Market Commentary | US
EDWARD MEIR +1 203-656-1143
Senior Commodity Analyst
emeir@mfglobal.com

MF Global

INSTITUTIONAL USE ONLY

Commodities Monthly Roundup -- August/September 2010

Market Highlights for August/September: Since we came out with our last monthly report in July, the commodity markets have been all over the place. As we note from the circled area in our chart below, the Reuters-Jeffries CRB index has seen a dramatic V-shaped formation over this two-month period, with prices bouncing off the August lows quite sharply and now hovering at nine-month highs. Gains in both precious metals and grains helped lead the September advance, and there were good showings in base metals as well, although none in the group (except for tin) have yet taken out their 2010 highs. The US equity markets followed the same V-shaped pattern as commodities did, with stocks now at five-month highs, but the dollar has been moving in an entirely opposite direction, strengthening during August while falling back in September.

TABLE OF CONTENTS

There were clear lines of thinking that explained these abrupt shifts in market behavior. The selling in August was brought on by growing fears that the global recovery was sputtering, with fears that the US in particular was in danger of tipping back into an another slow-down, if not an outright recession. China's economy was decelerating as well, especially if compared to the heady rates evident earlier in the year. However, by late August, a series of macro numbers reversed the market's more pessimistic perceptions. The first release was the unexpected increase in the August Chinese purchasing managers' index, with the rise in new orders being particularly reassuring. Some days later, China reported that August industrial production rose by 13.9% from a year earlier, while other reports had banks extending about $80.5 billion in new loans during the month. These relatively decent numbers paralleled a similar surprise coming out of the US, where the August ISM manufacturing index rose in July, a rather unexpected development considering that six out of eight regional Fed manufacturing readings-- out earlier in the month-- all fell. That same week, we had reports out of Europe showing exports surging by the greatest amount on record during the second quarter, while European corporate spending rebounded from a two-year slump. In addition, European manufacturing gauges, although slowing lately from the very strong pace seen in the second quarter, remained in expansion mode.

Outlook: We expect further gains in most commodity markets over the next month, as with recession fears allayed, investors will likely use the weaker dollar as an excuse to push prices higher. Of course, the markets could be vulnerable to a sharp technical setback at any time, but we suspect that, unlike August, funds will likely be buying the dips, particularly if the global macro picture remains on a moderate growth trajectory. We present brief synopses of 34 various markets in the pages that follow (see table of contents above) and will revisit the group next month to see how things have panned out. In addition, an excellent companion piece on fund flows written by our colleagues Tobias Woerner and Andrew Gardner will also be sent out as a separate distribution complementing this report.

Source for Chart: Futuresource.com

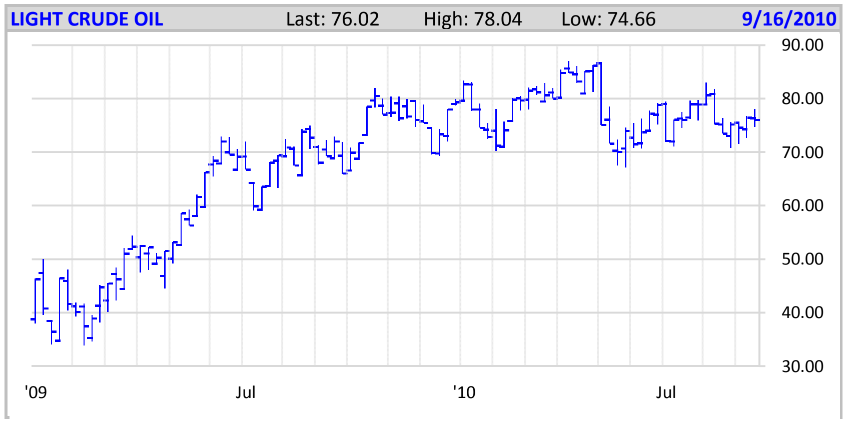
LONDON OFFICE +(44) 207-144-5525
NEW YORK OFFICE 1 212-589-6400
SINGAPORE OFFICE +(65) 6347 8997

MF Global UK Limited
Sugar Quay, Lower Thames Street
London, EC3R 6DU

ENERGY

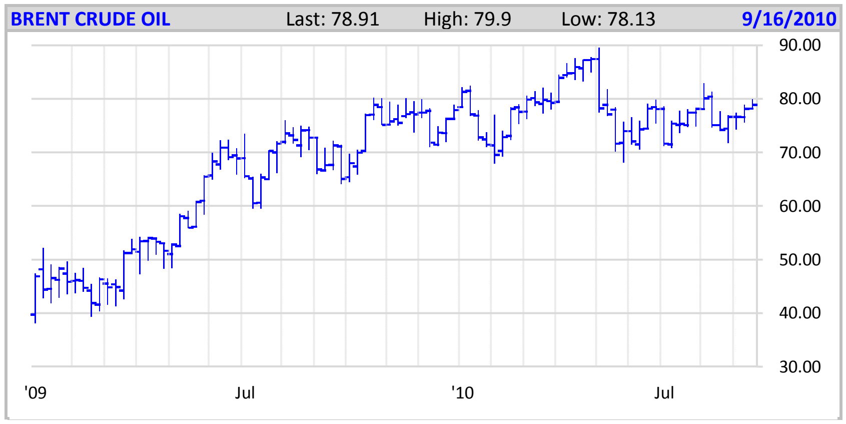
WTI NEARBY CONTINUATION

Crude oil prices have been trending within a relatively narrow band between $70-$80 for the past two months. There have been brief breaches both above and below this range, but for the most part, prices have held within it. Support has been provided by the fact that we have been in hurricane season for some time now, and given extremely busy season that was forecast, (where anywhere between 14-20 storms were expected), shorts have been understandably reluctant to stick their necks out too aggressively. On the upside, crude's overwhelmingly bearish supply picture is keeping any rallies above $80 somewhat in check. However, once the hurricane season starts to fade by mid-October, we are expecting to see a rather sharp break in prices, as the weather "prop" will be pulled away, allowing crude's more bearish fundamentals to set in. As a result, a sell-off to the mid-$60 level cannot be ruled out, while $80-$82 will continue to figure as good resistance.



