

MARKET ALERT: FIXED INCOME/EQUITIES/FOREX

Wednesday, October 11, 2006 (14:00 CDT; 15:00 EDT; 19:00 GMT)

ALERT:

WE HAD EXPECTED THE RELEASE OF MINUTES FROM THE SEPTEMBER 20TH FOMC MEETING TO REFLECT THE BALANCED SORT OF VIEW CONSISTENT WITH MR. BERNANKE'S RECENT REMARKS ABOUT THE ABILITY OF THE HOUSING SLUMP TO SPILL OVER INTO GREATER WEAKNESS FOR THE U.S. ECONOMY AT LARGE INTO NEXT YEAR. IN SPITE OF SOME MEMBERS OF THE FEDERAL RESERVE SYSTEM VOICING SOMEWHAT MORE HAWKISH OPINIONS, OUR EXPECTATION WAS THAT TOMORROW'S BEIGE BOOK WOULD BE MUCH MORE DECISIVE THAN THE MINUTES, WHICH WOULD BE MORE BALANCED.

IN THE EVENT, THEY WERE NOTHING OF THE SORT. IT LEADS ONE TO WONDER WHAT MR. BERNANKE WAS TALKING ABOUT IN HIS RECENT COMMENTS, OTHER THAN TO EXPRESS HIS OWN HOPES THAT FURTHER RATE INCREASES WOULD NOT BE NECESSARY. SAD TO SAY, THIS IS GETTING TO BE ANOTHER OF WHAT ARE DISTURBINGLY REPETITIVE FAILURES THAT IMPUGN HIS CREDIBILITY.

FROM THE UPWARD REVISION TO THE STAFF'S FORECAST FOR NEXT YEAR, TO THE LOWERING OF THE TREND (I.E. NON-INFLATIONARY) GROWTH POTENTIAL, TO THE ADMISSIONS THAT THE HOUSING WEAKNESS HAD NOT SPILLED OVER INTO THE REST OF THE ECONOMY IN ANY MATERIAL MANNER, AND THE GENERAL VIEW THAT THE SLOWING OF THE ECONOMY *MAY INDEED NOT BE SUFFICIENT TO LOWER INFLATION* IS ALL QUITE HAWKISH, EVEN IF NOT CHARACTERIZED AS SUCH IN THE MINUTES.

WHEN LINKED TO MR. GREENSPAN'S OBSERVATIONS (CONFIRMING OUR VIEWS AND THOSE OF SOME OTHERS) ON THE FED'S MISTAKE REGARDING THE LAST EQUITY MARKET BUBBLE, THAT THE HOUSING MARKET CORRECTION MAY HAVE ALREADY RUN ITS COURSE, AND THE FACT THAT SIGNIFICANT WEAKNESS IN ENERGY PRICES IS UNLIKELY, ALL OF WHICH IS ADDED TO THE MAJOR BLS CES REVISION FROM THE END OF LAST WEEK, IT IS VERY BEARISH TO FIXED INCOME.

Confirming the legitimacy of views emanating from some of the hawks, the key section which sums up the major thrust of the last FOMC meeting is buried in the middle of the minutes:

"Growth was likely to strengthen next year as the housing correction abated, with activity also encouraged by the recent decline in energy prices and ***still-supportive financial conditions***. In the view of many participants, ***economic expansion would probably track close to the rate of growth of the economy's potential next year and in 2008***. Many participants also noted that core inflation had been running at an undesirably high rate. Although most participants ***expected core inflation to decline gradually, substantial uncertainty attended this outlook***." (Our bold italics, of course.)

In the event, the meek **T-note** swing back barely to the bottom of the 107-19.5/-14.5 weekly down gap left yesterday confirmed the degree to which that left extra resistance in the mid 107-00 previous major UP Break and congestion area. By making it that much harder for the T-note to post a credible recovery above that area by the end of the week, the FOMC minutes are a pernicious factor. If tomorrow's Beige Book is anywhere as upbeat on the economy and questionable on inflation abating, it is hard to imagine what could possibly rescue the fixed income later this week.

That does not yet take into account the important news in Europe tomorrow morning, and whether that further depresses the European long ends prior to the long wait in the US until tomorrow afternoon's Beige Book. As noted on Monday, tomorrow is a very important set of the German Consumer Price Index data (SEP.) This is both because it is estimated to be no worse than the August numbers, the ECB's Quaden speaks at an inflation conference shortly afterward, and the ECB October Monthly Bulletin is released shortly after that; quite a confluence of information.

Especially so with the late session weakness in the US fixed income pressuring the **Bund** into its own low 117.00 previous major UP Breaks. It still takes a weekly Close in the Bund below the 116.80 Tolerance of that low 117.00 area support to complete the capitulation it was not ready for in mid-September. Yet, if that occurs, then both long dated fixed income upside leaders will be exhibiting failures that could lead to the reinstatement of aggressive down trends not seen since mid-May.

Note also that after so many bullish expectations were based upon the extensive **Eurodollar** forward premiums (which we have consistently cautioned are not predictive in nature), the September 2007 contract is already back slightly below the 94.94 UP Break that helped encourage the move to the 95.30 area just last Friday. Any further slippage below that key level will also point to a reinstatement of the bear trend in the short money, where the US had been the only real ray of hope.

The only thing to say about the equities is that they are demonstrating an impressive degree of resilience in the face of the fixed income weakness, and that is not necessarily good for the fixed income either. The next decision in the foreign exchange is on the cusp, with the **EUR/USD** right into 1.2500 support, and the **US Dollar Index** into low .8700 resistance.

We hope you find this helpful.

-Rohr
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