

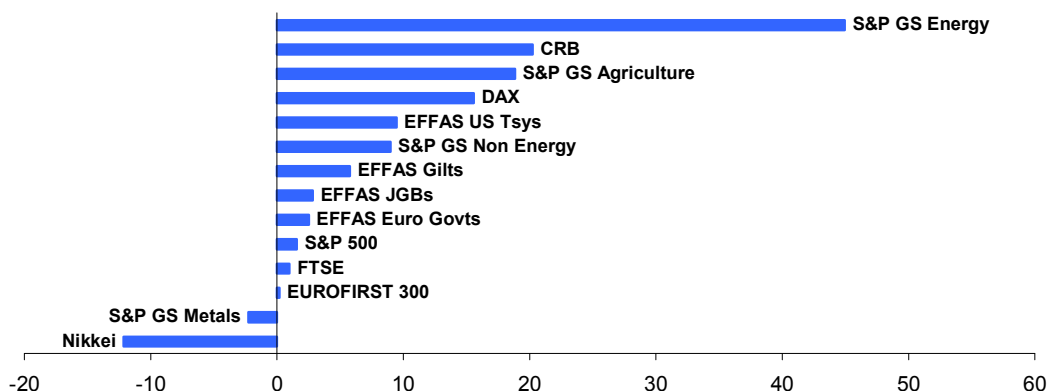


Strategy is available on Bloomberg: **MFLS<GO>**

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- Interest Rates / Fixed Income: Imminent Fed action?**
 It appears increasingly likely that the Fed will act regardless of the hardening tone from some officials. While markets continue to focus on the December FOMC, a more immediate cut in the Discount Rate cannot be ruled out.
- Equities: Buy now – beat the Christmas rush**
 The FTSE Eurofirst 300 is down 7.3% so far this month and November is shaping up to be the worst monthly performance for five years. We examine whether investors should continue to sell the market or if it represents an excellent buying opportunity.
- Energy: Oil – demand concerns going forward**
 While prices are at record highs they are unlikely to prove sustainable in the long term. We continue to look for opportunities to be short.
- Metals: Weaker price action to persist**
 We could see several more weeks of rather weak prices characterize trading in metals, as a strategy of selling the rallies will probably be the preferred course of action.

Global Index Returns YTD (%)



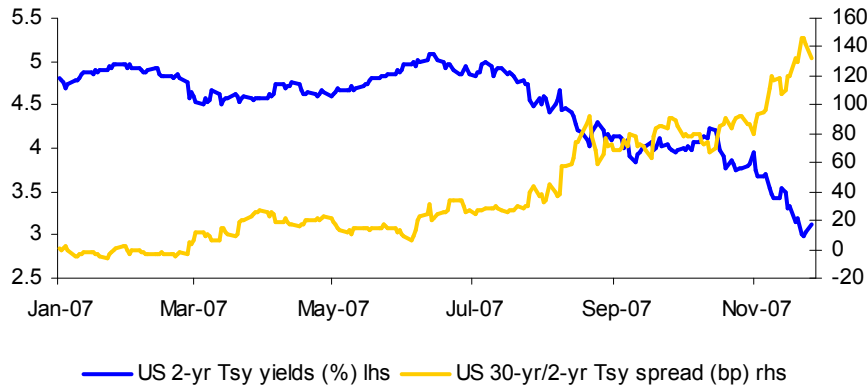
Source: Bloomberg / MF Global UK Limited

Interest Rates / Fixed Income

Imminent Fed action?

Last month we had suggested that 2-year US yields were stretched at 3.80%. In the interim, they have found a floor close to 3% and the bond curve has steepened by almost 60bp despite fresh hawkish Fed rhetoric aimed at paring back some of the aggressive Fed easing priced into 2008. So what now?