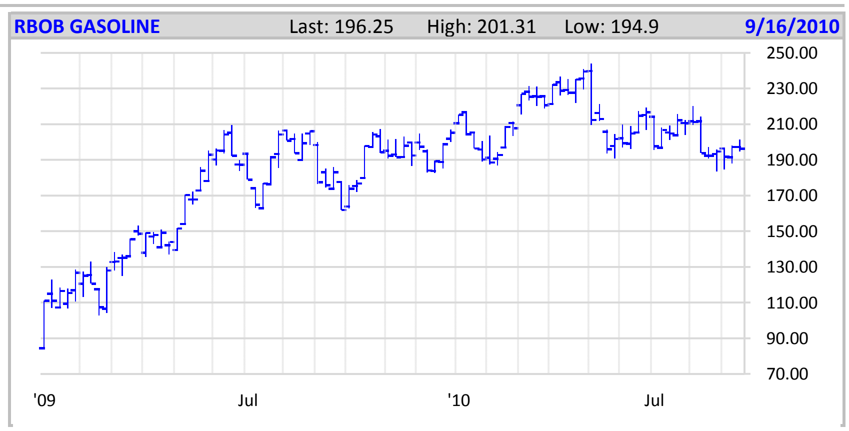
BRENT NEARBY CONTINUATION

Brent prices have also been in a similar range to what we have seen in WTI, and pretty much stuck within a $70-$80 trading band. However, Brent's technical picture looks slightly more constructive than WTI's, as it seems to be benefiting from a favorable arbitrage, which as of this writing was about $3.20 in Brent's favor. Clearly, the markets are viewing the well-stocked inventory picture in the US more negatively than what is evident in Europe, explaining the widening differential. Nevertheless, we suspect that Brent will be hard-pressed to break out of its trading range, at least until mid October, at which point the end of the hurricane season in the US could pressure prices lower.



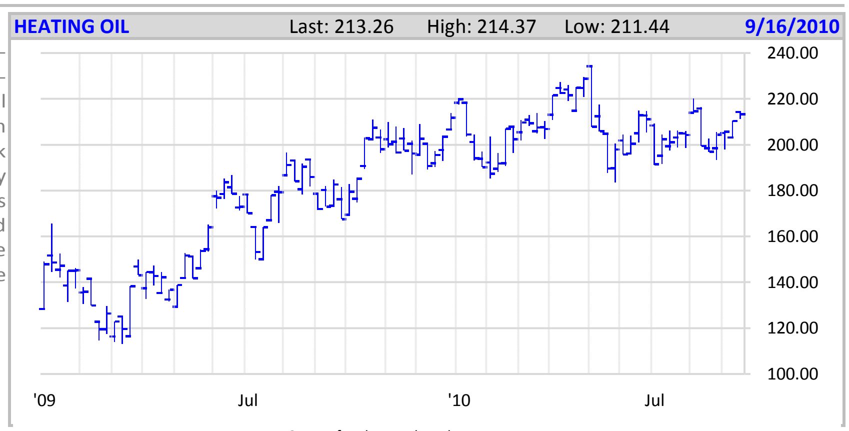
RBOB NEARBY CONTINUATION

With the US driving season behind us, and gasoline demand still very sluggish, we could see somewhat more pressure develop on the complex in the weeks ahead. In addition, gasoline has been quite vulnerable to perceptions of slowing US economic growth and poor consumer sentiment readings, both of which have been dominating the headlines this past month. We would not be surprised to see another retest of the mid-August intraday low of $1.82 perhaps setting in sometime in October, and likely brought about by the expected weakness we anticipate in crude. On the upside, resistance is at $1.97, and above that, at $2.02 basis the nearby contract.



HEATING OIL NEARBY CONTINUATION

Heating oil prices have been fairly resilient, especially compared to gasoline. Seasonal influences are working in heat's favor, but more importantly, US distillate demand has been quite strong for much of the last several months. Since heating oil is the contract of choice for most hedgers in this space, the higher demand readings are filtering through. Charts look fairly steady, and unlike both crude oil and gasoline, prices are well away from the bottom end of the trading range. Although the next few weeks could be sloppy given the weakness we expect in crude oil, things could pick up in late October as we head into the winter season. For the time being, we see resistance at $2.20, while support is at $2.05 basis the nearby contract.



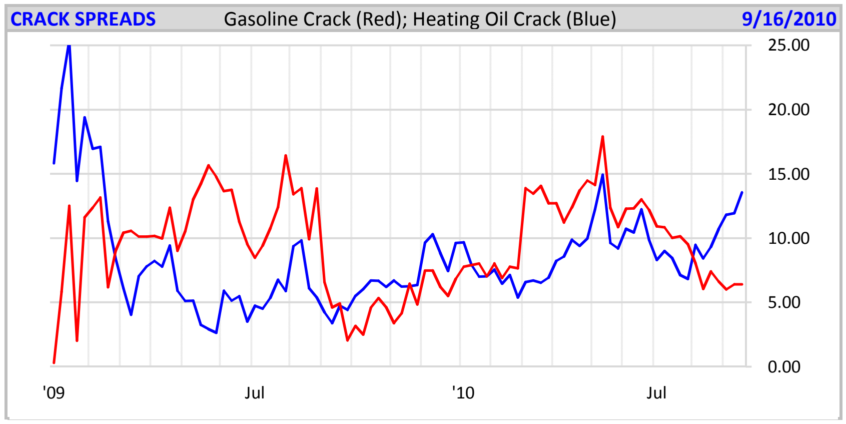
Source for charts: Bloomberg

NATURAL GAS NEARBY CONTINUATION

Natural gas has been one of the worst performing commodities in the CRB index so far this year. Prices hit an 11-month low in August, as inventory levels continue to climb to record highs. In addition, markets are seeing little signs of production cutbacks, as rig counts continue to stay high. The last week or two has seen a bounce off rather oversold levels, as the thinking is that utilities who are now using coal could now switch to more cheaper-priced natural gas. This is a plausible argument, which is why we suspect that the risk/reward profile favors the long side at the moment. Consequently, we see further gains to perhaps the $4.50 mark by the end of the year. Support is at $3.62, the late August intraday low.

CRACK SPREADS

The crack spreads have been, in effect, the "tale of two cities", with the gasoline crack languishing badly for much of the last few months, while the heating oil spread has moved sharply higher, as we note on the last part of our chart. As mentioned in our heating oil commentary, the fact that distillate demand has been quite buoyant is likely the key reason why the heating oil crack has been so strong, whereas the same cannot be said for gasoline. Having said that, the current differential between the two products -- now somewhere around $.21-- is starting to look a little rich to us, and we would likely reduce some (but not all) exposure to long heat/short gasoline spread.



EMISSSIONS

Emission prices have climbed by about 10% since our last report in mid-July, and prices are hovering at just under $15.50. Traders report that more offsets are being sought in anticipation of tighter supply that could potentially lie ahead, this after a UN panel proposed that project auditors could be liable for issuing too many CERs. Under the proposal, which still has to be agreed upon later next month, auditors would be forced to buy and cancel credits that were issued improperly. Since August, the UN board has delayed 10 requests from eight different HFC-23 projects, leading to the current concerns.

