CitiFX® Technicals – Bulletin

Technical Developments in the Foreign Exchange and Asset Markets

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Tom Fitzpatrick (1-212-723-1344)
Shyam Devani (44-207-986-3453)
CitiFX.Technicals@citi.com

Welcome to the U.S.S.R. (United States Socialist Republic)

First of all let's all get serious. Did anybody really believe that FNM and FRE would become anything other than de-facto nationalised???Was this a shock and surprise event? Has "bazooka" Hank just saved the World????

We are not credit people and we will leave the credit analysis of this to the experts but we struggle to see how translating the exposure of a major part of the U.S. mortgage industry to the U.S. consumer is something we should be jumping up and down for joy about. Neither is the fact that yet another financial institutions(s) has common stock effectively worth nothing and a realisation that preferred stock is not a risk free investment. Tell the guy who is part of Friday's 6.1% unemployment rate how a few basis points improvement in his mortgage (If that is actually what happens) makes everything o.k. Do we honestly believe that another sleight of hand from the Treasury/FED suddenly makes all the problems go away? Do U.S. consumers realise that they have just involuntarily doubled-down on the U.S. mortgage/housing market?-because if this bet does not work they will be "carrying the can" for this.

How many times have we seen this movie in the last 13 months???? Each time there has been a clamour to argue that this measure is the one that turns everything around and each time we see it followed by even bigger problems and bigger measures- exactly how a crisis tends to play out (Funnily enough all the big measure tend to come at a time that the Equity market is at or threatening the lows. This, despite the fact that the authorities do not target the Equity market. Yeah right! They know as well as anybody how corrosive the dual combination of Equities and housing under pressure can be to a strapped and indebted U.S. consumer as the economy slows.)

Is today's development going to have financial institutions running to lend more money to consumers now rather than rebuilding balance sheets? The credit squeeze is much more a function of stresses in the transmission mechanism than about levels of rates.

As we have seen in past major decisions over the last 13 months the euphoria around the decision has tended to see Equities move higher and often a bounce in yields. However we have also seen that these developments have not been sustained and renewed stresses have re-emerged. You have only so many fingers to "plug the leaking dyke" and eventually the flood overcomes you.

There is a strong perception that today's action is a "pivotal event" and we tend to agree with that, but not in the way of the market reaction. We believe it will become increasing apparent that this is just another reactive move to stem "the inevitable flood".
The problem is that people seem to believe this is the "big one"; this is the one that is going to turn it all around. While it will be great if that is the case….if it is not…the reaction could be really bad. Why??? Because then people are going to perceive that we have thrown everything we had at this problem and that it is just too big. If that happens what we have just seen may turn out to be just the supporting act before the main event.

We retain our view that where we are today is a consequence of excesses built up over 25 years+ (In the golden era following the Volcker induced recession) and that it is likely wishful thinking that we are going to come out of this as quickly or as easily as times past.

So we look at today and say…we've seen this movie before and remain far from convinced that this is the big turning point that everybody would like it to be (Us included)

The chart below focuses on the main dates where new material "measures" were announced in the last 13 months.