US 2-yr yields vs 30-yr/2-yr spread



Source: Bloomberg / MF Global UK Limited

The setback in the health of the financial markets over the past few weeks amid the fall of front end yields and the widening of credit spreads has been significant. **The focus for markets is currently headlines associated with bank trading losses and writedowns. In the absence of any turnaround in sentiment, this flight-to-quality driven environment alone looks set to prevent any correction at the short end in coming weeks.**

It does appear, however, increasingly likely that the Fed will act again regardless of the hardening tone within the latest comments from some officials. True, the latter suggest that the Fed would only consider cutting again if the slowdown in growth turns out to be more severe than it currently expects – but this just maybe the case. Surging energy prices will be a massive hit to real incomes, while the housing problems appear to be intensifying. Combined with the tighter credit conditions, the softness of retail sales that is already apparent and the sharp fall in consumer confidence, GDP growth may actually contract in Q4. **The FOMC has underlined that it is willing to act if recession risks mount and, ultimately, it may have no choice but to cut.**

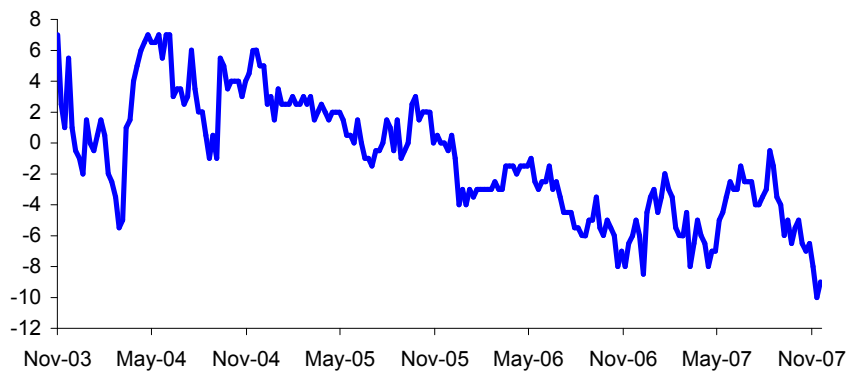
But ahead of this, the risk is growing that the Fed may attempt to administer some more immediate medicine in the next few days - beyond repos to assist year-end financing - and cut the Discount Rate down to the level of Fed Funds well ahead of the December meeting. This would provide a positive surprise for markets - exceeding current expectations, add significant liquidity, encourage a fresh willingness to lend and allow the target Fed Funds rate to stay at 4.5% (for now anyway) as officially desired. In this scenario, the liquidity premium at the short end of the Treasury curve may lose some of its shine and yields across the curve could rise.

Given our overall view that some Fed rate action will be seen sooner rather than later, we generally favour steepening plays further out the interest rate strips. We believe these trades are much more compelling than those involving contracts at the very front end, which have become increasingly distorted and unpredictable amid the credit fall-out and concerns about potential year-end funding pressures. Note that even the recent recommendations focussing on M8/M9 steepeners in both Eurodollars and Short Sterling

have been undermined by this effect and stopped out as the M8 contracts have been impacted by pressure on both their Z7 and H8 counterparts.

In the US, we continue to favour buying the ED4/5/6 fly (U8/Z8/H9) close to -9/-10bp. This entry level looks attractive historically (see chart below) and investors are selling EDZ8 and so eliminating any potential year-end pressures associated with this fly. We target a move back to the highs in positive territory, which should more than offset the negative roll.

ED456 - currently EDU8/Z8/H9 (bp)

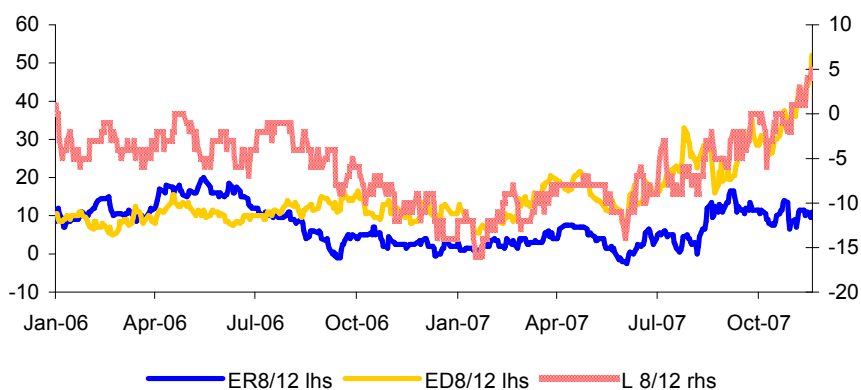


Source: Bloomberg / MF Global UK Limited

In Europe, mounting signs of a slowdown via the Eurozone business surveys, plus the strength of the euro and the buoyancy of oil prices, all reflect the unfavourable growth environment and that a turning point in the economic cycle is being reached.