URANIUM

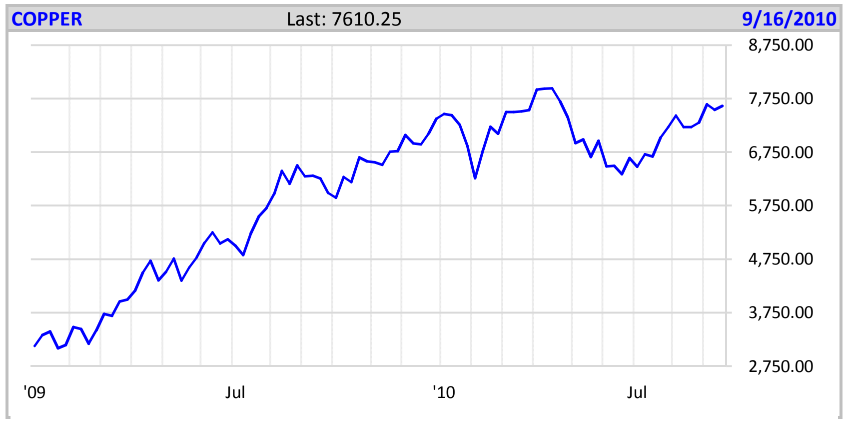
After not doing much for much of the last year except go down, uranium prices have finally pushed higher over the last two months, as it seems that some hedge funds are taking interest. But whether this advance continues remains to be seen, particularly in light of the rather uninspiring fundamentals. For one thing, supplies look quite comfortable, and will likely exceed demand through 2012, this according to a recent CRU report. However, the market's supply/demand balance will likely tighten in the "out-years" on the back of increased demand from countries like China, who have ambitious nuclear programs in the works. In this respect, the Chinese have 24 nuclear power plants under construction, this on top of the 440 that are operating globally. On the supply side, the leading uranium producer in Kazakhstan sees the share of nuclear power in global energy use rising to 20% over the next two decades from 15%, as more than 500 reactors are built. That, however, is "mega-long-term", and will likely not do too much for prices right now.

Source for charts: Bloomberg

LME BASE METALS

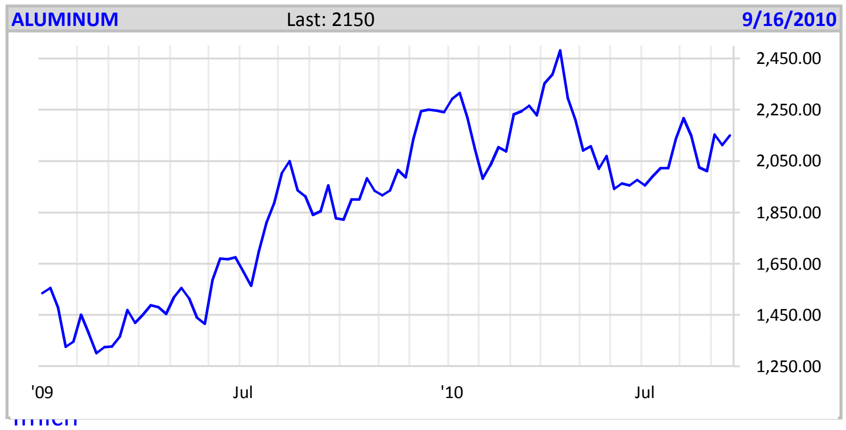
3-MONTH LME COPPER

Copper prices have been rallying sharply over the past several weeks, and are now at 4 1/2 month highs. We attribute this resilience to the fact that copper's supply/demand balance is moving increasingly toward a deficit, best reflected in the fact that inventories continue to get worked off. In this regard, global exchange stocks -- comprising those on the LME, COMEX, and the Shanghai Futures Exchange -- are now just under 600,000 tons, equivalent to just 11 days of global usage. In addition, China's copper import demand remains healthy, with higher July and August imports breaking four months of consecutive declines. Scrap imports are holding up even better, and are actually up by some 10% over last year. Finally, some of our leading Chinese fabricator accounts tell us that demand remains steady, suggesting that market could still be on track to push even higher. We expect an eventual test of $8200 this year, with substantially higher prices likely in store for next year where another projected deficit looms.



3-MONTH LME ALUMINUM

Aluminum prices have been relatively firm over the past several weeks, although the move higher is not as impressive as some of the other metals. Investors have also spent much of July and August observing the backwardation that set in within the cash to three's spread and the significant tightening that occurred in the forwards. Although the cash to three's spread has reverted back to almost full contango, the forwards are still quite tight, telling us that additional cash and carry financing programs may not be as lucrative as they once were. Price-wise, given the large inventory overhang, we are not as upbeat on aluminum's prospects; stocks still have the potential to snuff out any sizable rally, especially if inventories leave warehouses in the wake of persisting backwardations, which we think will be far more frequent going into 2011. For the balance of this year, we see prices trading between $1950-$2300.



3-MONTH LME ZINC

Zinc has rallied over the past two months, but just like in aluminum, the high level of ending stocks is restraining a more sizable advance. LME stocks, for example, are up almost 200,000 tons so far this year, standing at around 623,000 tons, while inventories in Shanghai are about a third of that level. An expected surplus this year will likely be followed by another surplus next year, meaning that inventory levels will climb yet again. As a result, we see zinc's upside potential relatively limited; for the balance of this year, we see prices trading between $1800-$2350, while next year, the upside target could push to $2700, but should we get there, this will likely be due to the spillover strength from the rest of the metals, particularly copper.

3-MONTH LME LEAD

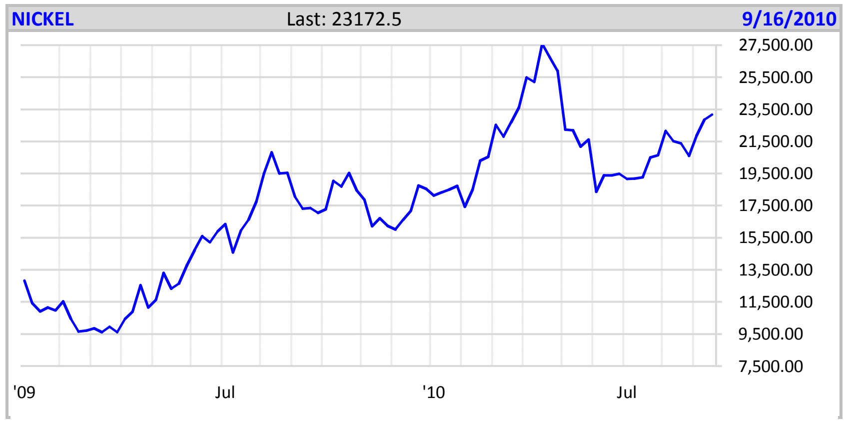
Similar to zinc, lead has been dogged by excess production, preventing stocks from declining. LME lead stocks are now just over 190,000 tons, up about 30% since the start of the year, and at their highest level in some eight years. Demand has been quite weak over the last few months, particularly in the US, where we have hardly seen any seasonal uptick in replacement battery shipments despite extremely hot weather in many parts of the country. In addition, Chinese automobile demand has also slowed somewhat of late due from the frenzied pace seen earlier in the year due to the government ending tax rebates and intense competition by car producers. Chinese imports of refined lead are also off sharply. For the balance of this year, we see prices fluctuating between $2000-$2400, but if the Chinese pick up the pace on imports, next year's prospects could be better, as ending lead stocks as a percentage of consumption is still quite tight.