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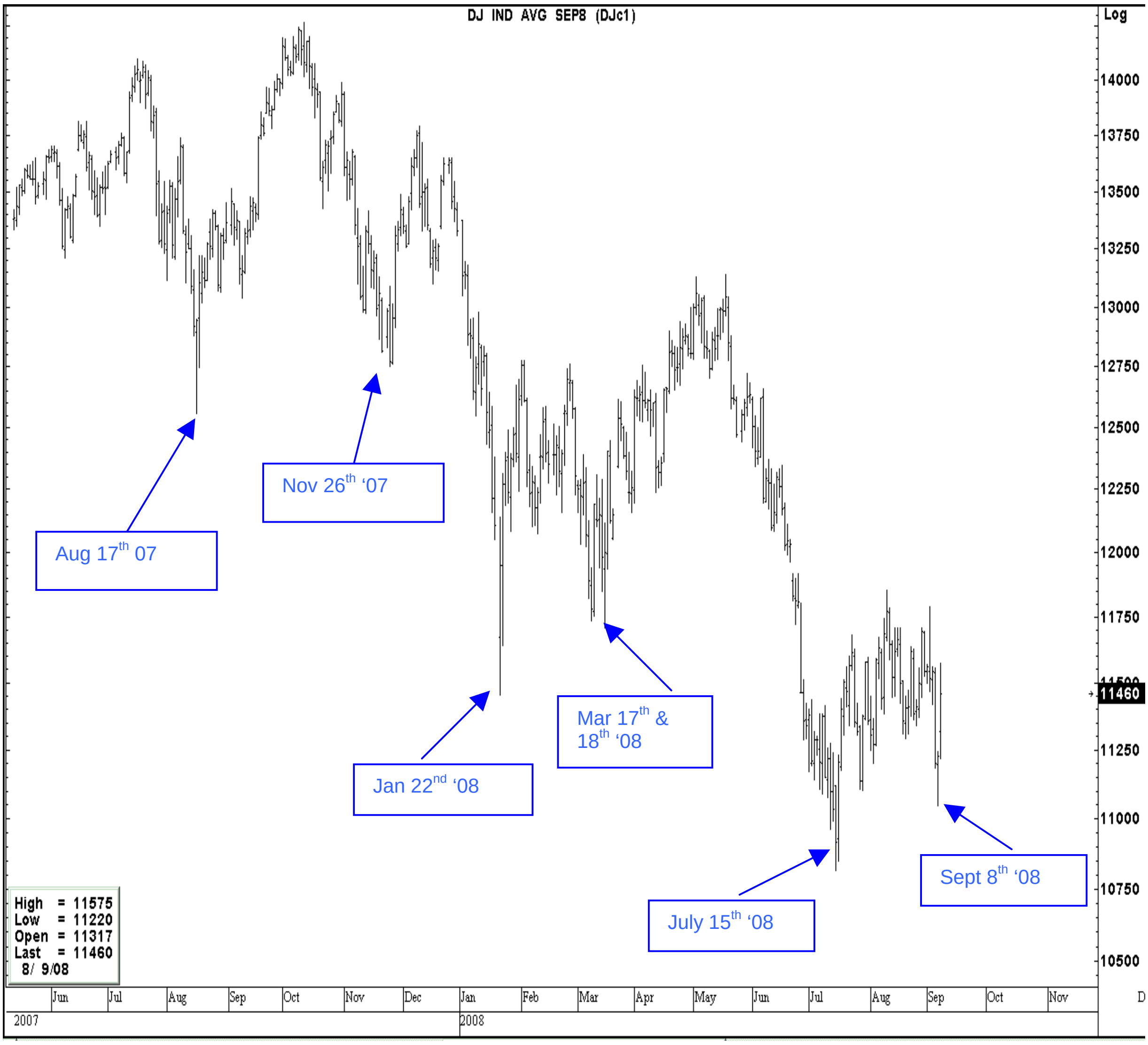


