



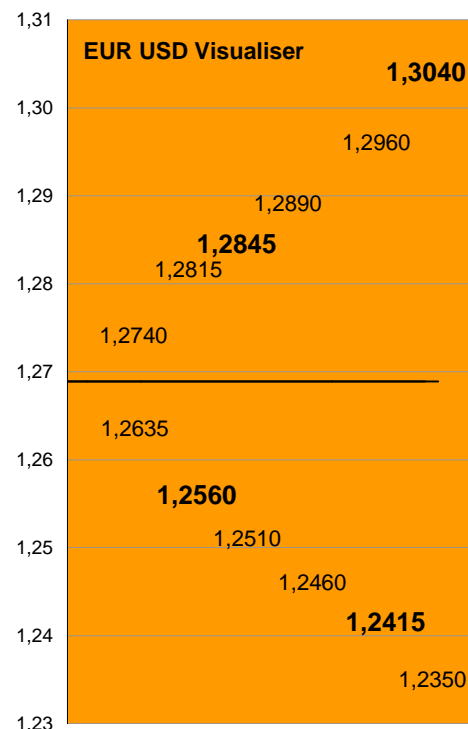
Daily Forex Outlook

The danger of ECB codewords

6th October 2006

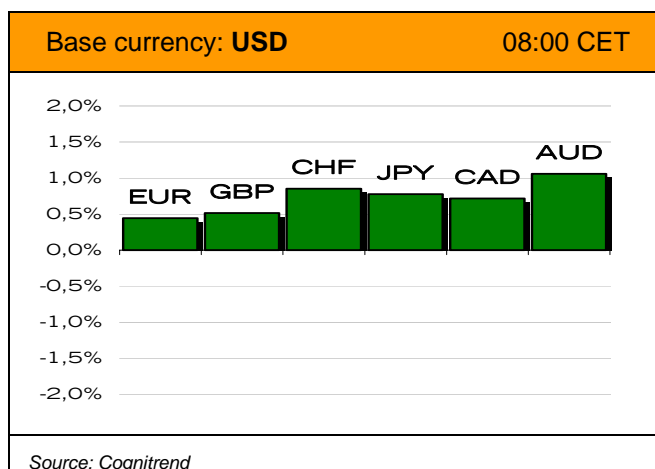
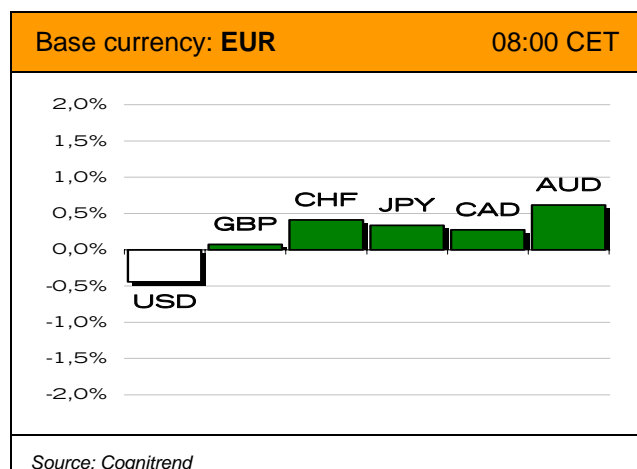
EUR USD (1.2690) For a central banker who has deemed the use of codewords 'unhelpful', Jean-Claude Trichet seems to have embraced the practice with gusto. From his use (or otherwise, in this case) of the magical expression 'vigilant', market participants have been able to deduce not only that the Bank will not move next month, but that it will hike by another 25bp in December. ECB-watchers will presumably be bursting with Pavlovian anticipation at the next meeting for the ECB chief to toss them the now familiar linguistic 'bone'. Otherwise the market will be thrown into disarray – precisely the 'painted-into-a-corner' situation that he hoped to avoid when he initially refused to espouse the use of codewords. The practice also debunks another ECB-inspired myth: that the Governing Council does not pre-commit to rate decisions. Coded language implies some degree of pre-commitment. In contrast to the Fed's 'pause', which was a non-event because the market had bets on both sides, the ECB's pause, when it comes, probably won't be.

The statement that followed yesterday's eurozone rate-hike was generally perceived as rather dovish and the euro thereafter drifted to the day's low. But the range remained very narrow. We continue to see the single-currency moving in a **1.2635 - 1.2890** band. The lower threshold remains vulnerable to a *false break*. This means that a violation would not necessarily be a meaningful signal.