Source for charts: Bloomberg

BASE METALS, STEEL, IRON ORE

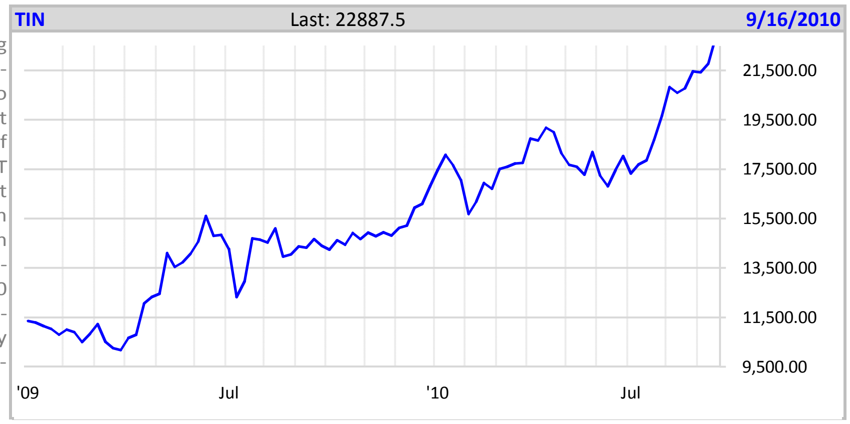
3-MONTH LME NICKEL

Nickel has been acting somewhat better over the last few weeks, but is still well off from its $27,500 intraday high reached back in April. LME inventory levels are falling, and are now down to about 120,000 tons from 155,000 tons seen earlier in the year. However, the price advance is being held back somewhat by questions about stainless demand (slowing sharply of late) as well as production prospects for next year. In this regard, Vale's strike-bound Canadian operations could all be back in full swing next year, while Goro nickel units should also start hitting the market in larger quantities by early 2011. This extra output may lead to a surplus setting in for 2011 following the modest deficit we are expecting for this year. We see nickel prices possibly taking a stab at the April highs of $27,000 by the end of this year, as the recent decline in stocks and a tightening cash-to-three's spread, will likely lead to further short-term buying. On the downside, we see support between $18,000-$19,000.



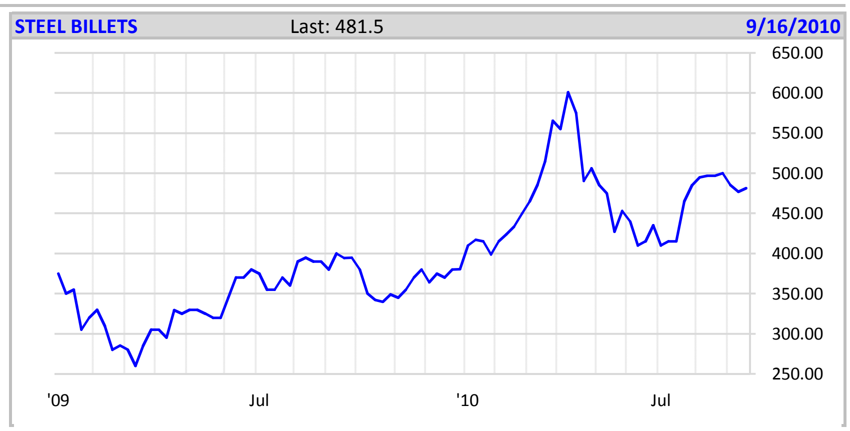
3-MONTH LME TIN

Tin's performance has been stellar this year, with prices now hovering around $23,000 a ton -- a three-year high. With only a handful of producers controlling the bulk of production, the market is quite vulnerable to supply shocks. This year's surprise came about when it became apparent that Indonesian production was badly lagging last year's levels because of heavy rains (with production thought to be off by 20% versus 2009). PT Timah, the country's largest producer, is exporting about 11% below last year's levels, while other smaller Indonesian producers are doing much worse. Because demand remains strong, (expected to be up 13% year on year, this according to ITRI), we are seeing a noticeable decline in tin inventories. LME stocks, for example, are down 45% this year to 50,000 tons, their lowest level since June 2009. We see tin prices fluctuating between $20,000-$25,000 through now and the end of the year, but they could hit $30,000 next year, particularly if supply remains as unresponsive as it has been so far this year.



LME STEEL

The LME has merged its two steel contracts this summer, and by all accounts, this has been a good move, as only one of the contracts really was performing. We are seeing growing interest in the current contract right now, typified by rising volume and open interest. In the meantime, LME billet prices have lifted off their July lows on talk of Chinese cutbacks due to power restrictions and government efforts to consolidate operations. Outside of billets, other steel categories have also seen price increases of anywhere between 1%-12% since the mid-summer. However, there is justifiable skepticism as to whether these increases will stick going into the fourth quarter, as some point out that the increases are confined mainly to the value-added end of the spectrum, and not in the more basic types of steel. In addition, excess production remains a problem; US steel capacity has moved from about 45% last year to an average of 70% right now, while Chinese output, despite recent cutbacks, still remains potentially lethal.



IRON ORE

Iron ore prices are hovering just above $140 a ton for 62% CFR China cargoes. Events in India have been a major source of support of late in that monsoon rains continued well into September, impacting exports from Goa and Karnataka. Exports are also being hindered by ongoing investigations into illegal and corrupt mining practices, and the government may reduce – if not altogether ban –exports in order to feed the local steel industry. On the other hand, demand variables could more than offset Indian supply pressures. China, for example, has ordered the closure of a number of inefficient steel mills in an attempt to meet energy efficient targets, and its August iron ore imports are running 16% below July's. Chinese pig iron production, on the other hand, should also trend lower during the second half of the year on account of these same factors. In sum, we do not view the current bounce in prices to be sustainable going into the year-end, and would not be surprised to see prices drift back down to the $120-$125 range.

Source for charts: Bloomberg

PRECIOUS METALS

GOLD COMEX NEARBY CONTINUATION

Gold prices have been on a tear lately, and it is impossible to tell from the charts where the current run could conceivably end, as we are now in record high territory. Short-term, the complex is quite overbought, with gold's RSI now at 72, a level seen only once so far this year. Having said that, we likely would buy gold on any setbacks, as the metal is still quite cheap. In fact, on an inflation-adjusted basis going back to 1980, gold should be somewhere around $2,300 an ounce, so this gives us some idea of the upside potential, at least based on theoretical valuations. Investors, on the other hand, are snapping up gold on much simpler logic, namely, their lack of confidence in paper currencies given that governments and central banks are increasing the monetary base. In addition, higher gold prices have yet to dent Indian jewelry demand, and instead, buying has risen some 67% in the first half of 2010. We see the current rally extending itself to about $1420 by year-end, while on the downside, a bout of profit-taking could take us down to $1200.

