

Overview, Reports & Events,...

...Extended Fixed Income Technical Decision Outlook

Overview

"Fed forced to cut!!" Maybe. As healthy skeptics of the received wisdom, we can only point to quite a few factors which might not be as conducive to what is becoming as foregone a conclusion as the current psychology might suggest. Confucius say, "Man who trades off of headlines today, possibly find himself out selling newspapers tomorrow."

Among the influences which might still derail the fixed income strength are the views of some central banks which remain quite hawkish on the overall impact of inflation. Admittedly, those views have had less influence as the news has become more benign of late. In addition, while the recent weak news has seemed the harbinger of more to follow, there is always the prospect of the economic data reverting to stronger tendencies. Yet, while they are still viewed as weak, energy markets also remain no worse than 60.00-59.00 **Crude Oil** support, and **Heating Oil** and **Natural Gas** forwards still anticipate hefty seasonal price recoveries. OPEC has also just signaled it is unlikely to allow this recent source of diminished actual and expected inflation tendencies to maintain its current dynamic weakness.

This is an addition to the extensively reviewed conundrum of what the Fed will actually do if equity markets become too 'exuberant' about the prospect of lower interest rates. As noted previous, in that regard, any extensive further rally in the stock markets might (and it is only a possibility) be self-limiting (more below.)

Even though we already mentioned it briefly in last Friday's **TrendView BRIEF UPDATE**, we will be expanding our views on how the recent strong technical developments in the long dated fixed income and US short money (less so in the European short money) have created an environment where a significant intermediate term trend decision is likely to unfold through the course of this week through next week's typical early-month major economic releases. Hence the atypical necessity of an **Extended Fixed Income Technical Decision Outlook** as the primary focus of our extended review this week.

It all boils down to whether the December **T-note** future holds the rather important daily and weekly UP Breaks at the bottom of the low-108-00/107-16 range support, which is also clearly defined recent and historic congestion. This will be the clearest sign of whether the bears can get the bull genie back into the bottle, and have the intermediate term trend revert back to an aggressive bear. If not, then the intermediate term trend will remain as bullish as recent UP Breaks and violations of resistance suggest. While the next higher meaningful resistance is as nearby as the 110-00/-16 area, that is likely moot: the higher broad channel resistances which still leave the T-note in a long term down trend (albeit quite a bit more gradual than the recent trend) are not until the mid 112-00 and mid 114-00 areas.

As such, the ability of the T-note to hold tests of the mid 107-00s on any near term setbacks (with any initial dip very likely to do so as the first retest of multiple UP Breaks) will confirm the reversal of the dynamic January-May down trend (with a minor extension into June.) That will encourage the T-note to extend the current rally from the late-June 104-00 area lows up into significantly higher resistances, with salutary effect on other long ends.

Even if the T-note fails from major resistances within a more gradual cyclical bear trend, an extension of the current rally to possibly as high as the mid 114-00 area would still be an intermediate term bull trend. What will be especially interesting is how well the fixed income fares on any further equity market strength which sees the **DJIA** sustain strength back above the 11,580 area early May weekly DOWN CPR. Any weekly Close above that will confirm it is ready to knock out the attendant 11,670 high, and challenge the 11,750 all-time high from back in January 2000. That said, the 11,750 resistance does remain important near term resistance based on weekly oscillator projections. As similar tendencies exist in other equities, they are likely to follow the US lead even though they are not nearly as close to their all-time highs.

The foreign exchange remains more than a bit convoluted, with the anticipated weakness of the US dollar in the wake of weaker yields (ostensibly led by the prospect of rate cuts from the Fed) in evidence late last week. Yet, that has been reversed into early this week in spite of the fixed income markets maintaining their strength (i.e. yields remaining under pressure.) With the mainstream US dollar relationships continuing for even longer than we suspected after the mid-May bottom of the buck, we are content for now to wait until the recently tested resistance is violated. That is the EUR/USD 1.2630 low, and .8617 high in US dollar Index. While the buck remains strong against the Pacific Rim after holding the anticipated USD/JPY 116.00 area support, hefty resistance remains in the low-mid 118.00 area, which is very similar to the AUD/USD stallout at .7570-.7600 still holding the .7500 support.