This backdrop should give our Euribor steepeners further out the strip – such as ERZ8/Z9 - increasing support. In particular, investors are now advised to undertake the ERU9/U10 steepener – given the lack of negative carry - at current levels of approximately 11bp with an initial target of 20bp and a stop at 6bp. The out-performance of the reds on the Euribor curve so far has lagged that seen in either Eurodollars or Short Sterling (see chart below) and we expect some catch up in the coming weeks.

Generic 8th/12th contract spreads - currently U9/U10 (bp)

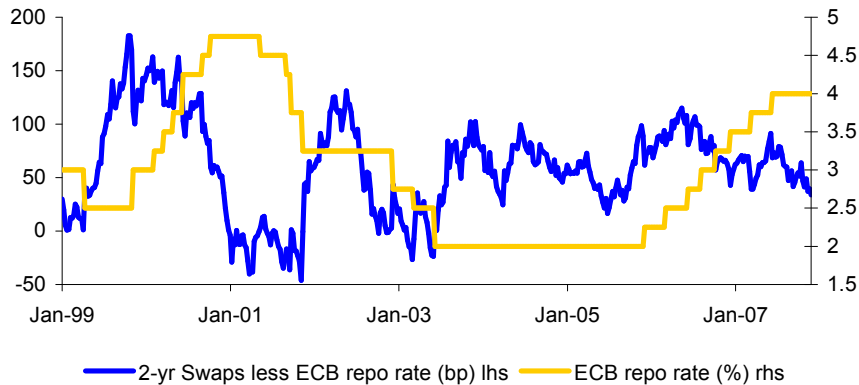


Source: Bloomberg / MF Global UK Limited

While we are more neutral on 2-year US rates at current levels, the 2-year sector of the Eurozone continues to look too cheap. The chart overleaf shows how the 2-year Euro swap/ECB rate spread, at approximately +34bp, is still considerably above the lows of close

to -50bp seen when rates peaked in late 2000/early 2001 before eventually being cut in May 2001. Another marked decline in the 2-year Euro swap/ECB rate spread was also seen when policy was steady during 2002 before cuts materialized late in the year. It appears that the 2-year sector has the potential to rally well before any rate cuts actually take place.

2-yr Euro Swaps vs ECB Official Rates

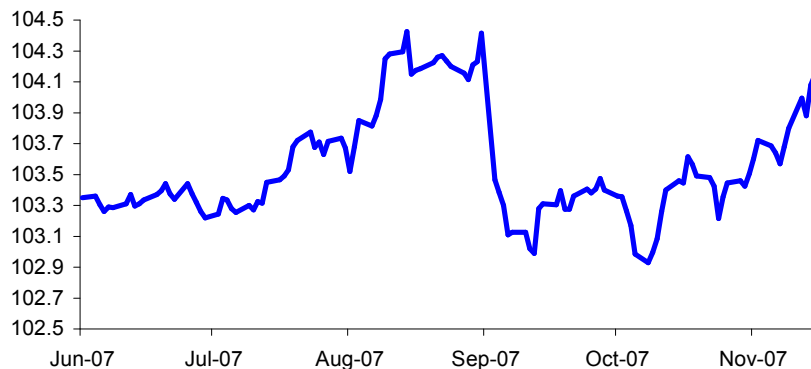


Source: Bloomberg / MF Global UK Limited

Moreover, on a cross-market basis, the spread of 2-year Euro swaps to official rates compares with approximately -45bp in the US and -30bp in the UK. Again this emphasizes the value at the short end of the Euro curve at a time when demand for low risk assets is particularly high.

Against this backdrop, we continue to favour upside plays on the Schatz. In particular, we focus on buying the DUH8 Jan 104/104.10/104.20/104.30 call condor at 2 (ref 104.10) and believe that this offers attractive risk/reward running into expiry. It currently has a small positive delta and the options expire on 20th December.

