Rohr Report

TrendView

BRIEF UPDATE: FIXED INCOME/EQUITIES/FOREX/ENERGY

Tuesday, July 15, 2008 (08:00 CDT; 09:00 EDT; 13:00 GMT)

OVERVIEW

- **While we have noted of late economic reports' backward looking nature makes them more than a bit irrelevant in the face of 'facts on the ground', it is worth citing the most telling releases. And those continue to indicate that equity market activity is a primary driver for the fixed income (short money as well as long dated government bonds) and foreign exchange. As expected June Final Italian CPI (still at elevated levels) followed by hotter than expected UK CPI and US PPI (also June) should be weighing on the debt markets. Yet the failure of the US equities yesterday in spite of Friday's FNMA and FHLMC support announcement along with this morning's extremely weak German and Euro-zone ZEW Surveys (all July) have left equities under pressure again this morning. That is both bolstering the fixed income and weighing on the US dollar.**

- **Disturbing as FNMA and FHLMC problems remain, the failure of IndyMac Bancorp was the third largest US bank failure ever according to FDIC (Federal Deposit Insurance Corporation.) That also raises issues over the health of other prominent regional banks such as Washington Mutual (the seventh-largest US bank by assets) and Cleveland's National City that also came under pressure on Friday following the closure of IndyMac. If it were not for the story being subsumed into the FNMA and FHLMC problems, no doubt that closure of a bank with extensive subprime and other exotic mortgage exposure would have been the primary headline. It all still gets back to a loss of consumer and depositor confidence due to the weakness of US housing that refluxes into the financial service sector through the failure of creative mortgages.**

- **Regarding the failure of the equities to take the FNMA and FHLMC support program seriously, we are all going to be treated to an interesting variation on Mr. Bernanke's *Monetary Policy Report to the Congress* in front of the US Senate today (to be followed by a similar exposition and Q&A at the House tomorrow): he will be joined by US Treasury Secretary Paulson. That is both rightful and very critical in light of combined Fed and Treasury roles in addressing what is becoming nothing much less than a low level panic. We are always careful to avoid playing Cassandra. Yet the FNMA and FHLMC problems are only symptomatic of the degree to which the US housing mess is affecting general financial and economic psychology down to the average individual.**

- **In a most interesting quirk of fate (or more likely deal making) Committee Chairman Senator Dodd just had his housing relief legislation (co-sponsored by Republican ranking member Richard Shelby) pass on Friday after a lengthy delay on specious political grounds. While it still needs to be reconciled with a House bill in joint committee meetings, this means that the Congress' housing relief legislation to assist at-risk borrowers and the communities experiencing foreclosures will soon be signed into law (over Bush's objections/veto?), and be funded to the tune of $300 billion.**

- **With that in mind, it might be constructive for either Senator Dodd or some other committee member to politely inquire of the Fed Chairman and US Treasury Secretary how many entities the US government thinks it is wise to underwrite before a more extensive at-risk borrower foreclosure prevention program is the enlightened move. Having noted it repeatedly since last September, it is still worth revisiting once again that everything from the initial interbank market illiquidity last August through to the major current problems have been based on the asset value destruction incurred though extensive US home price weakness; in good measure from failures of Hybrid Adjustable Rate Mortgages. (As inquired at various points previous, did everyone miss their acronym being HARM?!) Allowing there are 'moral hazard' concerns, they are quickly becoming far less important than the practical benefits of stabilizing home prices.**

- **The other scary aspect noted in yesterday's *Weekly Overview* is that the Fed's Yellen speaks on 'Stabilizing Communities and the Negative Effects of Foreclosures' this afternoon. In light of last week's perceived solvency issues at Fannie Mae and Freddie Mac and the administration's aversion to an at-risk borrower 'bailout', that should be most interesting. While we already focused on it extensively last week, recall that it was Ms. Yellen's disturbing reiteration of probable further extensive weakness in US housing and the return to a hawkish stance at the Fed which weighed so heavily on equities.**

- **Regarding equities, we are still going to concentrate on DJIA for the sake of brevity, and the fact that it remains the trend setter (if not always the most volatile.) In spite of the bounce from 11,000 area obvious 'big penny' and other actual technical support, the more critical DJIA technical level is 10,700. It is the confluence of major technical supports noted in yesterday's *Weekly Overview*: a major congestion level from all the way back on the bull move into early 2004 highs, with quite a few subsequent periods of highs and lows forming around it in the sustained up trend until the DJIA was finally ready to push above the 2000 all-time high in late 2006 (with the last major pullbacks to 10,700 into June-July 2006); also the major Fibonacci 0.50 retracement of the 2002-2007 bull move; and on a psychological level it is also just about how far DJIA might slip below the 11,000 area prior to looking like it is in free fall for a quick drop to 10,100-000. As such, if DJIA breaches 11,000 in a disorderly manner, by roughly 10,700 we suspect 'the powers that be' will feel pressure to 'do something' beyond that done already; Discount Window access for lottery tickets, or finally bail out at-risk home owners?**

- **While the foreign exchange has been much more subdued, last Thursday's ECB Monthly Bulletin refocus on sustained inflation concerns left it a bit more hawkish than some (albeit not this analyst) had expected. The recent data has reinforced that focus, and along with the ever more glaring weaknesses in the US economy that weighs on the US dollar. While we were not convinced the US dollar was back to being the secular weak sister of late due to weakness in the Japanese yen and British pound, today's activity reinvigorates that very weak US dollar view. USD/JPY back below the low end of the 105-106 range has a trend support Tolerance (broadest upward channel from the low back in March) at 104. Much below that it can drop back to 102.50 or even 100.00. EUR/USD back above the 1.5750-1.5800 interim resistance and even the previously resilient 1.5900 area resistance looked ready to finally push above the mid-April 1.6000 area high, and is challenging it at present. Even an extension of the rally only up to oscillator thresholds seen quite a few times throughout the euro bull move (i.e. not the more extreme extensions reached in March) project next resistance into the 1.6300 area.**

- **The other scary aspect of the Japanese yen returning to strength is that is it based in part upon the Bank of Japan expressing the view that while it is also watching the potential for US economic weakness to become a drag on their economy, any decrease in downside risks might require reversal of the prolonged period of accommodative financial conditions. It seems that all central bankers are inclined to bang the 'inflation mitigation' drum even as the primary credit contraction problem weighs on the markets.**
- **All other analysis remains consistent with yesterday's *Weekly Overview*, and we refer you back to that and last Tuesday's *Capital Markets Observer* IV-7 for further trend views and technical levels.**

We hope you find this helpful.

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