Reports & Events

While the market response last Wednesday to the FOMC decision and statement was rather muted, subsequent weak data reinforced the up trend in long ends led by the T-note. It was a bit bizarre that the sometimes inconsequential Philadelphia Fed Manufacturing Survey (SEP) should trigger such a robustly bullish reaction, especially as some of its components were not very constructive (employment and prices received among them.) This speaks of a market reaction which was primed to respond very constructively to any random piece of friendly news: essentially pent up bullish momentum.

Now that the market has indeed seen upside leader T-note post UP breaks on the way through 107-16/low 108-00 resistance, the ability of the evolving news to encourage it to maintain the low end of that range on setbacks is very important. And there is no small amount of critical news over the next two weeks. In fact, there is so much economic data and pronouncements from various financial luminaries this week, for the sake of brevity we are limiting our outlook to those which seem most important (i.e. not listing minor reports, or speeches on topics such as 'financial education' for example.)

So far this week the weakish German CPI (SEP) has been offset by a bit stronger than expected IFO Business Climate Index (SEP) and Import Prices (AUG.) When the US Consumer Confidence and Richmond Fed Manufacturing Index (both SEP) also came in a bit

stronger than expected, it was enough to bring the first minor weakness into the fixed income in several days, while boosting the equities.

Now on to the “Battle of the Hawks and Doves.” The speeches and appearances by financial figures this week are so extensive and potentially important that we will list them first (as opposed to normally mentioning them along with the daily report release outlook.) Evidence of fixed income strength was inherent in lack of reaction to the Fed’s Fisher offering his usual hawkish comments among weak indications for the housing and auto industries yesterday. On Wednesday the Fed’s Kroszner speaks on productivity in New York, while Thomas Hoenig speaks late in the day on the economy and central bank policy in Nebraska.

Thursday has an early speech by BoJ Deputy Governor Iwata at the Euromoney Conference, after which we hear from the Fed’s Minehan on ‘the role of central banks in economic and personal finance education’, ECB’s Tumpel-Gugerell on ‘financial system modernization and economic growth in Europe’, and the Gonzalez-Paramo on ‘expectations, uncertainty, and the design and the making of monetary policy.’

While that should be interesting, the coda to all of these comments will be Friday’s classic hawk/dove shootout between the ECB’s Stark on ‘economic education, an important factor in the implementation of the monetary policy’ (noted here for its potential monetary policy discussion), the ECB’s Weber on ‘financial system modernization and economic growth in Europe’, the Fed’s Poole on ‘data dependence’, and, last but by no means least, the Chicago Fed’s Michael Moskow on ‘globally competitive agriculture and the Midwest.’ While that last bit doesn’t seem very critical, it is Mr. Moskow, and the topic might segue into a discussion of foreign exchange and competitive interest rates.

The economic data is no less important, albeit almost always overshadowed by the prospect of the early-month data we will see next week, including the Purchasing Managers Indices and culminating with the US Employment report (all SEP.) Wednesday is release of the very current German GfK Consumer Confidence Survey (OCT), Italian Business Confidence (SEP) and Retail Sales (JUL), along with UK Gross Domestic Product (Q2 Final) and the CBI Distributive Trades Report (SEP), all followed by the US Durable Goods Orders and New Home Sales (both AUG), as well as various weekly energy stocks reports.

Thursday sees Japanese Small Business Confidence (SEP), the German ILO Unemployment Rate (AUG), UK Nationwide House Prices (SEP), along with French Gross Domestic Product (Q2 Final), and the likely more important German Unemployment numbers (SEP) and US GDP (Q2 Final) that includes any revision to the Personal Consumption and Core PCE.

Friday is various Australian and Japanese inflation numbers (AUG, except SEP for Tokyo) early, along with Japanese Construction Orders (AUG), German Retail Sales (AUG), French Consumer Confidence Indicator (SEP), French and Italian PPI (AUG), UK Net Consumer Credit (AUG), all manner of the usual Euro-Zone Confidence Indicators (SEP) and Estimated CPI (also SEP) that is anticipated to be very benign in the wake of the constructive German numbers, as well as the UK GfK Consumer Confidence Survey (SEP.) All which is followed by the US Personal Income and Consumption (AUG) along with its PCE Deflator and Core readings, Michigan Consumer Confidence (SEP Final), and the Chicago Purchasing Manager Index (SEP), along with the talking heads noted above.