GOLD Last: 1267.1 High: 1274.5 Low: 1244.6 **9/16/2010**

SILVER NEARBY CONTINUATION

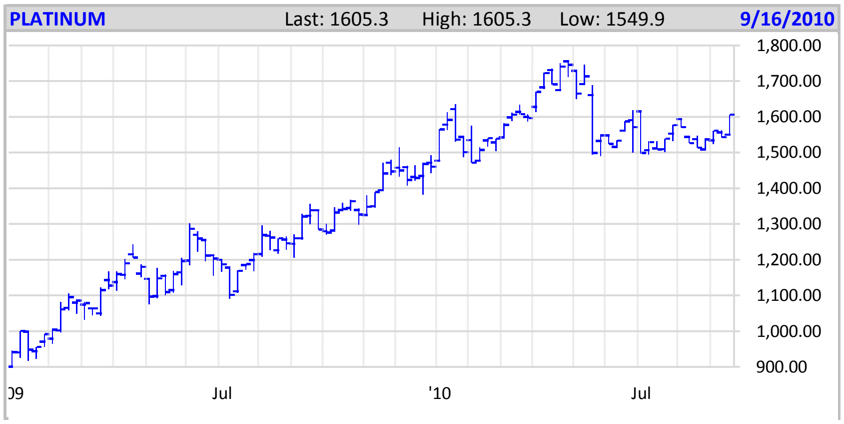
Not surprisingly, the strong gold market is pulling silver prices up along with it. It is difficult to say where the current rally will taper off given that we are in record high territory, (excluding the $50 print hit during the Hunt debacle back in 1979). Technically, we should note that silver's relative strength index is not as overbought as that of gold, now at 66, and well below the 80+ reading hit in early 2004 and 2006. Therefore, based on this metric alone, the silver run could extend for a little while longer. We see prices getting to $24.00 by year-end, while a decent sized correction could result in a pullback to around $18.50 level.

SILVER Last: 20.542 High: 20.55 Low: 19.99 **9/16/2010**

PLATINUM NEARBY CONTINUATION

Surprisingly, platinum has not participated in the record-setting rallies we have been seeing in both gold and silver. The complex has partly recovered from its hefty correction back in May, and since then, prices have been trading within a relatively tight $1500-$1650 band. We have to suspect that much of the "inflation hedge" money that has been piling into gold and silver has been doing so somewhat at platinum's expense. In addition, unlike gold, platinum is often viewed through the prism of economic data, and with recent macro readings being sluggish, particularly out of the US auto sector, platinum prices are likely being held back. Nevertheless, in view of a number of ongoing strikes at South African facilities, coupled with our view that both gold and silver should do better going into the final quarter of the year, we are friendly to the metal at current levels, and could see a move beyond the 2010 highs of $1750.

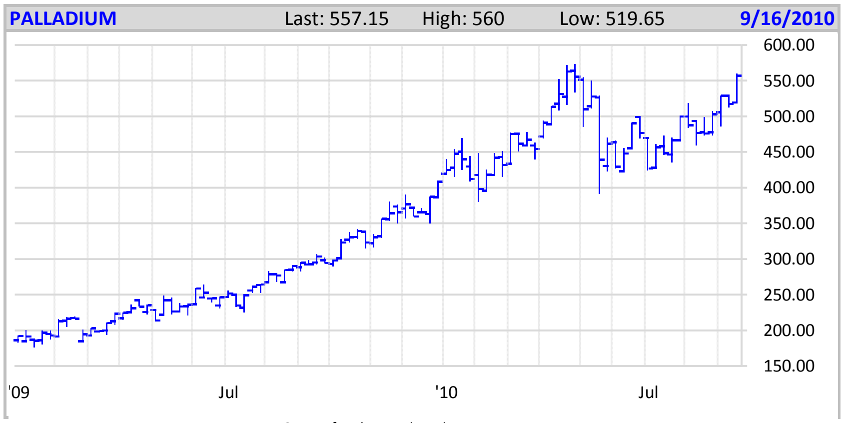
PLATINUM Last: 1605.3 High: 1605.3 Low: 1549.9 **9/16/2010**



PALLADIUM NEARBY CONTINUATION

Palladium has been tracking the precious metals group much better than platinum has, and is now very close to retesting its 2010 high. Although palladium's fortunes, like platinum, are also tied to the catalytic converter market, the fact that the metal is significantly cheaper than platinum gives it an entry advantage in some applications. Moreover, the palladium market has become more sensitive to supply availability, especially after Russia confirmed that it has depleted most of its Cold-War palladium stockpile earlier this year. Should palladium prices break above the $570 level basis the nearby contract, (which marks the April 2010 high), we could set off a series of stops and buy programs that could take prices higher still. Specifically, we would not rule out an advance to $700 by the first half of 2011, especially if auto sales start to pick up. Palladium is also benefiting from investor demand coming its way through ETFs. One such vehicle – the ETFS Palladium Trust – holds just over 780,000 ounces of metal.

PALLADIUM Last: 557.15 High: 560 Low: 519.65 **9/16/2010**

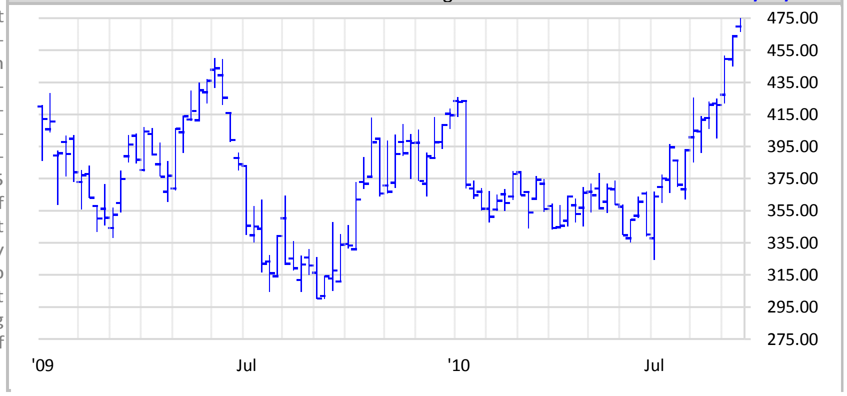


Source for charts: Bloomberg

CORN NEARBY CONTINUATION

Corn prices have been shooting higher ever since early August in what can only be characterized as a spectacular rally. Improving export demand, particularly out of China, stronger wheat prices, a severe Russian draught, and concern over this year's US crop, have all combined to power prices to two-year highs. With respect to US crop prospects, widely followed Informa Economics estimated a final crop yield of 158.5bpa in early September, a bullish projection that fell well short of the USDA's upwardly revised August number of 165bpa. As it stands, the USDA's 165 number is quite low itself; at that level, corn supplies as a percentage of total use comes in at a 15-year low. It is hard to say where this current rally will take us. We suspect that the market will likely define a top, likely when prices hit another record high, only to reverse course and end up on their lows. This is known an intraday reversal, and a technical sign that a short-term top has been reached. We very well could be approaching such a formation, as corn's RSI is at a frothy 86, while CFTC net longs as of early September were also at a record high.

