Rohr Report

TrendView

MARKET ALERT: EQUITIES/FIXED INCOME/FOREX/ENERGY
Monday, September 15, 2008 (09:00 CDT; 10:00 EDT; 14:00 GMT)

ALERT: FINANCIAL SERVICES CRISIS CONTINUES TO DRIVE PSYCHOLOGY

AS WE HAVE NOTED REPEATEDLY OF LATE, THE MARKETS ARE LESS CONCERNED ABOUT 'REAR VIEW MIRROR' ECONOMIC DATA (AS WEAK AS IT MAY BE) AND MUCH MORE FOCUSED ON 'FACTS ON THE GROUND' FROM THE CONTINUING LIQUIDITY CONTRACTION DUE TO SUSTAINED PROBLEMS IN DEBT DERIVATIVES. THOSE BOTH BURDEN SOME OF THE FINANCIAL SERVICES INDUSTRY PORTFOLIOS AT PRESENT, AND HIGHLIGHT THE WEAKNESS OF THEIR BUSINESS MODEL.

THE NET EFFECT OF LEHMAN BANKRUPTCY AND THE MERRILL LYNCH BUYOUT (AS WELL AS CONTINUED CONCERNS REGARDING AIG) HAS BEEN EXTENSIVE EQUITIES WEAKNESS, FIXED INCOME STRENGTH, A SUBDUED REACTION FROM THE US DOLLAR, AND A FURTHER OPENING OF THE LIQUIDITY FLOODGATES BY THE FED. THE NEAR TERM TRADING KEY WILL LIKELY BE WHETHER THE EQUITY MARKETS RESPECT THE PREVIOUS GSE RESCUE LOWS FROM BACK IN MID-JULY, WITH CORRESPONDING EFFECT ON THE LONG DATED FIXED INCOME.

In this week's *Weekly Overview* (reattached here for ease of access for those who missed its distribution at 14:00 CDT yesterday) we noted "…the fate of some of the financial services firms is critical." While we were certainly not unique in that, it reinforces the degree to which the markets are almost completely anticipatory regarding future impacts of the deleveraging which continues in a disorderly fashion. That is due to inability to price derivative portfolios containing suspect US housing debt. That said, this morning's much weaker than expected Empire (New York state) Manufacturing Index (SEP) and US Industrial Production and Capacity Utilization (AUG) only seem to confirm the degree to which the problems that were hopefully confined to financial services portfolios are spilling over into the real economy.

One of the primary problems is the degree to which the Fed and US Treasury have treated the situation as a liquidity problem since they first assigned that dynamic to it during the initial interbank lending problems last summer. Their steadfast refusal to take serious comments from many informed analysts (Including this analyst) that this always was going to be more of an 'asset value destruction' problem (as we clearly articulated slightly over a year ago) has left their 'just absorb the writedowns' approach in tatters. The degree to which the Fed has now lowered the criteria for acceptable collateral accepted against liquidity loans is nothing less than astounding relative to the previous regime. And we thought we were only joking in our previous quip regarding whether "lottery tickets" would be the next thing accepted at the Discount Window if the DJIA slipped below 11,000 (on the morning of July 15th prior to that being the event, triggering US Treasury's backing for GSE & at-risk borrower support.)

While we will have much more to say in this week's *Capital Markets Observer* on the reasons this mess continues to expand and what needs to be done about it, what to look for in the markets is more important for now. While the other equities have eroded below their mid-July weekly UP CPR indications (with weak sister DAX temporarily trading into a new low below the 6,000 area), unless and until the DJIA Closes below its 11,100-10,975 weekly UP CPR support there is room for a recovery. That is consistent with weaker sister S&P 500 future lead contract (still September until the end of this week) remaining above its 1,201 trading low from mid-July, and the even weaker NASDAQ 100 future sagging to no worse than the low hit last Thursday. That would all speak of the Fed's expanded liquidity support working; at least in the short term, with more concerns to follow from areas like the credit default swaps market and other areas.

As noted previous for the fixed income, any September T-note push above the 118-00 area resistance (Tolerance 118-12) leaves extended resistance not until 119-16/120-00. Yet, the full point discount in the December means any strength in the lead contract will need to be reconfirmed by December when it becomes the front month at the end of this week. Quite a bit of that will also likely rest with whether further equities weakness fosters an extension of the government bonds "haven" bid. That is necessary to sustain an extension of the long dated fixed income up trend due to the degree to which 'govvies' are already at extensive negative real yields. This has been the case because of the need for so many investors to hold only high grade debt in an environment where so much other credit quality is suspect.

It is interesting that (pending the further equity market trend developments) December Bund is not sustaining activity above the 115.00-.30 area. Extended resistance remains every full point up from there into the mid 117.00 area. December Gilt at a full 2.25 point premium to the September contract is also not sustaining activity above the lead contract January high at 112.57. (Note: December only becomes lead contract on the 26th.) Extended resistance above that are the 113.05 trading high from two weeks ago, and continuation congestion (from back in 2005-2006) at 114.50-.75 and 115.50.

The only place where the US dollar has moved sharply is against the Japanese yen, and even there the early three-and-half point trading drop has now recovered to a two point loss. That leaves USD/JPY into the 105.00 support, with further support into 103.80. While that is quite a spill, it also is partially driven by a sense the FOMC may actually cut rates tomorrow, driving the US base rate closer to the already depressed Japanese level. However, that remains problematic after the expanded liquidity function from this morning will likely be given at least a brief period to assess its effect. The balance of the foreign exchange implications will be revisited in this week's *Capital Markets Observer*.

The one other dramatic effect is the October Crude Oil drop below weekly congestion and Fibonacci support in the 100.00-98.50 area. However, it is another problematic aspect of the markets whether this is a reflection of the much weaker economic outlook and skepticism regarding OPEC discipline in reverting to previous quotas, or a distortion from the closure of US refineries due to Hurricane Ike damage and release of some stocks from the US Strategic Petroleum Reserve. Whatever the case, the extended supports are 95.50, 89.00 and back at the low 86.00 area December-February lows.

We hope you find this helpful.

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