DUH8



Source: Bloomberg / MF Global UK Limited

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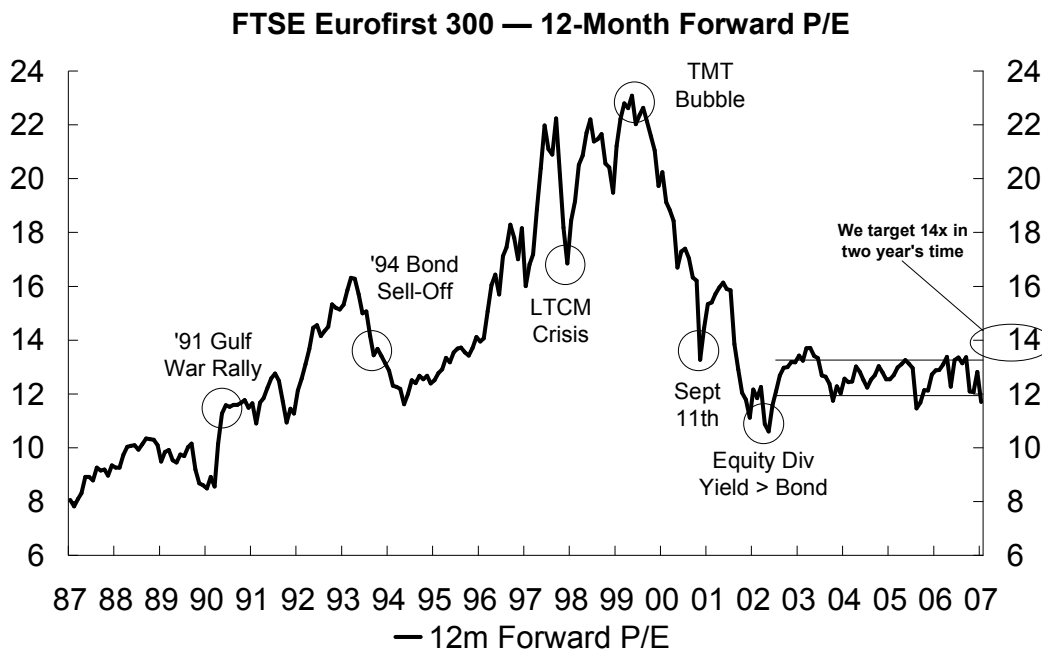
Equities

Buy now – beat the Christmas rush

The FTSE Eurofirst 300 is down 7.3% so far this month and November is shaping up to be the worst monthly performance for five years. We examine whether investors should continue to sell the market or if it represents an excellent buying opportunity.

Market is now very cheap

The Pan-European market has seen a 12-month forward P/E derating of 13%, from 13.4x just four months ago to 11.7x currently — on fears of a US recession. Prior to March 2003, you have to go back 15 years to 1992 to see the market as cheap as it now.

