Strategy Snapshot

Global Strategy

Contributors

Credit Suisse
Fixed Income Strategy Teams

(see inside for contributor names)

Mind Those Hedges

Since plunging 17% in ten trading sessions at the beginning of August the S&P 500 has oscillated between 1100-1120 and 1200-1220, traversing that range six times, with the seventh attempt now underway. And this is, within the global universe, a relatively low beta and highly liquid market. Correlations – or inverse correlations – for the most part remain abnormally high within and across asset classes. And most of our risk appetite measures remain at or very near extreme values.

These cannot be described as healthy or normal market conditions.

At some fundamental level it reflects the binary nature of the outlook for (global) growth and systemic stability. Failure to resolve the European sovereign debt and banking crisis would be catastrophic, creating two contrasting trends: massive pressure to find an adequate solution despite all the political obstacles, and a continuous search for efficient systemic hedges, which themselves rapidly become crowded trades – and, therefore, risky.

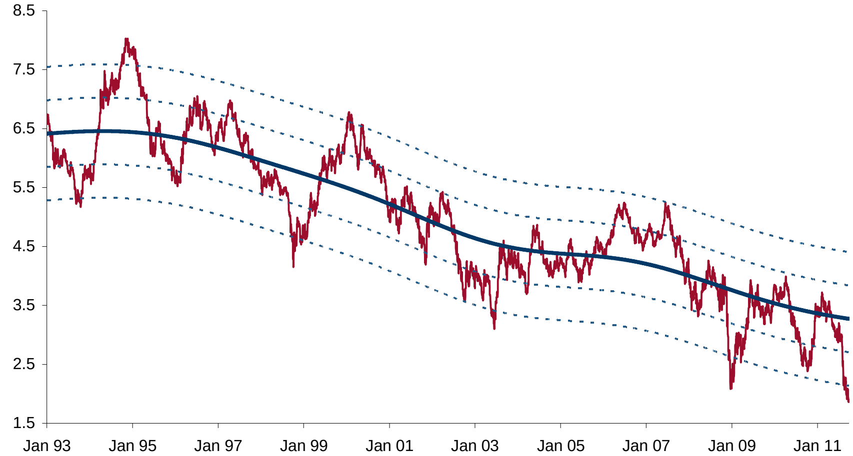
The first trend was particularly visible at the IMF meeting in Washington. It was, in fact, the third weekend in a row that European policy makers came under pressure from their peers to 'to get their act together', and to do so within a more realistic market timeline.

And it bore some fruit. There is a timetable of sorts (early November), a somewhat clearer sense that the EFSF should have greater firepower (although no consensus on how exactly to achieve that) and that European bank capital needs to be reinforced (although no clarity on how that might work either). There were also indications that the IMF will not limit its participation in Europe to conserve resources, and might even get some more to compensate, while hints that other countries might participate in a European rescue also emerged.

Vague as all that was in terms of detail, it was enough to spur some unwinding of the market's favourite systemic hedges, which had already become very stretched and much less efficient as a result. That applies to both US and German 10-year yields as shown in Exhibits 1 and 2. Gold was arguably even more stretched (Exhibit 3, but see also our Commodity section). All three 'hedges' proved vulnerable to the glimmer of hope from Washington – with the plunge in gold particularly dramatic. Short positions in European bank debt and equity were also favourite hedges that came under pressure and have reversed quite smartly in recent days, while European equities, more generally, are apparently also trying to form a base.

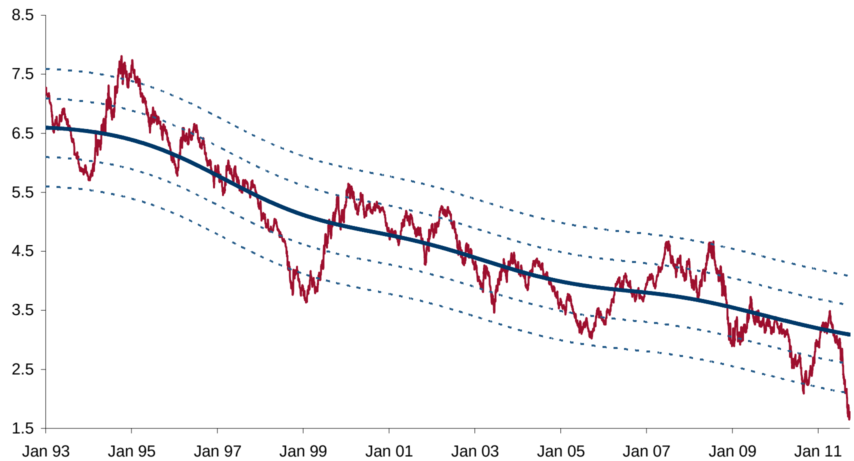
But when all is said and done, we are still a long way short of a comprehensive solution for Europe. And so far each recovery within its range for the S&P500 has lasted about five to seven trading days, which suggests that once quarter-end has passed and a little value been restored to the markets' favourite hedges – the whole risk off cascade may well start again……

Exhibit 1: US 10yr Yields with Kernel Trend



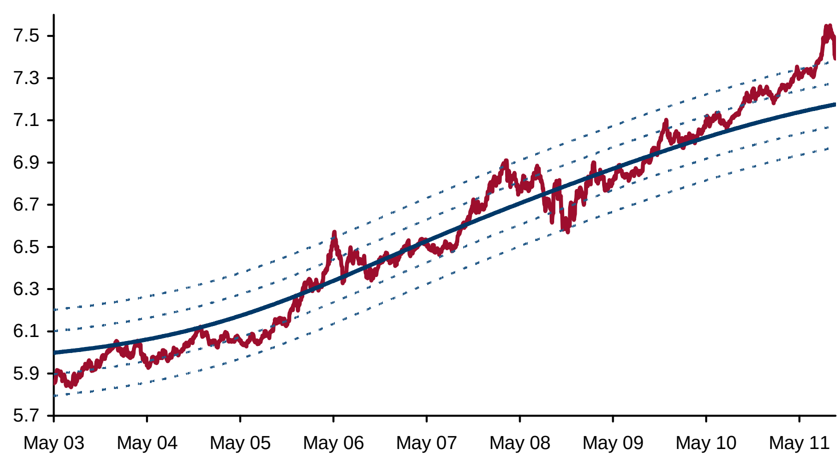
Source: Thomson Reuters Datastream, Credit Suisse