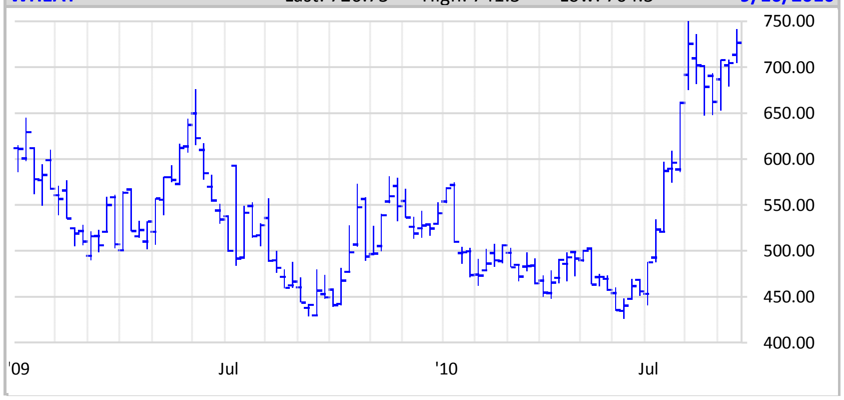
CORN Last: 495.25 High: 497.5 Low: 466.5 **9/16/2010**



WHEAT NEARBY CONTINUATION

Not to be outdone by corn, wheat prices have been moving sharply higher as well, as we can see from our chart alongside. However, unlike corn, wheat has experienced a recent wobble, with prices retracing down to $6.50 from $7.50 at one point before regrouping as of this writing. This recent topping action is attributable to easing concerns about the US wheat crop, with better (rainier) weather reported in the plains. In addition, the USDA unexpectedly increased its estimate for world inventories in September, while also upping its forecast for Canadian wheat production. Finally, Australia's government forecast that its wheat harvest will be the third largest on record. However the situation in Russia remains serious in that the harvest is badly lagging last year's, meaning that the country could reenter the import market at any time. For the moment, with the crop situation not being as dire as it was earlier this summer, we see a trading range market in wheat between $6.50 - $8.00.

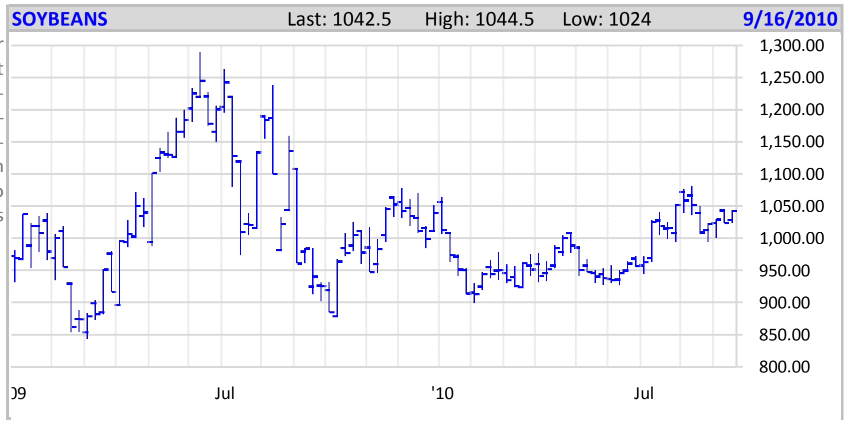
WHEAT Last: 726.75 High: 741.5 Low: 704.5 **9/16/2010**



SOYBEANS NEARBY CONTINUATION

Similar to wheat, soybean prices have retraced by some 10% from their August highs, but have since started to move higher, with prices now at eight-month highs. Cold weather in both China and Canada are threatening crops there, while a prolonged drought in Russia has slowed plantings. In addition, there are recent concerns that dry weather will hurt early plantings in South America, as a strengthening La Niña weather pattern increases the chances of crop damage in Brazil and Argentina, the two biggest exporters after the West. With $1.07 resistance taken out this week, we could be moving to $1.16 based on technicals alone.

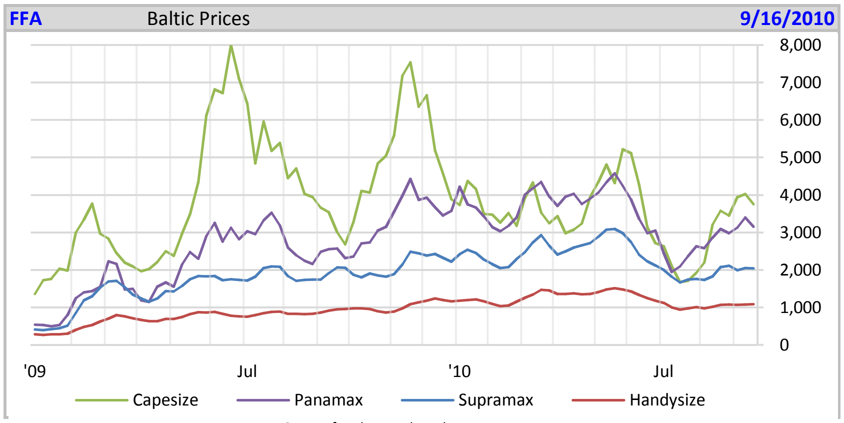
SOYBEANS Last: 1042.5 High: 1044.5 Low: 1024 **9/16/2010**



FFA

FFA prices have been ticking higher of late, this despite somewhat sluggish imports into China. Chinese iron ore imports, for example, are down some 16% in August vs. July, their biggest monthly decline in some seven months. In addition, Chinese steel production has also slowed markedly, with a number of plants on prolonged maintenance. However, grain bookings have been fairly strong, and this may have helped revive some pricing. The bulk of the recent strength is in Panamax and Capesize pricing, and less so in the Handysize and Supramax categories. Nevertheless, a Reuters poll taken last week of various ship brokers shows that 7 of 10 expect freight rates to generally rise in the last quarter of the year versus current levels, largely on account of rising winter energy demand that would necessitate more coal shipments.

FFA Baltic Prices **9/16/2010**

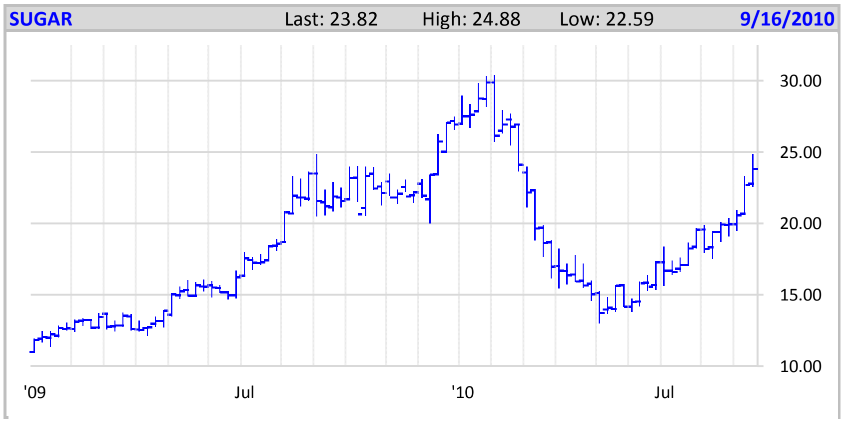


Source for charts: Bloomberg

TROPICALS

SUGAR NEARBY CONTINUATION

Sugar prices have had a stunning reversal since we last wrote about the complex back in July. At the time, prices were hovering around the $.16 mark, but have since charged higher to trade at just over $.25 per pound. Similar to the grains, the upside reversal is due mainly to adverse weather conditions setting in over key producing countries. As examples, production is expected to come in on the low side in both Brazil and Australia, while flooding in Pakistan will likely force that country to step up its pace of imports to as much as 1 million tons next year after it reported that 200,000 acres of sugar cane plantings were destroyed. One producer that is doing fairly well is India, where output in the country's Maharashtra state is expected to reach a record high of 9.5 million tons in the season starting October 1, up from 7.1 million tons seen this year. Technically, the sugar charts look extremely solid, as the long-term upchannel is still intact. We cannot rule out another test of the recent high of $.30 reached earlier in the year.