Market Bias Index™

The popular perception of the dollar as overvalued is slowly being tamed by the passage of time; traders simply get used to the dollar at the current levels. But it is nonetheless a clear bias.



The Cognitrend Market Bias Index seeks to measure the extent of the perceived over-/under-valuation of the given base currency against other major currencies. This is important for estimating the behaviour of the losers as this is also the inverse of the price change that must be recorded for their breakeven to be reached. The greater the loss, the greater will be the bias. To exploit it, one should favour a base currency position when the bias is positive and vice versa.

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USD JPY (117.60) Yesterday's dip was short-lived and not deep enough to allow us an entry into a bullish strategy. Given that a clear, but modest upside perspective to **119.30** is still present, we continue to favour a bullish approach in case of a retreat down to **117.00**. In this event, a 20-pip risk-limit would suffice to the downside.

EUR JPY (149.70) It is difficult not to notice the convenience of the recent market talk about the prospect of intervention by both the BOJ and the ECB to support the yen. It comes with the cross very near to its all-time high – a condition that makes it particularly appealing to short-term top-pickers. This is the group that is likely to be propagating any official or semi-official hints that there is discomfort with the current level of the cross. The short-positions, however, probably exist already. As a consequence, a break beyond **150.40/50** would be a bullish signal for a rally to

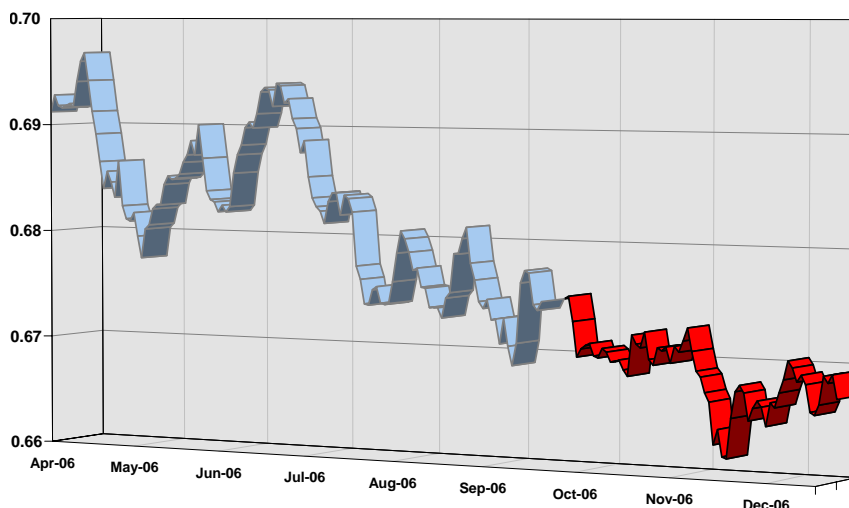
152.40. The risk-limit for an eventual bullish view would be set at **149.55**.

GBP USD (1.8770) Cable's modest slide came to a halt just ahead of our first support yesterday. For today, that initial demand point stands at **1.8720**. A failure there, however, would leave the Pound poorly supported ahead of **1.8630**. To the upside, the most worthwhile supply points within the current sideways range are at **1.8865** and at **1.8935**.

AUD USD (0.7445) The AUD rebound over the last couple of days has been uninspiring and certainly insufficient to allow any stranded longs to escape without injury. The risk therefore remains for further weakness down to **0.7380**. Overhead, we continue to reckon with hurdles at **0.7475** (weaker now) and at **0.7530**. Only a break of the latter could be treated as a bullish signal.

	USD CHF	USD CAD	NZD USD	EUR CHF	EUR GBP	EUR SEK	EUR NOK
	➡	➡	➡	➡	➡	➡	➡
Supply	1.2625	1.1390	0.6705	1.5990	0.6845	9.3590	8.4850
	1.2550	1.1330	0.6675	1.5910	0.6795	9.3065	8.4450
Demand	1.2465	1.1220	0.6605	1.5870	0.6710	9.2390	8.3300
	1.2380	1.1125	0.6550	1.5840	0.6665	9.2075	8.3050

Pattern Recognition Forecast Model



EUR GBP

Goodness-of-fit = 86%
(best results above 90%)

* Closest representation of the last six months of activity in the historical database. The price forecast is the actual historical outcome adjusted for volatility.

The objective of this model is to explore the possible future developments by basing a forecast on past movements in a purely mechanical way. The outcomes are therefore unrelated to the analysis otherwise contained in this document.