Exhibit 2: German 10yr Yields with Kernel Trend



Source: Thomson Reuters Datastream, Credit Suisse

Exhibit 3: Gold price with kernel trend, in logs



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

Exhibit 4: View Summary

	Strongest View	Preferred Expression
FX	Monetary easing should hurt the EUR even as it lowers credit risk. USD and JPY likely to outperform as stress rises again.	Short EURJPY.
Commodities	Long XAU/EUR (long gold/short EUR).	1x2 call spreads.
EM	We recommend flatteners in Argentina as a bullish trade with a tail-risk protection.	2s-10s flattener with an empirical hedge ratio that is long duration. A likely sharp curve inversion in a sell-off offers some protection against negative market scenarios.
USD Rates	We continue to favor lower rates and a flatter curve amid the weak domestic growth backdrop and the continued specter of the European debt crisis.	We recommend US/30s flatteners.
EUR Rates	We recommend using the recent back up in yields to re-enter long positions. We also expect increasing concerns over European banks to pressure risk spreads further.	In particular, we favour adding to received positions in EUR 2y2y. We also recommend longs in the March and June-2012 Euribor/EONIA basis versus USD.
JPY Rates	Not a time to be aggressive, in our view.	A barbell long on the JGB 4yr/7yr/9yr butterfly, which captures positive carry merit while bracing for a near-term upward backlash in yields.
AUD Rates	In the current environment, both the RBNZ and RBA are sidelined until further notice. Lower for longer yields in the North Atlantic mean diversification flow should drive yields lower, and cap the long end of the Antipodean curves.	Take profit on 3s10s box EFP (spread of spreads). Hold the following trades: received 7yr2y - 10yr2yr spread, 10-year receiver spread, 2s5s conditional flattener, received 1y1y AUDUSD and NZDUSD ccy basis. Look to exit received 3m6m12m OIS butterfly.
MBS	Lower coupon Ginnies should outperform Fannies post-Fed announcement.	Buy GN/FN 3.5.
Technical Analysis	Long 30yr US Bond.	Long 30yr US for 2.50%.
	Flatter 2s10s & 2s30s US Bond Curves.	2s10s targets 150/136bps; 2s30s targets 240bps.
	Bearish EUR.	Short EURUSD at 1.3825 for 1.3050; exit 1.4155.

Source: Credit Suisse

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Global Strategy

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Exhibit 5: Global IP Momentum minus Global Risk Appetite (standardized)

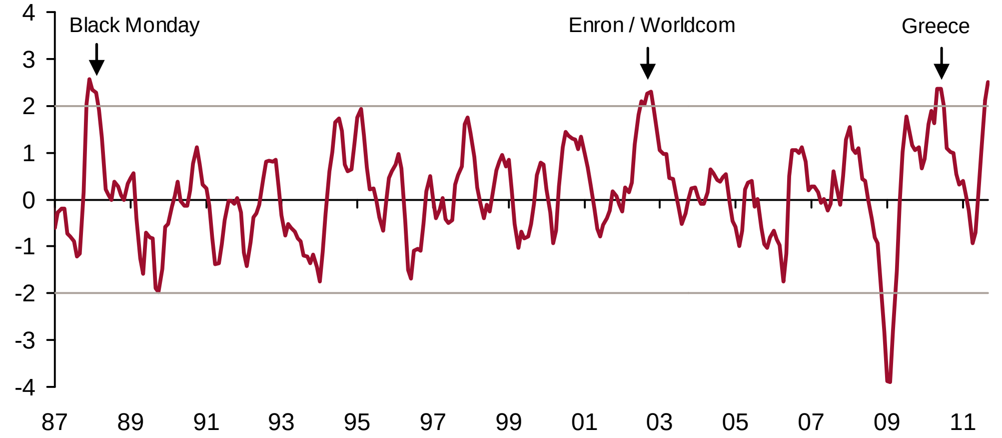


Exhibit 6: Global IP Momentum and Global Risk Appetite

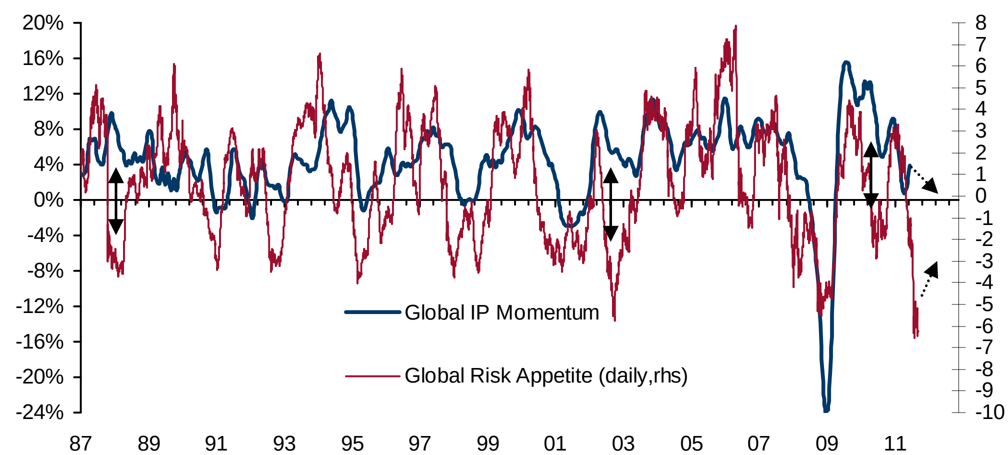
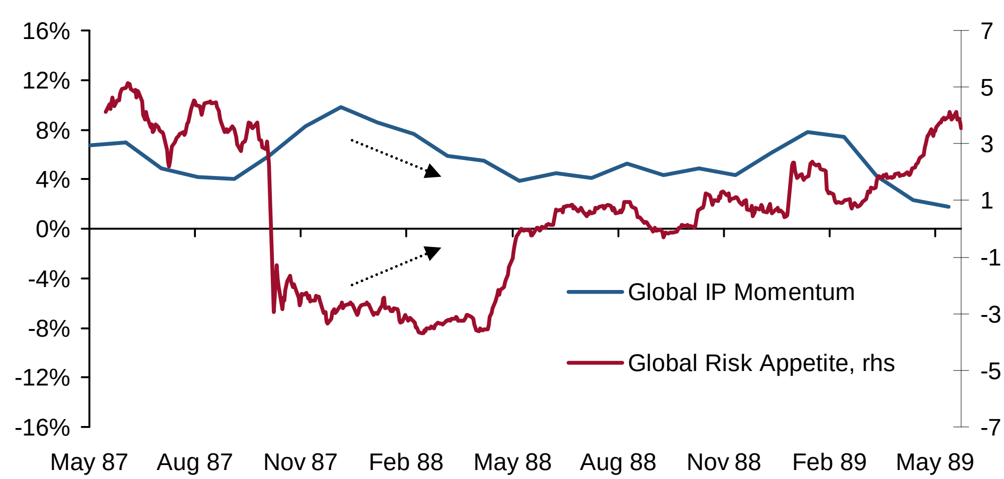