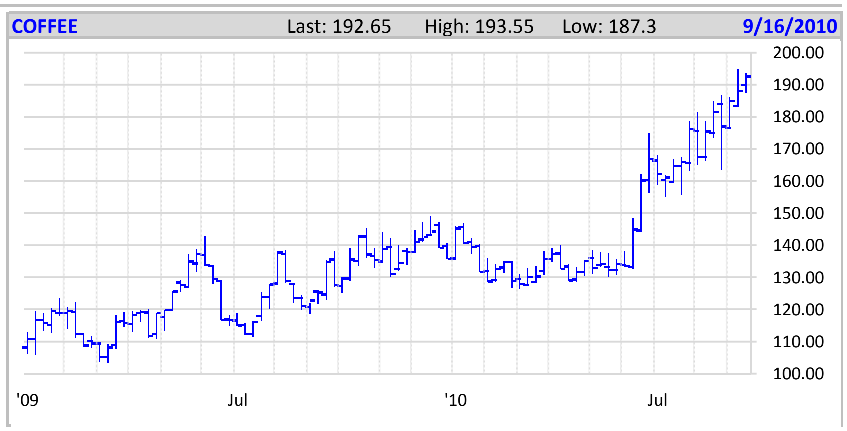


COCOA NEARBY CONTINUATION

Cocoa prices have gotten pummeled since our last report, as better than expected harvests in both the Ivory Coast and Ghana have alleviated concerns about supply prospects going forward. In addition, we have to suspect that massive long positions accumulated by a British hedge fund manager who took delivery of a large amount of cocoa over the summer months must have gotten pared back or redelivered. For the time being, the charts look miserable, and we seem to be on course to hit the July lows of $1600.

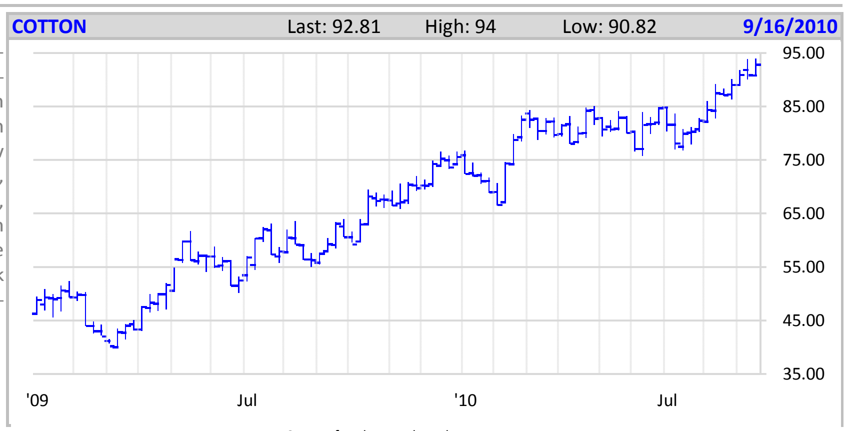
COFFEE NEARBY CONTINUATION

Coffee prices have been extremely strong lately, reaching levels not seen since the spring of 2008. In fact, the coffee complex has the distinction of being the biggest gainer among 22 commodities tracked by Bloomberg, with prices up a staggering 42% this year alone. Participants have bid prices higher on account of a variety of crop problems, chief among them, lower Arabica production in Colombia and Honduras due to a plant-damaging fungus outbreak caused by wet weather. In addition, Colombia, the world's second-largest producer, is struggling with its own production issues after having had its worst crop since 1976. Markets are also concerned about dry conditions in Brazil, while Vietnam is also experiencing problems with its harvest. We see support around $1.76 basis the nearby contract, with $2.00 figuring as resistance.



COTTON NEARBY CONTINUATION

Cotton prices have moved sharply higher since our last report, as unusually hot and dry conditions in the southeastern US, flooding in Pakistan, and strong Chinese buying, all combined to send prices soaring. In addition, Indian export restrictions have caused something of a panic in the physical markets, as traders anticipate near-term shortages until new crop becomes available. Reflecting the tight supply/demand conditions, the USDA has pegged world cotton stocks at 38% of world consumption, the lowest reading since the mid-1990's. At that time, the nearby cotton contract spiked to $1.17, so the potential still exists for further gains if we continue to see production issues persist. For the moment, charts look quite constructive, and we likely will push higher, at least until some better news comes along on the production front.



Source for charts: Bloomberg

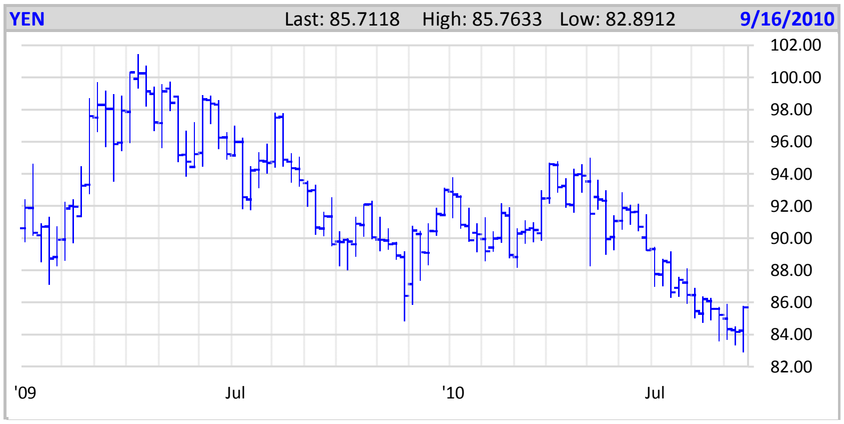
CURRENCIES

EURO

The Euro has staged a dramatic reversal over the past several weeks, as it has reclaimed the $1.34 mark, a level not far off from where the Euro crisis first erupted earlier this year. The currency's improved tone is due in large part to easing concerns about defaults, especially now that the ECB has put a "stabilization package" in place. Moreover, recently concluded "stress tests" have also offered a measure of support. Perhaps most importantly, the Euro is benefiting from surprisingly good growth seen across Europe. German growth, for example, hit a 20-year high in the second quarter of the year on the back of strong exports, while European corporate spending has rebounded from a two-year slump. In addition, European manufacturing gauges, although slowing lately from the strong pace seen in Q2, remain in expansion mode. Given the more favorable macro backdrop, we see the euro strengthening into year-end, with a probe of $1.37 certainly achievable. Should we get to $1.40 and beyond, the markets may be getting ahead of themselves, as at that level, the stronger Euro will start to impact the region's competitiveness.

