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BRIEF UPDATE: FIXED INCOME/ EQUITIES/FOREX

Wednesday, September 28, 2005 (07:00 CDT; 08:00 EDT; 12:00 GMT)

Very brief today indeed, as not that much has changed since yesterday's analysis in spite of the expanded comments on the US economy from Mr. Greenspan yesterday afternoon. Maybe it was just us, but the fact that he chose to recite the brief history of modern capital markets as a way to comment of the relative effectiveness of financial engineering was pretty astounding. From Adam Smith to "Conceptual advances in pricing options and other complex financial products…" in four pages; quite a tour de force. Now we would all just like to know what he thinks about the current economy, and what the Fed plans for short term rates.

As usual, the cryptic Chairman did allow a glimpse of the leaves at the bottom of the cup when he tacitly noted that the short term rates that the central bank controls had become even more of a blunt instrument than had been the case when banks were more substantive intermediaries of the effect of interest rates on the economy. The most telling portion of the comments for us was the section near the end that noted "…the significant monetary tightening of 1994 did not prevent what must by then have been the beginnings of the bubble of the 1990s. And equity prices continued to rise during the tightening of policy between mid-1999 and May 2000."

The implication seems to be that it is taking ever more extensive action on short term rates to effect changes in equity market and economic sentiment that have increasingly become dependent upon other factors affecting consumer and investor psychology. The current cycle's conundrum of long rates remaining so low reinforces this notion, as there has been an abiding sense that in spite of strong US economic growth the Fed has been out in front of any inflation threat. That may all be changing now, but the various durations' yield spreads seems to reinforce the Mr. Greenspan's view. With low long maturity yields not having helped the Fed cool the housing and construction sectors even a little bit, it is possible the Fed sees quite a bit more heavy lifting to be done in the short maturities if energy inflation accelerates.

What we know about the market impact is that this is not good news for anyone who felt that the Fed might be near the end of the tightening cycle, and this week's March EURDOLLAR future gap below a previous UP Break and important congestion in the 95.62-.60 range speaks of a market that likely has quite a bit further to go in spite of the extent of the down trend to date, and the degree of its discount to cash yields. What is even more interesting is the lack of any more extensive Eurodollar forwards discounts into contracts as far out as 2008.

The big mistake that traders made in the 2002-2003 period was anticipating the Fed putting rates back up rapidly once there was any sign of a rebound in the equity markets. In the event this caused the forward futures to trade at discounts of up to 150 basis points below depressed cash market yields. Yet, as the Fed not only abstained from increases but actually eased further into 2003 the bearish notion we proved wrong as the forward futures rallied mightily from significant selloff lows. Might traders be making a mirror image mistake now in anticipating that the impending weakness of the economy in the wake of the recent rate hikes will cause the Fed to demure from more rate hikes if energy driven inflation becomes a bigger problem? Only time will tell, but the charts on all of those extended Eurodollar forwards do look as damaged as the March 2006 picture.

Of course, none of this is helped by stronger than expected Euro-zone economic numbers this morning, which have left the previous strong sister December BUND slipping down for an even more vigorous test of its 122.60-.50 support than yesterday in spite of the T-note not getting back down to its own 110-00/109-16 support. That the GILT and SHORT STERLING are not responding well to some fairly abominable GDP and CBI Distributive Trades reports is a further sign that even weak economic indications are having trouble reinvigorating a suddenly more bearish fixed income picture. The one clear culprit here is the prospect of what is now stubbornly ingrained energy price inflation, which seemingly has gone through the looking glass from the constructive "drag on the economy" phase that prevailed over the past many months. The one additional effect of the weak UK numbers is the degree to which the British pound remains a weak sister, and very vulnerable relative to even the other currencies that have been weak against the US dollar.

GBP/USD still looks like 1.7600 is the critical support this side of the 1.7400-1.7300 range. The equities seem to still be hostage to the December S&P future decision on whether or not to Close convincingly back above the 1,225-30 range, or suffer another drop to the 1,200 if they fail to do so. Higher resistance remains in the mid-upper 1,240s.

All other technical levels and trend views remain the same as those of the past couple of days, and we refer you back to yesterday's **BRIEF UPDATE** for any additional technical information.

We hope you find this helpful.

-Rohr