Exhibit 7: Black Monday



Source: Thomson Reuters DataStream, Credit Suisse

Exhibit 8: Enron / Worldcom

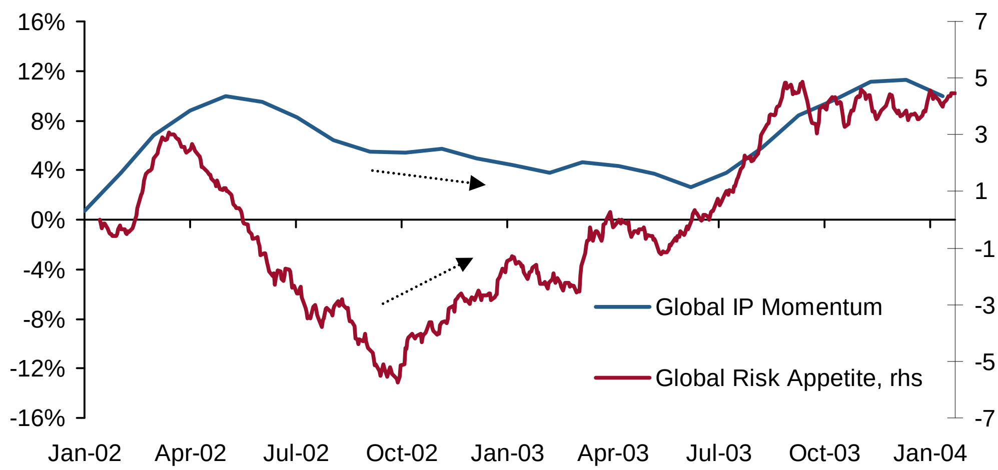


Exhibit 9: Greek Crisis

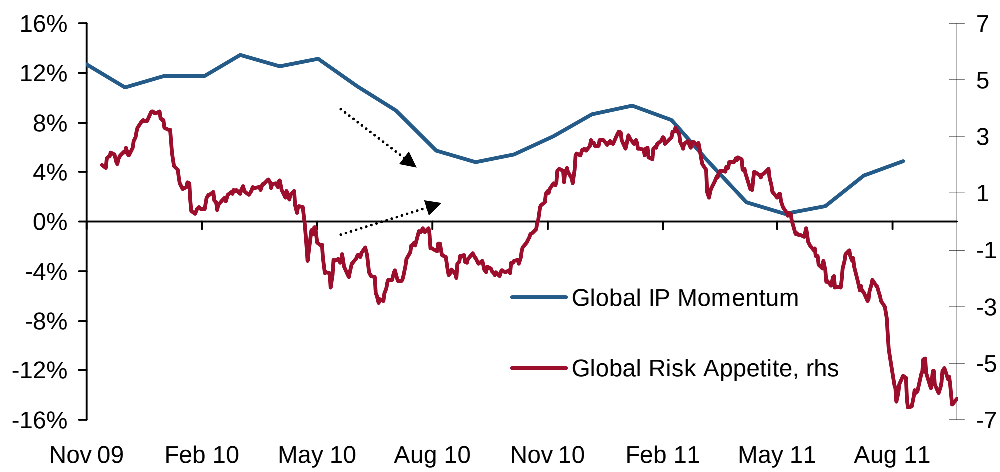
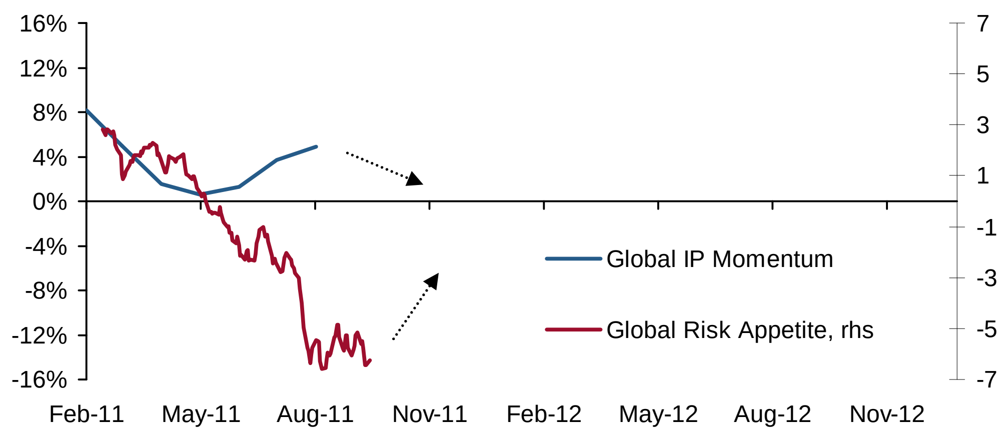


Exhibit 10: Debt Ceiling, S&P Downgrade, European Crisis



Source: Thomson Reuters DataStream, Credit Suisse

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The FX outlook remains highly binary to European policy. Expectations of ECB easing and potential policy measures to support the banking system have improved risk sentiment. We think the ECB's easing will help to stabilize euro area credit and risk appetite in general. However, the impact on the EUR is mixed as monetary easing should eventually hurt the EUR even as it lowers credit risk. Moreover, with the rates market already pricing in well more than a 25bp rate cut by the ECB next week, we think risk sensitive currencies in general and the euro in particular remain vulnerable to ECB disappointment.

A sustainable recovery in risk appetite and re-weakening in the USD requires conclusive policy direction on Italian sovereign yields and European bank solvency. This is unlikely to happen soon, in part because parliamentary approval of the 21 July changes to the EFSF's mandate will not occur until mid-October at the earliest. On its own, funding for Greece for another few months is unlikely to end market pressure on Europe's banks to delever or significantly improve market willingness to buy Italian sovereign debt.

Last week, we revised down our one-month EURUSD target to 1.3050. The expectation that Italian GDP may contract in both Q3 and Q4, as forecast by our economists, is likely to keep the market under pressure to sell Italian sovereign bonds. Combined with slowing European growth, we think ECB rate cuts will move yield spreads against the EUR. This mix of high peripheral sovereign spreads and lower EURUSD yield spreads leads our model to predict EURUSD sub-1.30. However, we note that the extent of short EUR positioning is already at historically stretched levels.

The combination of the liquidity crunch emanating from Europe and the Fed's unwillingness to expand its balance sheet has passed the burden of reflation to the ECB. As deleveraging of European banks, the largest international lenders, intensifies, asset prices have to fall if central banks are not going to provide an additional monetary base. Yet Fed twist does not provide new liquidity to markets and the recent moderation in the pace of expansion of the ECB's securities market program to only €4bn of bond buying last week shows fading ECB appetite to reflate quantitatively.

The USD's recent rally against EM currencies implies less official reserve manager buying of the EUR, GBP, CAD, and the AUD for diversification. Central banks across Asia, and in Turkey and South Africa have switched from buying dollars to selling to defend their currencies. Official reserve manager diversification into euros is a key reason EURUSD trades above our model estimate, but is likely to weaken over the next month or two. The combination of weaker global growth, downward pressure on commodity prices, and less reserve manager diversification flow all cut support for valuation richness of the commodity bloc. Accordingly, we also revised down our one and three-month targets for AUD, CAD, and NZD. See *FX Strategist: Policy shortfall opens scope for more USD and JPY upside*, 22 September.

Commodities

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Long gold/short EUR

We recently highlighted that gold was trading substantially above long-term trend lines (whether measured by exponential trend or Hodrick-Prescott filter trend) and commented that a significant correction was likely (see *Weekly Commodities Note: This Mess We're In*, 9 August).

