

Weekly Market Commentary

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Overview A quiet week where Treasury yields dropped a little from this year's highs but money markets were rattled by worries that rate hikes may come sooner than currently expected. Stock indices drifted, again from this year's highs, but conclusive Technical breaks were not seen and several continue to flirt with 50 and 200-day moving averages. Currencies went nowhere fast, though the yen gained a little against all crosses (which had also been trading at this year's highs) as did the pound, taking EUR/GBP to £0.8420 and a new low for the year; likewise the Czech koruna at 26.170. Commodities boring though CBOT Soybean Meal at \$433 per ton is terribly close to last year's record of \$456, which incidentally is where it peaked dramatically in 1973.

Political and Economic Developments Norway and Saudi Arabia trimmed their key interest rates by 25 basis points to 1.25% and 0.25% respectively; Mexico -50 to 4.75%. Other central bankers felt the need to remind the market that interest rates were unlikely to start increasing for some time yet - probably because 'green shoot' optimists were getting ahead of themselves. UK Public Finances are at their worst ever, Net Borrowing a record £19.86B in May.

The US Trade Balance has improved significantly over the last three years, from a trough of \$215B deficit in Q3 2006 it shrank to \$101B in Q1 2009. A combination of lower imports, both oil and from China, coupled with stronger exports because of a weaker dollar, have taken it back to where it stood in Q1 2002. US Capacity Utilisation dropped to a record low 68.3% in May, and with Unemployment at 9.4% this means that the slack in the economy is greatest since records began in 1967; this is obviously disinflationary. Continuing Jobless Claims shrank to 6,687K in the week to June 5th (from 6,835K the prior one) caused, we believe, because benefits only last for 26 weeks.

Underlying Themes Regulatory and supervisory roles continue to be assessed, discussed and 'improved' in order to try and avoid another banking fiasco. Separating out the needs of consumers, business, exchanges and the economy at large versus insurers, bankers, stock brokers and hedge funds is a massive complex task that cannot be rushed. Hot on the heels of President Obama's 'biggest reform of financial supervision since the 1930's', the EU leaders' Summit Communiqué from Brussels proposed the creation of **three** new pan-European bodies to promote financial stability, **plus** a Systemic Risk Board; progress will be reviewed in October ahead of the introduction of stricter capital requirements in 2010. Size matters, according to some central bankers. The Bank of England's King and Hildebrand of the Swiss National Bank are now espousing the concept that too big to fail means too big, full stop, a view echoed by the FDIC's chairman Bair. Threatening to shrink-to-fit Switzerland's two biggest banks he said, 'these institutions have long exceeded the size needed to make full use of these advantages'. Considering bank mergers were encouraged to stave off collapse, this conclusion must have been reached in hindsight.

What to watch for next week Sunday 21st Summer Solstice (with holidays through to Wednesday in some countries). Monday Japan April Tertiary Industry Index, May Supermarket and Convenience Store Sales, June UK Rightmove House Prices and German IFO. Tuesday German July GfK Confidence, June PMI's for various European countries, UK May BBA Mortgages, US Existing Home Sales and April House Price Index. Wednesday Japan May Trade Balance, Corporate Services Prices, US Durable Goods Orders, New Home Sales, Eurozone April Trade Balance and the Fed's FOMC is expected to keep rates unchanged at 0.25%. Thursday just EZ16 April Industrial New Orders and US final Q1 GDP. Friday Japan April All Industry Activity, May Nationwide CPI, Tokyo June CPI and for the different German states due from this day; US May Personal Income and Spending, Core PCE and Deflator, plus June final University of Michigan Survey. A general election in Albania on Sunday the 28th.

Positioning and Technical Analysis Thin summer markets coinciding with the end of Q2 2009 could lead to some liquidation and sharper intra-day price swings. We also feel that many will be in no hurry to allocate assets as there is still massive uncertainty and not especially attractive prices in many instruments. We still feel that top-quality long-dated fixed income real yields are generous and should eventually drop, so that yield curves flatten. Stock markets look tired if not precarious and are therefore likely to drift slowly. Generalised US dollar weakness will continue led by AUD and GBP, if not next week then next month.

Have a nice weekend!