OVERLAY Asset Management

OAM Market Updates
Monthly Market Commentary

September 2009

Month-end Exchange Rates

	August 31, 2009	September 30, 2009
EUR/USD	1.43505	1.46170
USD/JPY	92.765	89.535
GBP/USD	1.6298	1.59935
EUR/JPY	133.12245	130.8733
EUR/GBP	0.8805	0.91395
USD/CHF	1.05685	1.03765
USD/CAD	1.09825	1.0733
AUD/USD	0.84305	0.88255
NZD/USD	0.68575	0.72340

Market Commentary – September 2009

USD moved lower during September vs. both EUR and JPY, having fallen in both the previous two months during Q3, with the global recovery out of recession continuing to take a solid foot hold. For the month, USD fell 1.9% and 3.5% vs. EUR and JPY respectively; whilst it was down 4.2% and 7.2% against each currency for Q3. Although data in the US itself was somewhat mixed during the month, elsewhere the indication that the worst may be over became more pronounced throughout the month as it has over the quarter. Risk appetites, in general, despite some short periods of reassessment over the period, appear to be improving, and commodity prices are also showing solid gains – crude oil prices weakened towards the end of September due to an EIA report indicating an unexpected jump in crude stocks. Despite this, however, commodity sensitive currencies have all benefitted over the month and quarter as a whole from the improving environment, with AUD, CAD and NZD all making solid gains vs. USD. In September USD fell 2.3%, 4.7% and 5.5% against CAD, AUD and NZD; whilst the quarter saw even more significant gains (+7.6%, 9.2% and 11.7%) for each of these commodity linked currencies vs. USD.

GBP has been slow to capitalize on the improving outlook for the global recovery. July's slightly positive performance for GBP vs. USD, primarily a function of a weaker US currency rather than GBP strength, was more than reversed throughout the remainder of Q3. Both August and September saw GBPUSD move lower in direct contrast to the other major crosses which all made significant gains against the backdrop a generally weaker USD. Increasingly under the spot light has been the outlook for the quantitative easing measures that the Bank of England introduced earlier in the year to ease the extremely tight credit conditions stifling economic recovery. With no signs the central bank plans to ease up on introducing further liquidity into the markets, and comments late in September by the Governor that a weaker domestic currency may be beneficial to the economic recovery (export driven); GBP was particularly under pressure during the later part of the period. Although this rhetoric and the central bank measures have put downward pressure on Sterling, there are continuing signs of recovery in the sector affected most by the downturn and which provides the single most important sign of the sustainability of recovery – namely housing – which in turn is giving some support to GBP. House prices, according to latest survey indicators by mortgage providers and estate agents, continued throughout September and Q3 to show signs of recovery. This was seen despite the somewhat restrictive credit conditions that the banks are still imposing. In addition, by month and quarter end, CBI announced a considerable upgrade to Q3 GDP forecast, made in light of the better than expected Q2 release.

Continuing to hamper the upside for GBP over the coming months will be the politically inspired decision vacuum caused by the likelihood of a spring 2010 general election in UK. Underlying much of the debate by the prominent parties involved will be their reaction and forecast on how they intend to deal with the huge public account deficit over the coming years.

In all likelihood it will be addressed by a combination of tax measures and public service cost cuts which could have negative effects on the outlook for recovery and growth potential for some years to come. Not only will this dominate the public and political scene but importantly preoccupy market participant and analysts as they assess the likely outcome the effect on their forecasts will have for Sterling over the next 12 months.

Elsewhere, as noted earlier, commodity currencies have been improving throughout the 3rd quarter despite slightly weaker commodity prices during September. Better domestic economic conditions in Canada, Australia and New Zealand have added to the positive tone for these currencies, with AUD benefitting from a surprise 0.6% quarter-on-quarter gain in Q2 GDP; and CAD gaining from the unexpected 27k leap in the most recent employment data and biggest rise since April '02 for the leading indicator (+1.1% in Aug).

Looking forward, market participants appear to favour AUD outlook, despite intermittent signs of weaker commodity price activity, as the currency seems particularly well placed to benefit from the general global recovery. Indeed both Australia and Canada appear set to also benefit from the continued support to global stimulus from G20, announced during the latter part of September.

With the summer behind us, and as we move into the fourth quarter, liquidity has returned to the market. Q3 GDP data over the coming few months will be equally important across the major economies of USA, Eurozone and Japan as it will not only set the tone for whether each domestic economic region has sustained the earlier recovery, but will also allow the market to better assess when inflationary pressures may start to appear and with them the prospect of higher interest rates. Central banks and policy makers will have a very fine balancing act over the coming months. They will wish to ensure recovery continues at a pace (partially to help fund the huge deficits sustained during the recent crisis period) whilst at the same time be conscious of not inhibiting this growth by trying to contain inflationary pressures with higher rates.