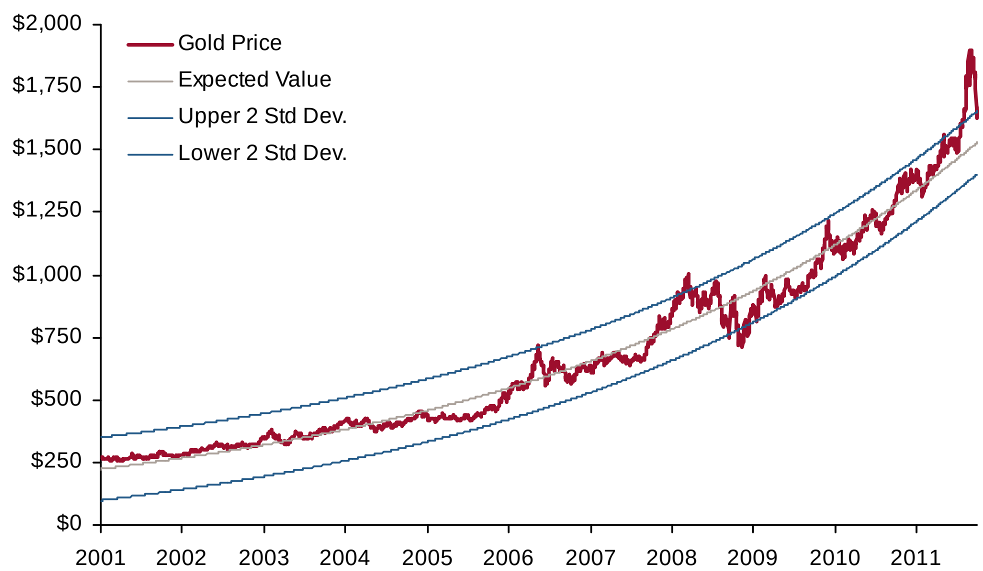
The flight to US Treasuries and demand for dollars over the past few days, somewhat reminiscent of late 2008, resulted in gold being liquidated alongside more risky assets. Liquidation was seen by investors of all types, though we note that ETF holdings of gold fell only slightly.

Increased margins on futures, and selling by short-term momentum trading programs contributed to the pressure. That resulted in a 15% fall in three days (from open to low), and a 20% drop from the early September high ($1,921) to the low point on Monday ($1,529)

The size of the correction in the price, unnerving as it may have been, served to bring gold back within a two standard deviation band either side of its 10-year exponential and HP trends (see Exhibits 11 & 12). The fall was also not out of line with other sharp corrections that have occurred over the last several years (gold fell 25% in the four weeks between mid-May and mid-June 2006, for example).

Exhibit 11: Gold price with exponential trend, 2001 to 2011

Two standard deviation bands

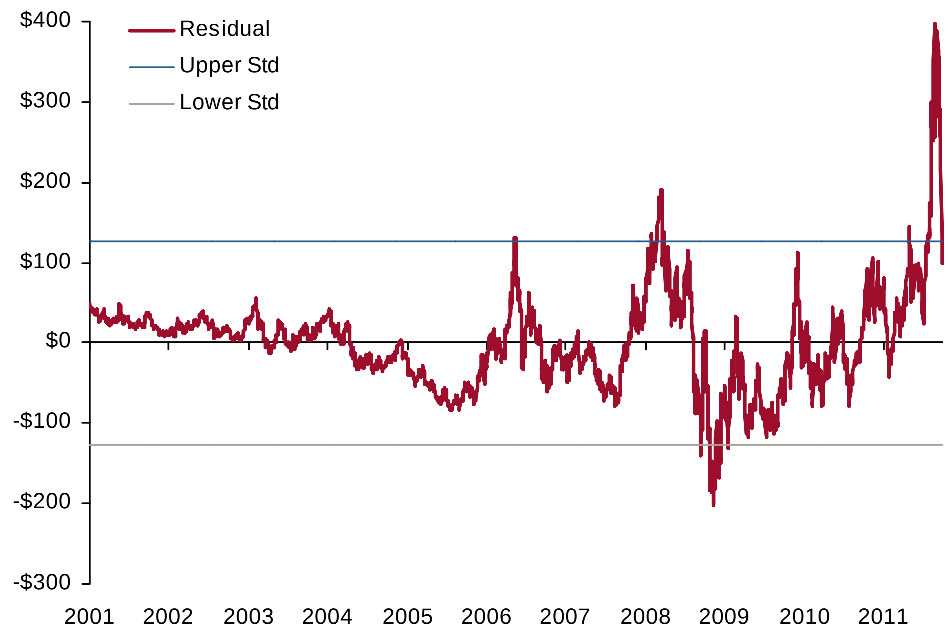


Source: Credit Suisse

The 200-day simple moving average subsequently provided strong technical support, as it has done since April 2009. The price has since rallied more than $120 as buyers of physical bullion across the Middle East and Asia have come back to the market in force, and as a risk-on relief rally has lifted other assets.

Exhibit 12: Deviation of gold price from long-term trend, 2001 to 2011

Deviation from Hodrick-Prescott filter trend, with two standard deviation limits



Source: Credit Suisse

Given the on-going political and economic uncertainty, coupled with deeply negative real interest rates, we think the recovery in the price of gold has a better chance of being sustained in the short-term than that in some other commodities. However, rather than go long gold in USD, a preferable near-term trade looks to be long gold/short EUR (long the XAU/EUR cross). Our FX colleagues believe further monetary easing in Europe would likely hurt the EUR in the medium term, even as it lowers credit risk. Meanwhile, should the ECB under-deliver on market expectations next week and the political stalemate continue, EUR would likely come under renewed downward pressure we believe. That chimes with the view of our technical analysts, who look to short EUR at 1.3825, targeting 1.3050.

At the same time, we think that implementation of any of the monetary policy choices that are available to the ECB are likely to be interpreted bullishly by the gold market. And the strength of the bounce over the last 48 hours, (driven by physical demand), coupled with the reduced speculative length in gold, suggests that the downside risk for the time being is low.

With one month XAU/EUR implied volatility quoted at close to 38% for 25 delta calls, buying upside exposure outright could be expensive, and although we are short-term bullish we are not expecting a quick re-test of the highs. So our preferred expression is to buy 1 by 2 call spreads in XAU/EUR with a suggested tenor of one month. Alternatively, selling out the money XAU/EUR put spreads also could be attractive given that volatility is still elevated. The risk to the trades is a potential fall in gold prices relative to EUR.

US Rates

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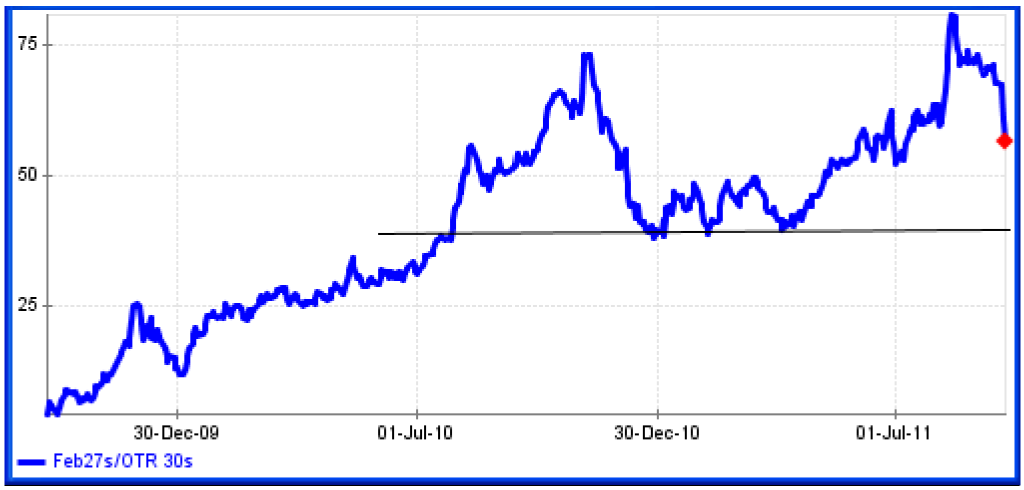
Trade Idea: US/30s Flattener

As discussed in our latest *US Interest Rate Strategy Weekly,* we see scope for continued significant flattening of the long end. We recommend US/30s flatteners to take advantage of further flattening at the very long end.