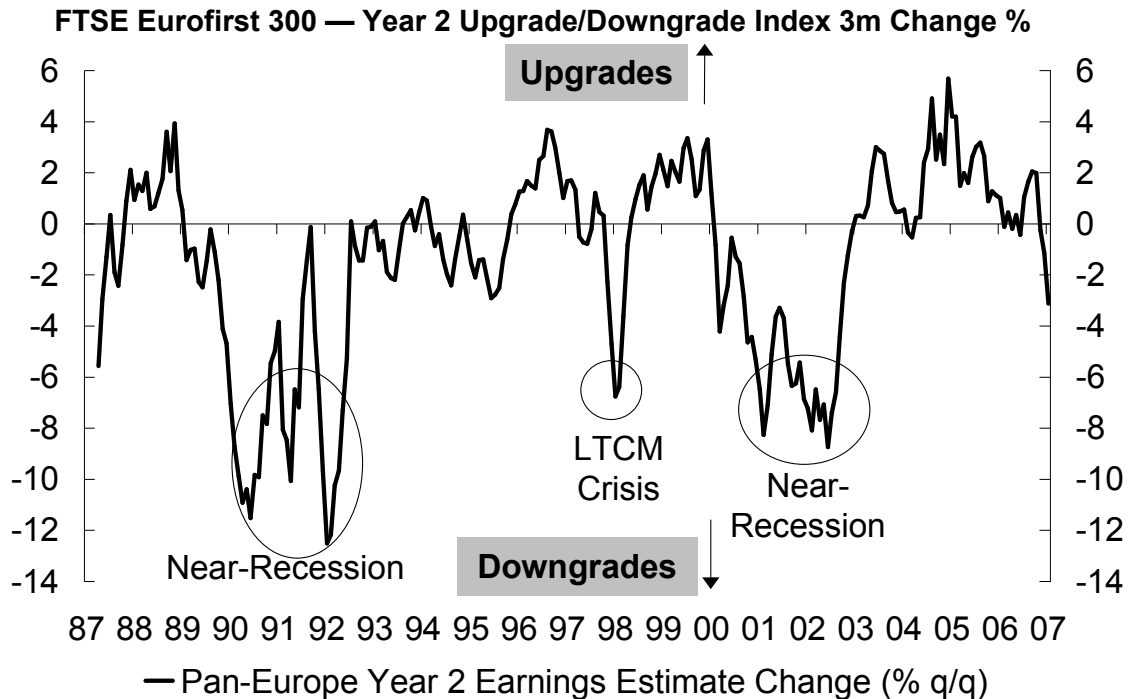


But what about the ‘E’?

Our central-case view is of a mid-cycle slowdown that sees our 12-month forward earnings change forecast fall from 11% this year to 9% in 2008 and 7% in 2009.

Worryingly, the recent credit turmoil means that we are seeing the first significant earnings downgrades for four years. The key decision is whether we are seeing an earnings decline blip, as experienced during the LTCM crisis in late 1998, or heading for recession and subsequent two years of downgrades.

On a worst-case scenario if we do suffer a US recession we estimate that analysts’ 12-month forward earnings growth numbers of 9% in 2008 and 7% in 2009 would suffer downgrades of 15% each year. This would reduce 12m forward earnings by 5% in 2008 and 7% in 2009 and would increase the market’s current 12m forward P/E from 11.7x to a not-too-scary 13.1x in 2009.



US Economy — mid-cycle slowdown or recession?

Consensus economic forecasts show US real GDP falling to a reasonable 2.0% in 2008 and rising to 2.3% in 2009. In fact, of the 68 economists polled by Reuters the lowest forecast for US real GDP in 2008 is a not-so-disastrous 1.0%.

The US ISM manufacturing survey has been falling over recent months but remains above the 50-expansion/contraction level. More importantly, it is well above 45 that we believe is another key recession-trigger level.

US consumer confidence remains in line with its 40-year average and above our 85 recession-trigger level. Meanwhile, US retail sales have actually **risen** over the past two months to 5.2% , which is double our 2.4% recession-trigger level and consistent with US real GDP of a healthy 2.6%.

More good news — US interest rates are set to fall. Crucially though, inflation is currently subdued at 2% and forecast to remain at 2.2% throughout 2008. This allows Fed chairman Bernanke more leeway to keep cutting rates.

We would, however, warn bearish investors that half the 5%+ average Q4 equity return tends to occur in the low-volume final two weeks of the year.

We retain our end '08 year-end FTSE Eurofirst forecast of 1860 representing 15% upside from our end '07 forecast of 1615.

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Energy

Oil – demand concerns going forward

The facts are there for all to see. We have warned that the global thirst for oil would prove impossible for an archaic refinery system to supply. Moreover, whilst the lack of a “hurricane season” has latterly assisted the bears, the looming winter means there are fresh fears of supply shortages. Remember also that any additional weakening of the dollar is likely to leave the Opec cartels increasingly reluctant to add more oil to the marketplace.

Meanwhile, although the political premium has ebbed of late, Iran’s nuclear ambitions and Nigeria’s militant Delta rebels continue to simmer in the background. At the same time, speculative and investor buying are also helping to drive the market higher as the oil sector becomes an ever more attractive haven for embattled equity investors.

Our concern going forward, however, is the demand scenario. High prices and a slowing global economy suggest that the desire for crude oil could fade. Overall, therefore, while prices are at record highs they are unlikely to prove sustainable in the long term. We continue to look for opportunities to be short via options, buying time and accounting for the risk of volatility.

