

**The 3M Report.  
Monthly Market Memo: April 2009**<http://research.mfglobal.com>**DEBT MARKETS:**

Treasury prices are expected to trade in a range. The best idea may be to buy 2010 Eurodollar futures as rates are likely to remain low and futures are likely to converge toward cash LIBOR. Additionally, LIBOR could leak lower as normalized financial conditions will pressure cash LIBOR toward the fed funds rate (say 75 bps), as the Fed keeps rates low for a prolonged period. The market faces conflicting cross currents and great uncertainty. On the bullish side, labor demand has yet to bottom and slack is building in the economy. The economy has shown signs of stabilizing, but the rebound is coming off extremely depressed levels. The ISM manufacturing survey remains below 40, and housing activity is still historically depressed in the face of high inventories. Moreover, credit conditions are still uncertain. The PPIP, TALF, and loosening of mark to market accounting rules argue for a pick up in risk taking and improved balance sheet health in the financial sector, but credit card, auto loan, and commercial mortgage loss is still being priced. Commercial real estate will remain a headwind to economic growth and will be supportive to deflationary pressures. On the bearish side, the supply is large. The corporate market is extremely active and presents an alternative to treasuries, especially given wide yields. Corporate debt issuance is setting a record helped by the FDIC guarantee program. Treasury supply is also brisk. Approximately \$160 bln worth of coupon debt is set to be sold this month and will offset the Fed's treasury purchase program over time unless the Fed extends the size and duration of its treasury purchases. Valuation is questionable relative to TIPS and wide credit spreads, especially if economic conditions normalize. Lastly, there could be an up tick in consumer spending as the stimulus take effect.

~Kalivas/Hoversen

**EQUITY MARKETS:**

Equity prices are expected to trade sideways to higher through the balance of April. Trade will be defined by the reaction to Q1 earnings reports in the financial and technology sectors, and trends in the transportation sector. The PPIP and loosening of mark to market accounting rules have brightened the outlook for bank profits and helped to put a floor under the financial sector. There is a strong probability that some bank assets will see higher values to the benefit of balance sheet health and profit growth.

However, the ability of the financial sector to work higher will depend on delinquency and default trends in housing, auto, credit cards, and commercial real estate. The lack of a peak in the unemployment rate argues for further credit loss in the consumer sector, but the market has already priced a heavy dose of the mortgage crisis. Card and auto credit loss are still being discounted in stock prices. Commercial real estate lags the business cycle and has the greatest potential to cap bank shares. Furthermore, the results of bank stress tests are due late month and there is uncertainty over the reaction of regulators who seem too willing to control banks at the expense of maximizing shareholder wealth. The technology sector is supported by signs that the inventory adjustment has ended and better than expected demand. Best Buy indicated that

spending was head of expectations and some products had been sold out, while Research in Motion reported strong profits. Likewise, channel checks have suggested Apple's iPhone is seeing increased production. Expansion in the emerging economies and preference shifts to high end technology products seem to be insulating some portions of the technology sector from rising unemployment and slower business spending. The sharp inventory correction, extremely depressed railcar numbers, and massive contraction in global trade have the transport sector looking for a pick up in volumes by summer. However, March operating statistics from Delta Airlines suggest business and leisure travel demand remains depressed and inconsistent with an economic recovery. A rally in the transportation sector will signal an end to the global recession. At the macro level, leading indicators of profit growth remain depressed. The ISM survey has stabilized, but remains at historically low levels implying limited profit growth through the summer. Credit spreads have also stabilized, but have yet to compress to levels consistent with sustained growth despite record corporate issuance. The bull story for stocks rests most strongly with what has been a historically large deviation from the long term trend and persistent underperformance relative to treasuries in recent quarters. Mean reversion argues for positive returns, and may offset some of the political uncertainty created by healthcare "reform" and "cap and trade" policy. Although the volume of M&A has been uninspiring, M&A premiums have surged in recent months and imply stocks are cheap.