The spread between the current USZ1 CTD, the 6.625s of 2/15/27 and on-the-run 30s has compressed to 56bps since the Fed meeting, but remains well above the 40bps level seen as recently as this April.

We recommend investors purchase on-the-run 30s versus selling USZ1 futures on a DV01 neutral basis, targeting 16 bps of flattening. We recommend a stop on a steepening of 10 bps. Trade details are given in Exhibit 14. The primary risk to the trade is the emergence of a steepening trend in the very long end.

Exhibit 13: USZ1 CTD versus 30s



Source: Credit Suisse

Exhibit 14: Trade details

	Contracts/Par	Instrument	Risk	DV01	Price	Yield
Sell	250	USZ1	16.07	(40,175)	145-10	2.29%
Buy	17,991,491	T 3.75 08/15/41	22.33	40,175	118-02	2.85%
				-		0.56%

Source: Credit Suisse

European Rates

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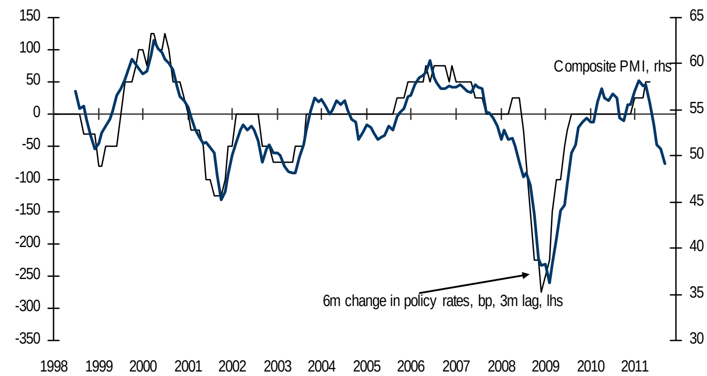
The ECB monetary policy meeting next week remains the main focus for European markets. The EONIA market is currently discounting at least a 25bps cut by the October meeting. Given the recent rhetoric from the ECB, it is also becoming increasingly likely that the ECB introduces further liquidity measures, either via a 1y fixed-rate, full allotment LTRO or an extension of the 6m LTROs. There has also been discussion of re-starting the Covered Bond Program. We expect that an extension of liquidity remains a likely outcome and maintain our long bias in core EUR rates markets.

The ECB broadly speaking has three, inter-related, roles to play. As with everything in Europe, they are, of course, highly inter-related:

Monetary policy

Exhibit 15: Euro area composite PMI and changes in policy rates



Source: Markit. CS Euro economics

On the monetary policy front, foremost is clearly the question of whether or not the ECB will cut rates, whether this would be by 25bps or 50bps, and when this might occur. With the further deterioration in the growth outlook in Europe, as highlighted by the continued slide in euro zone flash PMIs on 22 September, the downward revision to the IMF's growth forecasts and Trichet's emphasis on the importance of their change in growth outlook, our conclusion is that there is the potential for this to occur sooner rather than later. We find the warning by Rio Tinto that it is seeing a slowdown in demand particularly troubling: it can only be a matter of time before the volatility and uncertainty lead to a material drop in business and consumer confidence that weighs on the corporate outlook, to date one of the few areas of relative calm.

As an alternative to a rate cut, the ECB may also consider widening the corridor, which should lead to a decline in Eonia. However, the level of dispersion in Eonia fixings means that, just as it is hard to infer market expectations for a rate cut from the Eonia curve, it is not clear that widening the corridor will help those banks most in need of funding.

Liquidity provision

With full allotment, the ECB is already providing unlimited funding on a one-week, one-month and three-month basis. The ECB also recently reintroduced the six-month LTRO, and extended the USD swap lines with the Fed to cover year-end.

There is little additional that we see likely on this front, beyond possibly the reintroduction of a one year LTRO. Banks continue to have as much liquidity as needed, with excess liquidity already above €150 billion. The issue, as we discussed last week, is with the recapitalization of the banking sector, rather than additional liquidity provisions.

Stem contagion

The best way to stop the contagion from Greece to Italy and onward to the core of Europe has been extensively debated over recent months and weeks. Strengthening the banks clearly forms an important part of this; breaking the sovereign link is the other. The EFSF, while important in playing a role, can only form part of the answer. Just increasing the size leads directly to questions regarding the stability of France's AAA credit rating. Changing the structure to allow it to become an eligible ECB counterparty is another option, and the EIB provides precedent, but, in our opinion, does not fundamentally change the game. Ultimately, the ECB is the backstop, however one wants to dress it up… And our hope for the cleanest resolution to the situation lies squarely with them.

The situation in Greece continues to deteriorate

We expect little conclusive to emerge on this front in the next week or two ahead of a decision by the IMF/EU on the fifth review and the subsequent (presumed) disbursement of the sixth tranche of aid from the first bailout. The endless delays do not inspire confidence in the outcome, even less so of the next review (due November/December). It is clear that the euro area remains committed to Greece remaining in the euro, which as we mentioned last week, we believe is the most likely outcome.

However, it is unclear to us that the IMF remains committed to extending further loans, or that the euro group remain united in providing a second bailout ahead of a restructuring. The outlook remains extremely uncertain and Greek bonds have continued their declines accordingly. The PSI valuations look ever further away. We continue to keenly await the decision and language in the IMF review.

Japan Rates

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- Intermediate to long-term JGB yields have remained low and almost flat since early September, and we see no signs of any rebound at this point. Although all the talk has been about risk reduction, market moves since the beginning of the week have actually not shown much of a reaction to negative catalysts. With a growing number of market participants apparently expecting yields to remain low, we see no reason at this point to be bullish aggressively in the bond market.
- In the JGB market, movement in the over-10yr sector has stood out. There has been virtually no change out to the 10yr sector since late August, but yields in the over-10yr sector have declined substantially. We could attribute this to over 10-year JGB yields having become more attractive relative to yields overseas and to more favorable supply-demand conditions, including a fading of concerns over increased issuance. Nevertheless, as has been the case before, including in August 2010, such sharp and localized bull flattening may not last long, and we recommend bracing for a subsequent backlash. This localized bull flattening is likely to be followed by a bear steepening, in our view.
- Volatility in the yen rates market is in a moderate declining trend. As volatility moves lower, the market will likely become more focused on the carry and rolldown returns. One attractive relative value trade we like for capturing positive carry merit while bracing for a near-term upward backlash in yields is a barbell long on the 4yr/7yr/9yr butterfly trade.
- The BoJ announced its flow of funds accounts statistics for the April-June quarter. The data were notable for the sharp increase in the funds surplus of households. That surplus tends to be large in the April-June quarter most years, but was about ¥10 trillion larger than usual this year.

Japan Interest Rate Strategy Weekly, 23 September 2011.