Generic 1st Brent Crude Oil Future (\$)



Source: Bloomberg / MF Global UK Limited

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Metals

Weaker price action to persist

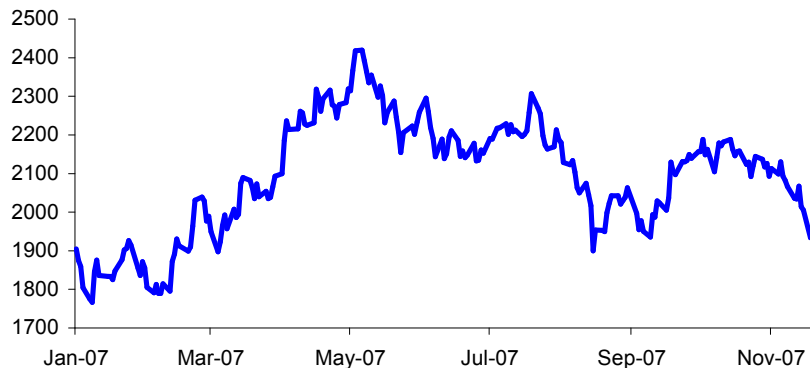
Metal bulls have had a tough run over the past few weeks, as the complex, perhaps more than any other commodity sector, has felt the reverberations of a slowing US economy and a persistently stubborn subprime crisis the most. In fact, since the beginning of November, metal prices have fallen anywhere between 10-20% in price, with zinc, lead and copper being the weakest in the group.

It does not look like the "buy-the-dips" strategy that has served participants so well for much of the past two years will be the way forward for metals anytime soon, as participants seem to be bracing for a US slowdown that just now seems to be gathering traction. Moreover, on the other side of the spectrum, Chinese metals demand has eased somewhat of late as well, with refined copper imports recently falling slightly on a month-over-month basis.

Additionally, exchange stock levels have started to climb as well, in line with rising LME stocks. And lastly, uncertainty with regard to the termination of export incentives are weighing on certain metals such as zinc, where the fear is that that with the removal of these rebates, more metal will stay in the local market.

Overall, we could see several more weeks of rather weak prices characterize trading in metals, as a strategy of selling the rallies will probably be the preferred course of action. This will certainly be the case until we get a better sense of how sharp the US slowdown will be.

S&P GSCI Industrial Metals Index



Source: Bloomberg / MF Global UK Limited

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Global Economic Snapshot

	Real GDP YoY	CPI YoY	Central Bank Rate
Australia	4.3	1.9	6.75
Canada	2.5	2.4	4.50
China	11.5	6.5	3.87
Eurozone	2.6	2.6	4.00
India	9.3	6.4	7.75
Japan	2.1	-0.2	0.50
New Zealand	3.2	1.8	8.25
Norway	6.6	-0.2	6.00
Sweden	3.2	2.7	4.00
Switzerland	2.8	1.3	2.75
UK	3.2	2.1	5.75
US	2.6	3.5	4.50

Foreign Exchange

	Current	+3m Fwd	+12m Fwd
EUR/USD	1.48	1.48	1.48
USD/JPY	108.50	107.35	104.90
GBP/USD	2.07	2.06	2.04
AUD/USD	0.88	0.88	0.86
USD/CAD	0.98	0.98	0.98

Bonds

(EFFAS All > 1yr)	Current	MTD Return (%)	YTD Return (%)
EFFAS US Tsys	247.93	3.20	9.46
EFFAS Euro Govts	147.42	0.98	2.52
EFFAS Gilts	252.81	2.40	5.78
EFFAS JGBs	151.08	0.90	2.84

Equities

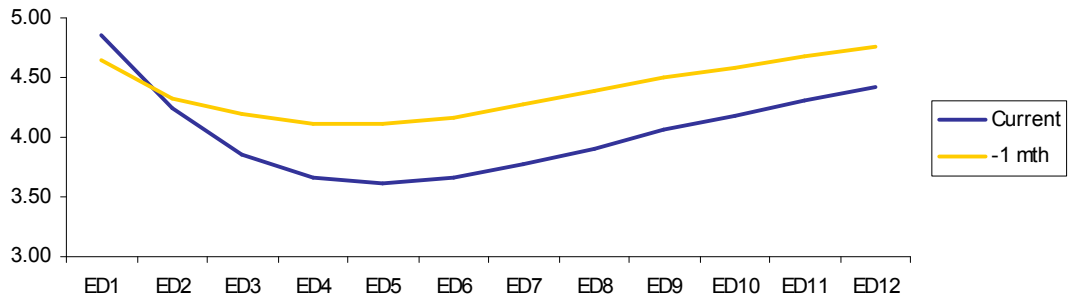
	Current	MTD Return (%)	YTD Return (%)
S&P 500	1440.70	-7.01	1.58
FTSEEUROFIRST 300	1486.18	-6.86	0.18
DAX	7624.51	-4.92	15.58
FTSE	6283.00	-6.53	1.00
Nikkei	15135.21	-9.57	-12.14

