus and a potential lack of revenue growth and poor guidance will challenge equity strength. Such a challenge will force the dollar and the yen higher. On the dollar/yen front, unless the BOJ looks to intervene (a strategy which the new MoF Fujii originally spoke out against), USD/JPY will trend lower.

~**Jessica Hoversen**

PRECIOUS METALS: Precious metals are expected to maintain their early-September upward trends during trade in October, with gold prices advancing toward the $1,040 Fibonacci resistance level. Silver and platinum prices could reach toward their Sep highs at $17.69 and $1,356 respectively. Metals should be well supported this month with reinforcement coming from expected weakness in the dollar, improving jewelry demand from key consumer India, and a favorable technical construct. Economic data in the last week of September was surprising weak and indicated that the economic recovery may be slowing. We believe that a shift in economic focus beyond the current recovery and toward an expected slowdown in FH ’10 is likely, and has been affirmed by multiple Fed members. As economic data is reported to improve in the Eurozone and as rhetoric increases about global economic rebalancing, we expect the dollar to fall. Gold will be uniquely positioned to endure what we think will be a false indication of risk appetite, as it traded only 3.8% below its mid-Sep peak at Friday’s low compared to nearly 6% lower for the more risk-sensitive S&Ps. Indian demand for jewelry during its festive season is increasing despite a poor monsoon season. Consumers used price dips below $1,000/oz to make new purchases, and scrap sales are decreasing, which suggests that consumers believe prices will soon rise. Finally, technical factors will contribute to market strength, as a positive seasonal pattern and a seven-month old bullish triangle project a rally up to the $1,111 level.

~Tom Pawlicki

ENERGIES: Energy markets are expected to trade in a lower direction this month, with CLZ9 likely to fall toward the $62/bbl level. Pressure on prices will be applied by signals that the economic recovery is losing steam. Data in the last week of September surprised markets with indications that economic recovery was slowing, which provided confidence to recent predictions of a double-dip recession in the first half of next year. Poor economic recovery should weaken the dollar, which could create an illusion of risk appetite, but one that we don’t anticipate being very supportive for oil prices. A sub-par recovery has been suggested by numerous Fed members, which should keep oil demand under pressure. On Sep 28th, the CEO of Saudi Aramco said that declines in Western demand for oil weren’t being fully offset by increases in demand from China. The threat of new CFTC regulations aimed at reducing participation by passive long index funds could create selling with the intention of reducing holdings below new position limits. Such trades were seen last week after Deutsche Bank energy and grain funds rebalanced toward OTC and ICE based contracts. Finally, the seasonal pattern in oil shows that a price peak is usually made around Oct 13th with prices falling through Dec 9th. The average decline is 11.6% and the trade has worked in 14 of the last 18 years.

~Tom Pawlicki

GRAINS: Advise selling deferred soybeans and wheat on rallies and selling out of the money corn calls. With the US soybean harvest approaching 20%, we have enough evidence to support higher ’09 US production that will accommodate likely understatement of ‘09/10 US soybean demand. Look for strong soybean basis and board spreads to entice sufficient farm selling to meet record Q1 US demand. Meanwhile 2010 S. American soybean production, on heels of favorable El Nino weather, could advance a record 28 mmt. 2010/11 US soybean stocks are poised to exceed 400 mil bu unless portion of total US planted area base added in recent years is taken off-line. Surging oil share as % of product value reflects ongoing soft domestic meal demand due to poor livestock feeding margins. The wheat market, where USDA is grossly understating 6/10 US wheat stocks, must brace for another gain in 6/11 US wheat stocks against backdrop of adequate world supplies, more new crop wheat acres than needed and relaxed global end users who recognize a buyer’s market. Our downside objective on WZ is $4.10 with lower lows possible 1st quarter of next year which corresponds with timing of lows in analog years of large year-to-year gains in US wheat stocks. Our $8.00 downside objective on SX at today’s BN/CN ratio suggests CZ retest of $3.00 area. Late October grain/oilseed price upside is limited unless gut-slot corn harvest reveals disappointing yields. Corn should work erratically lower but only after US harvest pace accelerates LH October. Until then advise selling $3.60 and $3.80 CZ calls on rallies. Bottom line—lower prices and eroding volatility into year-end suggest selling grain/oilseed option volatility while monitoring possible emergence of 2010 S. American weather adversity which would propel late year row crop prices well above subdued price levels currently envisioned.

~Rich Feltes

CRB: Expect CRB to trade in 410-430 range during October amid conflicting crosscurrents that will pre-empt an upside breakout while offering support on breaks. Globally, the pace of economic recovery has moderated as evidenced by slowing of PRC loan growth and downsizing of key Chinese industries. Pace of Indian recovery will be capped by the poor 2009 summer monsoon. Additionally, dollar weakness has moderated amid OECD recognition that further dollar weakness is not in their collective interest. Meanwhile, crude oil is poised to erode to $61-65 range in wake of negative Q4 seasonals, sluggish demand and bearish chart action. The CRB will derive support from an uptrend in gold market which could approach $1100/oz area by year end. Additional support will be derived from demand driven recovery in oversold hog market and transition to potentially adverse late autumn weather in the US southern plains that could send live cattle substantially higher. Grains/oilseeds will probe lower lows but bulk of pre-harvest price erosion is dialed in. Bottom line—reigning in of Asian liquidity, disappointing ISM purchasing manager's index, further weakness in crude and mixed tone to consumer sector will more than offset positive outlook for precious metals and livestock forcing CRB to maintain 410-430 range in place since early August.

~Feltes/Kalivas/Pawlicki

Debt Markets: sell 2/10 at 238 bps. Risk 245 bps and target 210 bps.

Equity Markets: Buy NDZ at 1641 and risk 1624. Target 1705.

Currencies: Buy CAD/EUR at .6300; Risk .6213; Target: .6500.

Sell EUR/NOK at 8.500; Risk: 8.600; Target: 8.200

Buy AUD/CHF at .8750; Risk: .8654; Target: .9340

Energies: Sell CLZ9 at $72.00, target $62.00, risk $76.00

Precious Metals: Maintain long GCZ9 from $1005, target $1,100, risk $980

Grains: Sell CZ corn $3.60 and $3.80 corn calls

Sell WN on rallies over $5.15

Sell SX 2010 over $9.10

CRB: Sell CRB rallies near 430