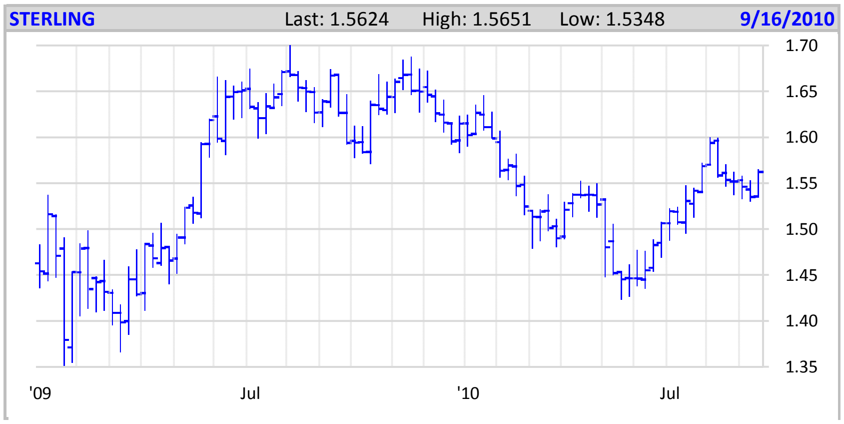
YEN

The Japanese yen has been soaring lately, as the currency has been deemed to be a safe haven given the strong current account surplus Japan enjoys. Once the currency got to around 83 level against the dollar in mid-September -- a 15-year high – the government decided to intervene unilaterally, apparently selling more than $20 billion of yen in one day, and moving the currency some 3% over this period. However, it remains to be seen how effective this intervention will be. A 15-month effort by the Swiss authorities to rein in the franc did little to stem its rise, and the Japanese may find themselves in a similar predicament. For the time being however, traders are sufficiently nervous not to rush back in on the long side anytime soon, and as a result, we likely could see the currency trade between the 84-88 level for the next few weeks.



STERLING

Sterling has been fairly stable ever since putting in a 2010 low shortly after the British elections were over back in May. Investors seem to be pleasantly surprised by the workings of the unusual coalition put together between the Conservatives and the Liberal Democrats. More importantly the new government has set out for radical proposals for tax increases and budget cuts, designed to shrink the public deficit from the current 11% of GDP, to 2.1% by 2015. Although this kind of fiscal policy should be theoretically constructive for a country's currency, the government has to be concerned about strengthening sterling too much, lest it starts impacting the country's relatively vibrant export sector. For the time being, and at least through the end of the year, we see a slightly higher trading range set in, somewhere between $1.52-$1.60



DOLLAR INDEX

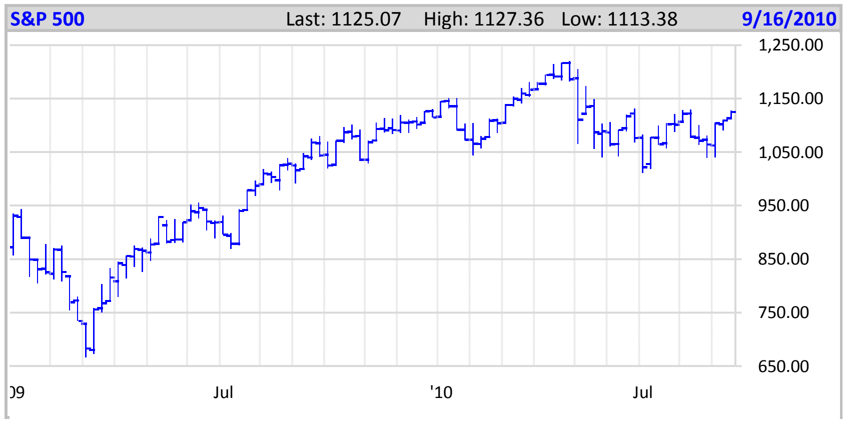
The dollar seems to be strengthen every time there is a crisis somewhere, as investors run for cover. Not so lately, as we note from our chart alongside. Investors have recently abandoned the dollar as they have moved into alternative asset classes, like equities and commodities. From a fundamental point of view, there is not much that is inspiring about the dollar; US deficits still stretch out as far as the eye can see, while the Federal Reserve has clearly stated that it is not going to raise rates anytime soon. As a result, as long as the global growth story remains intact, we should expect further erosion in the dollar. Our charts point to support at 80 on the index (but likely to go through it in our view) with resistance at 83.50.

Source for charts: Bloomberg

FINANCIALS

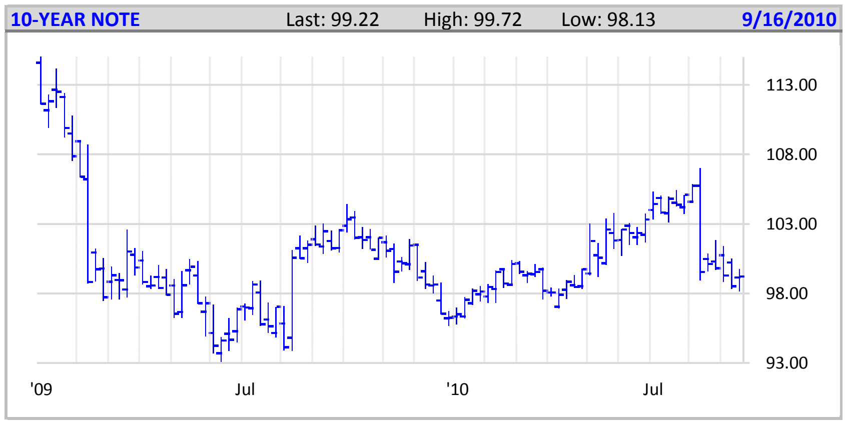
S&P 500

After a dreadful August, the S&P 500 has been doing much better. Its current recent rally to almost five-month highs is all the more surprising given that September is historically the worst month of the year for the stock market. As of this writing, key triple-top resistance at 1130 level on the nearby S&P contract has been taken out, but we now need to decisively pull away from it, and not fade back below the breakout line. The macro picture should help; recent fears about the US economy slipping into recession seem to have faded, with the slump even officially declared dead over a year ago. We could see a rather sizable rally heading into the fourth quarter, particularly if some of the policy uncertainties having to do with fiscal and tax start to fade, and if the markets get what they are pining for – gridlock in Washington.



10-YEAR NOTE

The 10-year note has proved to be a big winner during much of August, as equity and commodity markets slumped on growing fears that we were approaching recessionary conditions. However, with these fears subsequently fading, investors left the relative safety of treasuries over September, putting their money to work in riskier asset classes. This week's Fed policy statement indicating that it would be ready to engage in further quantitative easing provided a short-term boost for prices, but if the macro picture in the US starts to stabilize, we could see the recent gains erode once again going into the fourth quarter. The biggest jolt that could hit the note market could come from the jobs side, particularly if nonfarm payroll data starts to strengthen over the next few months. This could conceivably send yields back to the 3% mark possibly by the first quarter of next year from its current level of 2.55%.



Source for charts: Bloomberg