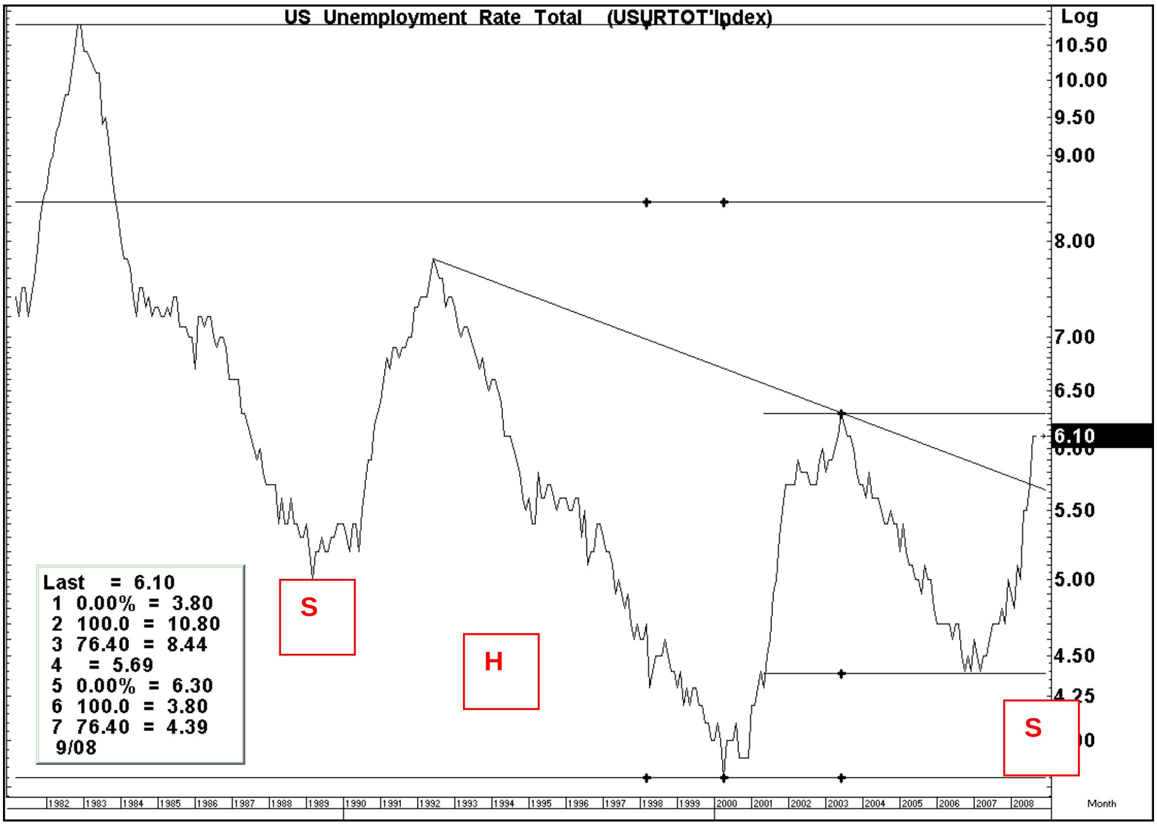
1. **Aug 17, 2007:** The Federal Reserve Board announced a reduction in the primary credit discount rate from 6.25% to 5.75%. **DJIA rallies 1,680 points over 9 weeks**
2. **Nov 26, 2007:** Significant changes in limits for SOMA securities lending programme (federal reserve banks of NY). **DJIA rallies 1,056 points over 3 weeks**
3. **Jan 22, 2008:** FOMC decided to lower its target for the federal funds rate 75 b.p.s in an unscheduled meeting. **DJIA rallies 1,134 points over 2 weeks**
4. **Mar 17/18, 2008:** Bear stearns takeover on 17th March and FOMC decided to lower its target for the federal funds rate 75 b.p.s. Market expected 100 b.p.s. **DJIA rallies 1,400 points over 8 weeks**
5. **Jul 15, 2008:** Paulson's testimony before Senate Banking Committee outlining plan to support GS'S (liquidity, sufficient capital and Fed consultative role). DJIA rallies 1,039 points over 9 weeks
6. **Sept 08, 2008** Treasury takes control of Fannie and Freddie.

So what do we see?

The five main market troughs throughout the past year have all corresponded with authoritative action / market developments.

Support levels were eventually breached and the market trended lower. As the market falls aggressively, we find that there are further developments from authorities that act as ST supports for the Dow. But the real concern is that each crisis has been followed by a bigger crisis and this just does not feel like the "capitulation blow out"

As noted above, this turmoil that is now having a significant impact on the economy – let us not forget that unemployment is at 6.1% (and rising….see chart below) while it was at 4.4% last year.



Whether authorities in the U.S. are actively watching equities or not, further deterioration in stocks is would not be good news.We have moved on from perceiving the equity markets as a victim of the credit crisis to being part of the problem.

One of the arguments that has been supportive of the stock market to date has been the strong global economy and the weak USD. Well guess what? That punchbowl just got taken away and the last party is over.