Commodities

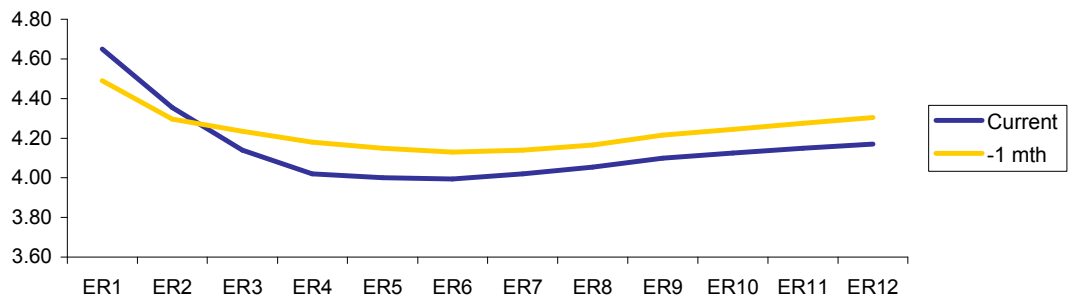
	Current	MTD Return (%)	YTD Return (%)
CRB	346.84	1.17	20.25
S&P GS Agriculture	772.10	2.45	18.83
S&P GS Energy	1959.86	4.47	44.96
S&P GS Metals	1901.25	-10.56	-2.27
S&P GS Non Energy	2817.75	-1.64	8.99

Source: Bloomberg / MF Global UK Limited

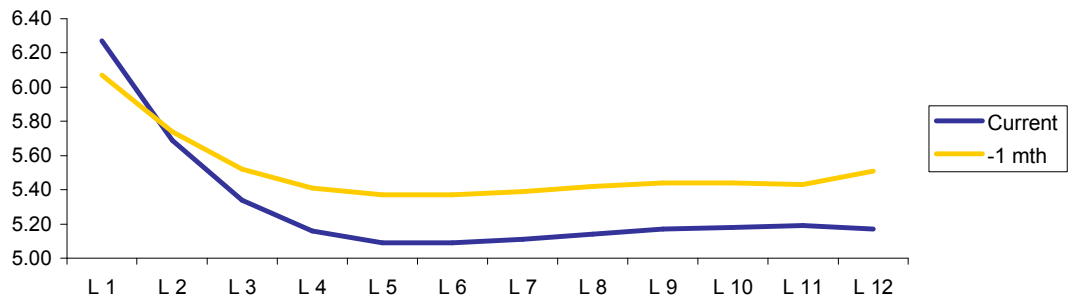
Eurodollars - Implied Generic Rates (%)



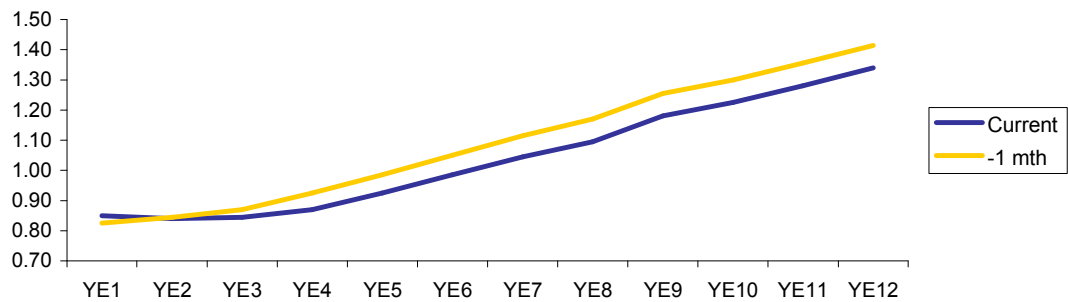
Euribor - Implied Generic Rates (%)



Short Sterling - Implied Generic Rates (%)



Euroyen - Implied Generic Rates (%)