All of which will be tempered to some degree by the prospect of major early-month reports coming up next week, likely creating a bit of nervousness after recent directional trends.

Extended Fixed Income Technical Decision Outlook

LONG DATED FIXED INCOME

This is the reason why it is now likely that the fixed income enters a consolidation phase in the short run, even if the reinforcement or reversal of the recent bull signals is complete by roughly the end of next week. The multiple UP Breaks below the December **T-note** future at the bottom of the low-108-00/107-16 range support likely means that the first reaction holds not much worse than the 108-02/107-31 Runaway Gap left between last Thursday's Close and Friday's low. In essence, there is so much support back in the 107-16 area that the market is not likely to dip fully down to that level on the first selloff. However, there is also interim resistance prior to the 110-00/-16 area in the 108-26/109-05 range (previous weekly interim up channel DOWN Break as well as the Fibonacci 0.50 retracement of the swing from the 114-07 June 2005 high to the lows.)

As such, very much in line with the vagaries of the news likely becoming more of a two way affair after the recent consistently constructive numbers, the T-note is likely to take a couple of swings between the low 109-00 and upper-mid 107-00 area prior to the final decision on whether to hold or fail that lower support. The obvious problem for both bulls and bears is the likely lack of any major decision until release of the US Employment report next Friday.

Similar conditions are therefore likely in the other markets as well. The European long ends have squeezed modestly above the continuation highs from early September, yet are faltering just a bit in the wake of the T-note's modest near term topping activity. While that overt high in the Bund was 118.49, the actual extended continuation resistance in the Bund was always the low 119.00 area. Lower support is back at the psychological/technical levels of 118.00 and 117.80-.60. Of course the ultimate lower support remains the low 117.00 UP Break Tolerance at 116.80, which held multiple tests over the last several weeks, and is not likely to be violated unless the T-note fails 107-16 on a weekly Close.

Similar conditions exist in the weak sister **Gilt**, as there is still plenty of higher resistance into the interim continuation high at 110.84 (from mid-June, even though the other long ends have markedly exceeded their equivalent levels), and the congestion around the November 2005 low and violated Fibonacci support in the 111.20-.40 range. Lower support is 110.00-109.80, with extended levels at the reinstated 109.60 and 109.35.

SHORT MONEY

The September 2007 Eurodollar recovered sharply back above the ostensible failure below its 94.94 UP Break. Just as the Bund has been the volatility leader of the long end trend in both directions since January, the Eurodollar has been the bullish ray of light for the otherwise depressed short money. As such, its decision to also exceed resistance into the 95.03-.07 congestion, gap, Fibonacci and oscillator resistance left it ready to also overrun interim resistance at 95.15 on the way to more major resistance in the 95.25 area. The December contract was more subdued, and has stalled against its 94.70-.72 resistance, with lower support back at the recently violated 94.63-.60 congestion.

December Euribor also held the slippage below its previous major low at 96.295, and has been up near 96.40 resistance. However, that remains somewhat critical in light of both technical factors and the continued hawkishness of the ECB that points to at least one more

rate hike prior to the end of the year. September 2007 Euribor recovered smartly from its 96.10-.05 support, and has congestion every 10 points up from there to more major resistance at 96.40-.45 which it stalled against in the past couple of days. However, as noted previous, daily Closes above 96.20 was all that is necessary to put the market back above trend averages, and turn daily MACD back UP, and that will lend an improved undertone on any near term setbacks to the 96.20 area.

Similarly in the September 2007 Short Sterling, recovery from 94.60-.58 support generated by the mid-August daily UP CPR from the new low for the break was strong enough to push through initial resistance at 94.72. However that resistance was always going to become heavier into congestion and trend MAs in the 94.80 area, which the market is currently probing. Above that the next important levels are the gaps and congestion into the 94.92-.95 range. The December contract remains weak just below the bottom of its own 94.80-.75 support today, likely in deference to the likelihood BoE will raise rates once more prior to the end of the year.

We will be distributing more extensive technical levels and trend views for the other markets in tomorrow's **TrendView BRIEF UPDATE**.

We look forward to providing further comments as the situation warrants, and hope you have found these perspectives helpful.

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