So what happens now? How many events will take place before equities turn for real? Unfortunately we do not have the answer to that question, nor do we believe that it is the right question to be asking.

This study simply illustrates that the only thing supporting the equity markets have been announcements from U.S. authorities (some of them huge ones) and that the underlying trend is down. While equity indices may consolidate/correct in the ST, we continue to expect the Dow Jones Industrials to test 10,000 in the weeks and months ahead.

On a minor scale given the “hype” this morning about this new announcement these equity markets better be looking pretty good at the close or we could see disappointment re-emerge even quicker than past episodes.

The fact that the VIX is surging on the day and that the NDX is re-testing the 200-week moving average does not fill us full of confidence.

CitiFX® Value Added Services & Products

Corporate solutions group

Cathy Chiang Agle	New York	1-212-723-1287	cathy.agle@citi.com
Matthew Daniel	New York	1-212-723-6855	matthew.daniel@citi.com
Erik Johnson	London	44-20-7986-1525	erik.johnson@citi.com
Stephane Knauf	New York	1-212-723-1274	stephane.knauf@citi.com
Samuel Kolli	London	44-20-7986-1589	sam.kolli@citi.com
Joakim Lidbark	London	44-20-7986-1586	joakim.lidbark@citi.com
Hector Lugo	New York	1-212-723-1403	hector.lugo@citi.com
Masashi Mizobuchi	Tokyo	81-3-6270-9112	masashi.mizobuchi@citi.com

Emerging Markets

Stephen Leach	New York	1-212-723-9332	stephen.leach@citi.com

FX Strategy & Technicals

Shyam Devani	London	44-20-7986-3453	shyam.devani@citi.com
Todd Elmer	New York	1-212-723-1240	todd.elmer@citi.com
Tom Fitzpatrick	New York	1-212-723-1344	thomas.fitzpatrick@citi.com
Michael Hart	London	44-20-7986-3311	michael.hart@citi.com
David Pais	London	44-20-7986-3313	david.pais@citi.com

Quantitative Investor solutions

Hetty Colchester	London	44-20-7986-1434	hetty.colchester@citi.com
Philip Gladwin	London	44-20-7986-1441	philip.gladwin@citi.com
Shuji Ikebuchi	New York	1-212-723-1510	shuji.ikebuchi@citi.com
Jessica James	London	44-20-7986-1592	jessica.james@citi.com
Jonah Jiang	New York	1-212-723-1528	jonah.jiang@citi.com
Kristjan Kasikov	London	44-20-7986-3032	kristjan.kasikov@citi.com
Guy Saxton	Tokyo	81-3-6270-9124	guy.saxton@citi.com
Aysu Secmen	New York	1-212-723-1281	aysu.secmen@citi.com
Weiwei Tan	New York	1-212-723-1515	weiwei.tan@citi.com
Louis Yang	London	44-20-7986-9098	louis.yang@citi.com

Structuring group

Mark Balascak	New York	1-212-723-1113	mark.balascak@citi.com
Saiful Pungot	Singapore	65-6328-5937	saiful.pungot@citi.com
Michele Ghidoni	London	44-20-7986-1807	michele.ghidoni@citi.com
Alexandre Godet	London	44-20-7986-9381	alexandre.godet@citi.com
Mehdi Gzouli	New York	1-212-723-7951	mehdi.gzouli@citi.com
Stephane Knauf	New York	1-212-723-1274	stephane.knauf@citi.com
Matt Schefer	New York	1-212-723-7443	matthew.schefer@citi.com
Rene Schwarzl	London	44-20-7986-9647	rene.schwarzl@citi.com
Francesco Tonin	New York	1-212-723-1071	francesco.tonin@citi.com

Value added products

Philip Brass	London	44-20-7986-1614	philip.brass@citi.com
Nicolas Thomet	Zurich	41-58-750-7646	nicolas.thomet@citi.com

Value added Services & Products-Global Head

Arnold Miyamoto	New York	1-212-723-1380	arnold.miyamoto@citi.com

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