Australian Rates

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"Reasonable grounds for optimism"?

The market was inundated with RBA speak over the week, but sentiment in the markets was again swamped by offshore developments (see below). Renowned RBA hawk, Deputy Governor Ric Battellino tried to calm the markets by stating there is 'reasonable grounds for optimism' with regards to the growth outlook, and the current bout of pessimism has yet to be justified by the data. Battellino noted "It is simply too early" to gauge the economic impact of the recent financial market turmoil; but the most poignant statement from the speech was in reference to market pricing:

"The present situation has some similarities to that in 2003. **From late 2002 to the third quarter of 2003, financial markets were pricing in cuts in interest rates in Australia**, largely on the back of concerns about the sluggishness of the US recovery at that time. In the event, however, that sluggishness in the United States did not flow through to the Australian economy and Australian **interest rates did not fall**." (Battellino)

The RBA meets next week, and we expect a statement similar to that delivered in September. The RBA have moved decisively to a neutral bias, and are on hold until further notice. The RBA remains reluctant to ease policy with such a strong medium term growth and inflation outlook. That said, the risks of a move to an easing bias seem increasingly with developments in Europe and the disappointing growth outlook for the developed world.

Currency driven receiving dominates AUD curve

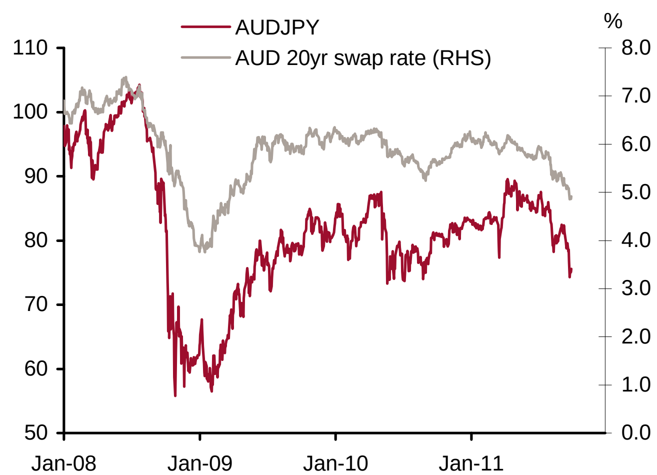
The movement in the long-end of the curve was the main focus of the AUD rates market over the past week. Since the beginning of September, AUD has started depreciating amid weakness in global equities and growth outlook, declining from 1.07 to 0.99 against USD. In particular, the depreciation of AUD against JPY (declining from 82.5 to 75.5 in September) had a significant impact on the long-end of the AUD swap curve (Exhibit 16). Over the past week as AUDJPY anchored below 80, strong demand for receiving the long-term AUD swaps (10yr or more) started to emerge and pushed the long-end of the curve lower. The 10yr AUD swap rate was at one point 4.71% compared to 5.10% at the beginning of September. This strong receiving demand was driven by the AUDJPY linked structured product hedging. The AUDJPY linked structured products such as PRDC (power reverse dual currency) notes and TARN (target redemption notes) have been popular among Japanese financial institutions for their high coupon structures. As AUDJPY depreciates, the callability of these structured notes declines and their duration increases. As a result, exotic trading desks managing these products need to receive long-term swaps to hedge against the duration extension. Over the past few years, this AUDJPY driven structured product hedging has been one key driver to the movements in long-term AUD swap rates. For instance, it explains about 50% of the movement in the AUD 20yr swap rate (Exhibit 17).

A couple of our recommendations benefitted from recent bull-flattening of the AUD curve. The 3s10s EFP swap box spread received position (*Strategy Snapshot*, 29 June and *Macro Tactics,* 8 July) gained 20bps as the spread declined very rapidly recently to the one-year low of 5bps (Exhibit 18). We use this opportunity to take profit on this trade as further decline of the box spread might be limited unless a global financial stress emerges. Similarly, the 7yr forward 2y - 10yr forward 2yr spread received position gained 15bps as the spread declined from 35bps to 20bps because of the bull-flattening of the curve (*Strategy Snapshot,* 6 September).

In terms of relative value on the curve, as noted last week, the AUD 2y2y and the belly of the NZD curve have declined to their historical lows on the continual waves of global pessimism. The declining trend continued after the FOMC's Operation Twist announcement last week. In our view, the current levels of the AUD 2y2y and NZD 2y2y are becoming attractive based on the fundamentals. We now look for the right opportunity to accumulate shorts out to the five-year sector.

Exhibit 16: AUDJPY versus AUD 20yr swap rate

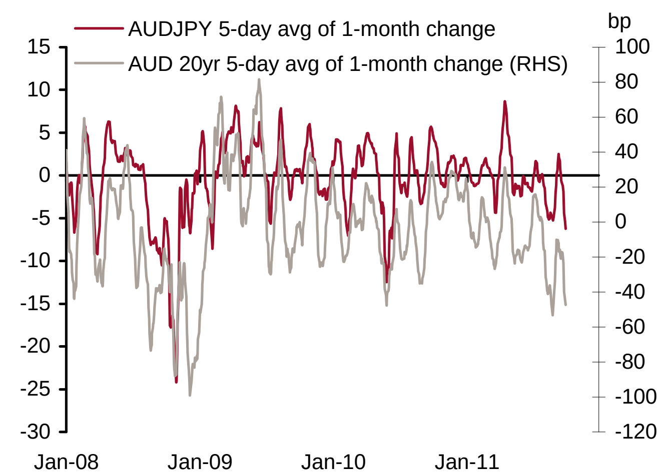
Recent depreciation of AUDJPY from 80s to 70s triggers rallies in AUD 20yr



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 17: Changes in AUDJPY and AUD 20yr rate

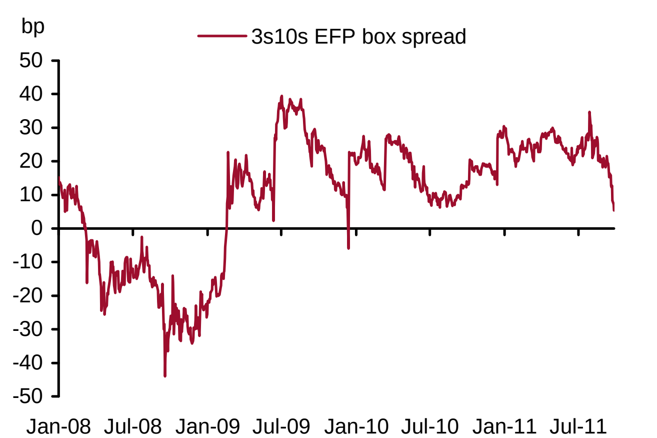
Changes in AUDJPY drive changes in AUD 20yr: 0.7 correlation since 2008



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 18: AUD 3s10s EFP box spread collapsing