~Nick Kalivas

#### **CURRENCIES:**

MFGR foresees the FX markets moving into a range. The cross currents are robust and ambiguity palpable. The correlation to risk in the currency markets, especially in the euro, ebbs and flows. MFGR believes that until the financial system is in repair, risk will remain a viable variable in price action, albeit one with varying intensity. The US equities are heading into Q1 earnings and the markets await with bated breath the releases. Expectations are low which could leave room for a base effect surprise. However, the FX markets reaction will be contingent on the equities response to earnings. Stronger footing in US equities will encourage risk appetite and adversely affect the dollar and yen.

Outside of risk and earnings, the markets will look to policy both domestically and abroad. The news out of Washington plays into the risk dynamic. The stress tests are on going and expectations for the success of the PPIP are in question. The deadline for participation has been extended two weeks and details of the second round of the TALF are in the pipeline. The market is eagerly awaiting the ECB's decision on monetary policy and quantitative ease. Expectations are mounting that the bank will cut rates again at the May7th meeting, given the current rhetoric. Additionally, the commentary on "alternative policy" suggests that the bank is closer to assimilating. MFGR believes however that the ECB is more prone to purchase corporate debt over sovereign debt as a.) it attacks the issue of credit and b.) avoids the bank having to decide what sovereign issues to purchase. Such policy decisions along with the expectations of this action will be bearish the euro. QE in general has not been well digested by the FX markets. MFGR continues to believe that countries that QE will lose to countries that do. This in mind, MFGR continues to favor the AUD and NZD. Note that despite a down day yesterday in equities and a rate cut by the RBA the AUD/USD climbed back from its more depressed levels of the day. MFGR is also marginally in favor of the loon and would look to short EUR/CAD. The improving sentiment in Canada coupled with the questions over policy in Europe make this cross a candidate for a short. Both Canada and Europe are benefactors in a risk loving environment. However Canada has been

clear on policy while there are still questions over the route the European may take on alternative policy. As MFGR believes they will in tandem announce easier policy and a move toward some form of "QE", MFGR favors Canada over Europe. Additionally, Canada does not have the problems Europe does in terms of EM loans and broad banking stress. The risk to both these commodities currencies is the continued contraction in demand. Baltic freight has slid for 19days and the trend in demand is still to the downside. The argument of the Baltic Freight also helps illustrate that the inflation discussion is not an issue for the "now". Though once credit gathers stronger momentum, the issues should be revisited, energy is better wasted on thinking about economy recovery.

~Jessica Hoversen

### **PRECIOUS METALS:**

Gold and silver markets are expected to trade in a mixed-to-lower direction this month. Both markets may move slightly higher in the first half of the month based on our expectations for a marginal downside correction in the equity market. However, gold prices should hold below resistance at \$917.00 while silver holds below \$13.50. Beyond any near-term strength, MFGR looks for gold prices to fall toward the \$813-\$851 range while silver is expected to break down below \$12.00 support. Pressure will come from the recent slowdown in investment demand, weakness in jewelry demand, and from a lack of inflation. Investment demand will move inverse to equities, but the past month has showed that traders' attention has shifted toward equities from commodities. Jewelry demand in India should pick up soon due to the April 27th Akshaya Tritiya festival, but the country is still awash in scrap gold and rupee weakness makes the metal still quite expensive. Some traders have been bullish on gold based on prospective inflation stemming from growth in the Fed's monetary base. However, MFGR believes most of the growth will bolster balance sheets rather than being inserted directly into the economy.

~Tom Pawlicki

### **ENERGIES:**

Oil prices are expected to trade heavy this month. The first key support will be at \$47.26, but we see a likelihood that prices fall toward the \$41.75-\$43.75 range. Pressure will be applied by deterioration in U.S. demand data, the likelihood that both the IEA and EIA revise downward their 2009 global demand figures over the next week, and elevated U.S. oil and product inventories. OPEC imports should fall near the end of the month, as evidence from Oil Movements last week showed renewed compliance with existing cuts. Technical factors will offer background pressure on oil due to last week's failure to fully test the Mar 26th high, the bull-trap reversal made in late-Mar, and from signs that large funds are liquidating long positions. Correlation with stock prices should remain high, and stocks are due for a short-term correction as the G-20 meeting passes and earnings season approaches. MFGR still believes that a long-term bottom has been made in oil, and looks to enter long-term long positions in low \$40's. Our year-end objective is unchanged at \$75/bbl.