Source: Bloomberg / MF Global UK Limited

Dollar Forward Swaps

Tenor	Current	+3m	+6m	+12m
1	4.35	4.21	3.93	3.62
2	4.07	3.95	3.88	3.94
3	4.14	4.08	4.07	4.18
4	4.26	4.25	4.24	4.34
5	4.38	4.37	4.37	4.48
6	4.49	4.49	4.49	4.59
7	4.58	4.59	4.59	4.68
8	4.65	4.66	4.67	4.75
9	4.72	4.73	4.73	4.81
10	4.77	4.78	4.79	4.86
15	4.96	4.97	4.97	5.03
20	5.04	5.06	5.05	5.09
25	5.06	5.08	5.07	5.11
30	5.07	5.08	5.07	5.11

Euro Forward Swaps

Tenor	Current	+3m	+6m	+12m
1	4.55	4.48	4.17	3.97
2	4.35	4.26	4.17	4.11
3	4.32	4.27	4.22	4.18
4	4.33	4.29	4.26	4.27
5	4.35	4.32	4.30	4.29
6	4.37	4.36	4.34	4.35
7	4.41	4.40	4.39	4.40
8	4.44	4.44	4.44	4.45
9	4.48	4.48	4.48	4.50
10	4.52	4.53	4.52	4.54
15	4.68	4.69	4.69	4.71
20	4.75	4.77	4.76	4.77
25	4.76	4.78	4.78	4.78
30	4.75	4.77	4.77	4.77

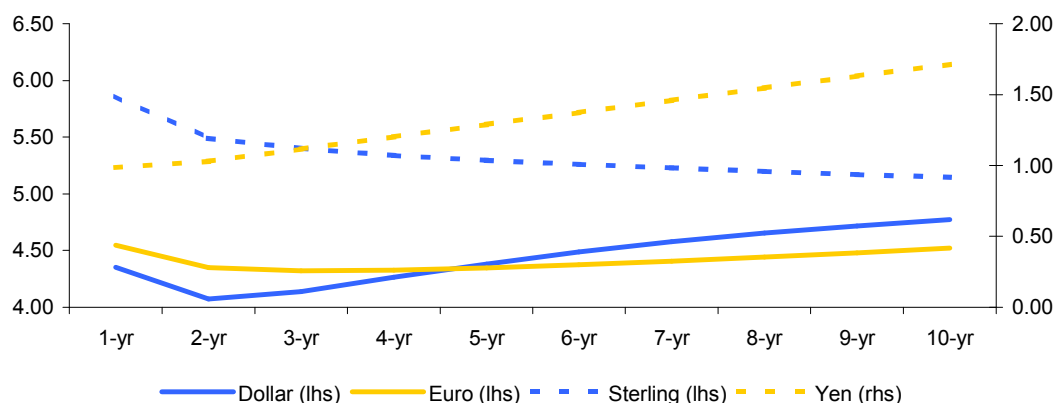
Sterling Forward Swaps

Tenor	Current	+3m	+6m	+12m
1	5.86	5.53	5.23	5.03
2	5.49	5.32	5.22	5.12
3	5.40	5.27	5.20	5.12
4	5.34	5.24	5.18	5.12
5	5.30	5.21	5.16	5.11
6	5.26	5.19	5.14	5.09
7	5.23	5.16	5.12	5.07
8	5.20	5.14	5.10	5.05
9	5.17	5.12	5.08	5.04
10	5.15	5.10	5.06	5.02
15	5.02	4.98	4.95	4.92
20	4.92	4.88	4.86	4.82
25	4.83	4.80	4.78	4.74
30	4.77	4.73	4.71	4.68

Yen Forward Swaps

Tenor	Current	+3m	+6m	+12m
1	0.99	1.10	1.08	0.97
2	1.03	1.06	1.09	1.13
3	1.12	1.15	1.18	1.24
4	1.20	1.24	1.28	1.34
5	1.29	1.33	1.36	1.43
6	1.37	1.41	1.45	1.52
7	1.46	1.50	1.54	1.61
8	1.55	1.59	1.63	1.70
9	1.63	1.67	1.71	1.79
10	1.72	1.76	1.79	1.87
15	2.03	2.06	2.09	2.15
20	2.23	2.26	2.28	2.33
25	2.35	2.37	2.39	2.43
30	2.42	2.44	2.46	2.50

Current Swap Curves (%)



Source: Bloomberg / MF Global UK Limited

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