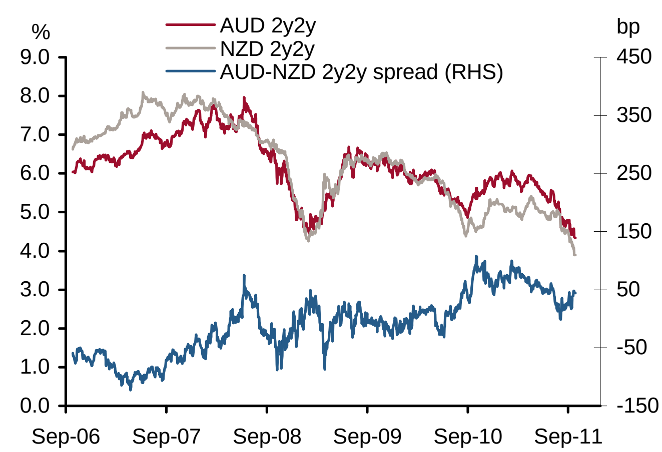
10yr EFP swap spread minus 3yr; declined rapidly to 5bp in the last two weeks



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 19: AUD and NZD 2y2y reach all-time low

AUD reached its low at 4.34% and NZD reached its low at 3.89% recently



Source: Credit Suisse

US Mortgages

Fed returns as a net buyer of agency MBS

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Last week, the Fed surprised the market with its announcement to reinvest Agency MBS and debt paydowns into Agency MBS. This is a significant move by the Fed, which has decisively turned supply/demand dynamics in favor of Agency MBS in 2012 and beyond. In a 4% mortgage rate scenario, we believe that Fed purchases should result in additional net demand of roughly $265 billion over the next five quarters. We also show our updated supply/demand projections for the remainder of 2011 and for 2012 (Exhibit 20). Demand is likely to exceed supply by $110 billion over the next three months in a 4% mortgage rate scenario. In 2012, we expect around $65 billion of excess demand for a 4% mortgage rate. This compares to our previous projection of -125 billion in excess demand.

Fed's motivation remains unclear

This move is contrary to the Fed's previously stated intention to return its portfolio to its historical Treasury bias, and complicates its exit strategy. Furthermore, generationally low mortgage rates and manageable supply/demand technicals for MBS in the near term raise questions regarding the stated Fed's objective for this action "to help support conditions in mortgage markets". We do not expect any meaningful impact on home prices from an auto-refi program.

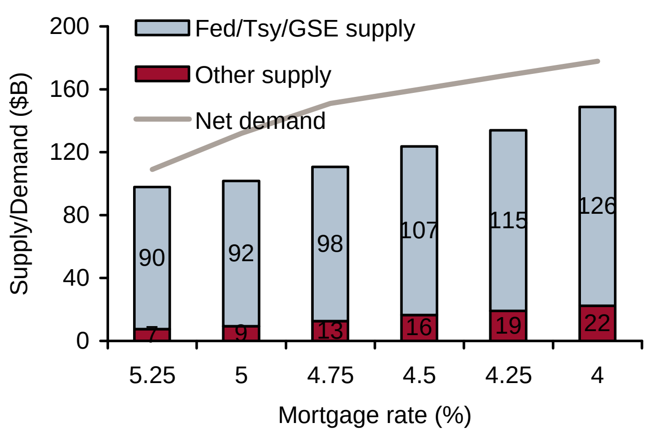
This leaves open the possibility that the Fed is preparing to take down supply in an auto-refi scenario. A key concern about any broad based auto-refi program has been its impact on supply in production coupons, which, in turn, could result in higher mortgage rates. The Fed's action addresses this issue. We believe that auto-refi remains a low probability event. However, the Fed's move has incrementally raised its probability.

Expect muted impact on mortgage rates

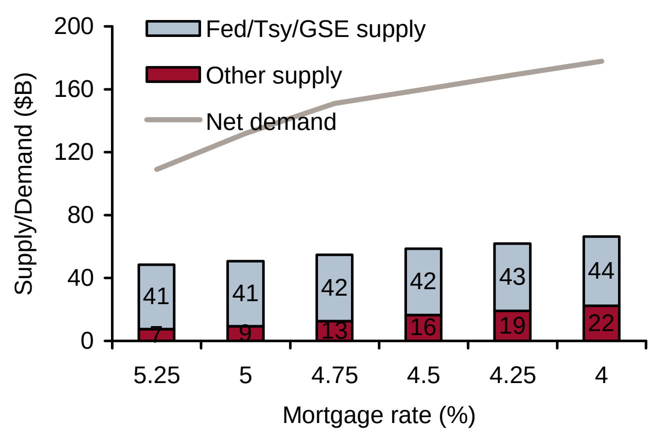
Mortgage rates are likely to remain sticky due to widening in the primary/secondary spread. Anecdotal evidence suggests that originators are already operating at capacity. Based on the recent relationship between primary/secondary spread and current coupon, we estimate one-point primary 30-year mortgage rate should drop by roughly 10bps to 4.05 based on a 2.97% current coupon.

Exhibit 20: Fed's announcement has turned supply/demand estimated technicals decisively in favor of MBS

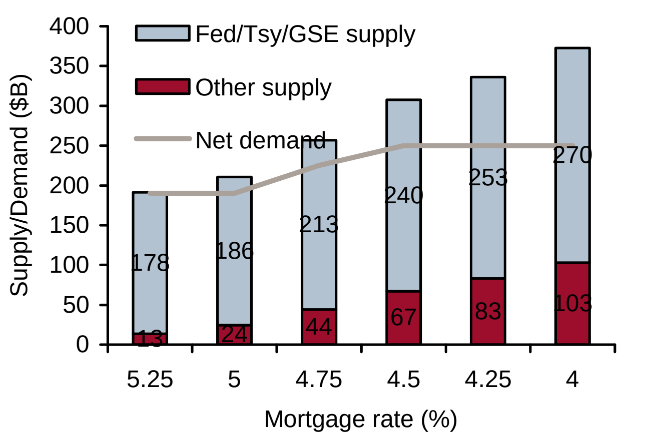
Pre-Fed Announcement, Sep-Dec 2011



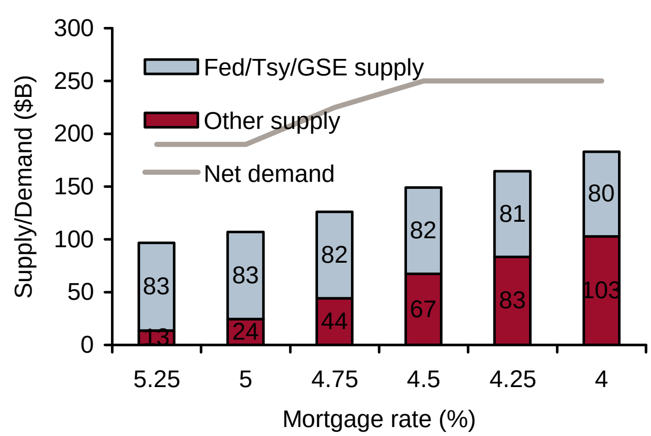
Post-Fed Announcement, Sep-Dec 2011



Pre-Fed Announcement, 2012



Post-Fed Announcement, 2012



Source: Credit Suisse

Emerging Markets

Current strategy recommendations

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We summarize our current EM strategy recommendations below.

Argentine peso and Argentine local currency rates: We recommend short 1-year ARS NDFs against long 3-months NDFs, as we think pressures in the forward and the parallel exchange rate market will continue to build. We are neutral on CER-linked bonds but we think government-controlled institutions may enter the market to support these bonds at current price levels.