~Tom Pawlicki

### **GRAINS:**

Look for grains/oilseeds to add additional risk premium despite negative April price seasonals in corn & wheat and steady April soybean seasonal. Weekly charts in all three markets are trending higher in part on increased fund capital flow into Ag markets. Further support is derived from a constructive 3/31/09 acreage/stocks report, ongoing

strong PRC soybean import demand and prospects for a late start to '09 US row crop planting. Early April freeze in US HRW belt underscores not only the remnants of a hard winter but a wider than normal range of weather extremes that places traders and end users on high alert. Corn market fundamentals are anchored by likely shrinkage in 9/2010 US corn stocks while the soybean market is supported by dwindling 9/2009 US soybean stocks. Wheat, fundamentally and technically, has lowest prospects for mounting a sustained rally although erratic price action in wheat will persist amid presence of fund shorts and vulnerability of row crops to weather induced spring rallies. Steady shift in investor sentiment to owning commodities amid rising long term inflationary expectations makes Ag markets at brink of '09 North American growing season especially vulnerable to rallies from real or imagined supply threats. Advise buying deferred corn & front end soybeans on modest breaks, selling rallies in oil share, buying CN/selling WN over \$1.65 and buying KWN/selling MWN over 50 cents if and only if US Northern Great Plains spring weather pattern normalizes. Look for Ag markets to lose risk premium mid-May onward once US crops are planted if equity/crude markets (which will continue to influence Ag markets when grain fundamentals stagnate) cap out or correct.

~Rich Feltes

#### **CRB:**

Expect CRB to range trade during April as real or imagined supply cuts in crude and grains are offset by flat commodity demand. Prospects for rising unemployment, ongoing erosion in Natural Gas (a proxy for manufacturing activity) and somber purchasing manager's survey will serve to offset modest increase in capital inflow to commodities. And although some economic indicators show signs of turning, we would characterize changes as a slowing rate of descent rather than a harbinger of growth.

Crude, the flagship commodity, is expected to range trade during April amid equity market trade that is more likely to consolidate March gains than post new highs near term. Look for strong CRB support at 360 and resistance at 380 in a market that has stubbornly adhered to a 325-383 trading range since early November 2008. By sector we are positive grains and livestock, negative gold and neutral crude. Do not expect upside CRB breakout until global labor markets bottom this summer. PRC and India stimulus programs (a precursor for the US stimulus program?) are slowing rate of economic contraction but not driving new demand back to commodities in these key emerging market economies. Major risks to our neutral CRB outlook include an extended US spring planting delay, a sharp equity market rally or a prolonged disruption in Middle Eastern oil supply.

~Feltes/Kalivas/Pawlicki

#### **TRADE RECCOMENDATIONS:**

**Debt Markets:** Buy EDH10 at 98.52. Risk under 98.38 and target 98.87.

**Equity Markets:** Buy NDM9 at 1252. Risk under 1225 and target 1300.

**Currencies:** Go long AUD/JPY at 70-35. Target 75-78. Risk. 68-22.

Short EUR/CAD at 1.6541. Target 1.6000. Risk. .16831

Buy USD/CHF at 1.1300. Target 1.1660. Risk 1.1250.

**Energies:** Buy CLM9 at \$43.00, target: \$56.00, risk \$40.00.

**Precious Metals:** Sell GCM9 at \$915.00, target \$851.00, risk \$930.00.

**Grains:** Buy deferred corn & front end soybeans on modest breaks  
Sell rallies in oil share,  
Buy CN/sell WN over \$1.65  
Buy KWN/sell MWN over 50 cents **if and only if** US Northern Great  
Plains spring weather pattern normalizes.

**CRB:** N/A.