Argentine hard currency market: We recommend 10s-2s CDS flatteners in Argentina with an empirical hedge ratio as a bullish position with a tail-risk protection. We are short Argentina against Venezuela in the model portfolio.

Brazilian local currency rates: Breakeven inflation has jumped recently, and we recommend switching from NTNB 17s into NTNF 14s, with FX risk hedged. We are biased in favor or PRE-CDI curve steepeners because the central bank is likely prioritize risks to growth.

Chilean local currency rates: We recommend long positions in one-year breakeven inflation, which currently trades at 2.50%, well below our economists forecasts of 3.5% for 2011 and 3.0% for 2012. We also recommend a 2s-5s steepener in Chile. Short end rates are likely to move lower as the central bank of Chile gradually takes a more dovish stance. The worsening in the global growth outlook makes us think that the bank may cut the policy rate in 2012 from the current level of 5.25%.

Venezuela dollar debt: Long PD 14 and PD 17N bonds, but hedge with sovereign CDS. Short and mid-term PDVSA bonds look substantially cheaper than sovereign bonds. Given the recent volatile market conditions, we prefer long positions that are CDS-hedged as bonds have underperformed CDS

Turkish local rates: We continue to recommend taking advantage of the wide basis by going long one- to two-year T-bills/bonds and paying on cross-currency swaps. Although we have a neutral view on swap rates, the basis has widened out so much that we think that it makes sense for real-money accounts to go overweight the one- to two-year sector of the T-bill/bond curve.

China local rates: We recommend 1s5s IRS steepeners anticipating pivot steepening in the swap curve. Front end rates could ease by more than what is implied factoring in a stabilization in repo rates and liquidity conditions. At the same time, the back end should rise to reflect policy pause amid structural inflation, upward pressure on the interest rate structure and increased hedging interest.

India local rates: We think it is too early to expect any indications of a reversal in policy bias. We continue to see upward pressure on the OIS curve given our view on the policy rate trajectory. Additionally, supply should keep bonds from gaining materially in the coming months, limiting the relative outperformance in OIS, which are at currently record spreads to bonds.

Thailand local rates: We recommend paying 3s10s THB IRS to position for duration pressures. The 10y IRS is trading rich to bonds and should be bid as markets absorb supply and hedging interest resurfaces. The 3y IRS could be biased lower, reflecting any expectations of policy easing, should the global growth outlook deteriorate further. Further hikes by the BoT should trigger inversion in the front end (1s3s) of the IRS curve.

Technical Analysis

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Further signs of a base for European Banks

As we highlighted a couple of weeks ago (*Market Spotlight: European Banks & Financials – Time for a floor for the Banks*, 14 September), the sector had declined to our 119/117 "ideal" bear target. This week has not only seen a successful retest of this key support, but yet another higher RSI low, reinforcing an improving momentum story (Exhibit 21, lower panel). The subsequent recovery leaves the market undergoing a concerted test of key near-term resistance at 133/136. Above 136 would now be sufficient to put a small base in place, opening the door to a more concerted recovery to 146/150 – 12% higher from current levels. Bigger picture though, we would still view this strength (if seen) as corrective, and look for 150 to cap.

Additionally, the completion of a base by the banks would suggest a broader "risk on" phase (even if only temporary) can emerge.

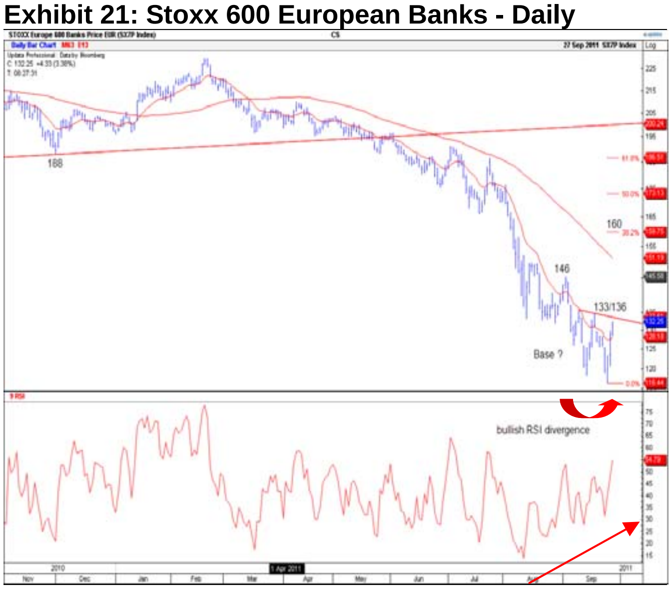
While 136 caps a base can be avoided, but with a close below 117 needed to mark a resumption of the underlying downtrend.

We also see evidence in other European equity indices of a base, although these are as yet unconfirmed. Key resistance levels that need to be cleared to confirm are seen at 5660 for the DAX, and 2190/95 for the Euro Stoxx 50.

10yr Germany also threaten a yield base after holding channel resistance

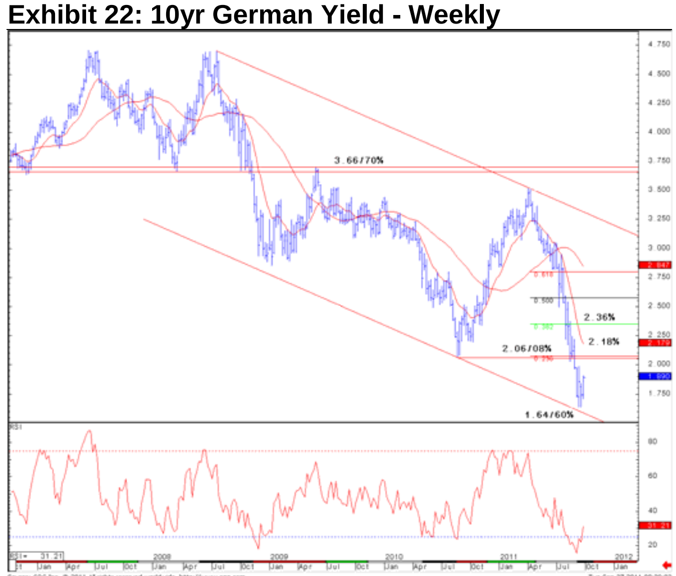
As we also highlighted (*Market Spotlight: 10yr German, UK & US Yields – Time for a corrective setback?*, 14 September), the strong rally in **10yr Germany** has extended to within a whisker of our bull target and channel resistance at 1.60/55%. The end of last week has not only seen this resistance tested and again hold, but also a small bearish "reversal day" complete. **If we are going to see a base for European Banks, this should significantly increase the risk of a bearish reversal here, even if only for a corrective setback.** Key support is seen from the 1.98/99% recent high. A break above here would see a "double bottom" reversal complete, targeting the 40-day average at 2.03/06% initially. Although this should be allowed at first, a break can target 2.20/25%, potentially 2.35%. We would view this 2.25/2.35% zone as an excellent opportunity to re-establish a long. While 1.99% caps, a base will be avoided.

Exhibit 21: Stoxx 600 European Banks - Daily



Source: CQG, Credit Suisse

Exhibit 22: 10yr German Yield - Weekly



Source: CQG, Credit Suisse

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